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Sluggish Growth, Rising Risks

Europe and Central Asia Economic Update

Office of the Chief Economist

Fall 2023

WORLD BANK **ECA ECONOMIC UPDATE** FALL 2023

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Abbreviations

bbl	barrel
BHAS	Bosnia and Herzegovina Agency for Statistics
BiH	Bosnia and Herzegovina
BOS	businesses of the state
CAD	current account deficit
CAIT	Climate Watch - country greenhouse gas emissions dataset
CAD	current account deficit
CAIT	Climate Watch - country greenhouse gas emissions dataset
CAR	capital adequacy ratio
CBA	Central Bank of Armenia
CBA	Central Bank of Azerbaijan
CBU	Central Bank of Uzbekistan
CDS	credit default swap
CIS	Commonwealth of Independent States
CO2	carbon dioxide
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
ECAPOV	ECAPOV (ECA Poverty) database of standardized household surveys
ECB	European Central Bank
EU	European Union
FDI	foreign direct investment
FX	foreign exchange
GDP	gross domestic product
GFCF	gross fixed capital formation
GHG	greenhouse gas
GNI	gross national income
GUS	Central Statistical Office of Poland
H1, H2	first and second halves of the year
HBS	household budget surveys
HHS	household surveys
HICES	Household Income and Consumption Expenditures Survey
HICP	Harmonized Index of Consumer Prices
HLCS	Household Living Conditions Survey
ICT	information and communications technology
ILCS	Integrated Living Conditions Survey
INSTAT	Institute of Statistics (Albania)
KIHS	Kyrgyz Integrated Household Survey
LCU	local currency unit
LFS	Labor Force Survey

LNG	liquefied natural gas
MPO	Macro Poverty Outlook (World Bank)
mtCO2e	metric tons of carbon dioxide equivalent
NBG	National Bank of Georgia
NPL	non-performing loan
NRRP	National Recovery and Resilience Plan
OECD	Organisation for Economic Co-operation and Development
pc	per capita
PMI	Purchasing Managers' Index
PPP	purchasing power parity
Q	quarter
R&D	research and development
RVC	regional value chain
sa	seasonally adjusted
SILC	Statistics of Income and Living Conditions
SMEs	small and medium-sized enterprises
SOEs	state-owned enterprises
SOFAZ	State Oil Fund of the Republic of Azerbaijan
UMIC	upper-middle-income country
VAT	value-added tax
WB	World Bank
WDI	World Development Indicators
yoy	year-over-year

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, Russia, South Caucasus, Türkiye, and Western Balkans.

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

Central Europe: Bulgaria, Croatia, Poland, Romania

Eastern Europe: Belarus, Moldova, Ukraine

Russia

South Caucasus: Armenia, Azerbaijan, Georgia

Türkiye

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

Executive Summary

Europe and Central Asia (ECA) continues to be negatively impacted by the Russian Federation's invasion of Ukraine, tighter global financial conditions, sticky inflation, and global economic fragmentation. Five-year global growth for 2020–24 is at its weakest in three decades, reflecting a weak recovery in China and a sharp slowdown in the euro area—ECA's largest trading partner. Synchronized increases in policy rates across advanced and developing economies have resulted in higher bond yields and spreads, weakened market access, and reduced availability of credit. Inflation has partly receded in ECA, as global commodity prices have eased from last year's peaks, although disinflation slowed during the summer and real incomes have yet to recover from the 2022 cost-of-living crisis.

In this challenging environment, ECA's growth is projected to remain weak relative to the long-term pre-pandemic average. Although the regional growth forecast has been upgraded to 2.4 percent for 2023, from the 1.4 percent projected in June, the divergence within the region has widened as growth projections were left unchanged or downgraded for about half of the ECA countries.

For Türkiye, growth is projected to increase to 4.2 percent in 2023, up from the 3.2 percent projected in June, because of resilient household consumption and reduced policy uncertainty. The latter reflects the positive steps the authorities have taken to normalize macroeconomic policies following the May 2023 elections. For Russia, increased government spending, largely on military buildup and social transfers, together with stronger credit growth, has led to an upward revision in the growth projection.

The growth projections have also been upgraded for most of the economies of the South Caucasus and Central Asia, as these countries absorbed a significant inflow of migrants, businesses, trade, and money flows over the last year and a half. These developments boosted growth in domestic demand and output and supported currency appreciation and lower inflation. In Eastern Europe, which has endured the most negative effects of the invasion of Ukraine, growth is gradually regaining momentum.

After a large decline in 2022, output is up this year in Ukraine due to more stable electricity supply and increased government spending. However, economic conditions in the country remain in a state of extreme distress amid the escalation of security risks, additional damage to infrastructure, renewed upward pressure on energy prices, and capacity constraints in the grain transport routes to international markets. By contrast, growth in Central Europe and the Western Balkans is expected to be weaker, reflecting the sharp slowdown of activity in the euro area, a slow recovery of real incomes, and tight financial conditions.

ECA's average annual growth is expected to remain little changed at 2.6 percent during 2024–25, owing to the continued negative effects of Russia's invasion of Ukraine, weak expansion in the euro area, and slow progress with structural reforms. Growth in Russia is projected to continue to be weak, at only 1.1 percent a year on average during 2024–25, curbed by capacity constraints, tight labor markets, and the lack of access to technology and equipment due to sanctions. Growth in Türkiye is expected to slow over the forecast horizon as well, with monetary policy normalization and fiscal consolidation cooling domestic demand.

Risks to the outlook differ across countries, although they are generally on the downside. Inflation may persist amid increasing labor costs, the heightened volatility of global commodity markets, and the recent surge in global energy prices. Global growth may surprise on the downside, leading to a slower than expected recovery in exports. A drawn-out period of tight financial conditions could trigger renewed bouts of volatility in the global financial markets and test the resilience of the financial systems in ECA. Persistent economic weakness of regional economies and elevated policy uncertainty could further sap the reform momentum and delay the needed green transition.

1

Recent Developments, Policies, and Outlook

Europe and Central Asia (ECA) continues to be negatively impacted by the Russian Federation's invasion of Ukraine, tighter global financial conditions, sticky inflation, and global economic fragmentation. Global prospects for 2023 are modestly better than expected in June 2023, thanks to the resilient growth momentum in the United States and emerging markets and developing economies (EMDEs) other than China. Nonetheless, five-year global growth for 2020–24 is at its weakest in three decades. Tighter monetary policies in advanced economies and ECA have resulted in higher bond yields and spreads, weakened market access, and reduced availability of credit.

Economic expansion in ECA is projected to strengthen to 2.4 percent in 2023 from the 1.4 percent projected in June, reflecting largely better growth in Russia because of a surge in government spending on the military and social transfers, and consumer resiliency and reduced policy uncertainty in Türkiye. In the latter, the authorities have taken positive steps to normalize macroeconomic policies following the May 2023 elections. The growth projections have also been upgraded for most of the economies of the South Caucasus and Central Asia, as some of these countries absorbed a significant inflow of migrants, businesses, trade, and money flows over the last year and a half. Despite the upward growth forecast revisions in these countries, in more than half of the ECA economies, the growth projection is little changed or lower than was assumed in June 2023. Excluding Russia and Ukraine, regional output is expected to grow by 3 percent in 2023 compared to the 2.5 percent projected in June 2023, largely because of stronger prospects for Türkiye and Central Asia. Inflation pressures in the region have partly receded, but disinflation has slowed, and, in many countries, real incomes have yet to recover from the 2022 cost-of-living crisis. Climate change is becoming a serious constraint on growth, as extreme weather events are affecting the region with increased frequency and severity. During 2024–25, growth is expected to remain little changed at 2.6 percent a year, amid a weak expansion in the European Union (EU), the region's largest trading partner. Risks are predominantly on the downside. These include slower growth in the euro area, lower commodity prices, and a slower expansion in Russia. Stubborn inflation could lead to further monetary tightening with adverse impact on economic growth.

Recent Economic Developments

Upgraded projections for growth in 2023

The countries of ECA are adapting to the turbulent environment of tighter financial conditions, sticky inflation, continued spillovers from Russia's invasion of Ukraine, and the impact of global economic fragmentation. Synchronized increases in policy rates across advanced and developing economies have resulted in higher bond yields and spreads, weakened market access, and less availability of credit. Inflation has partly receded, as global commodity prices eased from last year's peaks, although disinflation slowed during summer 2023 and real incomes have yet to recover from the 2022 cost-of-living crisis. The impact of climate change has become a starker reality, with record-high temperatures, widespread fires, devastating floods, and other natural disasters across ECA and the EU.

Five-year global growth is at its weakest in three decades, including economic growth in the EU, ECA's largest trading partner. Global prospects for 2023 are only modestly better than was expected at midyear. Prospects for the EU and the euro area have remained bleak and little changed since June, as the German economy experienced two quarters of negative growth (box 1.1).

BOX 1.1 Global Outlook: A Small Upgrade for 2023, a Modest Downgrade for 2024

The Consensus Forecast for global growth in 2023 has been modestly upgraded, owing to the resilience of the US economy during the first half of this year despite much tighter monetary policy and the headwinds from the Russian Federation's invasion of Ukraine. However, the divergences across countries and sectors have widened (table B1.1.1). While a rebound in spending on travel and tourism supported activity and labor markets in service intensive economies, a slump in global goods trade has taken a toll on growth in more manufacturing intensive countries.

The economic growth in China has weakened because of fragility in the real estate sector, weak domestic demand, and falling exports. Growth in the euro area, the largest trading partner of Europe and Central Asia (ECA), stalled in 2023, with negative growth in Germany for the first two quarters of the year as the downturn in global trade and manufacturing deepened.

Despite the forecast upgrade for 2023, global growth remains weak, unbalanced, and shows signs of significant moderation in many countries and regions. The latest Consensus Forecast for global growth in 2023 has been upgraded by 0.2 percentage point from the June survey to 2.5 percent, primarily driven by a 0.9 percentage point upgrade of growth in the United States (figure B1.1.1, panel a).

Global demand for manufactured goods and goods trade have softened further, reflecting weakening consumption and subdued investment because of heightened geopolitical and economic uncertainty (figure B1.1.1, panel b). A boost to global manufacturing activity earlier this year from improving global supply chains has lost momentum, tempered by tighter financial conditions and a waning recovery in China. Business activity in the service sector, supported by the strong recovery of the travel, leisure, and tourism sectors earlier this year, leveled off in the second half of

(Continued next page)

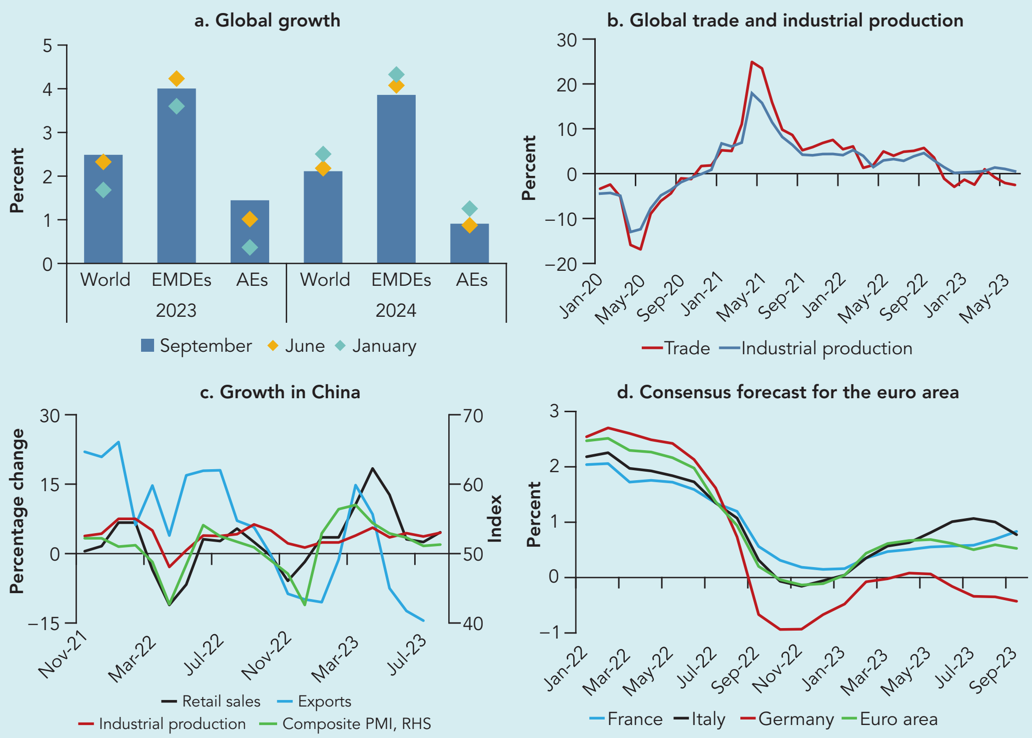
BOX 1.1 (continued)

TABLE B1.1.1. Consensus Growth Forecasts

	September survey		Difference from June survey	
	2023	2024	2023	2024
World	2.5	2.1	0.2	−0.1
EMDEs	4.0	3.9	−0.2	−0.2
EMDEs excl. China	3.1	3.3	0.2	−0.1
China	5.0	4.5	−0.7	−0.4
Advanced economies	1.4	0.9	0.4	0.0
United States	2.1	0.9	0.9	0.3
Euro area	0.5	0.7	−0.1	−0.2
Germany	−0.4	0.6	−0.3	−0.5

Sources: Consensus Economics; World Bank.
Note: Forecasts are from the Consensus Forecast survey. The sample includes 88 economies. Aggregates are calculated using real US dollar gross domestic product weights at average 2015 prices and market exchange rates. The last observation is September 2023. EMDEs = emerging markets and developing economies.

FIGURE B1.1.1. Recent global economic trends



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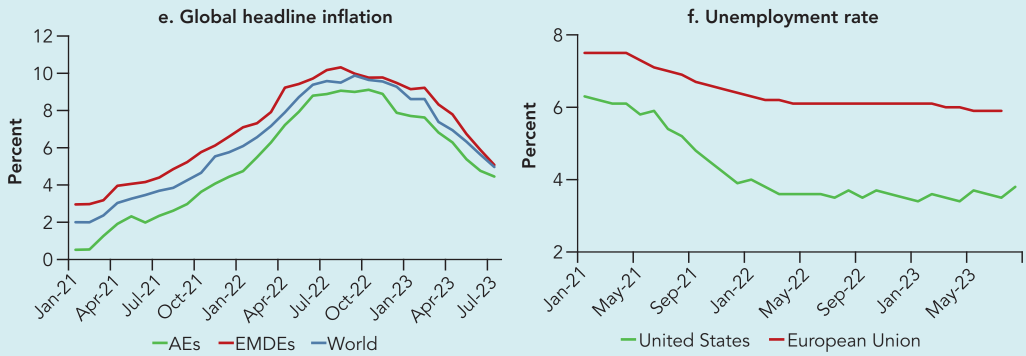
BOX 1.1 (continued)

FIGURE B1.1.1. (continued)



Sources: Consensus Economics; CPB Netherlands Bureau for Economic Policy Analysis; Eurostat; Haver Analytics; International Monetary Fund; National Bureau of Statistics of China; World Bank.
Note: AEs = advanced economies; EMDEs = emerging markets and developing economies; PMI = Purchasing Managers' Index.
a. The sample includes 51 EMDEs and 34 AEs. Aggregate growth rates are calculated using real gross domestic product at 2015 prices and market exchange rates. The last observation is September 2023.
d. The last observation is September 2023.
e. Median 12-month headline inflation rates for each group of countries. The sample include 32 AEs and 86 EMDEs. The last observation is July 2023.
f. The last observation is August 2023.

2023 with pent-up demand for travel and tourism starting to dissipate.

Following a strong recovery at the start of the year, economic conditions deteriorated substantially in China as multiple headwinds to growth intensified, including a sharp slowdown in consumption, declining exports, and deepening financial problems in the housing sector (figure B1.1.1, panel c). On the upside, downward pressures on activity appear to be abating as policy makers stepped up measures to prop up domestic demand. Meanwhile, economic weakness in the euro area has been building up, with the composite Purchasing Managers' Index deteriorating further in August.

Business activity in Germany, the euro area's largest economy, is shrinking at its fastest pace in more than three years because of the worsening slowdown in manufacturing and, more recently, sliding activity in the service sectors. Therefore, growth in the euro area is expected to remain low as sticky inflation and rising borrowing costs together with cooling labor markets weigh on demand (figure B1.1.1, panel d).

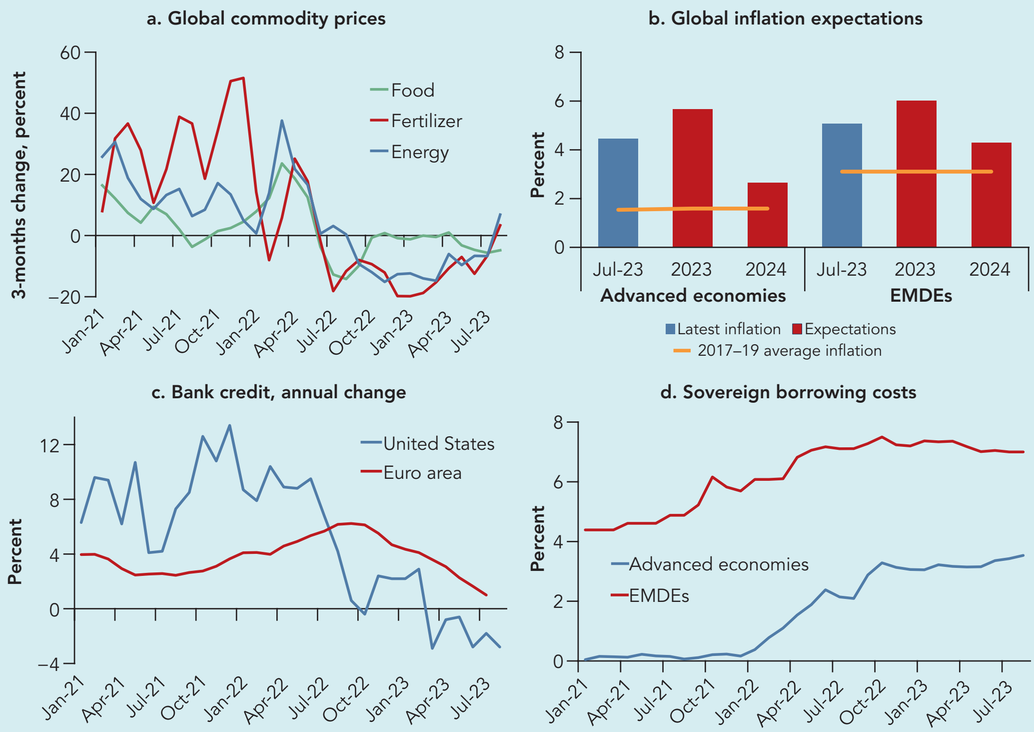
Growth is expected to ease to 2.1 percent next year, a 0.1 percentage point downgrade, as the slowing growth in China and the lagged effect of the aggressive rate hikes in the United States and other advanced economies weigh on global economic activity. Lackluster growth in the European Union (EU) is expected to persist next year as well, tempered by tight monetary policy and weak external demand (European Commission 2023). Still, EU growth momentum is expected to strengthen marginally next year as resilient labor markets and moderating inflation will support a gradual improvement in real incomes.

Downside risks continue to loom over the global outlook. As Russia's invasion of Ukraine continues, volatility in key commodity markets could intensify further, leading to renewed pressures on global energy and food prices (figure B1.1.2, panel a). Elevated levels of geopolitical uncertainty, in ECA and

(Continued next page)

BOX 1.1 (continued)

FIGURE B1.1.2. Risks to the global outlook



Sources: Consensus Economics; European Central Bank; Federal Reserve; Organisation for Economic Co-operation and Development; World Bank.
Note: EMDEs = emerging markets and developing economies.
b. Values are medians across each group of countries. Inflation expectations are from Consensus Forecasts. The last observation is September 2023.
d. Values are medians across country groups. The sample includes 11 EMDEs and 30 advanced economies. The last observation is August 2023.

globally, could deepen the deterioration of investor sentiment, causing capital outflows and currency depreciations. Global inflation has eased markedly owing to lower energy and food prices (figure B1.1.1, panel e). However, the disinflation process has stalled amid still robust wage pressures, especially in the service sectors, and renewed pressures on prices as energy prices have started to increase again. Furthermore, core inflation remains sticky and hovers well above the target in many countries due to rising labor costs. The recovery in labor markets, which proved exceptionally resilient during the first half of 2023, appears to be stalling as demand continues to moderate. Nevertheless, historically low unemployment rates indicate that wage growth, albeit slowing, will keep driving inflation (figure B1.1.1, panel f).

With inflation expectations for this year and 2024 still above their long-term averages both in advanced economies and emerging markets and developing economies (EMDEs), monetary policy could remain tighter than expected for longer (fig-

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BOX 1.1 (continued)

ure B1.1.2, panel b). Although policy makers in most countries are slowing or even pausing interest rate hikes, rates could rise further if more demand compression is needed to curb persistent wage pressures. Higher interest rates could deepen a slump in activity as tighter credit standards and higher interest on loans are tempering credit growth (figure B1.1.2, panel c). A combination of slowing growth and high funding costs could reignite financial stress across banking systems, especially in countries where banks' balance sheets have already been weakened by various domestic vulnerabilities, such as currency mismatch and large holdings of domestic sovereign debt. Lenders with excessive exposure to the interest rate–sensitive sectors, such as commercial real estate, are especially vulnerable to a prolonged period of tight financial conditions.

Costlier borrowing would also severely limit the space for countercyclical fiscal response and even more so in countries already struggling with market access, elevated debt servicing costs, and rapidly rising interest rates (figure B1.1.2, panel d). Lingering volatility in the financial markets and fragile investor sentiment could constrain access to international borrowing for many EMDEs, while persistently high policy rates will keep funding costs high, especially for speculative-grade issuers. For many EMDEs, this high interest rate environment could be unsustainable, heightening the risks of debt distress and bankruptcies.

Moreover, a series of recent global shocks has brought about new challenges to sustained long-term growth, which was already weakened by slowing productivity, aging population, and decelerating progress in educational outcomes. If left unaddressed, these emerging constraints on growth could severely threaten the long-term growth prospects of the world economy. For example, more frequent supply shocks together with tighter financial conditions make the inflation-output trade-off much more difficult for central banks, especially in EMDEs. The COVID-19 pandemic and Russia's invasion of Ukraine have given rise to geoeconomic fragmentation and tougher restrictions on cross-border trade and investments, making the global economy more vulnerable to future adverse shocks. Increased frequency and magnitudes of extreme weather events require substantial investments in climate mitigation and adaptation; yet many EMDEs lack fiscal space to strengthen resilience to climate change.

In this challenging environment, growth in ECA is projected to remain weak relative to the long-term pre-pandemic average. Although the regional growth forecast has been improved to 2.4 percent for 2023 compared to the 1.4 percent projected in June, the divergence within the region has widened (table 1.1). Growth forecasts were revised up for half the countries, including ECA's two biggest economies, Russia and Türkiye, by 1.2 percentage points on average. These upgrades reflect a smaller than initially feared impact from the energy shock, larger budget spending in Russia, better resilience of ECA consumers, and an improved forecast for war-hit Ukraine. Stronger than earlier expected pent-up demand for services, particularly for travel, has also supported the upward growth revisions. At the same time, the growth projections were left unchanged or downgraded in the other half of the ECA countries (table 1.2).

According to high-frequency indicators, after a strong start earlier this year, growth in ECA has recently begun to moderate, albeit to varying degrees across countries and subregions (figure 1.1, panels a and b). The Manufacturing Purchasing Managers' Index fell deeper into contractionary territory in Poland and

TABLE 1.1. Europe and Central Asia Economic Growth Summary, 2020–25

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

							Percentage point difference from June 2023 projections		
	2020	2021	2022	2023f	2024f	2025f	2023f	2024f	2025f
EMDE ECA	**−1.7**	**7.2**	**1.2**	**2.4**	**2.5**	**2.7**	**1.0**	**−0.2**	**0.0**
EMDE ECA excl. the Russian Federation and Ukraine	−1.0	8.5	4.8	3.0	3.2	3.7	0.5	−0.5	0.0
EMDE ECA excl. the Russian Federation, Türkiye, and Ukraine	−2.7	6.6	4.4	2.1	3.2	3.7	0.1	0.0	0.2
Poland, the Russian Federation, and Türkiye	−1.2	7.5	1.6	2.2	2.1	2.3	1.1	−0.4	0.0
Central Europe[a]	−3.0	7.1	5.0	1.1	2.9	3.5	−0.2	0.0	0.1
Western Balkans[b]	−3.1	7.7	3.2	2.5	3.0	3.5	−0.1	−0.1	−0.1
Eastern Europe excl. Ukraine[c]	−1.7	4.0	−4.7	2.7	1.3	1.3	1.9	−0.5	−0.4
South Caucasus[d]	−5.3	6.7	7.0	3.3	3.2	3.3	0.3	−0.2	−0.3
Central Asia[e]	−1.3	5.3	4.1	4.8	4.6	4.8	0.8	0.2	0.6
Russian Federation	−2.7	5.6	−2.1	1.6	1.3	0.9	1.8	0.1	0.1
Türkiye	1.9	11.4	5.5	4.2	3.1	3.9	1.0	−1.2	−0.2
Poland	−2.0	6.9	5.1	0.7	2.6	3.4	0.0	0.0	0.2

Source: World Bank.
Note: GDP and expenditure components are measured in average 2010–19 prices and market exchange rates. World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, the 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. ECA = Europe and Central Asia; EMDE = emerging markets and developing economies; f = forecast; GDP = gross domestic product.
a. Includes Bulgaria, Croatia, Poland, and Romania.
b. Includes Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia.
c. Includes Belarus and Moldova.
d. Includes Armenia, Azerbaijan, and Georgia.
e. Includes Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan.

weakened in Türkiye, although the index remained stable in Russia. In the region's three largest economies, which jointly account for over three-quarters of ECA's gross domestic product (GDP), output fell in both the first and second quarters of 2023 in Poland, while growth strengthened in Russia and Türkiye. Some countries in the South Caucasus and Central Asia have seen continued large inflows of investment and people that have supported growth in domestic demand and output. For the second year in a row, the region's top three growth performers are Armenia, Georgia, and Tajikistan.

GDP in Poland fell by 1.4 percent year-over-year in April-June 2023—the second consecutive quarter of negative GDP growth.[1] This reflects a deeper slowdown in consumer demand, with household consumption decreasing by 3 percent in the second quarter as elevated inflation dented real wages. Although the two increases in minimum wages in January and July partly helped to offset the impact of high inflation, average monthly real gross wages and salaries in Poland

1. GDP data in Poland were especially volatile in recent quarters, partly reflecting the impact of sizable inflows of migrants from Ukraine and large fluctuations in inventories. In the first half of this year, GDP in Poland fell by 1 percent compared to the first half of 2022.

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

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

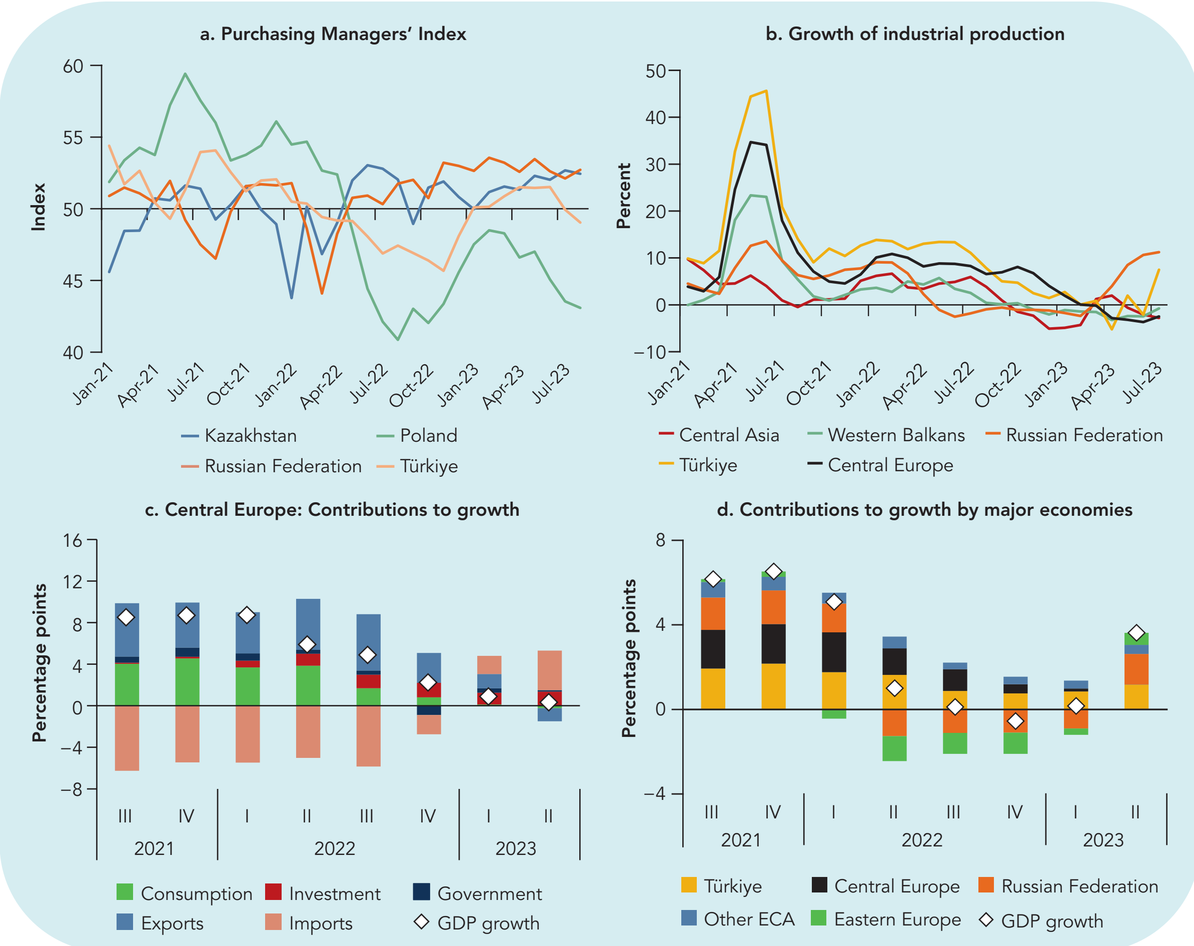
							Percentage point differences from June 2023 projections		
	2020	2021	2022	2023f	2024f	2025f	2023f	2024f	2025f
Albania	−3.3	8.9	4.8	3.6	3.2	3.2	0.8	−0.1	−0.1
Armenia	−7.2	5.8	12.6	6.6	4.1	4.5	2.2	−0.7	−0.5
Azerbaijan	−4.3	5.6	4.6	1.5	2.4	2.5	−0.7	−0.1	−0.1
Belarus	−0.7	2.4	−4.7	3.0	0.8	0.7	2..4	−0.6	−0.6
Bosnia and Herzegovina	−3.3	7.1	4.0	2.2	2.8	3.4	−0.3	−0.2	−0.1
Bulgaria	−4.0	7.6	3.4	1.4	2.7	3.3	−0.1	−0.1	0.3
Croatia	−8.5	13.1	6.2	2.7	2.5	3.0	0.8	−0.6	−0.3
Georgia	−6.8	10.5	10.1	5.9	4.8	4.5	1.5	−0.2	−0.5
Kazakhstan	−2.5	4.3	3.2	4.5	4.3	4.5	1.0	0.3	0.9
Kosovo	−5.3	10.7	3.5	3.2	3.9	4.0	−0.5	−0.5	−0.2
Kyrgyz Republic	−7.1	5.5	6.3	3.5	4.0	4.0	0.0	0.0	0.0
Moldova	−7.4	13.9	−5.0	1.8	4.2	4.1	0.0	0.0	0.0
Montenegro	−15.3	13.0	6.4	4.8	3.2	3.1	1.5	0.1	0.2
North Macedonia	−4.7	3.9	2.1	1.8	2.5	2.9	−0.6	−0.2	0.0
Poland	−2.0	6.9	5.1	0.7	2.6	3.4	0.0	0.0	0.2
Romania	−3.7	5.8	4.7	1.8	3.7	3.9	−0.8	−0.2	−0.2
Russian Federation	−2.7	5.6	−2.1	1.6	1.3	0.9	1.8	0.1	0.1
Serbia	−0.9	7.5	2.3	2.0	3.0	3.8	−0.3	0.0	0.1
Tajikistan	4.4	9.4	8.0	6.5	5.0	4.5	0.0	0.0	0.0
Türkiye	1.9	11.4	5.5	4.2	3.1	3.9	1.0	−1.2	−0.2
Ukraine	−3.8	3.4	−29.1	3.5	4.0	6.5	1.5	0.5	0.0
Uzbekistan	2.0	7.4	5.7	5.5	5.6	5.8	0.4	0.2	0.0

Source: World Bank.
Note: GDP and expenditure components are measured in average 2010–19 prices and market exchange rates. World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, the 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. f = forecast; GDP = gross domestic product.

were still more than 3 percent lower in July than at the start of 2023. Elsewhere in Central Europe, the growth momentum also slowed in the first half of this year but remained more resilient than in Poland owing to a strong rebound in tourism (Bulgaria and Croatia) and still robust household consumption and investment spending.[2] In the second quarter of 2023, annual growth eased in Bulgaria, Croatia, and Romania as the combination of slower increases in real consumer incomes and tighter financial conditions exerted an increasing drag on activity. Headwinds from the deterioration of economic conditions in key export markets, especially in Germany, grew stronger as well. For the first time since the start of

2. In all four Central European economies, seasonally adjusted annual growth in the second quarter of 2023 was at its weakest since the first quarter of 2021. Annualized quarterly growth, however, indicates that growth momentum remained robust in Croatia and strengthened somewhat in Romania.

FIGURE 1.1. Growth in ECA



Sources: Eurostat; Haver Analytics; National statistical offices; World Bank.

Note: ECA = Europe and Central Asia; EMDEs = emerging markets and developing economies; GDP = gross domestic product.

a. A reading greater than 50 indicates expansion. The last observation is August 2023.

b. Values are three-month moving averages. Subregional aggregates are calculated using GDP weights. The sample includes 11 ECA EMDEs. The last observation is July 2023.

c. Values are based on seasonally and calendar adjusted data. The sample includes Bulgaria, Croatia, Poland, and Romania.

d. The sample includes 17 ECA EMDEs, representing almost 99 percent of the aggregate ECA GDP. Eastern Europe includes Ukraine. Other ECA includes Central Asia (Kazakhstan and Uzbekistan), South Caucasus (Armenia, Azerbaijan, and Georgia), and the Western Balkans (Montenegro, North Makedonia, and Serbia). Quarterly GDP growth rates for Ukraine are estimates by the National Bank of Ukraine. For some countries and quarters, quarterly growth rates are derived from the cumulative GDP growth rates (Azerbaijan, Belarus, Kazakhstan, and Uzbekistan). Regional and subregional aggregates are calculated using GDP weights.

2021, export growth in all four Central European countries fell in the second quarter of 2023 (figure 1.1, panel c).[3]

Similarly, slowing growth of both exports and consumption weighed on the pace of economic expansion in the Western Balkans. For example, annual growth in North Macedonia fell to 1.1 percent in the second quarter of 2023, from 2.1 percent in the first quarter, as the growth rate of household consumption almost

3. Slowing economic activity in Poland exerted a substantial drag on Central Europe as Poland accounts for over 63 percent of the aggregate output of this ECA subregion.

halved. Economies with deeper integration with euro area supply chains (for example, the car parts industry in North Macedonia) and those with substantial export and remittance exposures to the slowdown in the EU market (for example, Italy is the destination for over 40 percent of all exports of goods from Albania) are facing stronger economic headwinds too. On the upside, the weakness in exports of goods, which tempered growth in manufacturing, was offset by a strong recovery of services exports driven by tourism and exports of information and communications technology (ICT) services. Domestic demand remained resilient, supported by falling inflation, still robust remittances, indexation of minimum wages in some countries, and absorption of EU funds, which added momentum to public investment. A rebound in demand for tourism and services drove recoveries in tourism-reliant economies, which saw improving employment growth and faster growth of nominal wages.

Increased military expenditure and larger social transfers from the government in Russia and exceptionally strong consumer demand in Türkiye delivered better than expected growth in ECA in the first half of this year (figure 1.1, panel d). Growth in Russia rose to 4.9 percent year-over-year in the second quarter of 2023, its first positive reading since the start of the country's invasion of Ukraine. This reflects a strong bounce in retail sales and construction, a rebound in industrial production, owing to a low base effect, and a resilient oil sector. At 3.8 percent year-over-year, the second quarter growth in Türkiye surprised on the upside as well, with consumption expanding at double-digit rates and government spending remaining strong. However, the rate of decline of exports of goods and services increased to 9 percent, from 2.6 percent in the first quarter of this year, which, together with a shift toward a tighter monetary policy stance, could limit further growth later this year.

Large inflows of people from Russia, accompanied by surging remittances and increased cross-border trade, continued to fuel domestic demand in Central Asia and the South Caucasus. Although the initial wave of remittances has subsided, partly reflecting a recent sharp depreciation of the Russian ruble, domestic demand remains resilient owing to robust wage and employment gains. Exports have been exceptionally strong in some countries driven in part by the changing patterns of regional trade flows. In Armenia and Georgia, annual growth remained strong in the second quarter, albeit down in the former to 9.1 percent from 12.1 percent in the first quarter. Georgia maintained robust growth momentum in the second quarter as well, with output increasing by 7.5 percent year-over-year. The drag from the oil and gas sector in Azerbaijan lessened somewhat in the second quarter of this year, but the annual growth in non-resource sectors slowed from 4.9 percent in the first quarter to 3.4 percent in January-July, reflecting falling remittance inflows from Russia.

In Central Asia, spillovers from high commodity prices, remittance inflows, and surging trade bolstered activity in non-resource sectors with growth momentum persisting in services and construction. There is, however, a divergence within the ECA energy producers. Crude oil production in Azerbaijan is constrained by aging offshore oil fields. In Kazakhstan, the second largest oil producer in ECA, annual growth improved to 5.1 percent in the first half of 2023, from 3.2 percent last year, driven by strong performance of services. Oil production remained resilient as Kazakhstan increased oil exports through routes bypassing Russia.

In Eastern Europe, which bore the brunt of the negative effects from Russia's invasion of Ukraine, growth is gradually regaining some momentum as the economies recover. Output contraction eased in Moldova, thanks to substantial monetary easing and a resumption of growth in real wages. Growth in Belarus strengthened to 2 percent year-over-year in the first half of this year, after GDP declined by 2 percent in the first quarter of 2023. This reflected lower inflation, more accommodative monetary policy, and higher government spending on wages and social benefits. Exports remained strong because of growing trade with Russia, and capital spending picked up, owing to monetary and fiscal support as well as import substitution projects. Growth picked up in Ukraine as well, due to more stable electricity supply, a good harvest, rerouting of exports through the country's western borders, and increased government spending.[4] Nevertheless, economic conditions in Ukraine remain in a state of extreme distress amid the escalation of security risks, additional damage to infrastructure, renewed pressures on energy prices, and capacity constraints in the grain transport routes to international markets. Even as Ukraine increasingly uses alternative routes to bypass Black Sea ports, the termination of the Black Sea Grain Initiative in July disrupted exports.

