REGIONAL ECONOMIC PROSPECTS

European Bank
for Reconstruction and Development

MAY
2023

GETTING BY

High inflation weighs on purchasing power of households

Regional Economic Prospects in the EBRD Regions

Getting by

High inflation weighs on purchasing power of households

May 2023

Growth in the EBRD regions slowed to 3.3 per cent in 2022 from 7.2 per cent in 2021, as the war on Ukraine took its toll and the post-Covid recovery mostly ran out of steam. However, outcomes were better than previously expected.

Output in the EBRD regions is expected to grow by 2.2 per cent in 2023, a 0.1 percentage point downward revision relative to the forecasts published in February. Projected growth has been revised down in Turkiye reflecting the economic effects of the February 2023 earthquakes as well as the expected tightening of credit conditions later in the year, in the southern and eastern Mediterranean where reforms have been delayed and in central Europe and the Baltic States on subdued growth in advanced economies, persistent inflation and tighter financing conditions.

Growth is expected to pick up to 3.4 per cent in 2024 (0.1 percentage point up relative to the February forecast) as inflationary pressures gradually subside.

The price of gas in Europe increased sharply in 2022 as supplies of pipeline gas from Russia to Europe fell, but has eased from its recent peak to pre-war levels as of mid-April 2023. Nonetheless, gas prices in Europe still exceed the US price by a factor of six and markets expect some of this differential to persist, with a further pick-up in prices in the coming winter. As prices of energy and food rose, inflation in the EBRD regions peaked in October 2022 at 17.5 per cent. As private savings accumulated during the Covid-19 lockdowns were actively spent in Emerging Europe, consumption growth in the first half of 2022 held up despite falling real wages. This resulted in a sharp widening of current account deficits in central Europe (current account representing the difference between domestic savings and investment). However, by September 2022 this deficit had narrowed as Covid savings largely ran out. Against this background, the EBRD regions experienced two consecutive quarters of negative quarter-on-quarter growth in the second half of 2022 (the definition of a technical recession). It was the fourth such occurrence since the mid-1990s (following the Asian and Russian economic crises of 1997-98, the global financial crisis of 2008-09 and the Covid-19 crisis).

As energy prices have moderated, inflation started coming down, averaging 14.3 per cent in the EBRD regions in March 2023. In most economies in the EBRD regions, inflation (year-on-year) was lower in March than in February. In Egypt and Turkiye, recent depreciations have added to inflationary pressures. Most central banks in the EBRD regions tightened policy rates in response to inflationary pressures. Some monetary authorities, including in Moldova, Tajikistan and Turkiye, started reducing policy rates as inflation peaked and the growth outlook weakened.

Financing conditions have tightened, and the median sovereign bond yield in the EBRD regions increased by 3.8 percentage points between February 2022 and April 2023 (of which 1.4 percentage point on account of higher spreads relative to US or German benchmarks). Against this background, fiscal and external vulnerabilities have increased and are particularly pronounced in Egypt and Tunisia.

At the same time, banking liquidity jitters following the collapse of Silicon Valley Bank on 10 March 2023 and the merger of Credit Suisse and UBS have had a limited impact on the EBRD regions. While non-performing loan ratios in the region continued to decline, bankruptcies started picking up at the end of 2022, albeit from historically low levels.

Repeated crises—reflected in two recessions in quick succession—have weighed on the financial situation of households. Preliminary results from the new round of the Life in Transition Survey, a representative household survey conducted by the EBRD in partnership with the World Bank across the EBRD regions, suggest that 55 per cent of households in the EBRD regions cannot save, living from paycheck to paycheck; 10 per cent of respondents report running up debts. Most households have very limited buffers –much lower than those found in Germany. 59 per cent of households in the EBRD regions report being unable to cover their basic expenses for more than a month out of savings. The survey started in October 2022 and is expected to be finalized across all economies later in 2023.

*Growth in **Central Asia** is forecast to remain strong at 5.2 per cent in 2023 (revised up since February) and 5.4 per cent in 2024. Projections reflect strong growth outcomes in year-on-year terms in the first quarter of 2023 and robust real wage growth in year-on-year terms. Relocation of Russian businesses and increased oil exports are providing a boost to growth in Kazakhstan while Mongolia is benefitting from expanded mining production and the reopening of China.*

*Output in **central Europe and the Baltic states** is expected to grow by a modest 0.5 per cent in 2023, revised down relative to February on slower-than-expected growth in advanced economies and persistent (in particular core) inflation. While the region proved resilient in 2022, the post-Covid recovery has largely run out of steam and growth has recently turned negative in quarter-on-quarter terms. Growth is expected to pick up to 2.9 per cent in 2024.*

*Growth is also expected to decelerate in the **Caucasus** as the extraordinary factors that boosted economic activity in 2022 provide limited additional stimulus. The region is forecast to grow by 3.5 per cent in 2023 and 3.7 per cent in 2024. The **Ukrainian** economy is expected to grow only modestly as businesses adapt to war circumstances.*

*Growth forecasts for 2023 have been revised up for the **south-eastern EU** economies, supported by the prospect of Eurozone accession boosting investor confidence in Bulgaria, higher public investment in Romania and the carry over effect of stronger outturns in Greece in the last quarters of 2022. The region is expected to grow by 2.3 per cent in 2023 and 3 per cent in 2024.*

*Output in the **southern and eastern Mediterranean** is expected to grow by 3.6 per cent in 2023 and 4.4 per cent in 2024. Downward revisions for 2023 reflect delays in reforms, spillovers from weak growth in advanced Europe and increased fiscal and external vulnerabilities in Egypt.*

*Growth is **Turkiye** is expected to slow to 2.5 per cent in 2023 and 3 per cent in 2024. The downward revision for 2023 reflects the impact of the February 2023 earthquakes (not reflected in the previous forecast) as well as expected credit tightening in the second half of 2023.*

*Output in the **Western Balkans** is forecast to expand at the rate of 2.2 per cent in 2023 amidst headwinds from inflationary pressures and a subdued outlook for advanced economies in Europe, before picking up to 3.4 per cent in 2024. With the exception of an upward revision for Kosovo in 2023 the forecasts are unchanged relative to February.*

