WORLD BANK GROUP

Weak Growth, High Inflation, and a Cost-of-Living Crisis

Europe and Central Asia Economic Update

Office of the Chief Economist

Spring 2023

WORLD BANK **ECA ECONOMIC UPDATE** SPRING 2023

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Abbreviations

COICOP	Classification of Individual Consumption According to Purpose
COL	cost of living
CPI	consumer price index
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECA	Europe and Central Asia
EEA	European Economic Area
EMDE	emerging market and developing economy
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
GHG	greenhouse gas
IFPRI	International Food Policy Research Institute
IMF	International Monetary Fund
NDC	nationally determined contributions
NPL	non-performing loan
OECD	Organisation for Economic Co-operation and Development
PMI	purchasing managers' index
PPP	purchasing power parity
RMSD	root mean square deviation
SOE	state-owned enterprise
SP	social protection
UNHCR	United Nations High Commissioner for Refugees
UNWTO	World Tourism Organization
VAT	value-added tax

Country Codes

Albania	ALB	Latvia	LVA
Armenia	ARM	Lithuania	LTU
Austria	AUT	Luxembourg	LUX
Azerbaijan	AZE	Malta	MLT
Belarus	BLR	Moldova	MDA
Belgium	BEL	Montenegro	MNE
Bosnia and Herzegovina	BIH	Netherlands	NLD
Bulgaria	BGR	Norway	NOR
Croatia	HRV	Poland	POL
Cyprus	CYP	Portugal	PRT
Czechia	CZE	Republic of North Macedonia	MKD
Denmark	DNK	Romania	ROU
Estonia	EST	Russian Federation	RUS
Finland	FIN	Serbia	SRB
France	FRA	Slovak Republic	SVK
Georgia	GEO	Slovenia	SVN
Germany	DEU	Spain	ESP
Greece	GRC	Sweden	SWE
Hungary	HUN	Switzerland	CHE
Iceland	ISL	Tajikistan	TJK
Ireland	IRL	Türkiye	TUR
Italy	ITA	Turkmenistan	TKM
Kazakhstan	KAZ	Ukraine	UKR
Kosovo	XKX	United Kingdom	GBR
Kyrgyz Republic	KGZ	Uzbekistan	UZB

Regional Classification Used in this Report

This report covers the Emerging Market and Developing Economies (EMDEs) of Europe and Central Asia (ECA). These are divided into the following groups: Central Asia, Central Europe, Eastern Europe, South Caucasus, Western Balkans, Russia, and Türkiye. The report occasionally uses the term ECA to refer to the countries in both EMDE ECA and the EU.

TABLE E.1 Regional classification used in this report

Central Asia	Central Europe	Eastern Europe	South Caucasus	Western Balkans
Kazakhstan Kyrgyz Republic Tajikistan Turkmenistan Uzbekistan	Bulgaria Croatia Hungary Poland Romania	Belarus Moldova Ukraine	Armenia Azerbaijan Georgia	Albania Bosnia and Herzegovina Kosovo Montenegro Republic of North Macedonia Serbia
	Russian Federation		**Türkiye**	

Executive Summary

The Russian Federation's invasion of Ukraine has had devastating economic and social consequences for Ukraine and profound impacts on development and poverty alleviation in Europe and Central Asia (ECA). Growth in economic activity in the emerging markets and developing economies of ECA slowed substantially in 2022 to 1.2 percent, as surging inflation, energy and value chain disruptions, and marked monetary tightening weighed on the economic expansion.

Economic growth is set to remain mediocre in 2023, with real GDP projected to increase to 1.4 percent, as the contraction in Russia eases and the fall in Ukraine's output subsides. The economic expansion in Türkiye will soften as the impact of the two devastating earthquakes the country suffered in February, as well as weakening external demand and private consumption, present drags on growth. The February earthquakes, along with more than 9,000 aftershocks and several additional earthquakes, have resulted in over 50,000 deaths in Türkiye. The affected areas comprise nearly a tenth of the country's output and are expected to suffer considerable economic damage, with direct physical damages amounting to an estimated $34.2 billion, or 4 percent of GDP. The resulting economic destruction in these regions further exacerbates the immense human tragedy from the earthquakes.

Excluding Russia and Ukraine, growth in ECA is projected to fall to 2.4 percent in 2023 from 4.7 percent in 2022, reflecting the impact of tighter financial conditions, persistent inflation, and subdued external demand. Growth in 2023 may be weaker still if there is an escalation of the war in Ukraine, further increases in food and energy prices, an accelerated tightening of monetary policy globally or in the region, or a sudden reversal of capital flows into the region.

Inflation surged in 2022, with large increases in food and fuel prices following Russia's invasion of Ukraine, building on an already large increase in 2021 as economies reopened after the COVID-19 pandemic. Inflation remains stubbornly high in the region. Core inflation—excluding food and fuel prices—is projected to remain elevated, and efforts to reduce it will take longer than most market participants and policy makers expect.

Tighter financial conditions will continue to weigh on private investment in most economies, with sustained core inflation pressures raising the possibility of additional policy rate hikes by major central banks. The risk-off environment that characterized most of 2022 has resulted in volatile market movements, generating an increasing risk of financial turmoil that has continued into 2023. Following substantial outlays of government support to protect households and firms from two back-to-back crises, fiscal consolidation will be a priority to restore fiscal space and rebuild fiscal buffers in most of the region.

Over the medium to long term, structural constraints amid an incomplete market transition in many countries, weak productivity, problematic education outcomes, limited innovation, and a rapidly aging population need to be addressed to help expand the region's productive capacity. The recent energy crisis presents an opportunity for the region to accelerate green transition goals. By enacting policies to support a steady and sensible transition away from a high dependence on fossil fuels, ECA countries can facilitate a reduction in the region's high energy intensity and ameliorate environmental degradation.

Against the background of slow growth and high inflation, this *ECA Economic Update* also focuses on the cost-of-living crisis—the impact of high inflation on the standards of living of people in the region. A sharp rise in consumer prices, particularly for food and energy, resulted in median annual inflation in the emerging markets and developing economies of ECA of 15.9 percent in September 2022, a level not recorded since 1999.

Rising food prices and energy bills, higher mortgages and rents, and elevated prices for services are eroding the standards of living for a large part of the population of ECA. Households have become vulnerable to various income shocks that have pushed them into poverty or substantial vulnerability. The cost-of-living crisis in the region is so acute that 93 percent of Europeans identify inflation as their most pressing concern.

The analysis conducted for this *Update* shows that the high inflation of 2022 had a heterogeneous impact on the population of ECA. Due to differences in both consumption patterns and price increases across goods and services, the poorest households faced significantly higher inflation than the wealthiest households in almost every country in ECA in 2022. In the emerging markets and developing countries in the region, households in the bottom decile of the consumption distribution faced cost of living increases that were on average more than 2 percentage points higher than those faced by households in the top decile, with the difference reaching 5 percentage points in some countries.

In addition, the average inflation estimated using the cost-of-living increases for different households was higher than Consumer Price Index (CPI) inflation measured using an aggregate consumer price basket. In most countries in the region, the poverty headcount rate, the poverty gap, and the Gini index of inequality were all higher when using household-specific cost-of-living indexes than when using the CPI. Using the CPI to measure inflation in such situations could lead to policies with potentially unintended redistributional consequences. Not considering diverging inflation patterns might be especially harmful in today's times of lower growth.

These findings have strong policy implications, because many public programs targeting vulnerable populations link eligibility and benefit levels to the average CPI-based inflation rate and not the (higher) cost-of-living increase that disproportionately affects the poor. Policies to protect vulnerable groups and promote economic growth should account for the heterogeneity of inflation across households. Using inflation indicators that capture more precisely the actual costs of living of the poor are essential for designing efficient poverty alleviation policies.

1

Recent Developments, Policies, and Outlook

The Russian Federation's invasion of Ukraine has had devastating economic and social consequences for Ukraine and profound negative impacts on developments in Europe and Central Asia (ECA). The expansion of economic activity in ECA slowed markedly to 1.2 percent in 2022, as disruptions to the supply of key commodities, surging inflation, and the tightening of monetary policy weighed on activity in the region. Modestly higher oil production in Russia, as well as resilient private consumption due to robust fiscal support in most countries to shield households from the cost-of-living crisis, resulted in a 1 percentage point upgrade to ECA growth in 2022 relative to January 2023 projections. Strong inflows of migrants, money, and business from Russia and Ukraine, as well as trade and investment diversion as a result of Russia's war in Ukraine, led to a surge in output in several countries.

Following a substantial increase in 2021 due to the reopening of ECA's economies from COVID-19-related restrictions, inflation surged further in 2022, as Russia's invasion of Ukraine exacerbated existing pressures in food and energy prices. Inflation has remained stubbornly high through the first quarter of 2023.

Output in the region is projected to increase moderately by 1.4 percent in 2023, better than projected in January 2023, largely reflecting upgrades to the pace of economic activity in major economies. Excluding Russia and Ukraine, growth is projected to weaken to 2.4 percent in 2023, from 4.7 percent in 2022, as a result of tighter financial conditions, persistent inflation, and subdued external demand. These projections are subject to profound uncertainty, with Russia's war in Ukraine representing a shock of historical proportions. Risks to the outlook are further tilted to the downside, including from the further tightening of financial conditions following recent developments in US and European banking sectors.

Recent Economic Developments

Economic expansion slowed as a result of Russia's invasion of Ukraine

The Russian Federation's invasion of Ukraine, the subsequent disruption of energy, food, metals and other supplies, and the tightening of monetary policy and financial conditions dramatically slowed growth in Europe and Central Asia (ECA) in 2022. Growth of regional activity weakened to 1.2 percent in 2022 from 7.1 percent in 2021, with a contraction in Russia, a deep recession in Ukraine, and a substantial slowdown in Türkiye (box 1.1; figure 1.1, panel a). In addition to the significant human toll, Russia's war in Ukraine resulted in surging prices for food, fuel, and other commodities, heightened commodity price volatility, increased policy and geopolitical uncertainty, and dampened domestic and external demand. Rapid and sizable tightening of monetary policy and global financial conditions—triggered by the need to rein in above-target inflation in the world's major economies—led to similar tightening across developing ECA that further weighed on activity.

BOX 1.1 Global outlook[a]

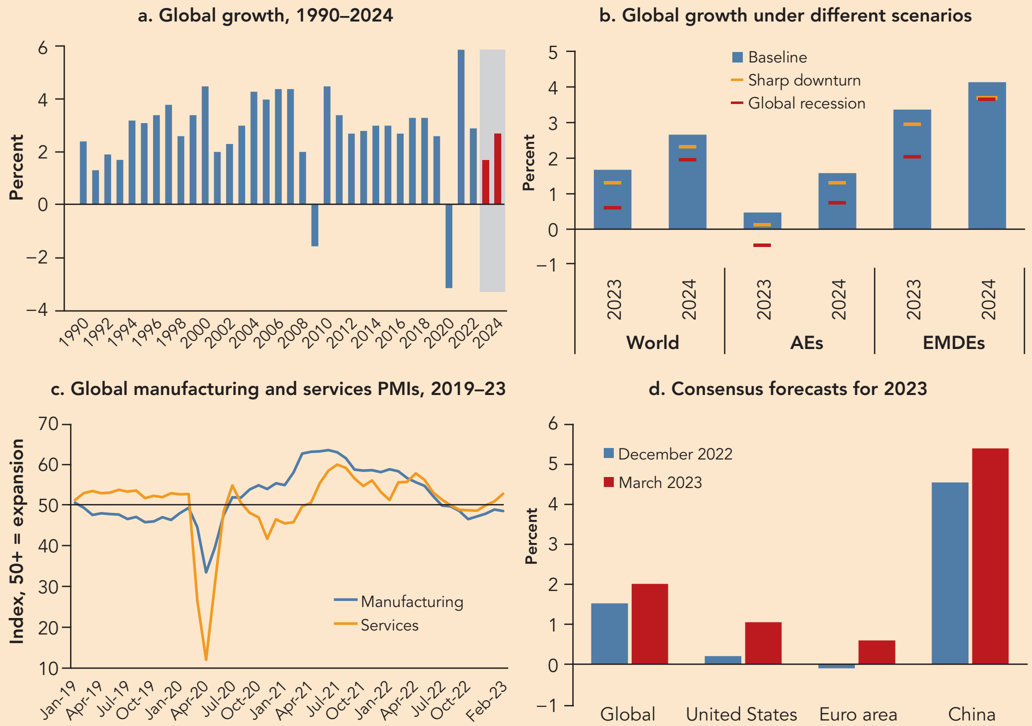
Global growth is projected to slow sharply in 2023, resulting in the third weakest pace of expansion in nearly three decades after the global recession caused by the COVID-19 pandemic and the global financial crisis (figure B1.1.1, panel a) (World Bank 2023a). The slowdown reflects ongoing monetary policy tightening to contain very high inflation, fiscal adjustment, worsening financial conditions, and continued disruptions from the Russian Federation's invasion of Ukraine. Amid tight financial conditions, the recent developments in the US financial sector have generated increased financial market stress and threatened additional weakness in the United States and the euro area. The resulting spillovers, including elevated risk-off sentiment, threaten to exacerbate other headwinds faced by emerging markets and developing economies and present further drag on growth prospects.

Global activity, especially on the services side, appears to have stabilized in early 2023, reducing the likelihood of a global recession (figure B1.1.1, panels b and c).[b] After contracting for six months, the global composite Purchasing Managers' Index (PMI) returned to expansion in February 2023, reflecting a strong pickup in services activity. Services trade is likely to continue to benefit from the recovery in international tourist arrivals, which remained about 25 percent below pre-pandemic trends in December 2022. By contrast, global manufacturing activity has continued to be subdued after global goods trade volumes and industrial production experienced renewed weakness in late 2022. The recovery in the global manufacturing PMI in early 2023 has lagged that of services, reflecting an ongoing contraction in new export orders. China's economic reopening is likely to boost headline global growth, but the positive spillovers to other economies and global trade could be modest given that the rebound has been less manufacturing- and external trade-intensive relative to previous recoveries. More broadly, global demand for manufactured goods is likely to remain muted

(Continued next page)

BOX 1.1 (continued)

FIGURE B1.1.1 Global economic activity



Sources: Consensus Economics; Haver Analytics; World Bank (2023a); World Bank.
Note: AEs = advanced economies; EMDEs = emerging markets and developing economies; GDP = gross domestic product; PMI = Purchasing Managers' Index.
a. Aggregate growth rates are calculated using real US dollar GDP weights at average 2010–19 prices and market exchange rates, as published in World Bank (2023). The shaded area indicates forecasts. The sample includes up to 37 advanced economies and 144 EMDEs.
b. Growth aggregates computed by Oxford Economics using 2015 market exchange rates and prices.
c. PMI readings above (below) 50 indicate expansion (contraction). The last observation is February 2023.
d. The figure shows growth projections from the last Continuous Consensus Forecast survey of the month indicated. Data are through March 27, 2023.

amid the ongoing and accumulating effects of tighter monetary policy. Nevertheless, weak goods demand and continued normalization of shipping conditions have helped ease global supply chain pressures, with suppliers' delivery times falling to pre-pandemic levels in February 2023.

The outlook for the global economy appears to have improved in early 2023, with Consensus forecasts for global growth in 2023 rising from 1.5 percent in late December to 2 percent in late March (table B1.1.1 and figure B1.1.1, panel d).[c] Various economic indicators suggest that particularly in large economies, activity was more resilient in late 2022 than earlier expected, implying that the drag from a weak fourth quarter in 2022 will weigh less on activity going forward. In the United States, con-

(Continued next page)

BOX 1.1 (continued)

TABLE B1.1.1. Consensus forecasts for real GDP growth in 2023

	December 2022 Survey	March 2023 Survey
World economy	1.5	2.0
United States	0.2	1.1
Euro area	-0.1	0.6
China	4.5	5.4

Sources: Consensus Economics; World Bank.
Note: GDP = gross domestic product. Table shows real GDP growth. Data are based off of the last Continuous Consensus Forecast survey. Data are through March 27, 2023.

tinued strength in the labor market has supported services activity and underpinned a pickup in consumption in early 2023, with Consensus forecasts up from 0.2 percent in late December 2022 to a still modest 1.1 percent in March 2023. The Consensus forecast for US growth in 2024, which is 0.8 percent, points to sluggish activity as tighter monetary policy weighs on domestic demand.

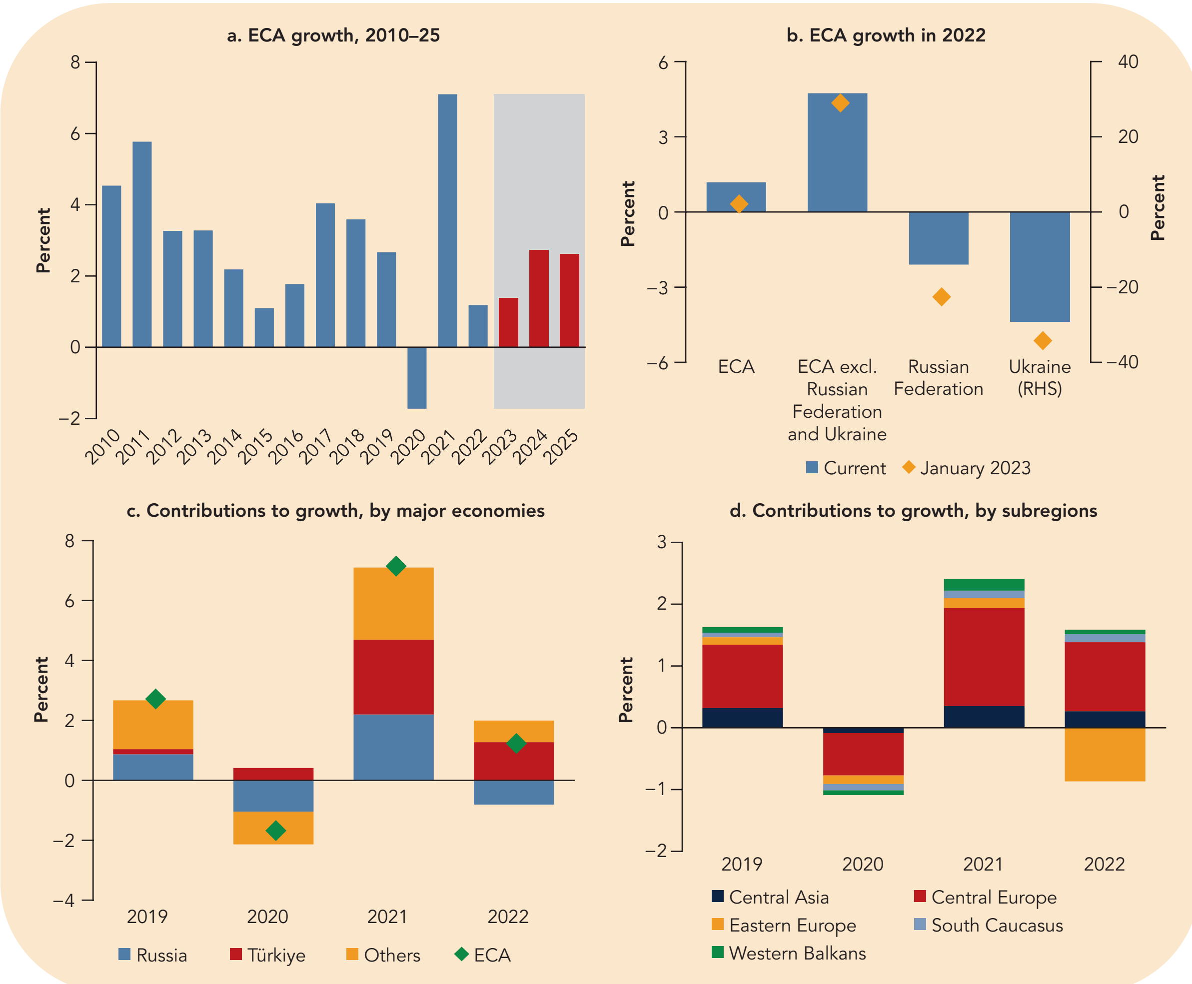
For the euro area, Europe and Central Asia's largest economic partner, Consensus forecasts for 2023 growth remain subdued at about 0.6 percent, still an improvement from the contraction envisioned in December 2022. The upward revision to the Consensus forecasts for euro area growth in 2023 is largely due to better-than-expected growth outturns in the fourth quarter of 2022, with activity benefiting from a warmer winter and the decrease in energy prices from the highs earlier in the year. Incoming survey data point to an ongoing recovery in sentiment, particularly in services, with the services PMI rising to its highest level in February 2023 since June 2022, amid a pickup in new business and improving expectations. In contrast, the manufacturing PMI in February 2023 contracted for the eighth consecutive month, with the decline in new export orders mirroring the weakness in global goods trade. Inflation also continues to weigh on euro area activity. The Consensus forecast for 2024 growth in the euro area remains subdued at 1 percent, as continued tightening of monetary policy to rein in inflation is expected to hold down domestic demand.

Risks to the global outlook remain tilted to the downside, including from sustained high inflation, financial stress, Russia's continued war in Ukraine, and rising geopolitical tensions. Inflation remains high in many economies. Although the Harmonized Index of Consumer Price Inflation has slowed in early 2023, core inflation continues to reach new record highs. Moreover, there is substantial uncertainty about the impact of central bank policy in terms of both magnitude and timing. To bring inflation under control, central banks may need to hike policy rates more than is currently expected. Financial stress among sovereigns, banks, and nonbank financial institutions may result from the combination of additional monetary tightening, softer growth, and falling confidence in an environment of elevated debt. Given the already weak global growth, a combination of sharper monetary policy tightening, and financial stress could result in a more pronounced slowdown this year.

a. Based on World Bank (2023a), the February and March 2023 "Global Monthly" Newsletters, and Consensus estimates from Consensus Economics. Data are as of March 27, 2023.
b. Defined as a contraction in annual global per capita income.
c. Consensus Economics, https://www.consensuseconomics.com.

The large slowdown in regional output growth in 2022 was less pronounced than expected in January 2023, with ECA's growth upgraded by 1 percentage point (figure 1.1, panel b) (World Bank 2023a). Russia's economy is estimated to have contracted by 2.1 percent in 2022, an upgrade of 1.4 percentage points relative to January 2023, accounting for a large share of the regional upgrade for 2022 (figure 1.1, panel b). Substantial fiscal stimulus partly offset weaker private consumption and exports to deliver a better-than-expected outcome. Oil production in Russia rose modestly in 2022 rather than decrease as earlier expected. Besides Russia, the improvement relative to previous estimates was broad-based, with growth for 2022 revised higher in nearly two-thirds of ECA's economies. In

FIGURE 1.1 **Regional economic activity**



Sources: World Bank (2023a); World Bank.
Note: ECA = Europe and Central Asia. Aggregate growth rates are calculated using real US dollar GDP weights at average 2010-19 prices and market exchange rates.
a. Shaded area indicates forecasts.
b. "Current" refers to projections in tables 1.1 and 1.2. "January 2023" refers to projections released in the January 2023 edition of the *Global Economic Prospects* report (World Bank 2023a).
c, d. Figures shows contribution to ECA output. "Others" includes Central Asia, Central Europe, Eastern Europe, South Caucasus, and Western Balkans subregions, which is shown in panel d.

Türkiye, robust growth in private consumption and exports helped output expand by 5.6 percent in 2022, serving as a significant driver of regional growth last year (figure 1.1, panel c).

Excluding Russia and Ukraine, growth of ECA's gross domestic product (GDP) is estimated to have slowed to 4.7 percent in 2022 from 8.3 percent in 2021, reflecting to a substantial extent the hit to consumption growth from high inflation eroding household purchasing power. The underlying growth momentum in most countries was robust relative to potential, reflecting the ongoing reopening from the COVID-19 pandemic and the subsequent release of pent-up demand (figure 1.1, panel d). In Central Europe and the Western Balkans, following stronger-than-expected growth in the first half of 2022, activity weakened in the second half of the year in tandem with the euro area. In Central Asia and the South Caucasus, large inflows of migrants and money transfers—predominantly from Russia and also Ukraine—and double-digit trade growth led to significant output growth in the second half of last year, leading to upgrades in full-year growth by 0.2 and 0.5 percentage points, respectively. Because of a growth surge in Armenia—the fastest growing country in ECA in 2022 and one of only two

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

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

	2020	2021	2022[e]	2023[f]	2024[f]	2025[f]	Percentage point differences from January 2023 projections 2022[e]	2023[f]	2024[f]
EMDE ECA[a]	**−1.7**	**7.1**	**1.2**	**1.4**	**2.7**	**2.7**	**1.0**	**1.3**	**−0.1**
EMDE ECA excl. the Russian Federation and Ukraine	−1.0	8.3	4.7	2.4	3.6	3.7	0.5	0.3	0.2
EMDE ECA excl. the Russian Federation, Türkiye, and Ukraine	−2.7	6.4	4.2	1.8	3.2	3.4	0.3	0.1	0.1
Central Europe[b]	−2.9	6.7	4.7	1.1	2.9	3.3	0.2	0.0	0.2
Western Balkans[c]	−3.1	7.6	3.0	2.5	3.1	3.6	−0.1	0.0	0.0
Eastern Europe excl. Ukraine[d]	−3.1	3.6	−20.3	0.6	2.8	4.4	3.9	−0.5	−0.7
South Caucasus[e]	−5.3	6.7	7.0	3.0	3.4	3.6	0.5	−0.3	−0.1
Central Asia[f]	−1.3	5.3	4.1	4.0	4.3	4.2	0.2	0.1	0.0
Russian Federation	−2.7	5.6	−2.1	−0.2	1.2	0.8	1.4	3.1	−0.4
Türkiye	1.9	11.4	5.6	3.2	4.3	4.1	0.9	0.5	0.3
Poland	−2.0	6.8	4.9	0.7	2.6	3.2	0.5	0.0	0.4

Source: World Bank.
Note: World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other World Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time. Due to lack of reliable data of adequate quality, the World Bank is currently not publishing economic output, income, or growth data for Turkmenistan, and Turkmenistan is excluded from cross-country macroeconomic aggregates. Since Croatia became a member of the euro area on January 1, 2023, it has been removed from the ECA aggregate.
e = estimate; ECA = Europe and Central Asia; EMDE = emerging market and developing economies; f = forecast; GDP = gross domestic product.
a. GDP and expenditure components are measured in average 2010-19 prices and market exchange rates.
b. Includes Bulgaria, Hungary, Poland, and Romania.
c. Includes Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia.
d. Includes Belarus, Ukraine, and Moldova.
e. Includes Armenia, Azerbaijan, and Georgia.
f. Includes Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan.

countries with stronger growth in 2022 than in 2021—the South Caucasus is the only ECA subregion where the pace of economic expansion was faster in 2022 than in 2021.

Government spending measures that were enacted to ameliorate the impact of inflation on households and firms helped partly offset negative price shocks and shield households in several economies (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Moldova, Montenegro, North Macedonia, Poland, Romania, and Serbia). Among energy exporters, elevated energy prices cushioned activity and boosted exports, limiting the slowdown in growth (Azerbaijan and Kazakhstan). The recovery in tourist arrivals lifted services exports and growth, notably in Albania, Croatia, Georgia, Montenegro, and Türkiye.

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

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

	2020	2021	2022[e]	2023[f]	2024[f]	2025[f]	Percentage point differences from January 2023 projections 2022[e]	2023[f]	2024[f]
Albania	−3.5	8.5	3.5	2.2	3.4	3.4	0.0	0.0	0.0
Armenia	−7.2	5.7	12.6	4.4	4.8	5.0	1.8	0.3	0.0
Azerbaijan	−4.3	5.6	4.6	2.2	2.5	2.6	0.4	−0.6	−0.1
Belarus	−0.7	2.4	−4.7	0.6	1.4	1.3	1.5	2.9	−1.1
Bosnia and Herzegovina[b]	−3.0	7.4	4.0	2.5	3.0	3.5	0.0	0.0	0.0
Bulgaria	−4.0	7.6	3.4	1.5	2.8	3.0	0.3	−0.2	−0.5
Croatia	−8.6	13.1	6.3	1.3	2.8	3.0	−0.3	0.5	−0.3
Georgia	−6.8	10.5	10.1	4.4	5.0	5.0	0.1	0.4	0.0
Hungary	−4.5	7.1	4.6	0.6	2.6	2.6	−0.5	0.1	0.4
Kazakhstan	−2.5	4.3	3.2	3.5	4.0	3.6	0.2	0.0	0.0
Kosovo	−5.3	10.7	3.5	3.7	4.4	4.2	0.4	0.0	0.2
Kyrgyz Republic	−8.4	6.2	7.0	3.5	4.0	4.0	1.5	0.0	0.0
Moldova	−7.4	13.9	−5.9	1.8	4.2	4.1	−4.4	0.2	0.0
Montenegro	−15.3	13.0	6.1	3.4	3.1	2.9	0.2	0.0	0.0
North Macedonia	−4.7	3.9	2.1	2.4	2.7	2.9	0.0	0.0	0.0
Poland	−2.0	6.8	4.9	0.7	2.6	3.2	0.5	0.0	0.4
Romania	−3.7	5.8	4.8	2.6	3.9	4.1	0.2	0.0	−0.3
Russian Federation	−2.7	5.6	−2.1	−0.2	1.2	0.8	1.4	3.1	−0.4
Serbia	−0.9	7.5	2.3	2.3	3.0	3.8	−0.2	0.0	0.0
Tajikistan	4.4	9.4	8.0	5.0	4.0	4.0	1.0	0.0	0.0
Türkiye	1.9	11.4	5.6	3.2	4.3	4.1	0.9	0.5	0.3
Ukraine	−3.8	3.4	−29.2	0.5	3.5	6.5	5.8	−2.8	−0.6
Uzbekistan	2.0	7.4	5.7	5.1	5.4	5.8	0.0	0.2	0.3

Source: World Bank.
Note: World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other World Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time. Due to lack of reliable data of adequate quality, the World Bank is currently not publishing economic output, income, or growth data for Turkmenistan, and Turkmenistan is excluded from cross-country macroeconomic aggregates.
e = estimate; f = forecast; GDP = gross domestic product.
a. Data are based on GDP measured in average 2010-19 prices and market exchange rates, unless indicated otherwise.
b. Production approach-based numbers.

On February 6, 2023, Türkiye—the region's second largest economy—experienced two major earthquakes, with magnitudes of 7.8 and 7.5 on the Richter scale, with several additional earthquakes and more than 9,000 aftershocks reported in the following weeks. The first earthquake was the most powerful one recorded in the country since 1939. The earthquakes resulted in more than 50,000 deaths and 100,000 injured. The 11 Turkish provinces affected by the earthquakes account for 16.4 percent of the country's population and 9.4 percent GDP. Direct losses as a result of the earthquakes are estimated at $34.2 billion, or 4 percent of 2021 GDP, based on the World Bank's Global Rapid Post-Disaster Damage Estimation released on February 27, 2023 (Gunasekera et al. 2023). The actual costs to meet the full range of recovery and reconstruction needs could be double the direct damages. The World Bank has committed $1.8 billion in support to the country after the earthquakes.

Private consumption growth was negatively affected by higher inflation

Growth of real private consumption, excluding Russia, Türkiye, and Ukraine, fell by nearly half to 3.6 percent in 2022 as inflation eroded household incomes and significantly curbed spending.[1] However, several factors supported consumption. Most important were the substantial government support measures. Further, tight labor markets fueled significant wage increases that helped boost consumption in the first half of the year in several countries. Migrants from Russia and refugees from Ukraine lifted demand for goods and services throughout the region. Higher remittances and money transfers from the European Union and the United Kingdom to Albania, Bosnia and Herzegovina, and Kosovo and from Russia to Armenia, Azerbaijan, Kyrgyz Republic, Tajikistan, and Uzbekistan supported private consumption in these countries. Large minimum wage increases, such as those in Türkiye, also boosted real household incomes, resulting in a surge in private consumption in 2022.

Growth in fixed investment has slowed

After averaging 23 percent of GDP over 2010-19, fixed investment in ECA has been negatively affected by the COVID-19 pandemic, the sharp tightening in financial conditions, and the increase in risk aversion of both domestic and foreign investors amid Russia's invasion of Ukraine.[2] In 2022, fixed investment growth slowed to 4.2 percent—with the ratio to GDP only modestly higher than the historical outcome—down from the post-pandemic surge of 6 percent in 2021 and slightly above the 2010–19 average of 4.1 percent.

In response to Russia's invasion of Ukraine, governments in ECA adopted support measures to help firms and households amid two back-to-back crises. As

1. Sample includes 17 ECA economies for which GDP component data are available.
2. Fixed investment refers to gross fixed capital formation. Fixed investment in ECA has been about 5 percentage points higher than in Latin America and the Caribbean but has substantially lagged East Asia and Pacific by about 10–15 percentage points since the mid-1990s (World Bank 2023a).

a result, many governments delayed capital spending. For example, fixed investment in Bulgaria weakened to 15.4 percent of GDP in 2022, with a sharp slowdown in government investment to less than 4 percent of GDP, impacted negatively also by an ongoing political crisis and the lack of a regular government.

Recent declines in ECA's foreign direct investment (FDI) inflows pose challenges for long-term growth prospects. In the four years leading to the global financial crisis, FDI inflows to Central Europe and the Western Balkans increased to an average of 8.2 percent of GDP. FDI inflows in the two subregions slowed after the crisis and fell to a near 20-year low of 1.7 percent of GDP by 2020, also reflecting the impact of the COVID-19 pandemic. High global interest rates and investor concerns about elevated risks in ECA are continuing to weigh on FDI into the region. Inflows of FDI are projected to average 2 percent of GDP in 2023 and remain little changed over the medium term.

External trade has been mixed

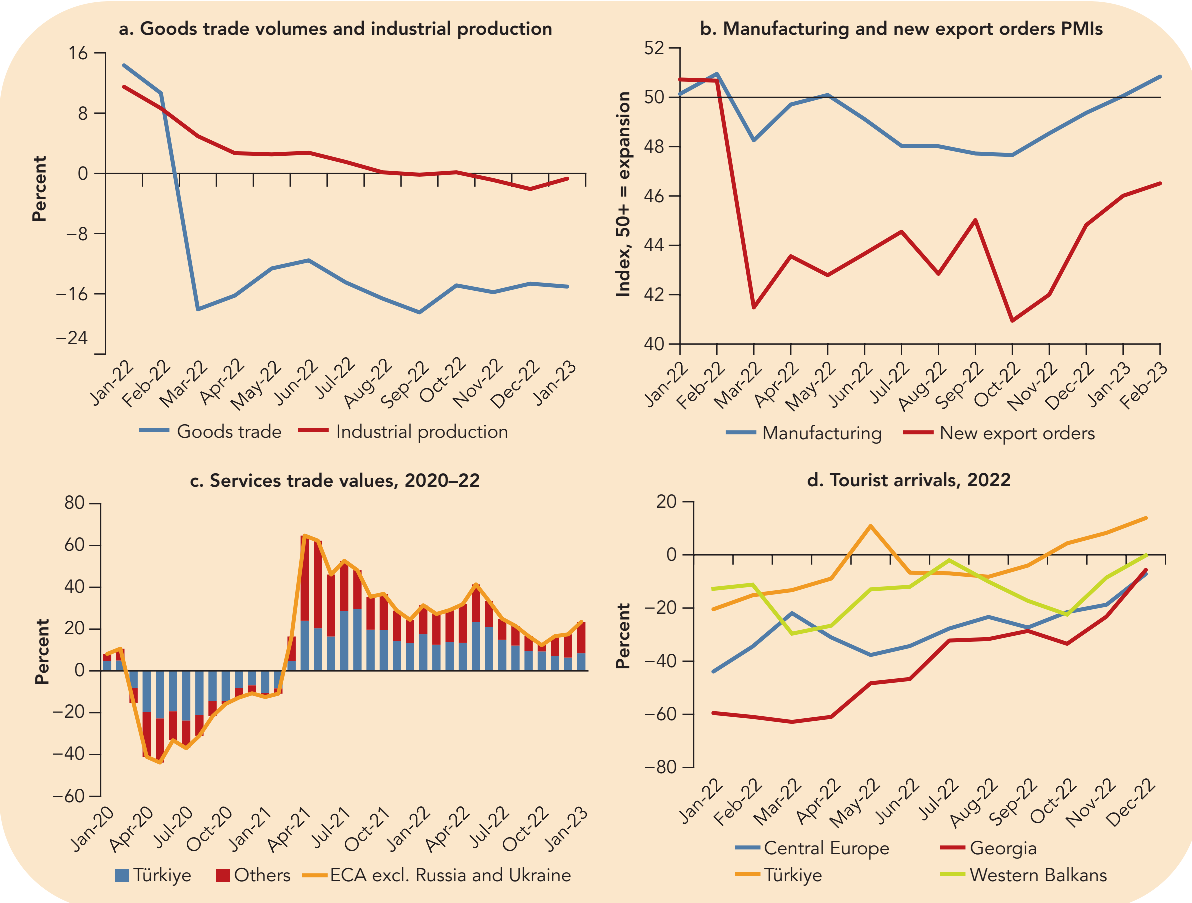
Following Russia's invasion of Ukraine, trade volumes contracted on average in 2022, reflecting supply chain disruptions and weaker demand from the European Union (EU) (figure 1.2, panel a). The averages hide huge variation across ECA, nonetheless. The manufacturing Purchasing Managers' Index (PMI) subindex for new export orders, despite remaining in contractionary territory, has shown signs of a smaller contraction in early 2023 (figure 1.2, panel b).[3]

Trade diversion led to a surge in exports in several countries. In Armenia, export volumes increased by 70 percent in the second half of 2022, pushing growth for the year up to 55 percent; in Georgia, export volumes increased by 25 percent in 2022. High commodity prices benefited commodity exporters in the region, especially Azerbaijan and Kazakhstan. Azerbaijan's current account surplus almost doubled to nearly 27 percent of GDP in 2022, and it looks likely to remain elevated at just below 20 percent in 2023. In Kazakhstan, foreign trade turnover amounted to $134 billion, an all-time high, and the current account shifted from a deficit of 4 percent of GDP in 2021 to a nearly 3 percent surplus in 2022. Amid the ongoing reopening of ECA's economies after the COVID-19 pandemic, tourism rebounded, leading to an increase in services exports (figure 1.2, panel c). International tourist arrivals recovered to nearly 80 percent of pre-pandemic levels in 2022 in Europe (figure 1.2, panel d). In some ECA countries, tourist arrivals even surpassed pre-pandemic levels (for example, Albania).

In mid-2022, the European Union adopted a package of sanctions banning seaborne imports of crude oil and oil products from Russia to the European Union. These sanctions came into force on December 5, 2022, for Russian crude oil exports and on February 5, 2023, for Russian petroleum products. The sanctions prohibit shippers, lenders, and insurers from supplying services unless oil products are purchased at or below the price caps set by the European Union. The price caps, which are meant to limit global price pressures and profits, are set at $60 per barrel for crude oil, $45 per barrel for discounted petroleum products,

3. Manufacturing PMI surveys are available for four ECA economies: Kazakhstan, Poland, Russia, and Türkiye.

FIGURE 1.2 **Regional recent developments**



Sources: CPB Netherlands Bureau for Economic Policy Analysis (database); Haver Analytics; World Bank; World Trade Organization.
Note: ECA = Europe and Central Asia.
a. Figure shows percent year-on-year change in goods trade volumes and industrial production. Trade volumes are calculated as the average of imports and exports of Eastern Europe, as defined by the CPB Netherlands Bureau for Economic Policy Analysis. The last observation is January 2022.
b. Purchasing Managers Index (PMI) values above (below) 50 indicate expansion (contraction). New export orders are a subindex of the manufacturing PMI. Aggregates are calculated as average for 4 ECA economies for manufacturing and for 3 ECA economies for new export orders. The last observation is February 2023.
c. Figure the contribution of ECA economies to the year-on-year percent change of monthly services values in ECA. Sample includes Bulgaria, Hungary, Poland, Romania, Serbia, and Türkiye. Last observation is January 2023.
d. Figure shows percent change in tourist arrivals compared to the same month in 2019. Aggregates are calculated as medians. Central Europe sample includes Bulgaria, Hungary, Poland, and Romania. Western Balkans includes Albania, Bosnia and Herzegovina, Montenegro, North Macedonia, and Serbia.

and $100 per barrel for premium petroleum products. These sanctions apply only to the EU countries but not to the other countries in ECA. As a result, non-EU EMDE countries in ECA have continued to import Russian oil and natural gas.

In Türkiye, strong export growth in 2022 was offset by a surge in imports due to the country's rising energy bill and demand for gold, the latter used to hedge against inflation. Exports have benefited from a recovery in tourism and trade diversion following Russia's invasion of Ukraine. The composition of trade also shifted to include additional machinery, and food to Russia. Overall, the country's current account deficit widened to $48.8 billion in 2022, its largest 12-month deficit since mid-2018.

Inflation remains stubbornly high

Median 12-month headline inflation in Emerging Market and Developing Economies (EMDE) ECA moderated to 15.3 percent in early 2023 after peaking at 15.9 percent in September 2022, the latter being the highest rate since 1999 (figure 1.3, panel a). ECA has been among the hardest hit regions by surging inflation, and with median inflation the highest among EMDE subregions, notably East Asia and the Pacific, Latin America and the Caribbean, and the Middle East and North Africa (figure 1.3, panel b). A decline in energy prices from record highs, supported by a milder winter in Europe and diversification of energy imports, helped cool inflation alongside the emerging effects of ongoing monetary policy tightening (figure 1.3, panel c).

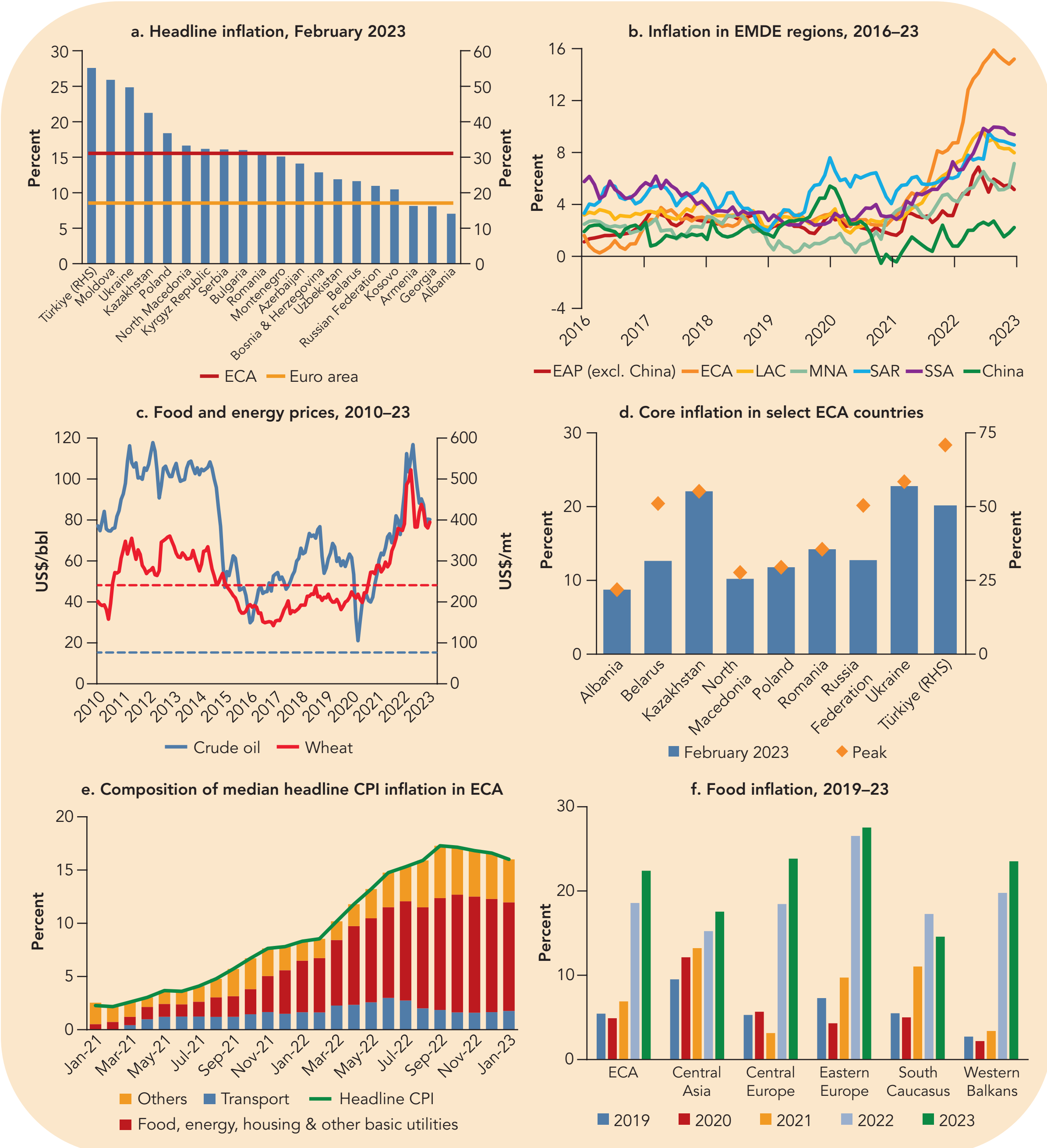
Inflation in Central Europe peaked at 21.2 percent in January 2023, but price pressures have continued to intensify in some countries. In Hungary and Poland, inflation was among the highest in the EU, rising to 25.3 percent and 18.4 percent in February 2023, respectively. In the Western Balkans, inflation has moderated to 14 percent from its peak of 15.9 percent in October 2022 as households have increasingly curbed spending in response to higher prices. The inflow of migrants and money transfers into Central Asia and the South Caucasus drove up domestic demand and inflation but also helped appreciate some of the currencies, notably in Armenia and Georgia. Inflation peaked in the second quarter of 2022 in the South Caucasus, reaching 13.3 percent in May 2022. Inflation appears to have continued to increase in Kazakhstan and the Kyrgyz Republic, however.

Prior to Russia's invasion of Ukraine, inflation was already rising in 2021 and early 2022 as countries in ECA reopened following the COVID-19 pandemic. The release of pent-up demand from the 2020 recession revealed stark shortages and supply chain disruptions, with bottlenecks continuing to push up inflation in 2022. With labor markets already tight in many ECA countries prior to the pandemic, the sudden increase in demand for goods and services during the pandemic recovery spilled over into firms' increased demand for labor to meet production needs, leading to rising wages, higher input prices, and elevated production costs. Reduced labor force participation in many countries, including the large share of young people neither in employment nor in education or training, has been an important reason behind the tight labor markets.

Excluding food and energy, median 12-month core inflation surged before peaking at 17.9 percent in September 2022, an increase of 9.8 percentage points from February 2022 (figure 1.3, panel d). Excluding Russia, Türkiye, and Ukraine, median 12-month core inflation has more than doubled since February 2022, climbing to 13.8 percent in December 2022, its highest rate in nearly 26 years, before subsiding to 12.5 percent in February 2023.

The surge in food and energy prices accounted for 60 percent of the increase in headline inflation in ECA in 2022 (figure 1.3, panel e). Russia's invasion of Ukraine led to disruptions in exports of key food commodities, which exacerbated food price increases throughout the region. A jump in fertilizer prices, as well as domestic challenges, including drought, low crop yields, and export bans in some cases, have also contributed (Azerbaijan, Bosnia and Herzegovina, Bulgaria, Hungary, Kazakhstan, Moldova, Montenegro, North Macedonia,

FIGURE 1.3 Inflation



Sources: Haver Analytics; International Monetary Fund; World Bank.
Note: CPI = consumer price index; ECA = Europe and Central Asia; EMDE = emerging market and developing economies.
a. Figure shows non-seasonally adjusted data, except for Kazakhstan.
b. Figure shows median inflation by region. Last observation is January 2023.
c. Dashed lines indicate 2010-19 averages. Last observation is February 2023.
d. Figure shows core inflation and corresponding peak in 2022 for countries indicated. The peak is October 2022 for Albania and Türkiye; August 2022 for Belarus; December 2022 for Kazakhstan, North Macedonia, Poland, Romania, Ukraine, and Uzbekistan; and April 2022 for the Russian Federation.
e. Figure shows year-on-year headline CPI inflation and contributions to inflation for categories indicated. Aggregates are calculated as median. Sample includes 14 ECA economies. Last observation is January 2023.
f. Figure shows annual averages of food consumer price inflation. Sample includes 22 ECA economies. Aggregate inflation rates are based on median non-seasonally adjusted year-on-year inflation across countries, except for Kazakhstan which is seasonally adjusted. Data are through February 2023.

Romania, Poland, Serbia, Türkiye, and Ukraine). ECA's heavy reliance on Russia for energy left the region particularly vulnerable to the supply disruptions generated by Russia's war in Ukraine, adding to energy insecurity. Before the war, EMDE ECA energy imports from Russia accounted for 36 percent of the region's total; for natural gas, Russia's share was 42 percent, similar to the share of the EU.