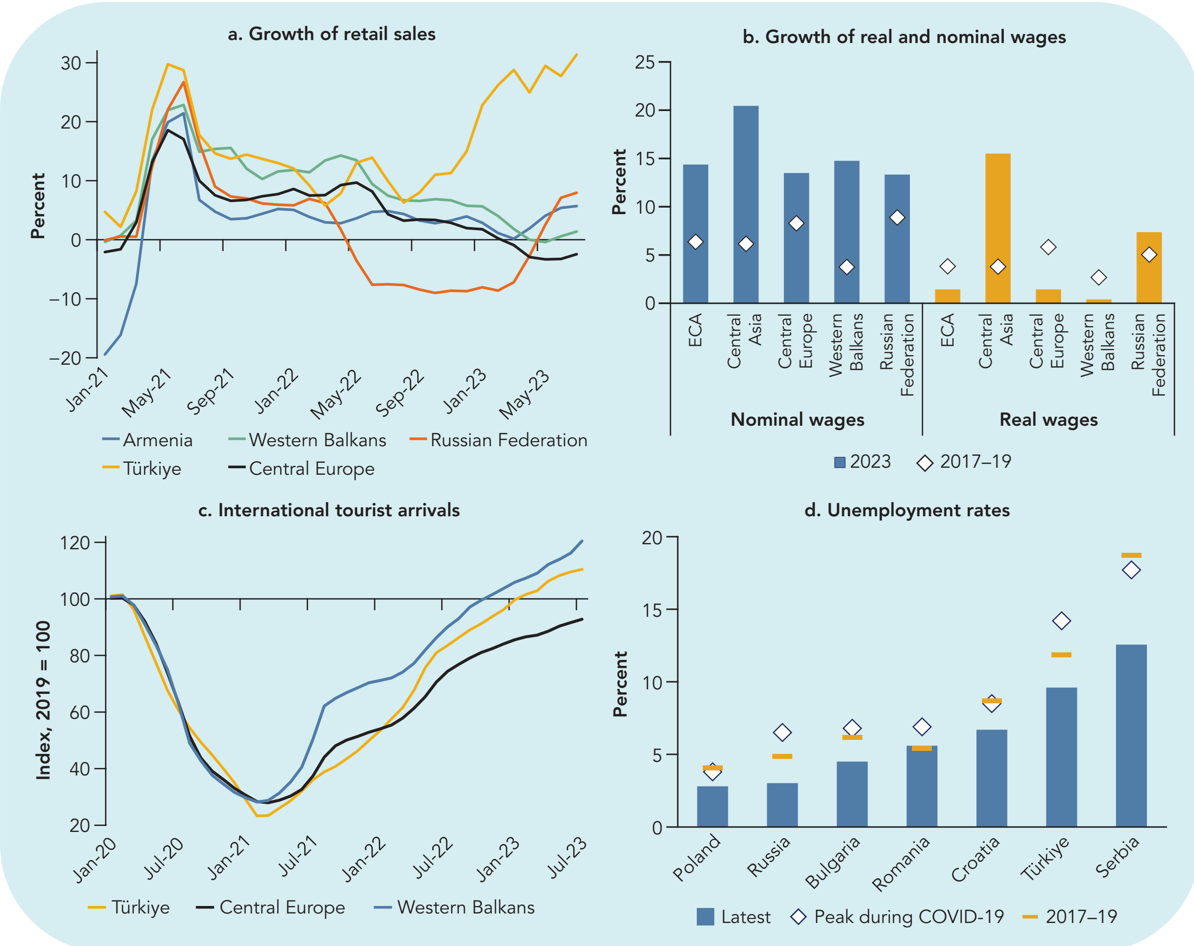
Consumption growth: resilient but slowing

The consumption engine of ECA, the key driver of growth across the region, has recently been sputtering under the pressure of persistent inflation, tighter financial conditions, and moderation of remittance inflows in some countries. Deteriorating consumer sentiment and elevated food prices have tempered household spending as well, although divergences across the region have widened (figure 1.2, panels a and b). In the second quarter of this year, household consumption fell in Poland for the third consecutive quarter, while annual consumption growth almost halved in Romania to 3.4 percent. In the Western Balkans, household consumption continued to decline for the second straight quarter in Serbia and grew at a slower pace in North Macedonia.

On the upside, labor markets remain tight, owing to a strong rebound in services across the region, especially in tourism-reliant economies enjoying a solid pickup of foreign visitors (figure 1.2, panel c). In the second quarter of 2023, household consumption increased faster in Bulgaria and Croatia. Household consumption in Russia and Türkiye remained resilient as well, bolstered by increased government expenditure and robust wage growth. In both Türkiye and Russia, the growth of nominal wages far outpaced consumer inflation, with average nominal wages up by 111 percent in the second quarter of 2023 in Türkiye and by 15 percent in Russia.

4. The National Bank of Ukraine estimates that GDP grew by 18.6 percent (year-over-year) in the second quarter of 2023. This recovery represents only a modest reversal of the catastrophic economic losses suffered a year ago.

FIGURE 1.2. Recent developments in ECA



Sources: Eurostat; Haver Analytics; World Bank.
Note: ECA = Europe and Central Asia; EMDEs = emerging markets and developing economies; GDP = gross domestic product.
a. Values are three-month moving averages. Subregional aggregates are calculated using GDP weights. The sample includes nine ECA EMDEs. The last observation is July 2023.
b. Real wages show nominal wages adjusted for headline inflation.
c. Values are cumulative 12-month arrivals of international tourists. The sample for Central Europe includes Bulgaria, Croatia, Hungary, Poland, and Romania. The sample for the Western Balkans includes Albania, Bosnia and Herzegovina, Montenegro, North Macedonia, and Serbia. The last observation is July 2023.
d. The figure shows unemployment rates. The peak during COVID-19 indicates the highest value in 2021–22. The last observation for Bulgaria, Croatia, Poland, Romania, Serbia, and Türkiye is June 2023, and for the Russian Federation it is July 2023.

Remittance inflows cooled (Azerbaijan and Uzbekistan), but they continued to support consumption across the region, especially in Moldova and some countries in the Western Balkans, Central Asia, and the South Caucasus, with Armenia and Georgia being the primary destinations for people arriving from Russia (figure 1.3, panel a). The volume of retail trade has been increasing at double-digit rates in Armenia and Georgia, although the pace of growth has slowed somewhat in recent months. Higher minimum wages and inflation indexation of social benefits added resilience to consumption across the region as well.

The outlook for consumption growth in ECA has recently become more challenging. Household spending remains constrained by weakening consumer sentiment, deteriorating economic conditions, and restrained access to credit. High and increasing energy costs, reflecting renewed upward pressures on global energy prices and upward adjustments of utility tariffs in some countries, are tempering consumption growth as well. Although labor shortages persist in some economies, the growth of jobs is slowing as the impacts of the policy tightening and deeper deceleration of domestic and external demand are being felt more acutely. For example, in Poland annual private sector employment growth stood at 2.4 percent per month on average last year but slowed to just 0.8 percent in the first quarter of 2023 and dropped further to 0.3 percent in April-July. The annual growth of nominal wages slowed to 10.4 percent in July—still below the 11.5 percent headline inflation. Annual employment growth slowed sharply in Türkiye to just 3.3 percent per month on average in the second quarter of this year, from 6.3 percent in the first quarter, reflecting substantial cooling of hiring in manufacturing and a broad-based deceleration of job creation in the service sectors.

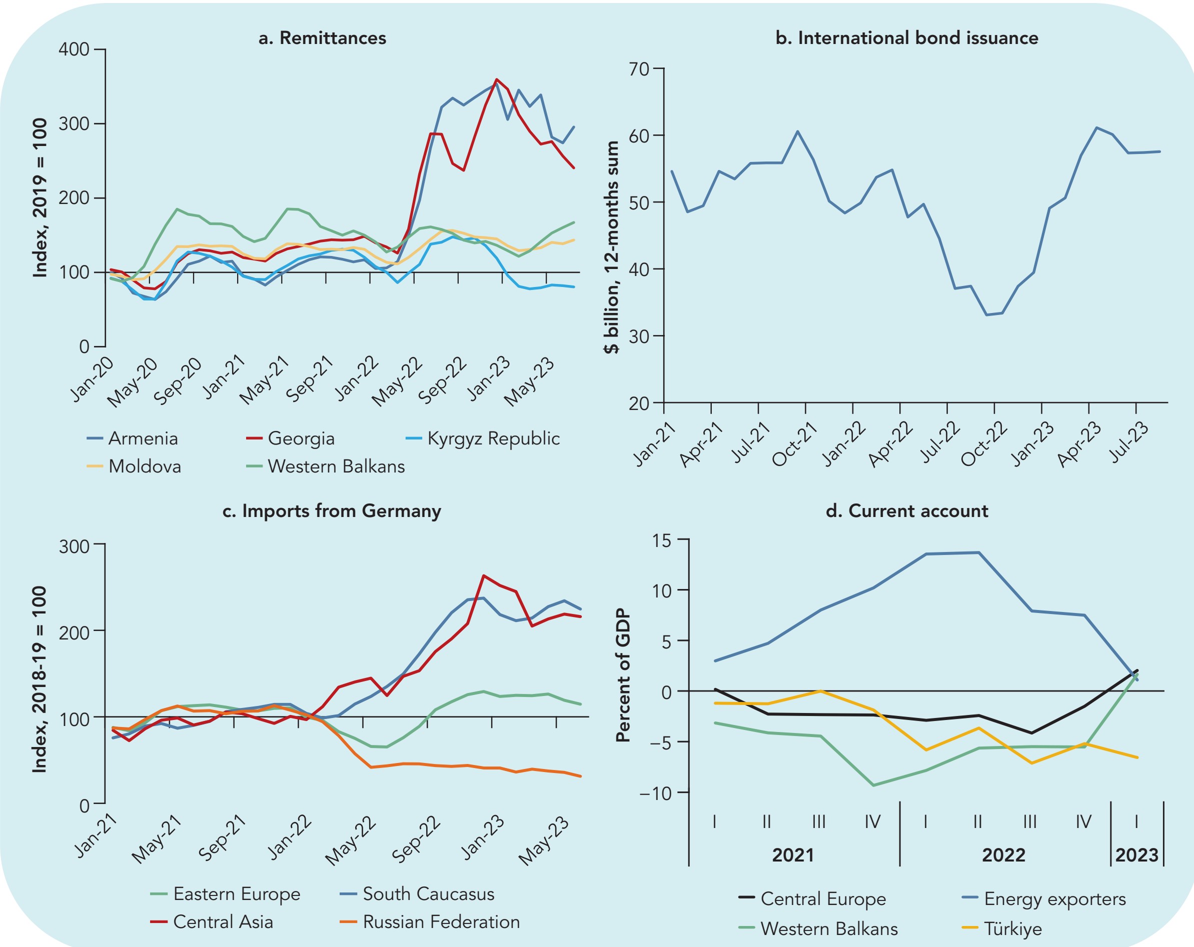
Energy transformation supports investment recovery

Investment growth picked up in most countries in the region despite tighter financial conditions. In Central Europe, gross fixed capital formation grew by 7.1 percent year-over-year in the second quarter of 2023, reflecting increased spending on energy and transport infrastructure, more firms adopting energy-saving technologies, and larger structural funds from the EU backing spending on energy efficiency. Cuts to the supply of Russian gas to Europe have also encouraged more investment in alternative sources of energy and liquefied natural gas (LNG) infrastructure. Examples include the ongoing work on construction of the LNG terminal in Gdansk Bay in Poland, and the capacity expansion of the Omisalj LNG terminal in Croatia.[5]

Increased infrastructure spending also supported investment growth in some countries in the Western Balkans. In Serbia, gross fixed capital formation grew by 3.9 percent in the second quarter of this year, which was twice as fast as in the first quarter. Resilient demand for services sustained a broad-based pickup in investments in service sectors across the South Caucasus and Central Asia. In Kazakhstan, fixed capital investment increased by 13.4 percent in the first half of this year, largely because of double-digit investment growth in the mining and service sectors. In Türkiye, investment growth strengthened to 5.1 percent in the second quarter of 2023, due to strong activity in services and construction, owing to reconstruction efforts after the earthquake in February and retrofitting of existing buildings to withstand future earthquakes. Increased public spending, partly driven by import substitution efforts, propped up investment growth in Belarus and Russia. Fixed capital investment fell further in Moldova, albeit at a slower pace, as the construction sector struggles with high interest rates and elevated input costs.

5. Poland, for example, has already made substantial progress in diversifying its energy supply. The Baltic Pipe, a natural gas pipeline between Europipe II and Poland, was completed. The capacity of the LNG terminal was increased, and the gas interconnections between Poland and Lithuania and Poland and the Slovak Republic were brought online.

FIGURE 1.3. **External sector developments in ECA**



Sources: Dealogic; Eurostat; Haver Analytics; The Federal Statistical Office of Germany; World Bank.
Note: ECA = Europe and Central Asia; GDP = gross domestic product.
a. Values are three-month moving averages. Western Balkans include Kosovo and North Macedonia. The last observation is July 2023.
b. Values are 12-month cumulative issuance of bonds by governments and nonfinancial corporations. The ECA aggregate excludes the Russian Federation.
c. Values are three-month moving averages. Eastern Europe includes Belarus and Moldova; the South Caucasus includes Armenia and Georgia. The last observation is June 2023.
d. Values are medians. Central Europe includes Bulgaria, Croatia, Poland, and Romania; energy exporters include Azerbaijan, Kazakhstan, and the Russian Federation; the Western Balkans include Albania and North Macedonia.

After these solid increases, headwinds to investment growth in the region are becoming stronger, owing to higher borrowing costs, tighter lending standards for businesses, and more fragile investor confidence. Moreover, tighter access to international markets weighs on investment spending in ECA as well. Following a strong recovery earlier this year, international bond issuance by corporations and governments in ECA stalled in the second quarter of 2023 as global investor sentiment deteriorated on expectations of interest rates remaining high for longer (figure 1.3, panel b). Foreign direct investment has remained weak as concerns over the growth outlook and elevated policy uncertainty in some countries have deterred investors.

Slowing exports

External demand weakened in the second half of this year as growth slowed sharply in ECA's key trading partners, particularly in the EU. Global commodity prices, especially for metals, eased on worries over the strength of the global economic recovery. Energy exporters (Azerbaijan, Kazakhstan, and Russia) saw a decline in export revenues, with energy prices weakening compared to last year's record highs. However, energy prices have picked up since July.

Weaker economic growth in the EU exerted a drag on export growth in Central Europe, the Western Balkans, and Türkiye. The euro area is the destination of about 60 percent of all exports from Poland, over half of all exports from Serbia, and 40 percent of all exports from Türkiye. In Poland, after surging by almost 15 percent in the first quarter, exports fell by over 2 percent in the second quarter, as exports to the EU declined by 5 percent.[6] Bulgaria's exports to the EU declined by over 5 percent in the first half of this year, reflecting a 7.8 percent drop in exports to the euro area, the destination of almost 45 percent of the country's exports. Furthermore, a growth slowdown in ECA is having negative spillovers due to strong interregional trade linkages as well. For instance, Romania is the second largest EU export market for Bulgaria; Serbia and Türkiye are important export destinations as well. On the upside, exports of services across the region remained robust, supported by travel and tourism, as well as increasing exports of ICT services.

Exports remained strong in the South Caucasus and Central Asia reflecting booming trade with Russia (figure 1.3, panel c). Armenia's exports increased by more than 62 percent year-over-year in the first seven months of this year as shipments to Russia surged by 70 percent. Much of this growth was driven by a tenfold increase in reexports of transportation equipment. Booming reexports of cars sustained the double-digit growth of exports in Georgia, even as exports of metals shrank, reflecting lower global prices. Unlike in Armenia, car reexports from Georgia to Azerbaijan and Central Asia increased sharply. As a result, the share of motor vehicle exports in total exports in Georgia increased from about 10 percent before Russia's invasion of Ukraine to 32.9 percent in the first seven months of 2023. Even as Kazakhstan's exports fell by almost 9 percent year-over-year in January-July 2023 because of lower prices of crude oil and nonferrous metals, exports of machinery and equipment jumped by 70 percent, driven by larger shipments to Russia and other countries in the Commonwealth of Independent States (CIS). This increase in exports mirrors a surge in imports of the same products from non-CIS trading partners.

Current account balances improved in most commodity importers, other than Türkiye, as the impact of last year's unfavorable terms-of-trade shocks dissipated, remittances remained robust, and softening domestic demand curbed the growth of imports (figure 1.3, panel d). Meanwhile, current account surpluses shrank (Azerbaijan and Russia) or flipped into deficits (Kazakhstan) in energy exporting countries. In Russia, the current account surplus fell by almost 90 percent year-over-year in January-August 2023, reflecting lower oil prices and falling export volumes, a recovery in imports, and a widening deficit in trade in services driven by outbound tourism.

6. For Bulgaria and Poland, percentage changes are calculated using monthly export flows measured in local currencies.

The current account deficit in Türkiye widened to $42.3 billion in January-July of this year, up by over 31 percent from a year earlier, because of the continued strength of imports, including gold, and falling goods exports.[7] The total value of exports of manufactured goods (over 90 percent of all exports from Türkiye) was down by about 1 percent in January-July 2023 as exports of manufactured goods dropped by 19 percent, reflecting a drop of over 45 percent in exports of iron and steel and a decline of 22 percent in exports of nonferrous metals. Export volumes fell by 5.1 percent year-over-year in the second quarter after a decline of 1 percent in the first quarter as external demand continued to soften.

Declining but sticky inflation

After peaking in late 2022, inflation has slowed in most countries in ECA as food and fuel prices have eased. Median 12-month headline inflation in ECA slowed to 8.4 percent by August 2023, from a peak of almost 16 percent in September 2022 and 15 percent at the start of 2023 (figure 1.4, panels a, b, and c). However, inflation is still well above its 2010–19 average as well as central bank target rates. As in previous high-inflation periods in the region, the reduction in inflation is turning out to be a protracted affair despite the aggressive policy tightening and weakening demand.

Much of ECA's recent disinflation reflects the pass-through into domestic inflation of lower global commodity prices, especially for energy. Nevertheless, there are numerous country-specific factors driving inflation, including exchange rate and labor market developments, national price measures, the extent of policy tightening, and inflation expectations. For example, the median 12-month inflation for the ECA restaurants and hotels sector stood at 13.2 percent in August and in over three-quarters of the countries it outpaced annual food price inflation. In August, the lowest food price inflation was registered in Armenia at -4 percent, while food prices grew at the fastest pace in Türkiye, up by 73 percent.

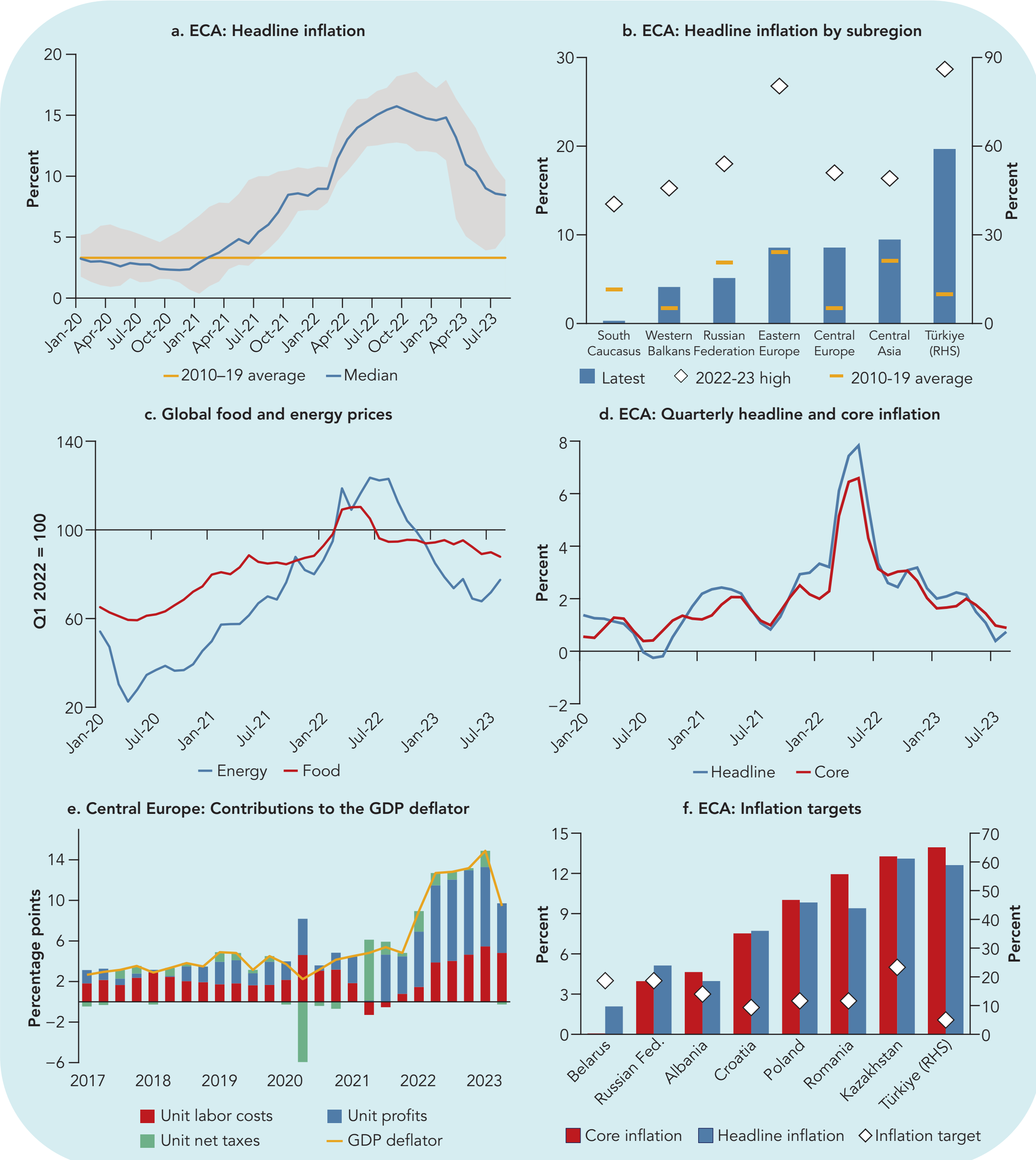
In several countries, large currency depreciations (for example, in Türkiye) have passed into domestic prices. Robust profit margins, as firms were generally able to pass through higher input and labor costs to consumers, have been feeding domestic price pressures in ECA as well (OECD 2023) (figure 1.4, panel e).

Inflation rates differ widely across ECA. Armenia has the lowest inflation rate at a 12-month drop in prices of 0.2 percent, while inflation is running at almost 60 percent in Türkiye. This difference partly reflects strong currency appreciation in Armenia and sharp depreciation in Türkiye. There is a similarly large divergence between the declines in inflation, with the largest declines in Eastern Europe, the South Caucasus, and the Western Balkans.

Core inflation—inflation excluding food and energy prices—has slowed substantially but remains elevated. This reflects in large part the second-round effects of earlier increases in food and fuel prices, demand-pull inflation from a strong uptick in tourism, and rising labor costs. Median 12-month core inflation fell to 7.7 percent by August, from 17.2 percent in September 2022, when it was almost five times higher compared to its pre-pandemic average.

7. Imports of nonmonetary gold jumped almost threefold in January-July 2023.

FIGURE 1.4. **Recent inflation developments**



Sources: Central Bank News 2023; Eurostat; Haver Analytics; World Bank.
Note: ECA = Europe and Central Asia; EMDEs = emerging markets and developing economies; GDP = gross domestic product.
a. The sample includes 20 ECA EMDEs. The shaded area shows the 25-75 percentile range. The last observation is August 2023.
b. Median 12-month inflation rates. The sample includes 20 ECA economies, three Central European economies, and three Eastern European economies. The last observation is August 2023.
d. The figure shows the three-month changes in core and headline inflation. The last observation is August 2023.
e. The average for the sample including Bulgaria, Croatia, Poland, and Romania. The unit labor costs refers to the compensation of employees per unit of real GDP; the unit profits refers to the operating surplus and mixed income per unit of real GDP. The last observation is Q2 2023.
f. Values are 12-month core and headline inflation rates. The last observation is August 2023. Inflation targets are for 2022.

The countries of the South Caucasus lead the region in the speed of disinflation, with the median 12-month inflation falling to 0.2 percent by July from 13.4 percent in May 2022, well below its 3.8 percent average in 2010–19. A sharp reduction in the prices of food and energy imports, helped by stronger currencies in both Armenia and Georgia, was the main driver of inflation dynamics. In Azerbaijan, by contrast, food inflation is slowing but remains high. Lower fuel costs led a sharp reduction in prices of transportation services; however, inflation in other service sectors persists, reflecting resilient demand, partly owing to large inflows of people from Russia.

Similarly, falling prices of transportation services and lower food price increases helped to reduce median 12-month headline inflation in the Western Balkans to 4.1 percent in July, from a high of 15.1 percent late last year. Inflation in the Western Balkans, however, is still almost three times higher than its 2010–19 average.

Median 12-month headline inflation in Eastern Europe fell to 8.6 percent by August, which was less than half its peak rate in late 2022, as food inflation has moderated. Food price inflation in Belarus is at an almost three-year low, owing to price controls introduced in October 2022. These favorable disinflation trends in food prices have been partly offset by stickier inflation in services and an upward adjustment of utility tariffs and taxes in Moldova and Ukraine.

Median 12-month headline inflation in Central Asia fell to 9.5 percent by August, although food inflation persists in some countries, reflecting weaker currencies, elevated production and transportation costs, and a high dependency on imported food.

Inflation is much higher in Central Europe than pre-pandemic trends and appears to be more persistent than in other ECA countries. Median 12-month headline inflation fell to 8.6 percent by June from its 17 percent peak in 2022, but it is well above the 1.7 percent average in 2010–19. As in the rest of the region, the decline reflected sharp decreases of energy prices and a slower growth of prices of food. Nevertheless, the median food price inflation in Central Europe is the highest among the ECA countries other than Türkiye, partly due to resilient demand supported by the strength of the tourism sector and government measures to shield households from cost-of-living increases. Disinflation in Central Europe has also been limited by increases in labor costs. Nominal unit labor costs have been increasing at double-digit annual rates since the second quarter of 2022, more than twice as fast as in the EU.

After falling sharply during the first half of this year, 12-month headline inflation in Russia has picked up, rising to 5.2 percent by August. This reflected the impact of surging government spending, a tight labor market, the recent weakening of the ruble, and worsening capacity constraints. Similarly, headline inflation in Türkiye increased sharply in the second half of this year after nine months of slowing price growth, owing to exceptionally strong demand, the effects of a sharp currency depreciation, higher minimum wages, and a recent fuel tax hike. In both Russia and Türkiye, resurgent inflation also reflects the persistence of substantial macroeconomic imbalances and a delayed policy response to the buildup of vulnerabilities.

The decline in inflation across ECA has slowed since midyear. After slowing to 0.2 percent in July from 0.9 percent in the first quarter of 2023, median monthly inflation in ECA picked up to 0.4 percent in August. In over a quarter of the ECA countries, average monthly inflation has increased since April. Many central banks across the region are now facing difficult choices amid the renewed pickup of global energy prices, increasing inflation pressures from rising labor costs, and the prospects of protracted economic weakness.

Economic Policies

Policy tightening on pause

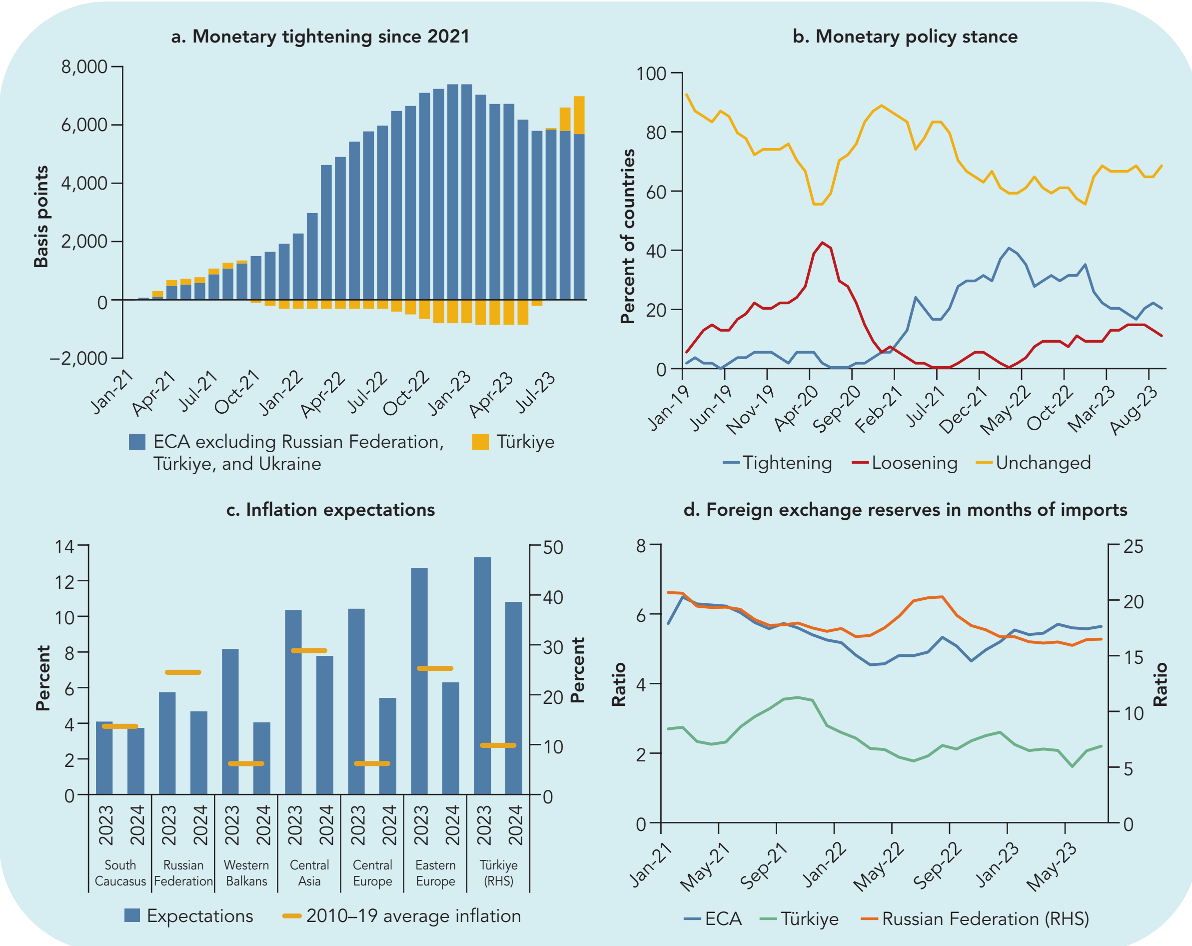
Despite the recent pickup in monthly price increases, the sharp declines of 12-month inflation across the region from the highs of late 2022 are prompting central banks in ECA to pause and even reverse monetary tightening. However, the inflation battle has not been won, and policy rate increases may resume to bring inflation closer to target and prevent it from becoming entrenched in inflation expectations (figure 1.4, panel f).

After a median increase in policy rates of 475 basis points during 2022, ECA's central banks have cut rates by a median of 175 basis points so far in 2023. The central banks of Armenia, Belarus, Georgia, Moldova, Kazakhstan, Poland, Tajikistan, Ukraine, and Uzbekistan all cut policy rates in 2023. Moldova implemented the steepest reduction in policy rates, bringing them down by 1,400 basis points, or to 6 percent by June from 20 percent at the start of the year, to revive the country's flagging economy. In early September, Poland's central bank cut its policy rate by 75 basis points, a much larger reduction than the markets had expected, triggering a 5 percent depreciation of the Polish zloty, which could further slow the disinflation progress.

Monetary policy continued to tighten in Russia and Türkiye, by contrast, amid sizable recent exchange rate depreciations and persistent inflation. In August-September, Russia's central bank hiked its key interest rate twice by a cumulative 450 basis points to 13 percent—its highest level since May 2022—as the value of the Russian ruble against the US dollar dropped to its lowest level since March 2022. Notwithstanding some strengthening in the second half of August, depreciation pressures resumed in September and the Russian ruble remains more than 30 percent weaker than in 2021 on average. From June to September, Türkiye's central bank increased its policy rate to 30 percent, which translates into a cumulative tightening of 2,150 basis points, as the government and the monetary authorities have been pivoting toward more conventional macroeconomic policies to curb runaway inflation.

Policy stances remained unchanged or tightened slightly in other countries (figure 1.5, panel b). Although inflation expectations in ECA are falling, they remain well above trend inflation levels, threatening to become entrenched (figure 1.5, panel c). In addition, lack of competition in the banking sector, underdeveloped local financial markets, high levels of dollarization, and frequent central bank interventions in foreign exchange markets impair the transmission of higher interest rates to inflation in many countries, especially in Central Asia and the South Caucasus (Poghosyan et al. 2023). Monetary policy transmission also tends

FIGURE 1.5. Monetary policy in ECA



Sources: Haver Analytics; World Bank.
Note: ECA = Europe and Central Asia; EMDEs = emerging markets and developing economies.
a. The figure shows the cumulative change in policy rates since December 2020 for the sample of 17 ECA EMDEs. The last observation is September 2023.
b. Values are three-month moving averages of the percent of ECA economies that took a policy action (cut, hiked, or kept interest rates unchanged) during the month. The sample contains 17 economies. The last observation is September 2023.
c. Values are medians. Inflation expectations are from the Consensus Forecasts as of September 2023.
d. The figure shows the median ratio of foreign exchange reserves divided by the latest six months of imports. The sample includes 14 ECA economies. The ECA aggregate excludes the Russian Federation and Türkiye. The last observation is July 2023.

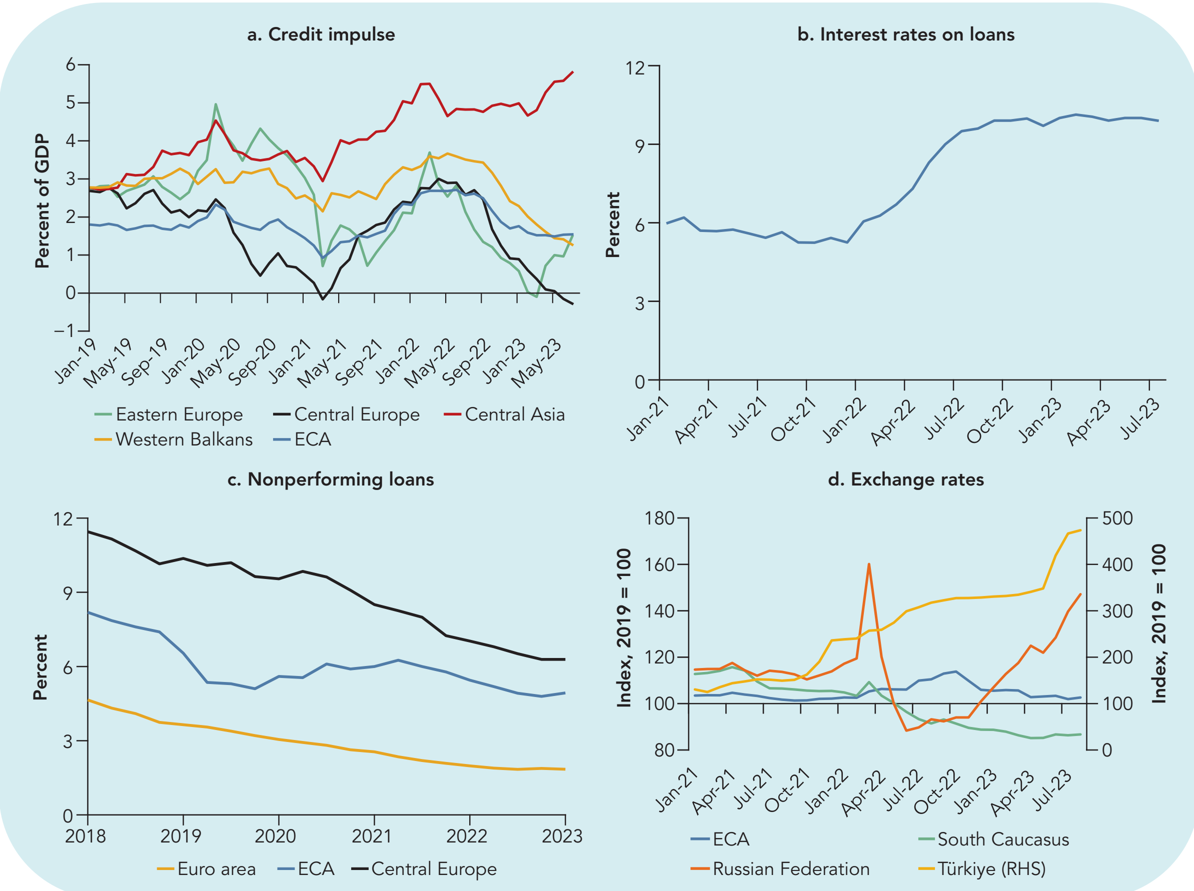
to be slower in high-inflation environments—the exact circumstances with which most central banks in ECA are currently struggling (Kurdovi 2023). All of this means that a shift toward more accommodative monetary policy in ECA could be further delayed.

Financing conditions in ECA have become more restrictive. Senior loan officer surveys in major ECA economies (Kazakhstan, Poland, Russia, Serbia, and Türkiye) indicate that commercial banks already tightened their corporate lending standards in the first half of this year, with tight credit standards expected to persist in the coming quarters. Credit to the private sector is slowing in many countries in the region. In Poland, lending to the private sector has declined since

April as borrowing costs have increased substantially, especially for nonfinancial corporations.[8] In Romania, credit to the private sector grew twice as slowly in the second quarter of this year compared to the first quarter as loans to households declined reflecting weak demand for mortgages.

In Bulgaria and Croatia, however, credit to the private sector remained robust amid substantial bank liquidity and strong demand for loans by households. Credit growth has also been resilient in Central Asia and the South Caucasus (figure 1.6, panel a). In the second quarter of this year, the annual growth of credit to households increased to double digits in Georgia and stood at almost 20 percent in Armenia. Nominal credit growth remained in double digits in Central Asia

FIGURE 1.6. Financial conditions in ECA



Sources: European Central Bank; Haver Analytics; International Monetary Fund; World Bank.
Note: ECA = Europe and Central Asia; EMDEs = emerging markets and developing economies; GDP = gross domestic product.
a. Credit impulse is calculated as the four-quarter change in the ratio of credit to the private sector to GDP. The last observation is July 2023.
b. Median interest rates on local currency–denominated loans. The sample includes Armenia, Bosnia and Herzegovina, Kazakhstan, Montenegro, Poland, Romanian, and the Russian Foundation. The last observation is August 2023.
c. Medians. Values are the percent of nonperforming loans in total loans. The sample includes 13 ECA EMDEs. The last observation is Q1 2023.
d. Values are medians. The last observation is August 2023.

8. For example, in July, interest rates on new local currency denominated loans to nonfinancial corporations and households stood at 8.8 and 12.1 percent, respectively, compared to 2.4 percent and 6.6 percent, on average, in 2021.

as consumer borrowing surged—in July, consumer loans grew by 29 percent in Kazakhstan and almost doubled in Uzbekistan. Credit to households continued to climb in Türkiye—up by 84 percent year-over-year in July—although annual inflation-adjusted growth of credit to households eased from its peak of over 32 percent in May-June. In Russia, annual credit growth to nonfinancial businesses and households grew faster—by nearly 21 and 18 percent, respectively.

The banking sectors across the region remain well capitalized and the share of nonperforming loans (NPLs) is stable (figure 1.6, panel c). Asset quality however could deteriorate if credit growth slows further and weak economic conditions persist. On the upside, banks in ECA continue to benefit from favorable interest rate spreads, while corporate balance sheets in most countries are strong thanks to robust profit margins and a recent moderation of the costs of energy and raw materials.

Most ECA currencies remained stable or strengthened against the US dollar this year, reflecting improvements in current account positions, notably from strong incomes from tourism and continued inflows of remittances (figure 1.6, panel d). Central European currencies experienced a 3.5 percent appreciation on average this year. A weaker US dollar added strength to currencies in the Western Balkans as well, where exchange rates strengthened by 3.7 percent since the start of 2023. In the South Caucasus, exchange rates remained stable, strengthening by 2.3 percent since the start of the year. In both Georgia and Armenia, the US dollar exchange rates remain 30 and 20 percent stronger, respectively, than at the start of Russia's invasion of Ukraine. In Central Asia, currencies weakened against the US dollar in some countries (by about 8 percent in Tajikistan and Uzbekistan, and 3.5 percent in the Kyrgyz Republic) as remittances from Russia fell; but currencies remained stable in other countries (for example, Kazakhstan). Shrinking foreign exchange reserves in some countries (the Kyrgyz Republic and Uzbekistan) add to depreciation pressures as well.