Table 1. GDP growth in real terms

	Actual			Forecast (May'23)		Revision since Feb'23	
	2020	2021	2022	2023	2024	2023	2024
EBRD Regions	**-2.2**	**7.2**	**3.3**	**2.2**	**3.4**	**-0.1**	**0.1**
Central Asia	**-0.3**	**5.1**	**4.5**	**5.2**	**5.4**	**0.2**	**0.0**
Kazakhstan	-2.6	4.1	3.2	3.9	4.2	0.4	0.2
Kyrgyz Republic	-8.6	3.7	7.0	7.0	7.2	0.0	0.0
Mongolia	-5.3	1.6	4.8	7.2	7.5	0.2	0.0
Tajikistan	4.5	9.2	8.0	7.5	7.5	-0.5	-0.5
Turkmenistan	5.9	6.2	6.2	6.5	7.0	0.0	0.0
Uzbekistan	1.6	7.4	5.7	6.5	6.5	0.0	-0.5
Central Europe and the Baltic states	**-3.3**	**6.3**	**4.0**	**0.5**	**2.9**	**-0.1**	**0.2**
Croatia	-8.6	13.1	6.3	1.5	2.3	0.0	0.0
Czech Republic	-5.5	3.6	2.5	-0.1	2.9	-0.3	0.7
Estonia	-0.6	8.0	-1.3	-1.3	2.8	-1.5	0.3
Hungary	-4.5	7.2	4.6	0.4	3.5	0.6	1.0
Latvia	-2.3	4.3	2.8	0.0	2.5	0.2	0.5
Lithuania	0.0	6.0	1.9	0.0	2.0	0.0	0.3
Poland	-2.0	6.9	5.1	0.6	3.0	-0.4	0.0
Slovak Republic	-3.4	3.0	1.7	1.4	3.0	0.9	-0.4
Slovenia	-4.3	8.2	5.4	1.5	2.3	0.5	0.0
Eastern Europe and the Caucasus	**-4.7**	**5.3**	**-13.0**	**1.9**	**3.3**	**0.1**	**0.0**
Armenia	-7.5	5.8	14.2	5.0	5.0	1.0	0.2
Azerbaijan	-4.2	5.6	4.6	2.5	2.7	0.0	0.0
Georgia	-6.8	10.5	10.1	5.0	5.3	0.0	0.0
Moldova	-8.3	13.9	-5.9	-1.3	3.5	0.0	0.0
Ukraine	-3.8	3.4	-29.1	1.0	3.0	0.0	0.0
South Eastern EU	**-5.6**	**7.0**	**4.9**	**2.3**	**3.0**	**0.8**	**-0.1**
Bulgaria	-4.0	7.6	3.4	1.3	2.9	0.3	0.3
Greece	-9.0	8.4	5.9	2.4	2.3	0.9	-0.7
Romania	-3.7	5.8	4.7	2.5	3.5	0.8	0.2
Southern and Eastern Mediterranean	**-2.0**	**6.2**	**3.1**	**3.6**	**4.4**	**-0.4**	**0.1**
Egypt	1.4	7.2	4.2	4.2	5.2	-0.4	0.2
Jordan	-1.6	2.2	2.5	2.5	2.5	-0.2	0.0
Lebanon	-25.9	-10.0	-4.0	1.0	3.0	-1.0	0.0
Morocco	-7.2	7.9	1.1	3.1	3.2	-0.2	0.0
Tunisia	-8.6	4.3	2.4	2.0	2.3	-0.5	-0.4
Turkiye	**1.8**	**11.4**	**5.6**	**2.5**	**3.0**	**-0.5**	**0.0**
Western Balkans	**-2.9**	**7.8**	**3.1**	**2.2**	**3.4**	**0.0**	**0.0**
Albania	-3.3	8.9	4.8	2.5	3.3	0.0	0.0
Bosnia and Herzegovina	-3.1	7.5	3.9	2.0	3.0	0.0	0.0
Kosovo	-5.3	10.7	3.5	3.5	4.0	0.5	0.0
Montenegro	-15.3	13.0	6.1	3.3	3.7	0.0	0.0
North Macedonia	-4.7	3.9	2.1	2.0	3.0	0.0	0.0
Serbia	-0.9	7.5	2.3	2.0	3.5	0.0	0.0
Memo: Egypt (fiscal year to June)	3.6	3.3	6.6	4.0	4.8	-0.7	-0.2
Caucasus	-5.3	6.7	7.4	3.5	3.7	0.2	0.0
Belarus	-0.7	2.4	-4.7	-1.0	1.3	0.0	0.0
Russia	-3.0	4.7	-2.1	-1.5	1.0	1.5	0.0

Source: National authorities and EBRD. Notes: Weights are based on the values of gross domestic product in 2022 at market exchange rates. 2022 estimates from national authorities and Refinitiv Eikon/Oxford Economics.

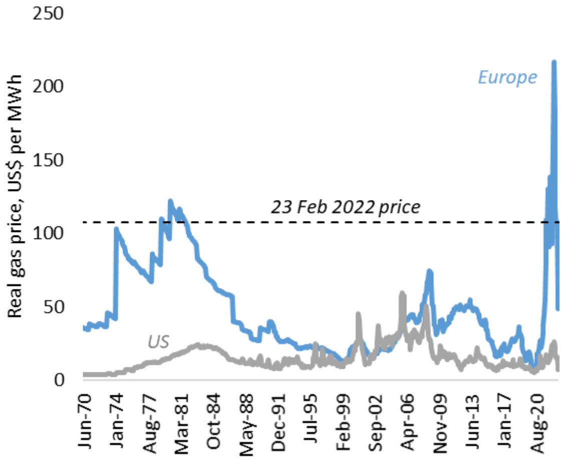
Output in the EBRD regions increased by 3.3 per cent in 2022

Output in the EBRD regions contracted by 2.2 per cent in 2020, rebounding to 7.2 per cent growth in 2021 (see Table 1). Growth then slowed to 3.3 per cent in 2022 as the war on Ukraine took its toll and the post-Covid recovery ran out of steam.[1] However, outcomes were better than previously expected.

Gas prices have eased, but markets expect them to pick up over the next winter season

The price of gas increased sharply in 2022 as supplies of pipeline gas from Russia to Europe fell by more than 70 per cent year-on-year in the second half of the year. However, commodity prices have eased from their recent peaks to pre-war levels (see Chart 1).

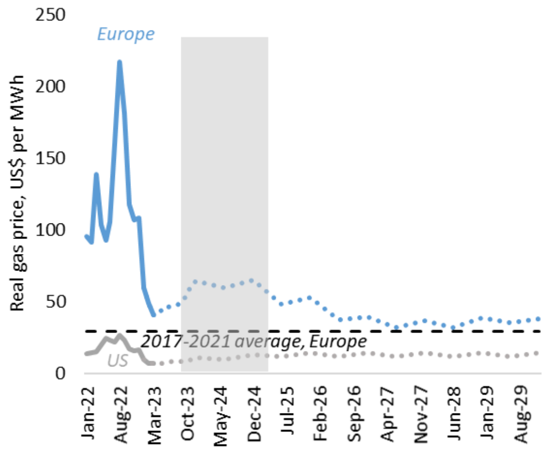
Chart 1. Gas prices in Europe have eased from their recent peaks



Source: IMF, World Bank via CEIC and authors' calculations.
Note: Prices adjusted for US inflation.

Those levels still exceed the US price of gas by a factor of six. Markets expect prices to remain above their 2017-21 average level, with a further pick-up in the coming winter heating season when demand for gas rises (see Chart 2).