Prices for both food and energy have eased from last year's highs but remain elevated relative to historical levels. The Black Sea Grain Initiative has helped enable exports from Ukraine since August, with wheat exports amounting to 23.6 million tons in the second half of 2022, or a third below the level a year earlier. A substantial increase in prices for oil and coal in 2022, and all-time highs for natural gas, have helped reduce consumption of these fuels. Energy prices subsequently declined in line with this reduced consumption, slower global demand, and a milder winter in Europe (World Bank 2023a). Although international commodity prices have continued to ease in the first quarter of 2023, prices for natural gas remain double their averages in the decade prior to the COVID-19 pandemic, and prices for maize and wheat are double their 2015–19 averages.

Food inflation has remained high in early 2023, with over half of the ECA region experiencing food inflation of 20 percent or greater at the start of the year (figure 1.3, panel f). The median 12-month food price inflation climbed to 22.2 percent by February 2023, nearly double the rate in February 2022 and a more than six-fold increase relative to January 2019. Food inflation in the region has surged to even higher levels in several countries, peaking at 102 percent in Türkiye and 49.4 percent in Hungary in November 2022—both much higher than in the rest of EMDE ECA.

Inflation measured by the Consumer Price Index masks substantial variations in the inflation rate experienced by households with different consumption patterns (see part 2). A feature of high inflation episodes is that prices increase at a substantially different pace across categories of goods and services, leading to an increase in relative price dispersion. As a result, households with different patterns of consumption face different inflation rates on the goods and services they consume. Due to differences in both consumption patterns and price increases across goods and services, the poorest households faced significantly higher inflation than the wealthiest households in almost every country in ECA in 2022. In EMDE ECA, households in the bottom decile of the consumption distribution faced cost of living increases that were on average more than 2 percentage points higher than those faced by households in the top decile, with the difference reaching 5 percentage points in some countries.

Financial conditions have tightened substantially

Higher policy and lending rates, and dollar appreciation in 2022 resulted in tighter financial conditions. The risk-off environment that characterized most of last year has resulted in volatile market movements, generating an increasing risk of financial turmoil that has continued into 2023. The March 2023 collapse of several banks in the United States has exacerbated financial pressures; rapid interest rate increases were at the core of the difficulties faced by these banks. The deterioration in market sentiment has forced many banks to tighten lending, leading to even tighter financial conditions, which could weigh on activity in some advanced economies, raising concerns of weaker growth and the risk of significant spillovers to the ECA region.

After rising to its highest level since the early 2000s in October 2022, the US dollar has remained volatile, affecting several of the currencies in the region (figure 1.4, panel a). A surge in money transfers from abroad to Armenia and Georgia led to currency appreciations of nearly 14 percent and 9.5 percent, respectively, during 2022. Bond spreads on dollar-denominated debt largely declined in the second half of 2022 and into 2023, with the median Emerging Markets Bond Index declining to 244 basis points after widening to as much as 436 basis points in 2022 as a result of the invasion and tighter global and domestic financial conditions (figure 1.4, panel b). However, spreads have climbed in March 2023, reflecting the impact of tensions in the banking sector in the United States and Europe. Ten-year spreads on local currency bonds eased to 5.9 percent on average after peaking at 7 percent on average in October 2022 (Bulgaria, Georgia, Hungary, Montenegro, and Poland).

January 2023 was one of the busiest months for EMDEs issuing international debt. The uptick followed a sharp decline in debt issuance in 2022, during which spreads on dollar-denominated debt exceeded 10 percentage points in about one in five EMDEs, up from less than one in fifteen in 2019, effectively locking them out of global debt markets (World Bank 2023a). In ECA, Romania issued the equivalent of $3.75 billion in maturities of 5, 10, and 30 years in January. Hungary issued the equivalent of $4.25 billion at similar maturities, and Türkiye issued a $2.75 billion 10-year bond yielding 9.75 percent. Serbia raised $1.75 billion with two dollar-denominated Eurobonds. After issuing €2.25 billion euros of Eurobonds at 7- and 12-year maturities in September 2022, Bulgaria also raised an additional €1.5 billion in a 10-year Eurobond issuance yielding 4.5 percent in January.

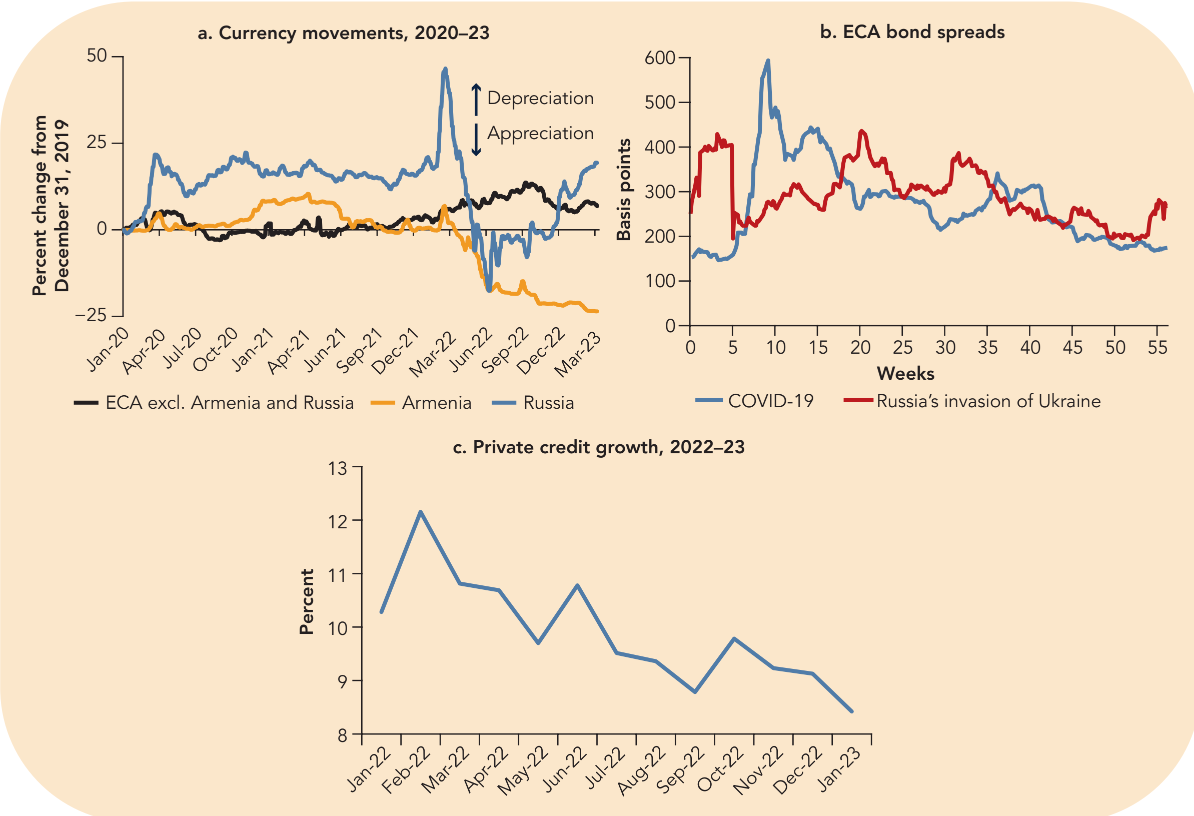
Credit growth has slowed

Tighter monetary policy and a surge in uncertainty negatively affected credit growth across most countries in ECA in 2022. Nominal private sector credit growth slowed during 2022 in most countries, including Kazakhstan, Moldova, Romania, Russia, Serbia, and Ukraine (figure 1.4, panel c). By contrast, nominal credit growth picked up in Tajikistan and Uzbekistan. In real terms, however, credit to the private sector slowed substantially in most ECA countries, hampering enterprises' efforts to expand.

While the banking sector in Europe and Central Asia has remained broadly resilient, nonperforming loans (NPLs) face upward pressure in many economies. Across Central Asia, regulatory disclosed NPLs are likely lower than the actual problem loans in the banking systems as signaled, for example, by the upward adjustments of problem loans mandated by asset quality reviews.

Although the rate of NPLs in Türkiye remained stable, the overall level of distressed debt (NPLs plus debt at risk of default) rose sharply in 2022 (World Bank 2023a). The economic impact of the devastating earthquakes that struck

FIGURE 1.4 Financial conditions



Sources: Haver Analytics; Institute of International Finance; World Bank.
Note: EMBI = Emerging Markets Bond Index.
a. Figure shows 7-day moving average of median. Sample includes 20 ECA economies. Last observation is March 27, 2023.
b. Figure shows the Emerging Market Bond Index (EMBI) for the weeks since the onset of the COVID-19 pandemic and Russia's invasion of Ukraine. The date of onset is January 20, 2020, for COVID-19 and February 24, 2022, for Russia's invasion of Ukraine. Aggregates are calculated as medians of daily data. Bond index calculated using subindices of the EMBI Global Index, which includes dollar denominated government debt. Last observation is March 24, 2023. Sample includes 10 ECA economies.
c. Figure shows the median year-on-year growth in private sector credit. Data are monthly and in nominal local currency units. Sample includes 11 ECA economies.

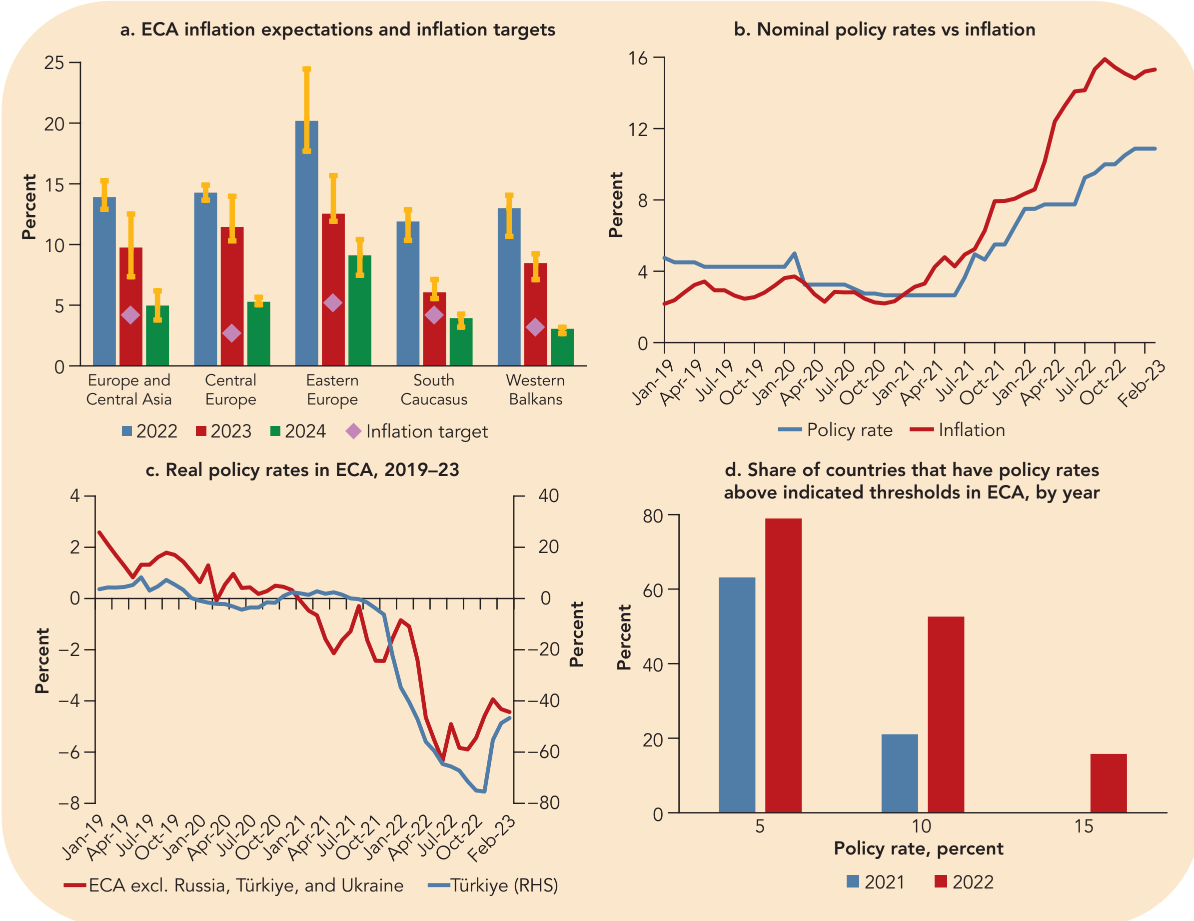
Türkiye in February 2023 will depend to a substantial degree on the fiscal response. It is expected that the impact on the banking sector will be more limited as the financial sector's exposure to the earthquake-affected provinces is modest.

Economic Policies

Higher inflation led to tighter monetary policy in 2022

In response to surging inflation, central banks in many ECA countries without currency boards or pegged exchange rates increased policy rates substantially in 2022. Of the 17 central banks with inflation targets, 16 reported headline inflation above the upper bound of the target band in 2022 (figure 1.5, panel a). Most of these central banks raised policy rates last year, with the median policy rate

FIGURE 1.5 Monetary policy



Sources: Consensus Economics; Haver Analytics; International Monetary Fund; World Bank.
a. Aggregates are calculated as median. Inflation data reflect actuals for 2022, and Consensus Economics forecasts of headline CPI inflation based on the March 2023 survey for 2023-24. Sample includes 16 ECA economies. Whiskers indicate interquartile ranges. Diamonds indicate inflation targets as of March 24, 2023.
b.c. Aggregates are calculated as median. Figure shows year-on-year percent change. Sample includes 18 ECA economies for policy rates and 20 ECA economies for inflation and excludes Russia and Ukraine. Last observation is February 2023.
d. Figure shows the share of ECA economies with policy rates higher than 5, 10 and 15 percent by end of the year for 2021 and 2022. Sample includes 19 ECA economies.

increase amounting to 475 basis points (figure 1.5, panel b).[4] Cumulative policy rate hikes since the start of 2022 ranged from 1,150 basis points in Moldova to just 50 basis points in Georgia. Georgia had already increased interest rates to double digits in 2021 as domestic demand rebounded strongly when COVID-19 related restrictions were lifted. These rate increases compare to a cumulative hike of 350

4. Countries that use the euro as the official currency (Kosovo and Montenegro) or have currency board arrangements with currencies pegged to the euro (Bulgaria and Bosnia and Herzegovina) do not have active monetary policy (World Bank 2021; IMF 2022c). The euro is also the official currency in Croatia following the integration of the country into the euro area and the Schengen Area on January 1, 2023, although prior to the country's accession, Croatia's currency was pegged to the euro. The Central Bank of North Macedonia targets the exchange rate rather than inflation.

basis points by the European Central Bank through late March 2023. Despite sharp increases in policy rates in ECA, inflation continues to outpace the policy rate in many countries, resulting in negative real policy rates (figure 1.5, panel c).

Although most inflation-targeting central banks in the region tightened monetary policy, the region's two largest economies implemented rate cuts. In Russia, after doubling the policy rate following the invasion of Ukraine, the central bank implemented a series of rate cuts from April through September 2022 that left the policy rate 100 basis points below its December 2021 level. In Türkiye, despite a surge in the officially measured inflation, which peaked at 85.5 percent in October 2022 (substantially above the 7 percent upper band of the inflation target range), the central bank cut the policy rate by 500 basis points during 2022. Inflation has eased to a still high 55 percent by February 2023. In response to the devastating earthquakes, the central bank cut the policy rate by an additional 50 basis points to 8.5 percent in February 2023.

For some countries—notably Moldova and those in the South Caucasus and Central Asia—substantial dollarization and shallow financial markets have limited monetary policy transmission and, in some cases, led to large policy rate increases in 2022. For others, policy rate hikes have had a modest impact, as inflation has been driven largely by external factors, notably higher prices for food and fuel. Nonetheless, monetary policy actions have likely helped to buoy investor confidence, which is critical in ECA given the elevated policy uncertainty and geopolitical tensions in the region (World Bank 2021).

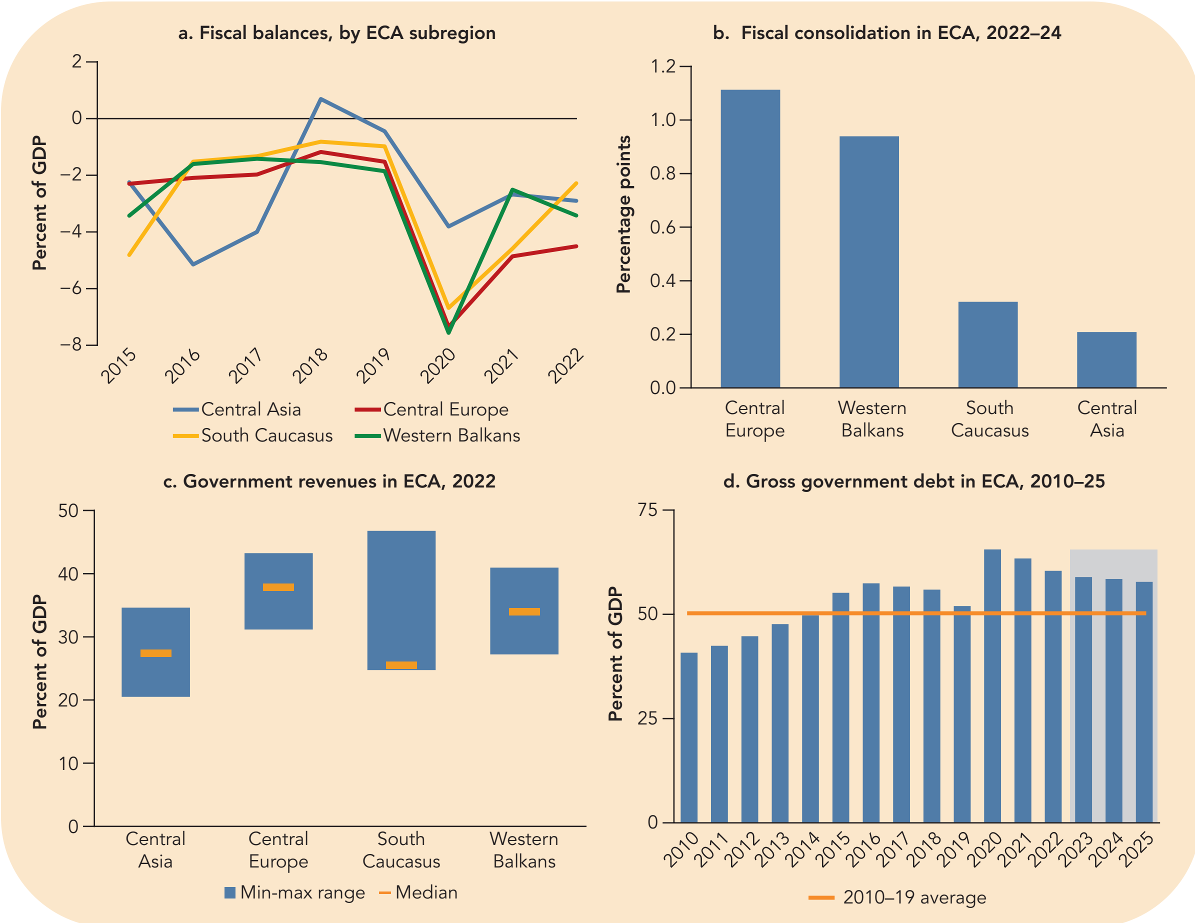
Fiscal consolidation was delayed

Measures to ameliorate the impact of the surge in food and energy prices and help refugees from Ukraine limited scope for fiscal adjustment in ECA in 2022. In many ECA countries, nonetheless, spending increases were partly offset by higher revenues driven by both higher growth and inflation and commodity-related receipts (figure 1.6, panel a). Most ECA countries are set to step up fiscal consolidation efforts in 2023 as emergency support measures are unwound, driving improvements in fiscal balances (figure 1.6, panel b).

A common denominator of fiscal developments in the region was the substantial support measures to help households and firms cope with surging fuel and food prices and support refugees from Ukraine (box 1.2). The median energy-related fiscal package in Central Europe, the Western Balkans, and Türkiye amounted to 2.7 percent of GDP. Social protection measures enacted by governments included shoring up social assistance programs (Albania) and increasing pensions (Albania, Bosnia and Herzegovina, and Bulgaria). In Poland, government spending rose because of increased social spending (Solidarity Package measures and public assistance to Ukrainian refugees), as well as foregone revenues of about 1 percent of GDP under the "anti-inflation shields." The unwinding of COVID-19-related support measures also helped on the expenditure side (Georgia).

For many ECA countries, stronger fiscal revenues due to better-than-expected growth and improved tax collection were the main reason for improved fiscal balances in 2022 (figure 1.6, panel c). Energy exporting countries, such as Azerbaijan and Kazakhstan, benefited from higher energy prices and stronger oil and

FIGURE 1.6 **Fiscal policy**



Sources: IMF (2022a); World Bank.
Note: Data for 2022-25 are projections as calculated by IMF (2022a).
a. Aggregates are calculated as median.
b. Figure shows percentage point differences in fiscal balance as a share of GDP. Aggregates are period averages over 2022-24 of medians.
c. Sample includes 21 ECA economies.
d. Figure shows median gross debt. Sample includes 22 ECA economies. Shaded area indicates forecasts.

natural gas-related revenues. In Uzbekistan, higher gold exports supported revenues. In Armenia, revenues rose by 21 percent in nominal terms because of double-digit output growth and stepped-up tax collection. A similarly large increase in revenues (29 percent) was observed in Georgia. Under-execution, or delay, of planned spending (Albania, Kosovo) and curbs to capital outlays (Bulgaria and Kosovo) also helped reduce expenditures and alleviate pressures on fiscal balances.

Some countries in the region experienced a deterioration in fiscal balances due to idiosyncratic factors. In Russia, a marked increase in military and social spending and a decline in resource-related revenues—despite higher oil production—shifted the fiscal balance from a surplus to a deficit. In the Kyrgyz Republic, the increase in the fiscal deficit in 2022 was due in part to stepped-up lending to energy state-owned enterprises. In Tajikistan, the deficit widened from 1.4 percent

BOX 1.2 Fiscal cost of the 2022 policy responses to the cost-of-living crisis

Many countries in Europe and Central Asia implemented large fiscal packages in response to the high energy and food prices during 2022.

Several countries in Central Europe, the Western Balkans, and Türkiye were very dependent on imports of natural gas from the Russian Federation. These countries implemented energy price caps, introduced energy subsidies, and stepped up social assistance programs. The median energy-related fiscal package in these countries amounted to 2.7 percent of gross domestic product (GDP) with the packages in Croatia and Kosovo exceeding 4 percent of GDP (table B1.2.1). Countries in Central and Eastern Europe are also hosts to large numbers of refugees from Ukraine, and the fiscal costs associated with their accommodation and temporary protection amounted to about 1 percent of GDP in the Czech Republic, Estonia, and Poland (IMF 2022b).

TABLE B1.2.1 Fiscal packages implemented in 2022 in response to the cost-of-living crisis in select countries of Europe and Central Asia (in percent of GDP)

Country	Social protection (SP) and income support measures	Energy related measures	Total	Comments
Albania	0.6	1.3	1.9	Increases in support to vulnerable households, minimum wage and acceleration of pension benefit indexation.
Azerbaijan	1.6		1.6	Increases in wages, pensions, and social allowances, as well as VAT exemptions and subsidies for food
Bosnia and Herzegovina	0.7	3.0	3.7	The income support measures reflect wage increases in both entities.
Bulgaria			3.0	Price cap of electricity for households and firms; fuel subsidies; tax reductions for energy goods and services; additional pension increases.
Croatia			4.2[a]	Price caps for fuel and electricity, subsidies and tax reductions for natural gas, and cash supports for vulnerable households.
Georgia			0.2	Increases in transfer to local municipalities to accommodate costs associated to higher inflation
Kazakhstan	3.0		3.0	Increase in transfers to local governments and allocation to welfare-enhancing programs.
Kosovo	2.6	1.7	4.3	SP measures include agricultural subsidies.
Moldova	1.0	0.4	1.4	SP measures include funds for loans at subsidized interest rates.
Montenegro	0.3	0.9	1.2	Provided one-off support to pensioners and reduced fuel excises. The regulated electricity price has remained unchanged during 2022.
North Macedonia	0.6	2.2	2.8	Electricity block tariffs were introduced to incentivize energy savings.
Poland	0.1	1.4	1.5	Additional costs of about 0.4 percent of GDP were associated with the accommodation and protection of Ukrainian refugees.

(Continued next page)

BOX 1.2 (continued)

Country	Social protection (SP) and income support measures	Energy related measures	Total	Comments
Romania	1.5	1.0	2.5	The cost to the budget is broadly offset by windfall profit taxes on energy producers and higher SOE dividend payouts.
Serbia	1.1	2.2	3.3	SP measures include increases in pensions and public wages.
Türkiye		1.7	1.7	The government subsidized 80 percent of natural gas and 50 percent of electricity used by households, as well as increasing minimum and public sector wages and offering tax benefits to households.
Uzbekistan	0.7		0.7	Increase in social allowances to vulnerable people

Sources: IMF Article IV reports published in 2022 and other IMF publications; Ari et al. 2022; Sgaravatti et al. 2021.
Note: All figures are preliminary and correspond to estimates of spending during 2022 unless otherwise noted.
GDP = gross domestic product; SOE = state-owned enterprise; SP = social protection.
a. Includes expenditures to be incurred during the first quarter of 2023.

Some of the measures included:

- Croatia implemented a retail fuel price cap and electricity price caps for households and public institutions, while providing support to businesses facing higher electricity prices, as well as reductions of VAT and subsidies to natural gas. It also provided direct cash support for poor households.
- In Kosovo, the government allocated 2.6 percent of GDP in April and an additional 1.7 percent in September for pension and social assistance top-ups, wage bonuses, and energy subsidies for households and businesses.
- The Bosnia and Herzegovina entity governments capped electricity prices, suspended excises on fuel, and increased public wages and pensions.
- In Serbia, the fiscal package included subsidies to the national gas and electricity companies, social protection and income support measures, and reduced excises on fuel.
- Bulgaria subsidized firms' electricity bills, kept electricity prices unchanged for households, reduced VAT and excise taxes to energy good and services as well as some food items, and also strongly increased pensions.

Some countries are planning to phase out some of the energy subsidies during 2023 or move to more targeted programs, likely contingent on international price developments.

- Bulgaria plans to keep the price cap on electricity, directly (for households) or through compensation (in the case of businesses).
- Croatia's current price cap for electricity expires at the end of March 2023.
- Poland will keep electricity and natural gas prices fixed during 2023 for households; these measures are expected to cost about 2 percent of GDP, which is higher than the cost of the fiscal package in 2022 (1.5 percent of GDP).
- In Kosovo, International Monetary Fund projections indicate that electricity subsidies in 2023 would be about 1.5 percent of GDP if prices remain at 2022 levels.
- Moldova plans to increase spending to address the cost-of-living crisis, to 5.2 percent of GDP (2.4 percent in pension and wage increases, 0.7 percent in targeted social assistance programs, 1.7 percent in energy subsidies, and 0.4 percent in revenue measures).
- Türkiye plans to double energy subsidies to households in 2023, to about 3.5 percent of GDP.

(Continued next page)

BOX 1.2 (continued)

By contrast, the countries in Central Asia and the South Caucasus did not face major disruptions to their energy markets as they are net fuel exporters or have continued importing energy from their neighbors and Russia, in some cases at discounted prices. Several countries in Central Asia, especially Uzbekistan, but also Kyrgyz Republic and Tajikistan faced a severe energy crisis in early 2023, when much of the population was left without power or heat for a week in freezing temperatures. While many factors contributed to this, the overall energy environment caused by Russia's war on Ukraine, played an important role. The fiscal packages implemented by the countries in the Southern Caucasus and Central Asia were smaller size than those in Eastern Europe and the Western Balkans and included:

- Social protection measures during 2022 amounted to 1.6 percent in Azerbaijan (including increases in wages, pensions, and social allowances, as well as value-added tax exemptions and subsidies for food), and 0.2 percent in Georgia (mostly in transfers to municipalities). Armenia is planning to increase social protection spending by 0.2 percent of GDP during 2023.
- In Kazakhstan, the government implemented a price freeze for fuel, restricted exports of many food staples, and adopted a moratorium on utility price increases. It also ramped up its welfare-enhancing programs and increased transfers to local governments to a total of 3 percent of GDP.
- Support to vulnerable households was increased in Uzbekistan by about 0.7 percent of GDP, while the Kyrgyz Republic increased public sector wages, social benefits and pensions. Tajikistan also provided support to vulnerable households, and increased the minimum wage, public sector wages and pensions.

Sources: The authors; IMF Article IV reports published in 2022 and other IMF publications; Ari et al. 2022; Sgaravatti et al. 2021.

of GDP to 1.9 percent, with higher nontax revenues and grants partially offsetting lower revenue collection from reforms to streamline the number of taxes and reduce tax rates.

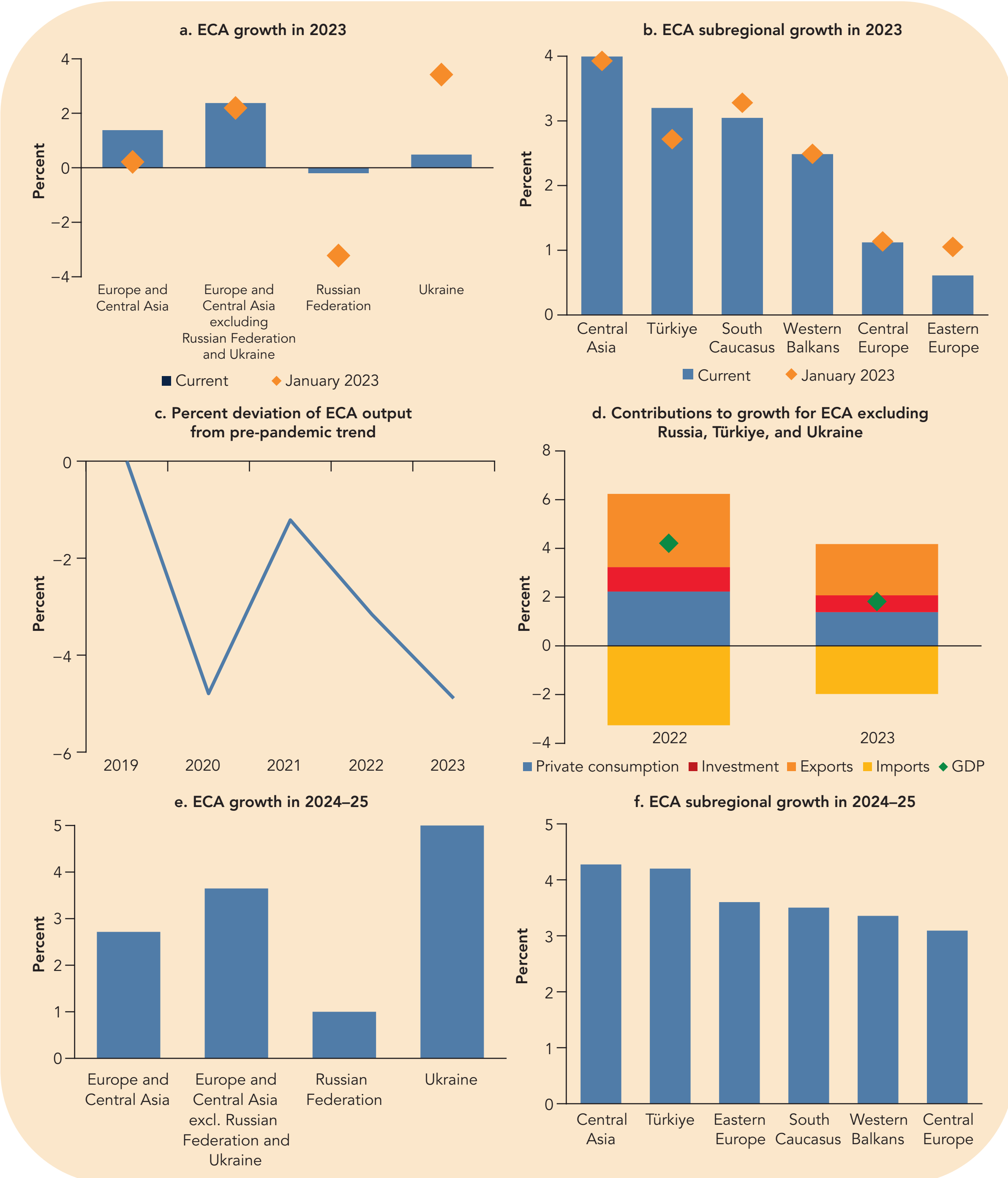
Public debt to GDP ratios declined in most countries, moderating from a median 66 percent of GDP in 2020 to an estimated 60 percent in 2022; the latter is still elevated relative to the region's 2010-19 median of 50 percent (figure 1.6, panel d). Weak growth prospects, delays in fiscal consolidation in some cases, and higher financial costs will likely affect debt prospects over the medium term.

Outlook

Growth in ECA is likely to remain lackluster in 2023

The pace of economic expansion in the EMDEs of Europe and Central Asia is projected to modestly increase to 1.4 percent in 2023 from 1.2 percent in 2022, as the contraction in Russia eases and the fall in Ukraine's output subsides (figure 1.7, panels a and b). The devastating earthquakes in Türkiye will pose headwinds to both the country's outlook and the region's prospects. The better projections for the region's largest economies have resulted in a 1.3 percentage point upgrade to the projections relative to those from January 2023 (World Bank 2023a).

FIGURE 1.7 Regional outlook



Sources: World Bank.
Note: ECA = "Europe and Central Asia". Aggregate growth rates are calculated using GDP weights at average 2010-19 prices and market exchange rates. Values indicate forecasts.
a, b. "January 2023" refers to projections released in the January 2023 edition of the Global Economic Prospects (World Bank 2023a).
c. Pre-pandemic trend is calculated by assuming that average growth achieved over 2010-19 is maintained through 2020-23.
d. Growth for components reflects data for 16 ECA economies for which GDP components data are available. "GDP" reflects growth rates found in table 1.1.

Although output for ECA as a whole has recovered to pre-COVID levels, output in 2023 is projected to be 4.9 percent below what it would have been had growth continued after 2019 at the average pace achieved before the pandemic (figure 1.7, panel c).

In Russia, growth is projected to remain in contractionary territory in 2023, although close to zero, with a 3.1 percentage point upgrade relative to the January 2023 forecast. The improvement reflects a smaller-than-earlier-expected fall in oil production in 2023, as Russia's energy exports are diverted from the European Union to other countries, particularly China and India. After a modest increase in oil production in 2022, production is expected to decline slightly in 2023, as EU sanctions continue to take hold and Russia voluntarily reduces production. For economies that are tightly linked with Russia and benefitted from trade and investment diversion in 2022—largely those in the South Caucasus and Central Asia—growth in 2023 is projected to slow as the boost from these positive shocks diminishes. Early indications point to smaller money flows in early 2023, including remittances, that will weigh on growth in these countries. In Türkiye, the slowdown in activity is likely to be contained as additional government support measures and earlier increases to minimum wages help households cope with inflation and lift domestic demand.

Excluding Russia, Türkiye, and Ukraine, growth in ECA is forecast to fall to 1.8 percent in 2023 from 4.2 percent in 2022. The deterioration in near-term growth prospects reflects dampened private consumption and investment amid additional tightening of global financial conditions, weaker external demand, and persistent inflation (figure 1.7, panel d). Sustained weakness in external demand is projected to hamper exports, as activity in the euro area continues to soften and spillovers from the reopening of China's economy remain modest.

Tighter financial conditions will continue to weigh on investment in most economies, with sustained core inflation pressures raising the possibility of additional policy rate hikes by major central banks. Private investment and inflows of FDI in most EMDE ECA countries are problematic given an unfinished market transition in some, the substantial share of state-owned and state-connected enterprises in others, and the uneven playing field for both private and public enterprises overall.

Public investment is also anticipated to increase after the pandemic and cost-of-living crisis prompted many governments to delay capital spending to increase the space for current outlays. In many countries, investment is expected to be lifted by energy infrastructure and reconstruction spending. Following substantial outlays of government support to protect households and firms from two back-to-back crises, fiscal consolidation will also be a priority to restore fiscal space and rebuild fiscal buffers in most of the region. The structural nature of fiscal deficits and government spending in many countries in ECA is a major challenge to overcome.

Private consumption has been a strong driver of growth in recent years and government support, including hikes in minimum wages, have been essential. As inflation remains high and given the emphasis on fiscal consolidation in many countries, consumption is unlikely to remain as strong a driver in the near term. It is essential for governments to be mindful of this, as weaker consumption growth will frustrate the ambitions of populations to achieve higher living standards.

Headline inflation is expected to ease in 2023 but remain above central bank targets. Slowing inflation largely reflects lower energy prices. Core inflation—excluding food and fuel prices—will remain elevated, and efforts to reduce it will take longer than most market participants and policy makers expect.

As inflation eases, domestic demand recovers, uncertainty partly dissipates, and the external environment improves, growth in ECA is projected to increase to an average 2.7 percent over 2024–25 (figure 1.7, panels e and f). This will be a subdued pace of expansion, nonetheless, that will do little to revive the convergence of ECA's incomes relative to those in advanced economies.

Slowing reform momentum will weigh on growth prospects

Over the medium to long term, structural constraints amid an incomplete market transition in many countries, weak productivity, lagging education outcomes, limited innovation, and a rapidly aging population need to be addressed to help expand the region's productive capacity. The recent energy crisis presents an opportunity for the region to accelerate green transition goals. By enacting policies to support a steady and sensible transition away from a high dependence on fossil fuels, ECA countries can facilitate a reduction in the region's high energy intensity and ameliorate environmental degradation.

An incomplete market transition in several countries, notably on reducing the role of the state in the economy, continues to present a drag on growth. Several countries made progress in improving the environment for private sector development, nonetheless. For example, the authorities in Serbia made energy tariff adjustments and advanced structural reforms to restore the financial balances of state-owned utilities while ameliorating the impact on households. In Georgia, the government is moving with the unbundling of power generation and transmission to meet its commitments to the European Energy Community. In Uzbekistan, despite significant progress on reforms in recent years, the state's overwhelming control over factor and key intermediate input markets has constrained private sector development. About 2,500 state-owned enterprises (SOEs) continue operation, and many of them benefit from monopoly rights and special privileges in crucial sectors of the economy. The government aims to partially privatize most of its large SOEs and also privatize most of the state-owned banks. To improve the environment for private sector growth, the authorities in Kazakhstan set up an independent Competition Agency to oversee competition policy, reduce explicit and implicit preferences for SOEs, and otherwise help level the playing field for all enterprises.

A declining and aging population is a major obstacle to stronger and sustainable growth in ECA. The share of people 65 and older in the total population rose from 6 percent in 1950, to 10 percent in 1995, and to 14 percent in 2023; it is projected by 2050, this share will increase to 22 percent.[5] Whereas aging is often driven by a fall in both fertility rates and mortality at old age, the rise in the median age in EMDE ECA is attributable to low and declining fertility rates rather than increases in longevity. Indeed, in more than half the countries in EMDE ECA, the population is already shrinking. In several countries, emigration has accelerated

5. Projections for 2023 and 2050 are based on the United Nations' medium-fertility demographic scenario (United Nations 2022).

population declines. Policies aimed at boosting labor force participation among inactive populations, as well through migrant worker integration, could provide meaningful progress in limiting the long-term implications of aging on growth (World Bank 2022a). Active labor market policies can increase labor demand and the efficiency of labor market matching, including through wage subsidies and job retention policies, as well as measures that enhance job search assistance and on-the-job training. Boosting female labor participation can be achieved by job training programs specifically aimed at women, including vocational training (Bandiera et al. 2020). The large share of young people neither working nor in schools is also an issue that needs urgent resolution. In Bulgaria, Croatia, Poland, and Romania, about 17 percent of people ages 15-29 are neither in employment, nor in education or training. Policies aimed at boosting economic freedom and improving business environments can also improve labor force participation.

Warmer temperatures and more volatile weather patterns are disrupting ecosystems across ECA, increasing the frequency of extreme weather events. If no action is taken, economic damages from droughts and floods in Central Asia are projected to be up to 1.3 percent of GDP per year, while crop yields are expected to decrease by 30 percent by 2050, leading to around 5.1 million internal climate migrants. Even EU countries will experience large impacts. Without adaptation, more than 400,000 jobs are expected to be lost annually by 2050, with the overall cost of climate-related extreme weather reaching €170 billion by the end of the century. The effects of climate change will deepen the ongoing natural resource degradation in ECA, with impacts concentrated on vulnerable populations that rely on natural resources for their livelihoods. More than half of the countries in the ECA region are experiencing declines in agricultural and forestry resources, and water stress levels are acute in a number of ECA countries. Air pollution is the largest environmental risk of premature death in ECA (482,800 deaths in 2019); estimated air pollution welfare costs are equivalent to 4.6 percent of GDP on average across ECA, with staggering peaks in some countries (e.g., 18.9 percent in Serbia, 16.3 percent in Bulgaria, 15.9 percent in North Macedonia, which are also the three countries with the highest welfare costs at the global level).

ECA has considerable potential for climate action, notably emissions reductions, but policy action has been limited to date. While emissions intensity has fallen faster in ECA than in most other regions, this is mainly driven by structural economic change and offshoring of emissions-intensive manufacturing. Overall emissions intensity in the region remains high, and 10 of the world's 20 most carbon intensive economies are in ECA. In ECA, 90 percent of emissions come from the energy sector, with significant contributions from electricity, buildings, heating, and flaring. Significant opportunities exist to substantially decarbonize energy use through massively expanding renewables, moving away from coal, and the broader electrification of buildings and transport sectors. Outside of the EU, however, investment to decarbonize the energy sector in ECA have been limited, Nationally Determined Contribution (NDC) commitments are largely modest, and initiatives to remove fossil fuel subsidies and introduce carbon pricing, while emerging, have been slow.[6]

6. Renewable energy sources contribute less than 7 percent of total energy supply in developing ECA, less than half the global average and less than one-third of the level in the European Union.

Despite limited progress on climate mitigation, more recently, many countries in the ECA region are laying the foundations for a more aggressive response to climate change. Virtually all countries in the region (19 of 22 outside of the EU) have submitted updated, more ambitious NDCs and the majority have established net zero targets. Emissions trading systems are operating in Kazakhstan and Ukraine, while Montenegro and North Macedonia, among others, are in the process of putting them in place. Climate laws have been passed in at least 10 countries, most recently in Serbia. Countries in the region are also taking steps to develop and implement policies to strengthen climate adaptation and resilience. Fifteen countries, plus those in the EU, include adaptation in their NDCs and at least 11 have established National Adaptation Plans. In Uzbekistan, even though some reforms – such as achievement of full cost-recovery tariffs and establishing a new energy regulator – were delayed by the COVID-19 pandemic and the uncertainty caused by Russia's invasion of Ukraine, they remain a high priority for the government in 2023. In Romania, energy intensity is above the EU average and there is a lot to be done to improve energy efficiency. The government, as a result, has set ambitious targets to reduce primary energy consumption and the renovation of buildings has been identified as a crucial initiative to meet these targets. In Kazakhstan, the government has moved to integrate sustainable development principles into sector policies and programs, reduce greenhouse gas (GHG) emissions, promote energy efficiency, and facilitate more investments in renewable energy. The new Environmental Code also introduces measures to address climate change vulnerabilities in agriculture, water management, and forestry. In Georgia, the Government has submitted to Parliament a draft law on Industrial Emissions to monitor, prevent, and reduce emissions, including of GHGs, that is fully aligned with EU Directives on Industrial Emissions.

Trends in Europe and Central Asia: Major Economies and Subregions

Russian Federation[7]

In Russia, output contracted 2.1 percent in 2022 as domestic demand, including investment, deteriorated significantly following international sanctions as a result of its invasion of Ukraine. The contraction in output is less severe than previously projected, as significant government support and better-than-expected oil production offset declines in private consumption and exports, leading to a 1.4 percentage point upgrade relative to the projections included in the January 2023 forecast (World Bank 2023a).

In response to international sanctions, Russia diverted a significant share of its international trade, with China, India, and Türkiye emerging as major partners. Last year, the value of Russian fuel exports to the European Union declined by

7. 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 the ability to assess the economic performance.

about 40 percent, while exports to India increased sixfold, with India accounting for nearly 20 percent of Russia's fuel exports (figure 1.8, panel a). Imports by Russia from the European Union declined by about 40 percent in value in 2022, while imports from Türkiye almost doubled.

The sanctions on Russia have impacted oil and gas revenues, which have declined 46 percent in January 2023 relative to January 2022 levels. As a result, Russia's fiscal deficit worsened, with the January 2023 budget deficit amounting to 1.8 trillion rubles, or 60 percent of the planned budget deficit for 2023 as a whole. The budget deficit is expected to increase in 2023 because of weakening revenues—notably from hydrocarbons—and higher spending for its war in Ukraine. The impact of sanctions is also evident elsewhere in the economy, with retail trade and industrial production posting their worst contractions in December 2022 since the COVID-19 pandemic hit in early 2020.

Output is projected to contract by 0.2 percent in 2023, a 3.1 percentage point upgrade from January 2023 projections (World Bank 2023a). Following strong oil production last year, the improvement in the outlook reflects a smaller-than-expected reduction in oil production in 2023, as Russia diverts oil exports to China and India after the implementation of the EU oil sanctions (figure 1.8, panel b). The projection for 2023 growth assumes that natural gas exports to the European Union remain at a fraction of the pre-invasion levels (figure 1.8, panel c).

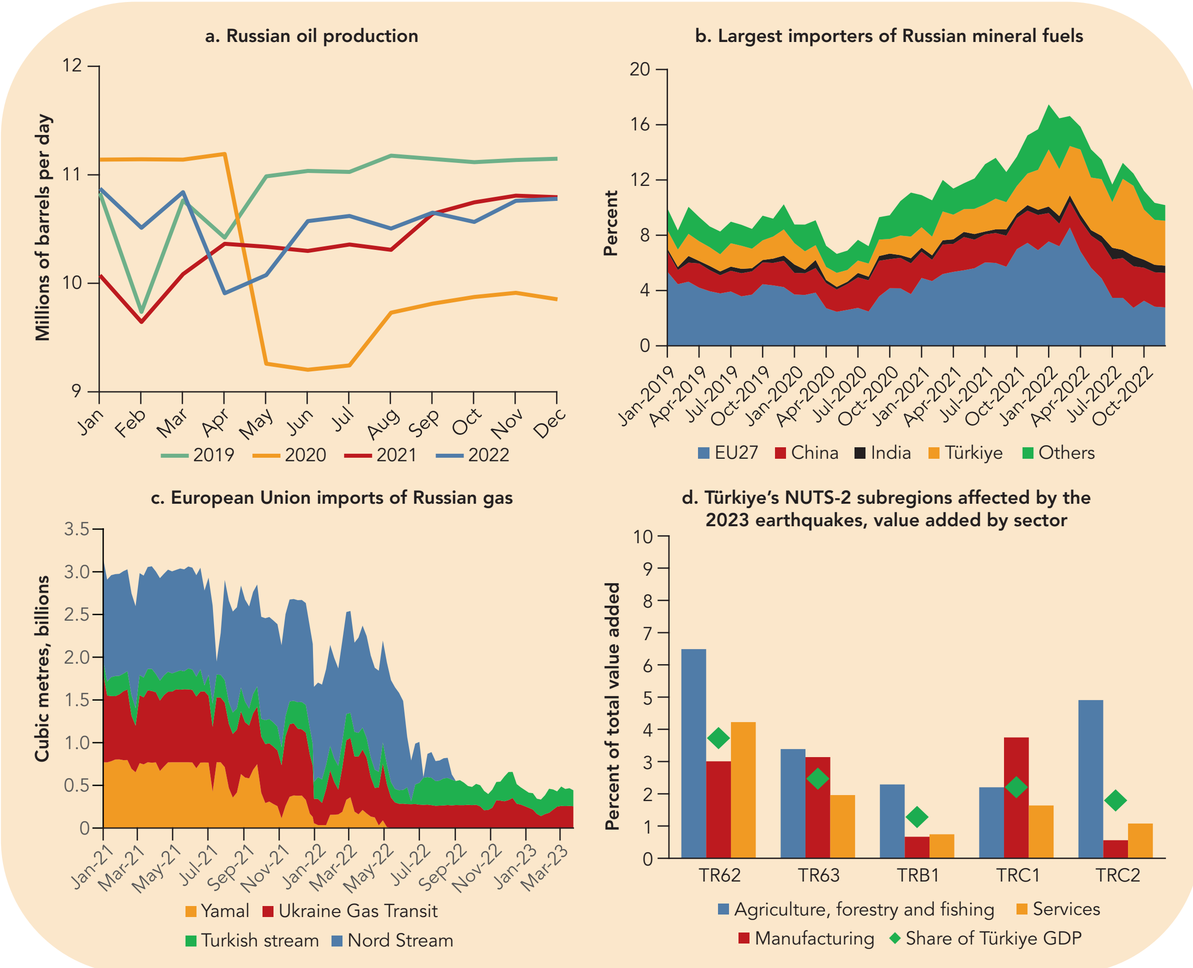
Growth is projected to resume but remain muted over the medium term, reaching 1.2 percent in 2024 and 0.8 percent in 2025, amid modest consumption growth and a marginal recovery in exports as Russia continues to reorient its trade relationships. Over the long term, its invasion of Ukraine and the associated repercussions are likely to reduce Russia's potential growth rate. The ruptures to trade and investment networks are likely to limit technology transfers, slowing productivity growth. Fixed investment is likely to be further discouraged by reduced access to international financial markets and increased economic and political uncertainty, and emigration is likely to be a drain on human capital.