The Russian ruble depreciated by over 36 percent since the start of the year, triggering an emergency rate hike in August. Yet, despite higher rates to arrest rapid currency weakness, depreciation pressures on the Russian ruble persist as trade surpluses continue to shrink. The value of the Turkish lira fell by 43 percent against the US dollar in 2023 as the currency crisis deepened—the Turkish lira has lost almost 80 percent of its value since 2019. Policy uncertainty and a decision to roll back foreign exchange–protected deposits pushed the value of the Turkish lira to a new record low level in August, although the currency has recently regained some strength.[9]

Fiscal positions stabilize

The median fiscal deficit projected for 2023 is forecast to worsen moderately to 2.5 percent of GDP from 2.2 percent of GDP in 2022 (figure 1.7, panel a). This reflects the impact of higher tax revenues in several countries that largely offset weaker

9. Türkiye instituted government-backed foreign exchange–protected savings accounts, known as KKM, in December 2021 to protect local currency deposits from depreciation. At about $124 billion, these deposits represent over a quarter of all deposits and far exceed the foreign exchange reserves of the central bank. The cost to the budget of these foreign exchange–linked savings came to almost $5 billion last year.

FIGURE 1.7. Fiscal policy in ECA

Sources: International Monetary Fund; World Bank.
Note: ECA = Europe and Central Asia; EMDEs = emerging markets and developing economies; GDP = gross domestic product.
a. Values are medians. The shaded area indicates the 25-75 percentile range. The sample includes 22 ECA EMDEs.
b. Values are medians. The sample includes 22 ECA EMDEs.
c. Values are contributions to annual changes in the debt-to-GDP ratio in a median ECA country, following Escolano (2010). The sample excludes Eastern Europe and the Russian Federation. Other drivers include the effects of stock-flow adjustment and exchange rate depreciations.
d. The last observation is August 2023 for Georgia, Poland, and Türkiye; July 2023 for Bulgaria; and May 2023 for Montenegro.

commodity-related revenues in the resource-rich economies. Spending pressures have eased because of the lower costs of food and energy subsidies and a gradual reversal of the temporary tax cuts on products and services. Nevertheless, consolidation efforts have been limited amid hikes of public sector wages, the indexation of social benefits, increased defense spending, and larger interest payments.

Excluding Ukraine, the median fiscal deficit in ECA is projected to worsen by a quarter point of GDP despite stronger growth. The deficit is projected to narrow in just a third of the ECA countries, notably Albania, Georgia, Montenegro, and Serbia. However, the median deficit in the resource-rich countries (Azerbaijan, Kazakhstan, Russia, and Uzbekistan) is set to widen from 0.5 percent of GDP to 2.3 percent as lower commodity prices weigh on tax revenues. Nonetheless, the median fiscal deficit is projected to be the lowest in Central Asia at 2 percent of GDP and the highest in Central Europe at 3.8 percent of GDP.

In Poland, state budget revenues were up by only 3.4 percent year-over-year in the first seven months of 2023 with some of last year's value-added tax (VAT) cuts on foods extended to the end of this year.[10] Personal income tax revenues were 16 percent lower owing to the tax rate cut for low-income individuals implemented in July 2022 under the Polish Deal 2.0. Meanwhile, state budget expenditure jumped by 21 percent year-over-year due to hikes in minimum wages and pensions, higher interest rate payments, assistance to displaced Ukrainians, and increased defense spending. Debt service expenditure more than doubled due to higher interest rates. Elsewhere in Central Europe, budget revenues increased at a faster pace, partly aided by increased efforts to improve revenue collection. For example, Bulgaria ended the first seven months of this year with a fiscal surplus of 0.2 percent of GDP. However, wage hikes in the public sector and energy subsidies pushed the budget deficit in Romania to 2.4 percent of GDP in January-July 2023, compared to 1.9 percent a year ago.

Fiscal revenues remained robust in the Western Balkans as well, reflecting a strong pickup in corporate profits and personal incomes. In the first half of this year, budget revenues grew by 13 percent in Serbia and 14.5 percent in Albania, both faster than government spending, resulting in large budget surpluses. For example, Serbia's consolidated budget surplus is estimated at 0.6 percent of GDP in the first half of 2023, compared to a sizable deficit a year ago. In Bosnia and Herzegovina, however, the fiscal consolidation was less impressive on account of higher government spending because of several hikes in minimum wages and pensions. In North Macedonia, the fiscal deficit remained unchanged owing to lower VAT revenues and higher public spending on transport infrastructure as well as hikes of wages and pensions.

In the South Caucasus, the growth of budget revenues continued to outpace increases in expenditure as strong economic growth and surging exports boosted proceeds from income taxes and customs duties. As a result, during the first half of this year, the budget surplus in Armenia reached 1.4 percent of projected GDP, and Georgia recorded a primary surplus of 0.7 percent of GDP. Spending on debt service increased in both countries—up by 20 percent in Armenia and 51 percent in Georgia. In Central Asia, spending pressures are still elevated due to higher public sector wage bills, extensions of fuel subsidies, and increased social spending (Uzbekistan), although the performance of tax revenues remained resilient because of improved revenue mobilization in some countries (the Kyrgyz Republic) and a pickup in domestic and foreign trade. Higher minimum wages and increasing interest payments in Moldova pushed the budget deeper into deficit—the fiscal deficit widened to 4.7 percent in the first half of this year as spending jumped by 20 percent.

Meanwhile, falling tax revenues from the oil sector, reflecting lower energy prices and declining oil exports and production, led to a 12 percent drop in Russia's federal budget revenues in January-June 2023. As a result, the federal

10. State budget revenues in Poland represent about 50 percent of the consolidated budget revenues (World Bank 2021).

budget ended the first half of this year with a deficit of 3.1 percent of GDP, compared to a 2 percent surplus a year ago, as budget expenditure jumped by 18 percent.[11] In Türkiye, the central government primary deficit swelled to about 3.2 percent of the January-June GDP (compared to 0.2 percent a year ago) reflecting reconstruction expenditure and a surge in pre-election social spending. On the upside, the primary balance of the central government returned to surplus in July and August owing to higher tax rates (increases in the VAT rate and a fuel tax introduced in July).

Debt dynamics in ECA are favorable as stronger post-pandemic recovery and higher nominal GDP have kept debt ratios stable. This year, the median debt-to-GDP ratio in ECA is expected to ease to 40 percent, from 49 percent in 2020. Nevertheless, high sovereign borrowing costs and rising debt service limit fiscal space. Median interest payments are projected to increase to 4.1 percent of fiscal revenues this year, from 3.8 percent in 2022, excluding Eastern Europe and the oil producers. In Armenia and Georgia, interest payments as a share of revenue are expected to exceed 8 percent on average this year—up from 6.6 percent in 2022. In Central Europe, this ratio is likely to remain stable at 3.3 percent, although in Poland it is projected to increase to 6 percent on average in 2023–24—2 percentage points higher than last year. In Türkiye, interest payments are anticipated to reach almost 12 percent of revenue this year—up from 8.7 percent in 2022.

Higher interest outlays and weak growth mean that more fiscal consolidation may be needed to ensure debt sustainability (figure 1.7, panel c). Such fiscal consolidation needs to be growth-friendly, however. Debt ratios tend to fall with unanticipated inflation increases (Garcia-Macia 2023). Anticipated inflation, by contrast, as is the case now, leads to higher nominal interest rates and shorter debt maturities in the long term. Successful historical episodes of sustained large declines in debt levels were often associated with persistent primary balances and strong economic growth, or financial repression that limited the interest rates government paid on debt (Arslanalp and Eichengreen 2023). This presents a formidable challenge for many ECA countries facing elevated debt levels and weak growth, combined with substantial spending needs to accelerate the green transition. The urgency of the need for structural reforms that could lift potential growth and increase fiscal space has never been more evident.

Outlook

Modest upgrades to weaker growth

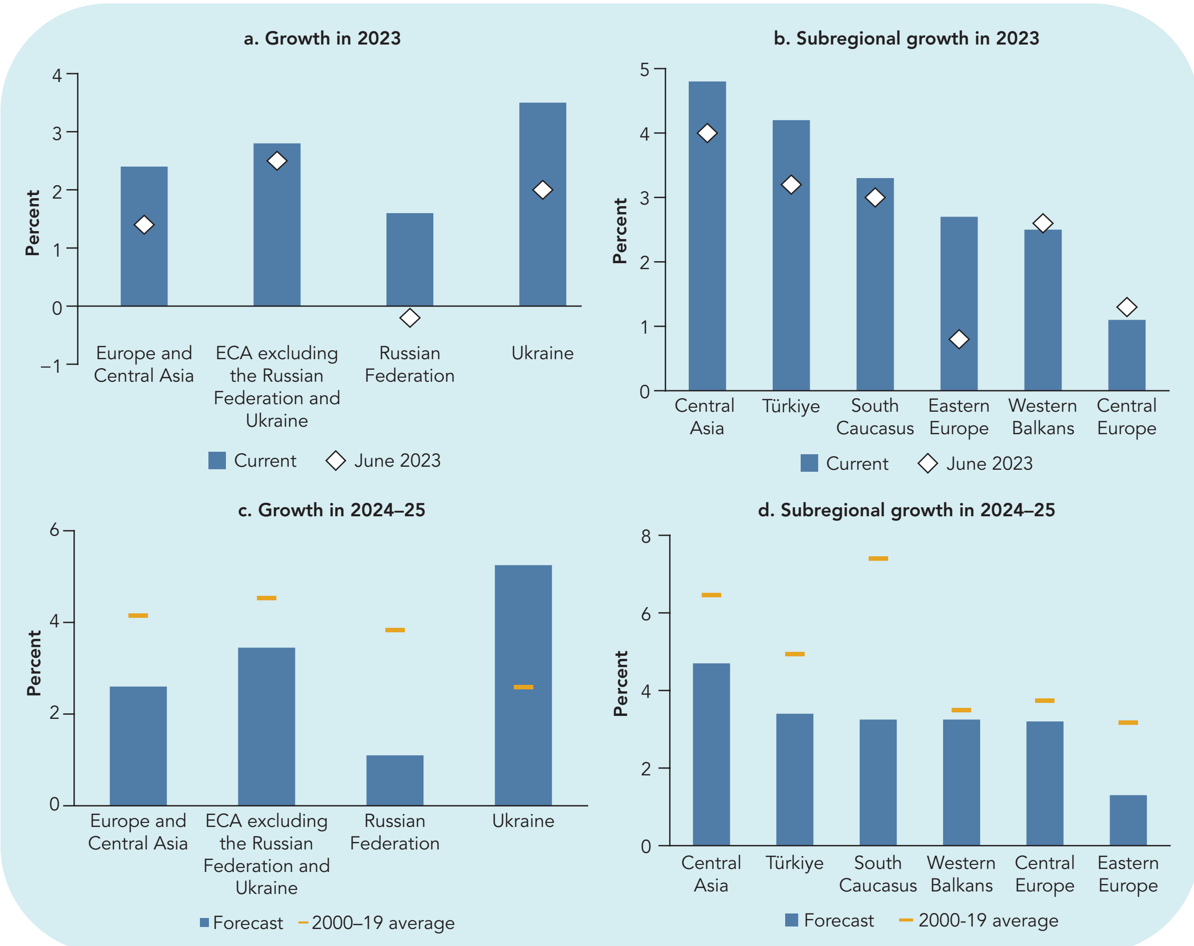
Growth in ECA for 2023 has been upgraded to 2.4 percent from the 1.4 percent projected in June and 1.2 percent in 2022 (World Bank 2023a). The upward revision of 1 percentage point for the region as a whole from June largely reflects increased growth projections for Russia and Türkiye. Growth forecasts have also been revised upward for Ukraine, Kazakhstan, Georgia, and Armenia (table 1.1; figure 1.8, panels a and b). In four other countries, the growth forecasts are

11. The budget deficit relative to GDP during the first half of the year.

modestly lower, while in the remaining 12 EMDE ECA countries, the growth projections are little changed. Excluding Russia and Ukraine, the growth forecast has increased to 3 percent for 2023, from the 2.5 percent projected in June. Altogether, the pace of economic expansion in more than half of the 23 ECA economies is expected to remain below their 2010–19 average.

Surging government spending, largely on military buildup and social transfers, and resilient household consumption have led to an upward revision for growth in Russia. Economic activity is projected to expand by 1.6 percent in 2023 compared to the modest contraction assumed in June and a contraction of 2.1 percent in 2022. For Türkiye, the growth forecast was upgraded to 4.2 percent in 2023, from 3.2 percent projected in June, because of better than expected resilience of household consumption, higher government spending, and reduced

FIGURE 1.8. Regional outlook for ECA



Source: World Bank.
Note: Aggregate growth rates are calculated using gross domestic product weights at average 2010–19 prices and market exchange rates. ECA = Europe and Central Asia.
a. and b. June 2023 indicates projections and forecasts from the June 2023 Global Economic Prospects report. Eastern Europe excludes Ukraine.
d. Eastern Europe excludes Ukraine.

policy uncertainty. By contrast, growth in Central Europe and the Western Balkans is projected to be marginally weaker in 2023 compared to the June forecast. Growth in Central Europe is expected to slow dramatically compared to 2022, to 1.1 percent in 2023 from 5 percent last year, reflecting the much weaker expansion in Poland—the largest slowdown among the ECA countries—and the sharp slowdown of activity in the euro area. Weaker export demand from the EU also resulted in a growth downgrade for the Western Balkans.

Growth in ECA is expected to remain little changed at 2.6 percent a year during 2024–25, much weaker than the 4.2 percent pace of expansion during 2000–19, amid the continued negative effects of Russia's invasion of Ukraine, weak expansion in the EU, and challenges with business dynamism (figure 1.8, panels c and d).

Although risks to the outlook differ across countries, they are generally on the downside. Inflation may persist amid heightened volatility of the global commodity markets and a recent surge in global energy prices. Global growth may surprise on the downside, leading to slower than expected recovery in exports. Russia's invasion of Ukraine may intensify, further constraining the global supply of energy and food. A drawn-out period of tight financial conditions could trigger renewed bouts of volatility in the global financial markets and test the resilience of the banking systems in ECA. Finally, persistent economic weakness of regional economies and elevated policy uncertainty could further sap the reform momentum and delay the needed green transition.

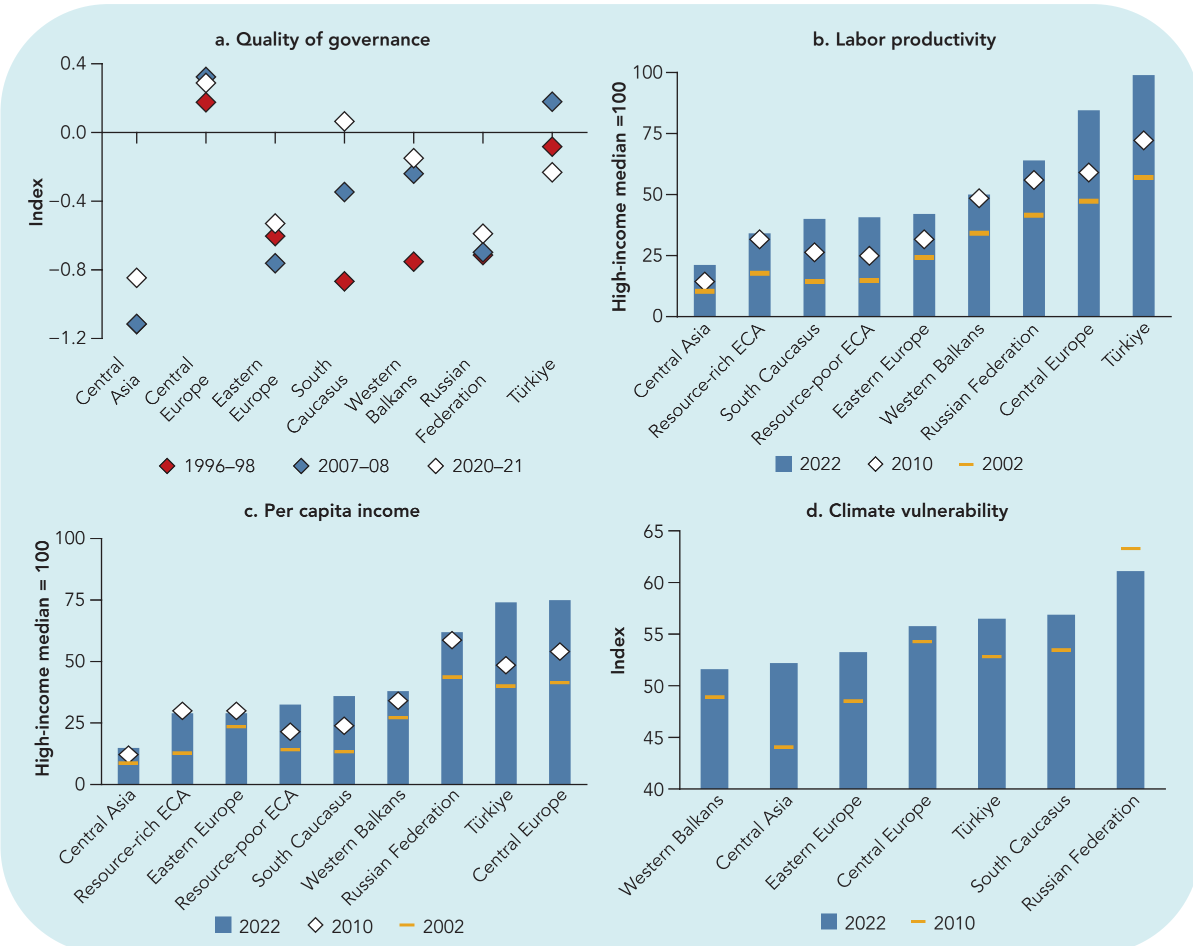
Structural reforms are needed to support more inclusive and more sustainable growth

ECA is facing formidable challenges and heightened economic uncertainty as overlapping shocks, including from the pandemic, Russia's invasion of Ukraine, and the cost-of-living crisis, are making longer-term growth prospects more challenging. On current growth trends and without a renewed push with structural reforms enabling more productive allocation of scarce resources, the convergence with high-income peers could stall further, delaying the green transition and slowing progress in poverty alleviation. The region needs to bring back its zeal for structural reforms that could deliver sustained gains in economic and social outcomes, improve resilience, reinvigorate productivity growth, and hasten efforts to decarbonize the economy.

The earlier reform waves in ECA advanced rapidly across multiple directions—governance, trade, finance, and product and labor market regulations—with liberalization of markets led by the countries that joined the EU or were advancing their EU alignment and accession. Although there has been progress along many critical reform dimensions, there remains substantial room to catch up in terms of improving product market competition, better governance of state-owned-enterprises (SOEs), energy security, and financial stability (EBRD 2022). More recently, the pace of reforms has slowed amid weaker political support for deeper structural changes. Several overlapping global shocks have slowed the reform momentum as well. There has been a reversal of reforms in some areas, especially after the 2009 global financial crisis, during the COVID-19 pandemic, and, more recently, because of the cost-of-living shocks (figure 1.9, panel a). Large gaps in reform progress and in the quality of institutions and regulations persist both within the region and compared to high-income peers. Closing those gaps could speed up convergence and, more importantly, jump-start a more sustainable and greener growth model.

Evidence on the impact of structural reforms is unambiguous: reforms could deliver sizable growth dividends, albeit there is substantial heterogeneity across countries depending on specific institutions, policies, and circumstances. Overall, successful reforms are implemented faster, often in propitious political and economic climates, with broad consensus among the political and economic elites. Successful reforms are supported by complementary measures, such as

FIGURE 1.9. Tracking progress on structural reforms in ECA



Sources: Notre Dame Global Adaptation Initiative, University of Notre Dame; World Bank.
Note: ECA = Europe and Central Asia; PPP = purchasing power parity.
a. Values are the medians of the World Bank Governance Indicators across ECA subregions.
b. Labor productivity refers to output per employed person in 2017 constant PPP international dollars. The last observation for the Russian Foundation is 2021.
c. Values are per capita incomes in 2017 constant PPP international dollars.
d. Values are the medians of the Notre Dame Global Adaptation Initiative (ND-GAIN) indices across ECA subregions. The ND-GAIN Index summarizes a country's vulnerability to climate change and other global challenges in combination with its readiness to improve resilience. Less vulnerable countries have higher ND-GAIN Index values.

strong social safety nets and labor market policies that mitigate the short-term adverse distributional effects. Furthermore, labor productivity in economies with better quality of institutions, strong governance, and more progress on structural reforms tends to converge faster with high-income peers, which translates into a faster convergence in incomes per capita. Indeed, median labor productivity is the lowest in Central Asia and in ECA's resource-rich countries, where the quality of governance and institutions lags other ECA peers—at just 21 and 34 percent, respectively, of the median level in high-income countries in 2022 (figure 1.9, panel b). Labor productivity in Central Europe and Türkiye is at 85 and 99 percent, respectively, relative to high-income countries (measured as GDP per person employed in constant 2017 purchasing power parity international US dollars), which translates into a much smaller gap in incomes. In both Central Europe and Türkiye, incomes per capita are only about 25 percent below the median in high-income peers (figure 1.9, panel c).

Deeper structural reforms are also needed to facilitate the green transition across the region. Meaningful decarbonization efforts entail the mobilization of substantial public and private resources to green activities. The following could significantly hinder those efforts: weak governance and institutions; inefficient infrastructure, especially in energy and transport sectors, which are often dominated by SOEs in ECA; large disparities in energy efficiency of firms; inadequate human capital and skill development; shallow integration into the global supply chains; and limited access to finance.

A more difficult global environment is amplifying existing structural challenges, such as the aging population and weak productivity growth. Furthermore, Russia's invasion of Ukraine is reshaping regional trade, energy, investment, and migration flows with consequential implications for sustained long-term growth. Global financial conditions remain tight, and the era of ultra-low interest rates is unlikely to return. This presents a challenge for economies overburdened with debt and rising debt service costs exactly when growth is slowing sharply and substantial resources are needed to upgrade security, support the green transition, reform energy infrastructure, and strengthen the resilience of food systems. In this high-debt and low-growth environment, many governments in ECA may lack fiscal space to achieve a meaningful boost in public investment. However, this situation presents an opportunity to mobilize more private resources into sustainable and greener activities. Reforms that improve the investment climate, encourage financial sector development, and reduce the carbon footprint of the financial flows could help to achieve this. Further liberalization of the energy and transportation sectors and encouraging firms to adopt green technology would also help.

It is no longer controversial that climate change translates into substantial risks to economic and financial stability. ECA economies are vulnerable to the effects of increased frequency and severity of extreme weather events (figure 1.9, panel d). Fluctuations in precipitation and temperatures could lead to serious short-term disruptions in agriculture and energy supply (especially in countries that rely on renewable sources of electricity) and infrastructure damage. Although many governments in ECA are building the foundations for more impactful climate action, the long-term detrimental impacts of climate change on crop yields, water supply, labor productivity, and health could set the stage for stagnating growth if the pace of reforms remains slow (World Bank 2023b). Many countries in ECA need to invest in disaster resilience to enhance resilience, response, and recovery and reduce the fiscal cost of future disaster assistance.

SOEs and the business of the state in ECA

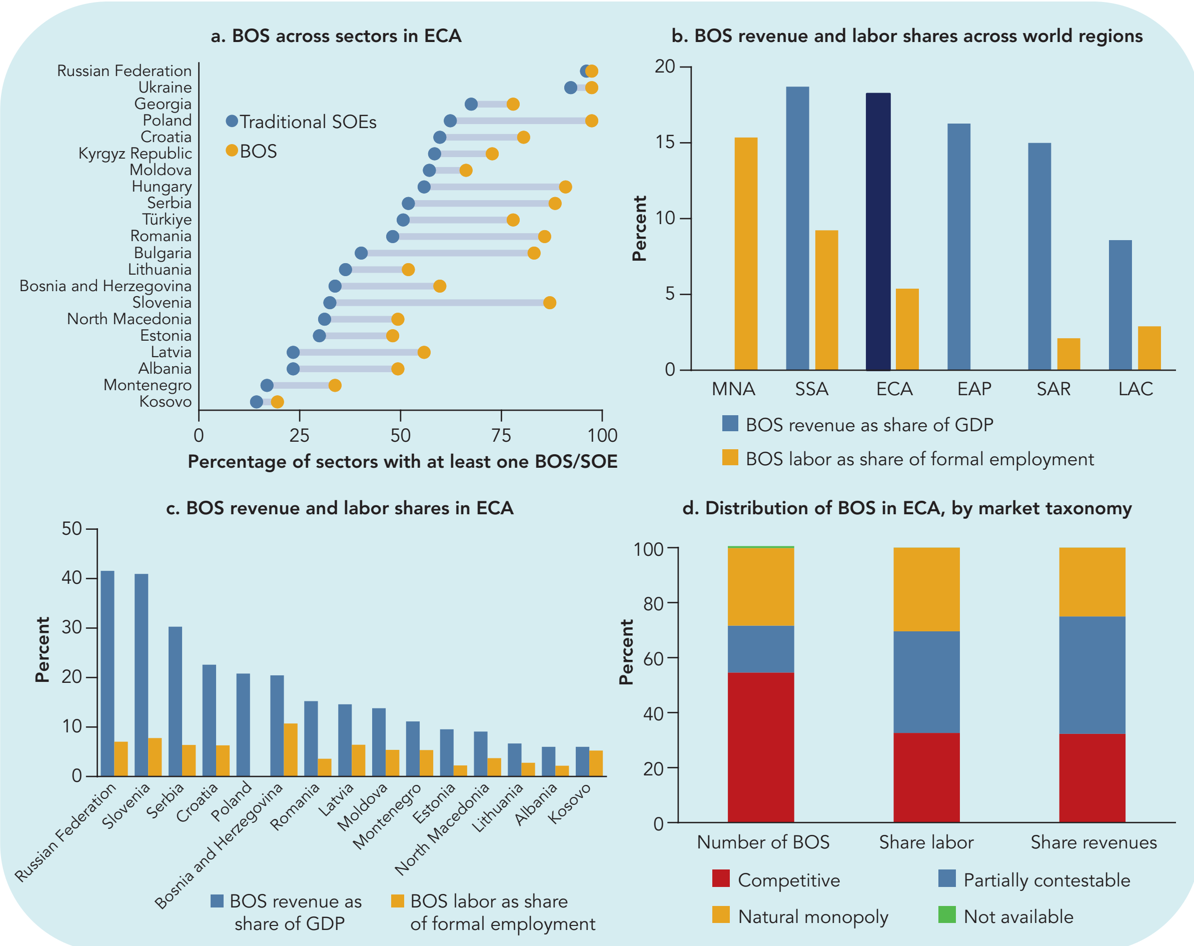
Long-standing structural issues in the region, which are related to a legacy of incomplete market transition and governance challenges as well as obstacles to private sector development, will need to be addressed to build the foundation for sustained growth. SOEs still account for a large share of economic activity in the region. More than three decades since the start of ECA's transition to a free market economy, the private sector share in economic activity has significantly increased in many countries, although the experience has been uneven across countries and sectors. The new World Bank Global Business of the State database documents that the role of the state and the extent of state ownership appear to be more extensive than what was previously assessed. In addition to SOEs, there are also firms that are indirectly owned or minority owned by the state, as well as businesses run by local governments (figure 1.10, panel a). This section refers to all such firms as businesses of the state (BOS).

The ECA region is home to more than 53,000 such firms spread across 21 countries, with Russia accounting for more than half of all BOS. While ECA has the largest number of firms with some degree of state involvement compared to other regions, the presence of such firms in ECA in terms of their revenue as a share of GDP and their employment as a share of formal employment is comparable to that in other regions (figure 1.10, panel b). On average, BOS revenues represent 18 percent of GDP, while BOS employ 5 percent of formal workers in ECA. Within ECA, however, there is significant variation, with the BOS revenue share ranging from just over 40 percent in Russia and Slovenia to just over 5 percent in Lithuania, Albania, and Kosovo. The BOS employment share ranges from 11 percent in Bosnia and Herzegovina to 2 percent in Estonia and Albania (figure 1.10, panel c). Notably, on average just over half (55 percent) of BOS in ECA operate in sectors classified as competitive according to the taxonomy of markets developed by Dall'Olio et al. (2022); that share is lower when considering the employment share or revenue share instead of the number of BOS (figure 1.10, panel d).

The extensive presence of state ownership across ECA can negatively affect firm dynamism, productivity, and financial performance (World Bank, forthcoming). In general, businesses with government stakes, dominant or minority, are less productive than their private sector peers, but the extent and nature of state ownership and sector types affect performance. State presence also affects market dynamism in the private sector. An increase in state presence is associated with lower rates of entry of new firms, crowding out of private investment, and increased market concentration.

Beyond divestiture and privatization, good corporate governance and pro-competition regulations and policies need to be prioritized to ensure that BOS operate on a level playing field with private sector firms, given that BOS have substantial presence in many sectors across the region.

FIGURE 1.10. Footprint of businesses of the state



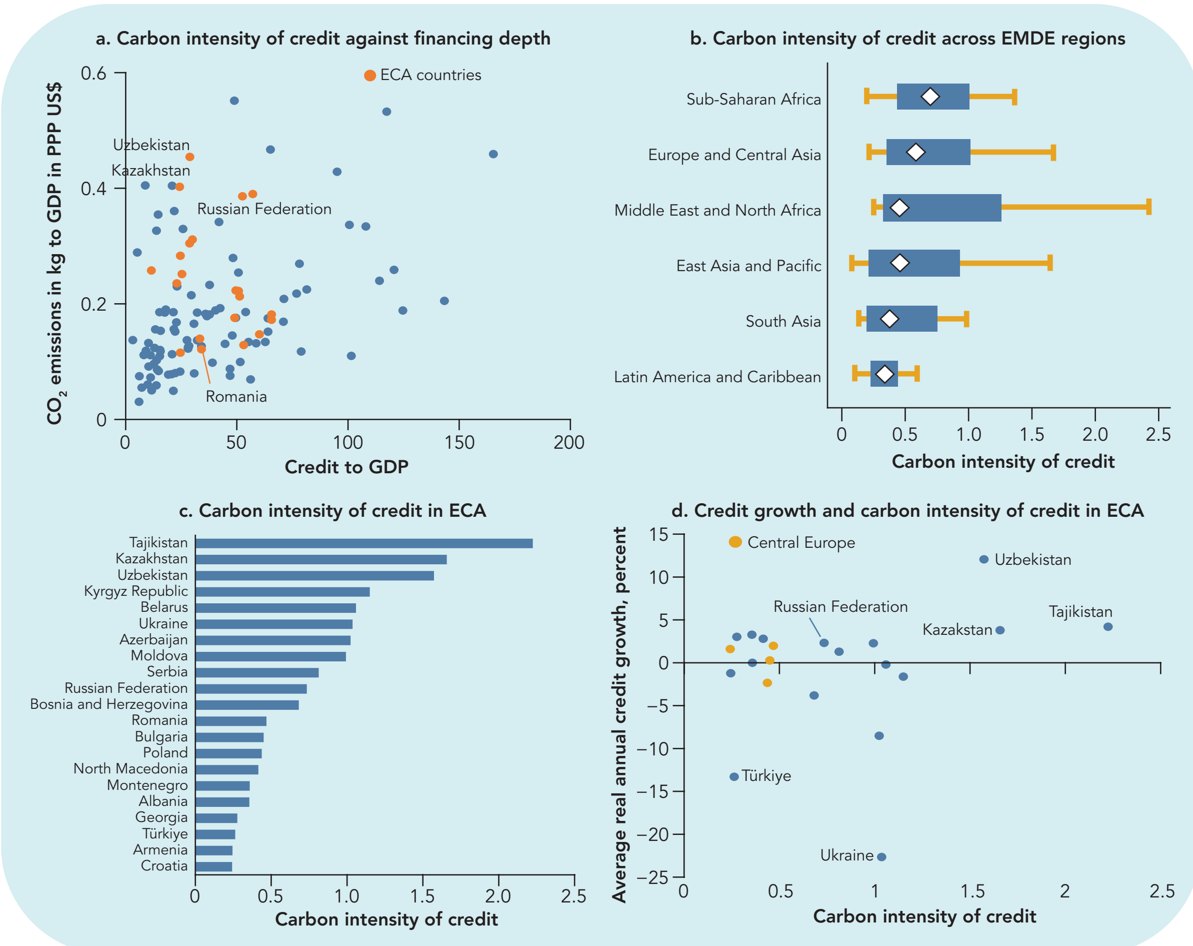
Source: World Bank.
Note: The BOS data are for 2019. BOS = businesses of the state; EAP = East Asia and Pacific; ECA = Europe and Central Asia; GDP = gross domestic product; LAC = Latin America and Caribbean; MNA = Middle East and North Africa; SAR = South Asia; SOE = state-owned enterprise; SSA = Sub-Saharan Africa.
a. The traditional definition of SOE implies majority, directly owned firms by the central government. When the ownership information was missing, the BOS was assumed to be centrally owned.
b. and c. Only countries within regions with revenue or labor data coverage exceeding 75 percent are included. Only regional averages based on country coverage exceeding 75 percent are included.
c. For Poland, data coverage does not exceed 75 percent for labor.
d. The figure uses the taxonomy of markets as developed by Dall'Olio et al. (2022). The sample includes Albania, Bosnia and Herzegovina, Croatia, Estonia, Kosovo, Latvia, Lithuania, Moldova, Montenegro, North Macedonia, Romania, the Russian Federation, Serbia, and Slovenia.

Carbon intensity of credit in ECA

The financial sector can play a critical role in mobilizing resources to speed up the transition to a less carbon-intensive economy. Financial institutions can support the green transition by requiring transparency and public disclosures from businesses and households about green versus brown investments and boosting the flow of funds toward green economic activities. Promoting green finance by reforming financial sector policies should be an integral component of the reform efforts that support climate change adaptation and mitigation. This is particularly relevant for countries with high carbon emissions per GDP and well-developed financial markets—measured by domestic credit to the private sector provided by the financial sector as a percentage of GDP—as they can leverage the depth of their financial systems to channel resources into decarbonization projects.

ECA countries show medium to low financial depth, while several countries produce medium to high levels of carbon dioxide (CO_2) emissions to GDP—such as Uzbekistan, Kazakhstan, Bosnia and Herzegovina, Russia, and Serbia—compared to other EMDEs (figure 1.11, panel a). In other words, financial systems in ECA countries can influence the carbon emission content of their GDP, but to a

FIGURE 1.11. **Carbon intensity of credit**



Source: World Bank.

Note: All data for 2019 unless otherwise indicated. Carbon intensity of credit is calculated as the ratio of carbon emissions in kg to domestic credit to the private sector in PPP US$. The sample includes 116 EMDEs. CO2 = carbon dioxide; EAP = East Asia and Pacific; ECA = Europe and Central Asia; EMDEs = emerging markets and developing economies; GDP = gross domestic product; kg = kilogram; LAC = Latin America and Caribbean; MNA = Middle East and North Africa; PPP = purchasing power parity; SAR = South Asia; SSA = Sub-Saharan Africa.

a. Credit to GDP is domestic credit to the private sector by the financial sector as percentage of GDP.

b. The white dot indicates the regional median, the boxes show the interquartile ranges, and the whiskers indicate the minimum and maximum scores excluding outliers.

d. Credit growth is calculated as the average real annual credit growth in 2019–22 (or the latest year available). The orange dots indicate Central Europe.

smaller magnitude relative to countries with similar CO_2 emissions and higher financial depth. The information delivered by the two ratios (carbon emissions to GDP and credit to GDP) can be summarized in the carbon intensity of credit ratio of carbon emissions to domestic credit to the private sector (Melecky and Singer, forthcoming).

ECA is the region with the second highest median carbon intensity of credit after Sub-Saharan Africa—a region with medium to lower emissions and lower financial depth than ECA (figure 1.11, panel b). Within ECA, Central Asia is home to the financial systems with the highest carbon intensity of credit (figure 1.11, panel c). While Tajikistan's high ratio is driven by the fact that it has the lowest financial depth in the region, Kazakhstan and Uzbekistan—along with Bosnia and Herzegovina, Russia, and Serbia—with medium to high emissions per GDP and medium to high financial depth would be well-positioned to use the financial system as a lever to decarbonize their economies. Leveraging the financial system is the most urgent in countries with a high carbon intensity of credit and high credit growth as it implies that financial systems channel resources into less green activities. In ECA, the countries with the highest carbon intensity of credit and growth of credit are Uzbekistan, Kazakhstan, and Tajikistan (figure 1.11, panel d). Improving information disclosure on the green content of new loans and decarbonizing new flows of credits could help reduce the contribution of the financial systems to CO_2 emissions in those countries.

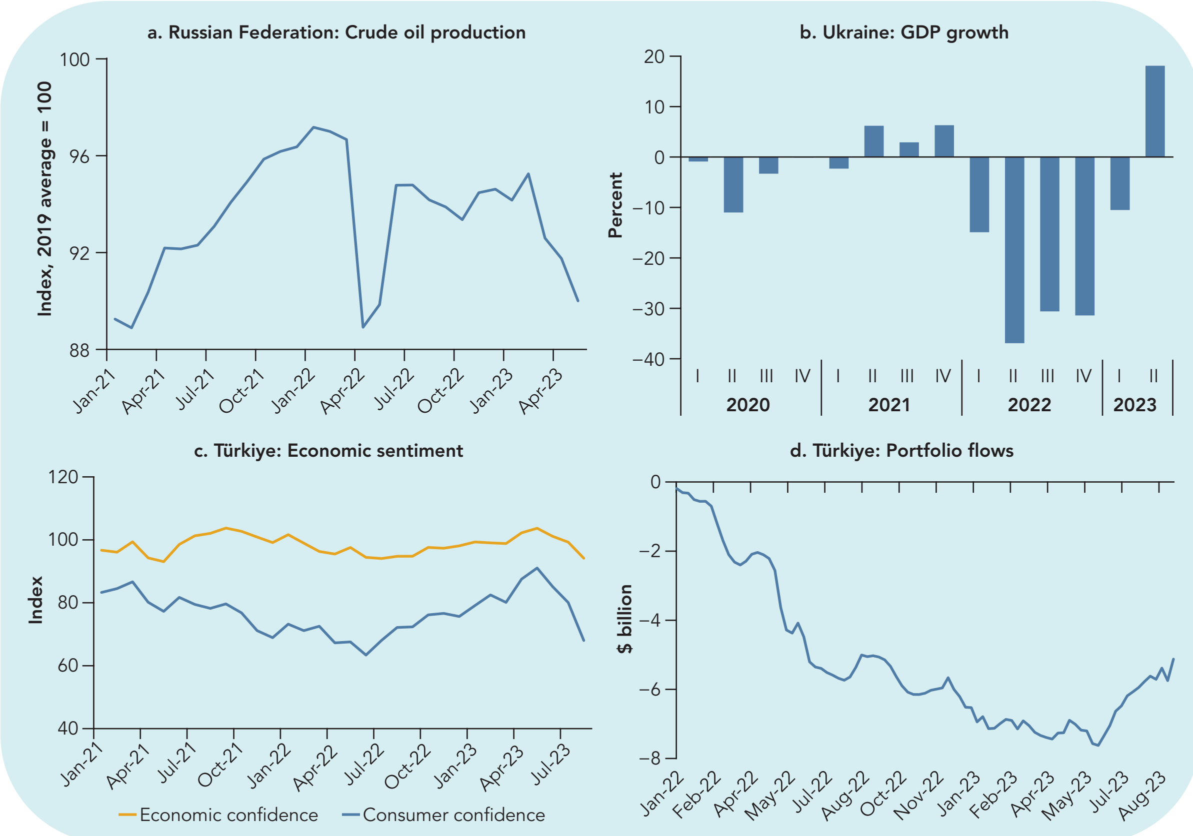
As countries transition to greener growth, better information on the carbon intensity of financial flows could help to improve policy design and direct resources to more impactful projects. For greater precision, transparency, and understanding of where leveraging the financial sector can make the biggest difference in supporting the green transition, carbon emission and credit allocation data at the level of industries need to become publicly available in a fully harmonized format.

Trends in Europe and Central Asia: Major Economies and Subregions

Russian Federation

Growth in Russia is expected to improve to 1.6 percent in 2023 following a 2.1 percent contraction last year. This represents a significant upward revision of 1.8 percentage points from the June forecast as activity picked up in the first half of this year on surging government spending and resilient consumption boosted by growing real wages and expanding consumer credit. Meanwhile, sanctions continue to weigh on activity in extractive sectors, as production of natural gas, metal ores, and crude oil remain weak. Crude oil production continued to fall after reaching its record high post-pandemic level in February 2023 (figure 1.12, panel a). Exports fell by 32 percent from a year earlier in January-August, pushing the current account surplus down to $25.6 billion, almost seven times lower than a year earlier. The moderation of global metal prices hit exports and slowed the growth of industrial production as well. The current account surplus is likely

FIGURE 1.12. **Recent developments in major economies**



Sources: Federal State Statistics Service of the Russian Federation; Institute for International Finance; National Bank of Ukraine; Turkish Statistical Institute; U.S. Energy Information Administration; World Bank.
Note: GDP = gross domestic product.
a. The last observation is May 2023.
b. Values are quarterly GDP growth estimates by the National Bank of Ukraine.
c. The last observation is August 2023.
d. Values are cumulative net inflows of equity and debt since the start of 2022.

to narrow to 2.6 percent of GDP in 2023 from 10.4 percent last year. Federal budget revenue declined sharply as tax receipts from resource sectors plunged. The budget deficit is likely to widen to 3.3 percent of GDP in 2023.