Chart 2. Gas prices in Europe are expected to pick-up again in the coming winter



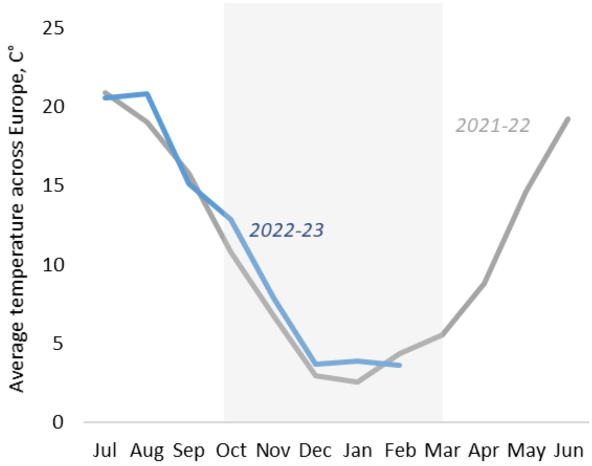
Source: IMF, World Bank via CEIC and authors' calculations.
Note: Prices adjusted for US inflation. Dashed lines denote futures.

The winter of 2022-23 was exceptionally warm on average (see Chart 3). Average temperatures in Europe in the October to March heating season were consistently above corresponding levels in previous years. This reduced demand for heating and helped to maintain gas in storage in Europe well above the corresponding 2021 levels (see Chart 4). In addition, household and industry consumption of gas responded to higher prices.

The Brent oil price has stabilised above US$ 80 per barrel as members of OPEC+, which groups the Organization of the Petroleum Exporting Countries with selected other producers, agreed in early April 2023 on further production cuts.

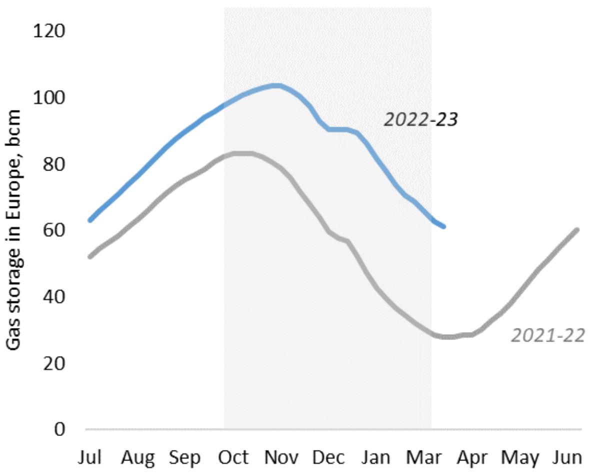
[1] Growth averages and projections have been recalculated using 2022 values of GDP at market exchange rates. The February 2023 *Regional Economic Prospects* used weights based on GDP values for earlier years.

Chart 3. The 2022-23 winter was relatively mild in Europe



Source: Meteostat and authors' calculations.
Note: Temperatures are calculated by taking monthly average temperatures across all weather stations in Europe.

Chart 4. Gas in storage in Europe is above corresponding 2021-22 levels

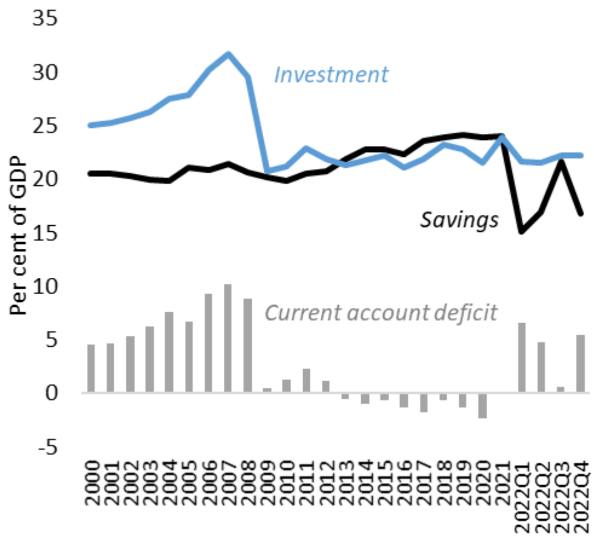


Source: CEIC, Refinitiv Eikon and authors' calculations.

Covid-19 savings have been largely run down

As private savings accumulated during the Covid-19 lockdowns were actively spent in Emerging Europe, consumption growth in the first half of 2022 held up despite falling real wages. This resulted in a sharp widening of current account deficits in central Europe (the current account representing the difference between domestic savings and investment). Once Covid-19 savings were largely used up, current account deficits narrowed in the second half of 2022 (see Chart 5). At the same time, early estimates point to relatively low levels of savings in the fourth quarter of the year reflecting high energy prices.

Chart 5. As Covid-19 savings have been run down, current account deficits narrowed



Source: Eurostat, IMF and authors' calculations.
Note: Simple averages across Croatia, the Czech Republic, Estonia, Greece, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia.

A technical recession in the second half of 2022

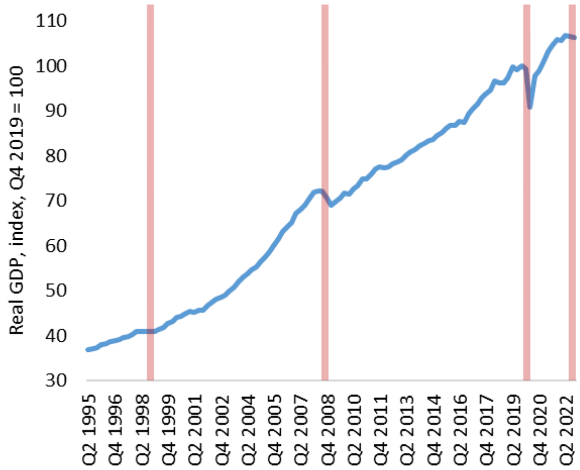
Against this background, the EBRD regions experienced two consecutive quarters of negative quarter-on-quarter growth (the definition of a technical recession) in the second half of 2022. Since quarter-on-quarter growth was strong at the end of 2021 and at the start of 2022, on the back of post-Covid rebound, the annual reading for 2022 came nonetheless firmly positive.[2]

It was the fourth recession occurrence in the quarterly data since the mid-1990s following the Asian and Russian economic crises in 1998; the global financial crisis in 2008 and the Covid-19 crisis in 2020, see Chart 6). The interval between

[2] Annual growth corresponds to the sum of values of quarterly GDP of 2022 divided by the corresponding sum in 2021. Strong quarter-on-quarter growth in the first quarter of the year affects GDP *levels* in all subsequent quarters, while weak quarter-on-quarter growth in the last quarter of the year affects GDP *levels* in all quarters of next year.

the last two recessions, in 2020 and in 2022, was much shorter than on previous occasions. A caveat is in order: these calculations are based on early estimates of quarterly GDP in constant prices and the data underpinning these calculations is subject to major revisions.

Chart 6. Two consecutive quarters of negative quarter-on-quarter growth at the end of 2022 mark the fourth recession in the EBRD regions since the mid-1990s

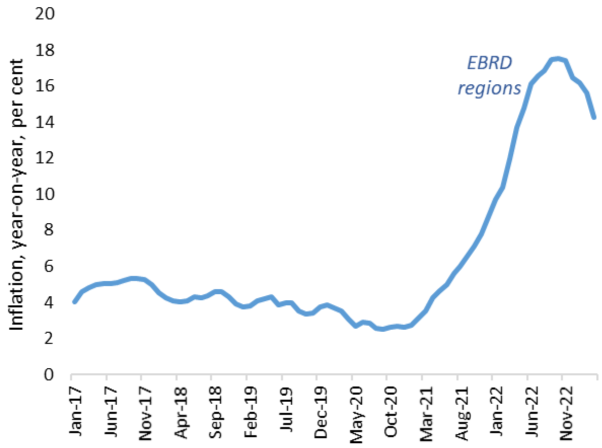


Source: Refinitiv Eikon, national sources, Oxford Economics and authors' calculations.
Note: Based on a panel of 33 economies in the EBRD regions before 2003 and 35 economies in the EBRD regions after 2003. Technical recessions (highlighted) are defined as two consecutive quarters of negative quarter-on-quarter growth.