Ukraine

Russia's invasion of Ukraine has dealt an unimaginable toll on the people of Ukraine and the country's economy, with activity contracting by a staggering 29.2 percent in 2022. The contraction in growth is less severe than previously projected, with output supported by the reopening of Ukraine's Black Sea ports and resumption of grain trade, as well as substantial donor support.

In 2023, output is projected to increase by 0.5 percent, albeit from the low levels resulting from the economic destruction created by the war. Growth estimates for 2023 assume that economic activity achieved in the fourth quarter of 2022 will continue in the medium term, with growth in sectors focused on supplying the domestic market and meeting wartime needs balancing out a projected 15 percent contraction in agriculture. Following Russia's attacks on Ukraine's power grid in the fourth quarter of 2022, missile attacks by Russia in March pose renewed downside risks to infrastructure stability. If Ukraine were to lose power, it would further paralyze Ukraine's economy, increase demand for energy imports, and inhibit war efforts.

FIGURE 1.8 Recent developments in major economies



Sources: Darvas, Martins, and McCaffrey (database); Eurostat (database); Haver Analytics; McWilliams, Sgaravatti, and Zachmann (database); TurkStat (database).
a. Figure shows crude oil production in million barrels per day. Last observation is December 2022.
b. Figure shows percent comprised by each country listed of total Russia mineral fuel exports. "Others" includes Japan, South Korea, the United Kingdom and the United States.
c. Chart demonstrates cubic meters in billions of gas imports to the European Union (EU27) from the Russian Federation by exporting route. The Yamal route is via Poland and Belarus. Last observation is the week of March 26, 2023.
d. Columns show value added by sector of activity of affected NUTS-2 subregions for 2015. Diamonds are based on nominal GDP data for 2019.

Growth is projected to increase further over 2024–25 to an average 5 percent, with underlying projections assuming that the hostilities cease in mid-2024. However, the outlook is subject to extraordinary uncertainty given the vicious war and overlapping global challenges.

After more than a year since the start of Russia's invasion, with nearly 9 million refugees outside the country and more than 5 million internally displaced people, the country has settled into a war economy that is smaller, structurally changed in favor of defense industries, more focused on providing supplies for the war effort, with much larger government employment, and stepped-up redistribution of private sector assets (UNHCR 2023). Public finances have been under severe pressure, with a substantial increase in spending needs for defense and social expenditures, combined with modestly reduced revenues, resulting in a fiscal deficit of 25 percent of GDP (excluding grants) in 2022.

In March 2023, the World Bank published an updated assessment of the damage and economic losses from the war covering the one-year period from Russia's invasion of Ukraine on February 24, 2022 (World Bank et al. 2023). The report estimates that direct damages exceed $135 billion, with housing, transport, energy, and commerce and industry being the most affected. Losses—disruptions to economic flows and production—have been estimated at around $290 billion, and estimated total reconstruction and recovery needs at about $411 billion (or double 2021 GDP).

The economic toll suffered by Ukraine as a result of the invasion is difficult to grasp through available data. Wars inflict particularly severe damage to productivity, generating adverse effects on long-term growth prospects through the destruction, disruption, and diversion of labor and capital (Dieppe, Kilic Celik, and Okou 2020). Over 30 percent of Ukraine's infrastructure has been damaged, with entire cities destroyed. Nearly 8 million children have been negatively impacted by the unavailability of schools, hospitals, and energy. The inability of children to engage in schooling threatens a stark depreciation in long-term human capital (Patrinos et al. 2022). Prior to the war, schools in the region were closed or disrupted due to the COVID-19 pandemic for up to 9.5 months, with the war contributing an additional one year of learning losses. The long-term impact to future earning losses could amount to more than 10 percent per year per student (Patrinos et al. 2022).

Türkiye

The February 2023 earthquakes in Türkiye have caused an enormous human toll and added to already considerable headwinds and risks to the growth outlook. Prior to the earthquakes, growth was projected to moderate in 2023, with activity dampened by high inflation, heightened policy uncertainty, and growing external vulnerabilities amid a sharp widening of the current account deficit. Minimum wage hikes and increased government spending ahead of the May 2023 elections were expected to partly offset slowing exports and domestic demand.

Incorporating the impact of the recent earthquakes, growth is projected to slow from 5.6 percent in 2022 to 3.2 percent in 2023. The forecast for 2023 growth is higher than previously projected as the drag from the earthquakes is more than offset by positive momentum from late 2022 and additional government support to households, including from the early retirement scheme. Investment is also expected to be stronger than previously envisioned, assuming that reconstruction efforts proceed rapidly, and policy uncertainty somewhat dissipates following the presidential election in May 2023. Assuming a normalization in macroeconomic policies, growth is forecast to accelerate and increase to an average of 4.2 percent over 2024–25, underpinned by investment amid ongoing reconstruction efforts.

Direct physical damage from the initial earthquakes is estimated at about 4 percent of 2021 GDP—but overall economic damages, including from indirect and secondary impacts on growth, could be at least twice as large (Gunasekera et al. 2023). Moreover, while the affected regions account for only about 9.4 percent of Türkiye's output, these areas are highly productive in the agriculture sector (figure 1.8, panel d). Damage to or the inability to work on arable land because of the earthquakes could put further upward pressure on food prices and exacerbate food insecurity.

Central Asia

Growth in Central Asia is projected to remain little changed at about 4 percent in 2023, the fastest among the ECA subregions. Trade and investment diversion following Russia's invasion of Ukraine helped support growth in 2022, offsetting a decline in consumption as high inflation curbed spending. In 2023, increased oil production (Kazakhstan) and energy infrastructure investment (Kazakhstan and Uzbekistan) are likely to be largely offset by a decline in metal production (Kyrgyz Republic) and lower household spending in response to high inflation (Kazakhstan). Further disruptions to the Caspian Pipeline Consortium, which carries the majority of oil out of Kazakhstan, could significantly impact oil exports and growth.

Growth is expected to increase moderately to an average of 4.3 percent over 2024–25, supported by progress in advancing structural reforms in Uzbekistan, Kazakhstan, and Tajikistan. New investments to expand hydrocarbon production capacity will also help support economic activity. The subregion faces downside risks because of high inflation, disruptions to key oil transportation infrastructure, and a deeper contraction in output in Russia. Greater-than-expected global demand and higher oil prices pose upside risks.

Inflation remains elevated despite monetary policy tightening, reflecting a strong push from external factors, earlier currency depreciation, and weak monetary policy transmission. The central banks in Kazakhstan and the Kyrgyz Republic have hiked rates by 700 basis points and 500 basis points, respectively, since the start of 2022. In Kazakhstan, inflation has continued to rise in 2023, reaching 21.3 percent by February 2023. By contrast, the Central Bank of Uzbekistan increased policy rates by a cumulative 100 basis points in 2022 (reflecting a hike of 300 basis points earlier in the year and a cut in July), with 12-month inflation falling to 11.9 percent in February 2023. Given weak monetary transmission mechanisms and high dollarization, efforts to reduce inflation on the monetary side need to be complemented by efforts on the fiscal side.

Long-term growth and investment prospects could be dampened as regional tensions, political instability, and social unrest erode confidence. Home to some of the world's most carbon-intensive economies, Central Asia faces the difficult challenge of reducing its heavy reliance on fossil fuels. Kazakhstan, which has committed to achieving net-zero emissions by 2060, was the first country in Central Asia to establish an emissions trading scheme. Kazakhstan is working to develop a low-emissions strategy that identifies the technology pathways necessary for achieving carbon neutrality. However, a more thorough investigation into the steps necessary for fully implementing the policy initiatives is needed to foster policy adoption (World Bank 2022b). Uzbekistan has committed to a goal of a net-zero emissions by 2050, in addition to cutting emissions by 30 percent by 2030 relative to the 2010 baseline and plans to set an ambitious goal of generating 30 percent of its electricity from renewable energy by 2030. In addition to carbon neutrality efforts, the Kyrgyz Republic, Tajikistan, and Uzbekistan have also worked to build resilience and address climate vulnerabilities as part of their nationally determined contributions. To achieve Central Asia's climate goals, governments in the region will need full engagement from the private sector and green financing.

Central Europe

In Central Europe, output growth is projected to slow sharply to 1.1 percent in 2023 from 4.7 percent in 2022, as additional monetary policy tightening to rein in high inflation weighs on firm and household activity. A slowdown in the euro area is expected to dampen external demand, creating a further drag on growth. Political uncertainty may amplify the downside risks, particularly ahead of elections or where the outcome of elections has yielded significant uncertainty around the formation of a regular government, such as in Bulgaria.

It is projected that industrial weakness in early 2023 will largely reverse in the second half of the year alongside a pick-up in the euro area. Last year, retail sales were the highest in November in Hungary and Poland and in December in Bulgaria and Romania. They are projected to continue increasing throughout 2023. Although the manufacturing Purchasing Manager's Index in Poland remains in contractionary territory, it has shown improvement recently.

After median 12-month headline inflation in Central Europe peaked at nearly 18 percent in September 2022—its highest rate since 1998—inflation is expected to moderate as food and energy prices stabilize but remain elevated, further eroding disposable income and curbing private consumption. Inflation is likely to moderate in the second half of 2023, but could remain sustained in some cases. Ongoing tightening of monetary policy in Central Europe has mitigated some of the effects, with the European Central Bank set on further policy tightening in 2023. Core inflation is expected to face ongoing pressure, especially in Hungary, which saw an increase of 10 percentage points in January 2023 relative to a month prior due to price hikes coming from rising production costs, currency depreciation, and indirect tax hikes in 2022. Continued upward pressure on core inflation could prompt further policy rate hikes in the subregion and lead to increased financial costs, weighing on investment.

Current account deficits are expected to improve in 2023 as prices of imported raw materials edge down. Prices for key raw materials have been slowly decreasing, falling from their peaks last year as pandemic-related supply bottlenecks ease. Fiscal deficits are expected to rise in Poland in 2023 due to higher government spending, while in Hungary and Romania they are budgeted to decrease. In Bulgaria, planned increases to state pensions and other spending, as well as the shifting of tax reductions and exemptions to combat inflation from the 2022 budget to 2023, will lead to higher spending. In Poland, the structural tax reform (Polish Deal), the temporary impact of the Solidarity Package measures, and the public assistance provided to Ukrainian refugees will weigh on the deficit in 2023. On the other side, Hungary is planning for a large fiscal adjustment in 2023 in order to ensure longer-term fiscal sustainability. A majority of the subregion will need to unwind pandemic- and inflation-related fiscal support, which could be complemented by more efficient spending and stronger revenue mobilization. The subregion's aging population adds further pressure to the fiscal burden.

Croatia joined the euro and the Schengen Area on January 1, 2023. After a strong rebound in tourism last year, tourist arrivals reached 91 percent of pre-pandemic levels and are projected to recover fully in 2023 (UNWTO 2022a, 2022b). Risks to the outlook are balanced; higher than expected energy prices and lower government investment due to absorption capacity issues could slow growth, while stronger services exports or private investment could lift growth by more than expected. The Croatian economy continues to lag behind the euro area in terms of labor productivity and institutional quality.

Central Europe is expected to benefit from funding from the EU Recovery and Resilience Facility, the largest component of the Next-Generation-EU funds (World Bank 2022a). Key to the subregion's ability to benefit from these funds is improving absorption capacity, as well as progress in advancing structural reforms. Not receiving the funds in a full or timely manner poses a great risk to fiscal budgets and efforts to ensure resilient, sustainable growth.[8] Complete delivery of the expected EU funds will help address fiscal gaps, add much-needed investment, and spur sustainable, green, and inclusive growth in Central Europe. With most of Central Europe reducing its use of Russian natural gas, the subregion has the opportunity to capitalize on the current momentum to facilitate green energy transition efforts and reach the European Union's "Fit for 55" target of reducing net greenhouse gas emissions by at least 55 percent by 2030.

South Caucasus

Growth in the South Caucasus is projected to slow sharply from 7 percent in 2022 to 3 percent in 2023, as growth decelerates in key trading partners, including the European Union. In Armenia and Georgia, migrants and money transfers from Russia are assumed to continue to support activity in 2023. Nevertheless, tentative signs are emerging that some of these migrant and capital flows from Russia are reversing, at least in Georgia, which could pose a drag on domestic demand. The continued decline in oil production will weigh on growth in Azerbaijan. Downside risks reflect a potential escalation in border tensions between Armenia and Azerbaijan. Upside risks include an increase in energy prices, as well as an increase in natural gas exports to the EU, following an agreement to double natural gas exports from Azerbaijan to the block by 2027.

Alongside strengthening demand and increased energy prices in 2022, median 12-month inflation rose to 13.3 percent by May 2022. Price pressures have moderated since mid-2022, with inflation subsiding to 9.5 percent in the first quarter of 2023. Inflation is projected to decline further in Armenia and Georgia but remain above central bank targets. In Azerbaijan, the fixed exchange rate will continue to be a channel of transmission from price movements abroad. Increases in minimum wages, pensions, and social transfers are expected to limit the decline in consumption growth as a result of persistent inflation eroding disposable

8. As of 2022, 10.9 percent of the €41.2 billion of planned Recovery and Resilience Facility (RRF) grants and loans for Central Europe have been dispersed. Croatia has secured the highest amount in the region, or 35.3 percent, followed by Bulgaria and Romania at 21.9 percent and 21.8 percent, respectively. Hungary and Poland have not yet received any disbursements.

incomes (Azerbaijan). Although central banks have continued tightening monetary policy into 2023, monetary transmission to bank lending remains weak.

Over the medium term, growth in Azerbaijan is likely to be supported by higher investment amid several energy deals recently brokered with the European Union, as well as increased government spending for the implementation of Azerbaijan's 2022–26 Socio-Economic Development Strategy. In December, Azerbaijan and Georgia signed an agreement with Romania and Hungary to build an electric transmission cable under the Black Sea that will export power from the two countries in the South Caucasus to the European Union. A feasibility study is expected to be completed before the end of 2023.

Private sector growth in the South Caucasus remains constrained by headwinds related to the small size of the economies, limitations in connectivity and infrastructure, skills mismatches, and business environment challenges (particularly Azerbaijan). In addition, issues relating to managerial capabilities and low levels of innovation hamper firm productivity. According to the World Bank Enterprise Surveys, business executives identify access to finance as a major constraint, ranking it among the top two obstacles facing firms in the South Caucasus (World Bank 2023b). Those firms that had access to financing prior to the pandemic were less likely to experience a decline in sales (Amin and Viganola 2021), demonstrating the importance of access to finance in fortifying firm resilience and improving firms' ability to manage crises. Increasing access to finance for small- and medium-sized enterprises could also help these firms increase their average size and reduce their reliance on retained earnings to fund investment, which in turn would support job creation and deter suboptimal capital spending (Ayyagari, Demirgüç-Kunt, and Maksimovic 2017; Ayyagari et al. 2016; World Bank 2020).

Western Balkans

The Western Balkans are projected to experience a slowdown due to the ongoing spillover effects from Russia's invasion of Ukraine, lower private consumption, tighter global financial conditions, and a decline in demand from the European Union. Growth is projected to weaken to 2.5 percent in 2023 from 3 percent in 2022. Higher fiscal spending is expected to support consumption and investment growth in several economies (Kosovo and North Macedonia). Growth is projected to pick up moderately to 3.4 percent on average during 2024–25.

Downside risks dominate the outlook, mostly associated with sustained inflation eroding disposable incomes and consumer confidence, as well as a greater than anticipated slowdown in the euro area, the Western Balkans' main trading partner. Further tightening of global financial conditions could hamper access to external market financing. Weaker growth in the euro area could decrease remittances to the Western Balkans, subsequently causing a decrease in private consumption and growth in remittance-reliant economies (Albania, Bosnia and Herzegovina, and Kosovo). Rising geopolitical tensions in the region pose a risk to the downside (Kosovo and Serbia, and Bosnia and Herzegovina and Serbia). Political uncertainty and delays in reforms also weigh on the outlook (Bosnia and Herzegovina, Montenegro, and North Macedonia). Political fragility in the subregion exacerbates uncertainty, slows vital reform processes, and deflects focus from structural economic challenges.

Fiscal consolidation is likely to be slow but should remain a priority for some economies in the Western Balkans. Adjustments to energy tariffs and subsidies to energy state-owned enterprises will help restore fiscal balances (Albania, North Macedonia, and Serbia), while the withdrawal of social protection and emergency measures will ease government spending further (Albania, Bosnia and Herzegovina, Montenegro, and Serbia). Higher interest rates on debt payments will worsen fiscal deficits in several countries (North Macedonia and Serbia). On the revenue side, new tax policy measures to expand the tax base will also support fiscal consolidation efforts (Albania and North Macedonia).[9]

Inflation response in the subregion has been mixed. Many economies have continued to experience high inflation in early 2023, partly driven by earlier rises in producer costs and import prices. In North Macedonia and Serbia, inflation reached 16.8 percent and 16.2 percent, respectively, by February 2023, among the highest in the subregion. Still, inflation in the Western Balkans is expected to decrease to about 7.5 percent in 2023, assuming global commodity prices continue to stabilize. Nevertheless, at nearly five times its 2010–19 average and double inflation achieved in 2021, projected inflation for 2023 is high for the region relative to historical trend. The persistent negative effect from higher prices especially on necessities will continue to erode real disposable incomes, most severely for vulnerable and poor households.

Current account deficits are likely to remain in 2023, driven by high import prices. Some countries saw returns to pre-pandemic tourist levels in January 2023 (Albania, Bosnia and Herzegovina, Montenegro, and Serbia). A strong influx of tourists from the subregion (Serbia) and the euro area boosted tourist arrivals in Albania in 2022, surpassing 2019 levels by 18 percent. A higher-than-expected number of tourists was recorded in Montenegro and Serbia in 2022, largely caused by an influx of Russian migrants and a strong return to international travel following the pandemic-induced collapse in tourism.

9. In Albania, authorities also plan to introduce several tax policy measures to boost revenue, including a new personal tax regime for self-employed professionals in the Income Tax Law and a one-off windfall tax imposed on independent power producers.

Annex 1.1: Data and Forecast Conventions

The macroeconomic forecasts presented in this report are the result of an iterative process involving staff from the Europe and Central Asia Chief Economist's Office; the Macroeconomics, Trade and Investment Global Practice; the Poverty and Equity Global Practice; and the Prospects Group in the Development Economics Vice Presidency. 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.

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2

The Cost-of-Living Crisis in Europe and Central Asia

After a long period of historically low inflation, the post-pandemic recovery and Russia's invasion of Ukraine resulted in a sharp rise in consumer prices in the emerging markets and developing economies of Europe and Central Asia (ECA). Median twelve-month inflation reached 15.9 percent in September 2022, the highest since 1999. Households in ECA are experiencing a cost-of-living crisis.

High inflation has a negative impact on households' real incomes. Sharply higher food prices and energy bills, a jump in mortgage rates and rents, and higher prices of services have eroded the standards of living of a large share of ECA's population. Households that were previously above the poverty lines have either fallen back into poverty or dropped into a zone of vulnerability just above it.

In a survey conducted in the fall of 2022 in the European Union (EU), 93 percent of respondents cited the cost of living as a main concern (European Parliament 2023). More than 80 percent of people in various countries in Central Asia also expressed concern about prices rising too rapidly (World Bank 2022c).

Prices of different categories of goods and services rise at different rates, but these differences become especially pronounced during periods of high inflation, leading to an increase in relative price dispersion. As a result, households with different patterns of consumption face very different inflation rates on the goods and services they consume.

In 2022, food and energy prices rose much more than the prices of other consumption categories. In Central Asia, Eastern Europe, and the South Caucasus, food prices increased twice as much as prices for energy; in Northern, Southern, and Western Europe, the difference in price increases of food and energy was much smaller.

This part of the *Economic Update* provides estimates of the cost-of-living increases faced by different types of households across ECA. The analysis yields several important findings:

- Poor households appear to have suffered the most from higher prices. For the median emerging market and developing economy (EMDE) ECA, households in the bottom decile of the consumption distribution faced an inflation rate that was more than 2 percentage points higher than the inflation faced by households in the top decile. This difference exceeded 5 percentage points in some countries in the region, including Moldova, Montenegro, and North Macedonia. In European Union (EU)/European Economic Area (EEA) countries, the average difference in inflation rates between the poorest and wealthiest households was lower (about 1.6 percentage points), but it reached a staggering 8 percentage points in some countries.

- Higher cost-of-living inflation for poorer households than wealthier ones has implications for the measurement of poverty and inequality. A simulation using 2022 cost-of-living inflation shows that, for the average country in EMDE ECA, the poverty headcount rate at the $6.85/day (2017 purchasing power parity [PPP]) is 1 percentage point higher than the one obtained using the standard consumer price index (CPI)–based approach, which assumes uniform inflation for all households based on the official CPI basket. This difference can exceed 3 percentage points in some EMDE ECA countries. The index used also affects estimates of inequality: The average country in EMDE ECA would have had a Gini index of inequality that was about 0.5 points higher in 2022 if the cost-of-living indexes had been used to deflate households' income rather than the CPI.

- Policies to protect vulnerable populations and promote economic growth should account for the heterogeneity of inflation across households. The benefit levels and eligibility criteria of many government programs are adjusted annually for inflation; increases or decreases in government benefits tied to differences in inflation estimates thus have major implications for funding and eligibility requirements of poverty-reduction programs and government budgeting (Garner, Johnson, and Kokoski 1996). The analytical framework presented in this part of the *Economic Update*—which is limited by the nature of the cross-country data available—can be extended to country settings, allowing for more precise estimates of the inflation rates faced by households, providing governments with a clearer picture of the evolution of the cost of living their people experience.

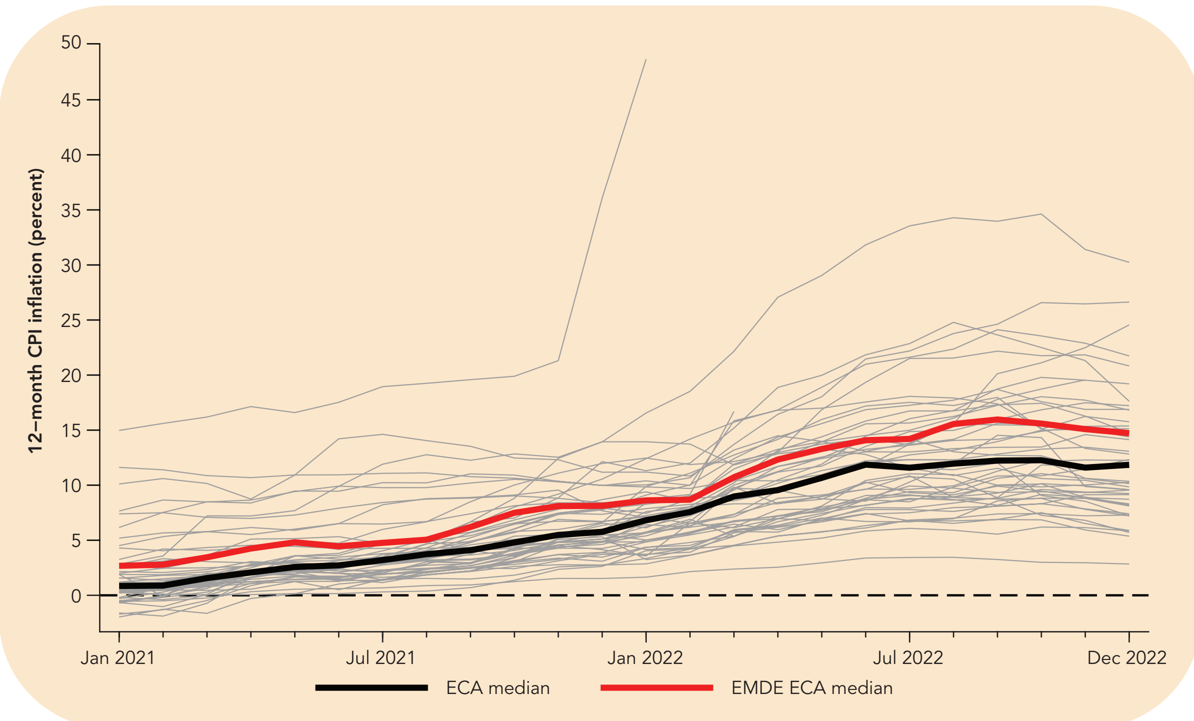
- Governments may consider revisiting the rationale and need for uniform (and therefore untargeted) caps or freezes on fuel and food price increases many introduced in 2022. Despite these measures, poorer households still faced higher inflation than richer households. Targeted support reflecting specific cost-of-living increases across households would be much more welfare improving.

The Nature of Price Increases in 2022

The reopening of ECA's economies after the COVID-19 pandemic receded, global supply constraints, and Russia's invasion of Ukraine led to a substantial increase in inflation across ECA in 2022. Median annual headline inflation in ECA including the European Union rose from 0.8 percent in January 2021 to 6.8 percent in January 2022, peaking at 12.3 percent in October 2022 (Figure 2.1). Inflation was higher in EMDE ECA, which saw median annual headline inflation increase from 2.8 percent in January 2021 to 8.6 percent in January 2022 and 15.6 percent in October 2022. The region had not seen inflation this high since the 1990s, during the transition from planned to market economies.[1]

Twelve-month inflation was dramatically different across categories of good and services in 2022 (Figure 2.2). Across ECA including the European Union, the consumption category with the highest inflation was food and beverages (with a median 12-month inflation in December 2022 of 17.8 percent), followed by

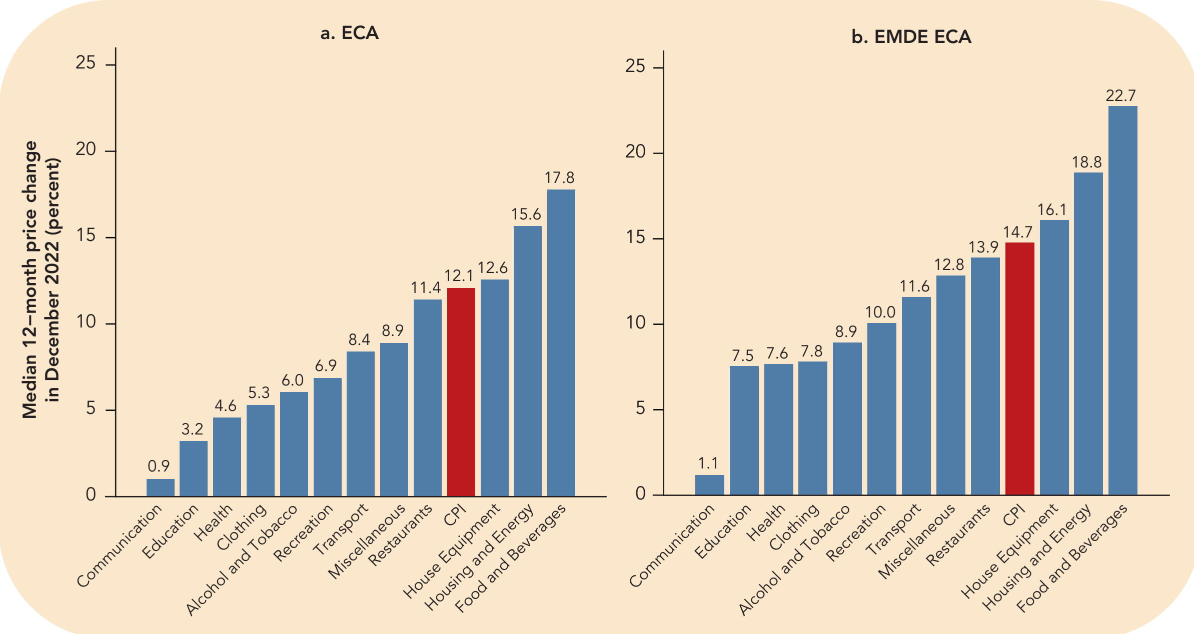
FIGURE 2.1 Headline inflation increased across Europe and Central Asia between early 2021 and the end of 2022



Source: IMF CPI database and national statistical institutes.
Note: Monthly 12-month CPI inflation for every ECA country (thin grey lines), the median value for ECA including the EU (solid black line) and the EMDE ECA countries (solid red line) in the period January 2021—December 2022 (or the latest available). The value for Türkiye is above the vertical axis range from February 2022 onward. EMDE ECA = emerging market and developing economies of ECA.

1. The last time median annual inflation in ECA including the European Union was above 12 percent was in 1994; the last time median annual inflation in EMDE ECA was above 15 percent was in 1999 (IMF 2023).

FIGURE 2.2 **Inflation varied widely across goods and services in Europe and Central Asia in 2022**



Source: IMF CPI database and national statistical institutes.
Note: Median 12-month price change across 47 ECA countries (left panel) and 21 EMDE ECA countries (right panel) by the 12 COICOP broad consumption groups. The bar in red indicates the median 12-month price change of the official Consumer Price Index (CPI) across all countries in each panel. The underlying price change values correspond to December 2022. EMDE ECA = emerging market and developing economies of ECA.

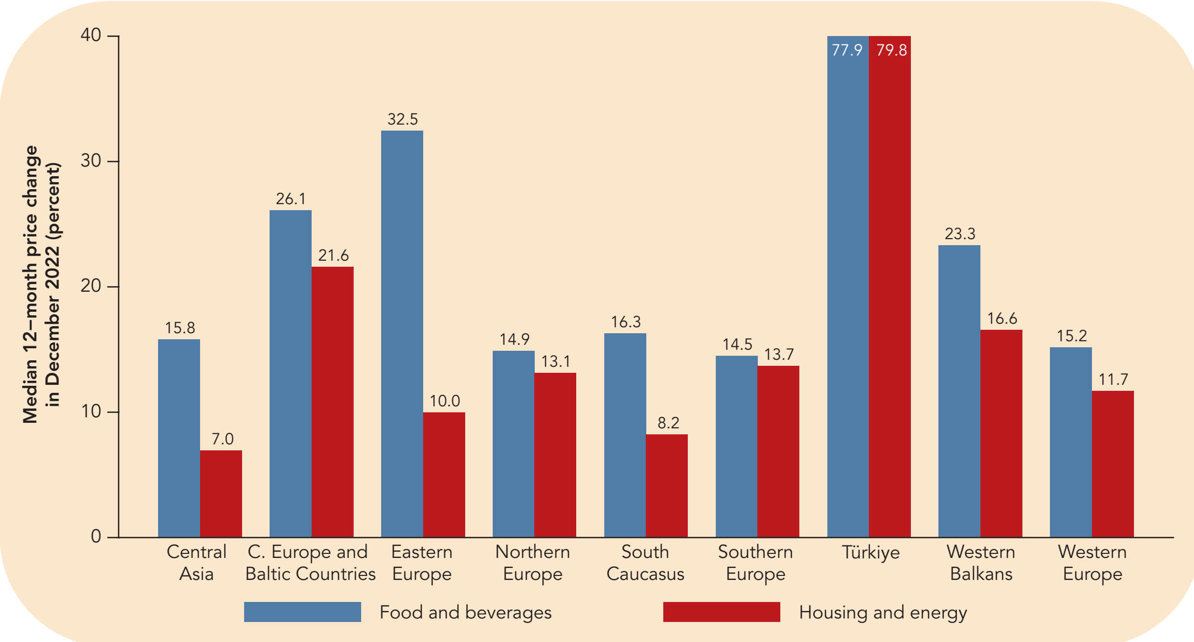
housing and energy (15.6 percent) and house equipment (12.6 percent).[2] This is in line with the dual price shock faced by ECA economies—an energy price shock and a food price shock. The categories that saw the lowest median annual increases in prices were communications (0.9 percent), education (3.2 percent), and health (4.6 percent) services. In all three of these categories, an important share of services is publicly provided, and prices are regulated.

In the EMDE ECA countries, food and beverages saw the highest price increase (22.7 percent), followed by restaurants (18.8 percent) and housing and energy (16.1 percent increase). The categories with the lowest increase were the same as in the rest of the region: communications (1.1 percent), health (7.5 percent), and education (7.6 percent) services.

This aggregate regional picture hides considerable subregional heterogeneity (Figure 2.3). In Central Asia, Eastern Europe, and the South Caucasus, the food and beverage category saw annual inflation during 2022 that was more than twice as high as for housing and energy. In Northern, Southern, and Western Europe, the difference in annual inflation between the two categories was much smaller; in Southern Europe, the median increase in housing and energy prices was on par with that for food and beverages. This pattern is not surprising, as the disruption in energy markets had the greatest effects on countries that saw interruptions in the supply of natural gas from Russia or are commercially integrated

2. Housing equipment includes furniture, household appliances, and goods and services for routine household maintenance.

FIGURE 2.3 Increases in food prices exceeded increases in prices of housing and energy in almost all subregions of Europe and Central Asia in 2022



Source: IMF CPI database and national statistical institutes.
Note: Median 12-month price change across ECA subregions of the COICOP categories food and beverages (blue bars) and housing and energy (maroon bars). The underlying price change values correspond to December 2022.

into the EU energy market. Countries in Central Asia and the South Caucasus did not see their energy supply interrupted but were most affected by the disruption in agricultural markets triggered by the substantial decrease in grain exports from Russia and Ukraine. The inflow of capital and labor from Russia to some countries in the South Caucasus also pushed real estate prices up (Box 2.1).

A characteristic of high inflation episodes is the increase in relative price dispersion (Alvarez and others 2019). Figure 2.4 presents a measure of relative price dispersion—the root mean square deviation (RMSD)— in annual inflation by consumption category for each country. The RMSD measures how price increases differ across consumption categories within a country. It equals zero if prices increased by the same rate for every consumption category. The country with the highest dispersion is the Netherlands, at a RMSD of almost 22 percentage points, driven by strong increases in the price of education. Moldova is the country with the second highest dispersion. In Moldova the 12-month inflation in December 2022 in the CPI was 30.2 percent but it was 75.9 percent in housing and 5.6 percent in communication—a difference between the latter two categories of 70 percentage points. Other countries that saw a high dispersion in price increases were Türkiye, Italy, and Lithuania. The country with the narrowest dispersion in inflation across consumption categories was Switzerland, where the RMSD was 2.4 percentage points. Annual CPI inflation was 2.8 percent; it was 5.7 percent in housing equipment and –3.3 percent in communications services, a difference of just 9 percentage points.

BOX 2.1 Prices for real estate and for rentals in Armenia and Georgia during 2022

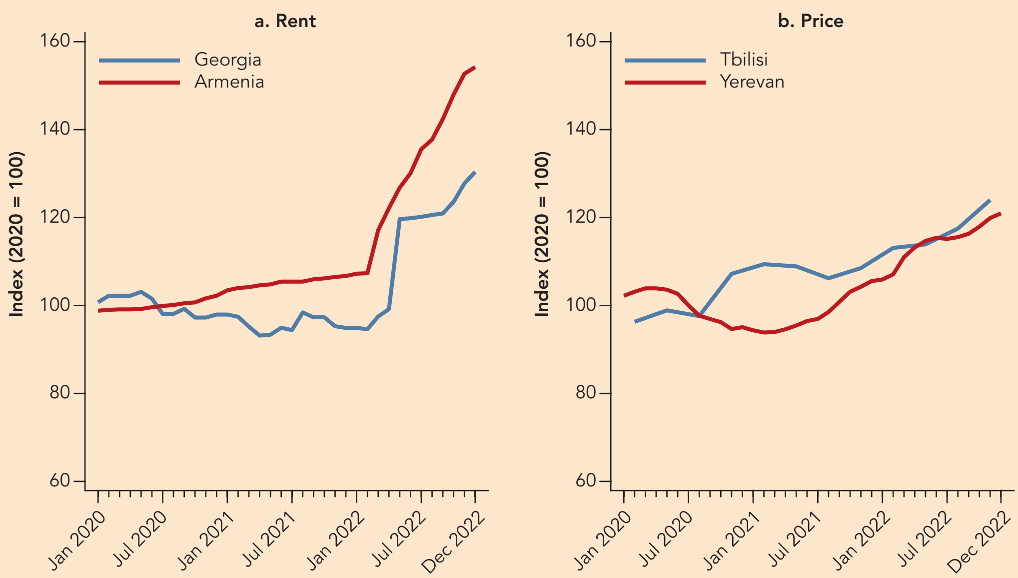
Russia's invasion of Ukraine triggered a food and energy price shock and drove nearly 10 million Ukrainians into countries in Central and Eastern Europe. Host countries had to quickly adapt to the arrival of these refugees, mostly women and children, and provide them with accommodation and temporary protection (World Bank 2022b).

Another smaller flow of people was that of Russian citizens fleeing mobilization and war. Most of these migrants went to countries in the former Soviet Union that had open border agreements with Russia. In September and October 2022 alone, about 60,000 Russian citizens entered Armenia, 69,000 entered Georgia, and more than 200,000 entered Kazakhstan (Oxford Economics 2022). These people added to the thousands who had already migrated since Russia invaded Ukraine in late February 2022. Since March 2022, these countries have registered a surge in the number of monthly business registrations; while there is no detailed information available, anecdotal evidence suggests that most of this is driven by individuals.

Russian migrants that fled their country did so with capital; many of them maintained income-generating activities in Russia (in many cases, remote work). This influx of capital and high-skilled labor provided a strong boost to the domestic economies of host countries (see part 1 of this report). However, the speed and volume of these flows overwhelmed the market for some goods and services including real estate and housing.

The price of housing rentals in Armenia and Georgia rose abruptly starting in March 2022 (Figure B.1.1, panel a). In December 2022, the price of rentals in Armenia was 44.5 percent higher than it was a year before; in Georgia it was 37.4 percent higher. Both figures were much higher than CPI inflation in the same period (8.3 percent and

FIGURE B2.1.1 Rents in Armenia and Georgia soared in 2022; housing prices also rose



Source: Statistical Committee of the Republic of Armenia and Geostat
Note: In panel a, values reflect "Actual rentals for housing" (Armenia) and "Apartment rent" (Georgia) in each country's CPI. In panel b, figures show the offered sale price of a 1 square meter property in the central district of Yerevan and the residential property price index of Tbilisi.

(Continued next page)

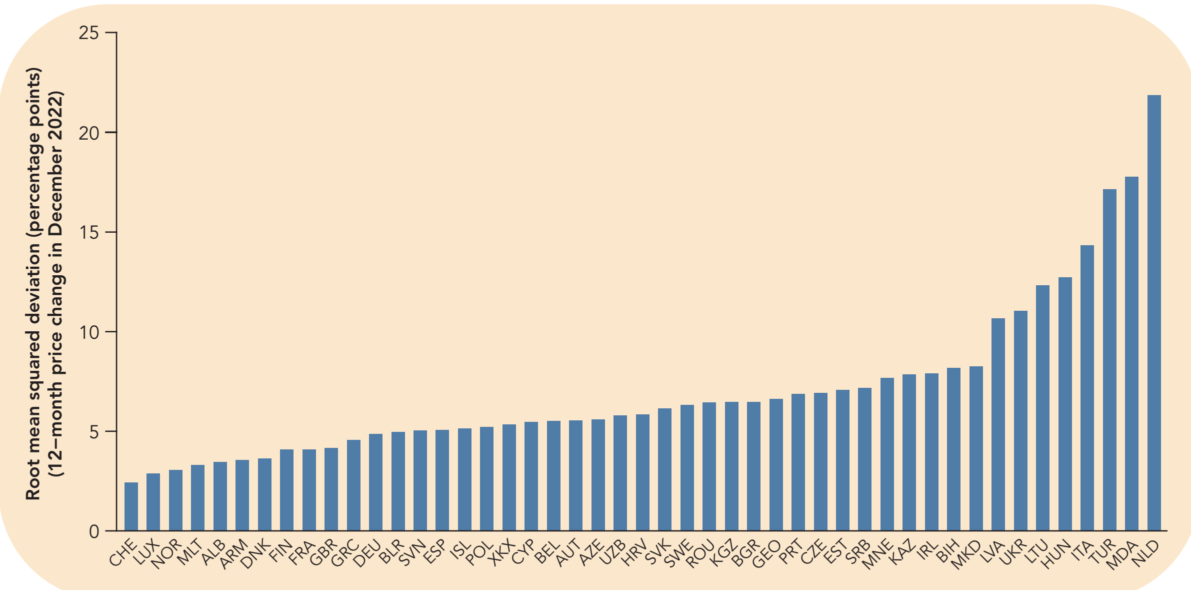
BOX 2.1 (continued)

9.8 percent, respectively). Anecdotal evidence shows that locals are being priced out of the rental market by the new arrivals (JAM News 2022). The surge in prices is smaller but still significant in the case of property for sale (Figure B.1.1, panel b), suggesting that for now, Russian migrants may not be planning on staying long term in these countries and therefore prefer rental housing.

The effects of Russian migrants on the housing markets of Armenia and Georgia illustrate the significant demand shocks that high-skilled migrants who typically brought their jobs and substantial savings can have in host markets and their effect on the host country population. The cost-of-living impact may differ across households: in this case, households that rent their housing may have seen dramatic increase in the cost-of-living, while households that own their housing would not face such an increase—and, if anything, may benefit from rental income and increased resale value.

Source: Authors.

FIGURE 2.4 Dispersion in price changes across consumption categories varied widely across Europe and Central Asia in 2022



Source: Classification of Individual Consumption According to Purpose (COICOP) consumption groups for every country.
Note: Figure plots the RMSD of 12-month price changes (by December 2022) across the 12 broad.

The Unequal Burden of the Inflationary Shock

Inflation has a negative impact on real incomes. Rising food prices and energy bills, increasing mortgages and rents, and higher prices of services erode the standards of living of a large share of the population. Households previously considered well-protected can become vulnerable to various price shocks that can push them into poverty.

The way in which an inflationary shock affects the welfare of households depends on which goods and services they consume and how much the prices of these consumption items rise. When inflation is low, the difference between the price increases of households' consumption basket may not be significant. When prices rise rapidly, however, as they did in ECA in 2022, the prices of some consumption items increase much more than others, and inflation may differ greatly across households.

Lower income households tend to concentrate their consumption expenditure in fewer goods and services than higher income households. If we look at how households allocate their expenditure across consumption categories, it is evident that households in the lowest deciles of the consumption distribution spend most of their money in food and beverages, followed by housing and house equipment, while households in the highest deciles tend to have a more diverse pattern of consumption (see Figure 2.5 for the cases of Moldova and North Macedonia). To the point that prices increase differently across consumption categories, the difference in consumption patterns can explain differences in the inflation rates faced by each household.

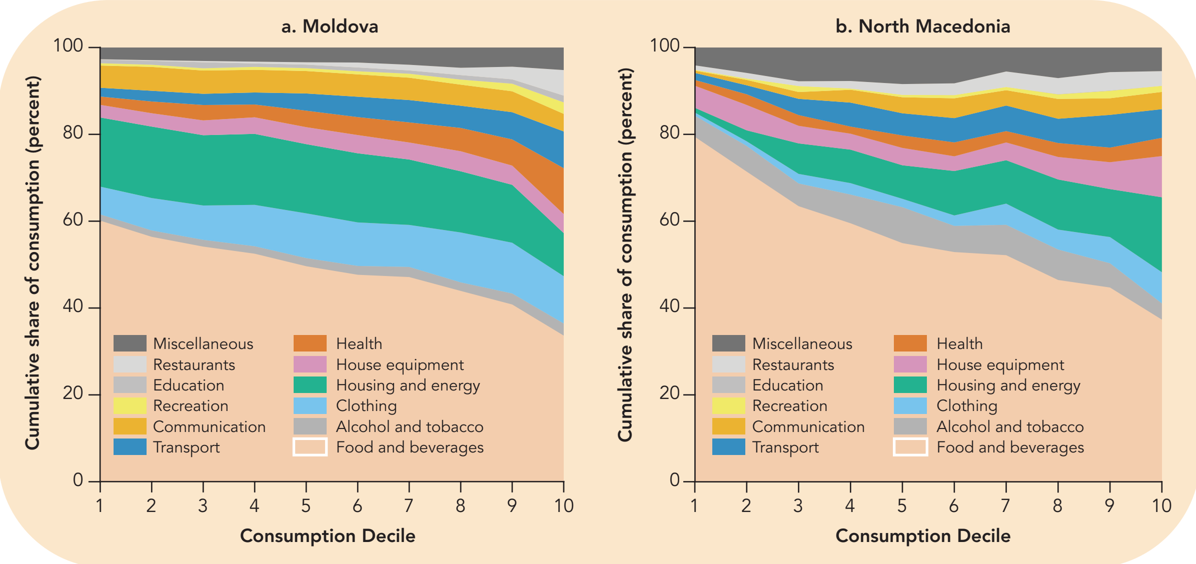
Moving from a single consumer price increase for the entire population of a country to a cost-of-living index for different categories of the population is crucial. Building on previous work on the topic (Pang-Tien, Chang, and Mizzi 2013; Gürer and Weicherieder 2018; Baez, Inan, and Nebiler 2022), Lokshin, Sajaia, and Torre (2023) estimate household-specific inflation rates for 19 ECA countries using nationally representative household budget surveys, which contain detailed expenditure microdata for a representative sample of households in each country. These data are combined with the evolution of prices by Classification of Individual Consumption According to Purpose (COICOP) two-digit consumption category, which allows the price of each household's consumption basket to be tracked over time in the nationally representative budget survey (Box 2.2).

Average cost-of-living inflation in ECA started to significantly deviate from headline CPI inflation in mid-2021. Median cost-of-living inflation was 1 percentage point higher than CPI inflation by the end of 2022 (Figure 2.6). In all ECA countries except Greece, the Kyrgyz Republic, and Spain, the official CPI inflation rate was lower than the cost-of-living rates across all household income groups by the end of 2022, suggesting that CPI inflation may have underestimated the actual increase in the cost of living for millions of households in 2022.[3]

The cost-of-living inflation rate is negatively correlated with household size. In 17 of the 19 EMDE ECA countries studied (all but Belarus, Bosnia and Herzegovina, and Uzbekistan), larger households appear to have faced smaller price increase in their consumption baskets than smaller households with the same level of total expenditure, location, age, gender, and employment status of the household head (Lokshin, Sajaia, and Torre 2023). In most countries, the magnitude of this effect appears nonlinear and decreases with household size, suggesting that the effect may be largest when comparing single-person households to two- or three-person households. The relatively lower inflation rates experienced

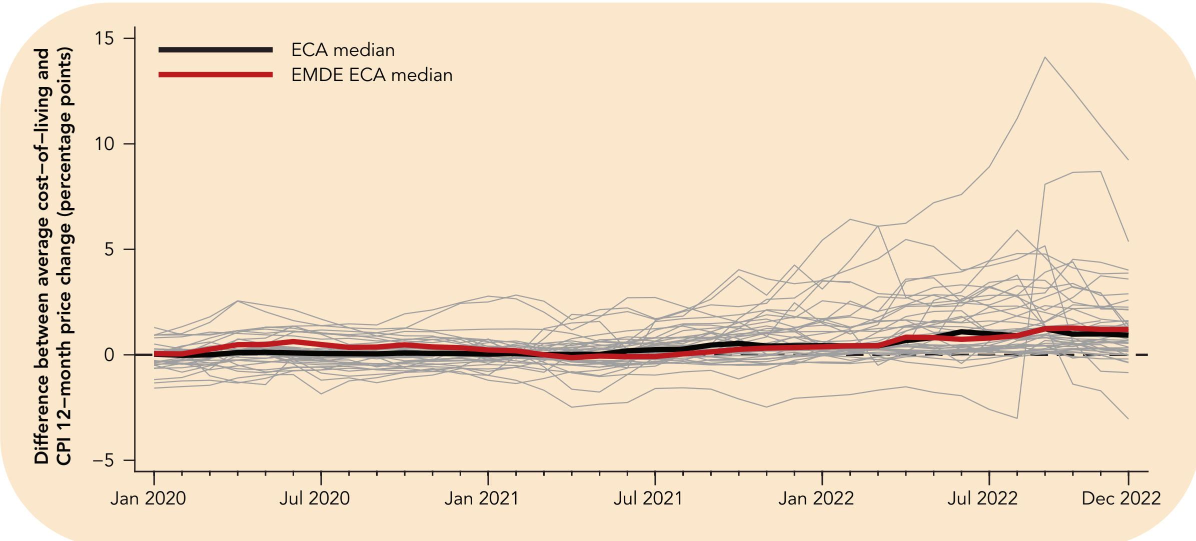
3. Before the energy and food price shock of Russia's invasion of Ukraine, average household inflation was below CPI inflation in Bosnia and Herzegovina, Kosovo, Montenegro, and Serbia but above CPI inflation in Albania and North Macedonia (World Bank 2022d).