As Russia shifted some oil exports to China, India, and, more recently, Türkiye, oil production has declined, negatively affecting growth. In September, Russia extended voluntary export cuts to the end of the year, having already agreed to cut production by 0.5 million barrels per day (or about 5 percent of the total output) earlier this year. In August, Russia-origin seaborne crude oil shipments fell to an 11-month low after peaking in May to a post-invasion high of about 3.9 million barrels per day as India bought record volumes of discounted Russian oil.[12] The Group of Seven's sanctions on Russia's crude oil exports have dampened export revenues as well.

12. S&P Global Commodity Insights.

The growth of industrial production is slowing, reflecting lower global demand for base metals. Meanwhile, capacity constraints in the non-resource sectors; elevated costs of imported inputs, owing to higher trade costs and the impact of sanctions; and tight labor markets limit the upside outlook for growth. Although retail sales remained resilient as nominal wages grew at an average annual rate of over 13 percent this year, renewed price pressures are curbing consumer demand. A sharp recent depreciation of the exchange rate triggered an emergency 300 basis points hike of interest rates in August to 12 percent, the highest level since April 2022. Policy rates were increased again to 13 percent in September. Policy tightening is likely to persist as inflation increased to 5.2 percent in August, further tempering growth.

Output expansion is projected to remain weak at only 1.1 percent a year on average during 2024–25. Efforts to enhance import diversification are running against capacity constraints, tight labor markets, and lack of access to technology and equipment because of sanctions. Inflation is expected to remain elevated at 5.2 percent next year. Tighter policies, both to contain inflation and exchange rate volatility and to reduce the budget deficit, are expected to restrain growth momentum as well. Government consumption is projected to increase by just 1.5 percent on average in 2024–25, a sharp slowdown from the 8.6 percent growth this year. The disintegration of Russia's trade and investment links is likely to deepen as the sanctions persist, further reducing potential growth.

Ukraine

The growth forecast for Ukraine is upgraded to 3.5 percent for 2023, up by 1.5 percentage points from June. A more stable electricity supply, increased government spending, large external assistance, a better than earlier expected harvest, and improving consumer and business confidence supported a gradual pickup in activity in the first half of this year, following a sharp contraction a year ago (figure 1.12, panel b).

Modest growth in Ukraine resumed in the second quarter of 2023 for the first time since Russia's invasion, bolstered by higher public consumption and some recovery in sectors benefiting from military spending and improved electricity supply. In agriculture, better growth than was expected earlier was supported by favorable weather conditions. A shift to alternative export routes bypassing the Black Sea ports alleviated some logistics pressures; nevertheless, the termination of the Black Sea Grain Initiative in July disrupted exports. Wage pressures increased amid a broad-based uptick in labor demand and constrained labor supply. Inflation eased to 8.6 percent in August, reflecting slower growth of food prices, albeit an upward adjustment of electricity tariffs in June added to price increases.

Growth in Ukraine is expected to strengthen to 4 percent next year and 6.5 percent in 2025, although the projections are conditional on the availability of external financial support and the assumed duration of Russia's invasion. Policies are expected to remain tight to restrain inflation and contain the widening of external imbalances, with private consumption delivering only a modest contribution to growth over the forecast horizon.

Türkiye

Türkiye is projected to grow by 4.2 percent this year, an upgrade of 1 percentage point from the June projection, reflecting resilient consumer demand, reduced policy uncertainty, and a less damaging impact than earlier expected from the February earthquakes. Nonetheless, growth in 2023 is slower than the 5.6 percent recorded in 2022.

Although the double-digit growth in household spending provided a substantial boost to growth, it has led to the rapid widening of external imbalances and surging inflation. Inflation in August jumped to almost 60 percent, its highest level since the start of the year, partly reflecting a sharp currency depreciation. A shift toward more monetary policy normalization has begun, with the central bank hiking policy rates by a cumulative 2,150 points since May, including an increase of 1,250 basis points in August-September alone. At the same time, external demand weakened substantially because of slower growth in key trading partners, especially in the euro area. Recent measures of economic confidence also indicate that the pace of economic slowdown increased in Türkiye (figure 1.12, panel c). On a positive note, debt and equity portfolio inflows have picked up since the election in May, alleviating pressures on foreign exchange reserves, which rose to $72 billion in early September from $56 billion at the end of May (figure 1.12, panel d).

Growth is likely to slow to 3.1 percent in 2024, a downgrade of 1.2 percentage points relative to the June projection, as the ongoing monetary policy normalization and fiscal consolidation cool domestic demand. Private consumption is projected to increase by only 1.7 percent in 2024, its slowest rate of growth since 2019, while the growth of government spending is expected to be only 2.1 percent, the lowest since 2011. A modest uptick in growth to 3.9 percent is envisioned for 2025.

Central Asia

Growth in Central Asia is expected to strengthen to 4.8 percent in 2023, an upward revision of 0.8 percentage point, driven by a 1 percentage point upgrade to the growth forecast for Kazakhstan. Growth is likely to ease in the rest of the region as falling remittances from Russia (Kyrgyz Republic, Tajikistan, and Uzbekistan) weigh on consumption.

Growth is expected to average 4.7 percent in 2024–25 assuming that inflation moderates. Risks to the outlook include a deeper slowdown in the global economy leading to a slide in global commodity prices. There is also the risk of slower growth of remittances from Russia as well as the risk of stricter international enforcement of sanctions on Russia, which could further disrupt regional trade flows. A slower than expected recovery in Russia could also lead to decreased remittances to Central Asia by more than expected, leading to a deeper slowdown in consumption.

The long-term prospects for the subregion are particularly vulnerable to the effects of climate change and the availability of reliable access to water. Access to shared water resources is often the source of tensions within Central Asia

(O'Donnell 2023). The dominance of water-dependent agriculture and hydropower sectors leaves the subregion exposed to fluctuations in precipitation and water levels, while adaptation capacity is weak. Moreover, many countries in the subregion, where the state still plays an oversized role in economic activity, lack vibrant private sectors that can lead the transition to a greener and more sustainable economy. The recent adoption of the Uzbekistan-2030 Development Strategy is an encouraging sign that governments in the region embrace the urgency of the need for structural reforms.

Central Europe

In Central Europe, growth is likely to weaken to 1.1 percent in 2023 from 5 percent in 2022, mirroring the overall slowdown of the EU economy. Persistent inflation has dented consumer incomes and tight financial conditions have slowed credit growth, depressing consumption and investment in some countries. Croatia's economy has proven to be the most resilient in the subregion, with 2.7 percent growth projected for 2023, thanks to strong private consumption and tourism-driven demand for services. Increasing EU-funded public investment, including that focused on improving the efficiency of energy and transport infrastructure, helped to support growth across the subregion as well. Nevertheless, in Croatia, as in the rest of Central Europe, the sustainability of growth is a challenge as pent-up demand fades and the travel and tourism sectors complete their recovery to pre-pandemic levels.

Growth is expected to strengthen to 2.9 percent in 2024 and further to 3.5 percent in 2025, as inflation moderates, external demand improves, and absorption of the EU funds under the National Recovery and Resilience Plans grows. Risks are substantial, including from protracted weakness in the euro area economy and a delayed shift toward a less restrictive monetary policy stance by the European Central Bank. Although Central Europe shares many similar structural challenges with the rest of the region, its aging population and the large influx of refugees from Ukraine make many reforms even more urgent.

Eastern Europe excluding Ukraine

Growth in Eastern Europe excluding Ukraine has been revised up by 1.9 percentage points to 2.7 percent in 2023 as the region is expected to emerge from the deep 4.7 percent contraction a year ago. Strong growth of Belarus after the largest contraction in almost two decades reflects the continued deepening of trade and investment links with Russia. The economy of Moldova is returning to growth as well, supported by stronger remittances, slowing inflation, and more accommodative monetary policy.

However, the growth paths of Belarus and Moldova are expected to diverge over the forecast horizon. The pace of economic expansion is projected to slow sharply in Belarus to just 0.8 percent a year on average in 2024–25, but it is likely to regain momentum in Moldova and average 4.1 percent a year during 2024–25. Risks vary across the region as well. Much slower than expected growth in Russia could push the economy of Belarus back into recession. A stronger than anticipated slowdown in the euro area would depress domestic demand in Moldova through the remittance channel and lead to weaker exports. An escalation of tensions between Moldova and Russia could also result in disruptions to the electricity supply.[13]

South Caucasus

Growth in the South Caucasus has been revised upward since June because of stronger expansions in Armenia and Georgia. Armenia and Georgia are likely to grow by 6.6 and 5.9 percent, respectively, this year, as consumption remains resilient, supported by robust remittances and booming reexports. In Azerbaijan, growth has been revised down to 1.5 percent as lower oil production tempers the expansion of the non-resource economy.

Growth is expected to be little changed at 3.3 percent a year in 2024–25. The outlook is subject to various downside risks, including a slowdown in money and remittance flows from Russia, a global growth slowdown, further restrictions on reexports, and longer than expected tightening of financial conditions. Rising tensions at the border between Armenia and Azerbaijan could further escalate and increase instability in the region. The long-term growth prospects are also constrained by the lack of diversification and excessive reliance on commodity exports and remittances.

Western Balkans

Growth in the Western Balkans is likely to slow to 2.5 percent in 2023 from 3.2 percent in 2022. Consumption remained resilient in Albania, Kosovo, and Montenegro, boosted by the strong recovery in tourism, while activity weakened in Bosnia and Herzegovina, North Macedonia, and Serbia as external demand deteriorated, owing to a sharp slowdown in the EU.

Growth is projected to pick up slightly over the forecast horizon and average 3.3 percent a year in 2024–25, reflecting moderation of inflation pressures, a gradual recovery of exports, and increasing public spending on EU-backed infrastructure projects. Risks to the outlook remain predominantly on the downside, including a deeper slowdown in the EU, a drawn-out period of tight financial conditions, and persistent inflation, especially food price inflation. Political tensions and uncertainty in the region, albeit easing, could escalate, slowing progress on reforms.

13. Energy supply in Moldova is now more diversified than at the start of Russia's invasion of Ukraine, as the country sources its natural gas for domestic use from the EU. However, almost 75 percent of Moldova's electricity needs are provided by the Cuciurgan power plant located in Transnistria and powered by natural gas from Russia.

Annex 1. Data and Forecast Conventions

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

Data

The data used to prepare the country forecasts come from a variety of sources. National income accounts, balance of payments, and fiscal data are from Haver Analytics; the World Bank's World Development Indicators; and the International Monetary Fund's (IMF's) World Economic Outlook, Balance of Payments Statistics, and International Financial Statistics. Population data and forecasts are from the United Nations' World Population Prospects. Country and lending group classifications are from the World Bank. In-house databases include commodity prices, data on previous forecast vintages, and country classifications. Other internal databases include high-frequency indicators—such as industrial production, Consumer Price Indexes, housing prices, exchange rates, exports, imports, and stock market indexes—based on data from Bloomberg, Haver Analytics, the Organisation for Economic Co-operation and Development's analytical housing price indicators, the IMF's Balance of Payments Statistics, and the IMF's International Financial Statistics. Aggregate growth for the world and all subgroups of countries (such as regions and income groups) is calculated as the gross domestic product–weighted average (in average 2010–19 prices) of country-specific growth rates. Income groups are defined as in the World Bank's classification of country groups.

Forecast process

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

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2

ECA Macro Poverty Outlooks

ALBANIA

Table 1	2022
Population, million	2.8
GDP, current US$ billion	18.9
GDP per capita, current US$	6743.1
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]	76.5
Total GHG emissions (mtCO2e)	8.5

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2017 PPPs.
b/ Most recent WDI value (2021).

Growth in 2022 reached 4.8 percent as private consumption, exports, and investment expanded despite increasing energy and food prices. Growth is expected to moderate in 2023, despite another year of exceptional increase in tourism. Poverty is expected to continue its downward trend as employment and wages increase. Medium-term prospects hinge on the global recovery, structural reforms, and fiscal consolidation.

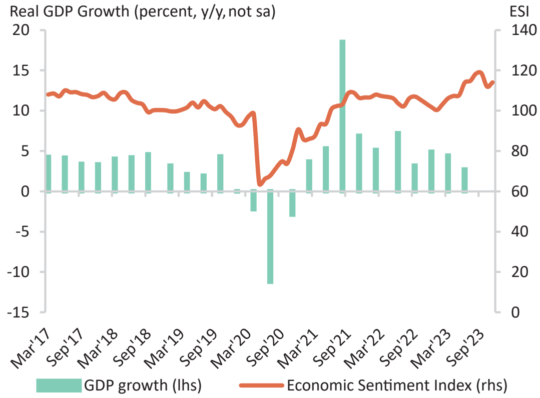
Key conditions and challenges

The Albanian economy has shown considerable resilience in the face of consecutive shocks during 2019-2022, including the 2019 earthquake, the pandemic and the ensuing economic turmoil, and Russia's invasion of Ukraine. The economy experienced a strong rebound, with real GDP expanding by 8.9 percent in 2021 and by 4.8 percent in 2022, and GDP exceeding its pre-pandemic level that year. Poverty rates continued their downward trend in 2022. A key factor in Albania's resilience has been the proximity to the European Union, which facilitates investment, remittances, and exports. As a consequence, construction and tourism are key growth drivers. The availability of hydropower, which meets 85 percent of domestic energy demand in a year with average precipitation, has provided some insulation from the ongoing energy crisis and contributed to containing the country's greenhouse gas emissions. Albania's key development challenges are its declining population, which is partially owed to large migration; the poor quality of the labor force and the low quality of jobs created; the moderate pace of structural reforms, especially in the areas of private sector environment and governance; and rising fiscal pressures, due to government responses to multiple crises, climate risks, contingent liabilities, and debt refinancing at a time of high interest rates. To address the gap in human capital investment and the need for climate-resilient infrastructure, while maintaining support for the most vulnerable, Albania will need to implement a Medium-Term Revenue Strategy to strengthen domestic revenues. Unlocking further growth is conditional on the swift implementation of the Government's program, anchored 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

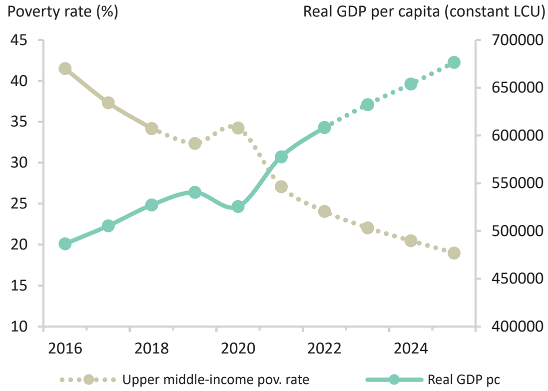
In the first quarter of 2023, GDP grew by 2.7 percent. Services, including trade and real estate, led growth on the supply side, followed by construction and manufacturing. Consumption and investment remained the main growth drivers on the demand side. Net exports reduced growth, due to smaller foreign demand. Leading economic indicators suggest growth accelerated during the second and third quarters with tourist arrivals hitting a record high through July 2023, and construction activity accelerating. Increased income from employment, credit growth, business and consumers sentiment indicators, and strong tax revenues all suggest an increasing contribution to growth from consumption, investment and net exports in the second and third quarters.

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



Sources: Instat and Bank of Albania.

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



Source: World Bank. Notes: see Table 2.

Employment grew by 4.4 percent yoy during Q1 2023. Increasing wages and employment incentivized labor force participation (ages 15+), which reached 64 percent in Q1 2023, the highest level since 2019. Average private sector wage growth reached 9.5 percent, down from 14.2 percent in the previous quarter, mainly driven by wage increases in trade, transport, accommodation industry and public administration. Unemployment reached 10.9 percent in Q1 2023, slightly higher than the end-2022 rate. Given strong GDP per capita growth in 2023, poverty is projected to decline by 1.9 percentage points to reach 22.2 percent.

The annual inflation rate dropped to 4.2 percent in July 2023 from a record high of 8.3 percent in October 2022, as a result of downward pressures from lower import prices, domestic currency appreciation and monetary policy normalization; upward pressures on inflation included wage increases and high-capacity utilization.

For the first half of 2023, the government recorded a high surplus, on account of strong revenue collection and lower spending. Grants accounted for most of the revenue increase (14.5 percent yoy), alongside social insurance contributions and personal income taxes, reflecting the increase in statutory minimum wages. The increase in expenditures was relatively small at 3.4 percent yoy but is expected to pick up during the second part of the year owing to increasing capital spending.

Outlook

Growth is expected to moderate to 3.6 percent in 2023, in the context of tight global financial conditions, limited economic growth in Europe, and the completion of programs for the post-earthquake reconstruction. Nevertheless, increased tourism and construction are expected to drive exports, consumption and investment growth at rates similar to the pre-pandemic period. The inflation rate is projected to start converging toward the 3 percent target by 2024. Economic sentiment remains positive (Figure 1), though it has recently outpaced economic performance.

Albania's primary balance is projected to reach 0.1 percent of GDP in 2023 and stay positive in observance of the fiscal rule. Fiscal consolidation is expected on the spending side. On revenues, Government plans to introduce further tax policy measures, envisioned in the Medium-Term Revenue Strategy. Public debt is expected to decline slightly to 63.1 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, 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 potentially constrain the fiscal space. As a small, open economy, Albania is highly exposed to external shocks, such as a 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 country's hydropower-based energy sector that are mainly due to variations in hydrology.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-3.3	8.9	4.8	3.6	3.2	3.2
Private consumption	-3.4	4.3	6.9	2.3	2.6	2.7
Government consumption	1.5	7.8	-4.8	4.6	1.5	1.0
Gross fixed capital investment	-1.4	19.2	6.5	-1.2	3.4	3.3
Exports, goods and services	-27.9	52.0	7.5	6.7	5.4	5.9
Imports, goods and services	-19.8	31.5	13.1	1.2	3.4	3.6
Real GDP growth, at constant factor prices	-2.9	8.2	5.2	3.6	3.2	3.2
Agriculture	1.3	1.8	0.1	0.3	0.3	0.3
Industry	-4.3	13.6	7.7	1.2	3.7	3.5
Services	-3.8	8.1	5.9	6.0	3.9	4.0
Inflation (consumer price index)	2.2	2.6	6.7	5.0	3.5	3.0
Current account balance (% of GDP)	-8.5	-7.8	-6.0	-5.6	-5.8	-5.6
Net foreign direct investment inflow (% of GDP)	6.7	6.5	6.7	6.8	6.8	6.8
Fiscal balance (% of GDP)	-6.7	-4.6	-3.7	-2.5	-2.3	-1.9
Revenues (% of GDP)	25.9	27.5	26.8	28.1	27.5	27.7
Debt (% of GDP)	75.8	75.4	65.4	63.1	62.1	60.8
Primary balance (% of GDP)	-4.6	-2.7	-1.8	0.1	0.3	0.5
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	34.3	27.1	24.1	22.0	20.5	19.0
GHG emissions growth (mtCO2e)	-5.7	4.8	-1.5	-4.0	-2.2	-1.9
Energy related GHG emissions (% of total)	46.3	49.6	49.4	48.1	47.8	47.5

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 2014- and 2019-SILC-C. Actual data: 2018. Nowcast: 2019-2022. Forecasts are from 2023 to 2025.
b/ Projection using point-to-point elasticity (2013-2018) with pass-through = 1 based on GDP per capita in constant LCU.

ARMENIA

Table 1	2022
Population, million	3.0
GDP, current US$ billion	19.5
GDP per capita, current US$	6572.2
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]	72.0
Total GHG emissions (mtCO2e)	13.5

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

Economic growth reached 10.5 percent (yoy) in H1 2023, driven by services and continued inflows of citizens and money transfers from Russia, and is projected at 6.6. percent in 2023 as a whole. This was accompanied by a sharp reduction in inflation to 3.6 percent (yoy) on average through July 2023. Unresolved issues at the Armenian border, a reversal of recent inflows, potential sanctions, and a slowdown in trade partner economies are the main risks to the outlook.

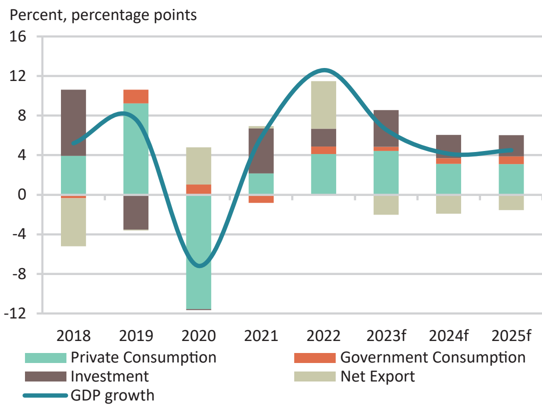
Key conditions and challenges

Following Russia's invasion of Ukraine, Armenia absorbed a significant inflow of migrants, businesses, and capital. Armenia also benefited from rerouted trade and money flows. These developments fueled domestic demand and supported the appreciation of the currency. While there are signs these flows are easing somewhat, Armenia continues to benefit from them, and the risk of reversal has so far not materialized.
Overall, the economic environment enjoys sound macroeconomic policies, including active inflation targeting, adherence to a fiscal rule, and sound financial sector oversight. In recent years, the authorities have aimed at reducing corruption and increasing transparency, particularly in the tax and customs administrations.
However, important structural challenges persist, resulting in an undiversified economic structure with limited manufacturing and a narrow export basis, subdued growth in the agriculture sector, insufficient investment, and challenges to attract FDI, limited human capital and skills mismatch.

Recent developments

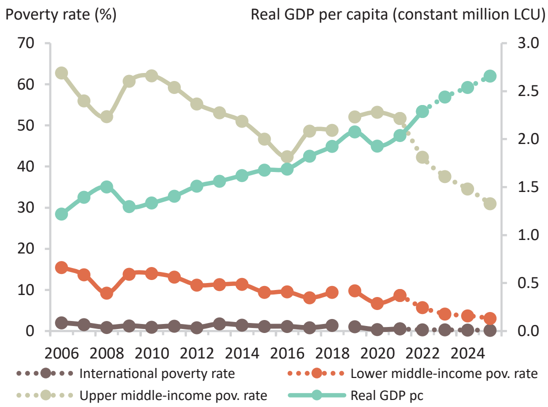
Armenia maintained double-digit GDP growth in H1 2023, at 10.5 percent (yoy) in real terms. As in 2022, growth was driven by a 14 percent (yoy) increase in services, particularly in IT, trade, and transport sectors. Growth in industry slowed to 1 percent (yoy) in H1 2023 due to contraction in the mining sector. However, construction continued to grow at the exceptional rate of 19 percent (yoy). Agricultural growth was flat, reflecting longstanding challenges in this sector (both statistical and structural).
The unemployment rate fell from 14.8 percent in Q1 2022 to 13.7 percent in Q1 2023, reflecting the strong economic activity.
Average inflation dropped sharply, from 8.6 percent in 2022 to 3.6 percent during January-July 2023, largely driven by a slowdown in food and transport inflation. In response to this trend, the Central Bank of Armenia reduced the policy rate by 50 bps, to 10.25 percent in August.
Credit to the economy increased by 14.6 percent in nominal terms (yoy) as of the end of June 2023, mostly driven by an increase in dram-denominated loans. This lowered loan dollarization to 35 percent as of the end of June 2023. Financial stability indicators remained sound, with the Capital Adequacy Ratio (CAR) above 20 percent and the Non-Performing Loans (NPLs) ratio below 3 percent.
The fiscal budget recorded a surplus of 1.4 percent of projected GDP in H1 2023, compared to the planned deficit of 1 percent of GDP. This was primarily due to a 6 percent overperformance in tax revenue collection, which rose by 19 percent (yoy) in nominal terms. This was mostly driven by increased profits tax and VAT tax collection of 45 percent and 20 percent (yoy, in nominal terms), respectively, explained by strong economic performance and higher

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



Sources: Statistical Committee of Armenia, CBA, 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.

consumption, and 20 percent greater income tax collection in nominal terms due to increased employment and salary levels. Current and capital expenditures were also higher by 12 percent and 16 percent (yoy, in nominal terms), respectively; however, capital expenditures fell short by 46 percent in nominal terms compared to the ambitious public investment plan approved in the budget. Driven by robust economic and fiscal performance, government debt to GDP continued to decline to about 44 percent of projected annual GDP at the end of July 2023.
Growth of exports and imports of goods continued to be strong in H1 2023, both at 73 percent (yoy, in USD value), due to rerouting of exports to Russia. The trade balance in nominal terms deteriorated by 73 percent (yoy), due to a 1.5 times larger import base compared to exports. This was partly compensated by higher service exports, including a 70 percent (yoy) increase in the number of tourist arrivals in H1 2023. While gross money transfers from Russia increased by 88 percent (yoy) in H1 2023, large outflows to third countries resulted in a 10 percent decline (yoy) in net terms. This contributed as well to the deterioration of the current account balance. Nevertheless, appreciation pressures on the AMD continued in 2023, resulting in a 2 percent stronger AMD against USD at the end of July 2023 compared to the end of 2022. International reserves declined in Q1 but rebounded to a record USD 4.1 billion at the end of July 2023.

Outlook

Growth is expected to moderate in H2 2023 as consumption slows due to the high base effect in H2 2022 and as import growth outpaces export growth. However, moderation will be milder than initially projected at the beginning of 2023, with growth revised up to 6.6 percent (yoy) in 2023. Growth in the medium-term will moderate further to an average of 4.3 percent in 2024-2025.
Average inflation is forecast to reach 3.7 percent in 2023 and to remain close to the target of 4 percent in the medium term.
The deficit is expected to reach 2.4 percent of GDP in 2023, which is lower than budgeted due to tax revenue overperformance.
The CAD is projected to widen in 2023, impacted by a pick-up in goods imports, a slowdown in exports from a very high base in 2022, and a deterioration in income accounts, while still being mostly financed by FDI inflows.
Due to continued and strong economic growth in 2022-2023, poverty is projected to fall from 51.7 percent in 2021 to 37.6 percent in 2023, as measured by the UMIC poverty line of USD 6.85/day (2017 PPP). This will be supported by the reduction in inflation, especially in food prices.
The outlook is subject to significant uncertainty, due to the risk of reversal of inflows; potential sanctions related to the re-exports of double-use goods; a possible slowdown in trading partner economies; and unresolved issues at the Armenian border.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-7.2	5.8	12.6	6.6	4.1	4.5
Private consumption	-13.9	2.8	5.5	6.3	4.5	4.4
Government consumption	9.2	-6.2	6.3	3.7	5.3	7.1
Gross fixed capital investment	-1.5	23.6	9.0	16.7	9.6	8.3
Exports, goods and services	-33.5	18.6	59.3	21.6	9.9	8.7
Imports, goods and services	-31.5	12.9	34.5	23.2	11.8	9.9
Real GDP growth, at constant factor prices	-6.8	5.6	13.2	6.6	4.1	4.5
Agriculture	-3.7	-0.8	-0.7	0.6	0.9	1.2
Industry	-2.5	2.6	9.2	6.0	5.3	4.7
Services	-9.6	8.7	18.2	7.9	4.1	4.9
Inflation (consumer price index)	1.2	7.2	8.6	3.7	4.0	4.0
Current account balance (% of GDP)	-4.0	-3.5	0.8	-2.1	-3.0	-3.4
Net foreign direct investment inflow (% of GDP)	0.7	2.5	4.9	2.5	2.7	2.9
Fiscal balance (% of GDP)	-5.1	-4.5	-2.2	-2.4	-2.8	-2.6
Revenues (% of GDP)	26.0	24.9	25.1	25.6	25.4	25.9
Debt (% of GDP)[a]	63.5	60.2	46.7	48.6	49.2	49.5
Primary balance (% of GDP)	-2.4	-2.0	0.1	0.4	0.4	0.5
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	5.7	4.2	3.7	3.1
Upper middle-income poverty rate ($6.85 in 2017 PPP)[b,c]	53.2	51.7	42.3	37.6	34.5	31.0
GHG emissions growth (mtCO2e)	-1.8	15.4	18.7	9.1	8.2	9.4
Energy related GHG emissions (% of total)	60.3	66.5	72.2	74.8	76.8	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/ Excludes 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]	69.4
Total GHG emissions (mtCO2e)	53.2

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

Economic growth slowed sharply to 0.5 percent in H1 2023, dragged down by contracting oil production and moderate non-energy sector activity. Growth is projected at 1.5 percent in 2023 as a whole. Inflation eased, although it remains in double digits as of June 2023, and is expected to continue to decline. The current account surplus is expected to reduce in 2023 due to a reduction in exports and money transfers.

Key conditions and challenges

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

Constraints to private sector development include a large state footprint in the economy, lack of a level playing field for companies, shallow financial markets, and a weak human capital base. 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 sustained 5-percent growth target in non-energy sectors in 2022–2026.

Recent developments

In H1 2023, real growth slowed to 0.5 percent, compared to 4.6 percent in 2022. The energy sector contracted due to a fall in oil production because of aging oil fields, while natural gas grew at a slower pace, with gas production nearing full capacity. The non-energy sector expanded by 3.1 percent, with service sectors (transport, hospitality, retail trade) cooling after strong growth in 2022.

On the demand side, consumption growth eased due to a decline in real wages and moderation in money transfers from Russia. Investment growth remained robust, supported by public investment largely directed toward reconstruction in liberated territories and the energy sector.

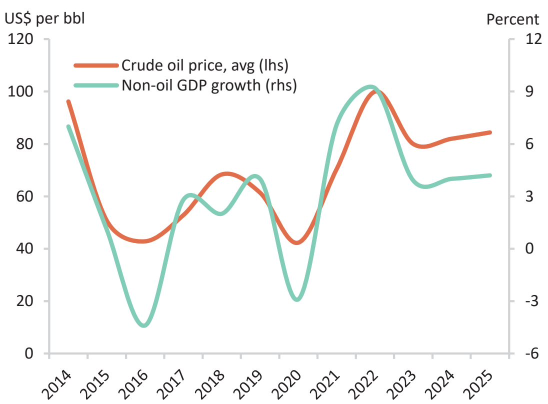
The latest official figures show that the national poverty rate decreased from 5.9 in 2021 to 5.5 in 2022. In the first months of 2023, the unemployment rate remained stable at 5.6 percent.

Inflation moderated to 10.7 percent (yoy) in H1 2023, from 14.3 percent at the end of 2022, driven by a slowdown in food inflation. With inflation still in double digits, the Central Bank of Azerbaijan (CBA) raised the policy interest rate by 75 bps in H1 2023, to 9 percent (which remains negative in real terms).

Falling energy prices and falling oil production in H1 2023 negatively impacted exports, with a decline of 2.9 percent (yoy) in USD terms, while imports increased by 29 percent (yoy), largely driven by public sector investment. Despite faster growth in imports, the trade surplus reached 27.5 percent of GDP in H1 2023. Money transfers dropped by 48 percent in H1 2023 (yoy). Foreign currency reserves increased by 2.7 percent compared to year-end 2022, reaching USD 9.2 billion or 5.4 months of import cover.

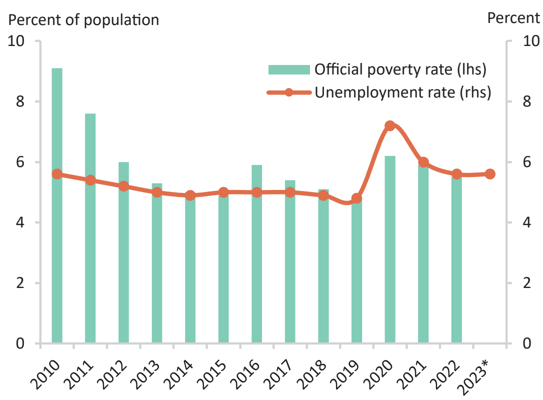
The fiscal balance recorded a large surplus in H1 2023, at 18.4 percent of GDP. This is due to surge in revenue to 44 percent of GDP, supported by higher tax receipts from sales of natural gas.

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



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

FIGURE 2 Azerbaijan / Official poverty rate and unemployment rate



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

Spending expanded to 26.5 percent of GDP, with public investment increasing to 6.5 percent of GDP, while current spending lagged. Due to a high revenue outturn, the Government increased the 2023 planned budget spending by 10 percent in nominal terms (from the original budgeted amount). Sixty percent of the increase will be allocated to reconstruction needs. Fiscal buffers remain strong, with reserves of the State Oil Fund of the Republic of Azerbaijan (SOFAZ) increasing by 12 percent, to USD 55 billion (70 percent of 2022 GDP). Public debt edged up to an estimated 14.5 percent of GDP.

Credit to the economy rose by 9 percent in H1 2023, driven by a 10 percent increase in consumer lending. The NPL ratio fell to 2.3 percent by the end of June, from 3.5 percent recorded a year ago, while bank profits increased substantially.

Outlook

GDP growth is projected at 1.5 percent in 2023 due to the expected reduction in oil production and slow growth in non-energy sector activity as growth converges to pre-COVID levels.

On the demand side, consumption will ease in 2023 while increased social transfers enabled by the revision of the budget are expected to limit the slowdown. Capital formation will largely be driven by public investment. In the medium term, in the absence of structural reforms, growth is expected to average 2.4 percent.

Inflation is projected to slow to 9 percent in 2023, as food prices continue to fall and external pressures ease while remaining above the CBA's upper range. Inflation is expected to return to CBA's target interval of 4+/–2 percent by the end of 2024.

The impact on poverty and inequality will depend on the extent of the reduction in food prices and the impact of slower economic activity on employment.

In 2023, the external balance is estimated to remain in surplus, supported by stable energy prices. Imports are expected to grow in 2023, largely driven by public investment. The fiscal balance is projected to remain in surplus in the medium term, averaging 3.4 percent of GDP, as energy revenue continues to offset higher spending in reconstruction and implementation of the development strategy.

The main downside risks are related to the uncertainty around the economic implications of Russia's invasion of Ukraine, including the risk of reversals of money transfers from Russia. In addition, a fall in energy prices could impact economic activity, as occurred in 2016. Upside risks include the potential increase in natural gas production due to a new gas field becoming operational.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-4.3	5.6	4.6	1.5	2.4	2.5
Private consumption	-5.1	7.0	4.9	4.0	3.6	3.6
Government consumption	4.8	3.8	7.4	7.1	3.1	3.1
Gross fixed capital investment	-7.1	-6.0	4.5	3.5	2.3	2.0
Exports, goods and services	-8.1	5.6	3.3	-1.0	1.7	1.8
Imports, goods and services	-10.5	2.5	3.2	2.2	2.7	2.7
Real GDP growth, at constant factor prices	-4.4	5.6	4.6	1.5	2.4	2.5
Agriculture	1.9	3.3	3.4	3.2	3.0	3.0
Industry	-5.2	4.1	2.4	-0.9	1.1	1.2
Services	-4.4	8.6	8.5	4.9	4.2	4.2
Inflation (consumer price index)	2.8	6.7	13.8	9.0	5.8	5.2
Current account balance (% of GDP)	-0.5	15.2	26.5	14.6	13.5	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	3.1	3.0	2.9
Revenues (% of GDP)	33.7	36.5	32.4	34.6	34.1	32.7
Debt (% of GDP)	18.4	16.2	11.7	13.3	14.0	15.0
Primary balance (% of GDP)	-5.7	4.8	5.9	3.4	3.3	3.2
GHG emissions growth (mtCO2e)	-1.6	0.7	1.4	0.0	0.7	1.3
Energy related GHG emissions (% of total)	62.5	63.9	64.3	64.0	64.2	64.5

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

BELARUS

Table 1	2022
Population, million	9.3
GDP, current US$ billion	72.0
GDP per capita, current US$	7732.1
International poverty rate ($2.15)[a]	0.0
Lower middle-income poverty rate ($3.65)[a]	0.1
Upper middle-income poverty rate ($6.85)[a]	1.3
Gini index[a]	24.4
School enrollment, primary (% gross)[b]	94.2
Life expectancy at birth, years[b]	72.4
Total GHG emissions (mtCO2e)	59.4

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent WDI value (2021).

Despite robust growth, the economy faces challenges from supply bottlenecks due to sanctions that target major currency-earning sectors, hindering exports and redirecting trade routes. Growth is bolstered by rebounding domestic demand, driven by accommodative monetary and fiscal policies, redirection of trade routes, and rising external demand from the eastern markets. As monetary and fiscal policies approach their limits, the increasing dependence on Russia and the looming threat of sanctions in the transportation sector pose significant risks.

Key conditions and challenges

Belarus's economy is experiencing a robust rebound following its sharpest GDP decline in two decades in 2022. Strong administrative measures have curbed inflation to single digits and stabilized the exchange rate. Soft monetary and fiscal policies are providing essential support to domestic demand, as reflected in strong real growth of disposable incomes. However, potential GDP decreased after the introduction of sanctions and while investment activity is showing signs of improvement, it has not yet reached historical levels.

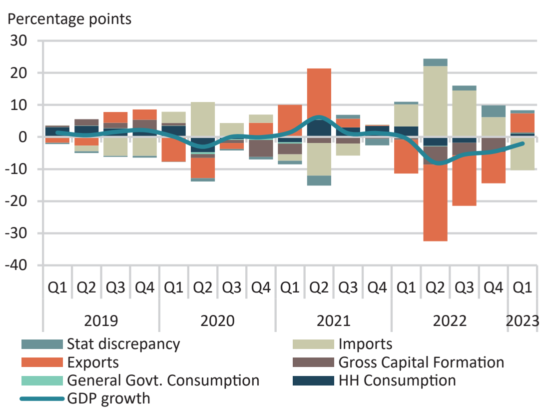
The economy is actively adapting to sanctions, forging new trade routes, and redirecting exports, particularly in potash fertilizers and refined oil products, through Russia, albeit with increased logistics costs. The current focus lies on import substitution strategies to address supply issues and boost local production. However, even if proven to be efficient, these efforts will take time to yield results, leaving Belarus vulnerable to weak external demand, particularly if Russia's economic outlook deteriorates.

Elevated security concerns and geopolitical tensions exert additional pressure on the economic outlook, especially if more sanctions are introduced, such as the closure of the western border for passenger and cargo transportation. Prolonged adherence to accommodative policies presents challenges, requiring Belarus to delicately balance the preservation of social benefits, wages, economic support, and overall economic stability. This, coupled with a declining current account and exchange rate, price controls, and labor force constraints, pose risks of high inflationary pressures. Lastly, Belarus's economy continues to grapple with its Soviet-era structure and a focus on quantitative growth with diminishing prospects of economic diversification.

Recent developments

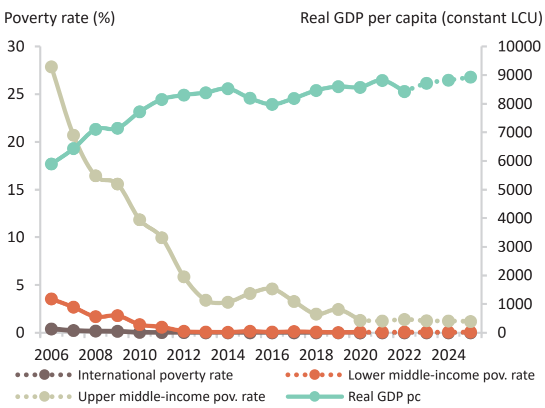
Benefiting from resilient demand from Russia, accommodative monetary policy, and a low statistical base, GDP grew by 3.1 percent in the first eight months of 2023. Growth was driven by manufacturing (9.6 percent), construction (8.7 percent), and retail and wholesale trade sectors (8.6 percent), recovering from the 2022 dip. The agricultural sector decreased (1.7 percent) due to lower grain harvest compared to last year. Conversely, the IT and transport sectors contracted, due to sanctions and labor migration. On the demand side, monetary and fiscal conditions fueled fixed investments (8.6 percent), while robust wage growth, decelerating inflation, and attractive interest rates on housing and consumer loans drove household consumption. Net exports made a negative contribution, as exports trailed behind imports due to sanctions and the collapse of IT services exports.