Inflation remains high

Inflation in the EBRD regions peaked in October 2022 at 17.5 per cent, but has started coming down since, averaging 14.3 per cent in March 2023 (see Chart 7).

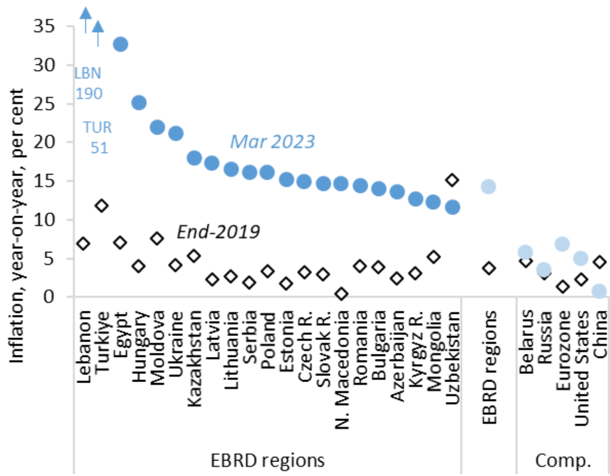
Chart 7. Inflation started coming down



Source: Bloomberg, national authorities via CEIC and authors' calculations.
Note: EBRD regions refers to a simple average across 33 economies, excludes Lebanon.

However, inflation was still in double digits in over three-quarters of economies in the EBRD regions in March 2023, reaching 190 per cent in Lebanon and 51 per cent in Turkiye (see Chart 8).

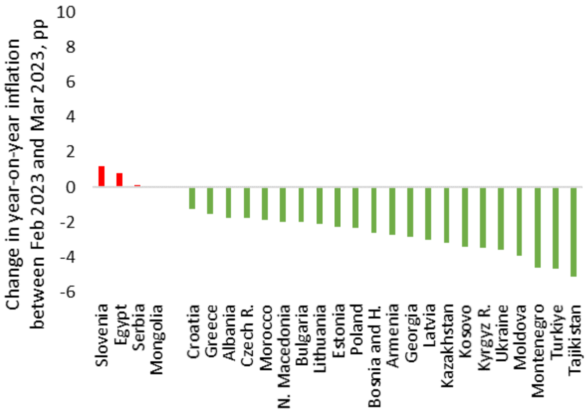
Chart 8. Inflation in double digits in over three-quarters of economies in the EBRD regions



Source: National authorities via CEIC and authors' calculations.
Note: EBRD regions refers to a simple average across 33 economies, excludes Lebanon. Select economies in the EBRD regions with high inflation shown.

In most economies in the EBRD regions, inflation (year-on-year) was lower in March than in February (see Chart 9).

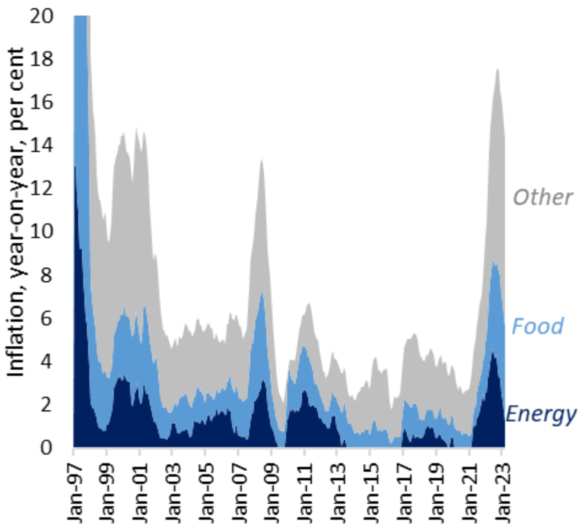
Chart 9. In most economies in the EBRD regions inflation declined between February and March 2023



Source: Bloomberg, national authorities via CEIC and authors' calculations.
Note: Economies with a positive change or a negative change of at least 1 percentage point shown.

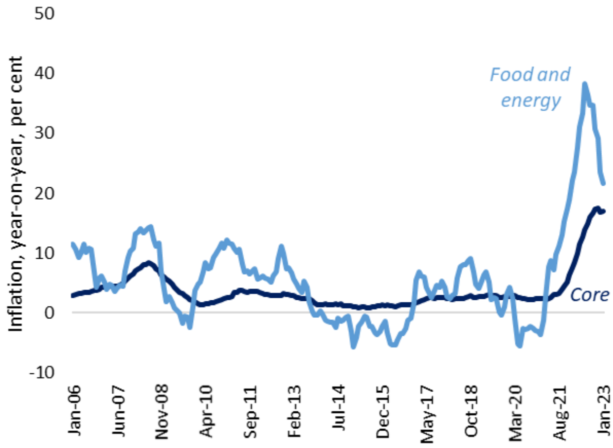
As food and energy price inflation started coming down (see Chart 10), core inflation (excluding food and energy) picked up (see Chart 11) reflecting broader wage pressures, including in the services sector where inflation has been on the rise even as goods price increases started to moderate (see Chart 12).

Chart 10. Food and energy price inflation started coming down



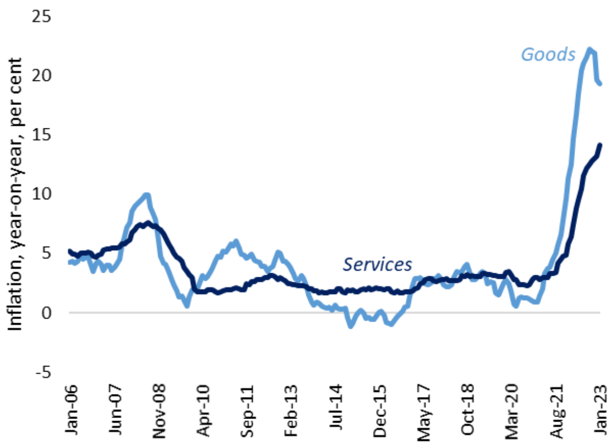
Source: Bloomberg, national authorities via CEIC and authors' calculations.
Note: Headline inflation is a simple average across 33 economies in the EBRD regions. The decomposition is based on an unbalanced panel ranging from 5 economies in 1997 to 11 economies from 2001. The decomposition is scaled to overall inflation in the EBRD regions.

Chart 11. Core inflation picked up



Source: Eurostat and authors' calculations.
Notes: Based on unbalanced samples of up to 14 economies. Year-on-year changes.