FIGURE 2.5 Wealthier households have a more diversified consumption than poorer households



Source: Lokshin, Sajaia, and Torre (2023)
Note: this graph plots the composition of consumption expenditure across deciles in Moldova (left panel) and North Macedonia (right panel). Moldova is the country with the lowest value in consumption diversity between households among the 19 EMDE ECA countries with decile data. North Macedonia is the country with the highest value in consumption diversity among the same group. Consumption expenditure is classified into the 12 COICOP 2-digit groups, each depicted in a different color. The values for both countries were calculated from their respective Household Budget Survey for 2021.

FIGURE 2.6 Average cost-of-living inflation exceeded consumer price index inflation in Europe and Central Asia between mid-2021 and the end of 2022



Source: Lokshin, Sajaia, and Torre 2023.
Note: This figure plots the difference between the cost-of-living (COL) average 12-month price change (average across 10 deciles or 5 quintiles) and the CPI 12-month price change by month for every ECA country in our sample. The difference is expressed in percentage points. The thick black line indicates the median difference across ECA at every month until December 2022, the month with latest CPI data for most countries in the sample. The thick red line indicates the median difference across EMDE ECA during the same period. Grey lines plot values for each country. EMDE ECA = emerging market and developing economies of ECA.

BOX 2.2 Does a cost-of-living index measure inflation more accurately than the consumer price index?

The consumer price index has long been used to assess the impact of inflation on incomes and standards of living (O'Neill and others 2017). The long-standing research debate about its limitations in informing economic policies resulted in efforts to find better instruments to measure the cost of living.

Konüs (1939) was the first to develop the formal theory of cost-of-living indexes. He and many other researchers after him argue that the CPI, as a fixed expenditure–weighted index, fails to account for changes in the composition of consumption in response to changes in relative price across households and the quality and variety of the purchased goods and services.

Lokshin, Sajaia, and Torre (2023) rely on this large body of literature to construct cost-of-living indexes. Their approach is based on the empirical observation that consumption patterns for households with different characteristics vary. Macroeconomists usually assume that all households in a country face the same CPI inflation. In fact, because the consumption basket purchased by each household is likely to differ from the nationwide CPI basket, the inflation rate faced by a particular household is likely to differ from the CPI inflation rate. Such differences can be especially large in periods of high inflation.

Formally, the CPI inflation is calculated based on the Lowe index, defined as:

$$L_0^t = \sum_{j=1}^{m} s_j^0 * \frac{p_j^t}{p_j^0}, \tag{1}$$

where L_0^t is the overall index; p_j^t/p_j^0 is the corresponding price index for the consumption component *j* (*m* is the number of consumption components) in period *t* and the price reference period *0*; and s_j^0 are the shares of consumption components for the reference basket evaluated at the price period *0*:

$$s_n^0 = \frac{p_n^0 * q_n^b}{\sum_{j=1}^{m} p_j^0 * q_j^b}. \tag{2}$$

Aggregate price change between periods *t* – 1 and *t* can be derived as a ratio of two indexes. It has the same structure as equation 1, except for the hybrid weights s_j^{t-1}, which reflect the consumption shares of the reference basket evaluated at prices of period *t* – 1:

$$L_{t-1}^t = \frac{L_0^t}{L_0^{t-1}} = \sum_{j=1}^{m} s_j^{t-1} * \frac{p_j^t}{p_j^{t-1}}, \tag{3}$$

Similar to equation (3), we define the inflation index for a household *i* as:

$$L_{i,t-1}^t = \sum_{j=1}^{m} s_{j,i} * \frac{p_j^t}{p_j^{t-1}}, \tag{4}$$

where

$$s_{n,i} = \frac{C_{n,i}}{\sum_{j=i}^{m} C_{j,i}} \text{ and } C_{j,i}$$

and $C_{j,i}$ is the consumption expenditure of household *i* on goods from consumption category *j*. Equation (4) shares a similar functional form as equations (1) and (3), but the interpretation of this index is slightly different, as it no longer refers to a fixed quantity vector priced at one of the periods being compared (*t* or *t* – 1).

The cost-of-living indexes for ECA countries are constructed on two stages. First, household-specific cost-of-living indexes are calculated (based on equation 4) for households in the samples of household budget surveys of 20 ECA countries. The cost-of-living indexes use consumption shares of 12 broad COICOP consumption categories in the base year and the corresponding prices for 2021 and 2022. These indexes are then used as dependent variables in the descriptive regression analysis to explore the heterogeneity of the impact of price changes by household characteristics. The regression specification for this analysis is:

$$L_i = \beta X_i + \pi D_i + \gamma R_i + \varepsilon_i \tag{5}$$

where L_i is the inflation rate experienced by household *I*; X_i is a vector of household characteristics, including household size, household size squared,

(continued next page)

BOX 2.2 (continued)

the share of children and elderly in the household, whether a woman heads the household, and whether a household member is unemployed; D_i is a set of dummy variables indicating the consumption expenditure decile to which a household belongs; R_i are regional variables, including urban/rural location and, for some countries, regional dummies; β, π, and γ are the estimated coefficients; and ε_i is an error term. These regressions are estimated separately for each country in our sample.

The regression analysis indicates that for the majority of ECA countries, household income, household size, and urban or rural location are the most important factors determining the level of inflation faced by households in the region. In the second stage, aggregate inflation indexes are generated for 10 consumption expenditure deciles, five groups of household sizes, and urban and rural location. The group-level COL indexes are calculated by aggregating household-specific indexes (equation 4). The "democratic" index $L^{D,t}_{G,t-1}$ (equation 6) assumes equal weights for every household (or a group) in calculating the aggregate inflation index.[a] The "plutocratic" index $L^{P,t}_{G,t-1}$ (equation 7) adopts a weighting scheme in which the importance of a household is proportional to its expenditure share in aggregate expenditures:

$$L^{D,t}_{G,t-1} = \sum_{i \in G} w_i * L^{t}_{i,t-1} = \sum_{j=1}^{m} s^{D}_{j,G} * \frac{p^t_j}{p^{t-1}_i}, \quad (6)$$

where the group-level shares are derived by averaging shares of all households i that belong to group G:

$$s^{D}_{j,G} = \textstyle\sum_{i \in G} w_i * s_{j,i}:$$

$$L^{P,t}_{G,t-1} = \textstyle\sum_{j=1}^{m} s^{P}_{j,G} * \frac{p^t_j}{p^{t-1}_j}, \; s^{P}_{j,G} = \frac{\sum_{i \in G} w_i * C_{j,i}}{\sum_{j=1}^{m} \sum_{i \in G} w_i * C_{j,i}}, \quad (7)$$

The analysis uses the plutocratic COL indexes to assess the sensitivity of the main results to different weighting assumptions. The household- and group-specific indexes are then used to evaluate the heterogeneity of inflation by population groups and the impact of using COL and CPI indexes for poverty and inequality measures.

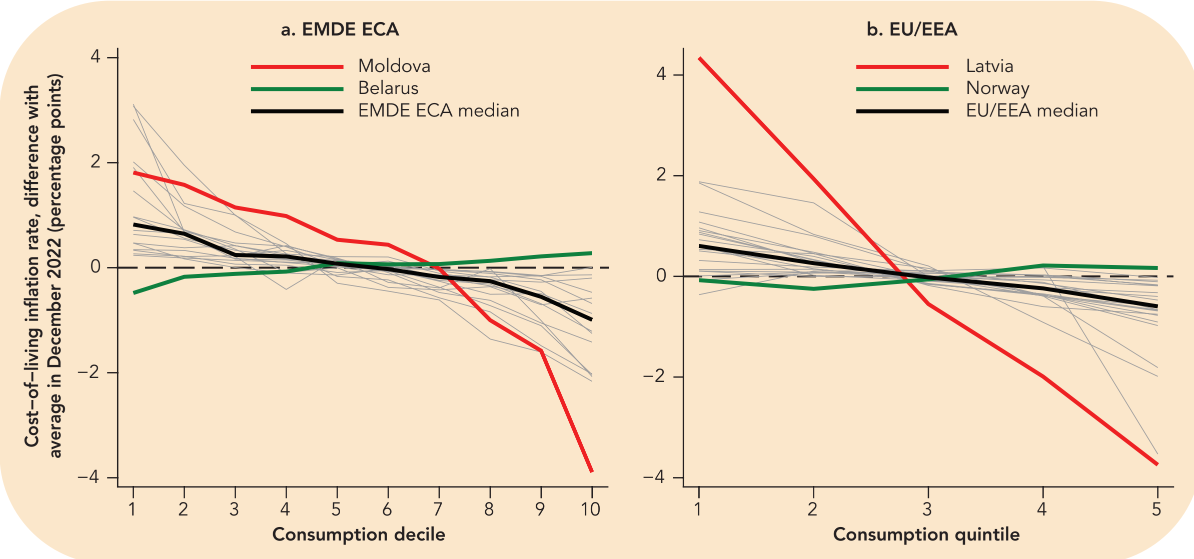
Source: Adapted from Lokshin, Sajaia, and Torre 2023.
a. As household sample surveys are used, w_i sampling weights are needed for the aggregation.

by larger households could be explained by economies of scale on household size that result in lower relative shares of some groups of products compared to these shares in the budgets of small-size households (e.g., Deaton 1998). Typically, the largest economies of scale are on housing and food consumptions. These are the categories for which prices increased the most in the ECA region in 2022.

The cost-of-living inflation rate is also correlated with a household's location. In 13 of 16 countries for which the estimation was possible, urban households experienced lower inflation than rural households with similar characteristics, with a median difference of 0.3 percentage points. In Moldova, North Macedonia, and Poland, urban households faced inflation that was 0.4–0.7 percentage points higher than that faced by rural households.

Cost-of-living inflation was 1.2 percentage points higher for the poorest deciles of the population than for the average population and 2.3 percentage points higher than the inflation faced by households in the top decile (Figure 2.7, panel a). This gap was largest in Moldova, where the inflation of the basket of goods and services consumed by households in the poorest decile of the consumption distribution was 1.8 percentage points higher than the average inflation in the

FIGURE 2.7 **In almost all countries in Europe and Central Asia, the cost of living increased more for poorer households than for richer ones in 2022**



Source: Lokshin, Sajaia, and Torre 2023.
Note: Cost-of-living (COL) 12-month price change by decile (EMDE ECA countries, left panel) or quintile (EU/EEA countries, right panel) of the consumption distribution for December 2022. The inflation by decile/quintile is expressed as a difference with respect to the average COL inflation. The thick black line indicates the median values within each group of countries. In the left panel, the red line highlights the values for Moldova, the country with the largest difference between the COL annual inflation in decile 1 and decile 10, and the green line highlights the values for Belarus, the country with the smallest difference between the COL annual inflation in decile 1 and decile 10. In the right panel, the red line highlights the values for Latvia, the country with the largest difference between the COL annual inflation in quintile 1 and quintile 5, and the green line highlights the values for Norway, the country with the smallest difference between the COL annual inflation in quintile 1 and quintile 5. EMDE ECA = emerging market and developing economies of ECA.

country and 5.7 percentage points higher than the inflation faced by the richest households. The gap was also large in North Macedonia, where the inflation rate for the lowest decile was 3.1 percentage points higher than the average inflation in the country and 5.2 percentage points higher than the inflation faced by households in the top decile. This trend was evident in most countries. An exception is Belarus, where richer households experienced higher inflation than other households (0.3 percentage points higher than the average and 0.8 percentage points higher than that of the bottom decile).[4]

Qualitatively similar patterns of regressive inflation are observed in the EU/EEA countries (Figure 2.7, panel b). The largest inflation gap between the poorest and richest households (of about 8 percentage points) is observed in Latvia; Norway shows no clear relationship between household consumption level and the cost-of-living inflation rates. The average difference in inflation rates between the poorest and wealthiest households in the EU/EEA countries is slightly lower than in EMDE ECA, at about 1.6 percentage points. Table 2.1 presents the country-specific estimates of cost-of-living inflation in 2022 by decile or quintile.

4. In Belarus, the consumption categories with the largest price increases were transport (21.2 percent annual increase by December 2022), miscellaneous goods and services (17.6 percent), and alcohol and tobacco (16.8 percent). In the first two categories, richer households allocate larger shares of their budgets than poor households do. For alcohol and tobacco, the share is larger for poorer households than for richer ones, but the difference in small.

TABLE 2.1. Consumer price and cost-of-living indexes for countries in Europe and Central Asia, 2022

(In percent, 12-month price change in December 2022)

	Consumer price indexes			Cost-of-living indexes			
Country/subregion	Consumer price index	Food and nonalcoholic beverages	Housing, water, electricity, gas, and other fuels	Poorest quantile[a]	Middle quantile[b]	Highest quantile[c]	Average
Central Asia	**14.7**	**15.8**	**7.0**	**14.6**	**14.3**	**14.4**	**14.3**
Kazakhstan	20.3	25.6	15.6	22.4	22.1	21.9	22.1
Kyrgyz Republic	14.7	15.8	7.0	14.6	14.3	14.4	14.3
Tajikistan	—	—	—	—	—	—	—
Turkmenistan	—	—	—	—	—	—	—
Uzbekistan	12.3	15.3	5.1	12.9	12.8	10.8	12.4
Central Europe and Baltic Countries	**16.8**	**26.1**	**21.6**	**18.8**	**17.1**	**16.1**	**17.1**
Bulgaria	16.9	26.1	19.9	19.8	18.1	16.5	17.9
Croatia	13.1	19.0	16.1	14.2	13.6	13.6	13.7
Czech Republic	15.8	25.5	17.0	17.0	16.4	16.0	16.4
Estonia	17.6	29.7	21.6	19.8	18.8	17.9	18.8
Hungary	24.6	47.8	33.7	31.2	30.0	28.1	29.9
Latvia	20.8	29.0	42.8	29.0	24.2	21.0	24.7
Lithuania	21.7	34.7	48.3	32.8	31.0	27.4	31.0
Poland	16.8	21.3	22.8	18.0	17.1	16.1	17.1
Romania	14.1	22.7	24.2	18.8	16.8	14.7	16.7
Slovak Republic	15.4	28.1	16.8	16.9	15.6	14.5	15.7
Slovenia	10.3	18.6	13.3	11.9	10.9	10.3	11.0
Eastern Europe	**26.6**	**32.5**	**10.0**	**23.6**	**23.3**	**21.2**	**23.0**
Belarus	12.8	13.4	10.0	12.3	12.9	13.1	12.8
Moldova	30.2	32.5	75.9	34.9	33.7	29.2	33.1
Ukraine	26.6	34.4	6.0	—	—	—	—
Northern Europe	**9.1**	**14.9**	**13.1**	**9.5**	**9.3**	**9.0**	**9.3**
Denmark	8.7	14.9	9.7	9.0	8.9	8.7	8.9
Finland	9.1	16.0	13.1	10.0	9.8	9.3	9.7
Iceland	9.6	10.1	14.5	—	—	—	—
Norway	5.9	11.5	2.4	5.4	5.5	5.7	5.5
Sweden	12.3	18.2	20.2	13.9	13.4	12.7	13.4
Russian Federation	**—**	**—**	**—**	**—**	**—**	**—**	**—**
South Caucasus	**9.8**	**16.3**	**8.2**	**12.2**	**11.6**	**10.6**	**11.5**
Armenia	8.3	10.0	8.2	9.2	8.9	8.2	8.8
Azerbaijan	14.4	19.7	5.4	15.9	15.6	14.1	15.4
Georgia	9.8	16.3	15.8	12.2	11.6	10.6	11.5
Southern Europe	**7.3**	**14.5**	**13.7**	**8.2**	**7.4**	**6.9**	**7.5**
Cyprus	7.2	12.5	16.8	10.4	9.2	8.6	9.4
Greece	7.2	15.5	2.5	6.3	6.5	6.3	6.4
Italy	11.6	13.1	54.5	—	—	—	—
Malta	7.3	13.5	10.6	8.2	7.4	6.9	7.5
Portugal	9.6	19.9	18.4	12.8	11.8	10.9	11.9
Spain	5.7	15.7	-4.5	2.3	2.8	2.6	2.7
Türkiye	**64.3**	**77.9**	**79.8**	**70.7**	**67.7**	**65.8**	**67.9**
Western Balkans	**14.9**	**23.3**	**16.6**	**17.3**	**16.2**	**14.9**	**16.1**

(Continued next page)

TABLE 2.1. (continued)

Country/subregion	Consumer price indexes			Cost-of-living indexes			
	Consumer price index	Food and nonalcoholic beverages	Housing, water, electricity, gas, and other fuels	Poorest quantile[a]	Middle quantile[b]	Highest quantile[c]	Average
Albania	7.4	14.2	2.8	9.4	8.9	7.8	8.8
Bosnia and Herzegovina	14.7	23.2	16.9	16.6	15.7	14.4	15.6
Kosovo	12.1	17.8	15.3	14.5	13.7	12.6	13.6
Montenegro	17.2	28.9	16.2	20.7	17.7	15.5	17.6
North Macedonia	19.2	26.4	20.2	23.7	20.3	18.4	20.6
Serbia	15.1	23.4	19.3	18.1	16.6	16.0	16.6
Western Europe	**8.2**	**15.2**	**11.7**	**10.0**	**9.2**	**8.8**	**9.3**
Austria	10.2	16.1	15.6	11.1	10.5	9.9	10.5
Belgium	10.4	15.2	20.5	13.0	12.7	11.7	12.5
France	5.9	12.9	8.2	6.9	6.9	6.7	6.9
Germany	8.1	19.4	7.3	8.2	8.1	8.0	8.1
Ireland	8.2	11.7	25.9	14.1	12.4	10.3	12.2
Luxembourg	5.4	10.9	6.1	5.8	5.7	5.5	5.7
Netherlands	9.6	16.8	12.4	10.2	9.5	9.3	9.6
Switzerland	2.8	4.0	4.2	—	—	—	—
United Kingdom	9.2	16.9	11.7	9.9	8.9	8.4	9.0
EMDE ECA (median)	**14.7**	**22.0**	**16.1**	**16.6**	**15.7**	**14.4**	**15.6**
EMDE ECA (mean)	**17.9**	**24.9**	**21.5**	**20.1**	**19.1**	**17.8**	**19.0**
ECA (median)	**12.1**	**17.8**	**15.6**	**13.0**	**12.8**	**12.4**	**12.7**
ECA (mean)	**13.8**	**20.9**	**18.4**	**16.1**	**15.2**	**14.1**	**15.1**

Sources: Data on consumer price indexes are from IMF's CPI database and national statistical institutes. Data on cost-of-living indexes are from Lokshin, Sajaia, and Torre (2023).
Note: Values for December 2022. Subregional values are country median averages. EMDE ECA = emerging markets and developing economies of ECA. Includes the following countries: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Hungary, Kazakhstan, Kosovo, Kyrgyz Republic, Moldova, Montenegro, North Macedonia, Poland, Romania, Russian Federation, Serbia, Tajikistan, Türkiye, Turkmenistan, Ukraine, and Uzbekistan.
— Not available.
a. Decile 1 for EMDE ECA countries except Hungary, for which it corresponds to quintile 1; quintile 1 for EU/EEA countries except Bulgaria, Croatia, Poland, and Romania, for which it corresponds to decile 1.
b. Decile 5 for EMDE ECA countries except Hungary, for which it corresponds to quintile 3; quintile 3 for EU/EEA countries except Bulgaria, Croatia, Poland, and Romania, for which it corresponds to decile 5.
c. Decile 10 for EMDE ECA countries except Hungary, for which it corresponds to quintile 5; quintile 5 for EU/EEA countries except Bulgaria, Croatia, Poland, and Romania, for which it corresponds to decile 10.

In other regions of the world, such as South Asia, the price increases across deciles were more heterogeneous, with inflation rates for poorer households being higher than the rates faced by richer households in some countries but with an opposite situation in some others (Box 2.3).

The difference between the cost-of-living inflation of the poorest and the richest households in ECA has increased in the last two years. The median cost-of-living inflation of the bottom decile in EMDE ECA has been consistently above the median cost-of-living inflation of the upper decile since mid-2021, and it has increased ever since (Figure 2.8). The difference during 2022 reached 2 percentage points by late 2022.

BOX 2.3 The distributional impact of high energy and food inflation in South Asia

South Asia, like many other regions, saw fast-rising prices during the last two years. The high inflation was first driven by supply bottlenecks affecting food prices during the pandemic, then by soaring energy prices due to a recovery in world demand and Russia's invasion of Ukraine. In India, the largest country in the region, monthly food inflation reached above 10 percent in 2020, while inflation of fuel and electricity reached 14 percent in late 2021 and stayed high for much of 2022 (Figure B.3.1, panel a). In Pakistan and Sri Lanka, food price inflation reached 36 percent and 84 percent, respectively, in 2022, while transport or energy-related price inflation touched highs of 60 percent and over 100 percent, respectively.

On the aggregate, as a net importer of energy, South Asia is especially vulnerable to rising prices of energy. At the same time, the fast-rising energy and food prices affect different groups of people differently, depending on their consumption patterns. The latest South Asia Economic Focus (World Bank 2023) analyzes these distributional impacts on households in South Asia.

Combining national and private household expenditure surveys and official monthly price data, the authors find that poorer households in South Asia spend larger shares of their total consumption expenditure on food items. In India, food takes up over 50 percent of household expenditure for the poorest 10 percent of households but only around 35 percent for the richest 10 percent (Figure B.3.1, panel b). In Bangladesh, the poorest spend over 60 percent on food, while the richest spend less than 40 percent on food.[a] Similar to many other developing countries, the poorer also spend smaller shares on energy-related consumption.

As a result of these differences in consumption patterns, rising food prices hit the poor especially hard, while soaring energy prices tend to impact the richer more. Assuming no change in consumption patterns, the computed decile-specific inflation based on consumption expenditure patterns shows that the poorest 10 percent in India saw much higher inflation than the rich in 2020 when food price inflation was high; the rich saw higher inflation than the poor in late-2021 as energy prices soared. For most of 2022, the two groups saw similar inflation rates, as both energy and food price inflation rates stayed high.

Which group was impacted more by high inflation over the past two years? The answer to this question varies by country. In Bangladesh, the poorest experienced a cumulative 13 percent price increase between January 2020 and July 2022, while the richest saw a smaller 11 percent cumulative price increase during the same period. But in India, the richest saw a larger cumulative price increase during 2020-2022, suggesting the effects of soaring energy prices have dominated rising food prices (Figure B.3.1, panel c). Other factors play a role as inflation remains high: incomes of some groups (e.g., fixed-income earners, pensioners) are more susceptible to inflation than others; consumption of food staples is less substitutable and hence less elastic than others, making the poor, who spend larger shares on food, more vulnerable to an overall increase in inflation.

a. Consumption expenditure share of India computed using Consumer Pyramids Household Surveys of India, for consumption expenditures in 2019. For Bangladesh, the Household Income and Expenditure Survey of 2016-17 is used. Decile rankings are based on real consumption per adult equivalent in a household. Only expenditures on purchased goods are included in the calculations; self-produced or non-market sourced goods are excluded.

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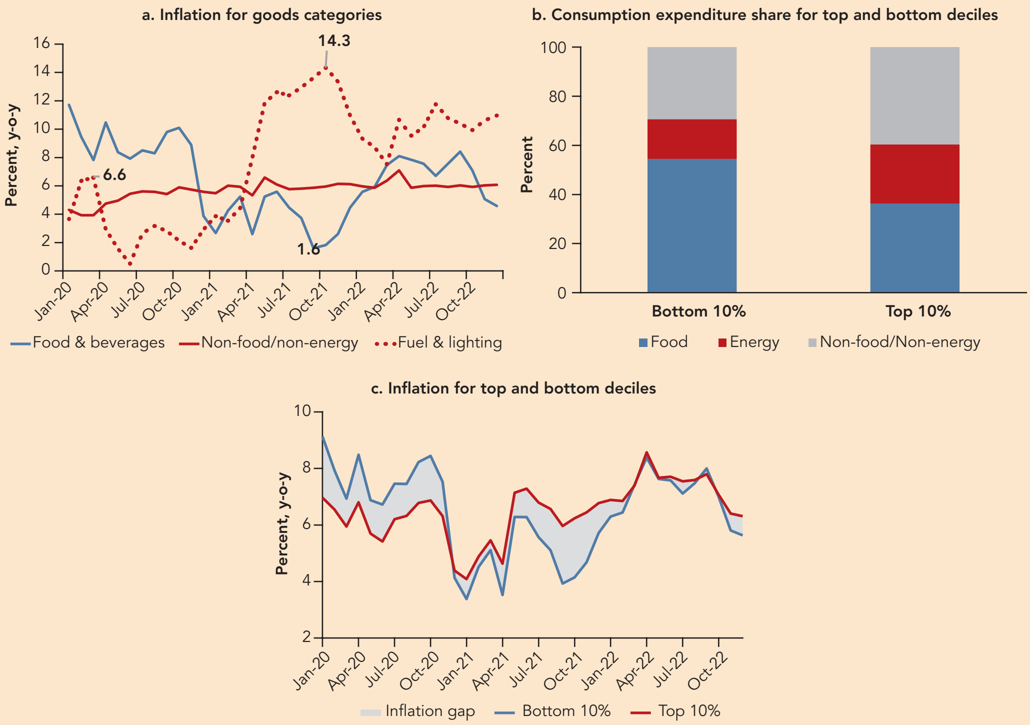
BOX 2.3 (continued)

FIGURE B2.3.1 Inflation and consumption expenditure across deciles and goods in India



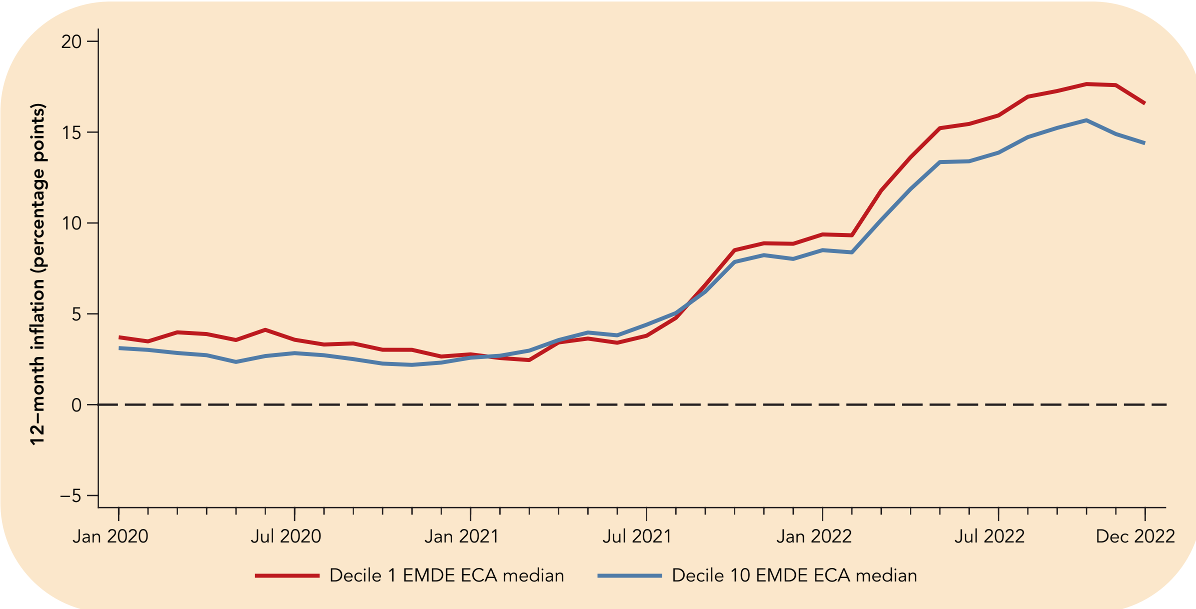
Source: Haver Analytics, India Consumer Pyramids Household Surveys (2019) and authors' calculations.
Note: The energy category includes fuel and electricity.

The cost-of-living inflation rates should be understood as upper bounds of actual inflation rates faced by households. There is evidence in the literature that households adjust to rising prices by, on average, substituting away from high priced goods, but this substitution is imperfect and heterogeneous (Kaplan and Schulhofer-Wohl 2017). For instance, low-income households may face liquidity constraints that do not allow them to take advantage of bulk discounts or temporary sales (Orhun and Palazzolo 2019).

Implications for the Estimation of Poverty and Inequality

The regressive nature of the inflationary shock of 2022 and the deviation of headline inflation from the actual evolution of the prices of households' consumption baskets have implications for the analysis of poverty and inequality. The standard approach to calculating such variables is based on adjusting households'

FIGURE 2.8 **The cost-of-living inflation for the poorest households has been higher than for the richest households since mid-2021**



Source: Lokshin, Sajaia, and Torre 2023.
Note: Median cost-of-living (COL) 12-month inflation for the bottom (first) decile of the consumption distribution (red line) and median COL 12-month inflation for the top decile (the tenth) of the consumption distribution (green line) for January 2020—December 2022. The sample includes only EMDE ECA countries.

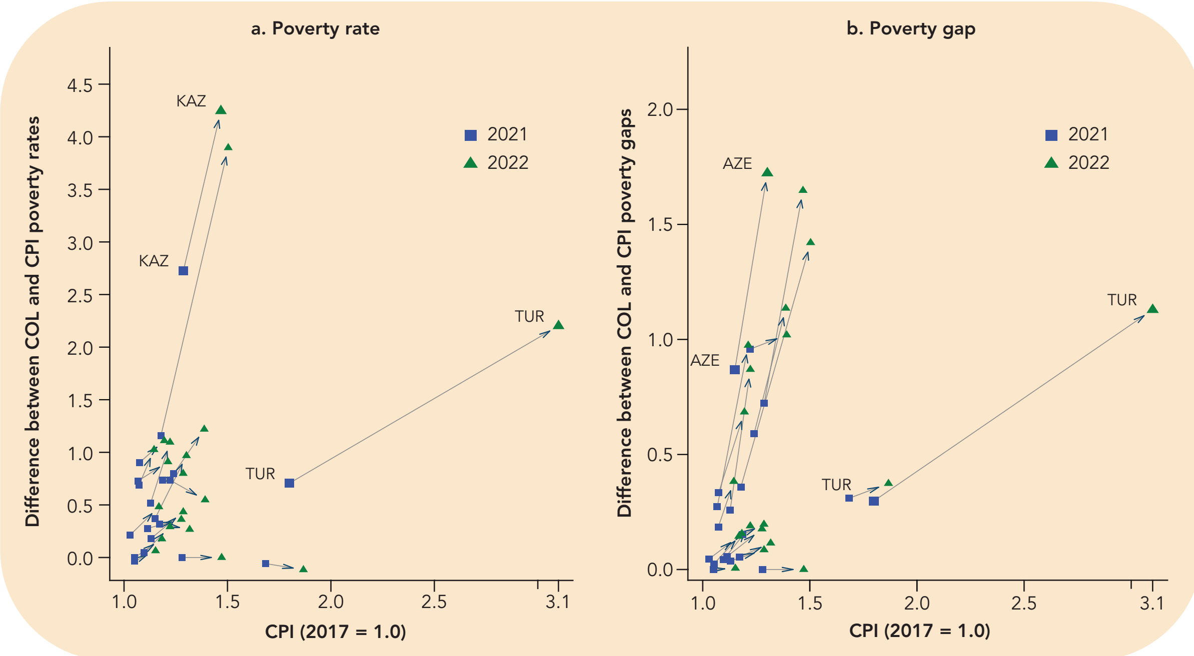
income by the CPI. If household-specific cost-of-living deflators are used as price deflators instead of the CPI, the evolution of real income is likely to be different.

Indeed, simulations by Lokshin, Sajaia, and Torre (2023) show that absent any changes in nominal income, the 2022 poverty headcount rate at the $6.85/day (PPP 2017) line would have been 1 percentage point higher in EMDE ECA had cost-of-living inflation rates instead of the standard CPI for the average country been used. In some countries, this difference in the poverty headcount rate would have been substantially larger (4.2 percentage points in Kazakhstan, 3.9 percentage points in Moldova, and 2.2 percentage points in Türkiye, for example). The difference also widens as inflation increases.

The difference between the 2021 poverty headcount rates using the CPI and cost-of-living values was 0.5 percentage points for the average country in EMDE ECA (Figure 2.9, panel a). For virtually all countries in the region, cost-of-living–based poverty was much higher than CPI–based poverty in 2022 than in 2021 (arrows pointing in the north-northeast direction).

The difference in the estimates using the CPI and cost-of-living values represent about 5 percent of the average country's poverty headcount rate. The average country in EMDE ECA had a poverty headcount rate at the $6.85/day (PPP 2017) line of 20.6 percentage points in 2022, and therefore the difference of 1 percentage point between the estimates using CPI and cost-of-living values represents about 5 percent of the headcount rate.

FIGURE 2.9 Cost-of-living-based measures of poverty were higher than consumer price index–based ones in Europe and Central Asia in 2021 and 2022



Source: Lokshin, Sajaia, and Torre 2023.
Note: Differences in the poverty rates and the poverty gap rates between the CPI–based and COL–based measures (vertical axis) and the CPI base 2017 (vertical axis) for 19 ECA EMDE countries. Each marker represents a value of corresponding poverty measure a particular country and year. Square markers show differences between the poverty measures for 2021, and triangular markers show these differences calculated for 2022. AZE – Azerbaijan; KAZ – Kazakhstan; TUR – Turkey.

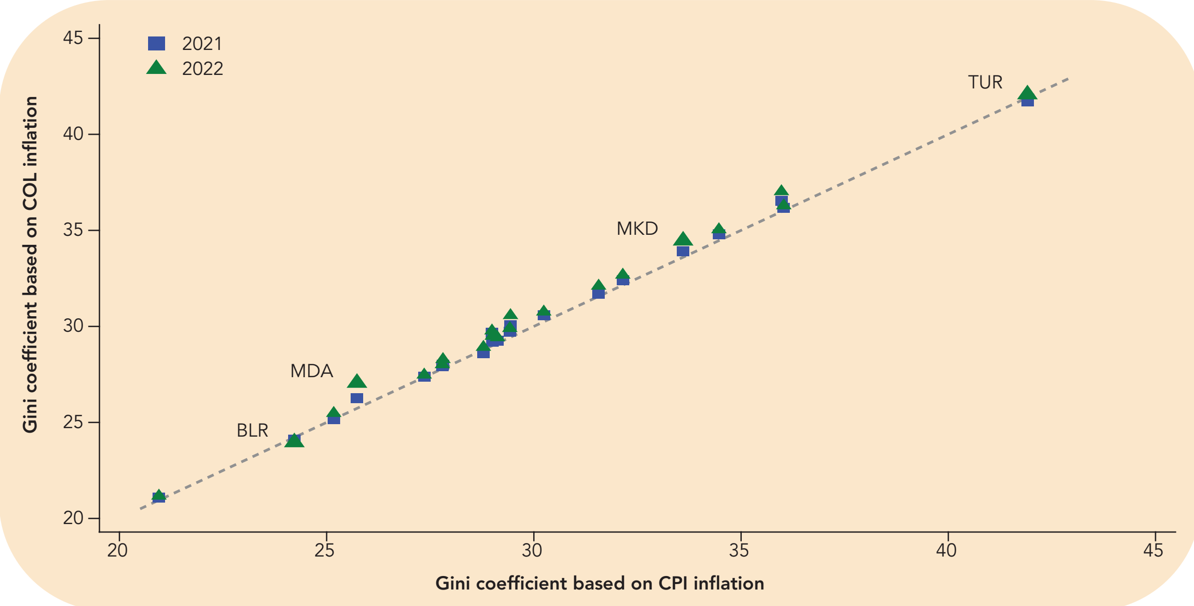
A similar pattern is observed for the poverty gap (Figure 2.9, panel b), which measures a household's distance from the poverty line. For the average country in EMDE ECA, the difference between the cost-of-living–based poverty gap rate and the CPI–based poverty was 0.6 percentage points in 2022 and 0.3 percentage points in 2021. The largest difference in 2022 was in Azerbaijan (1.7 percentage points). Other countries with large differences in 2022 were Kazakhstan (1.6 percentage points), Moldova (1.4 percentage points), and Georgia (1.1 percentage points)

The use of cost-of-living indexes to deflate income also affects the measurement of inequality, which is typically measured by the Gini index.[5] Consumption and income values recorded in household surveys are nominal values. To bring them to a common standard, they are deflated by a price index—typically the CPI. The choice of index affects the inequality measure.

Absent any changes in nominal income, the Gini index in the average country in EMDE ECA would have been about 0.5 points higher in 2022 if cost-of-living indexes rather than the CPI had been used to deflate households' income (Figure 2.10). The largest differences are in Moldova (1.3 Gini points), Azerbaijan (1.2),

5. The Gini index measures the difference between a scenario in which all individuals enjoy exactly the same level of welfare (perfect equality) and the actual scenario. Gini coefficients are expressed on a 0–100 scale, where a value of 0 corresponds to perfect equality and a value of 100 corresponds to perfect inequality.

FIGURE 2.10 Cost-of-living-based estimates of inequality were slightly higher than consumer price index–based ones in Europe and Central Asia in 2021 and 2022



Source: Lokshin, Sajaia, and Torre 2023.
Note: The Gini coefficients of per capita consumption expenditures for 19 ECA EMDE countries. Each marker represents a value of Gini coefficients for a particular country and year. Square markers show Gini estimated based on 2021 cost-of-living (COL) inflation, and triangular markers show Gini estimated based on 2022 COL inflation. Markers on the 45-degree dotted line indicate no difference between the CPI and COL–based Gini coefficients. The farther away the estimate is from the line, the larger the difference. BLR – Belarus, MDA – Moldova; MKD – North Macedonia; TUR – Turkey.

and Uzbekistan (1.1). In Belarus, the difference is –0.2. The differences between the cost-of-living– and CPI–based Gini's are significant enough to alter the cross-country inequality rankings for the Kyrgyz Republic, Kosovo, and Serbia.

Policy Implications

Poorer households faced higher inflation than richer households in most countries in ECA in 2022. Policies that do not account for the different inflation rates faced by households are likely to provide inadequate support to vulnerable groups and may end up being both inefficient and ineffective.

Governments across ECA implemented measures to address the cost-of-living crisis in 2022. The most common measure were subsidies, which 33 countries in the region adopted. These subsidies typically involved moratoriums on energy price increases, reduced public transport fees, and caps on electricity and natural gas prices for households and businesses (Gentilini and others 2022; World Bank 2022b). Many countries also reduced value added and excise taxes on energy and food (Box 2.4). Some of these measures, particularly price freezes, are fiscally costly and may not be sustainable.

BOX 2.4 What policies did countries in Europe and Central Asia adopt to address the cost-of-living crisis?

Countries across the region implemented various measures in response to high energy and food prices. Subsidies were the most popular measures, accounting for about a third of the measures recorded by Gentilini and others (2022) in ECA. Social assistance measures represented 27 percent of the policy responses in ECA and tax measures 21 percent. The remaining responses consisted of social insurance, active labor market, and trade-related policies. In terms of budget, subsidies represented more than 52 percent of government spending in response to the cost-of-living crisis, social assistance measures represented 27 percent, and tax-related measures about 16 percent.

Within subsidies, the most extensively used intervention in ECA were subsidies to utilities, in the form of price caps, discounted prices, or moratoria on payments. These types of measures represented about 70 percent of the subsidies implemented in ECA and were implemented by at least 33 countries in the region. Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Malta, Montenegro, Romania, and Serbia capped the price of electricity, in most cases to all households and to small business consumers. North Macedonia implemented electricity block tariffs to incentivize energy savings while moderating price increases for lower blocks of electricity consumption. Kosovo implemented a similar pricing scheme for electricity.

Fuel subsidies were the second-most common type of subsidy in ECA, accounting for about 16 percent of the subsidy measures implemented in the region. They typically took the form of caps on price increases (Croatia, the Czech Republic, Hungary, Kazakhstan, Slovenia); discounts (€0.18 per liter in France, €0.20 in Spain, and €0.22 in Greece); and vouchers (the provision by private companies of up to €200 per worker in vouchers to their employees). Hungary, Kazakhstan, and Romania implemented subsidies in late 2021, which they extended following Russia's invasion of Ukraine.

Several countries provided cash top-ups for households. Croatia and Poland provided cash support to energy-poor households; Moldova, North Macedonia, and Romania provided targeted payments to vulnerable households. Kosovo and Serbia provided broader cash top-ups (to pensioners or beneficiaries of social assistance in general. Azerbaijan, Bosnia and Herzegovina, and the Kyrgyz Republic raised public sector wages. France, Germany, and Italy made cash transfers, either directly or in the form of energy vouchers.

The most popular tax-related measures were reductions in value added tax (VAT) and excise taxes. Azerbaijan cut VAT rates on food, Poland cut VAT rates on energy, and Bosnia and Herzegovina and Serbia reduced excise taxes on similar products.

Source: Ari and others 2022, Bruegel Institute 2022, and Gentilini and others 2022.

Many of the measures implemented by governments in ECA in 2022 applied to all households that consumed a specific good or service (fuel, electricity, or food, for instance). Such untargeted measures tend to be regressive, as richer households benefit more from them, given their higher consumption levels (World Bank 2022a). But they also help reduce poverty, because they target goods and services that represent a large share of poor households' consumption.

Despite these measures, inflation in 2022 affected poor households more than wealthy ones. An untargeted approach to price controls would probably have required wider coverage of goods and services to reduce inflation for more vulnerable households—an approach that would have implied an even higher degree of regressivity than the measures adopted. It is worth revisiting the rationale for such regressive untargeted measures.

Policies to protect vulnerable populations and promote economic growth should account for the heterogeneity of inflation across households. The benefit levels and eligibility criteria of many government programs are adjusted annually for inflation; increases or decreases in government benefits due to differences in inflation estimates could have major implications for funding and eligibility requirements of poverty-reduction programs and government budgeting (Garner, Johnson, and Kokoski 1996). Using the CPI for inflation compensation in wages may lead to adjustments that are insufficient to prevent real income loss for the poorest households. Refined inflation indicators that capture the actual costs of living of the poor are essential to designing efficient poverty alleviation policies. Updating of social transfers and other income support to poor households could be anchored to price changes of a few consumption items (those most closely related to the basic needs of poor households) rather than average inflation. The same could be true about social pensions, where consumption patterns could inform indexation of those in poor households headed by the elderly.

The conceptual framework used to analyze households' cost-of-living rests on a series of assumptions about prices and consumer behavior that are necessary to perform a cross-country analysis. For example, the analysis is based on a strong assumption that households do not adjust their consumption in response to higher prices on certain products. Focusing on this assumption, the results presented in this part of the *Economic Update* could be interpreted as estimates of the upper bounds of the actual impact of inflation on the households' wellbeing. However, other assumptions might work in a different direction, and it is impossible to sign the direction these assumptions would move the inflation estimates in the general case. The framework allows for a relaxation of these assumptions when focusing on a single country. Governments may consider the possibility of performing such an analysis in order to gain a better sense of the evolution of the cost-of-living changes their citizens face.

The analysis presented in this chapter focuses on the effects of inflation on households' welfare based on their consumption patterns. Inflation also affects households' investment and saving decisions: Rich households allocate a larger share of their assets to interest-bearing instruments than poor households and are thus better protected from inflation (Erosa and Ventura 2002).

One aspect of the cost-of-living crisis that will need to be monitored in the short and medium term is the impact of monetary policies to reduce inflation. This effect will depend significantly on households' balance sheets. Households with variable-interest mortgages and stocks will see their balance sheets deteriorate following an increase in interest rates, while households with cash-like assets will benefit from the slowdown of inflation associated to the increase in interest rates. Given that mortgages and stocks are typically held by wealthier households, monetary tightening may hurt better-off households more than vulnerable ones. However, monetary tightening usually leads to a slowdown in labor demand, which disproportionately affects the earnings of poorer households. On aggregate, monetary policy appears to have a relatively uniform effect across households (McKay and Wolf 2023). The effect may differ across countries, however, as some transmission channels may be stronger than others.

Over the long term, disruptions of trade or "de-globalization" (Goldman Sachs 2022) may have differential impacts on households through the price channel. Trade integration in middle- and high-income countries has been shown to reduce the price of tradables, which usually represent a larger share of consumption for poorer households than for wealthier ones (Carroll and Hur 2020). A reduction in trade integration is likely to increase the price of tradables, which would have a regressive impact on households' welfare.

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3

Selected Country Pages

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ALBANIA

Table 1	2022
Population, million	2.8
GDP, current US$ billion	20.0
GDP per capita, current US$	7069.2
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]	95.9
Life expectancy at birth, years[b]	77.0
Total GHG emissions (mtCO2e)	7.5

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2017 PPPs.
b/ Most recent WDI value (2020).

Growth in 2022 is estimated at 3.5 percent, as private consumption, exports, and investment expanded, despite increasing energy and food prices. Growth is expected to remain subdued for 2023. Poverty is expected to continue its downward trend. Medium-term prospects hinge on global recovery, structural reforms, and fiscal consolidation.

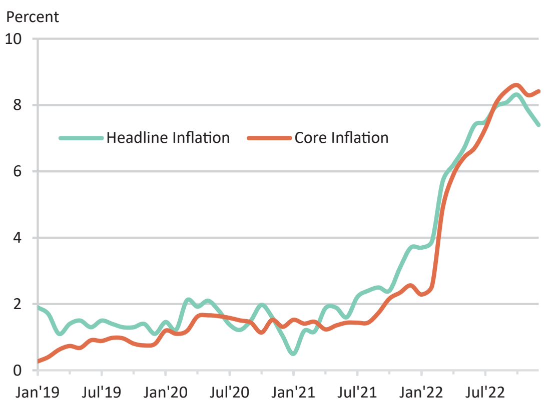
Key conditions and challenges

The Albanian economy has shown considerable resilience in the face of consecutive shocks since 2019-2020. During 2021-2022, the economy experienced a strong rebound, with GDP fully recovering to pre-pandemic levels. Real GDP expanded by 8.5 percent in 2021, surpassing its level in 2019 by 4.7 percent and fully closing the output gap. Poverty levels continued their downward trend in 2022.
Key drivers of Albania's resilience have been the proximity to the European Union (EU), as well as strong remittances and exports. The availability of hydropower, which meets 85 percent of domestic energy demand in a year with average precipitation, has contributed to contain the country's greenhouse gas emissions and has provided some insulation from the ongoing energy crisis; more diversification through other renewable energy (RE) sources, and the development of the RE market, is needed to strengthen energy security at affordable prices. Key challenges are a declining population, also due to large migration; the poor quality of the labor force and of the jobs created; the moderate pace of reforms; and rising fiscal pressures, due also to rising debt and contingent liabilities. The government has to carefully balance the need to mitigate the impact of multiple shocks on the households against the necessity of gradual fiscal consolidation. A sound Medium-Term Revenue Strategy (MTRS) could make a more ambitious, revenue-based consolidation possible.
Unlocking further growth is conditional on the swift implementation of the Government's program, anchored on the EU accession aspiration and built on reforms tackling productivity, including improving the business environment, streamlining government interactions with the private sector, and expanding Albania's integration into foreign markets.

Recent developments

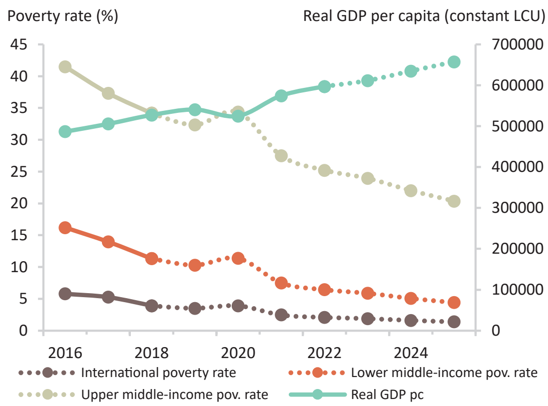
Albania's economy is estimated to grow at 3.5 percent in 2022. Despite increasing energy and food prices, in line with the 2021 trend, household consumption and exports rose by 8.4 and 11.3 percent respectively for the first three quarters. After driving growth in 2021, gross fixed capital formation slowed in 2022, as government capital expenditures declined. On the supply side, trade and construction led growth. Lower energy production from hydropower subtracted from growth, given an exceptionally dry year.
Annual employment growth accelerated to an average of 3.9 percent in the first three quarters of 2022. Job creation was broad-based, while the number of vacancies increased, putting upward pressure on wages. Unemployment fell to a record low of 10.6 percent in Q3 2022, while labor force participation increased.
Given the strong growth in GDP per capita in 2022, poverty is estimated to

FIGURE 1 Albania / Headline inflation and core inflation



Sources: INSTAT and World Bank.

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



Source: World Bank. Notes: see Table 2.

have declined from 27.5 percent in 2021 to 25.2 percent in 2022.