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



Source: World Bank calculations based on Belstat data.

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



Source: World Bank. Notes: see Table 2.

Inflation slowed to 2.3 percent in August (YoY), driven by the base effect and price controls, resulting in 5.6 percent inflation during January-August 2023. This led to a reduction in the base interest rate in June to 9.5 percent from 12 percent in January 2023.

Sanctions have left the external position vulnerable, relying heavily on Russian credits. Exports grew by 8.6 percent in H1 2023, driven by Russian demand and commodity prices. However, with rising real household incomes, imports grew significantly (23 percent), reducing the trade balance surplus. Remittances remained strong (27 percent), but the current account deficit expanded by 30 percent y/y in the first quarter. This deterioration in the current account did not significantly impact external debt (-5 percent) or foreign reserves. However, foreign reserves in hard currency experienced an 8 percent reduction, reflecting Belarusian ruble volatility, which mirrors the Russian ruble.

Households' real disposable income declined by 3.6 percent in 2022 but grew by 3.9 percent in H1 2023 due to higher real wages and pensions. As a result, poverty, as measured by the national poverty line, remained stable at 3.9 percent in Q1 2023.

Outlook

While the economy redirects toward the East following the imposition of sanctions and the recession of 2022, the economic prospects appear dim. Recent macroeconomic stability masks deep-rooted inefficiencies and growing reliance on one partner. In 2023, growth is anticipated to be stimulated by expansionary policies, support to SOEs, and recovering disposable income. Nevertheless, GDP growth will stabilize at around 3 percent as the stimulative economic policies reach their limits, and a full recovery from the 2022 downturn is projected by 2024/25. Consumption, the main driver of aggregate demand, which slumped in 2022, will be underpinned by real wage increases (8.4 percent in seven months) and announced pensions and wage increases in the public sector in September. Likewise, investments are projected to have a positive contribution, particularly propelled by the construction sector, but less machinery. Amidst robust domestic demand and curbed foreign trade, imports are expected to outpace export growth, resulting in a negative net export contribution.

In the medium term, growth is anticipated to remain below potential, with domestic demand substantially curtailed due to diminished foreign exchange earnings and projected tighter monetary and fiscal policies. Excepting sectors aligned with Russian exports (oil, fertilizers, and machinery), investments are projected to decelerate as the economy remains insulated. Against this background, with limited potential for growth, the economy may follow a close to zero growth trajectory. Inflation is forecasted to stabilize at 8.2 percent, with a gradual decline to 7.2 percent expected by 2025 if administrative measures are effectively maintained. Lower external demand and commodity prices are projected to erode the current account balance, leading to currency pressures. The fiscal outlook is anticipated to worsen, with fiscal deficits expected due to the government's pursuit of economic stimulus and job preservation measures. With real disposable income up 3.9 percent over January-June 2023 compared with the corresponding period of 2022, poverty is projected to fall in 2023 to a level comparable to 2021, though the fall is likely to be tempered by the decline in the number of employed experienced so far during all months in 2023.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-0.7	2.4	-4.7	3.0	0.8	0.7
Private consumption	-1.1	4.9	-1.2	4.1	2.5	2.4
Government consumption	-2.0	-0.8	-0.1	1.5	0.2	0.0
Gross fixed capital investment	-3.9	-5.5	-13.3	7.6	0.8	1.1
Exports, goods and services	-3.7	10.1	-12.3	10.5	2.8	2.5
Imports, goods and services	-7.4	5.7	-11.4	14.8	4.7	4.4
Real GDP growth, at constant factor prices	-0.7	2.4	-4.7	2.8	0.7	0.7
Agriculture	4.8	-4.1	4.4	4.1	2.0	2.3
Industry	-0.4	3.1	-6.2	8.9	1.9	1.2
Services	-1.8	3.0	-5.1	-1.9	-0.5	0.1
Inflation (consumer price index)	5.5	9.5	15.2	8.2	8.9	7.2
Current account balance (% of GDP)	-0.3	3.1	3.7	0.8	-1.1	-1.4
Net foreign direct investment inflow (% of GDP)	2.1	1.9	1.8	1.8	1.9	1.8
Fiscal balance (% of GDP)	-1.7	0.0	-2.1	-1.0	-1.5	-1.2
Revenues (% of GDP)	37.9	37.4	34.7	35.7	36.0	36.2
Debt (% of GDP)	41.1	35.8	39.6	40.3	41.3	42.6
Primary balance (% of GDP)	0.0	1.7	-0.6	0.0	-0.5	-0.3
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]	0.1	0.1	0.1	0.1	0.1	0.1
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	1.3	1.2	1.4	1.2	1.2	1.2
GHG emissions growth (mtCO2e)	-1.6	-1.9	-5.7	-0.5	-1.1	-0.5
Energy related GHG emissions (% of total)	85.7	85.7	85.6	85.9	85.9	85.9

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
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]	75.3
Total GHG emissions (mtCO2e)	27.2

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

After decelerating to 3.9 percent in 2022, real GDP growth is expected to further slow to 2.2 percent in 2023 as private consumption weakens. Annual inflation will remain elevated at 6 percent in 2023 driven by food, housing, and energy prices, weakening disposable income, and creating risks for poverty reduction. Upcoming municipal elections will likely make the 2022 fiscal surplus short-lived. Public debt is expected at about 36 percent of GDP. Structural reforms remain delayed mainly due to ongoing political frictions.

Key conditions and challenges

To become an EU candidate, BiH needs to address 14 reform priorities in the areas of democracy, the rule of law, human rights, and public administration. In parallel, economic criteria for EU accession require BiH to reduce internal market fragmentation by strengthening country-wide regulatory and supervisory institutions, enhancing transparency and efficiency of the oversized public sector, and reducing political involvement in the management of the public sector, including state-owned enterprises. EU accession will also require an improved business environment in part based on (i) simplified business registration and licensing procedures and (ii) harmonized and mutually recognized licenses and certificates between the entities.

BiH has shown macroeconomic stability and resilience over the past decade, including during the COVID-19 and post-COVID periods. These have been largely facilitated by three economic anchors: the currency board (which ties the BiH mark to the euro), the state-wide collection of indirect taxes through ITA, and EU membership prospects.

Nevertheless, with real income growth averaging around 1.6 percent from 2009 to 2019, living standards are stagnant as real per capita consumption is around 40 percent of the EU27 average. Faster convergence toward the EU27 average will be difficult to achieve due to low investment rates, a growth model that relies on private consumption, and absent structural reforms.

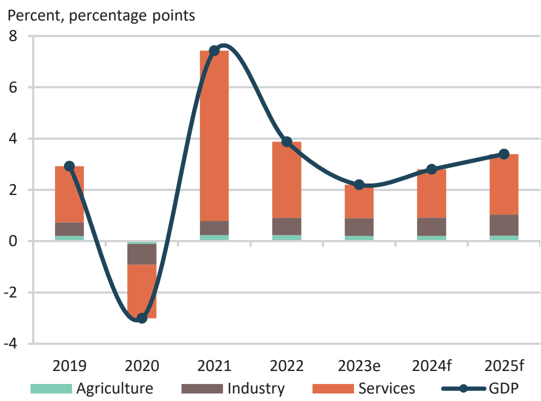
The implementation of structural reforms remains sluggish due to political frictions, pressures from frequent elections, widespread corruption, and fragmentation of responsibilities between the two entities and cantons. Because of the resulting poor welfare prospects, BiH exhibits one of the highest labor out-emigration rates in the Western Balkans.

Recent developments

In 2022, real GDP grew 3.9 percent compared to 7.4 percent the year before as the rebound from the post-pandemic period subsided. Economic activity slowed from 5.9 percent in Q1 2022 (yoy) to 1.7 percent in Q4 2022 (yoy) mainly due to output deceleration in manufacturing. This trend persisted into Q1 2023, with real output rising a mere 1.1 percent (yoy). The latter is primarily owed to the fall in private consumption, which contracted 0.4 percent (yoy) due to the weakening of real disposable income caused by high inflation.

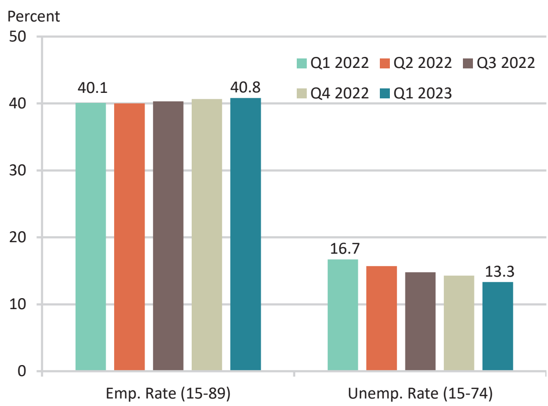
Inflation slowed to 4.9 percent in June (yoy), which translates into an inflation rate of 9.3 percent during January-June of 2023, a 2.2 percentage point contraction vis-à-vis the same period last year. Inflation dynamics were driven by higher food, housing, and transport prices, putting disproportionate stress on lower income groups, and generating risks for poverty reduction.

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.

Meanwhile, key labor market indicators remain static. The overall employment rate increased marginally to 40.8 percent in Q1 of 2023 compared to 40.1 percent in Q1 of 2022, while the unemployment rate shrunk to 13.3 percent, a 3.4 percentage points decline vis-à-vis Q1 2022. However, the decline in the unemployment rate was driven by people moving from employment to inactivity, and, thus, the overall activity rate declined by 1 percentage point during this period.
Stronger nominal tax revenues supported by high inflation generated a fiscal surplus of 0.4 percent of GDP in 2022. This compares to a deficit of 0.3 percent the year before, and 5.3 percent of GDP in 2020. Higher nominal expenditures in 2022 were driven by social measures aimed at softening the inflationary impact on households, and pre-election spending, including wage hikes and a hike in capital expenditures. Nevertheless, public debt remains low at 36 percent of GDP.
Adverse terms of trade caused a widening of the merchandise trade deficit during 2022 and the first half of 2023. The current account deficit therefore broadened to 4.5 percent in 2022 and is set to further widen to 4.7 percent of GDP in 2023. External financing largely entails net FDI inflows, mainly into the foreign-owned banking sector, which remained stable during the first half of 2023.

Outlook

Real GDP growth is set to decelerate to 2.2 percent in 2023, and 2.8 percent in 2024 as private consumption weakens due to the softening of real disposable income, and as exports adjust to much lower growth in the EU. By 2025, real output growth is expected to rebound to 3.4 percent as both exports and private consumption strengthen based on improving conditions in the EU and tightening labor markets. Stronger exports in 2024 and 2025 are likely to be offset by higher imports of consumer goods, resulting in a further widening of the current account deficit from 4.7 percent of GDP in 2023 to 5.1 percent by 2025. With general elections completed, and governments formed, the attention of policy makers could turn to the structural reform agenda and the fulfillment of legislative priorities for EU accession.
The return to fiscal surplus in 2022 is likely to be short-lived due to the upcoming municipal elections in 2024. Nevertheless, by 2024-25 the fiscal stance should be balanced again.
Given the ongoing supply shocks causing market disruptions and higher input costs for firms, inflationary pressures are projected to remain for some time. Hence, the inflation rate is expected to remain elevated at around 6 percent in 2023 and stabilize in 2024-25 at around 2 percent, in line with rates prior to the pandemic.
Downside risks dominate the outlook. Protracted market disruptions and uncertainty fanned by the war in Ukraine could have a negative impact on aggregate demand through depressed consumer and business confidence. Furthermore, the gradual recovery in the EU remains fragile, adversely impacting demand for BiH exports, except for energy. Adverse labor market developments across the EU could also limit remittance inflows, which support private consumption. Finally, geopolitical risks 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	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-3.3	7.1	4.0	2.2	2.8	3.4
Private consumption	-4.5	4.0	3.0	2.2	2.5	3.2
Government consumption	0.5	6.1	2.7	4.1	2.3	3.7
Gross fixed capital investment	-22.0	33.3	19.7	6.9	2.9	-0.4
Exports, goods and services	-8.5	5.0	9.9	4.0	5.5	6.0
Imports, goods and services	-13.4	8.0	12.0	6.0	4.0	3.4
Real GDP growth, at constant factor prices	-3.0	7.4	3.9	2.2	2.8	3.4
Agriculture	-1.5	3.4	3.5	3.1	3.0	3.2
Industry	-3.0	2.0	2.6	2.7	2.8	3.2
Services	-3.2	10.1	4.4	1.9	2.8	3.5
Inflation (consumer price index)	-1.1	2.0	14.0	6.0	2.5	1.0
Current account balance (% of GDP)	-4.0	-2.3	-4.5	-4.7	-4.8	-5.1
Net foreign direct investment inflow (% of GDP)	2.0	3.3	3.0	3.3	3.5	4.0
Fiscal balance (% of GDP)	-5.3	-0.3	0.4	-0.8	0.1	0.1
Revenues (% of GDP)	41.6	43.5	40.0	39.6	40.0	40.0
Debt (% of GDP)	40.3	38.0	35.9	36.2	36.1	35.8
Primary balance (% of GDP)	-4.0	1.0	1.2	0.0	0.9	0.9
GHG emissions growth (mtCO2e)	-2.5	7.7	5.5	3.7	3.6	4.1
Energy related GHG emissions (% of total)	86.6	87.2	87.7	87.7	87.6	87.4

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	6.5
GDP, current US$ billion	89.0
GDP per capita, current US$	13772.6
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]	71.5
Total GHG emissions (mtCO2e)	51.5

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

Following robust growth in 2022, the Bulgarian economy is set to slow down in line with EU trends. Inflation remains elevated, threatening plans for euro adoption in 2025. The fiscal deficit is expected to remain below the 3 percent Maastricht ceiling, possibly at the expense of reduced public investment. A new regular government is hoped to step up reform momentum. Poverty reduction is expected to slow down as Bulgaria faces slower growth and elevated inflation. Energy affordability remains a pressing concern.

Key conditions and challenges

Bulgaria’s development path over the past two decades has been characterized by gradual convergence to average real incomes in the EU. By 2022, it reached 59 percent of the average GDP per capita in the EU in purchasing power parity terms but remained the poorest member state. Yet, income convergence was much slower in the last decade, as reforms lost momentum while adverse demographic trends resulted in a rapid decline in the working-age population. Moreover, investment ran into diminishing returns, and factor accumulation leveled off as the country became richer.

Despite substantial progress in reducing poverty, Bulgaria's poverty rates remain among the highest in the EU, while income inequality was the largest in 2021. Child poverty remains a particularly serious issue, with 26 percent of children at risk of poverty in 2021. Energy affordability is also a challenge, with about 22.5 percent of households unable to keep their homes warm in 2021, the highest in the EU. This share rises to 42.7 percent among poor households.

The country needs a new set of policies and ambitious reforms to spur economic growth, so that it can reach average EU income levels in the next 15 years. Bulgaria needs to address its institutional and governance weaknesses and ensure fair competition to boost firms’ efficiency and private sector expansion. Investment in people’s skills will also help move the economy closer to the productivity frontier. 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.

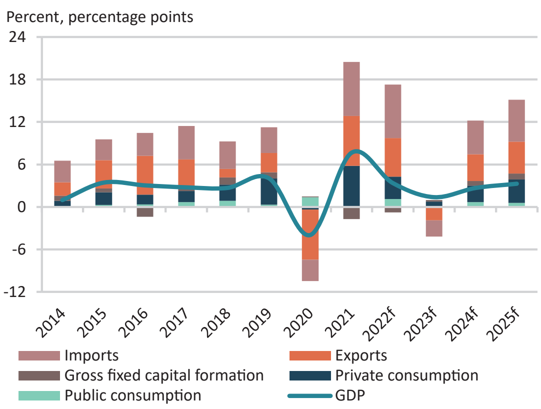
In parallel, the country needs to address persistent inequalities, including income inequality but also inequalities of opportunities, which limit human capital formation and growth, and further undermine growth prospects. Fiscal policy currently has a very limited impact on reducing child poverty. Yet, significant improvements can be achieved by fine-tuning certain measures, such as improved targeting and adequacy of means-tested child benefits.

Recent developments

GDP growth continued to decelerate in early 2023, in tune with trends in Western Europe. The economy’s expansion slowed down to 1.8 percent y/y in Q2 as final consumption growth cooled off, while export growth adjusted downward, mirroring the soft landing in key export markets in the EU.

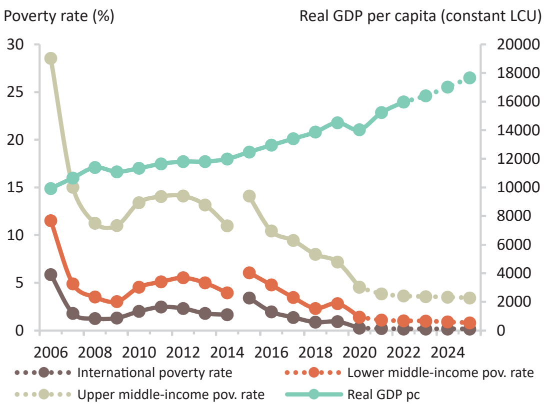
A declining working-age population has led to labor shortages across most sectors and skill sets, and a decrease in overall employment, accompanied by real wage increases since the start of 2023. Yet, the

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



Sources: World Bank and Bulgarian National Statistical Institute.

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



Source: World Bank. Notes: see Table 2.

working-age population is diminishing more rapidly than the overall decrease in employment, resulting in a still-rising employment rate.

Following 2022, when Bulgaria recorded one of the highest inflation rates in the EU, consumer price growth has slowed down in the early part of 2023, reaching 8.5 percent y/y in July. Even if energy and food price inflation gradually subsided in H1, food prices retained above-average growth and even resumed their rise in July, which impacts disproportionately the poorest segments of society. Moreover, core inflation also picked up in July, which may be attributed to still-strong demand pressures. Food and energy inflation can increase poverty by 1 percentage point ($6.85 line), slowing down overall poverty reduction in 2022. Energy price ripples, influencing core inflation, could amplify impacts up to 1.8 percentage points. Energy affordability remains a major concern: the World Bank's rapid survey in July reveals that 15 percent of households struggled to heat homes last winter, 30 percent faced summer cooling challenges, and 73 percent deemed existing energy price caps insufficient.

Following the rapid deterioration of the fiscal position in early 2023, the balance improved in June-July and returned to positive territory (+0.2 percent) for January-July. This became possible after the new government took steps to increase tax and non-tax revenue collection. For the full year, the government foresees a deficit of 3 percent on an accrual basis, with the aim of meeting the line Maastricht criterion of up-to-3 percent deficit and joining the euro area in 2025. The EC's Convergence Report on Bulgaria's readiness for accession is expected in spring 2024. While the fiscal balance target appears within reach, eurozone accession plans may stumble upon the Maastricht criterion for inflation. As of June 2023, Bulgaria's annual average HICP inflation is 5.3pp above the corresponding benchmark. Faster disinflation will be needed if the country is to align with the criterion by early 2024.

Outlook

Bulgaria's economy is expected to slow down substantially in 2023 – to 1.4 percent - in tune with the ongoing cooling off in the eurozone. Growth may be further suppressed if Bulgaria fails to deliver on the reform milestones under the National Recovery and Resilience Plan, resulting in further delays of upcoming tranches.

Inflation will continue to subside but remain elevated in 2023, putting at risk the official eurozone accession target for 2025. The government's 3 percent fiscal deficit target in 2023 is achievable but may come at the expense of lower-than-planned capital spending, which could hurt growth prospects going forward. The current account is projected to move to a slight surplus in 2023-2025 due to the expected downward adjustment of import prices of key raw materials and the increase of net services export.

Political risks have declined markedly following the formation of a regular coalition government in June 2023. The new government's priorities include speeding up the implementation of the NRRP, as well as preparing the country for near-term Schengen Area and eurozone accession. Yet, the upcoming local elections in October may increase pressure on the ruling coalition, and political uncertainty may re-escalate.

Given the growth deacceleration and potentially persistent inflation, poverty (using the 6.85$ UMIC poverty line) is expected to continue declining slowly, reaching 3.5 percent in 2023.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-4.0	7.6	3.4	1.4	2.7	3.3
Private consumption	-0.6	8.8	4.8	1.1	3.5	4.9
Government consumption	8.3	0.4	6.5	0.4	3.9	3.2
Gross fixed capital investment	0.6	-8.3	-4.3	1.3	4.0	5.1
Exports, goods and services	-10.4	11.0	8.3	-2.7	5.7	6.6
Imports, goods and services	-4.3	10.9	10.5	-3.0	6.5	7.8
Real GDP growth, at constant factor prices	-4.0	8.0	3.4	1.4	2.7	3.3
Agriculture	-3.3	28.8	-0.8	0.5	1.5	1.2
Industry	-8.2	1.7	11.9	-3.5	6.7	5.2
Services	-2.5	8.7	1.0	3.3	1.4	2.7
Inflation (consumer price index)	1.7	3.3	15.3	9.8	5.6	4.2
Current account balance (% of GDP)	0.0	-1.9	-0.7	1.6	1.9	0.9
Net foreign direct investment inflow (% of GDP)	4.5	1.8	2.4	1.8	2.6	2.9
Fiscal balance (% of GDP)	-2.9	-2.7	-0.8	-2.9	-2.9	-2.3
Revenues (% of GDP)	36.8	37.7	39.2	39.5	40.6	41.3
Debt (% of GDP)	24.5	23.9	22.9	22.5	22.7	22.1
Primary balance (% of GDP)	-2.4	-2.3	-0.4	-2.5	-2.5	-1.9
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	3.5	3.5	3.4
GHG emissions growth (mtCO2e)	-3.7	7.0	7.7	1.5	3.5	3.0
Energy related GHG emissions (% of total)	80.2	78.5	75.2	74.0	72.3	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 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	70.5
GDP per capita, current US$	18282.6
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]	76.4
Total GHG emissions (mtCO2e)	20.2

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

Croatia's economy remained on an expansion path in the first half of 2023 supported by robust private consumption and buoyant demand for travel services. Over the forecast horizon, economic growth is expected to stay close to 3 percent as inflation moderates, and the external outlook improves. Steady growth and a declining need for fiscal support are expected to keep the fiscal deficit contained and public debt on a declining path. Poverty in 2023 is expected to decline to 1.3 percent.

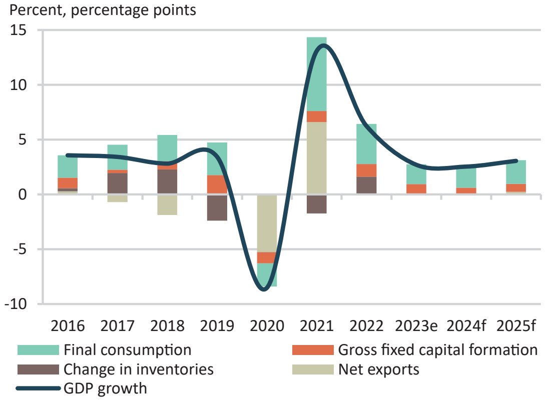
Key conditions and challenges

Despite significant headwinds coming from high inflation, monetary tightening, and faltering external demand for goods, Croatia's process of economic convergence continues, with GDP per capita (in PPP terms) in 2022 reaching 73 percent of the average EU27 level. The country has recorded the highest post-pandemic recovery of all EU member states (with notable exception of Ireland). The country's solid performance largely reflects post-Covid revival of global demand for travel, but also robust goods exports and personal consumption. However, as pent-up demand for services in tourism is unlikely to be sustained in the medium to long run, it will be crucial to address key structural issues that will support productivity and long-term growth acceleration. These are linked to low levels of Research and Development (R&D) investments, innovation and technology adoption, weaknesses in managerial and organizational practices, administrative capacity and judicial quality and efficiency. In addition, given unfavorable demographic trends and a tight labor market, improvements in education and labor market policies will be necessary to increase labor supply and improve the quality of human capital. Over the medium term, the elevated uncertainty linked to Russia's invasion of Ukraine and developments in energy and food commodity prices remain the key risk to the outlook as additional price shocks would dampen both domestic and external demand. Furthermore, the full effect of higher interest rates and monetary tightening is yet to feed through the economy increasing the vulnerabilities in non-financial sector and potential risks for financial stability. At the same time, price pressures might prove to be more persistent, leading to adverse real income and confidence effects. On the upside, economic stimulus coming from fiscal policy might be stronger than anticipated in light of the upcoming parliamentary elections next year.

Recent developments

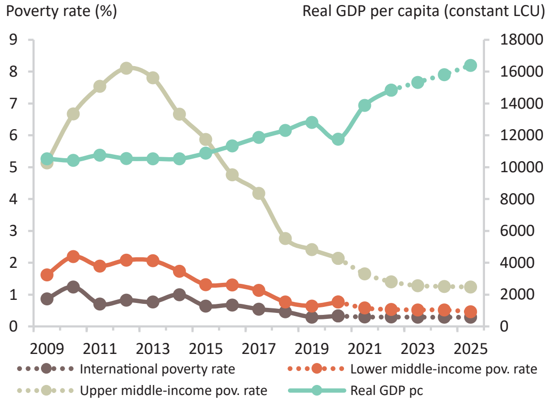
Croatia's economy further expanded in the first half of 2023, mainly owing to recovery of personal consumption and strong growth of tourism. In this period annual real GDP growth rate averaged 2.7 percent, well above EU average of 0.6 percent. Personal consumption recovered after a marked decline at the end of the last year following favorable labor market developments and recovery in consumer optimism. Furthermore, performance of export of services was also strong with foreign tourists' arrivals and overnight stays increasing on an average on an annual basis by more than 10 percent. Investment growth was relatively suppressed but business optimism in the construction sector remains high and it improved further at the beginning of Q3. On the other hand, export of goods declined, partly due to the weakening of economic activity in some

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 Croatia's main trading partners. Fiscal policy continued to play an important role in supporting economic activity by extending measures aimed at easing inflationary pressures. Inflation, albeit declining, remains high and, at 8.5 percent in August was the second highest in the eurozone. The ECB continued to increase key interest rates which also had an impact on financing conditions in Croatia. However, this impact was less pronounced compared to other euro area countries reflecting declining country risk premia, high bank liquidity, strong deposit base, and relatively low share of credits with variable interest rates.

The combination of strong economic growth and the rebound of the labor market improved household total income. However, high inflation eroded household real purchasing power. Poverty is estimated to have declined modestly from 1.4 percent in 2022 to 1.3 percent in 2023. Preliminary findings from the World Bank rapid assessment survey in June 2023 showed that one in every two Croatian households (and 75 percent among the bottom 40 percent of the income distribution) reported having some difficulty to make ends meet with their current income.

Outlook

Economic activity growth is expected to moderate in the second half of 2023, as demand for tourism services slows down and goods exports remain suppressed. Nonetheless, thanks to the relatively strong performance during the first six months, real GDP is set to grow by 2.7 percent in 2023, and growth is expected to take a slight uptick by the end of the forecast horizon. Personal consumption is projected to remain robust, as recovery in real incomes continues due to falling inflation and strong labor demand. Furthermore, EU funds are expected to continue supporting investment activity, especially government investments, while private sector investment growth might slow in the near term before strengthening towards the end of the forecast horizon as monetary policy normalizes. Exports of goods, after a sluggish performance in 2023, are expected to pick up in 2024 and 2025 as external demand strengthens, while, on the other hand, growth of exports of services might become more moderate after strong results in the 2021-2023 period. Inflation is expected to remain elevated over the near term but could decline towards the ECB target of close to 2 percent by the end of the forecast horizon, following monetary measures implemented since end-2021, unwinding of global supply bottlenecks, and easing of commodity price growth. The fiscal deficit is set to remain contained, as growth continues and the need for fiscal support declines. This will allow for further reduction in public debt which is expected to fall below 60 percent of GDP by the end of 2025.

Looking ahead, about 20 percent of Croatian households, and more than 30 percent of those in the bottom 40 expressed a pessimistic view of their financial prospect, according to the World Bank survey in June. Poverty is projected to decline marginally to 1.2 percent by 2025.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-8.5	13.1	6.2	2.7	2.5	3.0
Private consumption	-5.1	9.9	5.1	2.2	2.5	2.8
Government consumption	4.3	3.0	3.2	2.6	2.8	2.7
Gross fixed capital investment	-5.0	4.7	5.8	4.7	3.1	3.5
Exports, goods and services	-23.3	36.4	25.4	-1.0	4.2	5.0
Imports, goods and services	-12.4	17.6	25.0	-0.9	4.2	4.5
Real GDP growth, at constant factor prices	-7.5	12.6	6.4	2.7	2.5	3.0
Agriculture	-0.2	8.2	6.0	-0.2	3.5	3.5
Industry	-4.1	9.0	2.3	1.2	3.0	3.0
Services	-9.1	14.2	7.9	3.3	2.3	3.0
Inflation (consumer price index)	0.0	2.7	10.7	8.4	3.9	2.3
Current account balance (% of GDP)	-0.5	1.8	-1.6	-0.6	-0.8	-0.7
Net foreign direct investment inflow (% of GDP)	1.4	4.8	5.6	3.7	3.7	3.7
Fiscal balance (% of GDP)	-7.3	-2.5	0.4	-1.1	-1.3	-1.1
Revenues (% of GDP)	46.8	46.2	45.5	44.3	43.7	43.6
Debt (% of GDP)	86.9	78.3	68.8	62.8	60.2	58.3
Primary balance (% of GDP)	-5.3	-0.9	1.8	0.2	-0.1	0.2
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	1.3	1.3	1.2
GHG emissions growth (mtCO2e)	-5.6	13.2	5.7	0.2	0.4	0.7
Energy related GHG emissions (% of total)	88.3	88.8	88.6	88.1	87.6	87.2

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.

GEORGIA

Table 1	2022
Population, million	3.7
GDP, current US$ billion	24.6
GDP per capita, current US$	6667.4
International poverty rate ($2.15)[a]	5.5
Lower middle-income poverty rate ($3.65)[a]	19.1
Upper middle-income poverty rate ($6.85)[a]	55.4
Gini index[a]	34.2
School enrollment, primary (% gross)[b]	100.8
Life expectancy at birth, years[b]	71.7
Total GHG emissions (mtCO2e)	19.6

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

The economy performed strongly in H1 2023, with growth at 7.6 percent (yoy), and projected at 5.9 percent for 2023 as a whole. Buoyed by strong domestic consumption, employment recovered, and poverty continued to fall. Growth is expected to slow in H2 due to monetary tightening in advanced economies and to easing in money inflows from Russia putting pressure on the currency and increasing financing needs.

Key conditions and challenges

Georgia has made notable gains in income growth and poverty reduction over the past decade. A robust economic management framework saw the GNI per capita (constant 2015 USD) increase from USD 3,048 in 2010 to USD 5,424 in 2022. Poverty (measured by the USD6.85 poverty line in 2017 PPP) is also down from 70 percent at the start of the decade to 55.4 percent in 2021.

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 restrict private sector growth. Georgia also remains vulnerable to external shocks, largely due to its heavy reliance on tourism and trade openness. Foreign exchange depreciation remains a risk because of high dollarization and persistent dependence on external savings.

The application for EU candidacy, initiated in 2022, provides opportunities for further income growth while requiring significant reforms.

Recent developments

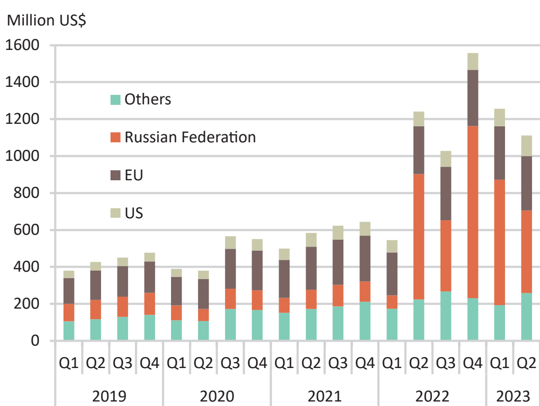
Growth remained robust in H1 2023, although it eased to an estimated 7.6 percent, compared to 10.1 percent in H1 2022, driven by a rebound in private consumption. Service exports remained supported by continued recovery in tourism. Unemployment continued to fall, reaching 16.7 percent in June 2023, below pre-pandemic levels.

Inflation has declined sharply. Headline inflation fell to 0.3 percent (yoy) in July 2023, from 9.4 percent in January. The decline was driven by lower commodity prices, particularly for food and fuel, along with a strong Georgian lari (GEL). On the other hand, the price of financial services, personal care, and utilities have continued to put pressure on inflation. Core inflation, which excludes food and energy components, dropped from 7.1 percent (yoy) in January to 3.2 percent (yoy) in July. In response, in August, the National Bank of Georgia (NBG) reduced the monetary policy rate by 25 bps, to 10.25 percent.

The banking sector has remained healthy. Returns on assets and equity reached 3.7 percent and 26.7 percent in June 2023, respectively. The share of non-performing loans (NPLs) stood at 1.5 percent by the end of June, down from 2 percent in June 2022.

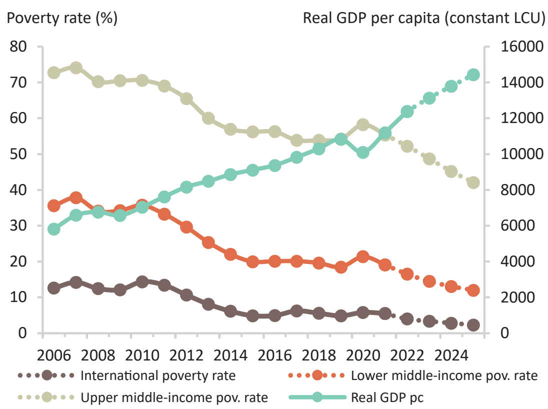
The current account deficit declined to 3.2 percent of GDP in Q1 2023, from 4 percent in 2022. During H1 2023, exports grew by 19.3 percent (yoy) in USD value, mostly driven by re-exports of used cars. Conversely, exports of raw materials (copper, ferroalloys, and nitrogen fertilizers) produced in Georgia declined, as international prices fell considerably, and domestic production declined. Meanwhile, imports expanded by 19.6 percent (yoy), driven by growth in used car imports, whose share of total imports almost

FIGURE 1 Georgia / Gross money inflows 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.

doubled to 18 percent. FDI inflows recorded an improvement in H1 2023 with an 11 percent increase compared to the same period in 2022, driven by the financial, energy, and manufacturing sectors. Money transfers, primarily from Russia, continued to support Georgia's external position and increased by 32.5 percent in H1 2023 compared to H1 2022. International reserves increased to USD 5.4 billion, or approximately 4.4 months of import cover.

Total revenue increased by 13.3 percent (yoy) in real terms in H1 2023, supported by higher collection across the board, except for profits tax. Current expenditures grew by 6.7 percent (yoy), reflecting increases in the wage bill, higher spending on goods and services, and increased (yoy) subsidies to SOEs and social assistance for the most vulnerable. Capital expenditure surged by 20.3 percent yoy in real terms as the pace of project implementation accelerated. Outturns for H1 2023 showed a small overall surplus and a primary surplus at 0.7 percent of GDP, due to the strong revenue performance The public debt-to-GDP ratio has continued to fall due to rapid economic growth and appreciation of the GEL.

Strong economic growth and improved employment rates resulted in higher real wages, contributing to increased household consumption. Steady remittance inflows and lower food inflation have also bolstered the population's purchasing power. The poverty rate (below USD 6.85 a day, 2017 PPP terms) is estimated to decrease to 48.7 percent in 2023.

Outlook

Growth is expected to slow in H2 2023 due to a slowdown in trading partners and an easing of money transfer inflows, reaching 5.9 percent this year. Looking ahead, growth is expected to stabilize at around 5 percent of GDP in 2024–2025, supported by robust investments and tourism.

Inflation is expected to end the year below the 3-percent target rate. Monetary policy is expected to be eased to support economic growth while remaining prudent.

Prospects for poverty reduction are positive. The overall poverty rate (measured below USD 6.85 per day, in 2017 PPP terms) is expected to continue declining and reach 45.2 percent in 2024 and 42.1 percent in 2025, driven by higher wages and improvements in the labor market.

On the external side, given the widening trade deficit, the current account is projected to deteriorate to 6 percent by the end of 2023. The inflow in money transfers in the aftermath of Russia's invasion of Ukraine is expected to ease in the second half of 2023 and subside further in 2024. The current account deficit is expected to remain below pre-war levels in the medium term, due to continued recovery in tourism and continued strong export performance.

The deficit is projected to reach 2.9 percent of GDP in 2023. The government is expected to comply with the GDP fiscal rule deficit ceiling in 2023 and in the medium term. To boost revenue collection, the authorities are committed to the rationalization of tax expenditures.

Substantial risks remain, reflecting Russia's invasion of Ukraine and broader uncertainties. A faster reduction in money inflows, a decline in tourism inflows, further monetary tightening in advanced economies, or an increase in global commodity prices, 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, money transfer inflows could remain stronger than expected, lifting economic growth.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-6.8	10.5	10.1	5.9	4.8	4.5
Private consumption	8.8	14.5	-1.8	5.6	4.2	4.4
Government consumption	7.1	7.7	0.7	4.8	5.2	5.9
Gross fixed capital investment	-16.5	-7.2	19.6	2.6	4.8	7.5
Exports, goods and services	-37.6	24.4	38.2	10.0	11.0	10.0
Imports, goods and services	-16.6	11.0	14.4	11.0	9.0	10.0
Real GDP growth, at constant factor prices	-6.6	10.4	10.1	5.9	4.8	4.5
Agriculture	8.1	0.1	2.0	2.5	2.5	2.5
Industry	-6.8	5.9	8.0	4.0	5.0	5.0
Services	-8.1	13.0	11.6	6.7	5.0	4.6
Inflation (consumer price index)	5.2	9.6	11.9	2.3	2.5	3.0
Current account balance (% of GDP)	-12.5	-10.4	-4.0	-6.0	-5.6	-4.7
Net foreign direct investment inflow (% of GDP)	3.6	4.9	7.5	3.9	4.7	4.9
Fiscal balance (% of GDP)	-9.8	-7.1	-3.5	-2.9	-2.7	-2.5
Revenues (% of GDP)	25.2	25.2	27.0	27.0	26.7	26.8
Debt (% of GDP)	60.1	49.6	41.3	39.4	38.9	38.3
Primary balance (% of GDP)	-8.2	-5.7	-2.4	-1.6	-1.5	-1.5
International poverty rate ($2.15 in 2017 PPP)[a,b]	5.8	5.5	4.0	3.3	2.8	2.3
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	21.4	19.1	16.5	14.5	13.1	12.0
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	58.3	55.4	52.2	48.7	45.2	42.1
GHG emissions growth (mtCO2e)	-0.6	3.5	7.8	5.7	1.4	1.6
Energy related GHG emissions (% of total)	55.0	56.8	60.2	62.7	63.6	64.5

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

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KAZAKHSTAN

Table 1	2022
Population, million	19.6
GDP, current US$ billion	225.3
GDP per capita, current US$	11476.6
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]	70.2
Total GHG emissions (mtCO2e)	194.9

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2017 PPPs.
b/ WDI for School enrollment (2020); Life expectancy (2021).

GDP is projected to grow by 4.5 percent in 2023 and subsequent years, aided by new oil production coming on-stream. Inflation is expected to return to target. Geopolitical tensions, with attendant risks of oil market disruption and secondary sanctions, present downside risks.

Key conditions and challenges

Since 2008 average growth has slowed to less than 4 percent a year as productivity gains have stalled. In recent years, coupled with rising living costs, this lackluster economic performance has fostered public discontent over inequality and elite capture, culminating in violent protests in January 2022. Russia's invasion of Ukraine has increased uncertainty and introduced new risks, given Kazakhstan's close economic ties to Russia.

Revitalizing economic growth and productivity requires implementing structural reforms to transition from a state-dominated development model to a more resilient private sector-led model. This entails fostering competition and limiting the market dominance of SOEs, reinforcing the rule of law, and resolute anti-corruption action. Enabling private investment and competition in non-oil growth sectors would need to be a key part of this effort. Public investment in human capital and public goods should support growth prospects and more balanced development across the country.

Recent developments

The economy grew by 5.1 percent in H1 2023, driven by exports and fiscal stimulus. The influx of an estimated 150,000 Russian migrants bolstered domestic demand and brought a significant increase in registration of new businesses, which has grown by over 20 percent (yoy) to June 2023. Robust growth of retail trade (8.8 percent in real terms, yoy), and car sales (11.1 percent, yoy) in H1 indicate strong consumer spending, while investment, driven by rising FDI, has also strengthened. Growth in production was broad-based, including mining and machinery manufacture, basic metals, and chemical products.