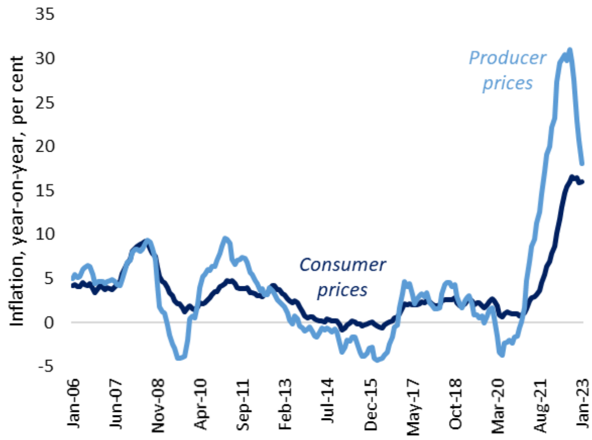
Chart 12. Service price inflation remains high



Source: Eurostat and authors' calculations.
Note: Based on unbalanced samples of up to 14 economies.

Large increases in producer prices (peaking above 30 per cent in September 2022) reflected the rising cost of energy, rising wages and, to a lesser extent, rising prices of imported intermediate goods. As energy prices moderated producer price inflation came down and was broadly in line with consumer price increases by March 2023 (see Chart 13).

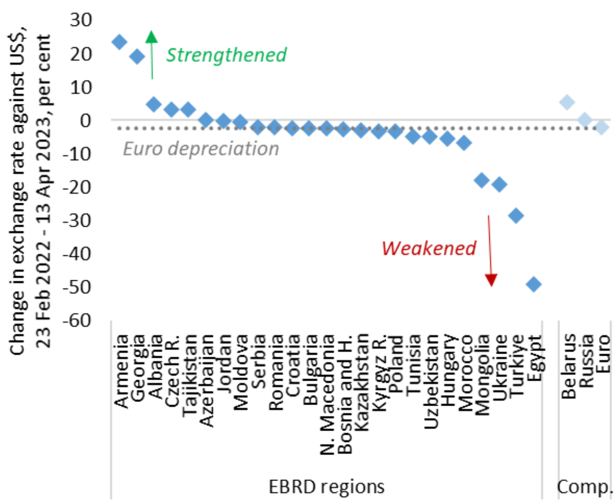
Chart 13. Producer price inflation peaked above 30 per cent on high energy prices



Source: Eurostat and authors' calculations.
Note: Based on an unbalanced sample of 13 economies.

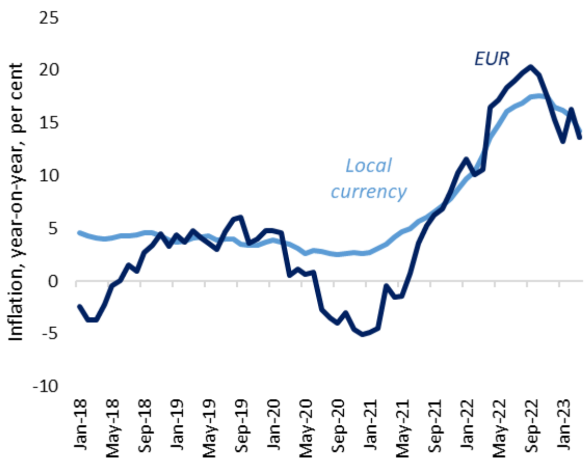
In Egypt and Turkiye, currency depreciations have added to inflationary pressures (see Chart 14). In most economies in the EBRD regions depreciations are not a major contributor to inflation: inflation expressed in euros averages around 14 per cent in March 2023 (see Chart 15).

Chart 14. In Egypt and Turkiye depreciations have added to inflationary pressures



Source: National authorities via CEIC and authors' calculations.

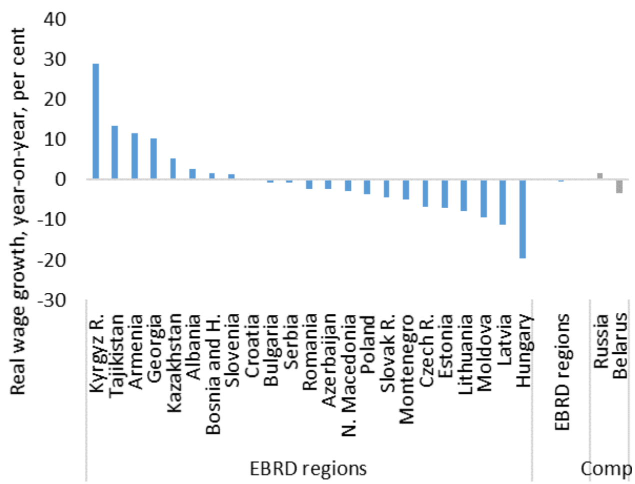
Chart 15. In most economies in the EBRD regions depreciations are not a major contributor to inflation



Source: Eurostat and authors' calculations.
Note: Based on an unbalanced sample of up to 33 economies.

While wage growth has been high in nominal terms, in most economies in the EBRD regions it has lagged behind inflation. The resulting declines in the purchasing power of wage income have been particularly pronounced in Hungary, Latvia, Lithuania and Moldova. However, real wage growth remained strong in Central Asia and parts of the Caucasus reflecting increased flows of trade, capital and migrants as discussed in the February 2023 *Regional Economic Prospects* (see Chart 16).

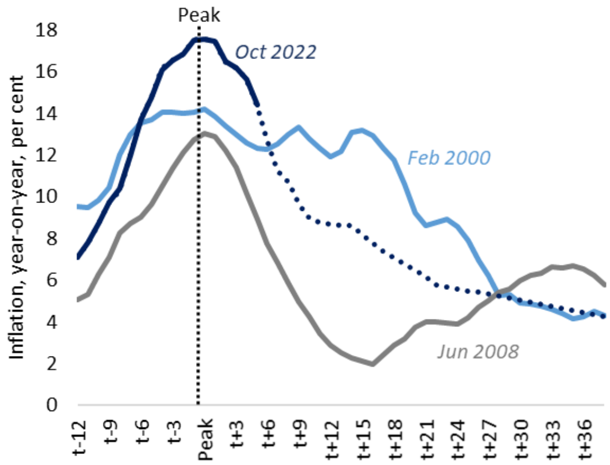
Chart 16. Real wage growth remained strong in Central Asia



Source: Refinitiv Eikon and authors' calculations.
Notes: February 2023 or latest available.

Past experience, including following the inflation spikes in 2000 and 2008, suggests that disinflation tends to be relatively slow (see Chart 17). On current projections of the International Monetary Fund, published in the April 2023 *World Economic Outlook* database, inflation in the EBRD regions would come down approximately as fast as it did in 2009, amidst a deep recession that followed the 2008-09 global financial crisis. However, since inflation peaked at a much higher level in 2022 compared with 2008, it is projected to remain above pre-Covid levels (of around 4 per cent on average) until at least 2025.