The annual inflation rate rose to 8.3 percent in October 2022, the highest since March 2020, driven by food and transport prices, adversely impacting the poorest citizens. The central bank raised its policy rate to 2.75 percent in November.

Credit growth supported the recovery in 2022. While capital adequacy is above regulatory requirements, the banking system remains susceptible to credit, exchange, and interest rate risks.

In 2022, the fiscal position improved on account of stronger-than-expected revenue collection and spending restraint. To provide temporary and targeted support to the most vulnerable, the Government revised the budget four times in 2022, bringing overall support to 0.6 percent of GDP. Additional subsidies were provided to the electricity state-owned enterprises (SOEs) amounting to 1 percent of GDP.

In 2022, strong exports' growth helped mitigate the impact of rising imports. Yet, the current account deficit remains elevated.

Outlook

Growth is expected to remain subdued in 2023, in the context of tighter global financial conditions, expected economic slowdown in Europe, and the withdrawal of policy support for the post-earthquake reconstruction. Real exports, consumption, and investment are expected to grow at rates below those in the pre-pandemic period.

The inflation rate is projected to start converging toward the 3 percent target by 2025. The central bank is expected to further increase the policy rate by an additional 2–2.5 percentage points in 2023.

The primary balance is projected to reach 0.7 percent of GDP only after 2023, in observance of the fiscal rule. Fiscal consolidation will largely come from the spending side. On the revenue side, the Government plans to introduce a number of tax policy measures, envisioned in the MTRS. The revenue gains of these measures in the short term are expected to be netted off by slower growth and partially by the increase in the minimum taxable wage introduced at the end of 2022.

Public debt is expected to decline slightly to 67.9 percent of GDP in 2023, and more significantly over the medium term, as a result of higher nominal growth and a gradual reduction of the fiscal deficit. Given Albania's growing reliance on external financing, the exchange rate, interest rate, and refinancing related risks 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 constrain fiscal space. As a small, open economy, Albania is highly exposed to external shocks, such as recession in Europe or further tightening of financing conditions in international capital markets beyond the current year. Domestic risks emanate from natural disasters, public-private partnerships, and SOEs, in addition to fiscal risks stemming from the energy sector.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-3.5	8.5	3.5	2.2	3.4	3.4
Private Consumption	-3.5	4.2	2.5	2.6	2.5	2.7
Government Consumption	1.5	7.8	0.7	-0.3	1.6	1.3
Gross Fixed Capital Investment	-0.9	19.8	1.8	0.5	3.1	3.3
Exports, Goods and Services	-27.9	46.0	8.3	5.1	6.3	6.2
Imports, Goods and Services	-19.8	31.7	3.5	3.4	3.3	3.7
Real GDP growth, at constant factor prices	-2.9	8.6	3.5	2.2	3.4	3.4
Agriculture	0.3	1.5	1.4	1.3	1.5	1.5
Industry	-3.5	10.8	2.6	1.3	3.7	3.5
Services	-3.8	10.3	4.6	2.9	4.0	3.9
Inflation (Consumer Price Index)	2.2	2.6	6.7	4.0	3.5	3.0
Current Account Balance (% of GDP)	-8.5	-7.7	-7.7	-7.8	-7.7	-7.6
Net Foreign Direct Investment Inflow (% of GDP)	6.7	6.4	6.5	6.5	6.5	6.6
Fiscal Balance (% of GDP)	-6.7	-4.5	-3.3	-2.7	-2.4	-2.4
Revenues (% of GDP)	25.9	27.0	27.9	28.6	28.3	28.3
Debt (% of GDP)	75.9	74.0	68.5	67.8	66.6	65.5
Primary Balance (% of GDP)	-4.6	-2.6	-1.3	0.0	0.7	0.7
International poverty rate ($2.15 in 2017 PPP)[a,b]	3.9	2.5	2.1	1.9	1.6	1.4
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	11.4	7.5	6.4	5.9	5.1	4.4
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	34.4	27.5	25.2	23.9	22.0	20.4
GHG emissions growth (mtCO2e)	-8.7	-1.7	-4.0	-4.4	-3.7	-10.2
Energy related GHG emissions (% of total)	44.5	44.6	43.0	40.7	38.7	31.9

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-SILC-C and 2019-SILC-C. Actual data: 2018. Nowcast: 2019-2022. Forecasts are from 2023 to 2025.
b/ Projection using point-to-point elasticity (2016-2018) with pass-through = 1 based on GDP per capita in constant LCU.

ARMENIA

Table 1	**2022**
Population, million	2.8
GDP, current US$ billion	19.5
GDP per capita, current US$	7014.2
International poverty rate ($2.15)[a]	0.5
Lower middle-income poverty rate ($3.65)[a]	8.7
Upper middle-income poverty rate ($6.85)[a]	51.7
Gini index[a]	27.9
School enrollment, primary (% gross)[b]	91.1
Life expectancy at birth, years[b]	72.2
Total GHG emissions (mtCO2e)	13.5

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

Economic growth was 12.6 percent in 2022, much higher than initially expected, mainly due to significant increases in services and private consumption, fueled by strong inflows of migrants and capital from Russia. The outlook is subject to significant uncertainty, due to the risk of reversal of inflows, continued geopolitical tensions, and unresolved issues at the Armenian border.

Key conditions and challenges

In 2022, Armenia absorbed a significant inflow of migrants, businesses, and capital following Russia's invasion of Ukraine. The country also benefited from the re-routing of some trade and financial flows through Armenia. These developments fueled domestic demand and supported the appreciation of the currency; they increased reserve levels and reduced credit dollarization.

Armenia's sound macroeconomic policies (active inflation targeting, adherence to prudent fiscal policy, and sound financial sector oversight) have supported generally positive economic performance in the last few years despite several significant shocks. Armenia has also pursued significant reforms, particularly aimed at reducing corruption and increasing transparency. However, significant structural challenges persist, which result in weak productivity, low investment and inability to attract FDI, limited human capital, an undiversified economic structure, and a narrow export base and export destinations.

Recent developments

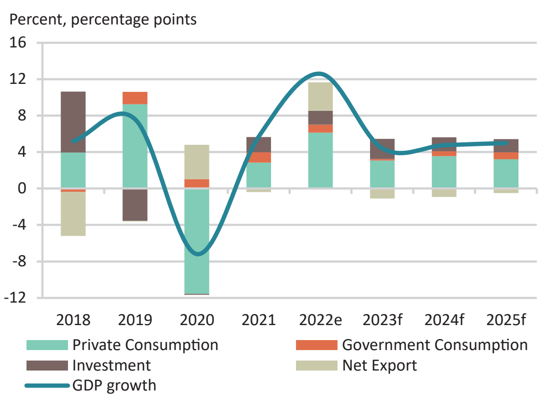
Economic performance in 2022 was unexpectedly strong, with real GDP growth reaching 12.6 percent. Robust growth in services (up 17.7 percent, yoy) contributed to approximately three-quarters of total growth. This was mainly driven by the finance, IT, transport, accommodation, and public catering sub-sectors. Industry and construction grew by 6 percent and 19 percent (yoy), respectively. While mining contracted by 3.2 percent in real term (yoy), manufactured base metal products show 16 percent growth (yoy). Agriculture contracted by 0.7 percent (yoy), reflecting challenges in the sector and possible limitations in actual data collection. On the demand side, growth was driven largely by private consumption (up 8.1 percent, yoy) fueled by exceptionally high inflows of people and funds from Russia, and by a 10 percent increase in real wages, driven by strong growth in wages in IT and finance.

The unemployment rate fell to 11.6 percent in Q3 2022, down from 15.5 percent at end-2021, and this is expected to drive substantial poverty reduction in 2022.

Inflation averaged 8.6 percent in 2022 compared to 7.2 percent in 2021. Inflation eased from a peak of 10.3 percent (yoy) in mid-2022 to 8.1 percent (yoy) in January 2023, as the Central Bank of Armenia (CBA) increased the policy rate by 300 bps in 2022, and international food and energy prices eased in recent months. The unprecedented appreciation of the AMD has also helped contain inflationary pressures.

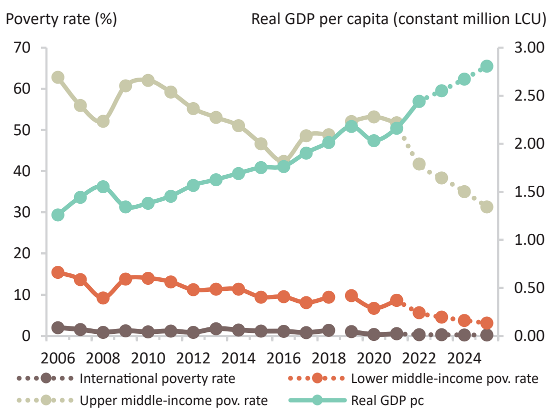
Fiscal performance was robust in 2022, with the budget deficit narrowing from 4.6 percent of GDP in 2021 to 2.2 percent in 2022 due to strong revenue collection. Tax revenues rose by 21 percent (yoy) in nominal terms, mostly driven by VAT and by increases in income and profit tax

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.

collection. While current spending grew only by 4 percent, capital expenditures increased by 193 percent (yoy), accounting for 4.6 percent of GDP, the highest level in the last decade. This was partly due to higher defense spending.

Driven by robust economic and fiscal performance and the appreciation of the AMD, government debt to GDP declined sharply, down 13.6 percentage points in 2022, bringing the debt to GDP ratio to 46.7 percent by end-2022.

The external balance improved significantly in 2022 with an unprecedented increase in exports of goods and services. Merchandise exports increased by 77.7 percent in 2022 in nominal terms, as the exports of machines and instruments, transport vehicles, and precious stones, surged, partly driven by re-exports to Russia. In turn, merchandise imports increased by 63.5 percent in 2022. Receipts both from tourism-related services and money transfers tripled (yoy) in 2022, mostly due to a significant increase in inflows from Russia. FDI more than doubled, mostly driven by investment in the financial sector and Russian investment in the real sector (particularly in mining, energy, and real estate). International reserves were boosted to the historically high level of USD 3.7 billion, or 4.4 months of import cover, at end-January 2023. As a result of high financial inflows and the switch to the RUB for gas import payments, the AMD strengthened significantly, with the average exchange rate against the USD appreciating by 14 percent in nominal terms and by 34 percent in real effective terms (yoy) in 2022.

Outlook

Growth is expected to ease to about 4.5 percent in 2023, due to the high base of 2022 and a slowdown among trading partners. Some pick-up in growth in the medium-term will be supported by consumption and higher private investment. On the production side, services are expected to remain the main driver of growth, followed by industry. Inflation is forecast to decline gradually to its target level of 4 percent by 2025. In line with the Government's medium-term expenditure framework, the fiscal deficit is expected to decrease from a planned 3.1 percent in 2023 to 2.5 percent in 2025. The current account deficit is forecast to deteriorate in 2023, after the sharp improvement in 2022, and to stabilize at around 3 percent of GDP over the medium-term.

Macroeconomic projections suggest that the population below the UMIC poverty line (USD 6.85/day, 2017 PPP) will have decreased from 51.7 percent in 2021 to 41.8 percent in 2022, and to a projected 38.4 percent in 2023. However, high inflation, particularly affecting food and real estate, may have a negative impact on the poorest households.

A reversal in inflows coupled with persistent inflation and further monetary tightening in advanced economies would put pressure on the currency, potentially resulting in balance sheet pressures and refinancing challenges. A possible extension of sanctions to Russia's main trade partners as well as geopolitical developments are another source of downside risks. On the upside, stronger inflows from Russia could lift growth above the forecast.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-7.2	5.7	12.6	4.4	4.8	5.0
Private Consumption	-13.9	3.7	8.1	4.2	4.9	4.4
Government Consumption	9.2	8.4	6.5	1.3	4.3	6.2
Gross Fixed Capital Investment	-1.5	6.3	9.5	11.4	7.3	6.7
Exports, Goods and Services	-33.5	16.6	54.4	9.8	9.2	8.5
Imports, Goods and Services	-31.5	12.9	33.8	10.5	9.5	8.1
Real GDP growth, at constant factor prices	-6.8	5.5	13.2	4.4	4.8	5.0
Agriculture	-3.7	-0.6	-0.7	1.2	2.0	2.7
Industry	-2.5	3.4	9.4	4.9	4.2	3.9
Services	-9.6	8.0	18.1	4.7	5.5	5.9
Inflation (Consumer Price Index)	1.2	7.2	8.6	6.5	4.5	4.0
Current Account Balance (% of GDP)	-3.8	-3.7	-0.4	-2.2	-2.7	-3.0
Net Foreign Direct Investment Inflow (% of GDP)	0.7	2.5	4.1	2.1	2.2	2.5
Fiscal Balance (% of GDP)	-5.1	-4.6	-2.2	-3.1	-2.8	-2.5
Revenues (% of GDP)	26.0	25.0	25.1	25.0	25.2	25.6
Debt (% of GDP)[a]	63.5	60.3	46.7	49.2	48.6	48.0
Primary Balance (% of GDP)	-2.4	-2.0	0.2	-0.2	0.2	0.4
International poverty rate ($2.15 in 2017 PPP)[b,c]	0.4	0.5	0.3	0.3	0.2	0.2
Lower middle-income poverty rate ($3.65 in 2017 PPP)[b,c]	6.7	8.7	5.6	4.5	3.8	3.1
Upper middle-income poverty rate ($6.85 in 2017 PPP)[b,c]	53.2	51.7	41.8	38.4	35.0	31.4
GHG emissions growth (mtCO2e)	-1.8	15.4	19.5	7.1	8.3	9.7
Energy related GHG emissions (% of total)	60.3	66.5	72.4	74.5	76.6	78.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Includes Governement and CBA debt.
b/ Calculations based on ECAPOV harmonization, using 2021-ILCS. Actual data: 2021. Nowcast: 2022. Forecasts are from 2023 to 2025.
c/ Projection using neutral distribution (2021) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

AZERBAIJAN

Table 1	2022
Population, million	10.2
GDP, current US$ billion	76.8
GDP per capita, current US$	7533.4
School enrollment, primary (% gross)[a]	94.3
Life expectancy at birth, years[a]	66.9
Total GHG emissions (mtCO2e)	53.3

Source: WDI, Macro Poverty Outlook, and official data.
a/ WDI for School enrollment (2021); Life expectancy (2020).

Economic growth was 4.6 percent in 2022, driven by non-energy sectors supported by recovering demand and fiscal expansion. Inflation accelerated sharply to 13.8 percent, driven by import prices. In the medium-term, growth is expected to moderate as non-energy sector growth returns to pre-COVID levels while the energy sector shrinks further. Risks to this outlook are balanced.

Key conditions and challenges

Azerbaijan's continued reliance on hydrocarbons as a major source of export and fiscal revenues remains its main vulnerability. This poses risks to long-term growth due to 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 firms, shallow financial markets, and a weak human capital base.

Another key development challenge for Azerbaijan is post-conflict reconstruction in liberated territories, which will require substantial public resources and adequate planning and implementation of investments, to ensure efficiency and fiscal sustainability.

Azerbaijan's 2022–2026 Socio-Economic Development Strategy lays out a reform plan to move to a private-sector-led growth model and the development of human capital, with a target of sustained 5 percent growth in non-energy sectors during 2022–2026.

Recent developments

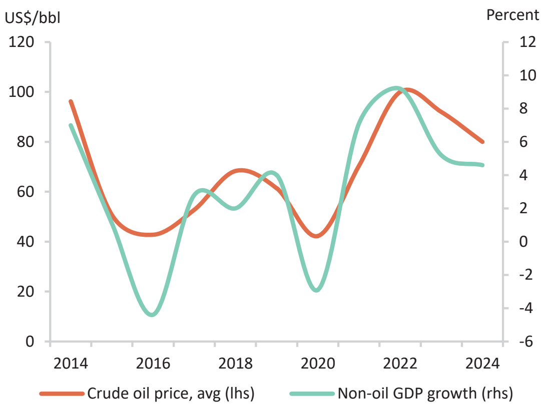
The economy expanded by 4.6 percent (yoy) in 2022, supported by strong growth in non-energy sectors. The energy sector shrank by 2.6 percent (yoy) as continued fall in oil production was only partially offset by an increase in natural gas production. The non-energy sector grew by 9.1 percent (yoy) in 2022 compared to 7.2 percent (yoy) in 2021, driven by services, including transport (largely due to trade rerouting following Russia's invasion of Ukraine), hospitality, and ICT. The construction sector also performed well, expanding by 13.4 percent (yoy) due to a sharp increase in public investment.

On the demand side, consumption grew at a healthy pace in 2022, supported by growth in real wages and a surge in money transfers from Russia (up 5.5-fold, yoy). Investment rebounded strongly, supported by public investment largely directed toward reconstruction in liberated territories.

Inflation rose from 6.7 percent in 2021 to 13.8 percent by end-2022, driven by high import prices, particularly for food. To counter inflationary pressures, the Central Bank of Azerbaijan (CBA) raised the policy rate by 100 bps during 2022 to 8.25 percent. However, the policy rate remains negative in real terms.

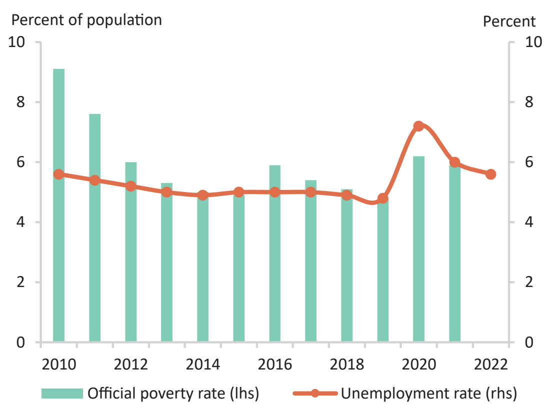
Soaring energy prices boosted exports in the first nine months of 2022 with exports doubling in nominal terms (yoy) while imports increasing by 28 percent (yoy). Strong exports coupled with the sharp increase in money transfers from Russia pushed the current account to a surplus of 30.7 percent of GDP over this period. This was offset partly by net financial outflows, which picked up to 16.6 percent of GDP, largely driven by investment repatriation by energy companies.

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



Sources: State Statistical Committee of Azerbaijan and World Bank staff estimates.

FIGURE 2 Azerbaijan / Official poverty rate and unemployment rate



Source: State Statistical Committee of Azerbaijan.
Note: The World Bank has not reviewed the official poverty rates for 2013–20.

Foreign currency reserves increased by 27 percent in 2022, to USD 9 billion, covering 5.3 months of imports.

The fiscal balance recorded a surplus of 5.4 percent of GDP in 2022. This was driven by a 24.7 percent (yoy) nominal increase in fiscal revenues. Fiscal spending increased by 17 percent (yoy) due to a 31 percent (yoy) increase in public investment. Higher fiscal revenues allowed the Government to cut transfers from the State Oil Fund of the Republic of Azerbaijan (SOFAZ) to the budget in 2022, which increased SOFAZ reserves by 9 percent to USD 49 billion (62 percent of GDP). Public debt declined to 11.7 percent of GDP.

Credit to the economy rose by 18 percent (yoy) in 2022, driven by a 27.3 percent (yoy) increase in consumer lending. The bank NPL ratio fell from 4.2 to 2.9 percent and bank profits increased substantially.

Outlook

Economic growth in 2023 is expected to moderate to 2.2 percent. On the energy side, the slowdown is driven by a projected fall in oil and gas production, due to the main oil field's declining production profile and the main natural gas field's near full capacity.

Growth in non-energy sectors is expected to ease to 5.2 percent, after two years of rapid growth, as it converges to the pre-COVID growth path. Growth will be supported largely by services and construction, which is expected to remain robust due to strong public investment focused on reconstruction. In the medium-term, growth is expected to average 2.5 percent in the absence of structural reforms.

On the demand side, consumption is estimated to ease in 2023, converging to pre-COVID levels. Increase in minimum wages, pensions, and social transfers are expected to prevent a steeper fall in consumption. Investment is expected to ease in the medium-term, as the private investment outlook remains cloudy due to continuing challenges in the business environment. External demand is likely to moderate in the medium-term as well, with slowing global growth and weaker prospects for global energy demand.

Inflation is projected to slow to 8.5 percent in 2023 as international prices ease, while remaining above the CBA's upper range. Over the medium-term, inflation is expected to moderate and return to the CBA's target interval of 4+/–2 percent by 2025.

The external balance is projected to remain in surplus in 2023 supported by high energy prices. Imports are expected to remain robust in 2023 supported by domestic demand, while moderating in the medium-term as growth slows. The fiscal balance is estimated to remain in surplus in the medium-term, averaging 3.9 percent of GDP. High energy revenues are expected to offset higher spending arising from the implementation of the recently approved 2022–2026 Socio-Economic Development Strategy.

The main downside risks to the outlook include the risk of reversals of money transfers from Russia and trade rerouting, which has benefited the Azerbaijani transport sector following the war in Ukraine. Upside risks in the medium-term include higher-than-forecasted energy prices and a potential ramp up of natural gas exports to the EU.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-4.3	5.6	4.6	2.2	2.5	2.6
Private Consumption	-5.1	7.0	4.9	4.0	3.6	3.6
Government Consumption	4.8	3.8	7.4	4.2	3.1	3.1
Gross Fixed Capital Investment	-7.1	-6.0	4.5	3.2	3.3	3.3
Exports, Goods and Services	-8.1	5.6	3.3	0.8	1.6	1.8
Imports, Goods and Services	-10.5	2.5	3.2	2.7	2.7	2.7
Real GDP growth, at constant factor prices	-4.4	5.6	4.6	2.2	2.5	2.6
Agriculture	1.9	3.3	3.4	3.2	3.0	3.0
Industry	-5.2	4.1	2.4	0.5	1.0	1.2
Services	-4.4	8.6	8.5	4.7	4.5	4.6
Inflation (Consumer Price Index)	2.8	6.7	13.8	8.5	6.2	5.4
Current Account Balance (% of GDP)	-0.5	15.2	26.5	19.2	14.8	13.0
Net Foreign Direct Investment Inflow (% of GDP)	-1.5	-4.1	-1.5	-1.0	-1.0	-0.9
Fiscal Balance (% of GDP)	-6.5	4.2	5.5	4.8	4.0	3.0
Revenues (% of GDP)	33.7	36.5	32.4	33.1	33.1	31.6
Debt (% of GDP)	18.4	16.2	11.7	10.9	10.8	11.0
Primary Balance (% of GDP)	-5.7	4.8	5.9	5.1	4.3	3.3
GHG emissions growth (mtCO2e)	-1.4	0.9	1.3	0.3	1.0	1.7
Energy related GHG emissions (% of total)	62.6	64.0	64.4	64.3	64.5	64.8

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	2022
Population, million	9.3
GDP, current US$ billion	72.0
GDP per capita, current US$	7732.1
Upper middle-income poverty rate ($6.85)[a]	1.3
Gini index[a]	24.4
School enrollment, primary (% gross)[b]	94.2
Life expectancy at birth, years[b]	74.2
Total GHG emissions (mtCO2e)	57.2

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

Real output dropped by 4.7 percent in 2022 after 2.4 percent growth the year before, largely due to an adverse impact of sanctions. Households' real income declined. As the economy was adjusting to the new environment, trade and financial dependence on Russia increased. Inflation picked up significantly and the government resorted to administrative price controls to bring it down to 15.2 percent.

Key conditions and challenges

Belarus' economy completed 2022 in a recession with the steepest GDP decline recorded in the last twenty years. The economy was adjusting to economic sanctions introduced after the disputed 2020 elections and in response to Belarus' involvement in Russia's invasion of Ukraine. As businesses were exploring new export transportation routes, supply chains and markets, foreign trade dynamics and patterns changed accordingly. The share of Russia and other CIS countries in total merchandise export destinations increased from 60 to 68 percent over one year, while the non-CIS share dropped to 32 from 40 percent. The share of merchandise imports did not change substantially. To offset the repercussions of sectoral economic sanctions and other restrictions, the Belarusian authorities increasingly relied on economic support from Russia. The agreements included: (i) securing preferential gas prices, which are close to domestic prices in Russia, to contain production costs in industry and heating tariffs for households; (ii) obtaining compensation from Russia for the 'tax maneuver' to lower the price of imported crude oil and increasing sales of refinery products to the Russian market; and (iii) using Russian ports and other facilities to reroute export flows.

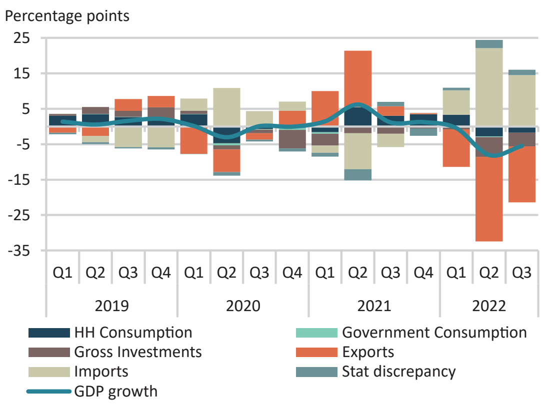
Sanctions against the financial sector limited the possibility to borrow from abroad. The government's decision to service Eurobonds in local currency instead of US$ (including a US$800 million Eurobond repayment in end-February 2023) resulted in a sovereign ratings downgrade to 'RD'. Belarus reached an agreement with Russia to defer repayments totaling US$ 1.4 billion on bilateral loans from 2022-23 to 2028-33 and on the Nuclear Power Plant loan from 2023 to 2024.

The authorities seek to reinvigorate growth by boosting investments into import-substitution projects implemented jointly with Russia.However, downside risks remain significant as the likelihood of additional economic sanctions is high subject to Belarus' role in the war in Ukraine.

Recent developments

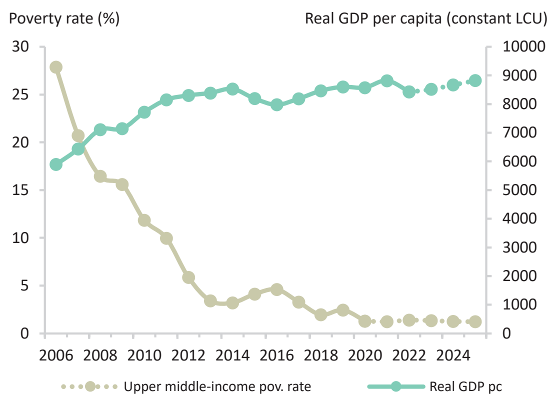
GDP declined by 4.7 percent, vs. 2.4 percent growth in 2021, reflecting a broad-based output contraction in manufacturing, construction, transportation, wholesale, and retail trade due to logistics and supply chain constraints because of sectoral sanctions. ICT, the most rapidly developing sector, recorded for the first time an annual output decline of 2.2 percent (including 10 percent in H2'22) reflecting business relocation and labor outflow. On the expenditure side, domestic demand remained suppressed as final consumption declined and fixed investments contracted by 14.4 percent by Q3 despite falling real interest rates reflecting a highly uncertain business environment.

FIGURE 1 Belarus / Contributions to quarterly GDP growth



Source: World Bank calculations based on Belstat data.

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



Source: World Bank. Notes: see Table 2.

Total exports dropped by 5.4 percent y/y while imports declined by 6.6 percent in nominal US$ terms. As companies reoriented export destinations towards the East, merchandise exports to non-CIS countries plunged by 24 percent y/y while CIS increased by 9.1 percent. Merchandise imports from both destinations dropped, however, imports from non-CIS countries remained more resilient and even increased from selected EU countries. As imports declined faster than exports, foreign trade remained in surplus at 7.5 percent of GDP and supported CA surplus of 4.1 percent of GDP in January to September 2022.

Headline inflation picked up to 18.1 percent in July. To curb inflation, the authorities introduced price regulations for 330 goods and administratively limited mark-ups for importers and retail trade which helped to reduce the CPI to 12.8 percent y/y in December but reduced the availability of a range of selected goods. Average annual inflation reached 15.2 percent in 2022.

Households' real disposable incomes declined by 3.6 percent y/y vs. 2.1 percent growth in 2021. Based on the upper middle-income line of US$6.85 a day (2017 PPP), poverty is low and estimated to have increased slightly in 2022.

Outlook

A weak economic growth is projected for 2023 as the economy will be further adjusting to an environment shaped by sanctions. A small uptick in economic activity will be supported by a projected recovery in the petrochemical sector, machinery and food processing industries which are oriented towards the Russian market or have established export routes through Russia. Accommodating monetary policy to support credit expansion and import-substitution projects that are planned to be jointly implemented with and financed by Russian loans would also support some recovery in manufacturing. Supply-side and logistical constraints will still remain and will be partially alleviated by 'parallel' imports. This will still have an adverse impact on producers.

Private sector growth will be affected by tightening business conditions due to changes in the tax code, which imply a 100 percent increase in tax rate paid by self-employed physical persons and individual entrepreneurs, while the simplified tax regime for individual entrepreneurs will be eliminated.

Resuming household income growth will depend on the extent to which economic growth can be maintained in a challenging external environment with constrained fiscal space. Poverty is projected to decrease only marginally in 2023 on the back of weak growth.

The medium-term prospects remain bleak as the downside risks remain significant including the possible introduction of additional sectoral sanctions, possible negative spillovers from the Russian economy, failures to adjust to the sanctions regime, and expansionary domestic policies in a bid to spur growth at the expense of maintaining macroeconomic and financial stability. Also, forecasting is affected by an increasing lack of access to important data, including on fiscal accounts, production and trade of sanctioned commodities, and the structure of foreign reserves.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-0.7	2.4	-4.7	0.6	1.4	1.3
Private Consumption	-1.1	4.9	-1.2	0.2	3.1	3.1
Government Consumption	-2.0	-0.8	-0.1	0.1	0.6	-0.3
Gross Fixed Capital Investment	-3.9	-5.5	-13.3	3.5	2.2	2.5
Exports, Goods and Services	-3.7	10.1	-12.3	3.5	4.0	3.0
Imports, Goods and Services	-7.4	5.7	-11.4	4.5	6.3	5.2
Real GDP growth, at constant factor prices	-0.7	2.4	-4.7	0.6	1.4	1.3
Agriculture	4.8	-4.1	4.4	3.2	2.0	2.6
Industry	-0.4	3.1	-6.2	2.1	2.5	2.3
Services	-1.8	3.0	-5.1	-1.0	0.4	0.3
Inflation (Consumer Price Index)	5.5	9.5	15.2	11.0	10.0	8.0
Current Account Balance (% of GDP)	-0.3	3.1	3.7	-0.1	-0.4	-0.6
Net Foreign Direct Investment Inflow (% of GDP)	2.1	1.9	1.8	1.9	2.0	1.9
Fiscal Balance (% of GDP)	-1.7	0.0	-1.3	-1.1	-0.3	0.0
Revenues (% of GDP)	37.9	37.4	34.7	35.2	35.3	35.1
Debt (% of GDP)	41.1	35.8	38.9	42.1	42.0	41.1
Primary Balance (% of GDP)	0.0	1.7	0.2	0.0	0.7	1.0
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	1.3	1.2	1.4	1.3	1.2	1.2
GHG emissions growth (mtCO2e)	-2.0	-3.5	-7.6	1.0	-1.5	-1.2
Energy related GHG emissions (% of total)	85.7	85.3	85.2	86.3	86.6	86.6

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 2020-HHS. Actual data: 2020. Nowcast: 2021-2022. Forecasts are from 2023 to 2025.
b/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

BOSNIA AND HERZEGOVINA

Table 1	2022
Population, million	3.2
GDP, current US$ billion	23.0
GDP per capita, current US$	7118.9
Life expectancy at birth, years[a]	76.2
Total GHG emissions (mtCO2e)	24.9

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent WDI value (2020).

Real output growth decelerated to 4 percent in 2022 from 7.4 percent the year before largely due to an adverse term of trade shock. The shock accelerated inflation to 14 percent from 2 percent in 2021 and negatively affected welfare, especially for the less well-off. EU candidacy status received in December 2022 could be a catalyst for delayed structural reforms, raising medium-term growth. In 2023, low growth in the EU is expected to dampen economic activity in BiH.

Key conditions and challenges

In December 2022, BiH received EU candidate status. To start the EU accession negotiations, the authorities need to address 14 largely political measures covering democracy, rule of law and fundamental rights, and public administration. In parallel, BiH needs to meet economic criteria that require progress on internal market and state institutional integration, strengthening of state supervisory and regulatory institutions, and reduction of an oversized public sector.

Macroeconomic stability has been maintained over the past decade with the help of three anchors: the currency board linked to the Euro, the state-wide collection of indirect taxes, and EU accession prospects. Macro stability is also enhanced because of fiscal prudence: prior to the pandemic the authorities ran fiscal surpluses between 1 and 3 percent of GDP from 2015 to 2019. The pandemic and post-pandemic period has seen the re-emergence of fiscal deficits, yet public debt levels remain among the lowest in the region, around 35 percent of GDP.

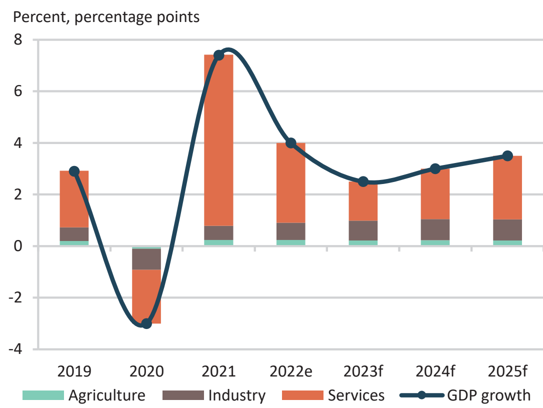
Nevertheless, despite real income growth of 3 percent annually since 2015, per capita GDP has remained at one-third of the EU27 average. Faster economic convergence toward the EU27 average will be difficult to achieve with the country's low investment rates and a growth model that relies heavily on private consumption. Thus, the structural reform agenda needs to gain momentum. Priority reforms include enhancing oversight and management of SOEs, improving the business environment, concluding WTO accession, enhancing employment policies for the youth, reducing the cost of labor, and transitioning to green energy from coal.

Recent developments

Real output growth decelerated to 4 percent in 2022, from 7.4 percent the year before, as a result of two countervailing forces. First, a robust increase in domestic demand of an estimated 6.3 percent driven by private consumption in addition to a surge in investment; and second, adverse terms of trade shock compounded by investment-driven imports, which caused a widening of negative net exports by 26 percent. Private consumption decelerated starting in Q3 of 2022 due to high inflation eroding real disposable income, while on the supply side industrial production growth sharply slowed to 1 percent in 2022.

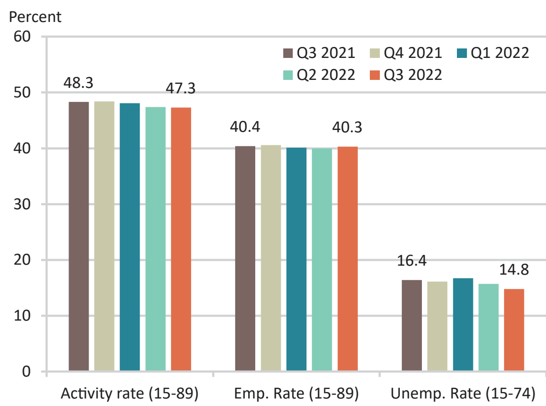
Inflation jumped to 14 percent in 2022 compared to 2 percent in 2021. This sharp rise was driven by surging food and transport prices that grew 22 percent and 26 percent respectively compared to the previous year, and which created challenges for poverty reduction by negatively affecting welfare especially among the poor and vulnerable households. This jump in prices reflected in part the adverse terms of trade shock of a sharp increase in

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 2021-2022 report and World Bank staff calculations.

import prices of processed food and oil products, with the latter feeding into higher prices of other products.

Labor market participation and the employment rate remained unchanged during the first three quarters of 2022, although high unemployment persists at about 14.8 percent, according to LFS Q3.

During 2022, stronger tax revenues supported by high inflation were more than offset by higher spending, which is expected to result in a fiscal deficit of 0.9 percent of GDP in 2022. This compares to a deficit of 0.3 percent of GDP last year, and 5.3 percent of GDP in 2020. Expenditures in 2022 are driven by social measures softening the inflationary impact on households and pre-election spending, including wage hikes, and higher capital expenditures. Nevertheless, public debt remains sustainable at around 35 percent of GDP. Adverse terms of trade and investment-driven imports widened the merchandise trade deficit to 24.4 percent of GDP or by 4.8 percentage points in 2022 compared to the year before. The current account deficit as a result broadened to an estimated 3.1 percent of GDP in 2022 compared to 2.3 percent in 2021. External financing largely entails net FDI inflows and government borrowing.

Outlook

Real GDP is expected to decelerate to 2.5 percent in 2023 as private consumption growth halves due to weakening real disposable income, and negative net exports further deteriorate due to weak output growth in BiH's main export markets. Real output growth is set to reach 3.5 percent by 2025 driven largely by private consumption supported by remittances. Investments in energy and infrastructure are expected to add to the growth stimulus, although not to the same extent as in 2021 and 2022. With general elections completed (October 2022), the attention of policy makers could turn to the structural reform agenda needed for EU accession.

Regarding fiscal policy, phased-out pre-election spending and one-off expenditures in response to the price shock will be in part offset by higher interest payments and the pension hike. That said, a return to fiscal surpluses is expected by 2024.

Inflationary pressures started dissipating toward the end of 2022, and a continuation of this trend is expected in 2023. Nevertheless, inflation is projected to remain around 5 percent in 2023, significantly above pre-pandemic levels. Barring further external shocks, inflation is expected to stabilize in 2024-25 at rates seen prior to the pandemic, at around 2 percent and lower.

Downside risks dominate the outlook. Protracted effects of Russia's invasion of Ukraine could have a negative impact on aggregate demand through depressed consumer and business confidence. Furthermore, war-related uncertainties can dampen the recovery in the EU, adversely impacting demand for BiH exports, except for energy. Adverse labour market developments across the EU could also limit remittances inflows (about 8 percent of GDP), which support private consumption. Inflation, possible lower aggregate demand, and limited remittances inflows create additional challenges for poverty reduction going forward. Finally, geopolitical spillovers could further aggravate domestic political frictions with adverse consequences for the much-needed structural reform push.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-3.3	7.1	4.0	2.5	3.0	3.5
Private Consumption	-4.5	4.0	3.0	2.3	2.5	2.8
Government Consumption	0.5	6.1	2.7	0.5	0.3	0.5
Gross Fixed Capital Investment	-22.0	33.3	19.7	3.5	3.4	2.7
Exports, Goods and Services	-8.5	5.0	9.9	7.0	6.8	6.9
Imports, Goods and Services	-13.4	8.0	12.0	5.0	4.0	3.7
Real GDP growth, at constant factor prices	-3.0	7.4	4.0	2.5	3.0	3.5
Agriculture	-1.5	3.4	3.5	3.3	3.3	3.2
Industry	-3.0	2.0	2.6	3.0	3.2	3.2
Services	-3.2	10.1	4.6	2.2	2.9	3.6
Inflation (Consumer Price Index)	-1.1	2.0	14.0	5.0	2.1	1.9
Current Account Balance (% of GDP)	-4.0	-2.3	-3.1	-5.1	-5.2	-4.9
Net Foreign Direct Investment Inflow (% of GDP)	2.0	3.3	3.0	3.2	3.5	3.4
Fiscal Balance (% of GDP)	-5.3	-0.3	-0.9	0.1	0.8	1.0
Revenues (% of GDP)	41.6	43.5	39.8	39.6	39.6	39.3
Debt (% of GDP)	40.3	38.0	35.9	35.8	35.5	35.1
Primary Balance (% of GDP)	-4.0	1.0	-0.1	0.9	1.6	1.8
GHG emissions growth (mtCO2e)	-4.6	4.5	2.2	1.3	1.6	1.6
Energy related GHG emissions (% of total)	86.3	86.5	86.6	86.6	86.7	86.7

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	2022
Population, million	6.8
GDP, current US$ billion	89.0
GDP per capita, current US$	13135.3
International poverty rate ($2.15)[a]	0.2
Lower middle-income poverty rate ($3.65)[a]	1.4
Upper middle-income poverty rate ($6.85)[a]	4.5
Gini index[a]	40.5
School enrollment, primary (% gross)[b]	85.2
Life expectancy at birth, years[b]	73.6
Total GHG emissions (mtCO2e)	50.1

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent WDI value (2020).

Following robust growth in 2022, the Bulgarian economy is set to slow down in line with EU trends. Inflation is expected to decelerate in 2023 but remain elevated. The fiscal position will likely worsen given the growth deceleration and rollover of government support measures. Political instability is already taking its toll on the prospects of absorption of EU funds and eurozone accession plans. Poverty reduction is expected to slow down as Bulgaria faces slower growth and prolonged elevated inflation.

Key conditions and challenges

Bulgaria's economic growth had slowed markedly in the decade before the Covid-19 pandemic. The country's growth potential is constrained by adverse demographic trends that result in a rapid decline in its working-age population. This, coupled with a relatively low number of years in schooling and declining quality of education as measured by international assessments, has been undermining Bulgaria's growth prospects. In addition, private sector expansion has been hindered by institutional weaknesses and insufficient enforcement of fair competition, which leads to resource misallocation away from the most productive firms. Public investment management is also suboptimal, particularly in ensuring investment efficiency and open and fair competition in public procurement. If Bulgaria succeeds in overcoming these challenges with an ambitious reform agenda, it could accelerate its economic growth to above 4 percent in the period up to 2050. Under a no-reform scenario, however, growth may slow down to 1.2 percent by the middle of the century.

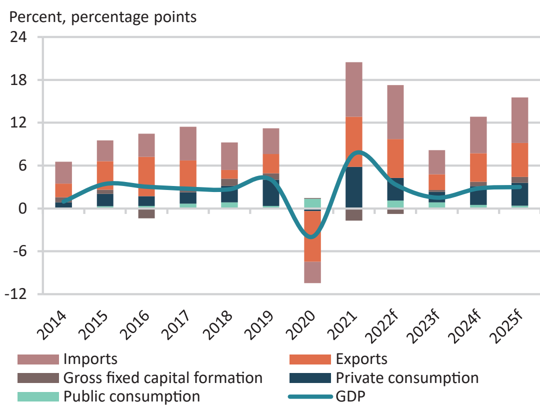
Bulgaria's development path has not been inclusive enough. Despite significant poverty reduction, poverty rates continue to be high by EU standards. Poverty incidence (US$6.85 2017 PPP) declined by 9.6 percentage points in 2015-2020, reaching 4.5 percent in 2020. Inequality has been increasing, and the country has the highest income inequality in the EU, with a Gini Index (of equivalized disposable income) of 39.7 in 2020. The at-risk-of-poverty rate (AROP) has shown an upward trend, with 22.1 percent of the population falling below the national poverty line in 2020 (income year), one of the highest in the EU. Regional disparities, and sizable differences across groups, such as Roma and women, are still highly prevalent. High inequality is linked to persistent disparities in labor market outcomes, inadequate coverage of the social protection system, and a fiscal system characterized by limited progressivity.

Recent developments

GDP growth exceeded expectations in 2022, as the economy expanded by 3.4 percent. Even if the deceleration of growth continued in Q4, the economy proved to be more resilient in 2022 than earlier forecasted. Throughout the year, the main growth driver remained final consumption on the back of labor market buoyancy and increased government spending. In 2022, the labor market recovered to its pre-Covid level, with employment reaching 54.9 percent in Q4/2022, and unemployment down to 3.9 percent against the backdrop of labor scarcity.

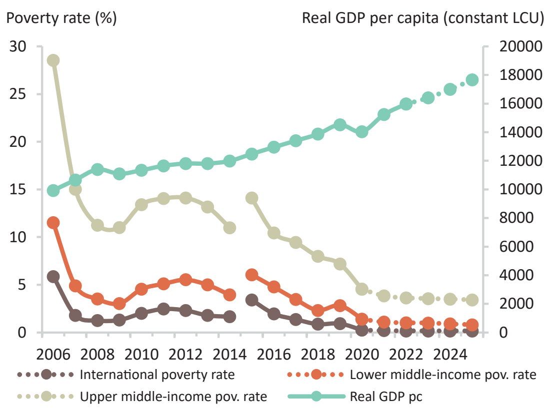
Bulgaria recorded one of the highest inflation rates among EU countries in 2022, with annual average CPI inflation reaching 15.3 percent. Imported inflation through higher energy and food prices

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



Source: World Bank.

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



Source: World Bank. Notes: see Table 2.

after Russia's invasion of Ukraine was the key factor. While headline CPI inflation (in y/y terms) started decelerating in October 2022, core inflation (food and energy excluded) went down only in January, 2023, to 12.2 percent y/y. Although y/y CPI inflation surpassed nominal wage growth in most months of 2022, the gap was less than 2 percentage points on average for the year, which helped contain the impact on the real purchasing power of workers. Moreover, the significant boost to pensions in response to the Covid-19 crisis and inflation – by between 56 percent and 136 percent in 2022 depending on the pension type - supported real incomes of pensioners. Nevertheless, food price inflation – 22 percent on average in 2022 - disproportionately impacted poorer households as they spend significantly higher shares of their income on food items.

The fiscal deficit in 2022 surprised on the positive side, reaching 0.8 percent of GDP on cash basis. The accrual-basis deficit was estimated by the Ministry of Finance at 0.1pp below the 3 percent EU ceiling. While current expenditure grew substantially on Covid-19 and inflation-mitigation measures, the deficit was contained due to the revenue-boosting impact of inflation and underperformance on capital spending. The receipt of the first tranche under the National Recovery and Resilience Plan (NRRP) also raised revenues, while not resulting in corresponding expenses due to its late-year arrival. Separately, the current account deficit remained marginal thanks to strong surplus on services trade.

Outlook

Bulgaria's economy is expected to slow down substantially in 2023 – to 1.5 percent - in tune with the downward trend in the eurozone. Growth may be further suppressed if Bulgaria fails to deliver on the reforms embedded in the milestones under the NRRP, resulting in a freeze or reduction of upcoming tranches, depriving the country of substantial resources.

Inflation will continue to subside but remain elevated in 2023. The fiscal deficit is projected to expand to 3.6 percent of GDP due to the economic slowdown and the rollover of fiscal discretionary measures to 2023. The current account is projected to move to a slight surplus in 2024-2025 due to expected downward adjustment of import prices of key raw materials.

Bulgaria's outlook continues to be marred by prolonged political instability. In addition to creating an unpredictable business environment, the political impasse is already impeding the implementation of reforms, the NRRP and eurozone accession plans. The lack of a working parliament has prevented the passage of key pieces of legislation, set as milestones under the NRRP and as commitments under the country's roadmap for euro adoption. Should this situation linger on, the country may lose EU funds and may delay its eurozone entry beyond the likely 2025, which would take a toll on its growth prospects and slow down convergence to average EU income levels.

The economic slowdown and prolonged inflationary pressures are expected to decelerate poverty reduction, with poverty ($6.85/day PPP) declining slowly, from 4.5 percent in 2020 to 3.6 and 3.5 percent in 2022 and 2023, respectively.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-4.0	7.6	3.4	1.5	2.8	3.0
Private Consumption	-0.6	8.8	4.8	2.2	3.9	4.7
Government Consumption	8.3	0.4	6.5	4.8	2.7	2.1
Gross Fixed Capital Investment	0.6	-8.3	-4.3	1.6	3.8	5.1
Exports, Goods and Services	-10.4	11.0	8.3	3.2	5.7	6.6
Imports, Goods and Services	-4.3	10.9	10.5	4.4	6.5	7.8
Real GDP growth, at constant factor prices	-4.0	8.0	3.4	1.5	2.8	3.0
Agriculture	-3.3	28.8	-0.8	0.2	1.5	1.2
Industry	-8.2	1.7	12.5	3.9	6.5	5.2
Services	-2.5	8.7	0.8	0.8	1.6	2.3
Inflation (Consumer Price Index)	1.7	3.3	15.3	8.7	4.8	3.7
Current Account Balance (% of GDP)	0.0	-0.5	-0.4	-0.3	0.6	0.9
Net Foreign Direct Investment Inflow (% of GDP)	4.5	1.4	2.2	1.9	2.7	3.0
Fiscal Balance (% of GDP)	-2.9	-2.7	-0.8	-3.6	-2.5	-1.4
Revenues (% of GDP)	36.8	37.7	39.2	37.6	38.6	39.4
Debt (% of GDP)	24.6	23.9	19.3	21.5	20.4	19.6
Primary Balance (% of GDP)	-2.4	-2.3	-0.4	-3.4	-2.2	-1.2
International poverty rate ($2.15 in 2017 PPP)[a,b]	0.2	0.2	0.2	0.2	0.2	0.2
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	1.4	1.1	1.0	1.0	0.9	0.8
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	4.5	3.8	3.6	3.6	3.5	3.4
GHG emissions growth (mtCO2e)	-4.2	6.5	6.0	2.3	4.1	3.7
Energy related GHG emissions (% of total)	80.4	77.7	75.7	74.0	72.1	70.5

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-EU-SILC. Actual data: 2020. Nowcast: 2021-2022. Forecasts are from 2023 to 2025.
b/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

CROATIA

Table 1	2022
Population, million	3.9
GDP, current US$ billion	71.0
GDP per capita, current US$	18368.9
International poverty rate ($2.15)[a]	0.3
Lower middle-income poverty rate ($3.65)[a]	0.8
Upper middle-income poverty rate ($6.85)[a]	2.1
Gini index[a]	29.6
School enrollment, primary (% gross)[b]	92.9
Life expectancy at birth, years[b]	77.7
Total GHG emissions (mtCO2e)	19.5

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent WDI value (2020).