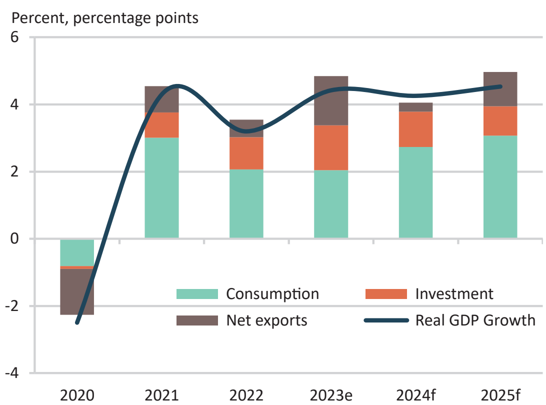
The unemployment rate declined slightly to 4.7 percent in Q2 2023, from 4.9 percent in 2022. Economic growth and an above-inflation increase in minimum wages drove up real wages by 1.2 percent in Q2 (yoy).

In August 2023, inflation slowed to 14 percent (yoy) from a peak of 21.3 percent in February, still well above the National Bank of Kazakhstan (NBK) 4-6 percent target range. Food price inflation decelerated to 13.5 percent yoy, while services inflation was 13.9 percent yoy.

The Central Bank (NBK) cut its policy rate by 250 basis points to 16.50 percent in August for the first time since February 2022.

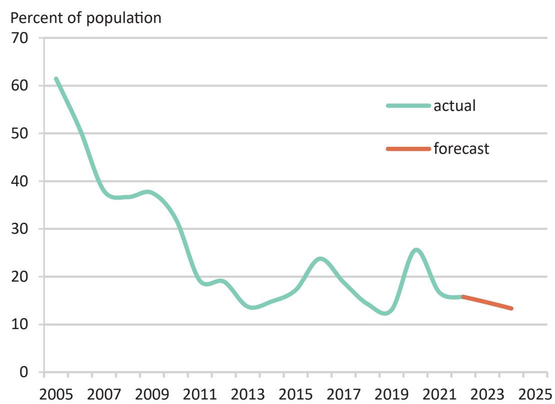
The current account deficit reached USD 3.6 billion in H1, reversing the surplus of USD 6.6 billion in H1 2022, as oil prices subsided, leading to a fall in nominal USD export values of 10.6 percent (yoy). FDI increased by 18.6 percent (yoy) in nominal USD value, with investments primarily flowing into the mining sector. Gross international reserves decreased slightly to 7 months of import cover at the end of June 2023. The KZT depreciated slightly against the USD in H1 2023, as the RUB depreciated sharply.

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.

The consolidated budget deficit reached an estimated 3.0 percent of GDP in H1 2023, compared to a 1.1 percent surplus in H1 2022. This deterioration is primarily due to increased spending on education, social assistance, housing, and utility infrastructure, driving expenditures up 2.9 percent to 25.8 percent of GDP. Elevated interest rates pushed up debt service costs to 2.3 percent of GDP in H1 2023 (compared to 1.9 percent in H1 2022).

The banking sector has sufficient capitalization levels and the reported asset quality is relatively good. As of March 2023, the ratio of capital to risk-weighted assets stood at 18.8 percent – compared to the minimum requirement of 12 percent. The share of non-performing loans has remained stable at 3.4 percent (although the share of overdue loans with less than 90 days has been increasing slightly).

Outlook

Economic activity is expected to weaken slightly in H2 owing to a lessening of inventory restocking and the impact of rising real interest rates. As a result, economic growth is projected at 4.5 percent in 2023 as a whole. Household spending will strengthen gradually as inflation and financial conditions ease. Investment, notably in mining and manufacturing, is expected to be strong. Growth is expected to remain at around the same levels in 2024 and 2025.

Inflation is projected to gradually decline to the target range by the end of 2025 due to monetary policy effects and easing external pressures.

The current account is expected to post a moderate deficit in 2023 and in future years. With FDI concentrated in the oil and gas sectors, foreign companies will continue to repatriate profits, leading to a primary income deficit.

Government expenditure as a share of GDP is expected to be 2 percent higher in 2023, but the government plans to wind back this increase over the next two years. However, the fiscal deficit is projected to increase further as revenues are projected to decrease rapidly driven by a reduction in lower oil-related taxes.

Poverty is expected to fall slightly to 14.6 percent (at USD 6.85/day) in 2023, as growth picks up and inflation subsides. High prices of basic items will remain a key factor impacting the population, especially the poorest households.

This outlook is subject to significant risks. Stubborn inflation may lead the authorities to sustain higher volumes of targeted support, increasing fiscal costs. Russia's invasion of Ukraine, escalating tensions in and near the Black Sea related to the invasion, and western sanctions against Russia, leave Kazakhstan vulnerable to disruptions in oil exports via the Russian-controlled Caspian pipeline, which could have serious economic and fiscal implications for Kazakhstan. In addition, the risk of secondary sanctions on Kazakh companies and banks continues to be a concern, given the wide and deep economic ties to neighboring Russia. Kazakhstan has become a transit point for the import of dual-use goods to Russia. If imposed, sanctions could bring sizable economic costs, erode confidence and hamper FDI, and threaten the development agenda and growth.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-2.5	4.3	3.2	4.5	4.3	4.5
Private consumption	-3.8	6.3	2.0	4.0	5.0	5.0
Government consumption	12.8	-2.4	9.1	4.1	1.0	0.5
Gross fixed capital investment	-0.3	2.6	3.6	5.2	4.8	5.0
Exports, goods and services	-12.1	2.3	10.2	6.1	3.9	6.7
Imports, goods and services	-10.7	-0.3	11.6	4.1	4.1	5.0
Real GDP growth, at constant factor prices	-2.5	4.1	2.9	4.6	4.4	4.5
Agriculture	5.6	-2.2	9.1	4.0	3.5	3.5
Industry	-0.4	3.6	1.2	5.2	4.1	5.7
Services	-4.5	5.0	3.5	4.2	4.6	3.8
Inflation (consumer price index)	7.5	8.5	20.3	11.6	10.2	6.8
Current account balance (% of GDP)	-6.4	-1.3	3.5	-1.1	-0.6	-0.2
Net foreign direct investment inflow (% of GDP)	-3.4	-1.0	-3.5	-3.2	-3.3	-3.7
Fiscal balance (% of GDP)	-6.5	-4.3	0.4	-1.0	-1.3	-1.0
Revenues (% of GDP)	18.0	17.6	22.0	21.7	20.8	19.8
Debt (% of GDP)	24.9	23.7	22.5	22.9	23.2	24.9
Primary balance (% of GDP)	-5.4	-3.1	1.8	0.2	0.6	0.7
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	25.6	16.7	15.7	14.6	13.3	12.2
GHG emissions growth (mtCO2e)	-5.8	-13.0	-12.4	-9.2	-8.4	-8.9
Energy related GHG emissions (% of total)	76.0	73.5	71.2	69.4	67.4	64.9

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 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	9.4
GDP per capita, current US$	5315.7
Upper middle-income poverty rate ($6.85)[a]	34.2
Gini index[a]	29.0
Life expectancy at birth, years[b]	76.8

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

Amid a challenging global context, growth decelerated but remains positive. GDP growth reached 2.9 percent in H1 2023, supported by export performance and consumption. Inflation decelerated, but core inflation remains heightened. Over the medium term, growth is expected to reach around 4 percent, close to Kosovo's potential, but risks associated to Russia's invasion of Ukraine and to a growth slowdown in Europe remain elevated.

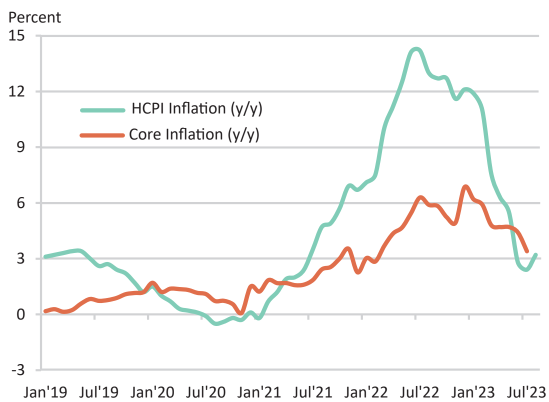
Key conditions and challenges

Following a robust post-pandemic recovery growth moderated in 2022 amid high inflation driven by increased international commodity prices brought on by the war in Ukraine. In 2023, amid a challenging global context, macroeconomic conditions remained favorable although growth decelerated. Despite steady economic progress since independence, there remains a large income gap between Kosovo and the average European Union member state. Limited firm dynamism and access to finance hamper private sector development and employment creation. The country's growth model relies on remittances to fuel consumption but has recently shifted to more export-driven growth. Investment is predominantly construction focused with limited contributions to growth. Human capital outcomes lag peer countries and the labor market continues to face severe challenges. Only one in three Kosovars is employed, 61.4 percent are classified as inactive, and gender gaps persist. In 2022, the working age population shrank, likely due to migration. Power generation capacity is limited and relies on outdated and unreliable lignite-fired generation plants, posing significant challenges to growth. Over the medium term, growth is expected to reach around 4 percent, close to Kosovo's potential, but risks remain elevated. An escalation of the war in Ukraine and weaker activity in Europe could negatively affect growth. Increased tensions in Kosovo's northern municipalities remain a risk. Migration, if not offset by higher labor force participation, could constrain potential growth. To accelerate poverty reduction, Kosovo needs to transition to a more competitive growth model that creates more and higher quality jobs, supports firm growth, and is driven by increases in productivity. To make this transition and increase potential growth, Kosovo should further prioritize reforms to entrench macroeconomic stability and governance, enhance human capital, and address regulatory gaps to support private sector development.

Recent developments

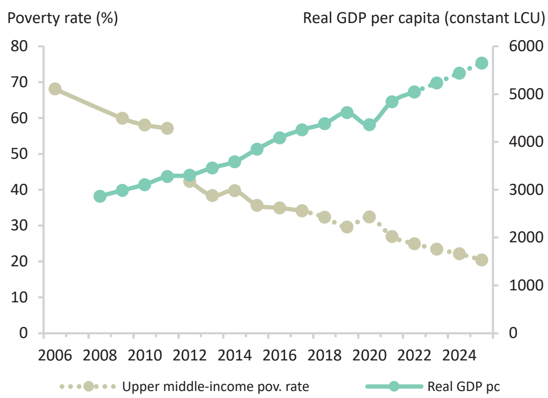
GDP growth reached 2.9 percent in H1 2023, driven primarily by a robust export performance (9.8 percent, y/y). At 2.4 and 1.6 percent (y/y) respectively, private consumption and gross capital formation marked a more moderate contribution to growth. On the production front, services and agriculture were the key contributors to H1 GDP growth. After reaching its 2023 peak in January, consumer inflation was on a downward trend until July 2023 (2.4 percent y/y) and experienced a slight uptick in August 2023 (3.2 percent y/y). During this period, significant contributors to inflation were furnishing, household items and maintenance (7.2 percent y/y), alcoholic beverages and tobacco (6.3 percent y/y), and food and non-alcoholic beverages (5.5 percent y/y), while transport

FIGURE 1 Kosovo / Consumer price inflation



Sources: Kosovo Statistics Agency and Central Bank of Kosovo.

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



Source: World Bank. Notes: see Table 2.

(-3.8 percent y/y) subtracted from the inflation rate. Labor market formalization is steadily growing, evident in the 2.3 percent increase in formal employment between July 2022 and July 2023. Additionally, the number of registered job-seekers decreased by 53 percent between July 2022 and 2023. The current account deficit showed signs of improvement by June 2023 (13.4 percent), driven by the lower value of imports coupled with a positive performance in service exports and balance of secondary income. By June 2023, the trade deficit decreased slightly (-4.6 percent, y/y), with nominal merchandise exports and imports dropping by 8.1 percent and 5.2 percent (y/y), respectively. During January-August 2023, tax revenues grew by 12 percent while overall revenues increased by 15 percent. Public and publicly guaranteed debt (PPG) decreased to 17.3 percent in June 2023, from close to 20 percent in 2022. The financial sector remains robust. In July 2023, the annual change in loans reached 14 percent. Bank capital buffers and asset quality also remain adequate, with non-performing loans remaining stable at 2 percent.

Outlook

Despite continued inflationary pressures, GDP growth is expected to reach 3.2 percent in 2023, driven by positive exports performance and private consumption. Diaspora-driven service exports are expected to remain positive throughout the year. Positive credit growth, stable remittances inflows, higher public wage spending following the implementation of the new Law on Public Wages, and elevated levels of public transfers, will support consumption growth. The medium-term outlook remains positive, with growth expected to accelerate towards 4 percent, bringing the level of economic activity closer to Kosovo's potential. The contribution of investment to growth is expected to pick up in 2024-2025, supported by the implementation of the Energy Strategy. Continued uncertainties related to the war in Ukraine, the slowdown in Europe, and the domestic political context entail significant risks. Poverty is projected to continue its decline, falling to 23.5 percent in 2023, measured using the upper-middle-income poverty line (US$6.85/person/day in 2017 PPP). Still, the materialization of downside risks could lead to a stagnation of poverty reduction. Inflation is expected to decelerate, yet price levels will remain elevated throughout 2023. The current account deficit is projected to narrow, with the expected decline in commodity prices and continued positive service exports. The fiscal deficit is expected to remain below 1 percent of GDP in 2023, driven by positive tax revenue performance and lower-than-budgeted capital expenditures. Over the medium term, public debt is projected to remain below 20 percent of GDP. Closing the income gap with the European Union requires an acceleration in the implementation of structural reforms in energy, education, social protection, and healthcare sectors. In addition, elevated global volatility requires authorities to continue preserving fiscal buffers while ensuring spending is balanced between promoting economic growth and current expenditures, including transfers.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-5.3	10.7	3.5	3.2	3.9	4.0
Private consumption	2.5	7.3	4.0	2.0	3.6	4.2
Government consumption	2.1	9.0	-1.5	4.9	2.7	-1.3
Gross fixed capital investment	-7.6	13.0	-6.1	1.2	4.2	4.3
Exports, goods and services	-29.1	76.7	17.2	9.8	5.5	5.5
Imports, goods and services	-6.0	31.4	4.9	4.6	4.2	4.2
Real GDP growth, at constant factor prices	-3.6	7.6	3.3	3.0	3.9	4.0
Agriculture	-5.8	-2.5	2.3	1.8	2.3	2.5
Industry	-1.0	7.8	1.9	2.0	3.5	4.0
Services	-4.8	9.4	4.4	3.9	4.4	4.3
Inflation (consumer price index)	0.2	3.4	11.6	4.8	3.0	2.5
Current account balance (% of GDP)	-7.0	-8.7	-10.5	-6.6	-6.0	-5.5
Net foreign direct investment inflow (% of GDP)	4.2	4.0	6.7	6.7	6.7	6.8
Fiscal balance (% of GDP)	-7.6	-1.3	-0.5	-0.6	-2.0	-1.5
Revenues (% of GDP)	25.4	27.4	27.7	28.8	28.3	28.4
Debt (% of GDP)	22.0	21.2	19.6	18.5	19.3	19.9
Primary balance (% of GDP)	-7.2	-0.9	-0.1	-0.3	-1.7	-1.1
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	32.4	27.0	25.0	23.5	22.2	20.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Calculations based on ECAPOV harmonization, using 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	11.5
GDP per capita, current US$	1697.5
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]	71.9
Total GHG emissions (mtCO2e)	15.5

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent WDI value (2021).

Growth is projected at 3.5 percent in 2023 due to a slowdown in agriculture and a contraction in manufacturing. Inflation remains high and the external position is weak. Fiscal outcomes were favorable in H1 2023 due to improved revenue performance, but driven by higher spending, the fiscal deficit is expected to increase slightly.

Key conditions and challenges

Economic growth has been volatile in the past decade due to overdependency on gold production and remittances, and because of political instability. On average, over the last decade, gold production and remittances accounted for 10 percent and 25 percent of GDP, respectively, while development assistance amounted to approximately 5 percent of GDP. High prices for imported food and fuel, and utility tariff adjustments kept domestic inflation in double digits for the last four years, adversely affecting poor households.

Although political stability was restored after the upheavals of 2020, public trust in government remains weak and frequent personnel changes within government continue to hinder decision-making. Russia's invasion of Ukraine and subsequent international sanctions triggered a decline in net remittances and increased uncertainty and risks to economic activity.

Growth is constrained by the lack of a competitive private sector. Fostering private sector development will require boosting competition and facilitating investment, notably by reducing the bureaucratic burden (particularly related to licensing, inspection, and taxation regimes), strengthening the rule of law and protecting investor rights, improving digitalization, attracting FDI, and facilitating cross-border trade.

Recent developments

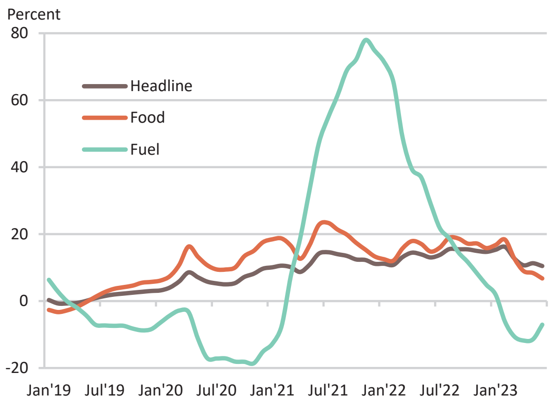
Economic growth moderated from 6.3 percent in 2022 to 3.9 percent in H1 2023 (yoy), as agricultural growth halved and gold production fell, following a build-up of gold stocks in 2022. Net remittance inflows in USD fell by 24 percent (yoy), contributing to an estimated 0.3 percent contraction in consumption.

CAD is estimated to have remained abnormally high in Q1 2023, with official statistics recording a 45.4 percent of GDP deficit. Such a large deficit, as in 2022, is associated with elevated errors and omissions (about 40 percent of GDP) indicating these figures are unconfirmed. Unrecorded (re-)exports and/or capital inflows may explain these numbers. Exports in USD are estimated to have increased by 15.6 percent (yoy) due to the resumption of gold exports, while imports grew by 27.4 percent (yoy), reflecting increased imports of food, fuel, machinery, equipment, textile and consumer goods.

The deterioration in the trade balance and the decline in remittance inflows have put pressure on the exchange rate, weakening the KGS against the USD by 1.8 percent in H1 2023. The National Bank of the Kyrgyz Republic (NBKR) sold more than USD 450 million in foreign reserves in a bid to avoid sharp fluctuations in the exchange rate. As a result, reserves fell by USD 359 million to 3.6 months of import cover by June 2023, down from 4 months at the end of 2022.

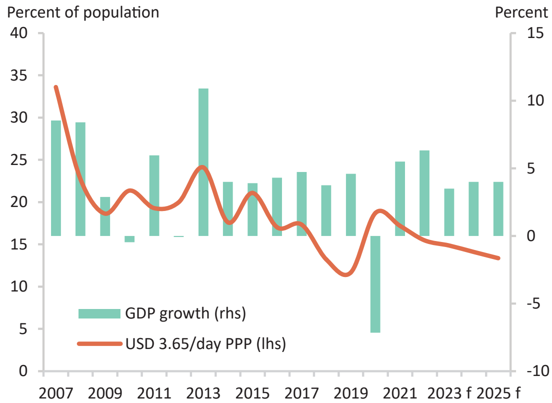
Inflation remained high, easing slightly to 10.5 percent by June 2023 as fuel and food

FIGURE 1 Kyrgyz Republic / Headline, food and fuel inflation



Source: Kyrgyz authorities.

FIGURE 2 Kyrgyz Republic / GDP growth and poverty rate



Sources: Kyrgyz authorities and World Bank staff.

prices moderated. Recent tariff increases for utilities, including electricity and water, were the largest contributors to inflation.

The NBKR kept its policy rate unchanged at 13 percent during H1 2023 after a 500 basis point increase in 2022.

The budget surplus strengthened in H1 2023 to 2.2 percent of GDP from 1.2 percent in H1 2022 thanks to strong tax performance, particularly VAT on imported goods, which more than compensated for the increase in public wages, social transfers and pensions from 2022, and higher spending on public infrastructure. Strong fiscal outcomes contributed to a reduction in public debt to an estimated 48.1 percent of GDP as of mid-2023, down from 49.2 percent in December 2022.

Banks remained well capitalized with a capital adequacy ratio of 23.5 percent as of the end of June 2023, nearly double the minimum regulatory requirement of 12 percent. The liquidity level was 83.9 percent, well above the 45 percent minimum requirement. The quality of loans improved slightly, with the non-performing loan ratio declining to 10.9 percent from 12.8 percent at the end of 2022.

The poverty rate (at USD 3.65/day) is expected to decline from 17.2 percent in 2021 to 15.5 percent in 2022. Increase in public and private wages, and social assistance under the "Social Contract" program drive poverty reduction, despite a lower volume of remittances and decelerating growth.

Outlook

GDP growth is expected to moderate to 3.5 percent in 2023 as gold production contracts and the agriculture sector experiences a slowdown. On the demand side, consumption and investment are expected to support growth, while net exports are projected to make a negative contribution. GDP is expected to converge to a potential growth rate of only 4 percent over the medium term in the absence of structural reforms.

Inflation is expected to remain elevated at 12 percent in 2023, driven by rising tariffs for electricity and other utilities. Assuming the NBKR maintains its monetary policy, inflation is projected to moderate gradually to 7 percent by the end of 2025.

The current account deficit is projected to be about 29 percent of GDP in 2023 and to narrow in 2024–2025 as external demand for non-gold goods improves and export of services increases. The deficit is expected to be financed by inward FDI and external borrowing.

The fiscal deficit is projected to increase slightly to 1.6 percent of GDP in 2023 as the full year effect of increases in public sector wages and social benefits will limit the decline in overall spending relative to the expected decline in non-tax revenues and grants as a share of GDP. The deficit is expected to widen to 2.6 percent of GDP in 2024, reflecting higher capital spending, and to narrow to 2.1 percent in 2025 as the authorities plan to consolidate current and capital spending.

In 2023, high food prices, job insecurity, and declining remittances will continue to be the most significant concerns for the welfare of the population. Poverty levels are expected to decline by 0.6 percent to 14.9 percent, reflecting the positive effect of increased social protection programs and wage increases exceeding the negative impact of falling remittances and slower growth.

Risks to this outlook remain significant. A deterioration of the Russian economy may lead to added decline in remittances. Stricter application of the existing international sanctions on Russia, or imposition of secondary sanctions against Kyrgyz-based companies might significantly impact trade and domestic economic activity. 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	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-7.1	5.5	6.3	3.5	4.0	4.0
Private consumption	-8.3	20.9	6.4	1.3	3.4	3.9
Government consumption	0.9	0.4	1.6	1.4	0.4	0.4
Gross fixed capital investment	-16.2	8.2	22.2	17.8	17.4	15.8
Exports, goods and services	-27.3	16.4	-7.3	27.0	15.5	16.4
Imports, goods and services	-28.0	39.3	62.1	13.3	13.5	14.0
Real GDP growth, at constant factor prices	-7.1	5.5	6.3	3.5	4.0	4.0
Agriculture	0.9	-4.5	7.3	2.0	2.5	2.5
Industry	-6.5	6.5	12.2	3.8	5.3	6.0
Services	-13.7	14.4	3.0	4.7	4.5	4.2
Inflation (consumer price index)	6.3	11.9	13.9	12.0	10.0	7.0
Current account balance (% of GDP)	4.5	-8.0	-47.0	-29.1	-10.4	-10.6
Net foreign direct investment inflow (% of GDP)	-7.0	6.1	6.5	3.9	4.0	3.9
Fiscal balance (% of GDP)	-4.0	-0.3	-1.4	-1.6	-2.6	-2.1
Revenues (% of GDP)	29.0	31.8	36.2	34.5	34.1	33.4
Debt (% of GDP)	63.7	55.7	49.2	48.9	48.2	47.2
Primary balance (% of GDP)	-2.8	1.2	-0.1	-0.4	-1.6	-1.2
International poverty rate ($2.15 in 2017 PPP)[a,b]	1.3	1.4	1.6	1.6	1.7	1.8
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	18.7	17.2	15.5	14.9	14.1	13.4
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	67.6	66.0	64.0	63.3	62.3	61.3
GHG emissions growth (mtCO2e)	-1.9	6.8	8.4	6.6	4.5	4.2
Energy related GHG emissions (% of total)	70.7	72.4	73.7	74.5	74.7	74.6

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 2014-KIHS, 2019-KIHS, and 2020-KIHS. Actual data: 2020. Nowcast: 2021-2022. Forecasts are from 2023 to 2025.
b/ Projection using average elasticity (2014-2019) with pass-through = 0.7 based on GDP per capita in constant LCU.

MOLDOVA

Table 1	2022
Population, million	2.5
GDP, current US$ billion	14.5
GDP per capita, current US$	5714.4
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]	68.8
Total GHG emissions (mtCO2e)	14.2

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

The Moldovan economy has endured severe repercussions stemming from Russia's invasion of Ukraine and a surge in inflation. By the first quarter of 2023, diminishing purchasing power led to economic contraction, nevertheless, inflation is gradually abating. The near-term outlook hinges on the unfolding invasion of Ukraine, commodity-energy prices, and weather conditions. In contrast, the longer-term outlook relies on realizing unfinished structural reforms and Moldova's pace toward EU accession.

Key conditions and challenges

Moldova has been severely affected by the spillover effects of Russia's invasion of Ukraine, which has led to energy and refugee crises. Despite concerted efforts to mitigate these crises through robust fiscal measures and swift monetary policies, private consumption was stifled by dwindling household incomes and uncertain financial conditions. As a result, the economy plunged into recession in 2022.

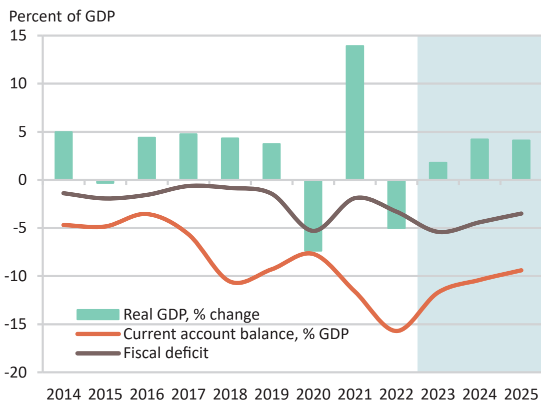
The medium-term outlook will be influenced by the government's ability to counter the erosion of households' purchasing power while maintaining momentum in the reform program. Key challenges include sluggish productivity growth, structural and governance deficiencies, a sizable state-owned enterprise presence, restricted competition, an imbalanced business environment, and tax distortions. Heightened risks of extreme weather events and energy shocks remain prominent.

Persistent inequality has hindered access to public services and dampened resilience and intergenerational mobility. Furthermore, the full impact of Russia's invasion and energy supply on the Moldovan economy in 2023 remains uncertain. The potential increase of energy costs in the latter half of 2023 might necessitate a reallocation of funds or additional financing to mitigate the impact on households. Moreover, elevated input costs and arid weather conditions may further diminish agricultural yields, amplifying inflationary pressures and dampening economic activity. Against this backdrop, the reduction in poverty observed in 2021 is likely to have been short-lived, as Moldova grapples with the repercussions of Russia's invasion of Ukraine, affecting vulnerable Moldovans due to high food and fuel prices. In the current geo-economic environment, Moldova's long-term outlook relies on aligning its reform agenda with EU accession and the pace of reforms aimed at enhancing productivity. These reforms encompass bolstering competition and public sector asset management, improving and digitalizing the business climate, improving public finance efficiencies, and a climate-resilient economy.

Recent developments

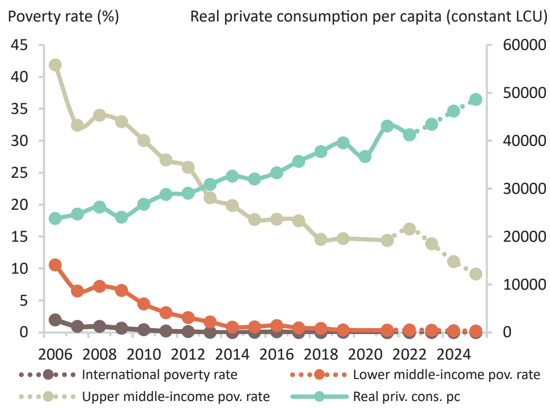
In the first half of 2023, GDP contracted by 2.3 percent. This was driven by a 4.7-percentage-point dip in private consumption, attributed to elevated prices and diminished purchasing capacity. Restocking efforts yielded a positive impact (1pp), and investments experienced a reduction (-0.8 pp), possibly due to a lenient monetary approach and heightened risks. Net exports added 2.3 percentage points as imports were muted in line with depressed domestic demand. On the supply side, the energy and trade sectors emerged as primary growth inhibitors, sapping 2.5 percentage points. Amid a subdued regional climate, manufacturing fell 1.3 percentage points,

FIGURE 1 Moldova / Actual and projected macroeconomic indicators



Source: World Bank, based on national statistics.

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



Source: World Bank. Notes: see Table 2.

while IT and communications contributed 0.5 percentage points. Agriculture struggled with last year's drought and input costs (-0.1pp).

Moldova's external position improved, but elevated energy costs and decreased exports pose vulnerabilities. Strengthened by robust service exports (transport and IT) and positive developments in primary and secondary accounts (remittances increased by 11 percent), the current account deficit diminished by 2.6 percentage points, reaching 16.1 percent of GDP. Financing primarily relied on cash and deposits. External debt, however, escalated to 66.6 percent of GDP.

The inflation rate is on a descending trajectory, reaching 18.7 percent between January- July. In the first half of 2023, the fiscal deficit expanded to 4.7 percent of GDP, propelled by a 20 percent rise in expenditures driven by interest rates and social spending. Revenues lagged (13 percent), as economic activity is subdued. Public debt increased by 2 percentage points, totaling 32.5 percent of GDP.

Due to record high prices and reduced purchasing power, average household real income declined by 6 percent during 2022, with consumption down 10 percent in real terms among households in the first quintile. Despite the decline in purchasing power, employment was up 2.2 percent in 2022 driven by a 4.5 percent increase in the employment of women. Poverty, as measured by the international US$6.85 2017 PPP per day poverty line is forecasted to have increased from 14.4 percent in 2021 to 16.2 percent in 2022.

Outlook

GDP growth is predicted to gradually rebound to 1.8 percent in 2023, fully recovering in 2024. Amidst strong base effects, growth will resume later this year due to strong remittances, fiscal stimulus, and better monetary conditions supporting consumption and investments. On the production side, agriculture is expected to strongly rebound from last year's drought. In medium term, growth depends on inflation dynamics, energy security, and the ongoing Russian invasion of Ukraine. Governmental measures, like higher pensions, social protection, and wages throughout 2023, are anticipated to alleviate the impact on households. Consumer credit remains subdued, and the proximity to Ukraine poses challenges to both domestic and foreign investments, as well as net exports. In terms of production, industry will remain constrained by heightened input expenses. Nevertheless, the service sector will spearhead growth, with a strong contribution from the transport sector, mainly due to Ukraine freight.

Assuming moderated import prices and controlled second-round effects, inflation will gradually recede towards the Central Bank target of 5 percent by end-2023. The external stance is expected to be challenged by high import prices and subdued capital inflows driven by heightened uncertainty. In the medium term, remittance inflows will stabilize as migrants seek alternative destinations, helping to address the structural deficit of the current account. The current account deficit is anticipated to exceed pre-COVID-19 levels and remain reliant on external financing. The expected economic slowdown will lower revenues, resulting in a 5.4 percent fiscal deficit in 2023. In the medium-term high deficits are expected to persist due to infrastructure needs. Despite the challenging outlook, public debt remains sustainable.

Poverty, as measured by the US$6.85 2017 PPP poverty line, is forecasted to decrease from 16.2 percent in 2022 to 13.9 percent in 2023. With the anticipated economic recovery, poverty is projected to decline further to 11.1 percent in 2024.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-7.4	13.9	-5.0	1.8	4.2	4.1
Private consumption	-8.3	15.5	-6.3	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	5.1	5.3
Exports, goods and services	-9.6	17.5	26.7	3.3	4.6	5.1
Imports, goods and services	-5.0	19.2	15.9	3.6	3.9	4.1
Real GDP growth, at constant factor prices	-7.6	15.6	-4.9	1.9	4.2	4.0
Agriculture	-26.4	18.7	-21.2	4.6	3.3	3.5
Industry	-4.3	5.6	-8.6	1.2	4.6	5.1
Services	-4.8	19.3	-0.7	1.8	4.2	3.7
Inflation (consumer price index)	4.1	5.1	28.7	14.1	6.2	4.9
Current account balance (% of GDP)	-7.7	-12.4	-15.7	-11.7	-10.4	-9.4
Net foreign direct investment inflow (% of GDP)	1.3	1.6	0.8	1.4	2.6	2.4
Fiscal balance (% of GDP)	-5.3	-1.9	-3.2	-5.4	-4.4	-3.5
Revenues (% of GDP)	31.4	32.0	33.4	32.1	31.8	32.5
Debt (% of GDP)	36.4	33.8	35.9	34.9	36.8	35.7
Primary balance (% of GDP)	-4.5	-1.1	-2.0	-4.6	-3.6	-2.9
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	0.4	0.3	0.3	0.2
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	15.4	14.4	16.2	13.9	11.1	9.2
GHG emissions growth (mtCO2e)	-2.4	10.8	-3.0	3.7	3.6	2.6
Energy related GHG emissions (% of total)	64.6	66.9	67.4	65.6	65.3	65.6

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

MONTENEGRO

Table 1	2022
Population, million	0.6
GDP, current US$ billion	6.2
GDP per capita, current US$	10093.4
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]	73.8
Total GHG emissions (mtCO2e)	3.8

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2017 PPPs.
b/ Most recent WDI value (2021).

Over the past two years, Montenegro defied external headwinds, as GDP growth remained solid, reaching 6.4 percent in 2022 and prospects remain good. However, multiple challenges loom and require attention, especially on the fiscal front, as the country approaches large debt repayments during 2024-2027 in an environment of high financing costs. Montenegro requires prudent fiscal and debt management policies to overcome these challenges and structural reforms to safeguard and improve development prospects.

Key conditions and challenges

Montenegro's small, open, and service-based economy is highly vulnerable to external shocks, while the country's strategies and policies have not always been conducive to enhancing resilience. After a deep recession of -15.3 percent in 2020, the economy recovered strongly in 2021 and 2022, averaging 13 and 6.4 percent growth, respectively. However, the unfavorable global environment, coupled with domestic challenges is weighing on growth prospects. Given euroization, Montenegro relies on fiscal policy and structural reforms to maintain macroeconomic stability. However, the debt-financed highway, the pandemic, and a lack of commitment to fiscal targets have contributed to increased fiscal vulnerabilities and debt. Despite a significant decline in public debt to an estimated 62.1 percent of GDP in 2023, it nevertheless presents a vulnerability because it is subject to significant financing and rollover risk in the present environment. Considering large Eurobond repayments in 2025 and 2027 and high borrowing costs, Montenegro must demonstrate fiscal prudence by consolidating its public finance to narrow the fiscal deficit and further reduce public debt.

Since a major political change in 2020, Montenegro's political and institutional landscape has been complex and fragile, resulting in a vote of no-confidence in two governments in one year. The new political party, Europe Now, won the most seats in the snap elections that took place in June 2023 and is tasked with forming a government. A political consensus focused on structural reforms, the rule of law, and fiscal prudence will be critical to safeguard and improve Montenegro's development prospects in a highly uncertain external environment.

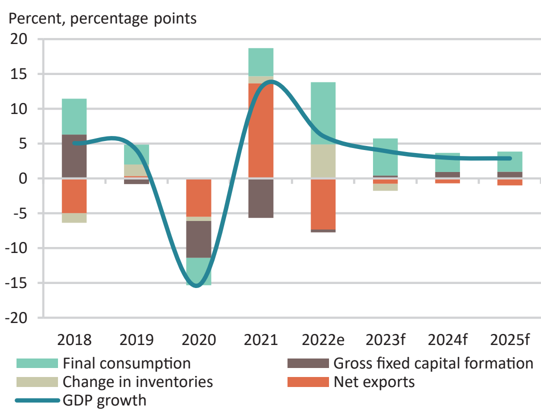
Recent developments

The economy made a very strong start in 2023, as GDP expanded by 6.6 percent in the first half of 2023, driven by personal consumption, underpinned by an increase in public sector wages, employment gains, and household borrowing, but also a very strong tourism season. In the first seven months of 2023, real retail trade grew by 10.4 percent y/y, while the number of tourist overnight stays outpaced the levels observed in the same period of 2019 by 29.1 percent. In the same period, industrial production increased by 5.4 percent, driven by stronger electricity production amid favorable hydrological conditions, and despite falling manufacturing. However, the value of construction works contracted by 11.8 percent in H1 2023, as investments remain subdued.

Strong employment gains in 2022 continued into 2023. Administrative data show record high employment in July and a record low administrative unemployment rate of 13.1 percent.

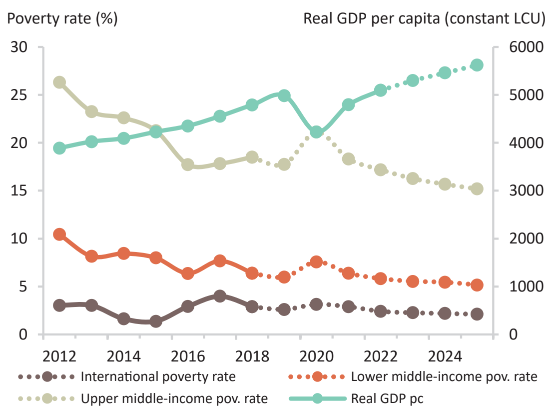
While annual inflation moderated to 10.1 percent y/y over the first eight months,

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.

monthly inflation remains elevated, led by food prices. Despite high inflation, real wages remained flat. Consequently, poverty (income below $6.85/day in 2017 PPP) is projected to decline to 16 percent in 2023.
By August, banking sector lending and deposits increased by 8.9 and 13.6 percent y/y respectively. In June, the average capital adequacy ratio was at a healthy 20.1 percent, while non-performing loans declined to 6.1 percent from 6.9 percent of total loans a year earlier.
On the external side, the current account deficit (CAD) narrowed slightly in H1, as export growth of 26.7 percent y/y outpaced import growth of 15.1 percent. Net income accounts increased marginally, despite a decline in net remittances of 5.7 percent y/y. Net FDI fell by 26.4 percent y/y, financing just half of the CAD, the remainder being financed from reserves.
On the fiscal side, by July, the central government achieved a fiscal surplus of 2.3 percent of GDP, due to strong revenues and capital budget under-execution. The surge in revenues of 24.5 percent y/y was supported by one-off payments of 1.8 percent of GDP for the economic citizenship program, a hedging fee, and grants, but also strong CIT and contributions collection. Expenditure growth of 12.9 percent was more moderate, as capital spending declined by 54.6 percent y/y, despite an increase in public sector wages and social spending. Consequently, government deposits increased to 3.9 percent of GDP from 1.9 percent of GDP in December 2022. By end-June, public debt declined to an estimated 61.3 percent of GDP.