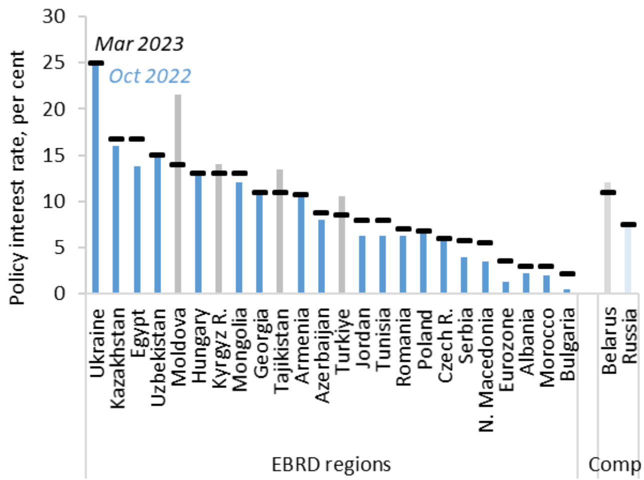
Chart 17. Past experience points to slow disinflation



Source: National authorities via CEIC, IMF forecasts (April 2023 World Economic Outlook), World Bank Global Inflation database and authors' calculations. Notes: Simple average across 29 economies in the EBRD regions for February 2000, 32 economies for June 2008 and 33 economies for October 2022 (excludes Ukraine 2024 onwards). Dashed line denotes IMF forecasts. t + 3 refers to 3 months after inflation peaks. Forecasted values for December of each year fall at t+14, t+26 and t+38.

Most central banks in the EBRD regions tightened policy rates in response to inflationary pressures. Some monetary authorities, including in Moldova, Tajikistan and Turkiye, started reducing policy rates as inflation peaked and the growth outlook weakened (see Chart 18).

Chart 18. Most central banks increased policy interest rates between October 2022 and March 2023



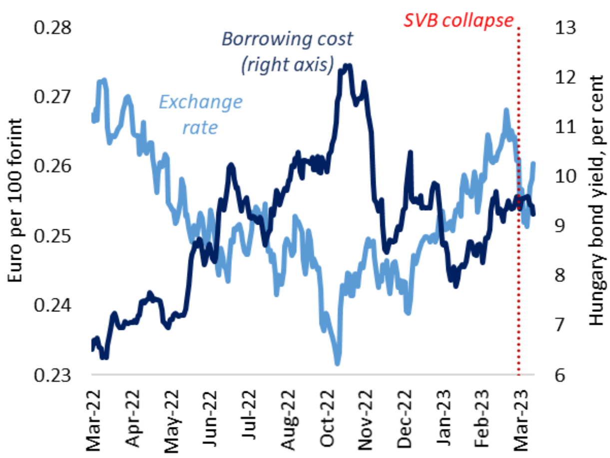
Source: National authorities via CEIC and authors' calculations.

Limited impact of the Silicon Valley Bank collapse

Recent banking sector turmoil that started with the collapse of Silicon Valley Bank on 10 March 2023 followed by the merger of Credit Suisse and UBS, highlighted policy trade-offs that make disinflation more challenging to achieve.

Banking liquidity jitters have so far had a limited impact on the EBRD regions. The Hungarian forint briefly hit a 10-week low against the euro in March, but quickly recovered, with no significant effects on borrowing costs (see Chart 19).

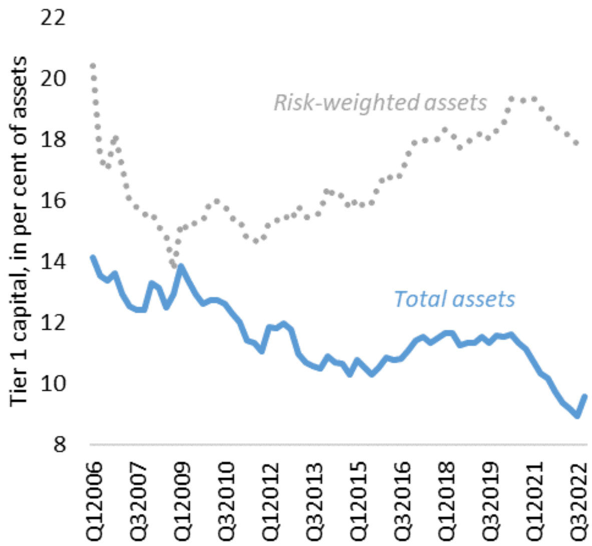
Chart 19. Hungarian forint briefly hit a 10-week low following the collapse of SVB but quickly recovered



Source: National authorities via CEIC, Refinitiv Eikon and EBRD forecasts.
Notes: "SVB collapse" refers to the liquidation of the Silicon Valley Bank on 10 March 2023. 5-year government bond yield.

Ratios of tier 1 capital (equity and similar instruments) to total assets have been declining but remain adequate (in risk-weighted terms ratios are significantly higher reflecting substantial holdings of government bonds that have low or zero risk weighting; see Chart 20).

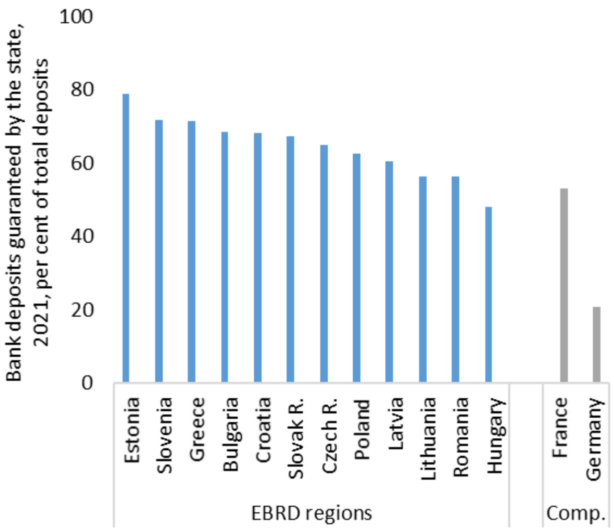
Chart 20. Capital ratios remain adequate



Source: IMF Financial Soundness Indicators and authors' calculations.
Note: Simple average across an unbalanced panel of 29 economies in the EBRD regions. Tier 1 capital includes equity and similar instruments.

The majority of deposits in banking systems tend to be covered by a state guarantee (50 to 80 per cent in central and south-eastern Europe, see Chart 21). These guarantees typically cover deposits up to a certain threshold (EUR 100,000 in the European Union, for instance) and they thus cover most depositors. At the same time, the share of large, uninsured deposits in the United States increased over time, from below 20 per cent of banks' total liabilities and equity in the early 2000s to above 35 per cent in 2022 reflecting increasing concentration of wealth at the top (see Vuillemey, 2023).

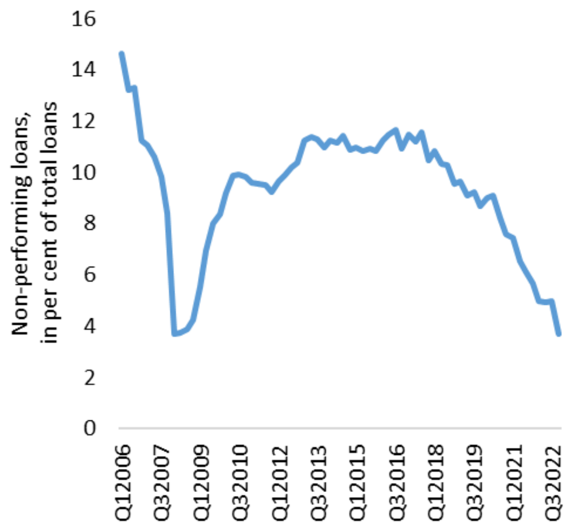
Chart 21. Deposit insurance covers most depositors



Source: European Banking Authority, World Bank and authors' calculations.