Real GDP growth in Croatia remained strong in 2022, with favorable developments concentrated in the first half of the year. The country is expected to avoid contraction in 2023 but growth is set to be subdued before strengthening in 2024. Fiscal deficit is projected to remain relatively contained ensuring further decline in public debt. Progress in poverty reduction has slowed with the poverty rate expected to have declined modestly to 1.4 percent in 2022.

Key conditions and challenges

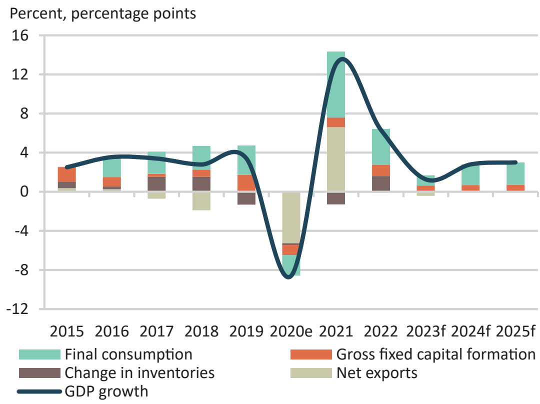
By entering the euro area and Schengen zone in 2023 Croatia has achieved its key strategic objectives but economic convergence is far from complete. GDP per capita (in Purchasing Power Parity nominal terms) reached 70 percent of the average EU27 level in 2021 and further improvements in living standards will critically depend on productivity improvements. Croatia's productivity is lagging its regional peers and is far from the EU frontier. This reflects low levels of Research & Development (R&D) investments, innovation and technology adoption, weaknesses in managerial and organizational practices, and constraints on competition. In addition, while institutions have improved, some lingering structural constraints remain, especially regarding administrative capacity, red tape, and judicial quality and efficiency. Closing the productivity gap with the top performing EU economies would markedly speed up income convergence but this will require an ambitious and comprehensive set of reforms aimed at strengthening institutions, reducing market inefficiencies, and upgrading firms' capabilities.

Over the short and medium term, the main risks include the elevated uncertainty due to Russia's invasion of Ukraine and related developments in wholesale energy and food prices and their pass-through to retail prices. Risks of energy supply disruptions in Croatia and its main trading partners also remain elevated and could lead to lover economic growth if they would materialize. In general, intensification of geopolitical tensions would further amplify commodity disruptions and supply bottlenecks leading to adverse real income and confidence effects. Inflation could also remain higher and more persistent than currently expected requiring stronger than projected monetary tightening with negative effects on the eurozone and the domestic economy. Furthermore, investment projection growth for 2023 largely relies on strong utilization of EU funds by the government, which will depend on improving the absorption capacity of all stakeholders. On the upside, greater resilience of private sector and stronger than expected demand for tourism could strengthen the growth outlook.

Recent developments

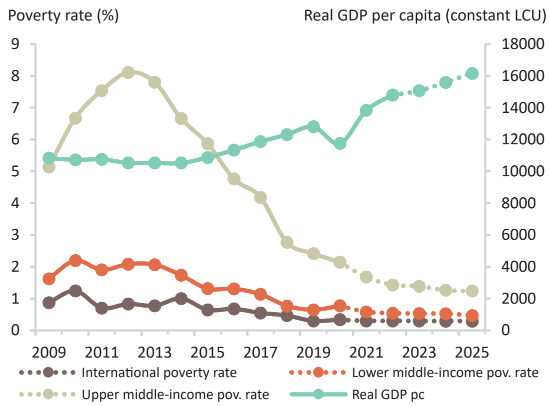
Croatia's real GDP growth in 2022 was strong, at 6.3 percent, supported by robust personal consumption and investments. Favorable developments were, however, concentrated in the first half of the year. Rising inflation, decline in real disposable incomes, and elevated uncertainty surrounding Russia's invasion of Ukraine led to a sharp decline in personal consumption at the end of the year. Exports of goods and services also moderated following negative external developments. However, investment activity held up relatively well, despite rising financing costs. Weakening

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.

of aggregate demand was reflected in manufacturing, which showed negative quarterly growth rates at the end of the year, while construction activity continued to expand. In 2022, employment growth continued, and the labor market remained relatively tight, but wages failed to keep up with rising inflation. Consumer prices in Croatia accelerated throughout 2022, with year average inflation of 10.7 percent. Price pressures somewhat eased at the beginning of 2023 with moderation in energy and food prices. Croatian authorities prevented stronger spillovers from high wholesale energy prices on CPI by adopting relatively generous stimulus packages at the beginning of the fourth quarter last year. Nonetheless, the budget is estimated to have been broadly balanced in 2022, a significant improvement from 2021. This mainly reflects strong growth in revenues and discontinuation of COVID-19 support schemes. Economic growth and fiscal adjustment led to a marked decline in public debt, which is estimated to have declined to around 68 percent of GDP at the end of 2022.

The rebound of the labor market combined with the government's assistance, supported household income. Poverty is estimated to have declined modestly from 1.7 percent in 2021 to 1.4 percent in 2022. However, rising inflation dampened households' purchasing power, especially for the poorest. Namely, those at the bottom quintile of the income distribution faced estimated inflation that was 2 percentage points higher than those at the top quintile due to the composition of their consumption basket.

Outlook

Growth in Croatia is projected to decelerate to 1.3 percent in 2023 before strengthening to 2.8 percent in 2024. Personal consumption growth in 2023 is expected to slow down but is projected to remain positive as real incomes improve, supported by a catch-up in real wage growth, resilience of labor markets, and continued fiscal support. At the same time, investment growth is expected to be underpinned by a pick-up in government investments, largely financed from EU funds, while, on the other hand, rising financing costs are projected to dampen private sector investments. Despite worsening of the external outlook, exports are also expected to grow further as demand for travel remains strong. Beyond the near term, Croatia's economic growth is set to gradually recover from a weak 2023 as uncertainty declines, the energy market price pressures fade, remaining supply bottlenecks are resolved, and the external outlook improves. Further strengthening of economic activity is expected to have positive effects on labor market developments, with employment growth picking up, and unemployment rate declining to below 6.5 percent in 2025. This also means that the labor market is expected to remain tight, especially in construction and services sectors. Notwithstanding labor supply shortages, inflation is projected to gradually decline over the forecast horizon towards ECB's target level of close to 2 percent, following tightening of monetary policy and unwinding of supply-side constraints. The fiscal balance might slightly worsen compared to 2022, averaging -1.3 percent of GDP over the forecast horizon, but will continue to support a decline in public debt that will fall below 60 percent of GDP in 2025.

Progress in poverty reduction is projected to stall with the poverty rate expected to stay stagnant in 2023 before declining marginally over the next two years, to 1.2 percent in 2025.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-8.6	13.1	6.3	1.3	2.8	3.0
Private Consumption	-5.1	9.9	5.2	1.1	2.8	3.0
Government Consumption	4.3	3.0	3.0	2.0	2.4	2.7
Gross Fixed Capital Investment	-5.0	4.7	5.8	3.2	2.9	3.2
Exports, Goods and Services	-23.3	36.4	25.4	3.6	4.9	4.2
Imports, Goods and Services	-12.4	17.6	25.0	4.2	4.6	4.0
Real GDP growth, at constant factor prices	-7.5	12.6	6.5	1.3	2.8	3.0
Agriculture	-0.2	8.2	6.0	2.5	2.5	2.5
Industry	-4.1	9.0	2.3	1.0	3.0	3.0
Services	-9.1	14.2	8.0	1.3	2.8	3.1
Inflation (Consumer Price Index)	0.2	2.6	10.7	7.2	3.2	2.3
Current Account Balance (% of GDP)	-0.5	1.8	-1.8	-1.4	-0.8	0.3
Net Foreign Direct Investment Inflow (% of GDP)	1.4	4.8	5.2	4.5	4.1	4.0
Fiscal Balance (% of GDP)	-7.3	-2.6	0.2	-1.5	-1.3	-1.1
Revenues (% of GDP)	46.7	45.9	44.8	44.0	43.0	42.2
Debt (% of GDP)	87.0	78.4	67.5	63.3	60.7	58.5
Primary Balance (% of GDP)	-5.3	-1.1	1.4	-0.3	0.0	0.1
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]	0.8	0.6	0.5	0.5	0.5	0.5
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	2.1	1.7	1.4	1.4	1.3	1.2
GHG emissions growth (mtCO2e)	-5.9	9.8	5.4	0.7	0.3	0.1
Energy related GHG emissions (% of total)	88.4	88.6	88.5	88.1	87.6	87.0

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-EU-SILC. Actual data: 2020. Nowcast: 2021-2022. Forecasts are from 2023 to 2025.
b/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

GEORGIA

Table 1	2022
Population, million	3.7
GDP, current US$ billion	24.6
GDP per capita, current US$	6657.6
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]	100.8
Life expectancy at birth, years[b]	72.8
Total GHG emissions (mtCO2e)	18.1

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

Growth is estimated at 10.1 percent in 2022 due to strong money inflows from Russia and recovery in tourism and investment. As a result, employment recovered and poverty continued to fall. Strong revenue collection contributed to the halving of the fiscal deficit. Growth is expected to slow down in 2023 while uncertainty remains high.

Key conditions and challenges

Georgia has made much progress over the past decade. As a result of sound economic management, GNI per capita converged toward EU levels, increasing from USD 3,048 in 2010 to USD 4,608 in 2021 (constant 2015 USD). The poverty rate (measured by the national poverty line) was more than halved over the same period.

Nevertheless, structural challenges persist, notably weak productivity and limited high-quality job creation. More than a third of all workers are engaged in low-productivity agriculture. Poor learning outcomes and lack of skills also constitute a barrier to private sector growth. Because of its trade openness and reliance on tourism, Georgia is vulnerable to external shocks. High dollarization and persistent dependence on external savings increase the risks associated with foreign exchange depreciation. Nevertheless, the swift post-pandemic rebound and the recovery from the initial impact of Russia's invasion of Ukraine and related sanctions have demonstrated growing economic resilience, supported by sound macroeconomic management. The application for EU candidacy initiated in 2022 provides opportunities for further income convergence while requiring significant and sustained reforms, which if not undertaken, could lead to further tensions.

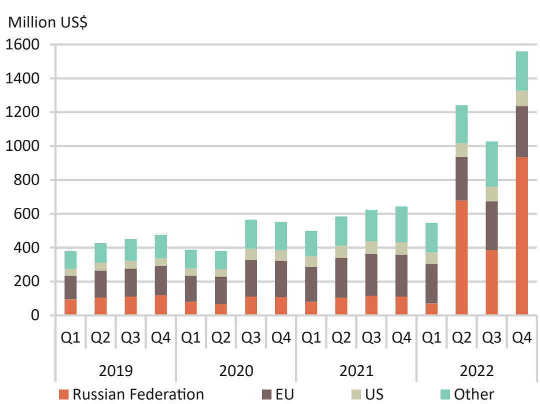
Recent developments

Growth in 2022 is estimated at 10.1 percent, buoyed by a surge in money transfer inflows (up 86 percent, yoy), largely from Russia, and by the recovery of tourism. Investment, on a downward trend since 2019, recovered in 2022. However, in the face of high inflation, private consumption fell slightly in real terms.

Inflation eased in Q4 2022 as global food and energy prices declined. Some demand-side pressures persisted. High rental rates (up 37.4 percent, yoy) and food prices (up 16 percent, yoy) accounted for almost 70 percent of the 9.8 percent headline inflation (eop), stimulated by the large inflows of money and people following the war in Ukraine. Since March 2022, the National Bank of Georgia has kept the monetary policy rate unchanged at 11 percent.

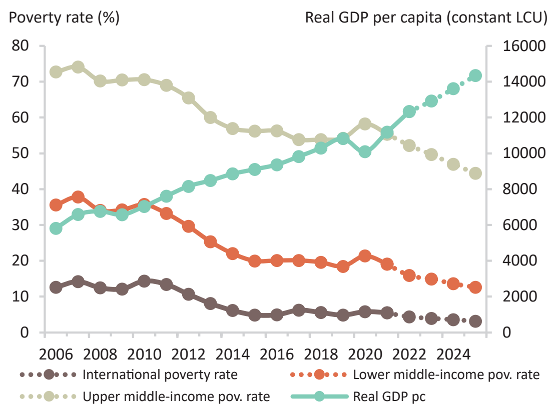
The current account deficit is estimated to have narrowed sharply in 2022 in response to robust growth in remittances, tourism proceeds, and exports of goods. Exports grew by 31.8 percent (yoy) in nominal terms (USD), driven by re-exports of used cars, and favorable market prices for Georgia-produced raw materials (copper and nitrogen fertilizers). Imports also expanded strongly with a 33.8 percent increase (yoy), driven by strong growth in food and fuel imports and capital goods. International reserves benefited from strong foreign exchange inflows, increasing to USD 4.9 billion, providing around 4.3 months of import cover.

FIGURE 1 Georgia / Money inflow by country of origin



Source: National Bank of Georgia.

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



Source: World Bank. Notes: see Table 2.

Strong growth supported fiscal revenues in 2022, which increased by 28 percent in nominal terms. Meanwhile, current spending grew by 9.1 percent (yoy). A key driver of fiscal consolidation in 2022 was the unwinding of COVID-19-related measures, including temporary social programs. Capital expenditure went up by 27.7 percent in 2022 in nominal terms. As a result, the fiscal deficit narrowed to 3.5 percent of GDP in 2022. Public debt stock continued to fall, largely benefiting from the contained fiscal deficit and the appreciation of the GEL.

Against this backdrop, the poverty rate (at USD 6.85 a day, 2017 PPP terms) is estimated to fall to 52.2 percent in 2022. While food inflation adversely impacted poorer households (including the elderly and Targeted Social Assistance recipients), social protection measures helped to soften the negative impact for households in extreme poverty.

Outlook

Growth is expected to ease to 4.4 percent in 2023, reflecting a projected slowdown among trading partners and tightened financial conditions. Growth is expected to stabilize at around 5 percent of GDP for 2024–25 as Georgia benefits from the recovery of trading partners.

Despite continued pressures likely on the demand side, inflation is expected to fall gradually. In the medium-term, as global commodity prices ease, positive real interest rates and the Government's fiscal consolidation efforts are all likely to support a more sustainable return to the inflation target of 3 percent by 2025. Monetary policy is expected to remain tight until inflationary pressures subside.

The economic recovery suggests that prospects for poverty reduction are promising. The overall poverty rate is expected to decline, driven by higher wages and improvements in the labor market.

Despite the widening trade deficit, the current account deficit is expected to remain contained in 2023. Windfalls from the war in Ukraine are expected to stabilize in 2023 and subside in 2024, but the current account deficit should remain well below pre-war levels because of the continued recovery in tourism, a flexible exchange rate policy, and continued efforts to improve Georgia's export competitiveness.

The 2023 state budget law reflects the Government's commitment to fiscal consolidation and improved fiscal discipline by reducing the deficit and public debt to 2.9 percent and 38.7 percent of GDP, respectively. To boost revenue collection, the authorities are committed to the rationalization of tax expenditures, which, together with a reduction in recurrent spending, will contribute to fiscal consolidation.

There are substantial risks to the outlook, reflecting the war in Ukraine and broader uncertainties. Monetary tightening in advanced economies, or a reversal in money inflows, could hinder growth, put pressure on the currency, and increase debt levels and financing needs. Currency mismatches due to dollarization and a high exchange-rate pass-through would also exacerbate vulnerability to currency depreciation. On the upside, tighter monetary and fiscal policy, with adequate buffers, is expected to help cushion a potential shock, while exchange rate flexibility would help shield reserve levels by supporting an adjustment in imports.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-6.8	10.5	10.1	4.4	5.0	5.0
Private Consumption	8.8	8.7	-1.8	2.0	2.5	3.0
Government Consumption	7.1	7.7	0.7	9.8	4.9	4.8
Gross Fixed Capital Investment	-16.5	-12.6	44.6	9.6	4.5	9.0
Exports, Goods and Services	-37.6	24.3	25.6	2.5	11.0	10.0
Imports, Goods and Services	-16.6	11.2	10.0	3.0	5.9	7.8
Real GDP growth, at constant factor prices	-6.6	10.4	10.1	4.4	5.0	5.0
Agriculture	8.1	0.1	2.0	4.0	4.0	2.0
Industry	-6.8	5.9	8.0	4.0	5.0	5.0
Services	-8.1	13.0	11.6	4.5	5.1	5.3
Inflation (Consumer Price Index)	5.2	9.6	11.9	6.6	3.5	3.0
Current Account Balance (% of GDP)	-12.5	-10.4	-3.0	-4.6	-5.1	-5.0
Net Foreign Direct Investment Inflow (% of GDP)	3.6	4.9	7.5	4.0	4.7	5.5
Fiscal Balance (% of GDP)	-9.8	-7.1	-3.5	-2.9	-2.3	-2.1
Revenues (% of GDP)	25.2	25.2	27.0	25.8	25.9	25.8
Debt (% of GDP)	60.1	49.6	41.3	38.7	38.0	37.3
Primary Balance (% of GDP)	-8.2	-5.7	-2.4	-1.6	-1.2	-1.1
International poverty rate ($2.15 in 2017 PPP)[a,b]	5.8	5.5	4.4	4.0	3.5	3.2
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	21.4	19.1	15.9	14.9	13.6	12.6
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	58.3	55.4	52.2	49.7	47.0	44.4
GHG emissions growth (mtCO2e)	-3.4	2.1	4.1	3.9	1.4	0.8
Energy related GHG emissions (% of total)	53.8	55.0	57.5	59.5	60.5	61.3

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-HIS. Actual data: 2021. Nowcast: 2022. Forecasts are from 2023 to 2025.
b/ Projection using neutral distribution (2021) with pass-through = 0.7 (Low (0.7)) based on GDP per capita in constant LCU.

KAZAKHSTAN

Table 1	2022
Population, million	19.2
GDP, current US$ billion	220.1
GDP per capita, current US$	11476.5
Upper middle-income poverty rate ($6.85)[a]	14.3
Gini index[a]	27.8
School enrollment, primary (% gross)[b]	100.3
Life expectancy at birth, years[b]	71.4
Total GHG emissions (mtCO2e)	228.1

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2017 PPPs.
b/ Most recent WDI value (2020).

The economy grew by 3.2 percent in 2022. However, a surge in inflation has squeezed the real incomes of low-income households and could undermine efforts to reduce poverty. Inflation is expected to moderate and growth momentum to build in 2023. Russia's invasion of Ukraine and geopolitical tensions, with their attendant risks for disruption in oil transportation, pose downside risks for Kazakhstan.

Key conditions and challenges

Since the 2000s, Kazakhstan has seen remarkable economic growth, resulting in a higher living standard and reduced poverty. The country removed trade barriers, privatized a substantial portion of state assets, and opened its energy sector to FDI. Despite this progress, the country still faces profound challenges. Since 2008, average real GDP growth fell to less than 4 percent as productivity gains stalled. This slowing dynamic, coupled with rising living costs, has intensified public discontent over inequality and elite capture, culminating in the violent protests of January 2022.

To renew strong growth, the authorities should prioritize structural reforms that increase competition, reform SOEs, and strengthen the efficiency of public institutions. Since Kazakhstan's economy relies heavily on oil-related revenues, and given the global shift toward decarbonization, the Government should focus on diversifying the economy. The transition to renewable energy needs to be accelerated to ensure a sustainable and resilient economic future. Investing in renewables, implementing carbon taxes, and energy tariff reforms are key areas to achieving this.

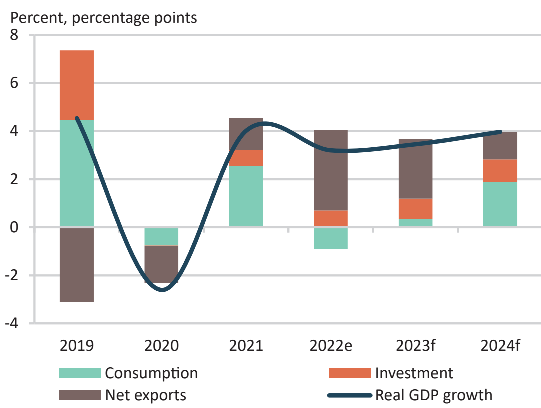
Recent developments

Despite challenges from decreased oil production and supply-chain issues stemming from the country's economic ties with Russia, Kazakhstan recorded 3.2 percent GDP growth in 2022. Growth was driven by non-oil exports to neighboring countries and investment growth of 7.9 percent, primarily in resource sectors, while consumer demand weakened as real incomes shrank under the weight of high inflation. Growth was also supported by an inflow of Russian tourists/immigrants and financial inflows, notably following the announcement of mass conscription in Russia in September. Additionally, following the war in Ukraine, some companies relocated to Kazakhstan, contributing to increased trade with Russia. On the supply side, agriculture, manufacturing, construction, and services sectors all contributed to growth.

The current account recorded a surplus of US$6.2 billion in 2022, supported by high oil export values, a significant reversal from the US$7.9 billion deficit in 2021. The acceleration in FDI was likely due to the high oil prices that drove investment into mining. Gross international reserves grew slightly and stood at 7 months of import cover by end-2022.

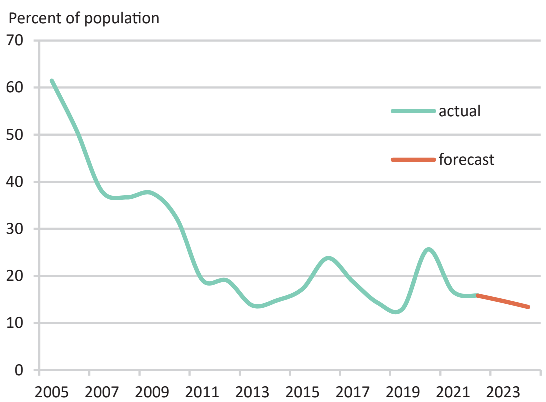
Inflation reached 21.3 percent (yoy) by February 2023, the highest in over 20 years, as a result of rising import prices, the large minimum wage and pay increases following the riots, and the depreciation of the tenge. Food prices have risen especially sharply. The Central Bank (NBK) tightened its policy rate to 16.75 percent in February 2023 from 10.25 percent a year ago. Following a depreciation of 8 percent against the US

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.

dollar in 2022, the tenge has remained stable in 2023.

The Government increased spending in 2022, on measures to alleviate the negative impacts of the war in Ukraine and the rising cost of living. Notably, it increased its welfare-enhancing programs and transfers to local governments by a total of 3 percent of GDP. Despite the higher spending, improved tax collection from both oil and non-oil resulted in higher revenues and delivered a fiscal surplus of 0.4 percent

The banking sector has remained resilient with robust capital and liquidity levels. Prior to the war in Ukraine, Russian subsidiaries held about 15 percent of assets, but, following sanctions, this fell to 0.4 percent. Real corporate loans contracted in December (yoy), while reduced consumer demand moderated lending growth to households. NPL rates reached 3.6 percent in December 2022, slightly up from 3.3 percent a year earlier.

The unemployment rate held steady at 4.9 percent throughout 2022. Labor strikes and a 41 percent increase in the minimum wage drove up real wages by 2.8 percent in Q4 (yoy).

Outlook

The economy is expected to see a moderate increase in growth to 3.5 percent in 2023 and to 4 percent in 2024, led by the hydrocarbons sector as oil production rises thanks to several new projects. Continued FDI in mining and the Government's affordable housing program will sustain investment. However, growth in household consumption is likely to be dampened by high inflation, rising borrowing costs, and increased indebtedness.

Inflation is expected to decrease but will remain elevated in 2023 due to the prolonged impact of high food prices. Tight monetary policy will contribute to a reduction toward the upper limit of its target range by 2025.

The poverty rate is expected to slightly decline to 14.7 percent (at US$6.85/day poverty line) in 2023 as growth picks up and inflation subsides. The rising cost of food and housing will remain as a key factor impacting the well-being of the population, especially the poorest households.

The 2023 budget plans for moderate real spending growth, particularly social welfare and wage increases. The budget is expected to remain balanced, albeit with continued quasi-fiscal activity. The Government plans to reduce withdrawals from the Oil Fund (NFRK) and raise non-oil tax revenue over time.

Oil prices are projected to soften, moderating export earnings and reducing the current account surplus in 2023, but a deficit may follow in subsequent years as oil prices continue to fall.

The outlook faces several downside risks. Any further disruptions to the Caspian Pipeline Consortium, transporting the majority of oil exports, could significantly impact growth. Persistently high inflation also poses a risk, particularly for low-income households. Access to effective coping mechanisms will be important to protect the poverty reduction gains of the last decade. This may call for continued monetary tightening and tighter control over fiscal spending, to make space for higher spending on social protection programs. Additional tightening of global financial conditions and potential capital flow volatility pose risks to the exchange rate. On the upside, global demand and oil prices exceeding expectations would boost growth.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-2.5	4.3	3.2	3.5	4.0	3.6
Private Consumption	-3.8	5.1	-0.9	2.0	4.2	4.0
Government Consumption	12.8	-1.1	-3.8	0.1	0.7	2.0
Gross Fixed Capital Investment	-0.3	2.6	3.0	3.3	4.1	3.7
Exports, Goods and Services	-12.1	2.0	18.0	8.1	5.1	2.2
Imports, Goods and Services	-10.7	-2.7	11.2	3.5	4.1	4.0
Real GDP growth, at constant factor prices	-2.5	4.1	2.9	3.5	4.0	3.6
Agriculture	5.6	-2.2	9.1	3.2	3.5	3.0
Industry	-0.4	3.6	1.0	6.3	5.1	3.1
Services	-4.5	5.0	3.6	1.8	3.2	3.9
Inflation (Consumer Price Index)	6.8	8.0	15.0	9.2	6.1	5.6
Current Account Balance (% of GDP)	-4.4	-4.0	2.7	0.1	-1.4	-1.6
Net Foreign Direct Investment Inflow (% of GDP)	-3.4	-1.0	-3.8	-2.7	-2.7	-2.9
Fiscal Balance (% of GDP)	-6.5	-4.3	0.4	0.2	-0.3	-0.3
Revenues (% of GDP)	18.0	17.6	22.5	21.4	20.3	19.9
Debt (% of GDP)	24.9	23.7	23.0	23.6	25.3	26.8
Primary Balance (% of GDP)	-5.4	-3.1	1.8	1.5	1.1	1.0
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	25.6	16.7	15.8	14.7	13.4	12.1
GHG emissions growth (mtCO2e)	-5.8	-13.0	2.5	2.9	3.8	3.2
Energy related GHG emissions (% of total)	76.0	73.5	74.8	76.1	77.5	78.8

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 2018-HBS. Actual data: 2018. Nowcast: 2019-2022. Forecasts are from 2023 to 2025.
b/ Projection using neutral distribution (2018) with pass-through = 0.7 (Low (0.7)) based on GDP per capita in constant LCU.

KOSOVO

Table 1	2022
Population, million	1.8
GDP, current US$ billion	10.3
GDP per capita, current US$	5759.8
Upper middle-income poverty rate ($6.85)[a]	34.2
Gini index[a]	29.0
Life expectancy at birth, years[b]	76.6

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2017), 2017 PPPs.
b/ Most recent WDI value (2020).

The terms of trade shock driven by Russia's invasion of Ukraine and the associated energy crisis continued to impact economic activity in 2022, but the economy showed resilience. Real GDP growth moderated to 3.5 percent in 2022, supported by private consumption and export growth. Inflation reached record highs, constraining disposable incomes. The inflationary crisis came with a heavy fiscal cost; yet the fiscal balance improved supported by positive revenue performance

Key conditions and challenges

In 2022, GDP growth moderated after an exceptional performance of almost 11 percent in 2021. The negative terms of trade shock driven by the war in Ukraine are weighing on private investment and consumption. Kosovo's growth model relies heavily on remittances that fuel domestic consumption, as well as diaspora-driven service exports and FDI, which proved resilient throughout 2022. More recently, a positive trend in merchandise export growth and diversification was recorded and could be further leveraged to catalyze growth and reduce poverty. Investment is predominantly construction focused and makes a limited contribution to productivity and growth. Kosovo's education and health outcomes still lag peer countries, limiting the contribution of human capital to inclusive growth. The increase in employment over 2021 and formalization gains in 2022 are encouraging; yet, the labor market continues to reflect weaknesses and gender disparities, with just one in three Kosovars employed and approximately 60 percent classified as inactive. Kosovo's power generation options are highly constrained by the limited availability of renewable resources, and heavy reliance on outdated and unreliable lignite-fired powerplants. The duration of the war in Ukraine, and hence the magnitude of its economic and social consequences remains highly uncertain. To cushion the impact of the terms of trade shock, in 2022 the Government provided support through increased transfers and subsidies, including electricity subsidies, equivalent to approximately 4 percent of GDP. Moving forward, the Government needs to ensure that crisis mitigation measures remain targeted and temporary. It also needs to ensure that public spending is balanced between transfers that support consumption today and support for economic transformation that will drive future growth.

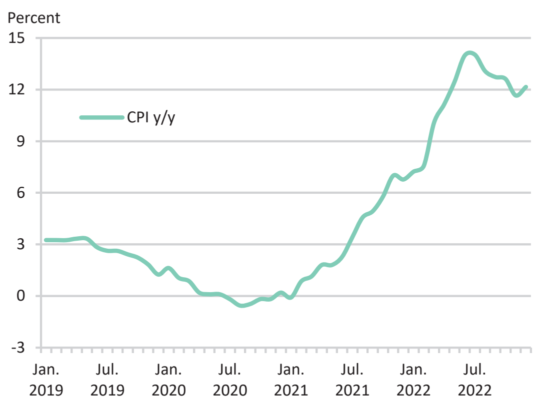
Recent developments

Growth reached 3.5 percent in 2022, driven by exports and private consumption. Consumption was supported by an increase in remittances (6 percent), government transfers (26.3 percent), and lending. On the production side, the construction sector contracted in real terms, contributing to softer growth.

Based on Kosovo's Statistical Agency data, consumer inflation peaked at 14.2 percent (y-o-y) in July, and remained above 11 percent until December, bringing annual average inflation to 11.6 percent. Key inflation drivers in 2022 remained transport (16.9 percent), food (16.3 percent), and energy (12.7 percent).

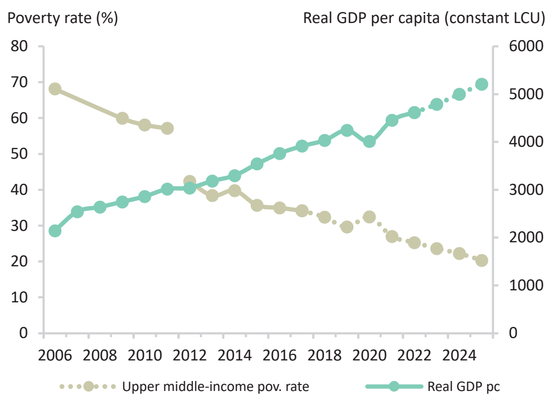
Labor market formalization continued. Pension contribution data show that formal employment increased by 4.9 percent compared to 2021. At the same time, 80.7 thousand jobseekers were registered by

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.

December 2022, a reduction of 1.5 percent from December 2021.

The current account deficit (CAD) deteriorated to 10.1 percent of GDP (from 8.1 percent in 2021), driven by higher import prices, against a large trade deficit of 32.1 percent of GDP. Nominal export growth reached 29.7 percent (y-o-y), supported by services exports associated to the resilient diaspora-driven demand for travel services, but also a 23.6 percent increase in merchandise exports. In parallel, the value of imports grew by 22 percent, on the back of higher prices for mineral products and food and beverages.

By the end of 2022, the fiscal deficit reached 0.5 percent of GDP, reflecting continued positive revenue growth (13.7 percent) supported by inflation effects as well as formalization gains. The combination of positive tax revenue growth and capital underspending outpaced increases in current transfers (26.3 percent y-o-y), associated to the implementation of crisis mitigation measures (4 percent of GDP).

The financial sector remains robust. In December 2022, the annual change in loans reached 16.1 percent. Bank capital buffers and asset quality remain adequate, with non-performing loans remaining stable at 1.8 percent.

Outlook

GDP growth is expected to pick up modestly, reaching 3.7 percent in 2023. The sizable impulse on private consumption and service exports from diaspora flows over 2021 and 2022 is expected to fade against an expected slowdown in EU growth. The contribution of government transfers to private consumption will also be more limited. However, a hike in public wage spending following the implementation of the new Law on Public Wages will add to consumption growth. After recording a real contraction in 2022, investment is expected to provide a positive contribution to growth in 2023. A gradual stabilization in international prices is expected to boost investment confidence.

The medium-term outlook remains positive, with growth expected to accelerate towards potential. However, continued uncertainties related to the war in Ukraine entail significant downside risks.

Poverty is projected to continue its decline, reaching 24.3 percent in 2023, measured using the upper-middle-income poverty line (US$6.85/person/day in 2017 PPP) but the materialization of downside risks could lead to a stagnation of poverty rates.

Inflation is expected to decelerate in line with international price dynamics; yet price levels could remain elevated throughout 2023. Despite an expected slowdown in service exports and remittances growth, easing import price pressures are expected to lead to minor a CAD improvement in 2023.

The fiscal deficit is expected to increase to 1.1 percent of GDP in 2023, fueled by increases in public compensation and capital investment. Further spending needs for energy subsidies could, however, increase the deficit. Over the medium-term, public debt is projected to remain below 25 percent of GDP.

Over the medium-term, there is a pressing need to preserve fiscal buffers by containing spending on untargeted transfers to respond to the changing macroeconomic environment, and accelerate implementation of structural reforms in energy, education, social protection, and healthcare.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-5.3	10.7	3.5	3.7	4.4	4.2
Private Consumption	2.5	7.3	4.0	2.1	3.4	2.7
Government Consumption	2.1	9.0	-0.8	7.0	5.2	4.8
Gross Fixed Capital Investment	-7.6	13.0	-6.9	6.1	5.8	6.2
Exports, Goods and Services	-29.1	76.7	17.2	3.1	3.5	3.7
Imports, Goods and Services	-6.0	31.4	4.9	2.9	3.2	2.9
Real GDP growth, at constant factor prices	-3.6	7.7	3.5	3.7	4.4	4.2
Agriculture	-5.8	-2.5	2.3	2.0	2.2	1.9
Industry	-1.0	7.8	2.0	3.2	4.6	3.9
Services	-4.8	9.4	4.6	4.2	4.6	4.7
Inflation (Consumer Price Index)	0.2	3.4	11.6	6.0	3.3	2.5
Current Account Balance (% of GDP)	-6.6	-8.2	-10.1	-9.7	-9.6	-9.2
Net Foreign Direct Investment Inflow (% of GDP)	4.0	3.8	6.6	5.7	5.5	5.5
Fiscal Balance (% of GDP)	-7.6	-1.3	-0.5	-1.1	-2.3	-2.9
Revenues (% of GDP)	25.4	27.4	27.6	27.9	26.7	26.9
Debt (% of GDP)	22.0	21.2	19.5	19.7	20.5	22.0
Primary Balance (% of GDP)	-7.1	-0.9	-0.1	-0.7	-1.9	-2.5
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	32.4	27.0	25.3	23.6	22.2	20.3

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 2017-HBS. Actual data: 2017. Nowcast: 2018-2022. Forecasts are from 2023 to 2025.
b/ Projection using neutral distribution (2017) with pass-through = 0.7 (Low (0.7)) based on GDP per capita in constant LCU.

KYRGYZ REPUBLIC

Table 1	2022
Population, million	6.8
GDP, current US$ billion	10.9
GDP per capita, current US$	1607.3
International poverty rate ($2.15)[a]	1.3
Lower middle-income poverty rate ($3.65)[a]	18.7
Upper middle-income poverty rate ($6.85)[a]	67.6
Gini index[a]	29.0
School enrollment, primary (% gross)[b]	99.2
Life expectancy at birth, years[b]	71.8
Total GHG emissions (mtCO2e)	14.9

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

Growth in 2022 was stronger than initially expected, driven by consumption, supported by remittance inflows, largely from Russia, and public investment. Inflation increased sharply, and the external position weakened significantly. Fiscal outcomes were favorable thanks to improved revenue performance. Growth is expected to moderate in 2023 and inflation to remain elevated. Driven by higher spending, the fiscal deficit will widen.

Key conditions and challenges

The Kyrgyz Republic has experienced volatile growth in the past decade because of heavy dependency on gold production and remittances and political instability. On average, gold production accounts for 10 percent of GDP and remittances 25 percent of GDP, while development assistance amounts to about 5 percent of GDP.

High global food and fuel prices have increased domestic inflation, adversely affecting poor households. The last two years have also seen significant political and governance upheavals, with snap parliamentary and presidential elections, and political instability continues to hamper the Government's ability to implement reforms. The nationalization of the largest gold producer, Kumtor Gold Company, put a dent in investor confidence although the dispute with the investor was resolved through a peace agreement.

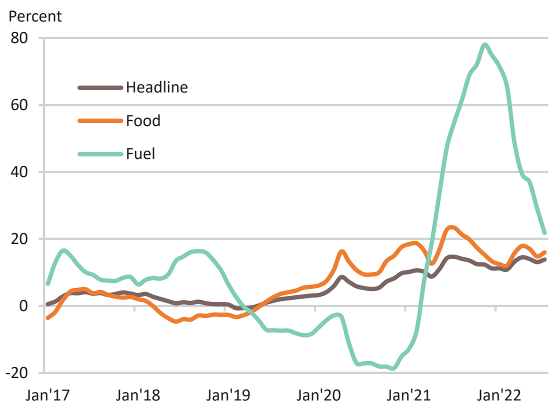
While there has been progress toward fiscal consolidation in recent years, broadening the tax base and improving the efficiency of public spending remain key challenges. The private sector is hindered by excessive bureaucracy. Accelerating economic growth will require stronger institutions and policies to foster private sector growth, spur international trade, and reduce the fiscal burden of the energy sector.

Recent developments

Economic growth reached 7 percent in 2022, which was much stronger than expected prior to Russia's invasion of Ukraine. Robust growth was driven by gold production, agriculture, and the services sector. The latter was supported by trade-related services and additional demand boosted by the relocation of Russian citizens to the Kyrgyz Republic. Non-gold output growth was 5.9 percent. On the demand side, growth was supported by private consumption, with gross remittance inflows increasing by 6.2 percent (in US dollars), and public investment, while net exports contributed negatively.

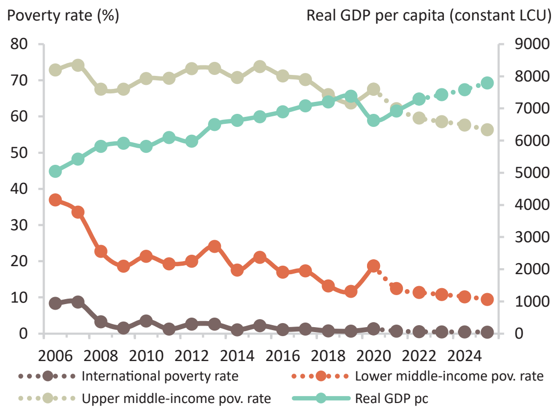
While gold production was strong, gold exports fell by 99 percent as domestic gold was sold to the Central Bank. As a result, the current account deficit is estimated to have widened to 27 percent of GDP from 8.6 percent a year earlier. Total exports are estimated to have shrunk by 31 percent, whereas imports grew by 51 percent, mainly due to increased shipment of goods from China. FDI has been a financing source of the current account deficit. However, a large share of the BOP financing has not been identified, leaving errors and omissions at 30 percent of GDP. The FX market was broadly stable although the Central Bank had to intervene more intensively to avoid sharp fluctuations. Over the year, the nominal Som/USD exchange rate depreciated by only 1.1 percent. In real terms, the effective exchange rate appreciated

FIGURE 1 Kyrgyz Republic / Headline, food and fuel inflation



Source: Kyrgyz authorities.

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



Source: World Bank. Notes: see Table 2.

by an average of 1.2 percent in 2022. International reserves remained unchanged at 4 months of import cover at end-2022. Inflation reached 14.7 percent in 2022. Rising inflation was driven by rises in global food and fuel prices and by higher domestic demand stemming from increased public wages and inflows of Russian citizens. The Central Bank raised its policy rate to 14 percent in March 2022 from 8 percent in December 2021 and reduced it to 13 percent in November, even though inflation remains in double digits. The fiscal deficit increased to 1.4 percent of GDP in 2022 from 0.3 percent a year earlier. The fiscal expansion was less than projected due to strong revenue performance. Tax revenues increased from 24.5 percent to 29.2 percent of GDP due to increased imports and improved tax compliance helped by the installation of cash registers in the retail sector. Expenditures increased from 32.8 percent to 38.4 percent of GDP following significant wage increases for public servants, doctors, teachers, and social workers, and higher capital spending. As a share of GDP, public debt declined to 52 percent in 2022 from 59 percent in 2021.

The poverty rate is estimated to have declined to pre-COVID-19 levels. Public sector salary increases and enhancements to social assistance programs targeting the poor absorbed the negative impact of high food prices on the vulnerable population.

Outlook

GDP growth for 2023 is expected to moderate to 3.5 percent as gold production contracts and agriculture and the services sector experience a slowdown. On the demand side, growth is expected to be supported by consumption and investment while net exports are expected to be negative contributors. GDP is expected to converge to a potential growth rate of 4 percent in the medium-term.

Inflation is expected to remain elevated at about 10 percent in 2023, driven by rising tariffs for electricity and other utilities. Assuming the Central Bank maintains its monetary policy, inflation is projected to moderate gradually to 7 percent by end-2025.

The current account deficit is projected to reach about 14 percent of GDP in 2023 and narrow slightly in 2024–25 as external demand for non-gold goods improves and export of services increases. The deficit is expected to be financed by FDI and external borrowing.

The fiscal deficit is projected to widen in 2023 due to the full year effect of increases in public sector wages and social benefits. However, the fiscal position is expected to be consolidated in 2024–25 due to higher revenues from the mining sector and the containment of expenses on goods and services, and lower capital spending.

High food prices and job insecurity will continue to be the most significant concern for the welfare of the population in 2023. The poverty rate is projected to reduce slightly to 10.8 percent (at the international poverty line of USD 3.65 a day, 2017 PPP) in 2023. Government measures increasing pensions and the scaling up and extension of coverage of social protection programs targeting the poor will help to mitigate adverse effects on the poor.

Risks and uncertainties remain high. The slowdown of the global economy may reduce demand for Kyrgyz export and a further deterioration of the Russian economy may lead to a decline in remittances. The domestic political situation remains sensitive to the upcoming increase in electricity and other utility tariffs.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-8.4	6.2	7.0	3.5	4.0	4.0
Private Consumption	-8.3	20.9	11.6	8.0	5.4	4.3
Government Consumption	0.9	0.4	9.6	0.8	0.0	-0.1
Gross Fixed Capital Investment	-16.2	8.2	22.2	2.2	7.9	13.2
Exports, Goods and Services	-27.3	16.4	-15.9	12.0	12.5	16.7
Imports, Goods and Services	-28.0	39.3	24.0	16.1	12.1	14.3
Real GDP growth, at constant factor prices	-7.4	6.2	7.0	3.5	4.0	4.0
Agriculture	0.9	-5.0	4.4	2.0	2.5	2.5
Industry	-7.0	7.2	10.0	8.7	8.0	8.0
Services	-14.3	16.4	7.7	2.3	3.3	3.1
Inflation (Consumer Price Index)	6.3	11.9	15.2	8.0	6.0	5.8
Current Account Balance (% of GDP)	4.8	-8.6	-27.2	-13.7	-11.4	-10.0
Net Foreign Direct Investment Inflow (% of GDP)	-7.5	6.6	3.8	4.3	4.5	4.5
Fiscal Balance (% of GDP)	-4.2	-0.3	-1.4	-2.7	-2.6	-2.0
Revenues (% of GDP)	30.9	33.6	38.4	35.9	34.3	31.4
Debt (% of GDP)	67.7	59.0	52.0	49.8	49.1	48.1
Primary Balance (% of GDP)	-2.9	1.3	0.0	-1.4	-1.5	-1.0
International poverty rate ($2.15 in 2017 PPP)[a,b]	1.3	0.7	0.5	0.5	0.5	0.4
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	18.7	12.5	11.4	10.8	10.2	9.5
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	67.6	62.2	59.6	58.6	57.7	56.3
GHG emissions growth (mtCO2e)	-2.9	5.1	7.2	7.7	5.7	4.8
Energy related GHG emissions (% of total)	70.4	72.0	73.3	74.3	74.7	74.7

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-KIHS. Actual data: 2020. Nowcast: 2021-2022. Forecasts are from 2023 to 2025.
b/ Projection using neutral distribution (2020) with pass-through = 0.7 (Low (0.7)) based on GDP per capita in constant LCU.

MOLDOVA

Table 1	2022
Population, million	2.6
GDP, current US$ billion	14.4
GDP per capita, current US$	5533.7
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]	14.4
Gini index[a]	25.7
School enrollment, primary (% gross)[b]	107.8
Life expectancy at birth, years[b]	70.2
Total GHG emissions (mtCO2e)	13.3

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

The Moldovan economy has been severely affected by Russia's invasion of Ukraine and a surge in inflation. GDP have contracted by 5.9 percent and inflation to have reached an average of 28.7 percent in 2022. The short-term outlook hinges on the evolution of the war in Ukraine and its ramifications on global commodity markets, particularly energy and weather conditions, while longer-term prospects depend on the unfinished structural reform agenda.

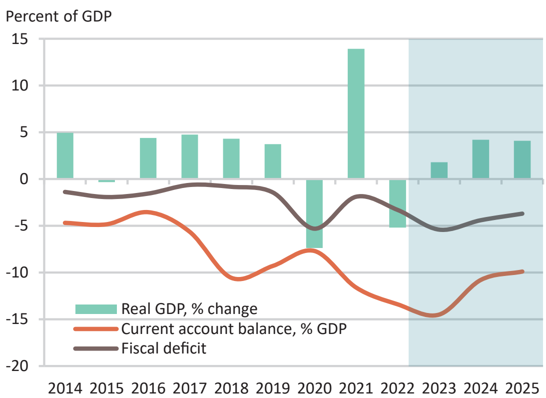
Key conditions and challenges

Moldova has been overtaken by the spillovers of the war in Ukraine, including the energy and refugee crises. Despite the efforts to mitigate the impact of the crises with a forceful fiscal impulse and swift monetary stance, private consumption was restrained by the erosion of households' disposable income and private investments by the uncertainty and challenging financial conditions, causing the economy to plunge into a recession in 2022. The medium-term outlook will be influenced by the ability of the Government to mitigate the households' eroding purchasing power while keeping the momentum on the reform program to address low productivity growth, persistent structural and governance weaknesses, the significant state-owned enterprises footprint, stifled competition, an uneven playing field, and tax distortions. The risks of extreme weather events and energy shocks remain high. Persistent inequality of opportunity limits the ability to access public services and reduces resilience and intergenerational mobility. Significant uncertainty also remains around the impact of the war in Ukraine on the Moldovan economy, and the supply and price of energy in 2023. A further increase in energy costs in the second half of 2023 may require spending reallocation and/or additional financing to mitigate the impact on households. High input costs and dry weather conditions may further reduce agricultural yields, resulting in additional inflationary pressures and dampened economic activity. On this background, the reduction in poverty observed during 2022, is likely to have been short-lived as Moldova felt the impacts of the war in Ukraine, with disproportionate impacts on poorer Moldovans primarily through the impacts of high food and fuel inflation.

Recent developments

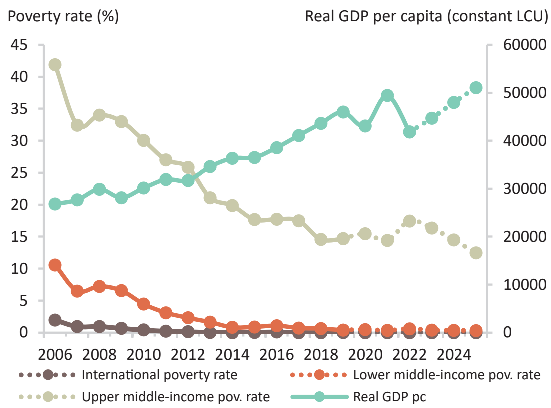
Moldova's GDP dropped by 10.6 percent in the fourth quarter, totaling a 5.9 percent decrease in 2022. High interest rates and proximity to the war in Ukraine had a negative impact on investments while high inflation eroded the disposable income of the population, resulting in a decrease in private consumption. Strong growth in exports (25 percent) on the back of good yields from last year and re-exports to Ukraine, were not however sufficient to compensate for the increase in imports (15.8 percent), mostly driven by high energy costs. As a result, the contribution to growth from net exports was negative. Public consumption increased by around 5 percent, modestly supporting growth.
Moldova's external position has deteriorated due to the impact of the energy crisis and lower remittances. As share of GDP, external debt decreased to 62.1 percent.
The monetary stance has been relaxed after inflation reached its peak in October 2022. In 2022, inflation surged to 28.7 percent triggered by adjustments in regulated prices. In 2023, the monetary authorities to

FIGURE 1 Moldova / Actual and projected macroeconomic indicators



Source: Author's calculations based on national statistics.