Outlook

Montenegro's growth is expected to remain strong at 4.8 percent in 2023, underpinned by private consumption and service exports, while investments remain subdued. However, the slowing of the global economy is weighing down on Montenegro's outlook. Over 2024-25, declining private consumption growth is expected to result in a slower average growth of 3.2 percent. Tourism is likely to surpass its 2019 level in 2023, and continue growing, although deteriorating growth prospects in the EU and the region may adversely affect tourism. Poverty is projected to decline by 0.6 percentage points from 2023 to 15.4 percent in 2025. Expected service export growth and moderation of imports due to slowing consumption are estimated to bring the CAD to 10.9 percent of GDP by 2025.
On the fiscal side, while one-off revenues will result in a lower-than-planned fiscal deficit of 2 percent of GDP in 2023, the fiscal deficit is expected to remain elevated at 3.9 and 3.6 percent of GDP in 2024 and 2025, respectively. Public debt is expected to increase from 62.1 percent of GDP in 2023 to 66.1 percent of GDP in 2024. Fiscal consolidation measures would, however, result in a better fiscal performance.
Given the tightening of global financial conditions and Montenegro's sizable financing needs over 2023-25, cautious fiscal management is needed, particularly with respect to expenditures, including implementing the pension and public administration reforms.
The outlook is surrounded with downside risks. High geopolitical uncertainties may weaken growth prospects in Montenegro's major trading partners. Monetary tightening is rapidly increasing the cost of external financing. Political challenges are major domestic risks. The severity of challenges ahead, however, requires strong political and economic stewardship through carefully designed and well-costed policies.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-15.3	13.0	6.4	4.8	3.2	3.1
Private consumption	-4.6	4.0	9.7	6.3	3.3	3.5
Government consumption	0.8	0.5	1.5	2.8	0.6	0.4
Gross fixed capital investment	-12.0	-12.3	0.1	0.0	2.6	2.8
Exports, goods and services	-47.6	81.9	22.7	11.1	4.9	4.3
Imports, goods and services	-20.1	13.7	21.3	5.9	3.9	3.8
Real GDP growth, at constant factor prices	-14.4	13.2	6.3	4.8	3.1	3.1
Agriculture	1.1	-0.5	-2.9	-0.2	0.1	0.1
Industry	-12.0	0.3	-8.1	1.6	2.0	2.4
Services	-16.9	19.9	11.7	6.1	3.6	3.5
Inflation (consumer price index)	-0.3	2.4	13.0	8.4	4.0	2.8
Current account balance (% of GDP)	-26.1	-9.2	-12.9	-11.5	-11.3	-10.9
Net foreign direct investment inflow (% of GDP)	11.2	11.7	13.2	8.0	8.1	7.9
Fiscal balance (% of GDP)	-11.0	-1.9	-5.1	-2.0	-3.9	-3.6
Revenues (% of GDP)	44.4	44.0	38.6	40.5	39.0	39.1
Debt (% of GDP)	105.3	84.0	69.3	62.1	66.1	62.3
Primary balance (% of GDP)	-8.3	0.5	-3.4	-0.3	-1.8	-1.0
International poverty rate ($2.15 in 2017 PPP)[a,b]	3.1	2.9	2.4	2.3	2.2	2.1
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	7.6	6.4	5.8	5.5	5.3	5.1
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	21.1	18.3	17.2	16.0	15.4	14.9
GHG emissions growth (mtCO2e)	-9.2	5.2	1.9	1.8	1.2	1.6
Energy related GHG emissions (% of total)	68.8	71.1	72.3	71.7	72.8	73.8

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 2019-SILC-C. Actual data: 2018. Nowcast: 2019-2022. Forecasts are from 2023 to 2025.
b/ Projection using neutral distribution (2018) with pass-through = 0.87 (Med (0.87)) 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]	6597.7
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]	74.5
Total GHG emissions (mtCO2e)	10.2

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent WDI value (2020) for population.
b/ Most recent value (2019), 2017 PPPs.
c/ WDI for School enrollment (2020); Life expectancy (2021).

The economic growth is decelerating as inflationary pressures remain persistent, and public finances are stretched amidst monetary tightening and rising borrowing costs. Poverty reduction resumed slowly. Fiscal consolidation needs to be prioritized given new spending commitments for highways and public sector wages. Boosting growth calls for structural reforms that have been delayed amidst a parliamentary impasse. The outlook over the forecast horizon is positive, but downside risks prevail.

Key conditions and challenges

Despite setbacks stemming from the energy crisis and Russia's invasion of Ukraine, growth in early 2023 proved to be more resilient than expected. After surpassing a two-decade peak in 2022, inflation dropped to single digits in June 2023, but core inflation remained elevated. Poverty reduction has resumed in 2023 albeit at a slower pace, with the poverty rate projected to fall by less than 1 percentage point given the disproportionate erosion of real incomes of the relatively less well-off and an anemic labor market. Namely, the employment rate (15+) remained at just over 47 percent during 2021-22, and the reduction in the unemployment rate from 15.4 percent in 2021 to 14.4 in 2022 came on the back of the increase in inactivity of the older age cohort, rather than transitions into employment.

Fiscal policy continues to be challenging. The additional fiscal cost of the public sector wage increase negotiated in July 2023 is estimated at around 0.7-0.8 percent of GDP a year. Furthermore, the construction costs for a highway to Albania worth 10 percent of GDP will need to be absorbed in the budget, adding to the need for fiscal consolidation. While public debt slightly declined, it is projected to rise over the medium term, while expenditure arrears remain consistently above 3 percent of GDP.

Monetary tightening continued to confront rising inflationary expectations, with the main policy rate in August 2023 reached 6.15 percent. Credit growth slowed largely due to reduced borrowing by firms as financial conditions tightened.

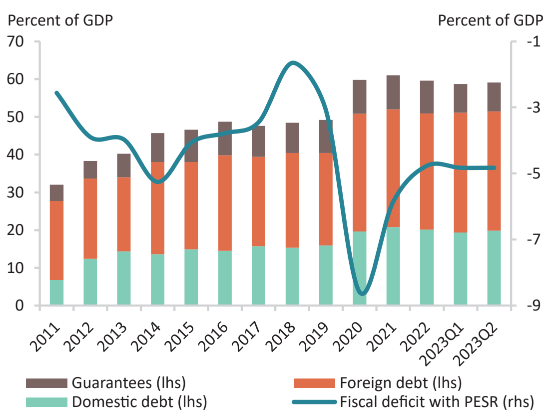
Overlapping crises have scarred the growth potential and further slowed convergence with the EU. Boosting productivity, advancing on inclusion, and enhancing fiscal and environmental sustainability are critical for long-term steady growth in the context of pronounced and widespread uncertainty. Rebuilding resilience to climate change shocks and decarbonizing to maintain international competitiveness given the EU CBAM implementation.

Recent developments

Output increased by 1.6 percent in H2 2023, led by decelerating consumption and exports, as imports and stockpiling pressures subsided. Growth was driven by services and industry which is slowing due to lower external demand, while agriculture and construction remained negative.

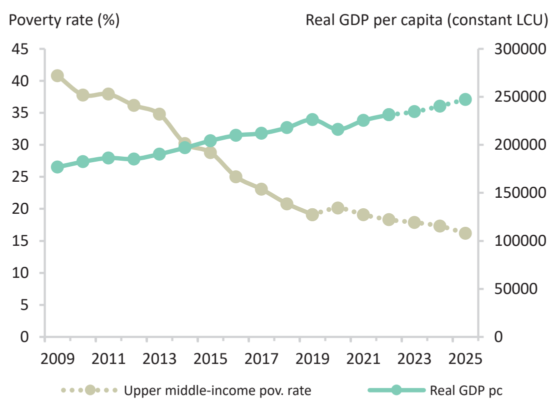
The Q2 2023 labor market data, lacking comparability due to census and methodological changes with previous years, reveal an unemployment rate of 13.1 percent, with the youth unemployment rate declining to 25.6 percent. The labor force participation rate (ages 15+) stood at a low of 52.4 percent (for women at 42.5 percent), while the employment rate remained stagnant at 45.5 percent. Wage growth surpassed inflation as of April 2023 after the minimum wage correction. Wages will increase

FIGURE 1 North Macedonia / Fiscal performance



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

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



Source: World Bank. Notes: see Table 2.

further as the Government signed a new collective agreement for the public sector that includes a 10-percent wage rise from September 2023 and a revision to the wage-setting methodology from 2024 linking the public sector wage to the national gross wage; an annual leave bonus at 30 percent of the average net wage; as well as loyalty bonuses. The fiscal deficit (with the State Roads) will likely remain at 4.8 percent of GDP for 2023 after the technical budget reallocation to accommodate new spending commitments. The central government deficit reached 2.7 percent of GDP by June as revenue growth decelerated and spending increased led by investments and social spending. Public debt to GDP stood at 59.1 percent of GDP in June 2023 and is expected to rise by 2025.

Banking sector stability was preserved with an increase in the capital adequacy ratio to 18 percent in Q1 2023 despite a drop in the liquidity rate to 19.1 percent. At the same time, the NPL ratio declined to 2.8 percent.

Headline inflation fell to 8.4 percent in July 2023, but core inflation remains sticky at above 8 percent. The pegged exchange rate has remained stable and FX reserves have recovered from losses incurred largely at the start of the war in Ukraine, standing at more than 4 months of imports in June 2023.

Outlook

The medium-term outlook is positive, but risks are tilted to the downside. Growth in 2023 is expected to increase modestly by 1.8 percent, reflecting a slowdown in external demand, and a persistent cost-of-living crisis, offset in part by the impact of the highway construction. Growth is expected to moderately accelerate in the medium term led by the rise in public investments, recovered consumption and exports, before slowing towards the potential growth trend thereafter. Annual inflation is projected to remain elevated at 9.1 percent in 2023 and fall to the long-term average of 2 percent in 2025. The baseline scenario is built on the assumption that the impact of crises subsides over the forecast horizon.

While underlying risks remain largely skewed to the downside and reflect the outlook for the country's main trading partners, moving ahead with EU accession negotiations may accelerate critical reforms and unlock growth. However, heightened political uncertainty and a prolonged parliamentary impasse due to lack of consensus for constitutional changes and upcoming elections may delay reform implementation. Finally, policy slippages may risk fiscal sustainability and inflation persistence in turn requiring further monetary tightening that can further restrict financing options and decelerate economic activity going forward.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-4.7	3.9	2.1	1.8	2.5	2.9
Private consumption	-3.4	7.8	3.1	4.2	1.5	2.4
Government consumption	9.7	-0.4	-2.6	0.3	0.2	0.2
Gross fixed capital investment	-15.7	0.9	15.9	8.0	6.5	6.5
Exports, goods and services	-10.9	11.7	13.4	6.0	5.5	5.0
Imports, goods and services	-10.9	11.9	16.1	5.8	4.5	4.5
Real GDP growth, at constant factor prices	-4.3	4.1	2.5	1.8	2.5	2.9
Agriculture	2.5	-5.2	2.0	2.0	2.5	1.8
Industry	-6.9	-1.8	-4.3	2.1	3.4	3.0
Services	-4.1	7.5	4.9	1.7	2.2	3.0
Inflation (consumer price index)	1.2	3.2	14.2	9.1	3.0	2.0
Current account balance (% of GDP)	-2.9	-3.1	-6.0	-3.7	-3.2	-2.8
Net foreign direct investment inflow (% of GDP)	1.4	3.3	5.2	5.2	4.7	4.2
Fiscal balance (% of GDP)	-8.2	-5.4	-4.6	-4.7	-4.1	-3.5
Fiscal balance incl. public enterprise for state roads (% of GDP)	-8.6	-5.8	-4.8	-4.8	-4.5	-3.8
Revenues (% of GDP)	29.9	32.5	32.4	34.9	35.0	35.7
Debt (% of GDP)	59.8	61.0	59.6	60.2	61.5	62.2
Primary balance (% of GDP)	-7.0	-4.1	-3.4	-3.2	-2.4	-1.5
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	20.1	19.1	18.3	17.9	17.3	16.2
GHG emissions growth (mtCO2e)	-5.5	-1.1	-3.0	-2.9	-3.0	-3.1
Energy related GHG emissions (% of total)	70.6	70.7	70.0	69.0	68.0	66.8

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 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	38.4
GDP, current US$ billion	690.2
GDP per capita, current US$	17959.9
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]	75.6
Total GHG emissions (mtCO2e)	333.6

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ WDI for School enrollment (2020); Life expectancy (2021).

After a robust 5.1 percent growth in 2022, Poland's GDP growth decelerated sharply in the first half of 2023 as high inflation, tighter financing conditions, and an unwinding inventory cycle weighed on growth. Private consumption declined due to declines in real wages, loss of purchasing power, and weak consumer sentiment. The large number of displaced 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 recovered robustly after the COVID crisis recession in 2020 (-2 percent) -- one of the shallowest recessions in the region.

Long-term inclusive growth and poverty reduction were supported by a sound macroeconomic framework, effective absorption of EU investment funds, a sound financial sector, access to long-term credit and to the European market. Strong domestic labor markets and higher median and bottom 40 real incomes have supported private consumption. The improved business environment and the accession to the EU fostered the integration into regional value chains (RVCs) and economic diversification. Higher private investment, an improved innovation ecosystem, and further upgrading of RVCs are needed to boost productivity and growth.

The policy response to mitigate the impacts of the COVID crisis and high inflation have narrowed the available policy space. Increased efficiency of spending and tax expenditure is needed to rebuild fiscal buffers, accommodate higher spending on health, defense, the green transition, and to prepare for fiscal pressures linked to the rapidly aging population.

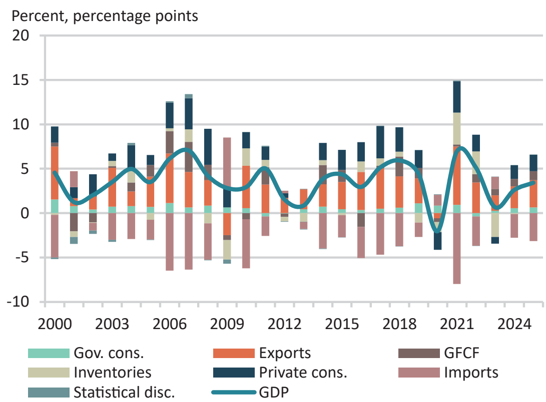
Over the medium term, a key challenge stems from expected declines in labor supply due to the declining and rapidly aging population. The large influx of displaced Ukrainians, estimated at nearly 1 million, temporarily eased some of the labor market tightness and boosted private consumption. Meeting decarbonization commitments is another challenge. Institutional strengthening is also needed for sustained and inclusive growth and for narrowing regional disparities.

Recent developments

Economic growth has decelerated markedly in the first half of 2023, from a robust 5.1 percent growth recorded in 2022, with a particular drag coming from household consumption which contracted in response to high inflation, tighter financing conditions, the unwinding of household support measures, and weak consumer sentiment. This is despite a robust labor market, with low unemployment rates, higher employment, and double-digit increases in average and minimum wages. The unwinding of the sizeable buildup in inventory is now representing a significant drag on growth. Strong financial performance of firms has bolstered investment activity, particularly for medium-sized and large companies in the energy, mining, and water sectors. Export growth remained robust, while weak domestic demand reduced import demand.

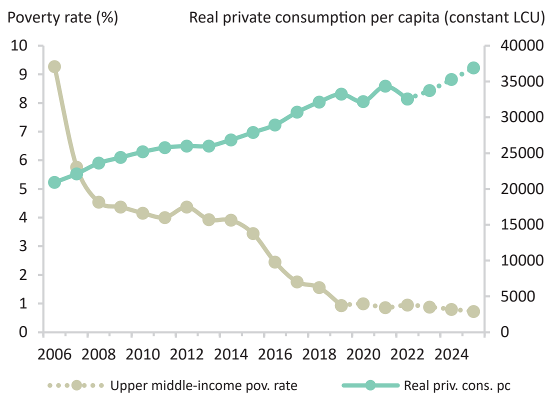
Inflation decelerated markedly from 18.4 percent in February 2023, to 10.1 percent by August, as global commodity prices, including energy prices, declined, the zloty appreciated, and supply disruptions eased. The zero VAT rate on staple food products and statutory price caps

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.

on fuels sold by local governments maintain prices lower.

The National Bank of Poland started its monetary easing cycle with a surprise 75 basis points cut in September, after an early and aggressive monetary tightening since October 2021 (665 basis points), even as inflation remains well above the targeted range. Markets price in additional rate cuts as inflation pressure eases. The zloty appreciated by 10 percent in 2023, before easing in response to the rate cuts. The banking sector remains well capitalized, although profitability of the banking sector has declined recently.

The terms of trade shock and robust domestic demand widened the current account deficit to 3 percent of GDP in 2022. Stronger exports and subdued imports resulted in a marked improvement in 2023.

Measures to protect households and firms from the energy and food price shock, predominantly untargeted, cost 2.4 percent of GDP in 2022, contributing to the widening of the fiscal deficit to 3.7 percent of GDP, as did higher debt service costs and assistance to displaced Ukrainians (a cumulative 1 percent of GDP), and resolving the Getin Noble Bank S.A. (0.3 percent of GDP). The tax system reform, which enhanced progressivity, contributed to the 0.9 percentage point decline in PIT revenue.

Extreme poverty rates using the national concept continue to remain elevated in 2022 compared to the pre-COVID-19 pandemic period, reflecting the deterioration of purchasing power among households whose consumption baskets are heavily tilted towards necessities; the Gini coefficient of inequality continued the upward trajectory visible since 2017.

Outlook

Economic growth is projected to decelerate markedly to 0.7 percent in 2023 due to high inflation, negative real income growth, tighter financing conditions, continued negative confidence effects related to the Russian invasion of Ukraine, and an unwinding of the large inventory cycle. A recovery in private consumption and stronger investment activity are expected to support growth over the medium term, although further delays in EU NRRP disbursements represent a downside risk.

Slowing demand from the EU will be partially compensated by stronger exports to Ukraine. This, together with weaker import demand and lower energy import prices, is expected to result in a current account surplus of 1.3 percent of GDP in 2023.

The general government deficit is expected to exceed 4.7 percent of GDP in 2023, on account of the impact of the structural tax reform (Polish Deal, 1.1 percent of GDP), the freeze on electricity and gas prices and the zero-VAT on food (2 percent of GDP), election-related spending, and assistance to displaced Ukrainians (0.2 percent of GDP). Defense spending is expected to rise by 0.8 percent of GDP this year. The general government deficit is expected to remain elevated in 2024.

A prolonged inflationary period poses a risk to progress on poverty reduction, with elevated energy and food prices affecting heavily poorer segments, who spend 50 percent of their monthly budgets on food and energy. The share of the population at risk of anchored poverty is expected to remain 1-2 percent above 2019 levels.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-2.0	6.9	5.1	0.7	2.6	3.4
Private consumption	-3.4	6.1	3.3	-1.3	2.8	3.3
Government consumption	4.9	5.0	-2.0	1.5	3.2	3.7
Gross fixed capital investment	-2.3	1.2	5.0	4.0	4.5	5.4
Exports, goods and services	-1.1	12.3	6.2	3.1	4.3	5.2
Imports, goods and services	-2.4	16.1	6.2	-2.5	5.1	5.9
Real GDP growth, at constant factor prices	-2.0	6.6	5.0	0.8	2.6	3.5
Agriculture	15.3	-11.5	-1.7	5.2	0.2	0.1
Industry	-4.5	1.9	6.7	0.5	3.0	3.1
Services	-1.4	9.7	4.5	0.9	2.5	3.7
Inflation (consumer price index)	3.4	5.1	14.4	12.0	6.1	3.5
Current account balance (% of GDP)	2.5	-1.4	-3.0	1.3	0.9	0.4
Net foreign direct investment inflow (% of GDP)	2.4	4.1	4.0	2.3	2.3	2.3
Fiscal balance (% of GDP)	-6.9	-1.8	-3.7	-4.7	-4.3	-3.4
Revenues (% of GDP)	41.3	42.3	39.8	38.0	38.2	38.6
Debt (% of GDP)	57.2	53.6	49.1	49.4	50.9	52.4
Primary balance (% of GDP)	-5.6	-0.7	-2.2	-2.5	-1.9	-1.7
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	1.0	0.9	0.9	0.9	0.8	0.7
GHG emissions growth (mtCO2e)	-3.5	3.4	4.4	-0.2	0.9	1.3
Energy related GHG emissions (% of total)	91.9	91.9	91.8	91.9	91.9	92.0

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 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	300.3
GDP per capita, current US$	15076.5
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]	73.0
Total GHG emissions (mtCO2e)	83.9

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

The Romanian economy decelerated to 1.7 percent in the first half of 2023, in spite of resilient private consumption and investment aided by EU funds. Growth will moderate in 2023, in alignment with EU's weakened economic activity, but rebound in the medium term. Fiscal and current account deficit pressures will remain elevated, necessitating structural reforms. Poverty reduction is set to decelerate due to high food and energy costs, partly offset by government support. Tackling energy poverty is key to poverty alleviation and social inclusion.

Key conditions and challenges

Romania has made impressive strides in enhancing its economic performance and prosperity over the past two decades, supporting convergence in living standards with the EU. However, several constraints, including weak institutions, shortages of skilled workforce, poor connectivity, low resilience to natural hazards, and the effects of climate change, hold Romania back from making growth more inclusive and more sustainable economically and environmentally.

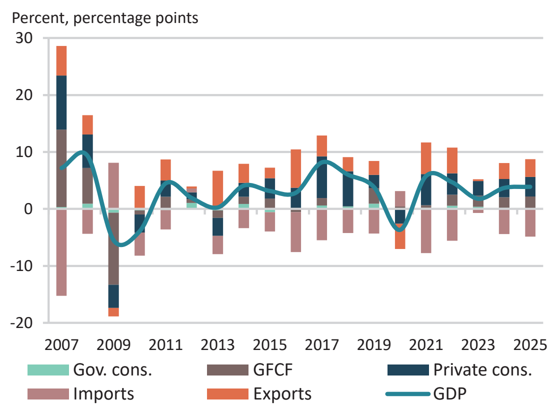
Romania's persistently high at-risk-of-poverty rate, particularly compared to EU peers with comparable or lower per capita incomes, remains concerning and could worsen due to ongoing inflation, especially among lower-income groups. In December 2022, a 3.1 ppts inflation gap existed between Romania's lowest and highest quintiles.

The key challenges in the short term are to curb the increase in the cost of living and sustainably address the significant twin deficits, while mitigating the impact of rising energy prices with targeted transfers to help the most vulnerable. The surge in inflation prompted a tightening of monetary policy, while elevated core inflation points to persistent inflationary pressures. Achieving a sustainable recovery and supporting fiscal consolidation efforts will hinge on implementing structural reforms in key areas, including education and health sectors, public administration, tax, and pension systems; and decarbonization reforms along with an efficient use of EU Multiannual Financial Framework and Next Generation EU funds.

Recent developments

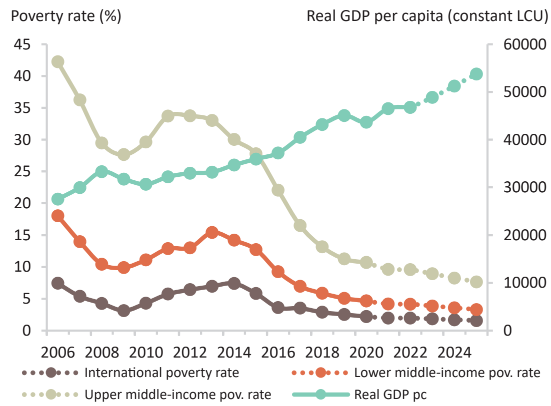
Romania's economic growth decelerated to 1.7 percent y-o-y in H1, 2023. Private consumption remained the main driver of growth, up 3.9 percent y-o-y, benefiting from higher wages and muted unemployment. Investment, up 11.2 percent y-o-y, was boosted by increased public investment supported by EU funds. Temporary factors notably dampened growth, with inventory changes contributing negatively to GDP dynamics. Despite weakening export volumes, trade and current account deficits narrowed, supported by higher services surplus and modest import compression. On the supply side, although construction (up 6.8 percent y-o-y) was the main driver of growth, its momentum waned, reflecting a slowdown in both residential and non-residential constructions. Industry continued to contract (down 3.3 percent y-o-y) due to elevated production costs, especially in energy-intensive sectors, which experienced among the highest output declines. Unemployment remains contained at 5.4 percent in June 2023. Nominal net wages grew by 15.4 percent y-o-y in June 2023, above inflation, driven by wage increases in the private sector propelled by a minimum gross wage rise fueling companies' labor

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.

costs. July's annual inflation slowed to 9.4 percent from 12.2 percent in March, driven by lower energy costs. Food prices remain high but should temper given the Government's temporary cap on markups for 14 staple items starting end of July 2023. Following 575 basis points of hikes from October 2021, the National Bank of Romania has maintained its policy interest rate at 7 percent since January 2023. Private sector credit growth decelerated to 6.4 percent y-o-y in June 2023 from 17.5 percent in June 2022, reflecting a slowdown in loans to households (0.1 percent y-o-y).

The fiscal deficit widened to 2.3 percent of GDP in the first half of 2023, a 0.7 ppts increase from the previous year. The deterioration resulted from slower fiscal revenue growth, notably VAT, coupled with increased expenditures, mainly stemming from social assistance spending, higher investments, and record high interest expenditures. Narrowing the fiscal deficit is a key challenge given its structural nature. To meet the deficit target agreed with the European Commission, the Government is working on a comprehensive fiscal reform package which includes measures aimed at increasing the equity of the tax system and reducing distortions, as well as measures supporting public wage and pension reforms.

Poverty ($6.85/day PPP) is projected to decrease from 10.7 percent in 2020 to 9.6 percent in 2022, due to positive GDP per capita growth and rising employment rates, but at a slower pace due to inflationary pressures. Microsimulation shows higher food and energy prices could increase short-term poverty ($6.85/day PPP) by 0.9 ppts without government support. Existing energy price caps temper this, but energy hikes' ripple effects are even more impactful via core inflation. In 2023, energy affordability remains a concern. The July 2023 World Bank rapid survey shows that 15 percent of households struggled to heat their homes during the past winter, and 30 percent found it difficult to cool in summer. Over half were dissatisfied with the Government's energy price caps, finding them insufficient against increasing prices. Poverty ($6.85/day PPP) is projected to decrease further to 8.9 percent in 2023.

Outlook

Growth is projected to decelerate in 2023 to 1.8 percent but firm over the medium term, supported by private consumption and EU funds aided investment. The outlook depends on multiple factors, including the extent and duration of Russia's invasion of Ukraine and its repercussions on the European economy, alongside fluctuations in global prices and domestic inflation. Romania’s capacity to efficiently absorb the EU funds will be critical for a sustainable, green, and inclusive recovery, aiding private investment amid higher interest rates and uncertainty. The sizable funds and associated structural reforms will also be critical in supporting a sustainable reduction of the fiscal deficit over the medium term, particularly aimed at reducing inefficient expenditures and strengthening revenue mobilization. Strengthened lifelong skills formation and private capital mobilization will be pivotal in boosting potential growth.

Due to the growth slowdown, 2024 may see slower poverty reduction. However, the poverty trajectory will hinge on the duration of the war in Ukraine and its impacts on food and energy prices, as well as the approach to tackle the fiscal deficit while protecting the more vulnerable. The Government's role in mitigating energy cost effects through targeted support is vital.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-3.7	5.8	4.7	1.8	3.7	3.9
Private consumption	-3.9	8.1	5.5	3.7	4.5	4.8
Government consumption	1.1	1.3	4.3	2.9	1.4	1.2
Gross fixed capital investment	1.1	1.9	8.0	7.9	7.2	7.5
Exports, goods and services	-9.5	12.6	9.6	0.7	5.8	6.3
Imports, goods and services	-5.2	14.9	9.9	1.2	7.5	8.0
Real GDP growth, at constant factor prices	-3.4	5.4	4.0	1.8	3.7	3.9
Agriculture	-15.3	5.9	-11.6	2.8	2.1	2.1
Industry	-6.5	6.6	-2.3	-2.5	1.9	2.1
Services	-0.8	4.8	8.2	3.7	4.5	4.7
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	-9.3	-7.4	-6.3	-6.1
Net foreign direct investment inflow (% of GDP)	1.4	3.7	3.7	3.1	3.2	3.2
Fiscal balance (% of GDP)	-9.2	-7.1	-6.2	-6.0	-4.8	-3.7
Revenues (% of GDP)	32.8	32.5	33.5	32.7	32.9	33.1
Debt (% of GDP)	46.9	48.6	47.3	50.8	51.5	51.9
Primary balance (% of GDP)	-7.8	-5.5	-4.6	-4.6	-3.4	-2.3
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	4.2	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	7.7
GHG emissions growth (mtCO2e)	-3.8	6.3	4.7	1.1	3.7	4.2
Energy related GHG emissions (% of total)	92.6	93.1	93.9	94.3	94.8	95.2

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 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]	143.6
GDP, current US$ billion	2274.5
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]	69.4
Total GHG emissions (mtCO2e)	1494.4

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

Growth is projected at 1.6 percent in 2023. Fiscal stimulus supported consumer demand and military spending, while the energy sector contracted less than anticipated. Heightened external pressure, with a shrinking current account surplus, and narrowing fiscal space worsen the outlook. Medium-term growth prospects are muted due to constraints on Russia's access to global markets, skilled human capital, and productivity-enhancing technologies. Poverty is expected to fall slightly between 2023 and 2025.

Key conditions and challenges

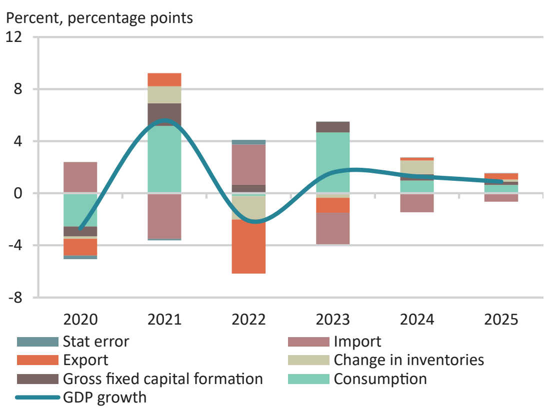
After the initial recessionary impact of sanctions in 2022, the economy has returned to growth in 2023, supported by credit growth and fiscal stimulus including military spending. However, Russian businesses and households continue to be affected by great uncertainty, restricted access to international markets, and higher trade costs. A shrinking current account surplus is driving exchange rate depreciation. The fiscal position has deteriorated, with energy receipts compressed by the sanctions. Banking sector risks, manageable in the short term, could add further pressure on the budget due to recapitalization needs. Loss of skilled workers, restrictions on imports of technological goods, and loss of productive FDI is expected to depress medium- to long-term growth prospects.

Recent developments

Following an economic contraction of 2.1 percent of GDP in 2022, GDP expanded by 1.6 percent (yoy) in H1 2023. On the demand side, growth was largely driven by consumer demand, boosted by accelerated public spending in H1 2023 (including a 7.1 percent real increase in pensions), and expanding consumer credit, while military spending remained high. Retail sale volumes grew by 1.1 percent (yoy) in H1 2023 (9 percent yoy in Q2 2023) with real wages 6 percent higher in H1. Investment grew by 7.6 percent in H1 2023. Both services and manufacturing contributed to growth, while the energy sector, affected by sanctions introduced toward the end of 2022, kept growth down. Oil production so far has been relatively resilient to sanctions introduced at the end of 2022 on the export of oil and derivatives, with oil production only 0.9 percent lower (yoy) in H1, although more substantive production cuts are expected in H2. Moreover, Urals prices decreased to USD 52.3/bbl on average in H1 2023, compared to USD 83.9/bbl in 2022, reducing oil sector revenues and export receipts. Gas production decreased by 12.3 percent in H1 2023 (yoy), largely due to a fall in Russian pipeline gas deliveries to the European Union, and prices also fell by 55 percent on average in H1 2023 (yoy).

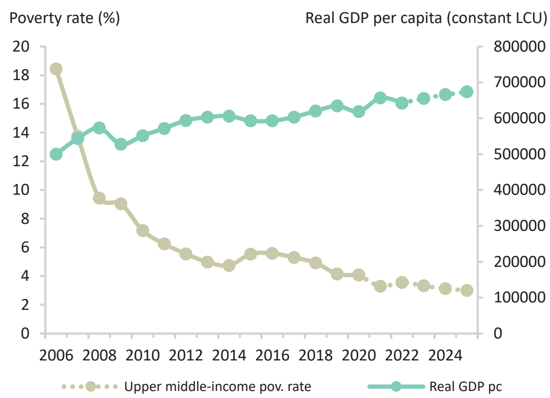
Expansionary fiscal expenditure (social benefits, government consumption, and investment – some directly related to the war – and loan subsidies) was an important factor in economic growth in H1 2023, with expenditure rising by 18.5 percent in H1 2023 (yoy). However, oil and gas revenues fell by 47 percent over the same period. This led to a rapidly expanding general government deficit, which reached 3.3 percent of GDP in H1, compared to a surplus of 4.6 percent of GDP in H1 2022. Public debt issuance (RUB 1.4 trillion, or USD 16.1 billion) and National Welfare Fund drawdown (RUB 0.5 trillion, or USD 5.3 billion at

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



Sources: Rosstat and World Bank.

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



Source: World Bank. Notes: see Table 2.

the end of June) were the main sources of deficit financing.

Russia's labor market remained tight as outward migration and the military sector reduced the amount of labor available for non-military-related activities. The unemployment rate fell to an unprecedented low of 3 percent in July 2023.

Russia's positive external balances narrowed over the course of 2023. The H1 2023 CAS was USD 29 billion, five times less than in 2022, as exports fell by 26 percent (yoy) and imports grew by 17 percent. As the external balance adjusted, the RUB began to depreciate rapidly, by 36 percent since the end of December 2022 to the end of August 2023.

The shrinking output gap and rising cost of imports fueled inflationary pressures. CPI inflation rose from 2.3 percent in April to 4.3 percent in July, with mom inflation in July more than doubling to 1 percent mom sa. In response, the Central Bank of Russia (CBR) raised interest rates by 550 bps to 13 percent – in three stages, in July, early August, and September – and suspended FX purchases.

The banking sector recorded a profit of RUB 2 trillion (USD 21 billion) in the first 7 months of 2023, compared to RUB 0.2 trillion in the full year 2022. Government support measures, including a RUB 100 billion recapitalization of VTB, and reportedly solid capital buffers allowed banks to continue lending throughout the year. Credit to the private sector grew by 9.7 percent in real terms (yoy) over the same period.

Outlook

It is currently difficult to produce growth forecasts for Russia due to significant changes to the economy associated with the Russian invasion of Ukraine, and Russia's decision to limit publication of economic data related to external trade and to financial and monetary sectors. Available data limit assessment of economic performance.

This outlook assumes that Russia's war on Ukraine and existing sanction will continue. A moderate contraction in crude oil and oil products exports, coupled with a rebound in domestic demand in 2023, mean the economy is expected to grow 1.6 percent this year, with growth moderating to 1.3 percent in 2024. Oil production is expected to contract by 2 percent in 2023. Growth momentum is expected to slow in H2 2023 as monetary and fiscal policy tighten; nevertheless, private consumption growth is expected to be strong in 2023 at approximately 6 percent.

Lower oil revenues and higher expenditure in 2023 are expected to widen the general government deficit to 3.3 percent, a deterioration of approximately 5 percent compared to 2022.

Average annual CPI inflation is expected to be lower in 2023, at 5.6 percent, with RUB depreciation contributing to rising inflation later in the year. Lower prices for commodities exported by Russia, lower export volumes, and growing imports are all expected to reduce CAS to approximately USD 50 billion in 2023 (2.6 percent of GDP), compared to USD 236.1 billion in 2022 (10.1 percent of GDP).

Moderate growth is expected in 2024, with consumer demand slowing and exports gradually recovering. In 2025, GDP is expected to grow by 0.9 percent, in line with lower growth potential.

Poverty is expected to fall slightly, if at all, between 2023 and 2025.

Russia's economic outlook remains closely tied to its ongoing invasion of Ukraine and possible further rounds of mobilization and sanctions. Broadly supported and strengthened sanctions, particularly affecting inflows of oil and gas revenues, and disruptions to evolving trade patterns may have significant impact.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-2.7	5.6	-2.1	1.6	1.3	0.9
Private consumption	-5.9	9.9	-1.4	6.3	1.3	0.7
Government consumption	1.9	2.9	2.8	8.6	1.6	1.4
Gross fixed capital investment	-4.0	9.1	3.3	4.1	2.3	1.2
Exports, goods and services	-4.2	3.3	-13.9	-4.3	0.9	1.9
Imports, goods and services	-11.9	19.1	-15.0	13.5	7.3	3.0
Real GDP growth, at constant factor prices	-2.2	6.1	-1.4	1.6	1.3	0.8
Agriculture	0.2	-0.8	6.7	0.5	1.2	1.2
Industry	-2.7	5.3	-0.2	1.5	2.0	1.4
Services	-2.2	7.0	-2.5	1.8	1.0	0.5
Inflation (consumer price index)	3.4	6.7	13.7	5.6	5.2	4.0
Current account balance (% of GDP)	2.4	6.6	10.4	2.6	2.1	2.0
Net foreign direct investment inflow (% of GDP)	0.2	-1.4	-1.2	-1.4	-1.4	-1.4
Fiscal Balance (% of GDP)[a]	-4.0	0.8	-1.4	-3.3	-1.9	-1.8
Revenues (% of GDP)	35.5	35.6	34.6	34.5	35.6	35.3
Debt (% of GDP)	19.9	17.3	16.9	19.4	20.7	21.8
Primary Balance (% of GDP)[a]	-3.2	1.6	-0.5	-2.4	-1.0	-0.9
Upper middle-income poverty rate ($6.85 in 2017 PPP)[b,c]	4.1	3.3	3.6	3.3	3.1	3.0
GHG emissions growth (mtCO2e)	-3.5	1.2	-3.4	-0.5	-0.6	-1.5
Energy related GHG emissions (% of total)	91.7	90.8	90.3	90.1	89.5	88.9

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 and Primary Balance refer to general government balances.
b/ Calculations based on ECAPOV harmonization, using 2020-HBS. Actual data: 2020. Nowcast: 2021-2022. Forecasts are from 2023 to 2025.
c/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

SERBIA

Table 1	2022
Population, million	6.7
GDP, current US$ billion	63.4
GDP per capita, current US$	9511.5
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]	72.7
Total GHG emissions (mtCO2e)	63.1

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent WDI value (2021).

The growth of the Serbian economy slowed down in the first half of 2023 amid elevated inflation that started to hurt consumption. Growth is expected to pick up in the second half of 2023, but risks to the outlook are tilted to the downside. The incidence of poverty declined to an estimated 8.5 percent. Going forward, poverty reduction is expected to stagnate, as income gains are eroded by high inflation and rising food prices in particular.

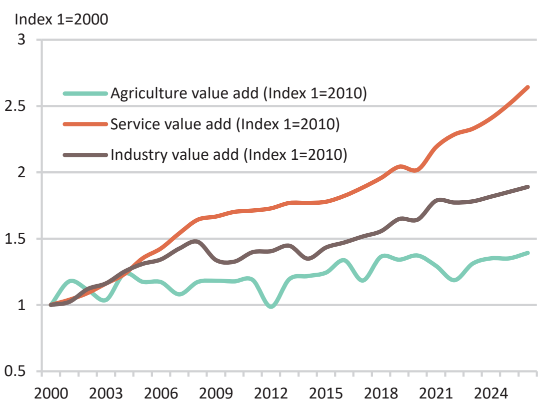
Key conditions and challenges

Growth in the first half of 2023 is estimated at 1.2 percent, y/y, significantly lower than in the same period of 2022. The main reason for this deceleration is a major decrease in investment with both private and public investment contracting. To a large extent, investment decreased due to lower inventories. Serbia needs to further remove bottlenecks for private sector investment including toward greener growth. Another challenge is the stubbornly high inflation, eroding the incomes of the poor due to their relatively high share of spending on food.
Over the medium term, under the base-case scenario, the Serbian economy is expected to grow at around 3 to 4 percent. With limited space for future stimulus packages, structural reforms are needed to accelerate growth to accelerate convergence to incomes of the EU.