The ratio of non-performing loans to total loans has been declining up to end-2022 (see Chart 22) as borrowers benefitted from extensive policy support during the Covid-19 crisis as well as negative real rates of interest (the difference between the nominal rate of interest and increases in prices of goods or services sold).

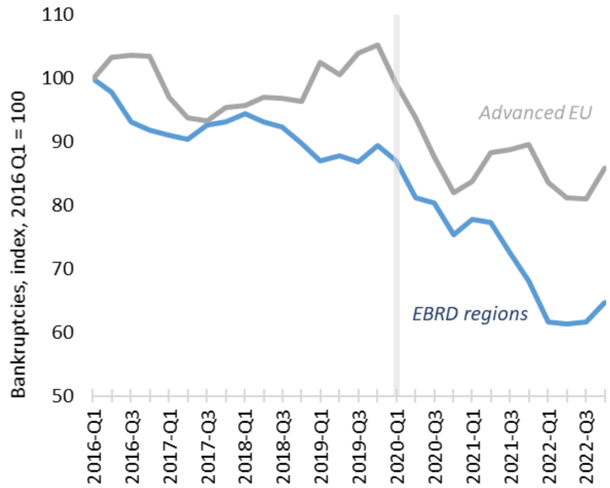
Chart 22. NPL ratio has been declining



Source: IMF Financial Soundness Indicators and authors' calculations.
Note: Simple average across an unbalanced panel of 29 economies in the EBRD regions.

Bankruptcies have, however, started to pick up in the last quarter of 2022, albeit from historically low levels (see Chart 23) as the economic outlook weakened and firms face higher debt servicing costs once they refinance their existing liabilities. Early data points to a further pick-up in bankruptcies in the first quarter in 2023.

Chart 23. Bankruptcies have started picking up as firms face higher refinancing costs

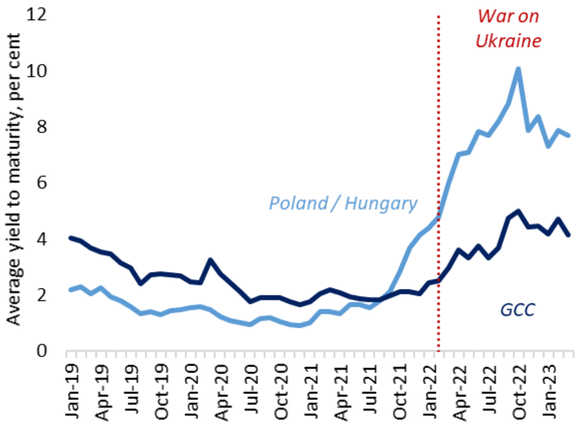


Source: Eurostat and authors' calculations.
Note: 4-quarter moving averages. Simple averages across 8 economies in the EBRD regions and 13 advanced economies.

Fiscal vulnerabilities have increased

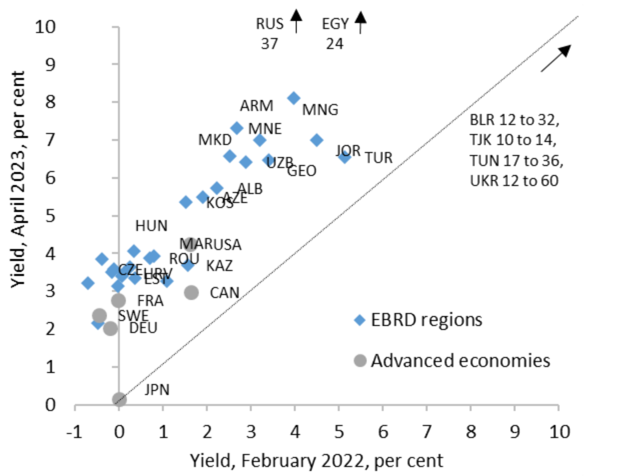
As inflation in many economies peaked in October 2022, bond yields in central Europe stopped rising. Overall, financing conditions have tightened and borrowing costs in the EBRD regions increased more sharply than in the Gulf Cooperation Council, where energy exporters benefitted from high energy prices (see Chart 24).

Chart 24. Borrowing costs in central Europe increased faster than in the GCC



Source: Bloomberg and authors' calculations.
Note: Bond yields is an average of 5-year government bond yields in local currency in Hungary and Poland.

Chart 25. The median yield in the EBRD regions increased by 3.8 percentage points since February 2022

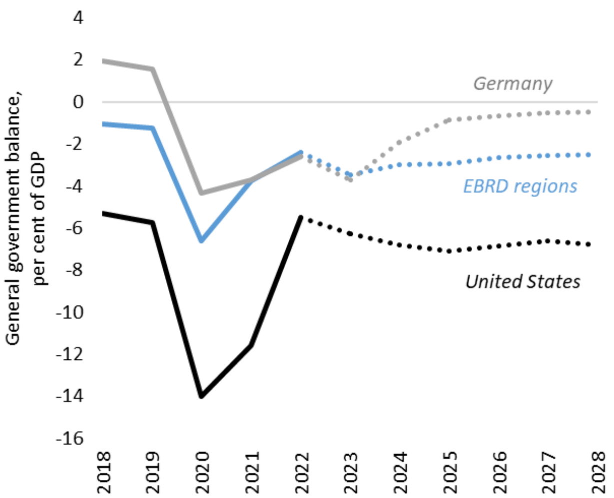


Source: Bloomberg and authors' calculations.
Note: Yields on 5-year government bonds in US dollars or closest benchmark available. As of 1 February 2022 and 27 April 2023.

The median yield on 5–year government bonds in the EBRD regions increased by 3.8 percentage points between early February 2022 (see Chart 25, horizontal axis) and late April 2022 (vertical axis). This mostly reflects tightening of monetary policy in advanced economies (yields on German and US bonds increased by 2.4 percentage points). A further 1.4 percentage points are due to a widening of the spread between the EBRD regions and Germany/ the United States because of a reassessment of emerging market economy risks including geopolitical risks. Yields increased most in Egypt, Lebanon and Tunisia as well as Belarus, Russia and Ukraine.

Fiscal deficits are expected to persist in the EBRD regions, as in advanced economies, reflecting increases in government spending and a weaker outlook for government revenues (see Chart 26). Having widened to 6.5 per cent of GDP in 2020, the average general government deficit in the EBRD regions narrowed to 2.4 per cent of GDP in 2022, in part as high inflation boosted revenues by more than debt servicing costs (see IMF, 2023). General government deficits exceeded 5 per cent of GDP in Hungary, Romania, Ukraine and in the southern and eastern Mediterranean. The average deficit-to-GDP ratio in the EBRD regions is expected to be in the 2.5 - 3.5 per cent range over the next few years based on forecasts from the International Monetary Fund's April 2023 *World Economic Outlook*.