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



Source: World Bank. Notes: see Table 2.

decrease the policy rate twice to 17 percent from 21.5 percent.

The fiscal position proved to be resilient in 2022, registering a deficit of 3.3 percent, thanks to a strong revenue performance. Public spending increased by 22.4 percent led by social spending and subsidies. Cash buffers were used toward the end of the year to secure the supply of energy. Public and publicly guaranteed debt decreased to around 33 percent of GDP in the first 9 months of 2022.

Amidst tight labor market conditions, poverty, as measured by the international US$6.85 2017 PPP per day poverty line, increased from 14.4 percent in 2021 to 17.5 percent in 2022.

Outlook

GDP growth is expected to slowly rebound to 1.8 percent in 2023, reaching its potential only in 2024, due to inflation dynamics, energy security concerns, and the ongoing war in Ukraine. The measures taken by the government in 2021 and 2022 (e.g., an increase in minimum pensions and indexation, social protection measures, and a higher minimum wage) are expected to partially mitigate the impact on households. Nevertheless, the main sources of disposable income are registering negative growth, while consumer credit is low. The proximity to the war in Ukraine poses headwinds to domestic and foreign investment, as well as to net exports.

Double-digit inflation will persist in 2023, only receding slowly toward the NBM's inflation target of 5 percent +/- 1.5 percent in 2024, under the assumption of a moderation in import prices and contained second-round effects. Moldova's external position is expected to weaken, reflecting overall elevated import prices coupled with subdued capital inflows due to heightened uncertainty. In the medium term, the inflow of remittances will stabilize as Moldovan migrants move to other destinations and help reduce the structural deficit of the current account. Overall, the CAD is expected to be higher than in the pre-COVID-19 period and remain reliant on external financing. Revenues are expected to decline in real terms as economic activity subsides, resulting in a fiscal deficit of 5.4 percent in 2023. Public debt remains sustainable despite the deterioration of the short-term outlook.

Poverty as measured by the US$6.85 2017 PPP poverty line is expected to decrease from 17.5 percent in 2022 to 16.3 percent in 2023. With growth anticipated to recover, poverty is projected to fall further to 14.5 percent in 2025. However, the growth outlook, and therefore projected poverty, is subject to substantial downside risks.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-7.4	13.9	-5.9	1.8	4.2	4.1
Private Consumption	-8.3	15.5	-4.0	3.0	4.1	4.2
Government Consumption	3.1	3.8	5.1	1.3	2.1	0.0
Gross Fixed Capital Investment	0.4	1.7	-6.8	1.9	5.0	5.3
Exports, Goods and Services	-9.6	17.5	24.9	3.3	4.5	5.1
Imports, Goods and Services	-5.0	19.2	15.8	3.7	4.0	4.1
Real GDP growth, at constant factor prices	-7.6	15.6	-5.9	1.8	4.2	4.1
Agriculture	-26.4	18.7	-25.8	2.6	3.3	3.5
Industry	-4.3	5.6	-17.9	2.4	4.6	5.1
Services	-4.8	19.3	2.0	1.5	4.2	3.9
Inflation (Consumer Price Index)	4.1	5.1	28.7	14.1	6.2	4.9
Current Account Balance (% of GDP)	-7.7	-11.1	-13.4	-14.5	-10.8	-9.9
Net Foreign Direct Investment Inflow (% of GDP)	1.3	1.6	0.8	1.5	2.8	2.8
Fiscal Balance (% of GDP)	-5.3	-1.9	-3.3	-5.6	-4.6	-3.9
Revenues (% of GDP)	31.4	32.0	33.6	32.1	31.8	32.1
Debt (% of GDP)	36.4	32.4	33.7	36.3	38.2	38.0
Primary Balance (% of GDP)	-4.5	-1.1	-2.0	-4.5	-3.7	-3.1
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]	0.5	0.3	0.6	0.4	0.3	0.3
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	15.4	14.4	17.4	16.3	14.5	12.5
GHG emissions growth (mtCO2e)	-5.6	8.9	-4.5	1.2	2.7	2.7
Energy related GHG emissions (% of total)	63.5	65.4	63.5	63.7	64.4	65.3

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-HBSActual data: 2021. Nowcast: 2022. Forecasts are from 2023 to 2025.
b/ Projections using neutral distribution (2021) with pass-through = 1 (High-2022), pass-through = 0.7 (Low-2023), pass-through = 0.87 (Medium-2024), pass-through = 0.87 (Medium-2025) based on GDP per capita in constant LCU.

MONTENEGRO

Table 1	2022
Population, million	0.6
GDP, current US$ billion	6.9
GDP per capita, current US$	11089.9
International poverty rate ($2.15)[a]	2.9
Lower middle-income poverty rate ($3.65)[a]	6.4
Upper middle-income poverty rate ($6.85)[a]	18.5
Gini index[a]	36.9
School enrollment, primary (% gross)[b]	102.3
Life expectancy at birth, years[b]	75.9
Total GHG emissions (mtCO2e)	3.7

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2017 PPPs.
b/ Most recent WDI value (2020).

While growth in 2022 was strong at an estimated 6.1 percent, it decelerated in the second half of the year. Private consumption propelled growth, but its contribution weakened by year-end as inflation surged to an average of 13 percent for the year. At 5.2 percent of GDP, the fiscal deficit was lower than planned, but still high due to forgone revenues and additional spending. The rise in the cost of financing and forthcoming debt repayments require utmost fiscal vigilance.

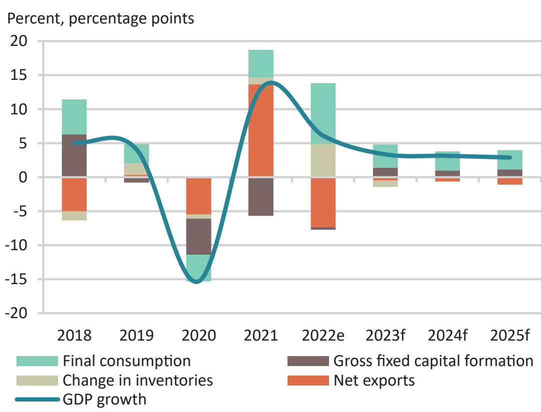
Key conditions and challenges

Montenegro's small, open, and service-based economy is highly vulnerable to external shocks, while the country's choice of strategies and policies has not always been conducive to enhancing its resilience. After a historic recession of -15.3 percent in 2020, the economy recovered strongly in 2021 and 2022, averaging 13 and 6.1 percent growth, respectively. However, it is facing renewed challenges from the Russian invasion of Ukraine, associated global geopolitical and economic uncertainties, but also domestic instability. Given unilateral euroization, Montenegro relies on fiscal policy and structural reforms to maintain macroeconomic stability. However, the debt-financed highway construction, the pandemic, and a lack of commitment to fiscal targets have increased fiscal vulnerabilities and increased public debt. Despite a significant decline to an estimated 70.8 percent of GDP in 2022, public debt remains high, particularly in the environment of increasing financing costs. In 2022, the government implemented a major tax reform, which reduced labor taxes from a flat 39 percent of total labor cost to an average of 22 percent by removing healthcare contributions and introducing progressive income taxation, while increasing the minimum wage from €250 to €450. The program has the potential to reduce inequalities and increase growth in the medium term, but also poses fiscal risks. These have been further amplified by additional spending, particularly on the social and wage bill. Considering large Eurobond repayments in 2025 and 2027 and higher borrowing costs, Montenegro must show fiscal prudence by consolidating its public finance, by narrowing the fiscal deficit and by further reducing public debt by 2025.
Montenegro has been in a political and institutional standstill since August 2022, when the government received a vote of no-confidence, and the Constitutional Court lost a quorum. The complexity and fragility of the political landscape exacerbates uncertainties, slows the reform process, and not only diverts the focus from imminent economic challenges, but amplifies them. Montenegro's immediate priority should thus be to resolve the institutional and political crisis.

Recent developments

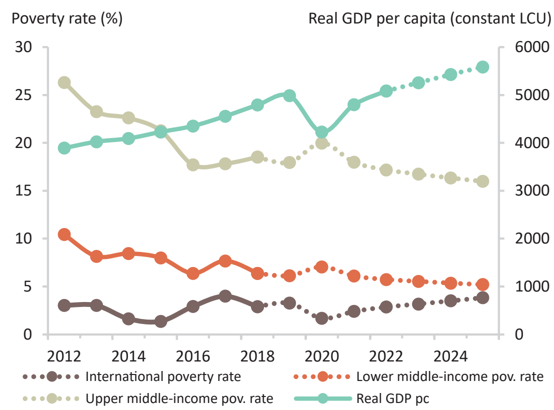
In 2022, economic activity was driven by an increase in real disposable incomes, further recovery in tourism, employment growth, and household lending. Real retail trade grew by 13.4 percent y/y, while the number of tourist overnights reached 92 percent of the 2019 level. However, the value of construction works contracted by 4.4 percent in nominal terms, while industrial production declined by 3.2 percent as unfavorable hydrological conditions affected electricity generation.
Employment gains were strong in 2022, contributing to a record high activity rate and a record low unemployment rate of

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 GDP per capita



Source: World Bank. Notes: see Table 2.

58.9 and 14.7 percent, respectively. In 2022, real net monthly wages increased by 18.7 percent. Consequently, poverty (income below $6.85/day in 2017PPP) is projected to have declined to 17 percent in 2022.

Inflation averaged 13 percent, led by a surge in food and energy prices. The inflationary impact on households has been largely mitigated by a wage increase through the tax reform program.

By December, lending and deposits increased by 9 and 24.3 percent y/y, respectively. In December, the average capital adequacy ratio was at healthy 19.3 percent, while non-performing loans declined to 6.3 percent from 6.8 percent of total loans a year earlier.

The current account deficit widened to 13.3 percent of GDP but was fully financed by net FDI. The trade deficit expanded by 40 percent, as strong export growth could not compensate for an even stronger increase in imports. Net income accounts further reduced the current account deficit, due to strong net remittances.

A shortfall in social security contributions and personal income tax collections, new spending and ad-hoc spending commitments, the clearance of health insurance arrears, and higher capital spending increased the fiscal deficit from 1.9 percent of GDP in 2021 to an estimated 5.2 percent of GDP in 2022. Public debt declined from 84 percent of GDP in 2021 to an estimated 70.8 percent of GDP in 2022, supported by regular repayment of debt and limited new borrowing.

Outlook

The unfavorable global economic outlook and high domestic uncertainty are weighing on Montenegro's otherwise positive outlook. Over 2023-25, growth is projected to average 3.1 percent, as private consumption growth slows, whereas investment is expected to provide marginally positive contributions to growth. Tourism is likely to continue recovering in 2023 to reach its 2019 level, although deteriorating growth prospects in the EU and the region may have an adverse effect on both tourism and wider growth prospects. Poverty is projected to decline to 16.6 percent in 2023.

Inflation is projected to decelerate to 7.9 percent in 2023 and further to 4 percent in 2024. While higher energy prices are disproportionally affecting the poor, they are also supporting Montenegro's electricity exports, helped by increasing generation capacities. These factors, together with exports of tourism and transport services are projected to support a reduction in the current account deficit to 11.1 percent of GDP in 2025.

The fiscal balance is expected to moderate over the medium term but will remain elevated at 4.9 percent of GDP in 2023 and 4.5 percent of GDP in 2024, due to higher wages, social, and capital spending. As a result, public debt will stay high at around 70 percent of GDP in 2023-25. Additional fiscal consolidation measures (both revenue measures and tighter expenditure control) would, however, result in a better fiscal performance.

Given the tightening of global financial conditions and Montenegro's sizable financing needs of around 10 percent of GDP in 2023, the country will require very careful fiscal management and stronger control over its expenditures.

The outlook is surrounded with multiple downside risks. High geopolitical uncertainties and global inflation may weaken growth prospects in Montenegro's major trading partners. Inflationary pressures are accelerating monetary tightening which translates into more expensive external financing. Political instability and delays in resolving the institutional standstill are major domestic risks. The severity of challenges ahead requires strong political commitment and actions to mitigate these risk.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-15.3	13.0	6.1	3.4	3.1	2.9
Private Consumption	-4.6	4.0	9.7	3.3	2.9	3.1
Government Consumption	0.8	0.5	1.2	1.6	0.4	0.1
Gross Fixed Capital Investment	-12.0	-12.3	-1.1	4.3	3.0	3.4
Exports, Goods and Services	-47.6	81.9	22.7	4.9	4.4	4.1
Imports, Goods and Services	-20.1	13.7	21.3	3.4	3.3	3.5
Real GDP growth, at constant factor prices	-14.4	13.2	4.8	3.3	3.1	2.9
Agriculture	1.1	-0.5	-0.4	0.1	0.1	0.1
Industry	-12.0	0.3	-5.0	2.0	2.0	2.0
Services	-16.9	19.9	8.4	4.1	3.8	3.4
Inflation (Consumer Price Index)	-0.3	2.4	13.0	7.9	4.0	2.8
Current Account Balance (% of GDP)	-26.1	-9.2	-13.3	-12.4	-11.9	-11.1
Net Foreign Direct Investment Inflow (% of GDP)	11.2	11.7	13.5	8.7	7.6	7.4
Fiscal Balance (% of GDP)	-11.0	-1.9	-5.2	-4.9	-4.5	-4.2
Revenues (% of GDP)	44.4	44.0	39.4	39.3	39.1	38.8
Debt (% of GDP)	105.3	84.0	70.8	69.0	70.3	69.6
Primary Balance (% of GDP)	-8.3	0.5	-3.5	-3.1	-2.2	-1.7
International poverty rate ($2.15 in 2017 PPP)[a,b]	1.7	2.4	2.9	3.2	3.5	3.8
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	7.1	6.1	5.7	5.5	5.4	5.2
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	20.0	18.0	17.2	16.7	16.3	16.0
GHG emissions growth (mtCO2e)	-9.2	5.2	-0.9	1.5	1.3	1.3
Energy related GHG emissions (% of total)	68.8	71.1	71.4	72.1	72.5	72.9

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-SILC-C and 2019-SILC-C. Actual data: 2018. Nowcast: 2019-2022. Forecasts are from 2023 to 2025.
b/ Projection using point-to-point elasticity (2014-2018) with pass-through = 0.7 based on GDP per capita in constant LCU.

NORTH MACEDONIA

Table 1	2022
Population, million[a]	2.1
GDP, current US$ billion	13.6
GDP per capita, current US$[a]	6567.8
International poverty rate ($2.15)[b]	2.8
Lower middle-income poverty rate ($3.65)[b]	7.6
Upper middle-income poverty rate ($6.85)[b]	19.1
Gini index[b]	33.6
School enrollment, primary (% gross)[c]	95.5
Life expectancy at birth, years[c]	75.7
Total GHG emissions (mtCO2e)	11.1

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent WDI value (2020) for population.
b/ Most recent value (2019), 2017 PPPs.
c/ Most recent WDI value (2020).

Despite brisk post-pandemic recovery, the energy crisis depressed growth and pushed inflation to a two-decade high, stretching public finances amidst a rise in borrowing costs. Government support for the energy crisis needs to be targeted and temporary to incentivize energy efficiency and the green transition. Structural reforms to boost medium-term growth should be prioritized ahead of the general elections in 2024. Downside risks to the outlook have subsided but prevail.

Key conditions and challenges

Despite a brisk recovery from the pandemic-induced recession, North Macedonia's growth momentum started losing steam as the energy crisis and the war in Ukraine took a toll on the domestic economy. After a decade of muted price increases, inflation accelerated to a peak of close to 20 percent in late 2022 driven by double-digit increases in food and energy prices.

Just as poverty was resuming a downward pathway in 2021, high inflation created additional challenges. Poverty is estimated to have declined moderately in 2022, as higher food and energy prices negatively affected household welfare, particularly among the less well-off who spend a higher proportion of income on these items and have fewer mechanisms to cope with higher prices. Government support measures, including electricity subsidies and an 18-percent rise in minimum wages, have cushioned the shock to some extent.

Corporate credit growth remained robust by December 2022, although worsening financial conditions in times of rising input and borrowing costs could weigh on firm performance and dent an already fragile recovery.

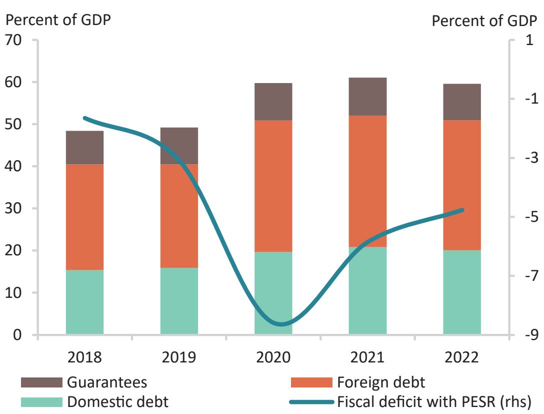
The overlapping crises also had an adverse effect on fiscal accounts and markedly reduced fiscal space for supporting growth over the medium term. Despite a rise in revenues due to inflation and positive growth since 2021, spending pressures to mitigate the impact of multiple crises have delayed fiscal consolidation beyond 2022. Public debt declined to 59.6 percent of GDP in 2022, but arrears increased to 3.2 percent, while the primary deficit remained high and subsidies to the state-owned electricity company to cover the losses hit 2.4 percent of GDP. Ambitious public investment plans are projected to keep the fiscal deficit elevated leaving the debt-to-GDP ratio high over the medium term.

Restoring the country's long-term growth prospects requires following up on pending reforms. Policy actions need to focus on rebuilding sustainability and resilience to shocks to prevent future setbacks to growth. Improving tax compliance and widening the tax base should be a priority as much as targeting social spending and building energy resilience. Reducing business regulatory costs, deepening the trade agreements, increasing market competition, supporting labor market participation, strengthening the independence of public institutions as well as launching the green transition would all be supportive of sustainable, inclusive, and resilient growth in an environment of pronounced uncertainty.

Recent developments

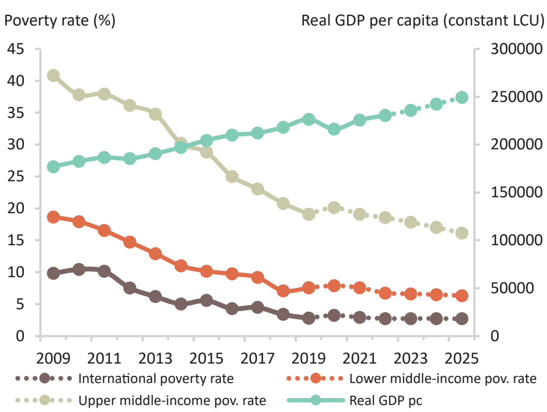
After growing by 3.9 percent in 2021, domestic output increased by 2.1 percent on an annual basis in 2022, as gross investments surged largely due to import-intensive stockpiling. Despite a double-digit

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 rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

rate of growth, exports lagged imports while personal consumption decelerated. On the production side, growth was driven by services, as the industry struggled, and construction dove further into negative territory.

The census-adjusted employment rate settled at 47.2 percent in Q4 2022, led by an increase in the female employment rate. The activity rate is still hovering around 55 percent, which is below the pre-pandemic peak. The unemployment rate decreased to 14 percent, but the youth unemployment rate remained high at 31.8 percent in Q4 2022.

Banking sector stability was preserved with an increase in the capital adequacy ratio to 17.7 percent in Q3 2022 despite a drop in the liquidity rate to 19.7 percent. Credit growth remained robust at 9.4 percent y-o-y in December 2022, led by accelerated FX-denominated corporate lending (20 percent of total lending). Headline inflation hit 14.2 percent in 2022, and despite deceleration, core inflation of 10.9 percent at end-2022 remains sticky. Since April 2022, the Central Bank increased the main policy rate to 5.25 percent to curb inflationary expectations. The pegged exchange rate remained stable and FX reserves recovered from losses incurred at the start of the war in Ukraine, as government borrowing and FDI inflows surged in H2 2022. In 2022, the general government deficit at 4.5 percent of GDP ended below the last budget revision as revenues led by personal and corporate income taxes outpaced expenditures, and as capital expenditure fell short of the planned amount. Public debt to GDP slightly declined but is expected to increase again as the highway construction project starts in 2023.

Outlook

The medium-term outlook is positive, and downside risks subsided as financing conditions eased and as the country secured financing for 2023. Growth in 2023 is expected to increase to 2.4 percent, 0.3 p.p. below the autumn round forecast, reflecting continued disruptions from the war in Ukraine, and a protracted energy crisis. Growth is projected to remain below potential, but to moderately accelerate as the large public investment starts and nearshoring of FDIs continues. With commodity prices expected to decline over the next two years, the inflation rate is projected to decelerate to 9.1 percent in 2023 and further to 3 percent in 2024. The baseline scenario is built on the assumption that the energy crisis subsides over the forecast horizon.

While underlying risks remain skewed to the downside and are closely tied to the outlook for the country's main trading partners, moving ahead with EU accession negotiations may provide a much-needed boost to reform appetite and unlock higher growth prospects. At the same time, heightened political uncertainty and a parliamentary impasse prior to elections may delay the implementation of critical reforms. Finally, higher-than-expected inflation may trigger more significant monetary policy tightening that can additionally restrict financing options and suppress economic activity.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-4.7	3.9	2.1	2.4	2.7	2.9
Private Consumption	-3.4	7.8	5.5	3.3	2.1	3.7
Government Consumption	9.7	-0.4	1.0	0.3	0.2	0.2
Gross Fixed Capital Investment	-15.7	0.9	20.0	10.0	5.5	3.0
Exports, Goods and Services	-10.9	11.7	11.0	6.0	5.5	5.0
Imports, Goods and Services	-10.9	11.9	16.5	5.8	4.5	4.5
Real GDP growth, at constant factor prices	-4.3	4.1	2.1	2.4	2.7	2.9
Agriculture	2.5	-5.2	1.8	2.0	2.5	1.8
Industry	-6.9	-1.8	0.4	3.1	3.4	3.0
Services	-4.1	7.5	2.7	2.2	2.5	3.0
Inflation (Consumer Price Index)	1.2	3.2	14.2	9.2	3.0	2.0
Current Account Balance (% of GDP)	-2.9	-3.1	-6.0	-4.2	-3.7	-3.2
Net Foreign Direct Investment Inflow (% of GDP)	1.4	3.3	5.2	5.2	5.9	6.2
Fiscal Balance (% of GDP)	-8.2	-5.4	-4.6	-4.8	-4.2	-3.3
Revenues (% of GDP)	29.9	32.5	32.4	33.5	33.5	34.1
Debt (% of GDP)	59.8	61.0	59.6	61.6	63.8	63.6
Primary Balance (% of GDP)	-7.0	-4.1	-3.4	-3.3	-2.5	-1.6
International poverty rate ($2.15 in 2017 PPP)[a,b]	3.2	2.9	2.7	2.7	2.7	2.7
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	7.9	7.6	6.7	6.6	6.5	6.3
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	20.1	19.1	18.6	17.8	17.1	16.1
GHG emissions growth (mtCO2e)	-3.4	2.0	0.2	0.3	-0.3	-1.1
Energy related GHG emissions (% of total)	71.3	72.2	72.3	72.2	71.9	71.2

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 2020-SILC-C. Actual data: 2019. Nowcast: 2020-2022. Forecasts are from 2023 to 2025.
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	2022
Population, million	39.3
GDP, current US$ billion	697.2
GDP per capita, current US$	17740.7
Upper middle-income poverty rate ($6.85)[a]	0.9
Gini index[a]	28.9
School enrollment, primary (% gross)[b]	84.1
Life expectancy at birth, years[b]	76.6
Total GHG emissions (mtCO2e)	328.3

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ Most recent WDI value (2020).

Poland's GDP grew by 4.9 percent in 2022 but high inflation, policy uncertainties, tighter financing conditions, and an unwinding of the inventory cycle will weigh on growth in 2023. The Russian invasion of Ukraine affects the economy, while the large number of Ukrainians joining the labor market relieved some of the pressures in the tight labor market. The share of the population at risk of poverty is expected to remain elevated through 2024.

Key conditions and challenges

The well-diversified Polish economy has proven to be one of the most resilient in the EU, recovering robustly after a relatively small contraction in GDP of 2 percent in 2020.

A sound macroeconomic framework, effective absorption of EU investment funds, a sound financial sector, better access to long-term credit, and access to European labor markets have supported long-term inclusive growth and poverty reduction. Strong domestic labor markets and higher median and bottom 40 real incomes have supported private consumption. With an improving business environment, Poland integrated well into regional value chains (RVCs). Higher private investment, an improved innovation ecosystem, and further upgrading of RVCs could boost productivity and growth.

The unprecedented policy response to mitigate the impacts of the COVID crisis and high inflation have, nevertheless, narrowed the available policy space.

Increased spending and tax expenditure efficiency are needed to rebuild fiscal buffers, accommodate higher spending on health, defense, the green transition, and to prepare for the growing fiscal burden arising from aging. Over the medium term, a key challenge is a tightening labor supply made more acute by the aging population. The large influx of displaced people from Ukraine could help address at least temporarily the labor market tightness. Achieving decarbonization commitments is another challenge. Institutional strengthening is also needed for sustained and inclusive growth and for narrowing regional disparities.

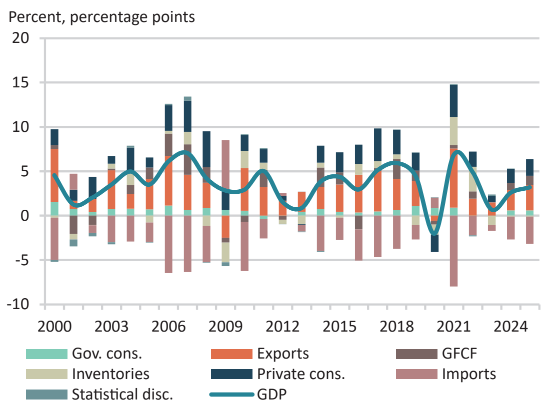
Recent developments

Economic growth decelerated to 4.9 percent in 2022 but remains well above potential GDP growth. Household consumption expanded by 3 percent in 2022, despite a decline in average monthly real gross wages and salaries of 2.1 percent in 2022, as households dissaved. Investment growth accelerated to 4.5 percent, while higher inventories contributed nearly 3 percentage points to growth, as firms moved from a "just-in-time" to a "just-in-case" approach to inventories.

Higher employment, record-low unemployment, increased labor force participation, strong nominal wage growth, and government transfers supported private consumption. Pent-up demand and demand from the nearly 1.3 million displaced Ukrainians in Poland also supported domestic demand in 2022. High-capacity utilization and strong corporate balance sheets supported investments. Supply side disruptions and lower external demand from Russia, Ukraine, and Belarus weighed on exports.

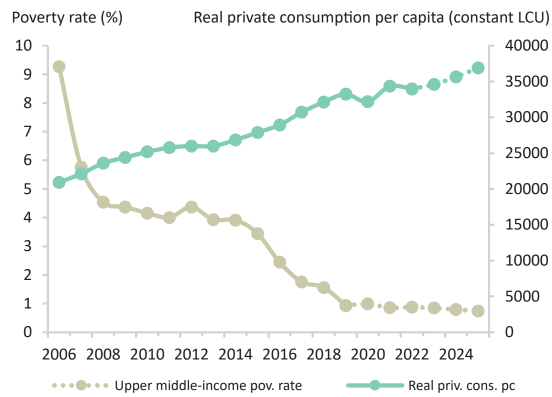
Inflation reached 18.4 percent in February 2023, sharply higher than the targeted range, as reduced VAT rates on electricity, gas and fuel reverted to the standard rate.

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



Sources: GUS and World Bank staff calculations.

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



Source: World Bank. Notes: see Table 2.

Caps on electricity and gas prices, and interventions on heating fuels, have limited a full passthrough to consumers and firms. Monetary policy tightening to respond to high inflation saw the reference rate increase by 665 basis points since October 2021. Meanwhile, the zloty appreciated by nearly 5 percent so far this year compared with Q4 2022 against the USD. The banking sector remains well-capitalized and has limited direct exposure to Russia, Ukraine, or Belarus, although profitability of the banking sector has declined in recent months.

The number of refugees registered in Poland has decreased to 1 million by early March 2023, from 1.3 million Ukrainian refugees in mid-2022. Refugees have temporary residence and access to the labor market and key public services (health, education), social assistance, and housing.

The current account deficit widened to 3.2 percent of GDP in 2022 as import prices for energy and intermediate goods rose sharply.

The unwinding of the 2020 fiscal stimulus and the strong increase in tax revenues brought the general government deficit to 1.8 percent of GDP in 2021. Measures to protect households and firms from the large energy price shock and high food prices caused the fiscal deficit to increase to an estimated 3.2 percent despite buoyant revenues in 2022.

Extreme poverty rates using the national concept declined in 2021, reversing the rise linked to the COVID-19 pandemic in 2020; the Gini coefficient of inequality however continued the upward trajectory visible since 2017.

Outlook

Economic growth is projected to decelerate to 0.7 percent in 2023, on account of high inflation, monetary policy tightening, negative confidence effects related to the war in Ukraine, a lower number of foreign workers compared with the previous year and slowing demand in key trading partners. Quarterly GDP is expected to register negative growth early in the year, following a larger than expected contraction in the fourth quarter of 2022, before recovering in subsequent quarters, primarily on account of a recovery in private consumption and stronger public spending.

Supply-side disruptions, high input costs, and uncertainty related to war in Ukraine will affect private investments. The National Recovery and Resilience Plan is expected to support public investment, but any further delays in disbursements represent a downside risk.

Elevated energy and food prices will weigh on household demand and will affect heavily poorer segments, who devote 50 percent of their monthly spending on food and energy. The share of the population at risk of anchored poverty is expected to remain elevated at 1-2 percent above 2019 levels.

Lower energy import prices and weaker import demand are expected to result in a slight improvement in the current account deficit to 2.2 percent of GDP in 2023, with further improvements over 2024-2025 as terms of trade and external demand strengthen.

The fiscal deficit is expected to exceed 4.5 percent of GDP in 2023, on account of the impact of the structural tax reform (Polish Deal), the freeze on electricity and gas prices, and the zero-VAT on food, and the public assistance provided to displaced Ukrainian. The fiscal cost of these packages is estimated at 1.1 percent, 2 percent, and 0.2 percent of GDP respectively in 2023. With increased geopolitical risks, defense spending is also increasing, with the government committing to increase defense spending by 0.8 percent of GDP this year.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-2.0	6.8	4.9	0.7	2.6	3.2
Private Consumption	-3.3	6.3	3.0	1.3	2.8	3.3
Government Consumption	4.9	5.0	-0.3	-0.2	3.5	3.5
Gross Fixed Capital Investment	-2.3	2.1	4.5	0.2	4.4	5.7
Exports, Goods and Services	-1.1	12.5	3.4	2.7	4.0	5.0
Imports, Goods and Services	-2.4	16.1	4.0	1.2	4.8	5.6
Real GDP growth, at constant factor prices	-2.0	6.6	4.8	0.8	2.6	3.2
Agriculture	15.3	-11.1	1.9	1.0	0.2	0.1
Industry	-4.5	3.4	7.0	1.2	3.0	3.1
Services	-1.4	8.9	3.9	0.5	2.5	3.3
Inflation (Consumer Price Index)	3.4	5.1	14.4	12.2	5.9	3.5
Current Account Balance (% of GDP)	2.5	-1.4	-3.1	-2.3	-2.2	-2.0
Net Foreign Direct Investment Inflow (% of GDP)	2.4	4.2	4.0	2.0	2.1	2.0
Fiscal Balance (% of GDP)	-6.9	-1.8	-3.2	-4.6	-3.7	-3.1
Revenues (% of GDP)	41.3	42.4	37.9	38.0	38.9	38.8
Debt (% of GDP)	57.2	53.8	48.4	50.6	52.0	53.3
Primary Balance (% of GDP)	-5.6	-0.7	-2.0	-2.4	-1.9	-1.9
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	1.0	0.9	0.9	0.8	0.8	0.7
GHG emissions growth (mtCO2e)	-3.5	2.5	3.7	1.7	2.0	2.2
Energy related GHG emissions (% of total)	91.9	91.8	91.8	91.9	92.0	92.1

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 2013-EU-SILC and 2020-EU-SILC. Actual data: 2019. Nowcast: 2020-2022. Forecasts are from 2023 to 2025.
b/ Projection using point-to-point elasticity (2012-2019) with pass-through = 0.7 based on private consumption per capita in constant LCU.

ROMANIA

Table 1	2022
Population, million	19.9
GDP, current US$ billion	291.7
GDP per capita, current US$	14643.2
International poverty rate ($2.15)[a]	2.2
Lower middle-income poverty rate ($3.65)[a]	4.7
Upper middle-income poverty rate ($6.85)[a]	10.7
Gini index[a]	35.2
School enrollment, primary (% gross)[b]	87.8
Life expectancy at birth, years[b]	74.4
Total GHG emissions (mtCO2e)	84.0

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent WDI value (2020).

Romania's economic growth was robust in 2022 at 4.8 percent, driven by strong private consumption and a pick-up in investment. Economic prospects are moderated by the spillovers from Russia's invasion of Ukraine, and risks are tilted to the downside. Fiscal and current account deficits will remain elevated. Poverty reduction is expected to slow down as a result of inflationary pressures, mainly from food and energy, though some of the impacts are mitigated by government support measures.

Key conditions and challenges

Romania has made impressive strides in raising its economic performance and prosperity over the past two decades. However, the COVID-19 pandemic and the war in Ukraine have tested the resilience of the Romanian economy and exacerbated its structural vulnerabilities, especially in terms of poverty and disparities in economic opportunity, persistently large gender gaps in labor force participation and employment, widening fiscal and current account deficits, and significant institutional constraints hindering the efficient use of resources.

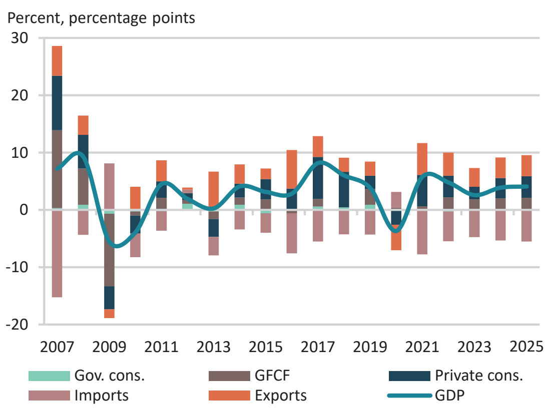
Despite measures to cap energy (gas and electricity) prices, rising costs of food and energy have disproportionally affected poor and vulnerable households as they spend a larger share of their budget on these items. Energy poverty is expected to increase. Romania's at-risk-of-poverty rate remains among the highest in the EU, exceeding that of countries with similar or lower per capita incomes, and the current inflationary environment could push additional people into poverty.

The key challenges in the short term are to contain the socio-economic effects of the war in Ukraine, including the rising cost of living and the significant twin deficits. Soaring inflation led to monetary policy tightening, and high core inflation points to persistent inflationary pressures. In the medium term, fiscal consolidation increased absorption and efficient use of EU funds, and enhanced private sector and investment growth will be critical for a sustainable, green, and inclusive recovery.

Recent developments

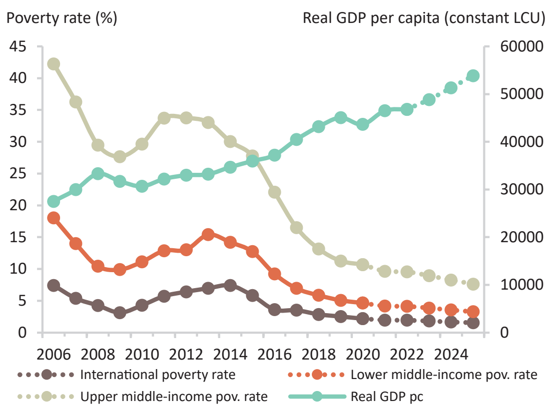
Romania's economy performed better than expected in 2022, expanding by 4.8 percent. Growth was driven by strong private consumption (up 5.5 percent y-o-y) benefiting from the phasing-out of the pandemic restrictions, higher wages, and muted unemployment. However, consumer spending gradually weakened in the second half of the year as higher prices squeezed disposable income. Investment, up 9.2 percent y-o-y, was boosted by new construction works and, to a smaller extent, by machinery and equipment. Strong private consumption coupled with global value chain disruptions and the terms of trade shock led to a significant widening of the goods trade deficit, and the current account deficit widened to 9.4 percent of GDP in 2022. On the supply side, growth was led by Information and Communications Technology (up 20.1 percent y-o-y), which benefited from businesses adopting digital technologies. Construction activity (up 11.2 percent y-o-y) was supported by the revival of the nonresidential buildings segment and capital repairs. Unemployment remains contained at 5.6 percent in December 2022 on the back of the economic recovery and labor supply constraints. Elevated inflation, labor shortages, and improvements

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.

in labor productivity contributed to wage increases, with nominal net wages growing by 13.4 percent y-o-y in December 2022. Annual inflation accelerated to 16.4 percent in December 2022, led by soaring electricity, gas, and central heating prices (up 39.7 percent), while food prices were up by 22.1 percent. Inflationary pressures prompted the National Bank of Romania to gradually increase the policy rate to 7 percent in early January 2023. Private sector credit growth decelerated to 12.1 percent y-o-y in December 2022, from 14.8 percent y-o-y in December 2021, reflecting the slowdown in loans to households.

The fiscal deficit narrowed to an estimated 5.7 percent in 2022 from 7.1 percent in 2021, reflecting higher nominal revenues (up 21.2 percent y-o-y). However, fiscal risks remain significant as financing conditions have tightened, and Romania faces higher spreads than regional peers on government bonds denominated in Euro.

The Rapid Household Survey in June 2022 showed that poorer households suffered most from work stoppage during the crisis, but they succeeded in catching up and finding back a job. However, labor force participation for those aged 15-64 remains below pre-pandemic levels, and gender gaps among uneducated groups- already large- continue to expand. Moreover, rising food and energy prices have affected energy poverty, food insecurity, and strained family budgets, especially among the poor and vulnerable, who often have little financial cushion to help absorb rising prices. The war in Ukraine and further disruptions to the global supply chains will continue to affect the economies of host countries for Romanian migrants, reducing remittances. Thus, despite economic and employment recovery, poverty ($6.85/day PPP) is expected to have declined only modestly, from 10.7 percent in 2020 to 9.6 percent in 2022.

Outlook

Growth is projected to decelerate to 2.6 percent in 2023. The outlook hinges on several factors, including the spillovers from the war in Ukraine impacting the European economy in which Romania is highly integrated, persistent core inflation, and additional volatility in energy and food prices. De-anchoring of inflation expectations could prolong the monetary tightening cycle leading to increased financing costs weighing down investment. Romania's capacity to efficiently absorb the EU funds will be critical for a sustainable, green, and inclusive recovery. The sizable funds, and associated structural reforms, should also partially mitigate the impact of higher interest rates and uncertainty on private investment and alleviate some of the fiscal pressures resulting from the heightened energy and food prices. Strengthened lifelong skills formation and private capital mobilization will be pivotal in boosting potential growth. Over the medium term, fiscal deficits will remain elevated. Renewed attention to fiscal consolidation is needed, particularly aimed at reducing inefficient expenditures and strengthening revenue mobilization.

Poverty is expected to continue declining slowly in 2024, depending on whether food and energy prices remain elevated for longer and the effectiveness of the mitigation measures helping families with low incomes to absorb rising food and gas prices. Declining remittance incomes could also mean a longer recovery process for vulnerable population segments in the coming years. A protracted war in Ukraine may weaken growth prospects in the medium term.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-3.7	5.8	4.8	2.6	3.9	4.1
Private Consumption	-3.9	8.1	5.5	3.2	5.1	5.4
Government Consumption	1.1	1.3	-2.0	1.1	1.2	1.2
Gross Fixed Capital Investment	1.1	1.9	9.2	6.9	7.2	7.4
Exports, Goods and Services	-9.5	12.6	8.6	6.7	7.1	7.0
Imports, Goods and Services	-5.2	14.9	9.2	8.1	8.6	8.5
Real GDP growth, at constant factor prices	-3.4	5.4	4.8	2.6	3.9	4.1
Agriculture	-15.3	5.9	-11.6	6.0	2.1	2.1
Industry	-6.5	6.6	-2.3	1.3	3.4	3.5
Services	-0.8	4.8	9.5	3.0	4.2	4.5
Inflation (Consumer Price Index)	2.6	5.1	13.8	10.1	5.4	4.2
Current Account Balance (% of GDP)	-4.9	-7.2	-9.4	-7.9	-6.8	-6.5
Net Foreign Direct Investment Inflow (% of GDP)	1.4	3.7	3.8	3.9	4.0	4.0
Fiscal Balance (% of GDP)	-9.2	-7.1	-5.7	-4.9	-4.6	-4.1
Revenues (% of GDP)	32.7	32.8	33.2	33.4	33.7	34.1
Debt (% of GDP)	46.8	48.9	48.7	49.4	49.9	50.2
Primary Balance (% of GDP)	-7.8	-5.6	-4.0	-3.4	-3.2	-2.7
International poverty rate ($2.15 in 2017 PPP)[a,b]	2.2	2.0	2.0	1.8	1.7	1.6
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	4.7	4.2	4.1	3.9	3.6	3.3
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	10.7	9.6	9.6	8.9	8.3	7.6
GHG emissions growth (mtCO2e)	-5.0	6.5	5.9	2.1	3.9	4.6
Energy related GHG emissions (% of total)	92.5	93.0	93.8	94.2	94.6	95.1

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 2014-EU-SILC and 2021-EU-SILC. Actual data: 2020. Nowcast: 2021-2022. Forecasts are from 2023 to 2025.
b/ Projection using point-to-point elasticity (2013-2020) with pass-through = 0.7 based on GDP per capita in constant LCU.

RUSSIAN FEDERATION

Table 1	2022
Population, million[a]	143.4
GDP, current US$ billion	2245.2
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]	104.2
Life expectancy at birth, years[d]	71.3
Total GHG emissions (mtCO2e)	1415.8

Sources: WDI, MPO, Rosstat.
a/ Most recent value (2021).
b/ Most recent value (2020), 2017 PPPs.
c/ Most recent value (2020).
d/ WDI for School enrollment (2019); Life expectancy (2020).

Russia's economy contracted by only 2.1 percent in 2022, in the face of severe sanctions, and is expected to contract by a further 0.2 percent in 2023. Sanctions will lower oil production, reducing the current account surplus. Lower revenues, together with larger spending for the war in Ukraine and the need for countercyclical support, will increase the budget deficit. Medium-term growth prospects are muted as Russia's access to inputs and productivity-enhancing technologies is limited.

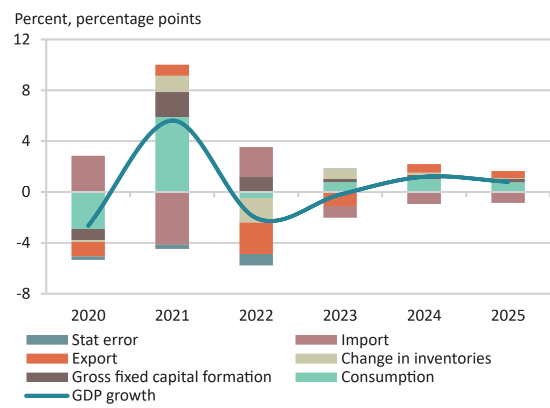
Key conditions and challenges

The sanctions imposed on Russia following its invasion of Ukraine continue to have significant adverse economic impacts on Russian enterprises due to high uncertainty, restricted access to international markets, restrictions on the export of several commodities, the import of technological goods, higher trade costs, and subdued domestic demand. New sanctions on the export of oil and derivatives are expected to reduce oil production by 7 percent in 2023 and raise transport costs for oil exporters. The fiscal position deteriorated in early 2023 with larger discounts on Russia's oil coupled with higher spending, in part on military needs and related social benefits. While the budget deficit remains manageable in the medium-term given relatively low public debt and accumulated fiscal buffers, higher public borrowing amidst restricted access to international markets will likely increase the cost of borrowing and crowd out the private sector. Longer-term challenges in the banking sector persist, with lending risks elevated. Greater uncertainty and restricted access to technology are likely to dampen private investment and make it less productive. These factors combined with a loss of skilled workers from the country will depress medium to long-term growth prospects.

Recent developments

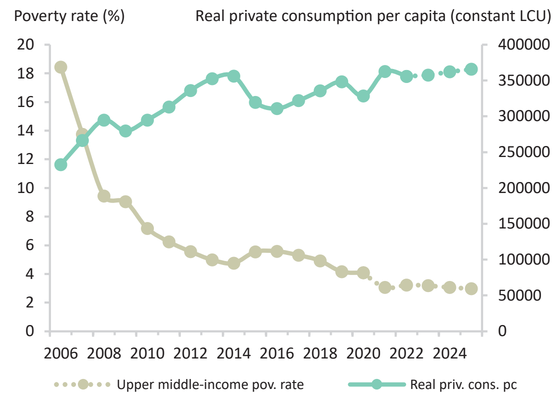
After a steep contraction in Q2 2022 (down 5.9 percent qoq, sa), driven by the imposition of sanctions, economic activity stabilized in H2 (1.9 percent growth hoh, sa) for a 2.1 percent contraction over 2022, considerably better than expected. The contraction was driven by a decline in exports (down 9.6 percent), in household consumption (down 1.8 percent) amidst falling real incomes, outward migration, and restricted imports, and gross capital formation (-0.8 percent) due to a substantial reduction in firms' inventories. Investment growth (5.2 percent) was bolstered by the resource sector, military demand, and investment into logistics.
On the supply side, growth was supported by agriculture (6.6 percent, yoy) with a record-high grain harvest; construction (5 percent); the financial sector (2.8 percent); and oil production (2.1 percent). While some manufacturing sub-sectors suffered from supply chain disruption (e.g., motor vehicles down 43 percent), military needs and import substitution drove growth of other sub-sectors (e.g. fabricated metals up 10 percent, computers and electronics up 4.1 percent, and medical products up 12 percent), resulting in a decline in manufacturing of 2.4 percent.
In 2022, the government delivered fiscal stimulus amounting to 4.2 percent of GDP, boosting social benefits, and providing subsidized loans and tax breaks to firms. The budget recorded a deficit of 2.2 percent of GDP, compared to a small surplus in 2021.

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 private consumption per capita



Sources: World Bank. Notes: see Table 2.

After a surge in March and then a deflationary spell, CPI inflation ended the year around 12 percent and averaged 14 percent in 2022. The Central Bank (CBR) normalized its monetary policy, keeping the policy rate unchanged at 7.5 percent since September.

After a record high current account surplus (CAS) in Q2 and Q3, by Q4 it had shrunk to its lowest level in 18 months as exports fell by 15 percent (qoq) and imports began recovering.

Banks managed to recover from H1 2022 losses of billion RUB 1.5 trillion (US$20.1 billion) to record a modest profit of RUB 0.2 trillion (US$3 billion) by year-end. Regulatory forbearance introduced by CBR limited the impact of volatility on financial markets and, alongside government support measures and capital buffers, allowed banks to continue lending. Over the year, credit to the private sector grew by 10.1 percent in nominal terms, putting real credit growth in negative territory.

The labor market has remained tight due to outward migration, and direct and induced military demand. The unemployment rate fell to an unprecedented low of 3.7 percent by end-2022. Nominal wages grew 12.6 percent in 2022, and nominal pensions by 12.8 percent, slightly below average CPI inflation. Food inflation was higher (14.9 percent). Social support helped reduce the official poverty rate to 10.5 percent in 2022, from 11.0 percent in 2021. Yet over 2022, the decline in private consumption is estimated to have led to a slight increase in poverty (under the UMIC poverty line) to 3.2 percent in 2022.

Outlook

It is presently difficult to produce growth forecasts for Russia due to the significant changes to the economy associated with the war in 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.