Recent developments

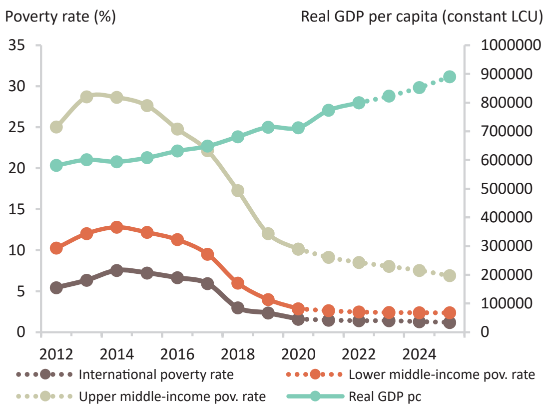
Weak GDP growth in Q1 and Q2 (0.9 and 1.7 percent, y/y) was caused by a significant decline in investment and to some extent by declining consumption (their contribution to growth was -4.7 and -0.7 percentage points in H1). On the other hand, net exports made a positive contribution to growth thanks to lower energy imports (compared to the same period of 2022), as well as to compressed non-energy import demand.
Labor market indicators remained broadly unchanged in 2023. The unemployment rate reached 10.1 percent in Q1 2023 (a slight increase compared to Q4 2022 when it reached 9.2 percent). Wages increased by 15.5 percent in nominal terms in the first half of the year compared to the same period of 2022.
Poverty (based on the upper-middle income line of $6.85/day in 2017 PPP) is estimated to have declined slightly from 9.1 percent in 2021 to 8.5 percent in 2022. In 2023, poverty reduction continued due to strong economic growth and improving labor market conditions, though it was partly countered by an output decline in agriculture, rising inflation at the end of the year, and the phasing out of government support programs.
Inflation remains stubbornly high, mainly due to a large increase in food and energy prices. The inflation reached a peak in March 2023 (16.2 percent), the highest since the CPI measurement started (in 2007). Inflation moderated to 12.5 percent in July. In the same month, food prices were 21.1 percent higher than a year earlier while energy prices were up by 23.7 percent. Rents for housing went up by 15.3 percent.
Budgetary revenues have overperformed thus far in 2023, primarily thanks to higher than planned collection of corporate income tax and high collection of contributions for social insurance. In the first half of the year, total revenues were

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.

higher by 12.6 percent in nominal terms (in real terms declined by 2.4 percent) compared to the same period in 2022. Over the same period, expenditures increased by 7.7 percent. As a result, the consolidated fiscal deficit recorded in the same period of 2022 turned into a surplus in 2023, reaching an estimated 0.6 percent of GDP. Public debt remained broadly stable throughout 2023 and stood at around 56 percent of GDP.

The current account deficit (CAD) shrank significantly in the first half of 2023 to 0.8 percent of GDP (down by 82 percent compared to the same period of 2022). This improvement, by and large, was driven by a major decrease in the trade deficit (which stood at EUR 3.2 billion in the first half of 2023 compared to EUR 5.3 billion in the same period of 2022) as imports slowed. Foreign currency reserves increased to a record high level of EUR 22.6 billion.

Outlook

The Serbian economy is expected to grow at around 2 percent in 2023, driven primarily by consumption. The impact of the war in Ukraine, a slowdown in global growth and tighter financing conditions, were key factors for the downward revision of 2023 GDP growth. Further revisions are possible depending on the performance of the economies of Serbia's main trading partners.

Over the medium term, the economy is projected to grow steadily at around 3-4 percent annually, supported by increases in consumption and investment. Foreign direct investment is expected to continue to play a key financing role. Inflation is expected to decline gradually as commodity prices normalize. The banking sector is expected to remain resilient, with NPLs stable at around 3 percent (at 3.2 percent in June 2023).

Poverty reduction is expected to gradually decline or stagnate in 2023 and beyond. While Serbia's economy is expected to continue to grow, contributing to income growth for households, rising inflation will limit purchasing power. Particularly, rising energy prices would disproportionately affect the poor. Poverty in 2023 is estimated at 8.0 percent, but it could be revised upward, depending performance of the economy in 2023. The pace of labor market recovery remains critical for resumed poverty reduction.

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

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-0.9	7.5	2.3	2.0	3.0	3.8
Private consumption	-1.9	7.6	3.9	1.8	2.4	3.4
Government consumption	2.9	2.6	1.6	2.0	0.3	3.0
Gross fixed capital investment	-1.9	12.9	2.0	-9.2	4.1	7.1
Exports, goods and services	-4.2	19.4	17.8	3.0	4.2	6.0
Imports, goods and services	-3.6	19.3	16.2	1.9	3.0	5.8
Real GDP growth, at constant factor prices	-0.7	7.3	2.0	2.7	3.0	3.8
Agriculture	2.3	-5.7	-8.3	12.0	3.4	3.4
Industry	-0.3	8.6	-0.7	0.3	4.5	4.5
Services	-1.2	8.4	4.5	2.9	2.2	3.5
Inflation (consumer price index)	1.6	4.0	11.9	12.7	5.3	3.5
Current account balance (% of GDP)	-4.1	-4.3	-6.9	-2.5	-3.6	-3.8
Net foreign direct investment inflow (% of GDP)	6.3	6.9	7.2	5.9	5.7	5.8
Fiscal balance (% of GDP)	-8.0	-4.1	-3.0	-2.8	-2.0	-1.5
Revenues (% of GDP)	41.0	43.2	43.4	42.9	41.9	40.9
Debt (% of GDP)	57.8	57.1	55.6	55.5	53.1	51.5
Primary balance (% of GDP)	-6.0	-2.4	-1.5	-1.0	0.0	0.3
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)	2.3	5.0	-5.1	3.2	5.1	4.3
Energy related GHG emissions (% of total)	74.7	75.6	74.8	75.5	76.5	77.3

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-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$	1054.2
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]	71.6
Total GHG emissions (mtCO2e)	19.9

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

Economic growth is projected at 6.5 percent in 2023 and moderating in future years in the absence of strong structural reforms to open up the economy. Inflation has been kept under control and expected to remain around 3.4 percent in 2023. The authorities' effort to support the currency in H1 2023 have resulted in a substantial loss of FX reserves.

Key conditions and challenges

Tajikistan's GDP growth averaged 7.1 percent over the 2010–2022 period. Strong growth and higher wages helped reduce poverty from 32 percent of the population in 2009 to an estimated 12.4 percent in 2022 (at the international poverty line of USD 3.65/day). However economic growth has been driven by remittance-induced household consumption and public infrastructure investment and the country remains characterized by the absence of a competitive private sector and very limited jobs creation, in the face of a fast-growing population.

The result has been substantial labor outmigration, notably to Russia, leading to increasing economic dependence on remittances. Remittances peaked at 50 percent of GDP in 2022. High dependence on an undiversified external income source has increased vulnerability to external shocks; the difficult domestic business environment inhibits the establishment of private sector-led alternatives.

To achieve the objectives of the National Development Strategy 2030, the authorities need to address the challenges brought by inefficient public enterprises, elite capture, corruption, weak competition, inadequate digital connectivity, poor transport links, insufficient financial intermediation, weak human capital development, and substantial social and environmental vulnerabilities.

This challenging reform agenda is also critical to enable the financing of Tajikistan's ambitious infrastructure plans, notably the construction of the Rogun Hydropower Plant (HPP), in a macroeconomically sustainable manner. Debt sustainability analysis highlights substantial risks that point to the importance of maintaining fiscal discipline, including reducing contingent liabilities and boosting exports by enabling a competitive private sector.

Recent developments

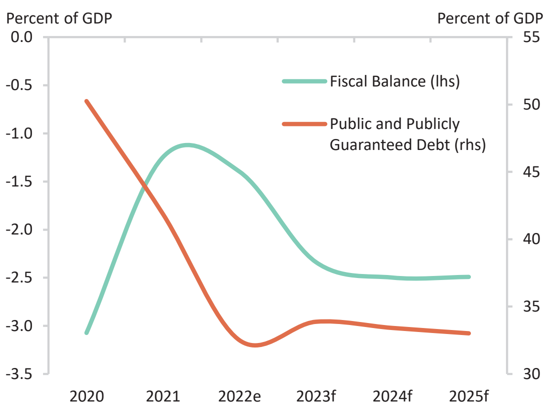
GDP growth was 8.3 percent (yoy) in H1 2023, driven by robust remittance inflows stimulating household consumption and investments. The share of households with a migrant reached 48 percent in June 2023, with the share of households receiving remittances rising gradually from 14 percent in January to almost 22 percent in June.

The average consumer price inflation rate declined from 7.7 percent during the first seven months of 2022 to 3.1 percent over the same period in 2023. Inflationary pressures decreased as the TJS appreciated against the RUB, lowering import prices for food and fuel products from Russia.

The Central Bank reduced the policy rate gradually from 13.5 percent in September 2022 to 10 percent as of May 2023. Since the transmission mechanism of the monetary policy is weak, the exchange rate is the main anchor to controlling inflation in Tajikistan.

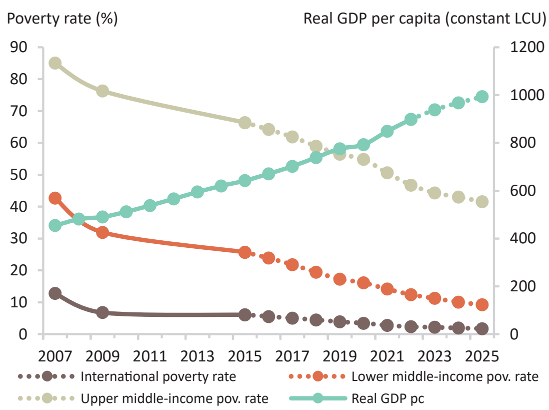
Despite the strong remittance inflows, Tajikistan's external position deteriorated in

FIGURE 1 Tajikistan / Fiscal balance and public debt



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

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



Source: World Bank. Notes: see Table 2.

Q1 2023. The current account recorded a deficit of 2.6 percent of GDP in Q1 2023 compared with a 15.6 percent surplus in 2022.
The trade deficit widened from 30 percent of GDP in H1 2022 to 41 percent in H1 2023, primarily due to the doubling of vehicle imports and a complete halt in the export of precious metals. The export of precious metals was temporarily halted to prevent the re-export of non-Tajik products due to Russian sanctions and to improve compliance with OECD standards.
Monetary authorities intervened in the foreign exchange market to support the TJS, resulting in a fall in international reserves from USD 3.8 billion at the end of 2022 to USD 3.2 billion in mid-2023. Reserves remain adequate at more than 6.5 months of import cover.
In H1 2023, the state budget was in balance. Tax receipts increased by 20 percent in nominal terms (yoy) to 22.5 percent of GDP (from 22 percent last year's same period) due to robust economic activity and better tax administration. Budget expenditures increased by 34 percent in nominal terms (yoy) to 33.8 percent of GDP (from 29.6 percent last year's same period), led by the energy and communication sectors. Since July 2023, the authorities have implemented targeted social assistance reforms to better identify vulnerable households and increased the amount of benefits for households with more children.
The banking sector has high capitalization levels; however, the asset quality is relatively poor. As of March 2023, the ratio of capital to risk-weighted assets stood at 25.9 percent – more than double the minimum requirement of 12 percent. On the other hand, the share of non-performing loans in total loans stood at 11.5 percent (albeit declining from 12.2 percent at the end of 2022).

Outlook

Tajikistan's growth is expected to slow to 6.5 percent in 2023 due to a projected moderation in remittance inflows (to 32 percent of GDP from the high base in 2022), lower FDI, and weaker exports. The economy's growth potential is estimated to be 4.5–5 percent over the medium term in the absence of structural reforms.
Inflation is projected to gradually rise toward the inflation target of 6 percent, after hitting a low in 2023.
Over the medium term, Tajikistan's current account deficit is projected to hover at 2.5 to 3 percent of GDP, assuming the normalization of remittance flows and lower prices for major export commodities (metals and minerals).
To ensure macro-fiscal stability, the authorities will need to allow greater exchange rate flexibility and limit the fiscal deficit at 2.5 percent of GDP over the medium term.
Expenditure on the construction of the Rogun HPP and other large infrastructure projects is projected to be financed by borrowing from development partners and streamlining other non-priority spending. The authorities plan to continue increasing targeted social allocations to better protect the vulnerable. Poverty is projected to fall from 12.4 percent in 2022 to 11.3 percent in 2023.
Risks to the economic outlook stem from geopolitical uncertainty, global financial conditions, remittance flow reversals (notably due to the risk of military conscription of migrants with dual Tajik-Russian citizenship), and the slow pace of structural reforms. Tajikistan also remains highly sensitive to climate change and natural disasters.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	4.4	9.4	8.0	6.5	5.0	4.5
Private consumption	3.1	4.3	9.0	7.1	3.0	3.0
Government consumption	2.3	4.6	7.8	6.4	4.3	3.7
Gross fixed capital investment	-4.6	12.0	10.3	11.2	5.3	4.6
Exports, goods and services	21.8	55.4	-15.0	-4.6	11.0	8.1
Imports, goods and services	-0.4	20.0	3.0	8.0	3.1	3.6
Real GDP growth, at constant factor prices	7.6	9.2	9.2	6.5	5.0	4.5
Agriculture	7.9	-0.3	5.1	5.0	5.0	5.0
Industry	17.3	13.2	8.3	8.0	5.0	5.0
Services	-1.9	10.6	12.5	5.6	5.0	3.7
Inflation (consumer price index)	8.6	9.0	6.6	3.4	5.4	6.1
Current account balance (% of GDP)	4.3	8.2	15.6	-2.4	-2.9	-3.1
Net foreign direct investment inflow (% of GDP)	0.4	0.4	1.5	0.0	2.4	2.6
Fiscal balance (% of GDP)	-3.1	-1.2	-1.4	-2.3	-2.5	-2.5
Revenues (% of GDP)	26.2	26.7	27.7	26.2	26.1	26.1
Debt (% of GDP)	50.3	41.9	32.5	33.5	32.9	32.2
Primary balance (% of GDP)	-2.3	-0.4	-0.7	-1.6	-1.7	-1.7
International poverty rate ($2.15 in 2017 PPP)[a,b]	3.5	2.8	2.3	2.2	2.0	1.8
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	16.2	14.2	12.4	11.3	10.1	9.2
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	54.8	50.6	46.8	44.3	43.0	41.6
GHG emissions growth (mtCO2e)	4.3	6.4	3.0	4.6	3.2	2.8
Energy related GHG emissions (% of total)	44.4	46.8	46.4	46.9	46.8	46.5

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 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	85.3
GDP, current US$ billion	906.3
GDP per capita, current US$	10627.4
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]	76.0
Total GHG emissions (mtCO2e)	525.0

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ WDI for School enrollment (2020); Life expectancy (2021).

Following the May 2023 elections, the government has taken positive steps to normalize Türkiye's macroeconomic policies. After growing by 5.5 percent in 2022, Türkiye's economy is projected to initially slow to 4.2 percent in 2023 and 3.1 percent in 2024 as the economy adjusts from the previous over-accommodative and unsustainable macroeconomic stance, followed by an expected acceleration of growth in outer years. The combination of high inflation, particularly food inflation, and the earthquakes could erode prior achievements in poverty reduction.

Key conditions and challenges

The new economic team, under Finance Minister Simsek and central bank Governor Erkan, has started to normalize macro-financial policies, and outlined more measures in the September Medium Term Program, to remedy imbalances in the economy. The central bank increased the policy rate from 8.5 percent in May 2023 to 30 percent in September (and signaled further tightening until there is significant improvement in inflation) and imposed new reserve requirements and other measures to limit loan growth. Distortive financial regulations are being unwound (including easing maintenance requirements on securities that require banks to hold government bonds and rolling back the FX-protected deposit scheme) alongside fiscal consolidation through tax increases.

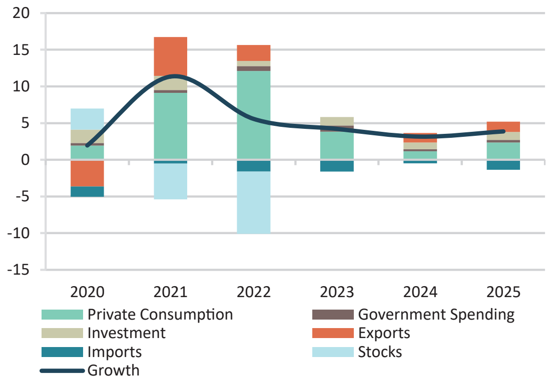
Recent macro-financial instability exacerbated longstanding structural challenges, including high private sector debt; persistent current account deficits financed by short-term portfolio flows; low productivity growth; and low labor force participation and employment levels. Nevertheless, high growth lowered the July 2023 seasonally adjusted unemployment rate to 9.4 percent, the lowest level since January 2014. However, high inflation – especially the 72.9 percent yoy food inflation in August 2023 – combined with the impact of the February 6 earthquakes, may erode prior achievements in poverty reduction.

Recent developments

After expanding 5.5 percent in 2022, real GDP grew 3.9 percent yoy in H1 2023. Responding to accommodative monetary policy, earthquake response and pre-election spending, H1 growth was driven by private and public consumption (16.4 and 5.7 percent real growth yoy, respectively) and investment (4.4 percent yoy), while merchandise exports in USD terms contracted 4.8 percent yoy as competitiveness and external demand weakened. On the production side, services grew 5.4 percent yoy in real terms in H1. On the other hand, the industry contracted 1.8 percent yoy in real terms due to early earthquake-related disruptions and a slight contraction in manufacturing. The PMI index remained above 50 since January but fell below 50 in July.

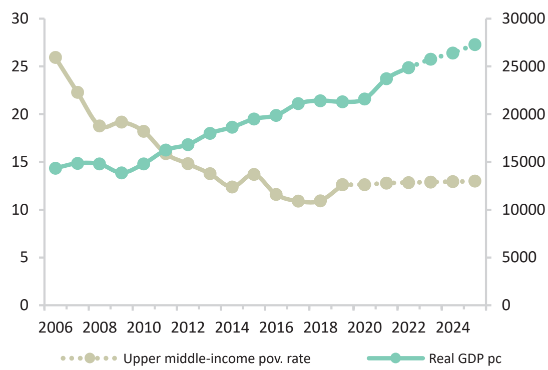
Policy normalization improved the external balance but vulnerabilities remain. The TRY continued its steady realignment, depreciating 26 percent since the May elections (and 31 percent since January) as foreign exchange interventions slowed. This helped the current account reach a surplus of USD 0.7 billion in June for the first time since October 2021 but returned to a USD 5.5 billion deficit in July. Reflecting greater investor confidence, CDS spreads have come down from 679, prior to the second round of elections in May, to under 400 in mid-September; and non-resident net portfolio inflows turned positive for 9 consecutive weeks, as of early August. As a result, central bank net reserves

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.

have started to recover, reaching USD 17.6 billion in mid-September from an all-time low of USD –5.7 billion in early June.

Financial market conditions tightened in response to monetary policy. Credit growth continued to slow and commercial and consumer loan interest rates increased, with the latter nearly positive in real terms. But TRY depreciation, a 34 percent minimum wage increase in July, and the impact of higher taxes reignited inflationary pressures. Annual inflation rose for the first time in nine months in July and August to 58.9 percent, after reaching an 18-month low in June, and year-end inflation expectations rose to 67.8 percent in September despite monetary policy tightening. Domestic asset prices continued to soar well above CPI inflation; across Türkiye, house prices increased 95 percent yoy in July and the stock market was up 140 percent yoy in mid-September. TRY depreciation led to declining CARs from 20.4 percent in March to 18.7 percent in August in private banks, and from 19.8 percent to 15.9 percent in state banks. Importers and non-traders are most exposed to TRY depreciation and SMEs to interest rate increases. While the official NPL ratio fell to 1.7 percent in mid-August despite phased-out forbearance measures, asset quality risks remain high from FX-exposed companies, past rapid credit growth, and remaining high loan exposures.

The authorities have also targeted fiscal imbalances. Parliament passed a supplementary budget in July to counter pressures from the February earthquakes and election-related pension and civil service wage increases, which resulted in a record high 12-month fiscal deficit in June of 4.8 percent of 2022 GDP. Increases in the VAT rate and a special consumption tax on fuels supported a central government budget surplus of TRY 49 billion in July and 51 billion in August, and a reduction in the 12-month deficit to 3.7 percent of 2022 GDP. Government debt remained manageable at 31.7 percent of GDP in 2022, but the FX-share was high at 66 percent.

Outlook

The economy is projected to grow 4.2 percent in 2023 and 3.1 percent in 2024 as it adjusts from the previous over-accommodative and unsustainable policy stance, followed by an expected acceleration in growth in outer years. Private consumption is the largest component of GDP and 12-month consumer confidence indicators fell sharply in August 2023, to the lowest level over 12 months due to expectations of a slowdown in income growth, the possibility of unemployment, and persistent inflation. Gradual fiscal consolidation is expected to continue supporting fiscal balances, and the macro-financial stabilization alongside lira depreciation and policy support to exporters is expected to further narrow the current account deficit.

Well-implemented and timely social protection programs, targeted expressly at vulnerable populations in earthquake-affected areas, can mitigate the earthquakes' impacts and economic slowdown on poverty. The government has already supported earthquake survivors by activating established social protection and labor schemes. Poverty is projected to stay at 12.9 percent in the next few years.

The outlook faces considerable uncertainty related to the macroeconomic policy stance in the run up to the March 2024 municipal elections and the phasing out of the FX-protected deposit scheme and heterodox regulations distorting the financial sector. Despite recent prioritizing of policy tightening and disinflation, a pre-election stimulus could increase short-term growth, while aggravating already-elevated external risks. The FX-protected deposit scheme, which accounts for 26 percent of total banking sector deposits and is sensitive to TRY depreciation, remains a source of fiscal risk. Some rating agencies have recently revised Türkiye's outlook from negative to stable with the return to a more consistent policy mix.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	1.9	11.4	5.5	4.2	3.1	3.9
Private consumption	3.2	15.4	18.9	6.1	1.7	3.4
Government consumption	2.2	3.0	4.2	7.2	2.1	2.4
Gross fixed capital investment	7.3	7.2	1.3	5.7	3.5	4.4
Exports, goods and services	-14.6	25.1	9.9	-2.2	5.4	5.8
Imports, goods and services	6.8	1.7	8.6	7.4	2.4	6.4
Real GDP growth, at constant factor prices	0.9	12.7	6.2	4.2	3.1	3.9
Agriculture	5.8	-3.0	1.3	0.4	1.5	1.6
Industry	0.8	13.0	-0.6	5.5	3.5	4.9
Services	1.1	13.2	10.1	3.5	3.1	3.6
Inflation (consumer price index)	12.3	19.6	72.3	53.4	57.2	27.5
Current account balance (% of GDP)	-4.4	-0.9	-5.3	-5.0	-3.3	-2.6
Net foreign direct investment inflow (% of GDP)	0.6	0.8	0.9	1.1	1.3	1.4
Fiscal balance (% of GDP)	-3.9	-2.6	-2.9	-5.3	-5.3	-3.8
Revenues (% of GDP)	32.4	30.9	26.4	26.9	27.8	27.5
Debt (% of GDP)	39.6	41.8	31.7	33.0	34.4	34.7
Primary balance (% of GDP)	-1.1	0.0	-0.6	-2.2	-1.7	0.0
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	12.6	12.8	12.8	12.9	12.9	13.0
GHG emissions growth (mtCO2e)	1.5	9.7	2.5	1.4	2.1	2.6
Energy related GHG emissions (% of total)	77.9	78.7	78.8	78.2	77.7	77.6

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 2014-HICES and 2019-HICES. Actual data: 2019. Nowcast: 2020-2022. Forecasts are from 2023 to 2025.
b/ Projection using annualized elasticity (2014-2019) with pass-through = 0.85 based on GDP per capita in constant LCU.

UKRAINE

Table 1	2022
Population, million	43.5
GDP, current US$ billion	155.4
GDP per capita, current US$	3568.5
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]	69.6
Total GHG emissions (mtCO2e)	153.4

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ WDI for School enrollment (2014); Life expectancy (2021).

Despite Russia's invasion, Ukraine's economy is showing signs of a modest recovery, aided by more reliable electricity supply, and underpinned by the steady receipt of external assistance that has upheld public demand. GDP is now expected to grow by 3.5 percent in 2023. Poverty is projected to remain elevated. Economic risks are rising, and Ukraine will continue to depend on assistance from its international partners in the medium term.

Key conditions and challenges

After contracting by 29.1 percent in 2022 Ukraine's economy has benefited from improved electricity supply, a localization of active fighting, and more reliable receipt of external assistance in H1 2023, which has allowed for a growth resumption. A low-base uptick of economic activity notwithstanding, Ukraine's economy remains fundamentally altered and operates as a war economy in which private demand is suppressed by contractionary monetary policy to finance, together with external assistance, a significant government deficit.

Ukraine's economy is in a fragile equilibrium in which policy must manage a triple imbalance. On the real side, high government expenditure generates substantial demand, which can only be met through the concurrent compression of private demand and the receipt of imports. This generates an external and fiscal imbalance, which, with the private sector suppressed, requires external resources to be financed. To date, Ukraine has managed these imbalances through assistance from its international partners, but pressure points are rising. For one, the discontinuation of the Black Sea Grain Initiative, unilaterally announced by Russia in July 2023, exerts downward pressure on Ukraine's main remaining exports. In addition, the reliance on external loans has generated a large external debt burden held by preferred creditors, which increases Ukraine's dependence on forex resources to meet debt service payments and complicates future debt treatment efforts. A reliance on deficit monetization in 2022 has increased the money supply and liquid savings in the banking sector, which poses inflation risks when efforts to compress demand end.

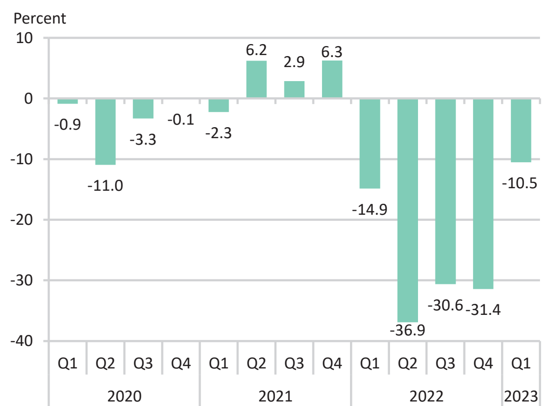
While Ukraine has continued to take reform steps during Russia's invasion, addressing institutional and structural constraints related to the rule of law, labor supply and competition will be critical to facilitate a sustainable recovery, as are reform efforts to accelerate Ukraine's EU accession. Ensuring continued delivery of key social services is important for livelihoods, especially among the poor and vulnerable already affected by the war.

Recent developments

Ukraine's GDP has started to recover, with growth turning positive in Q2 2023 for the first time since Russia's invasion. This was aided by public consumption and a modest supply recovery in sectors related to supporting the war economy and those benefiting from improved electricity supply.

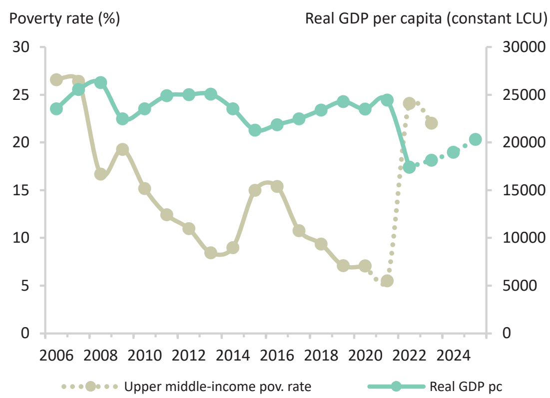
Inflation has also moderated, declining to 8.6 percent year-on-year at the end of August, led by food and transport prices, with restrictive monetary policy contributing to the decline. An increase of electricity tariffs from June has exerted upward pressure. Food and energy inflation especially hurt poor families because they spend a

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



Source: Ukraine Statistics Office.

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



Source: World Bank. Notes: see Table 2.

larger budget share on these. Banks have remained profitable and stable, but risks are prevalent.

Ukraine's current account has turned into a USD 1.3 billion deficit in H1 2023, driven by high import growth and a further contraction in exports. The financial account has also turned negative as government liabilities more than doubled and new trade credits – an earlier source of outflows– disappeared. Reserves were aided by front-loaded external assistance and reached USD 40.4 billion by September 1.

Public expenditure grew by 67 percent year-on-year in H1 2023, whereas tax revenue increased by only 25 percent, due in large parts to continued subdued economic activity. Revenue was aided by receipts from non-budgetary institutions. Ukraine met its financing needs through domestic bank borrowing and external assistance but has not resorted to monetization in 2023.

Loss of private sector jobs and income, high inflation, and assets loss brought on by the war have reversed 15 years of poverty reduction. Based on the global line of US$6.85 a day (2017PPP), poverty is estimated to have increased from 5.5 percent to 24.1 percent in 2022, pushing 7.1 million more people into poverty. 6 million people are still displaced to neighboring countries, and another 5 million are displaced internally.

Outlook

Ukraine's economic outlook remains conditional on the assumed duration of Russia's invasion. Under an indicative scenario in which active hostilities continue until mid-2024, GDP is expected to expand by 3.5 percent in 2023 and 4 percent in 2024. Starting in late 2024, Ukraine's economy is expected to recover more rapidly under the baseline assumption, driven by public investment, as reconstruction and export activity pick up. Private consumption growth is projected to remain modest due to contractionary monetary policy needed to reign in post-war inflation. Inflation is projected to decline gradually to 7 percent by 2025. Many households continue to face difficult financial situations, and poverty is projected to remain elevated at 22 percent in 2023. This scenario is subject to significant downside risks related to a deterioration of the security situation and overall macroeconomic risks are exceptionally high.

The current account is expected to register a 3.8 percent of GDP deficit in 2023 which is projected to widen to 4.8 percent by 2025 under the baseline assumption, as imports increase during the reconstruction period whereas exports remain subdued. In the medium term, reserves are expected to continue benefiting from external assistance inflows and are projected to remain adequate by 2025.

The fiscal deficit is expected to remain high during the wartime before declining to 11.5 percent of GDP by 2025. Public and publicly guaranteed debt is projected to stabilize around 100 percent of GDP in the medium term.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-3.8	3.4	-29.1	3.5	4.0	6.5
Private consumption	1.7	6.9	-26.7	5.0	6.0	7.0
Government consumption	-0.7	0.8	18.0	5.0	-4.0	-6.5
Gross fixed capital investment	-21.0	9.1	-35.3	9.3	14.0	21.2
Exports, goods and services	-5.8	-8.6	-42.4	-10.0	15.0	30.0
Imports, goods and services	-6.4	14.2	-18.5	3.0	10.0	15.0
Real GDP growth, at constant factor prices	-3.8	3.5	-29.1	3.5	4.0	6.5
Agriculture	-11.5	14.4	-25.0	-15.0	-5.0	3.3
Industry	-4.5	1.1	-60.0	3.0	4.5	5.0
Services	-2.2	2.4	-20.3	6.8	5.2	7.1
Inflation (consumer price index)	5.0	10.0	26.6	11.0	10.0	7.0
Current account balance (% of GDP)	3.5	-1.9	4.9	-3.8	-4.5	-4.8
Net foreign direct investment inflow (% of GDP)	0.0	2.4	0.4	0.4	0.4	1.9
Fiscal Balance (% of GDP)[a]	-6.1	-4.0	-25.0	-27.6	-21.5	-11.5
Revenues (% of GDP)	41.0	36.3	41.0	38.6	39.0	39.9
Debt (% of GDP)	60.4	49.0	78.5	93.5	100.8	100.3
Primary Balance (% of GDP)[a]	-3.1	-0.4	-22.0	-23.4	-16.0	-7.9
Upper middle-income poverty rate ($6.85 in 2017 PPP)[b,c]	7.1	5.5	24.1	22.0	..	..
GHG emissions growth (mtCO2e)	-3.8	1.7	-29.1	-5.7	-7.7	-5.1
Energy related GHG emissions (% of total)	77.8	78.1	74.3	75.5	75.1	74.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ 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 = 0.7 (Low (0.7)) 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. Forecasts are from 2023 to 2025.

UZBEKISTAN

Table 1	2022
Population, million	35.6
GDP, current US$ billion	80.4
GDP per capita, current US$	2255.6
School enrollment, primary (% gross)[a]	98.1
Life expectancy at birth, years[a]	70.9
Total GHG emissions (mtCO2e)	174.3

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

The economy is expected to grow by 5.5 percent in 2023. Fiscal consolidation is expected to continue gradually in the medium term, given the need to cushion the impact of external shocks and to restructure energy prices by bringing them to cost-recovery levels. The medium-term outlook remains positive as ambitious ongoing reforms are expected to stimulate private sector-led growth and job creation.

Key conditions and challenges

Uzbekistan has implemented an ambitious set of reforms in recent years. However, the Government recognizes that persistently stimulating private sector-led growth and job creation requires more reform: specifically, opening key sectors of the economy to competition, including factor markets and key services, and reducing the market dominance of SOEs. Further strengthening the regulatory environment and reducing high trade and transit costs would also encourage private sector growth.

In order to spur the transition towards low-carbon growth and renewable energy, the Government plans to strengthen energy sector regulation, gradually remove large and untargeted energy subsidies, and accelerate policy action on climate change.

Recent developments

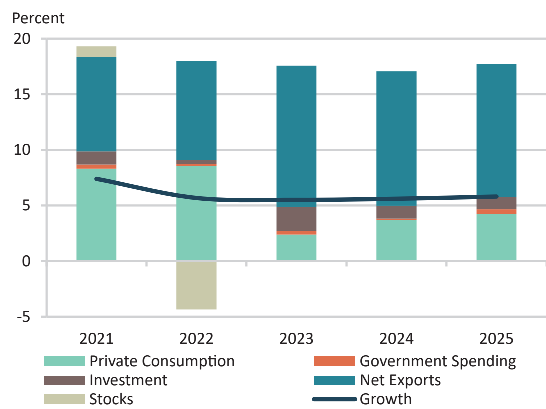
Real GDP grew by 5.6 percent in H1 2023, led by exports, remittances, and consumption. Total exports and non-gold exports increased by 16 percent and 12.5 percent, respectively, in H1 2023 (in USD value, led by fruit and vegetables, cars, and ferrous metals), while exports of gas, textiles, and chemicals decreased. Exports to Russia grew by 5.5 percent, compared to 44 percent in 2022. Services exports, mainly in transport and tourism, increased by 16 percent due to higher tourist arrivals (93 percent from Tajikistan, Kazakhstan, Kyrgyz Republic, and Russia). In response to higher domestic demand, imports expanded by 17 percent in H1 in machinery, equipment, fuels, and intermediary industrial goods. The trade deficit of 18.4 percent of GDP was partly offset by net remittance inflows of 12.1 percent of GDP in H1 2023 compared to 16.7 percent of GDP in H1 2022 (but still above the historical average of 8 percent of GDP). Thus, the current account deficit widened to 6.3 percent of GDP in H1, up from 1.4 percent of GDP in H1 2022. On the supply-side, higher growth in agriculture (3.8 percent) and industry (5.6 percent) was offset by slower growth in construction (4.8 percent) and services (6.4 percent).

Between January and August 2023, the UZS depreciated by 6.9 percent against the USD, in part due to the flow-on impact of the depreciation of the RUB.

By the end of June 2023, international reserves decreased by USD 2 billion to reach USD 33.7 billion, or 9 months of import cover. This was due to the depreciation of both the UZS and RUB, leading to lower inflows of foreign currency from trade and remittances, given Russia's position as a major trading partner and Uzbek migrant destination.

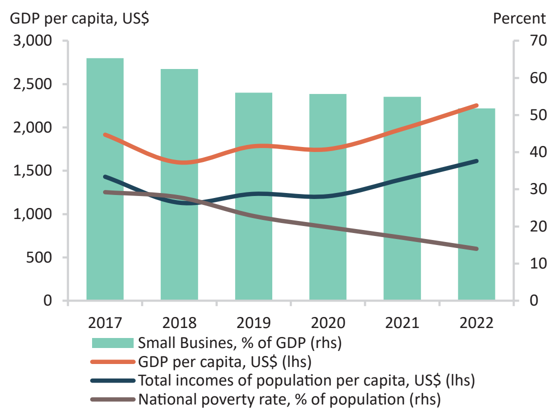
The fiscal deficit widened to 5.7 percent in H1 2023 from 4.1 percent of GDP in H1 2022 due to increased spending (e.g., emergency energy spending in the early 2023

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



Sources: Uzbekistan official statistics and World Bank staff calculations.

FIGURE 2 Uzbekistan / Poverty, GDP per capita, and small business development



Source: Uzbekistan official statistics.
Note: The national poverty line is more ambitious (67 percent higher) than the lower-middle-income country poverty line.

energy crisis) and lower than expected revenues from excise duties.
Lower global commodity prices drove CPI inflation to 9 percent in July 2023, down from 10.7 percent in July 2022.
The Central Bank of Uzbekistan (CBU) began monetary easing by cutting the policy rate by 100 bsp to 14 percent in March 2023, down from 17 percent in March 2022.
Credit growth slowed to 18 percent in June 2023, down from 36 percent in 2022, as capital buffers declined, and banks enacted more cautious lending policies following Russia's invasion of Ukraine. However, the banking sector remained resilient and adequately capitalized, with a CAR of 16.4 percent in June 2023, higher than the required 13 percent. NPLs declined to 3.3 percent in June 2023, down from 4.8 percent in June 2022. The poverty rate fell to 14 percent in 2022, down from 17 percent in 2021 (using the national poverty line), primarily due to higher remittance inflows, although the expected H2 2023 drop in remittances may stall this progress.

Outlook

Growth is expected to remain close to 5.5 percent in 2023 and accelerate gradually in the medium term. Consumption growth in 2023 is expected to fall as the remittances from Russia continue to decrease. Import growth is expected to accelerate in 2023 and grow fast in the medium-term to support Uzbekistan's economic modernization, and with decreasing remittances, the current account deficit will widen. The fiscal deficit is expected to widen to 5 percent of GDP in 2023 as a result of persistently high energy tariffs, higher expenditure on education, public sector wages, pension and allowances, and lower revenue collections.
Budget consolidation is expected to begin in the medium term, with the budget deficit falling to 4 percent of GDP in 2024 and 3.6 percent in 2025 due to reduced tax benefits and energy subsidies, and increased privatization proceeds. The Government is expected to adhere to its debt limits, with public debt increasing to 36 percent of GDP in 2023 and peaking at 36.6 percent in 2024.
Despite expanded social protection programs, slower growth in remittances and private consumption could limit expected progress in poverty reduction. The national poverty rate is projected to fall marginally to 13.9 percent in 2023.
Downside risks to this outlook include a deterioration in Russia's economic performance, higher external inflationary pressures, and tighter-than-expected global financial conditions. Upside risks include higher global gold, natural gas, and copper prices and stronger productivity growth due to ongoing structural reforms.

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

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	2.0	7.4	5.7	5.5	5.6	5.8
Private consumption	0.2	11.6	11.4	3.0	4.8	5.5
Government consumption	1.4	3.1	1.3	3.0	1.0	4.0
Gross fixed capital investment	-4.4	2.9	0.9	2.5	3.0	3.2
Exports, goods and services	-20.0	13.3	27.9	28.1	20.1	16.6
Imports, goods and services	-15.0	19.9	10.1	19.2	17.8	16.5
Real GDP growth, at constant factor prices	2.0	7.4	5.7	5.5	5.6	5.8
Agriculture	2.9	4.0	3.6	3.5	3.7	3.9
Industry	2.5	7.9	5.5	5.7	5.6	6.5
Services	1.2	9.1	7.0	6.4	6.6	6.4
Inflation (consumer price index)	12.9	10.8	11.4	10.2	10.0	9.9
Current account balance (% of GDP)	-5.0	-7.0	-0.8	-4.1	-4.5	-4.6
Net foreign direct investment inflow (% of GDP)	2.9	3.3	3.1	3.0	3.0	3.0
Fiscal balance (% of GDP)	-4.4	-6.0	-4.1	-5.0	-4.0	-3.6
Revenues (% of GDP)	25.5	25.9	30.9	29.7	29.6	29.5
Debt (% of GDP)	37.4	36.6	34.9	36.0	36.6	34.6
Primary balance (% of GDP)	-4.1	-5.7	-3.7	-4.4	-3.4	-3.0
GHG emissions growth (mtCO2e)	-1.8	-1.1	-3.2	-2.5	-2.3	-2.5
Energy related GHG emissions (% of total)	60.1	59.4	58.1	56.9	55.8	54.5

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** Fall 2023

Sluggish Growth, Rising Risks

Europe and Central Asia continues to be negatively impacted by the Russian Federation's invasion of Ukraine, tighter global financial conditions, persistent inflation, and global economic fragmentation. Economic growth in the region is projected to remain weak relative to the long-term trend, delaying the convergence of living standards to those of high-income countries. The impacts of climate change are becoming a serious constraint on growth, as extreme weather events are affecting the region with increased frequency and severity.

Economic growth for the emerging market and developing economies of the Europe and Central Asia region has been revised up to 2.4 percent for 2023. The pickup in growth reflects improved forecasts for Ukraine, Central Asia, Türkiye, and Russia. Downside risks cloud the outlook. High inflation may persist amid heightened volatility in global commodity markets and a surge in energy prices. Global financial conditions may tighten further. And global growth, already the weakest on record for any five-year period since 1990, may slow further.

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