The outlook assumes that Russia's invasion of Ukraine will continue, as will existing and planned new sanctions. Higher than expected momentum from 2022 and a more moderate than expected contraction in crude oil and oil products in 2023 mean the economy is expected to contract by only 0.2 percent this year. Continued fiscal stimulus is expected to support economic activity and lower revenues from oil and gas, will result in a substantial increase in the fiscal deficit. Household consumption is expected to rebound slightly in view of expanding social benefits and recovering availability of imported products. Growth in investment is expected to wane as capital inflows decline, some large international investment projects are halted, and uncertainty persists. Lower oil revenue receipts and higher expenditures are expected to widen the general government deficit to 3.7 percent. Average annual CPI inflation is expected to drop to 6.0 percent in 2023, as the post-sanction price shock moves into the baseline, and then gradually fall to the CBR target of 4 percent in 2025. Discounts for Russia's oil and oil products, lower export volumes, and rebounding imports are all expected to reduce the CAS to 4.4 percent this year. With continuing economic stagnation, poverty (under the UMIC poverty line) is expected at 3.2 percent.

Moderate growth of 1.2 and 0.8 percent is expected in 2024 and 2025 respectively as the economy stabilizes from the sanctions shock and sees a partial recovery in investment and exports. Growth is expected to remain muted as Russia's access to inputs and productivity-enhancing technologies is limited.

Poverty is expected to decline slowly between 2023 and 2025 if at all, but worsening conditions might easily reverse this trend.

Russia's economic outlook is vulnerable to further rounds of mobilization and sanctions, lower export volumes of crude oil and oil products, and weaker global demand for other commodities. Positive risk comes from higher exports of oil/oil products.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-2.7	5.6	-2.1	-0.2	1.2	0.8
Private Consumption	-5.9	9.9	-1.8	0.4	1.1	0.8
Government Consumption	1.9	2.9	2.8	2.8	1.8	1.5
Gross Fixed Capital Investment	-4.0	9.1	5.2	1.1	1.5	1.2
Exports, Goods and Services	-4.2	3.3	-9.6	-4.6	2.9	2.6
Imports, Goods and Services	-11.9	19.1	-9.7	4.1	4.0	3.5
Real GDP growth, at constant factor prices	-2.2	6.2	-1.4	-0.2	1.2	0.7
Agriculture	0.2	-0.8	6.6	0.4	1.2	1.2
Industry	-2.7	5.4	-0.2	-0.7	1.4	1.2
Services	-2.2	7.0	-2.5	0.0	1.2	0.5
Inflation (Consumer Price Index)	3.4	6.7	13.7	6.0	4.5	4.0
Current Account Balance (% of GDP)	2.4	6.7	10.1	4.4	2.3	2.2
Net Foreign Direct Investment Inflow (% of GDP)	0.2	-1.4	-0.7	-0.6	-0.6	-0.6
Fiscal Balance (% of GDP)	-4.0	0.8	-1.4	-3.7	-2.5	-2.0
Revenues (% of GDP)	35.5	35.6	35.0	32.6	32.9	33.4
Debt (% of GDP)	19.9	17.3	17.2	20.6	22.3	23.8
Primary Balance (% of GDP)	-3.2	1.6	-0.3	-2.5	-1.4	-0.9
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	4.1	3.1	3.2	3.2	3.1	3.0
GHG emissions growth (mtCO2e)	-4.5	0.3	-6.7	-4.9	-0.1	-1.4
Energy related GHG emissions (% of total)	91.5	90.6	90.2	89.9	89.3	88.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data: CAIT and OECD. Historical data prior to 2023 has been sourced from ROSSTAT, CBR and MOF. Starting in 2022, Russia limited publication of economic data, notably related to external trade, financial and monetary sectors, and this limits our ability to assess the quality of the published data. Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 2020-HBS. Actual data: 2020. Nowcast: 2021-2022. Forecasts are from 2023 to 2025.
b/ Projection using neutral distribution (2020) with pass-through = 0.7 (Low (0.7)) based on private consumption per capita in constant LCU.

SERBIA

Table 1	2022
Population, million	6.8
GDP, current US$ billion	63.6
GDP per capita, current US$	9401.5
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]	10.1
Gini index[a]	35.0
School enrollment, primary (% gross)[b]	96.8
Life expectancy at birth, years[b]	74.2
Total GHG emissions (mtCO2e)	64.8

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent WDI value (2020).

Growth decelerated in the second half of the year to an average of 2.3 percent in 2022, largely driven by private consumption. However, real disposable incomes are shrinking with still rising inflation, led by surging food and energy prices. Consequently, the 2022 current account deficit almost doubled but was still fully financed by net FDI. Strong revenue performance and controlled spending have reduced the fiscal deficit to 3.1 percent of GDP. However, multiple risks weigh on the still positive outlook.

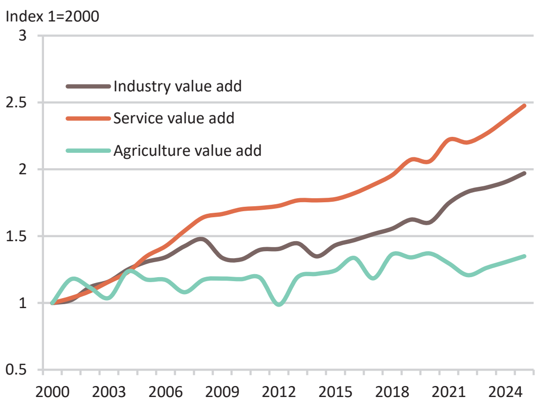
Key conditions and challenges

Before the pandemic, Serbia enjoyed several years of solid growth, rising employment, and low inflation. Its strong track record of fiscal consolidation over 2014-19 had helped build the fiscal buffers which allowed the country to weather the pandemic and energy crises. Serbia's economy contracted by 0.9 percent in 2020, lower than in most countries, and rebounded strongly in 2021 averaging 7.5 percent growth. Despite the unfavorable external environment and the energy crisis, 2022 GDP growth was still solid at 2.3 percent. The government's large fiscal support was critical to preserving economic activity in the crisis, while it's timely phasing out allowed for a reduction of the fiscal deficit from 8 percent of GDP in 2020 to 3.1 percent of GDP in 2022. The government is committed to reducing the fiscal deficit and public debt over the medium term. To ensure that these fiscal targets are met, in December 2022, the government changed the deficit ceiling fiscal rule and introduced two new rules for the wage bill and spending on pensions. Commitment to the fiscal rules, together with improving corporate governance of SOEs through a comprehensive reform program will be critical to enhance Serbia's fiscal sustainability over the medium term.
While the impact of the energy crisis in 2022 proved to be milder than initially expected, it has highlighted the importance of the need for Serbia to shift towards greener and more resilient drivers of economic growth. Despite improvements since 2000, Serbia's economy is still almost twice as energy intensive as the EU and relies heavily on fossil fuels for its electricity generation and industrial output. To accelerate the transition toward a more sustainable and greener economy, Serbia's strong commitments to the green growth agenda would require equally strong action.

Recent developments

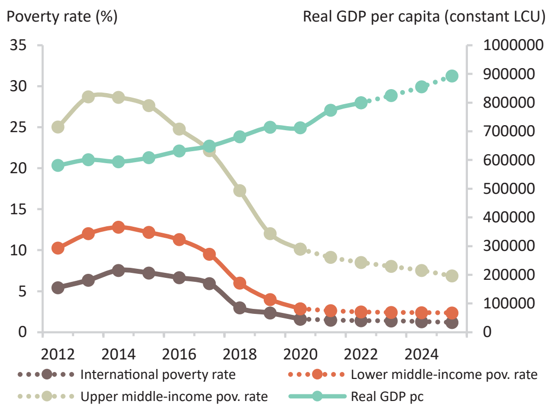
After a resilient performance in H1 of 4.0 percent, growth slowed to an estimated 0.7 percent in H2, as the contribution of private consumption to growth gradually faded with inflation biting into real disposable incomes. On the production side, the service sectors led growth, while the agriculture and construction sectors contracted strongly. Improvements in the labor market have led to record high employment and activity rates of 51.1 and 56.1 percent, respectively, while the unemployment rate declined to 8.9 percent. Real wage growth was only marginal, as inflation averaged 11.9 percent for the year, driven by food and energy prices. In response, the Central Bank has increased the policy rate several times reaching 5.5 percent in February 2023.
Despite high inflation and a poor agricultural season, poverty (defined as income under $6.85/day in 2017 PPP) is estimated to have declined slightly from 9.1 percent in 2021 to 8.5 percent in 2022, supported by

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 GDP per capita



Source: World Bank. Notes: see Table 2.

solid economic growth and an improving labor market conditions.

The current account deficit (CAD) widened to 6.9 percent of GDP, due to higher energy imports in the first half of the year, when prices of energy, metals, and other raw materials surged. The widening CAD was still fully financed by net foreign direct investments, which increased by 17.7 percent. NBS official foreign currency reserves increased to a historic high of EUR19.4 billion in December 2022, covering close to 5.5 months of imports. Strong revenue performance and controlled spending led to a better-than-planned fiscal deficit of 3.1 percent of GDP. Total revenues increased by 13.4 percent in nominal terms; more than half of this growth was explained by stronger VAT and social security contribution collections. Total government expenditure growth was more moderate, mainly driven by capital budget transfer loans to the state gas and electricity utilities (up by 300 percent), capital spending (up by 9 percent), and social transfers (up by 9.3 percent). Public debt declined to 55.2 percent of GDP from 56.5 percent of GDP in 2021. In December 2022, the IMF approved a Stand-by Arrangement of EUR 2.4 billion, while in January the country issued a dual-tranche Eurobond of USD 1.75 billion. The proceeds will be used to service debt and build extra buffers.

Outlook

Over the medium term, the economy is expected to grow steadily at around 3 percent annually. The main driver of GDP growth over the medium term will be consumption and to a lesser extent investment, while net exports will have a negative contribution as imports are projected to increase faster than exports. Inflation will remain moderate and is expected to return to the target band only in 2024. Poverty in 2023 is projected at 8.0 percent, lower than its 2022 level.

The fiscal deficit and public debt are expected to remain on their downward path. Based on the Fiscal Strategy 2023-25 approved along with the budget for 2023, the government plans to reduce the fiscal deficit gradually over the medium term and to reach a primary fiscal surplus by 2025. This would lead to a reduction of public debt to an estimated 51.5 percent of GDP in 2024.

However, multiple risks, both external and domestic, weigh on the positive outlook. First, prolonged inflationary pressures would further reduce household disposable income and dampen growth through lower consumption, but also lead to higher cost of financing. Another major risk is associated with the EU economic outlook and the performance of Serbia's other main trading partners. Finally, domestic risks are associated with national and regional political developments and SOE governance. To defy all these risks and achieve faster growth, Serbia should implement structural reforms to boost potential output, through increased human capital (improving the quality of education and increasing the level of labor-force participation), higher productivity (particularly by attracting higher quality FDI) and an improved business environment (including regulatory predictability and increases to market competition).

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	-0.9	7.5	2.3	2.3	3.0	3.8
Private Consumption	-1.9	7.6	3.7	2.3	2.4	3.4
Government Consumption	2.9	2.6	0.2	2.4	1.4	3.0
Gross Fixed Capital Investment	-1.9	12.9	-0.6	2.4	3.3	6.8
Exports, Goods and Services	-4.2	19.4	17.6	3.1	4.2	6.0
Imports, Goods and Services	-3.6	19.3	17.8	2.9	3.0	5.8
Real GDP growth, at constant factor prices	-0.8	7.4	2.3	2.3	3.0	3.8
Agriculture	2.2	-5.4	-6.8	4.5	3.4	3.4
Industry	-0.6	7.8	-0.9	3.0	4.5	4.5
Services	-1.2	8.9	4.9	1.7	2.2	3.4
Inflation (Consumer Price Index)	1.6	4.0	11.9	12.2	5.3	3.5
Current Account Balance (% of GDP)	-4.1	-4.4	-6.9	-6.4	-5.4	-5.2
Net Foreign Direct Investment Inflow (% of GDP)	6.3	6.8	7.1	5.6	5.5	5.7
Fiscal Balance (% of GDP)	-8.0	-4.1	-3.1	-3.1	-2.2	-1.4
Revenues (% of GDP)	41.0	43.2	43.4	41.8	41.3	41.6
Debt (% of GDP)	57.8	57.1	55.7	55.5	53.1	51.5
Primary Balance (% of GDP)	-6.0	-2.4	-1.6	-1.3	-0.4	0.4
International poverty rate ($2.15 in 2017 PPP)[a,b]	1.6	1.5	1.4	1.4	1.3	1.2
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	2.9	2.6	2.5	2.4	2.4	2.4
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	10.1	9.1	8.5	8.0	7.5	6.9
GHG emissions growth (mtCO2e)	2.5	5.0	-2.6	3.3	3.6	4.0
Energy related GHG emissions (% of total)	74.7	75.7	75.3	75.8	76.4	77.2

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-EU-SILC. Actual data: 2020. Nowcast: 2021-2022. Forecasts are from 2023 to 2025.
b/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

TAJIKISTAN

Table 1	2022
Population, million	10.0
GDP, current US$ billion	10.5
GDP per capita, current US$	1054.7
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]	100.9
Life expectancy at birth, years[b]	68.0
Total GHG emissions (mtCO2e)	21.3

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2015), 2017 PPPs.
b/ WDI for School enrollment (2017); Life expectancy (2020).

Tajikistan's economy grew by 8 percent in 2022, supported by strong remittance inflows amounting to over a third of GDP, largely from Russia. The short-term growth outlook is subject to significant downward risks associated with a possible reduction in remittances. Growth is expected to slow over the medium term, in the absence of structural reforms to open up the economy to competition, and greater investment in human capital.

Key conditions and challenges

Tajikistan's economy performed strongly over the last decade, with GDP growth averaging above 7 percent. This helped to halve the poverty rate from 25.7 percent in 2015 to a projected 13.4 percent in 2022 (at the international poverty line of USD 3.65 a day, 2017 PPP). Despite this performance, Tajikistan remains the poorest economy in Europe and Central Asia, with a GNI per capita of USD 1,150 (Atlas method) in 2021.

The growth model is based on natural resources extraction and exports, and substantial remittances from migrants working mainly in Russia. This model presents inherent vulnerabilities associated with the high dependency on income from labor migrants from one country, the limited domestic production base, and the undiversified export basket. The private sector has not been able to invest and grow in an environment with significant barriers to competition, obstacles to business operations, unpredictable tax regimes, and shallow financial markets. Moreover, underinvestment in human capital (in favor of physical infrastructure, mainly for large hydroelectric plants), high trade and connectivity costs, and predominance of inefficient loss-making SOEs, undermine the economy's competitiveness.

Tajikistan needs to accelerate structural reforms, primarily by strengthening the independence of the judicial system; opening up key sectors to competition and leveling the playing field for businesses, notably in backbone sectors such as telecommunications and aviation; refocusing public resources on human capital development; and enhancing management of public finance and the governance of public enterprises.

Recent developments

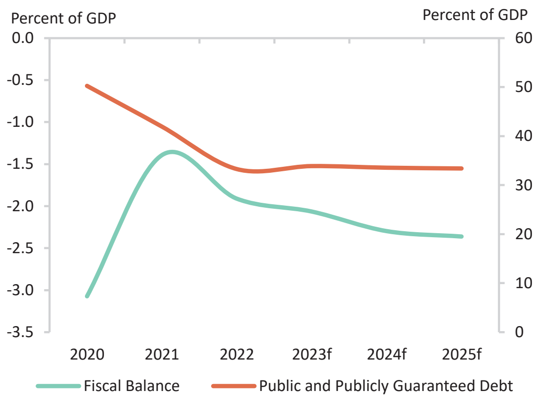
The Tajik economy expanded by 8 percent in 2022, driven by Russia's strong labor demand, which combined with the appreciation of the Russian ruble resulted in substantial remittance inflows. This positive shock fueled household consumption. Private investment was buoyant, led by the mining industry.

The trade deficit widened due to lower exports of precious metals and buoyant imports. However, the substantial remittances offset this and led to a current account surplus of 6.1 percent of GDP. Combined with net FDI inflows of 4.1 percent of GDP to the mining sector, international reserves rose to USD 3.8 billion, providing around 7.5 months of import cover.

Migration increased significantly in 2022 before reversing after Russia announced mobilization in September. The share of households with a migrant increased from 42 percent to 50 percent during H1 2022 but steadily declined afterward.

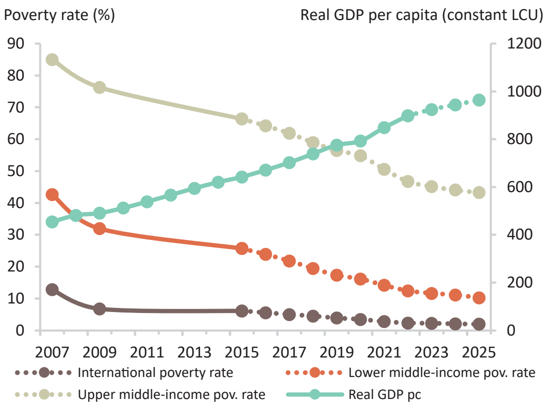
The average CPI inflation declined to 6.6 percent in 2022 from 9 percent a year

FIGURE 1 Tajikistan / Fiscal balance and public debt



Source: 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.

earlier. The Somoni appreciated by 2.6 percent against the USD in 2022, which helped curb external price pressure, while solid agricultural output and the sale of strategic food reserves contained domestic food inflation. The Central Bank (NBT) raised the policy rate slightly from 13 percent at end-2021 to 13.5 percent in October 2022. Economic growth and FX inflows supported good financial sector performance. Return on assets rose to 5.9 percent (from 1.1 percent in 2021), and the share of the nonperforming loans to total loans declined to 12.2 percent (from 13.7 percent in 2021).

The overall fiscal deficit widened to 1.9 percent of GDP, from 1.4 percent in 2021. Tax collections declined by approximately 2 percent of GDP with the enactment of the new tax code in 2022, which streamlined the number of taxes and reduced rates. The shortfall was partly offset by development partner grants and higher non-tax revenues. The budget deficit was financed primarily through external financing. Tajikistan is at high risk of debt distress (largely due to Eurobond and IMF Rapid Credit Facility principal repayments in 2025-2027) but on a sustainable debt path in the medium term.

Poverty measured at the international poverty line of USD 3.65 is projected to have declined to 13.4 percent in 2022, from 14.3 percent in 2021. The share of households reducing food consumption in H1 2022 was less pronounced than in previous years.

Outlook

Tajikistan's economic growth is expected to decelerate to 5 percent this year as the 2022 positive shock subsides and remittance inflows diminish, which is expected to result in a contraction in private consumption. Inflation is expected to decrease gradually and remain within the NBT's 4–8 percent target range, supported by tight monetary policy.

The external position is expected to normalize after a peak in 2022. Moreover, reduced global demand is expected to weaken Tajikistan's export of precious metals and minerals.

Over the medium term, the fiscal deficit is expected to remain in line with the Government's target of 2.5 percent of GDP. Spending on the Rogun hydropower plant (HPP) and other large infrastructure projects is expected to be financed by improving revenues over time, following the introduction of the new tax code and gradually phasing out tax exemptions.

Tajikistan's outlook faces substantial downside risks. Holders of dual Tajik and Russian citizenship remain at elevated risk of military mobilization in Russia, which could trigger a return of migrants and a greater need for social assistance. Extensive pressure on the state budget due to mounting SOE contingent liabilities, including from the national power company, and pressure on spending to complete the Rogun HPP, could divert resources from spending needed for human capital development. Tajikistan is highly sensitive to climate change risks and needs to adopt better mitigation and adaptation measures.

Poverty, at the USD 3.65 line, is projected to further decline from 13.4 percent in 2022 to 12.6 percent in 2023.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	4.4	9.4	8.0	5.0	4.0	4.0
Private Consumption	3.4	4.7	14.5	-4.0	4.4	4.2
Government Consumption	2.3	4.6	8.1	5.2	4.8	4.8
Gross Fixed Capital Investment	-4.6	12.0	10.3	8.9	7.7	7.7
Exports, Goods and Services	21.8	55.4	-19.1	-1.1	1.1	0.8
Imports, Goods and Services	-0.4	20.0	4.2	-0.3	9.6	5.0
Real GDP growth, at constant factor prices	7.6	9.2	9.2	5.0	4.0	4.0
Agriculture	7.9	-0.3	8.0	4.3	3.0	3.0
Industry	17.3	13.2	12.9	7.2	6.0	6.0
Services	-1.9	10.6	5.4	2.5	1.9	2.0
Inflation (Consumer Price Index)	8.6	9.0	6.6	5.6	6.5	6.5
Current Account Balance (% of GDP)	4.3	8.2	6.1	-1.5	-1.8	-2.3
Net Foreign Direct Investment Inflow (% of GDP)	0.4	0.4	4.0	2.4	3.4	3.8
Fiscal Balance (% of GDP)	-3.1	-1.4	-1.9	-2.1	-2.3	-2.4
Revenues (% of GDP)	26.2	26.6	27.2	26.2	26.6	27.0
Debt (% of GDP)	50.3	41.9	33.3	33.9	33.5	33.3
Primary Balance (% of GDP)	-2.3	-0.5	-1.2	-0.9	-1.3	-1.4
International poverty rate ($2.15 in 2017 PPP)[a,b]	3.5	2.8	2.3	2.3	2.1	2.0
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	16.2	14.2	12.4	11.6	11.1	10.2
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	54.8	50.6	46.8	45.2	44.1	43.3
GHG emissions growth (mtCO2e)	2.2	10.6	8.2	6.5	6.5	6.2
Energy related GHG emissions (% of total)	44.8	46.8	48.9	50.1	50.9	51.9

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: 2016-2022. Forecasts are from 2023 to 2025.
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	2022
Population, million	85.0
GDP, current US$ billion	906.0
GDP per capita, current US$	10661.2
Upper middle-income poverty rate ($6.85)[a]	12.6
Gini index[a]	41.9
School enrollment, primary (% gross)[b]	96.5
Life expectancy at birth, years[b]	75.8
Total GHG emissions (mtCO2e)	467.7

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ Most recent WDI value (2020).

Türkiye's economy grew by 5.6 percent in 2022 but has been losing momentum amidst a deteriorating external environment and heterodox monetary policies. Two devastating earthquakes struck on February 6, 2023, with enormous loss of life and physical damage. Pre-election spending and reconstruction efforts are expected to support growth, forecast at 3.2 percent in 2023 and 4.3 percent in 2024. Türkiye's progress in poverty reduction through the pandemic is at risk of being eroded by high inflation and the earthquakes' impact.

Key conditions and challenges

Two devastating earthquakes struck Türkiye and Syria on February 6, 2023, killing over 57,000 people. Beyond the human tragedy, the earthquakes caused significant physical damage to buildings and infrastructure in 11 provinces accounting for 16.4 percent of Türkiye's population and 9.4 percent of its economy. Direct losses are estimated at US$34.2 billion, but the reconstruction needs could be double.

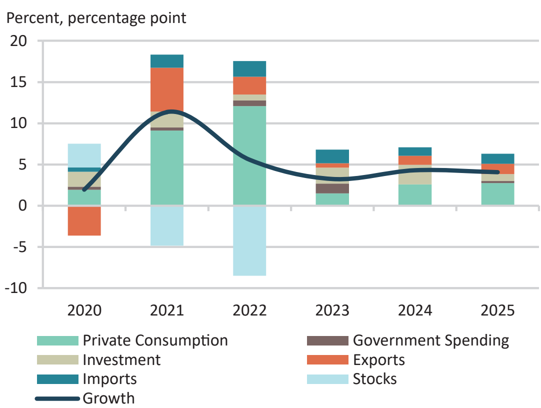
The earthquakes added pressures to an increasingly fragile macro-financial situation amidst a deteriorating external environment and particular domestic policy mix. Russia's invasion of Ukraine slowed Türkiye's exports to the EU and raised energy import prices. However, exports to Russia jumped, and Türkiye benefited from increased financial inflows from unknown origins. Meanwhile, despite rapidly rising inflation, the Central Bank of Türkiye (CBRT) continued to cut interest rates by 550 bps from August 2022 to March 2023, while relying on an increasingly complex mix of heterodox macro-prudential regulatory measures to support the TRY, reduce inflation, and control and direct credit growth.

Recent developments

Türkiye's economy expanded by 5.6 percent in 2022, though growth decelerated to 4.0 percent (yoy) in Q3 and 3.5 percent (yoy) in Q4, as exports, investment, and manufacturing activity lost momentum; investment growth fell from 4.9 percent (yoy) in H1 to 0.9 percent (yoy) in H2, and exports from 15.4 percent (yoy) in H1 to 4.0 percent (yoy) in H2 despite exports to Russia rising 177 percent in TRY in 2022. Private consumption however remained robust, expanding 19.6 percent in 2022. Value-added growth was led by the services sector (up 9.7 percent) and industry (up 3.3 percent) despite manufacturing growth falling from 9.0 percent (yoy) in H1 to 0.1 percent (yoy) in H2. In 2022, the labor market, supported by strong economic growth, rebounded fully from the pandemic. TURKSTAT's Economic Confidence Index remained broadly stable in 2022 but below the 100 thresholds reflecting a pessimistic outlook for consumers and constructors. Similarly, the manufacturing PMI averaged 48.2 points in 2022.

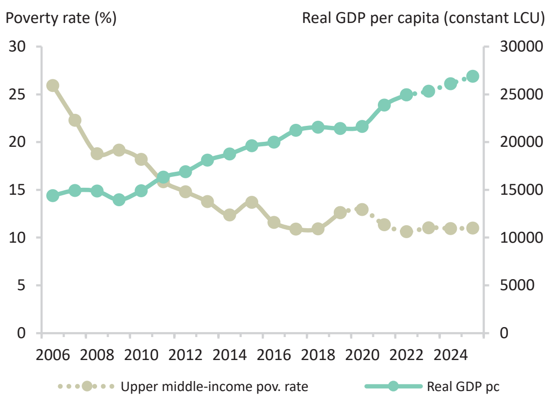
High aggregate demand growth and energy prices drove a nearly 7-fold rise in the current account deficit to US$48.7 billion in 2022, mainly financed through US$27.4 billion of capital inflows with unknown origin recorded as net errors and omissions. The TRY lost 30 percent of its value in 2022 despite some analysts' estimates of US$108 billion in indirect FX interventions by the CBRT. Despite these interventions, CBRT's gross international reserves improved to US$121 billion by end-February 2023 but remain deeply negative after accounting for banks' FX reserve requirements held at the CBRT and swaps with commercial banks and other central banks.

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 rate and real GDP per capita



Source: World Bank. Notes: see Table 2.

Macro-financial conditions have become increasingly challenging amidst a proliferation of heterodox macro-prudential policy measures. CPI inflation reached a 24-year high of 85.5 percent in October before easing to 55.2 percent in February largely due to base effects. The heterodox regulatory policy restraints have started to slow credit growth and align lending rates with the reductions in the policy rate. Banking sector profitability increased with the average return on assets at 4.5 percent (yoy) in Q3 2022. The banking sector continues to have adequate FX liquidity buffers to cover short-term liabilities, with the net FX position in surplus at 2.4 percent in December 2022. However, there are concerns about the accessibility of those buffers in times of stress as at least 70 percent of FX liquidity on the balance sheet of Turkish banks is at the CBRT in the form of currency swaps, required reserves, and free deposits. Rising exposure of banks through incentivized holdings of government bonds also increases contagion risks.

Strong revenue collections (up 77.1 percent in nominal terms and above average 2022 CPI inflation of 72.3 percent) despite tax breaks, helped keep the primary fiscal deficit at 0.6 percent of GDP, offsetting a substantial increase in spending (up 81 percent). Fiscal support includes increasing civil servants' salaries and pensions; energy subsidies; personal income tax allowances; eliminating a retirement age requirement; and financing support for businesses. Rapid growth helped reduce debt-to-GDP levels, yet the Government's cost of borrowing remains high despite declining domestic bond yields, due to risk premia on government securities; January 2023's Eurobond issuance was at 9.8 percent interest rate with 10-year maturity.

Outlook

Assuming a normalization in macroeconomic policies, economic growth is projected at 3.2 percent in 2023 and 4.3 percent in 2024. Despite a drag on growth in 2023 due to earthquake-related production, export, and consumption disruptions, economic activity is expected to remain solid in H1 2023, supported by a 55 percent net minimum wage increase in January 2023 and expansionary fiscal policies ahead of the 2023 elections set for May 14, which will counteract weakening global demand. Massive reconstruction efforts in the earthquake zone – with large multiplier effects – will boost growth in late-2023 and beyond. Pre-election spending and earthquake recovery will weaken fiscal balances.

Türkiye's progress in poverty reduction through the COVID-19 pandemic risks being eroded by high inflation and the earthquakes' impact. The 8 most-affected provinces contained 30 percent of Türkiye's poor in 2020 with poverty rates much higher than the national average, which could exacerbate inequality. Initial forecasts indicate a worsening of consumption-based poverty rate in 2023 by 0.4 percentage points to 11 percent through 2025.

The outlook faces considerable uncertainty and risk under the current macroeconomic policy mix. Post-election economic performance will depend on policy decisions to gradually phase out the heterodox regulatory web that distorts financial markets, and the adoption of macroeconomic policies to rebuild buffers and support investor confidence. Inflationary pressures could arise from fiscal expansion and earthquake-induced agricultural and logistics disruptions. External risks remain elevated given the high current account deficit and low net FX reserves; high external share of public debt (reaching 46 percent by Q3 2022); slower than expected recovery in the EU; and tightening global liquidity. There is also a risk that investor confidence will falter, intensifying pressure on the TRY, external balances, and corporate and bank balance sheets with the possibility that policy responses cause a real sector contraction.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	1.9	11.4	5.6	3.2	4.3	4.1
Private Consumption	3.3	15.3	19.6	2.2	3.7	4.0
Government Consumption	2.5	2.6	5.2	8.9	-0.7	1.9
Gross Fixed Capital Investment	7.4	7.4	2.8	7.9	9.3	3.1
Exports, Goods and Services	-14.4	24.9	9.1	2.1	4.5	5.0
Imports, Goods and Services	6.7	2.4	7.9	9.2	7.7	4.5
Real GDP growth, at constant factor prices	1.2	11.9	6.5	3.2	4.3	4.1
Agriculture	5.7	-2.9	0.6	-1.0	1.0	1.0
Industry	1.1	13.0	0.9	7.6	6.8	3.6
Services	0.8	13.1	9.7	1.8	3.5	4.5
Inflation (Consumer Price Index)	12.3	19.6	72.3	41.0	20.0	15.0
Current Account Balance (% of GDP)	-4.4	-0.9	-5.4	-6.0	-5.0	-4.9
Net Foreign Direct Investment Inflow (% of GDP)	0.6	0.8	0.9	1.1	1.2	1.2
Fiscal Balance (% of GDP)	-3.9	-2.6	-2.9	-5.9	-5.2	-3.3
Revenues (% of GDP)	32.4	30.9	26.4	27.4	28.1	29.9
Debt (% of GDP)	39.7	41.8	31.2	34.2	35.1	35.4
Primary Balance (% of GDP)	-1.1	0.0	-0.6	-3.0	-0.9	1.1
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	12.9	11.3	10.6	11.0	11.0	11.0
GHG emissions growth (mtCO2e)	10.1	0.1	0.1	2.9	3.7	3.2
Energy related GHG emissions (% of total)	76.9	76.6	76.5	76.0	75.4	74.9

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 2011-HICES and 2019-HICES. Actual data: 2019. Nowcast: 2020-2022. Forecasts are from 2023 to 2025.
b/ Projection using inequality adjusted methodology based on Lakner, Mahler, Negre, & Espen (2020).

UKRAINE

Table 1	2022
Population, million	43.5
GDP, current US$ billion	150.3
GDP per capita, current US$	3451.6
Upper middle-income poverty rate ($6.85)[a]	7.1
Gini index[a]	25.6
School enrollment, primary (% gross)[b]	99.0
Life expectancy at birth, years[b]	71.2
Total GHG emissions (mtCO2e)	144.5

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ WDI for School enrollment (2014); Life expectancy (2020).

While economic activity had stabilized in mid-2022, attacks on Ukraine's energy infrastructure starting in October have caused disruptions and undermined the recovery. GDP declined by 29.2 percent in 2022 and is expected to grow by only 0.5 percent in 2023. Thanks to international support Ukraine has been able to ensure the delivery of key social services. Continued donor support will be fundamental to maintain these gains.

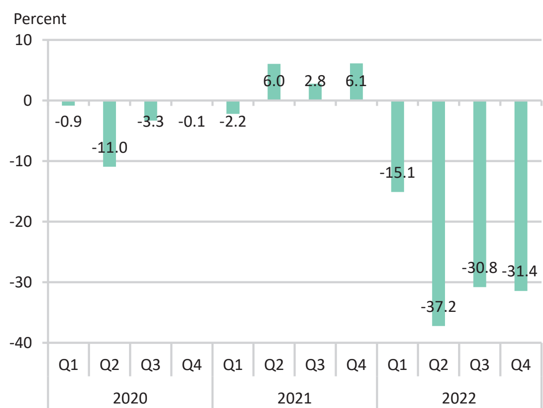
Key conditions and challenges

While Ukraine's economy has gradually adjusted to the wartime needs, attacks on the electricity network starting in October 2022 damaged over 40 percent of the country's power grid, thereby exacerbating production constraints for select sectors that drove Ukraine's GDP prior to the war. The attacks also imposed additional external pressure by limiting exports and increasing demand for energy-related imports. Ukraine's economic outlook will depend on the evolution of the war and the country's ability to adjust to continued aggression. With a prolonged war increasingly likely, Ukraine faces significant economic challenges. In the near term, maintaining the stable functioning of the war economy is critical. This will involve identifying opportunities to finance the elevated fiscal deficit - driven by the need to ensure defense and social expenditure while tax collection is limited - and domestic debt service. Annual debt service payments (interest and amortization) are estimated at US$17.6bn equivalent in 2023, of which US$15bn stem from the amortization of short-term domestic debt. Total fiscal needs are estimated to exceed US$41bn in 2023. Maintaining macroeconomic stability will also hinge on controlling inflation. In 2022, Ukraine relied on the monetization of residual financing needs. While the central bank has been able to effectively neutralize the inflationary impacts of such operations, a central challenge will be to encourage higher rollover rates for domestic banks to eliminate the need for monetization. In the medium term, Ukraine will need to set the conditions for economic recovery by funding capital expenditure and by continuing critical institutional reforms.
Considering these challenges, any stop or delay in external funding may lead to broad negative economic and social consequences. Continued foreign aid inflows are an essential lifeline as they help meet financing needs, balance the current account, and provide a lever for Ukraine to control inflation.

Recent developments

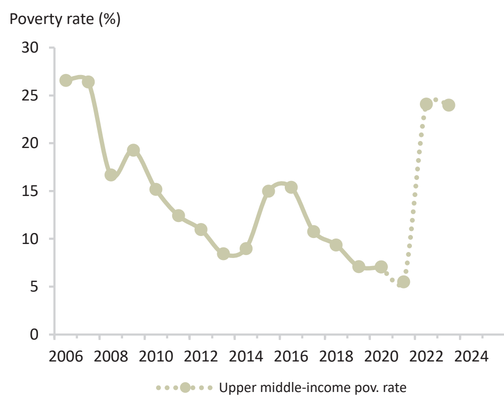
GDP declined by 29.2 percent in 2022. The contraction was less than expected as the UN-brokered grain deal and the return of nearly 4 million migrants boosted economic activity in Q3. The opening of new logistic routes and re-orientation of supply to wartime needs by the private sector added to growth. However, attacks on the electricity infrastructure caused disruptions and a 31.4 YoY contraction in Q4. Inflation stood at 26.6 percent at end-2022. NBU intervened in the currency market to establish an exchange rate peg and mopped up domestic liquidity to control demand, preventing further inflation growth. While the invasion has affected asset

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



Source: Ukraine's Statistics Office.

FIGURE 2 Ukraine / Actual and projected poverty rate



Source: World Bank. Notes: see Table 2.

quality in the financial sector, banks have remained profitable and stable.

Ukraine's current account surplus was 5.7 percent of GDP in 2022, with grant inflows compensating for a growing trade deficit that reached 16 percent of GDP. Annual exports declined by 30 percent, while imports contracted by only 4 percent. The capital account was under pressure due to the withdrawal of foreign exchange by refugees and outflows of trade financing. This was compensated through loan inflows, that helped restore international reserves to US$29.9bn, close to the pre-war level.

Public finances remain under pressure. The consolidated budget deficit excluding grants amounted to 26.5 percent of GDP in 2022. Tax revenue declined by a nominal 8 percent in nominal terms (30 percent in real terms) as indirect taxes suffered contractions. Direct revenue showed resilience, supported by wage increases in the defense sector. Expenditure grew by 65 percent, with war-related spending and essential public and social services prioritized. By contrast, capital expenditure declined by 37 percent. The deficit was financed through international assistance and monetization by NBU.

Poverty is estimated to have increased from 5.5 percent in 2021 to 24.1 percent in 2022, pushing 7.1 million more people into poverty and retracting 15 years of progress.

Outlook

Despite a localization of active combat, Ukraine's economic outlook remains highly uncertain and is dependent on the duration of the war. The projections assume a continuation of economic activity at the level of 4Q22 into the medium term, adjusting for seasonal effects and accounting for recent improvements in the energy supply. GDP is expected to grow by only 0.5 percent in 2023.Domestic trade and light industries, focused on supplying the domestic market and meeting wartime needs, are projected to recover gradually. However, agricultural output is expected to decline by about 15 percent due to problems with sowing and a reduction in arable land. Heavy industry output is also expected to remain subdued. Inflation is expected to decline slightly to 18 percent by the end of 2023 as monetary policy continues to contain domestic demand. This scenario is subject to significant downside risks related to a deterioration of the security situation.

The current account is expected to register a 4.5 percent of GDP deficit in 2023 as a widening trade deficit offsets expected secondary income from international grants of around US$10bn. Exports are estimated to remain low, due to lower agricultural output and persistent logistics bottlenecks. By contrast, imports are expected to increase by a nominal 20 percent YoY, driven by strengthening domestic demand and continued needs for the import of energy-related goods.

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

	2020	2021	2022e	2023f
Real GDP growth, at constant market prices	-3.8	3.4	-29.2	0.5
Private Consumption	1.7	6.9	-15.5	7.7
Government Consumption	-0.7	0.8	16.7	0.0
Gross Fixed Capital Investment	-21.3	9.3	-80.0	5.5
Exports, Goods and Services	-5.8	-8.6	-60.0	15.0
Imports, Goods and Services	-6.4	14.2	-30.0	20.0
Real GDP growth, at constant factor prices	-3.9	3.4	-29.1	0.5
Agriculture	-11.5	14.4	-25.0	-15.0
Industry	-4.5	1.1	-60.0	1.5
Services	-2.3	2.4	-20.3	2.9
Inflation (Consumer Price Index)	5.0	10.0	26.6	18.0
Current Account Balance (% of GDP)	3.4	-1.6	5.7	-4.5
Net Foreign Direct Investment Inflow (% of GDP)	0.0	-2.4	0.0	0.0
Fiscal Balance (% of GDP)[a]	-5.0	-4.0	-26.5	-28.2
Revenues (% of GDP)	39.9	36.3	43.4	39.5
Debt (% of GDP)	60.4	43.3	78.0	97.0
Primary Balance (% of GDP)[a]	-2.1	-0.5	-23.8	-24.9
Upper middle-income poverty rate ($6.85 in 2017 PPP)[b,c]	7.1	5.5	24.1	24.0
GHG emissions growth (mtCO2e)	-3.8	1.7	-33.2	-3.3
Energy related GHG emissions (% of total)	77.8	78.1	73.4	74.9

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 2022-2023.
b/ Calculations based on ECAPOV harmonization, using 2020-HLCS.
c/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU. 2022 estimate based on simulation reflecting economic contraction and poverty impacts of inflation. Actual data: 2020. Nowcast: 2021-2022.

UZBEKISTAN

Table 1	2022
Population, million	35.6
GDP, current US$ billion	80.4
GDP per capita, current US$	2254.9
School enrollment, primary (% gross)[a]	98.1
Life expectancy at birth, years[a]	70.3
Total GHG emissions (mtCO2e)	174.3

Source: WDI, Macro Poverty Outlook, and official data.
a/ WDI for School enrollment (2021); Life expectancy (2020).

Uzbekistan's economy grew by 5.7 percent in 2022, which is better than expected, largely supported by strong remittances and exports. Fiscal consolidation is continuing, albeit on a more gradual trajectory given the need to cushion the impact of external shocks this year as well. The medium-term outlook remains positive as ambitious ongoing economic reforms are expected to continue to invigorate private sector-led growth.

Key conditions and challenges

Uzbekistan has developed an ambitious set of reforms in recent years, but more are needed to continue to spur private sector-led growth and job creation. Notably, reducing the dominance of SOEs and opening up key sectors of the economy to competition, with priority on factor markets and backbone services, strengthening the regulatory environment, and reducing the high trade and transit costs, would strengthen market incentives and sustainability.

The Government recognizes that the transition must be inclusive. In that regard, recent reforms expanding coverage and the targeting of social assistance have been significant.

Natural gas and power outages were experienced in December 2022 in many parts of the country, including in the capital. This highlights the systemic crisis and needs for reforms in Uzbekistan's energy sector.

Recent developments

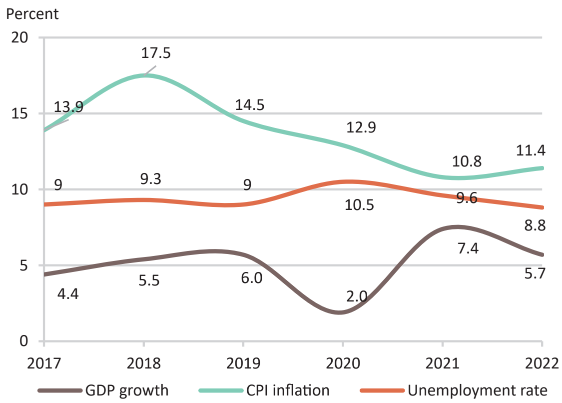
GDP grew by 5.7 percent in 2022, led by strong remittances, consumption, and exports. Non-gold exports grew by 21 percent in 2022 (in USD value), led by textiles, non-ferrous metals, fertilizers, and food, largely driven by high export growth to Russia (52 percent). This constituted around 17 percent of total goods exports in 2022. Services exports, mainly in transport and tourism, increased by 53 percent. This reflects a three-fold increase of tourists or immigrants inflow from Russia, as well as a pick-up in tourism from Kazakhstan, Kyrgyzstan, and Tajikistan. Imports expanded by 20.4 percent as imported food and energy prices rose with rising domestic demand. Remittance inflows doubled as a share of GDP to 18.9 percent in 2022 due to RUB appreciation and increased migrant inflows.A part of these financial inflows reflects the increased private money transfers of Russian citizens fleeing Russia and companies relocating to Uzbekistan following Russia's invasion of Ukraine. This narrowed the current account deficit from 7 percent in 2021 to just 0.6 percent of GDP in 2022.

The fiscal deficit declined from 6.1 percent of GDP in 2021 to 4.2 percent in 2022, supported by higher revenues. By end-2022, international reserves increased slightly to reach USD 35.8 billion, or 14 months of import cover.

Higher costs of food, fuel, and logistics drove CPI inflation up to 12.3 percent (yoy) in December. The UZS depreciated by 3.8 percent against the USD in 2022, and the real effective exchange rate appreciated slightly by 0.4 percent. After initially raising the policy rate by 300 bps to 17 percent, the Central Bank (CBU) cut the rate back to 15 percent in July 2022 and to 14 percent in March 2023.

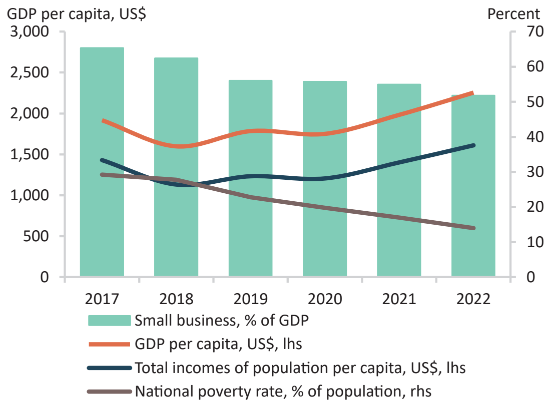
Credit growth in nominal terms stepped up to 21.5 percent in 2022 from 18.5 percent the prior year. The banking sector remains adequately capitalized with a

FIGURE 1 Uzbekistan / GDP growth, inflation, and unemployment



Source: Uzbekistan official statistics.

FIGURE 2 Uzbekistan / Poverty, GDP per capita, SME development



Source: Uzbekistan official statistics. Note: The national poverty line is more ambitious (67 percent higher) than LMIC poverty line.

capital adequacy ratio of 17.8 percent at end-2022 relative to a required CAR of 13 percent. NPLs reduced from 5.1 percent at the end-2021 to 3.5 percent at end-2022.
The unemployment rate fell to the pre-COVID-19 level of 8.8 percent, down from 9.6 percent in 2021, although it remains higher for youth and women and in lagging regions. The poverty rate is projected to have declined from 17 percent in 2021 to 14 percent in 2022 (using the national poverty line) supported by higher remittances.

Outlook

Growth is expected to moderate to 5.1 percent in 2023 and accelerate gradually in the medium term. Russia's protracted war in Ukraine, and increased logistical challenges linked to the sanctions on Russia, are expected to prolong high food and energy prices and reduce private consumption growth. Private investment and trade are expected to grow, and the current account deficit to widen, with remittances to Uzbekistan expected to moderate from their peak in 2022. The projected recovery in China may increase demand for Uzbekistan's textile and food exports.
Higher revenues from gold and copper exports and slower public investment spending will see the fiscal deficit decline to 3.3 percent of GDP in 2023, close to the Government's target of 3 percent.
Budget consolidation is expected to continue in future years, supported by both revenue mobilization and spending efficiency. The Government is expected to adhere to its overall debt limits, with public debt and total external debt gradually falling to 32 percent and 55 percent of GDP, respectively, by 2025.
Continued growth and expanded social protection programs are expected to sustain poverty reduction, and the national poverty rate is projected to fall to 12 percent in 2023.
Risks to the outlook are tilted downside, including a possible deeper contraction of Russia's economy and tighter-than-expected global financial conditions. Positive surprises may potentially include higher global gold, natural gas, and copper prices; and stronger productivity growth from ongoing structural reforms.

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

	2020	2021	2022e	2023f	2024f	2025f
Real GDP growth, at constant market prices	2.0	7.4	5.7	5.1	5.4	5.8
Private Consumption	0.2	11.6	10.5	5.0	5.8	6.0
Government Consumption	1.4	3.4	1.4	3.1	3.5	4.4
Gross Fixed Capital Investment	-4.4	2.9	5.0	4.2	5.3	5.6
Exports, Goods and Services	-20.0	13.3	25.3	20.5	17.9	18.4
Imports, Goods and Services	-15.0	19.9	11.5	20.6	20.3	19.6
Real GDP growth, at constant factor prices	2.0	7.4	5.7	5.1	5.4	5.8
Agriculture	2.9	4.0	3.6	3.7	3.9	3.9
Industry	2.5	7.9	5.5	5.0	5.6	5.6
Services	1.2	9.1	7.0	5.9	6.1	6.9
Inflation (Consumer Price Index)	12.9	10.8	11.4	11.8	10.0	6.6
Current Account Balance (% of GDP)	-5.0	-7.0	-0.6	-3.7	-3.8	-4.1
Net Foreign Direct Investment Inflow (% of GDP)	2.9	3.3	2.4	2.8	3.1	3.2
Fiscal Balance (% of GDP)	-4.4	-6.1	-4.2	-3.3	-3.0	-3.0
Revenues (% of GDP)	26.0	26.1	29.5	27.1	27.6	28.2
Debt (% of GDP)	37.4	35.5	34.5	34.2	32.9	31.9
Primary Balance (% of GDP)	-3.4	-5.0	-3.2	-2.4	-2.1	-2.2
GHG emissions growth (mtCO2e)	-1.8	-1.1	-3.2	-2.7	-2.1	-2.6
Energy related GHG emissions (% of total)	60.1	59.4	58.1	56.8	55.7	54.4

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

WORLD BANK **ECA ECONOMIC UPDATE** Spring 2023

Weak Growth, High Inflation, and a Cost-of-Living Crisis

Economic growth slowed sharply last year in Europe and Central Asia, as Russia's invasion of Ukraine, a surge in inflation, and the sharp tightening of monetary policy and financing conditions hit private consumption, investment, and trade. The marked increase in food and energy prices boosted the costs of living at a pace not seen in more than 20 years.

This ECA Economic Update shows that the burden of inflation was spread unevenly across households. The poorest households in the region faced inflation that was more than 2 percentage points higher than the inflation faced by the richest house-holds, with this difference exceeding 5 percentage points in some countries.

This report also shows that poverty and inequality rates derived from household-specific inflation rates differ from those based on the standard consumer price index (CPI) approach. These differences have important policy implications, because many programs use CPI-based inflation adjustments, which do not accurately capture changes in the cost of living of targeted populations.

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