Chart 26. Fiscal deficits moderated in 2022



Source: IMF April 2023 World Economic Outlook and authors' calculations.
Note: Simple average based on 34 economies in the EBRD regions. Dashed lines denote IMF forecasts.

General government debt is forecast to remain around 52 per cent of GDP in the EBRD regions on average in 2023, with debt especially high in Greece, Mongolia and the southern and eastern Mediterranean. In Egypt the cost of servicing public debt is forecast to exceed 60 per cent of government revenues in 2023 and 70 per cent in 2024. In Mongolia total debt in foreign currency reaches almost 200 per cent of GDP.

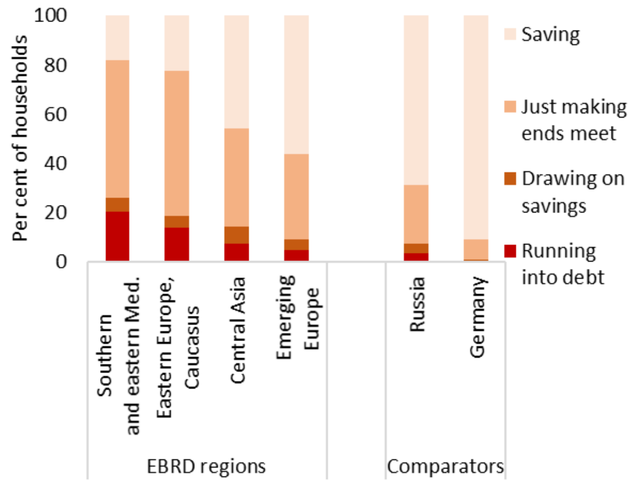
Most economies in the EBRD regions recorded current account deficits in 2022 as higher energy prices increased import costs. Among exceptions are several economies in Central Asia and the Caucasus, in particular commodity exporters, which befitted from elevated prices of hydrocarbons and metals.

Getting by: The impact of repeated crises on household finances

The following section zooms in on the effects of the Covid-19 and cost-of-living crises on households in the EBRD regions as well as Russia and Germany. It draws on preliminary data from the new, fourth wave of the Life in Transition Survey, administered by the EBRD in partnership with the World Bank between October 2022 and April 2023 (see EBRD, 2016, for a discussion of the earlier waves of the survey).

Repeated crises weighed on the financial situation of households. On average, 55 per cent of households in the EBRD regions report that they cannot save, of which 10 per cent are running up debt (and as high as 21 per cent in the southern and eastern Mediterranean). This is in stark contrast with Germany, where 91 per cent of households are able to save, and just one per cent are running into debt (see Chart 27).

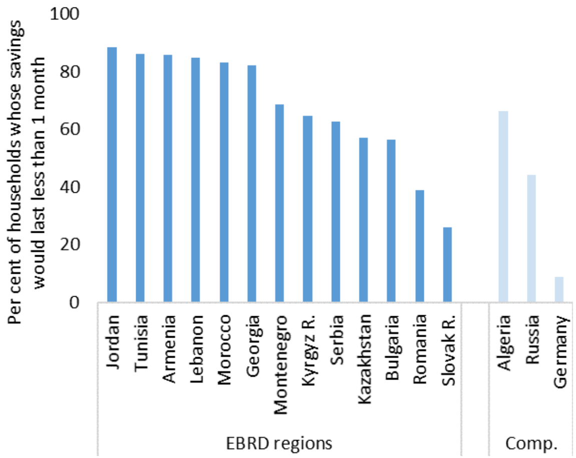
Chart 27. 55 per cent of households in the EBRD regions live from paycheck to paycheck, being unable to save



Source: Life in Transition Survey 2022 and authors' calculations.
Note: This and subsequent charts are based on preliminary data, EBRD regions is a sample-weighted average across 129 economies with at least 100 interviews each; 19 economies have at least 1000 interviews each. The survey started in October 2022 and is expected to be finalized across all economies later in 2023.

Reported saving stocks are equally low. If they lost their main source of income, 59 per cent of households in the EBRD regions (and around 86 per cent of households in the southern and eastern Mediterranean and the Caucasus) report being able to cover their basic expenses for less than a month (see Chart 28). In contrast, this is the case for 9 per cent of households in Germany, where most households (66 per cent) could cover their basic expenses for at least three months.

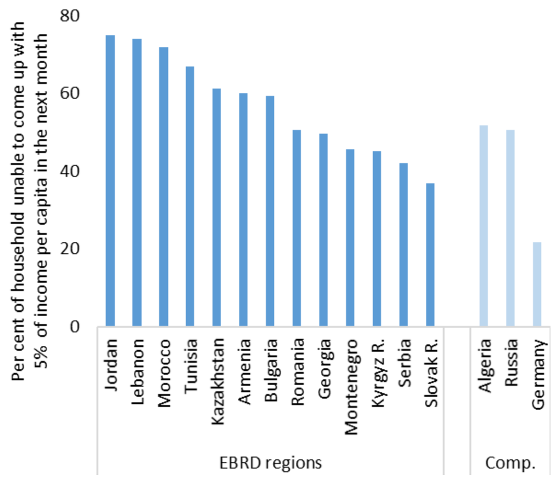
Chart 28. Households in the EBRD regions have limited savings buffers



Source: Life in Transition Survey 2022 and authors' calculations.
Note: Select economies with at least 1000 completed interviews shown. The survey started in October 2022 and is expected to be finalized across all economies later in 2023.

Consistent with these patterns, 52 per cent of households in the EBRD regions could not come up with 5 per cent of annual income per capita in the next month in case of an emergency. This is the case for 22 per cent of households in Germany (see Chart 29).

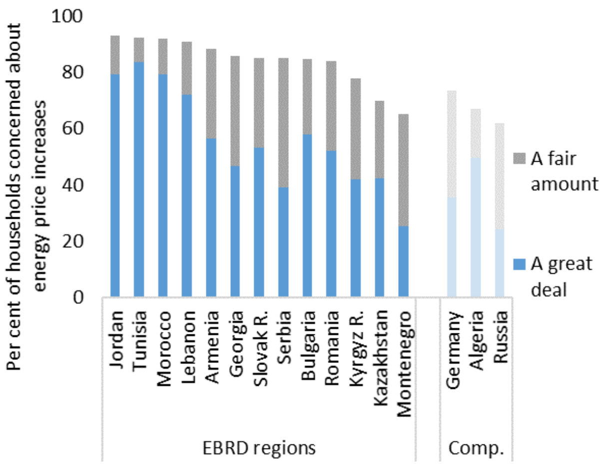
Chart 29. Over half of households in the EBRD regions could not come up with 5 per cent of income per capita in case of an emergency



Source: Life in Transition Survey 2022 and authors' calculations.
Note: Select economies with at least 1000 completed interviews shown. The survey started in October 2022 and is expected to be finalized across all economies later in 2023.

Most households in the EBRD regions also expect to be severely affected by increases in food and energy prices as well as negative consequences from the war on Ukraine, more so than in Germany (see Charts 30 and 31).

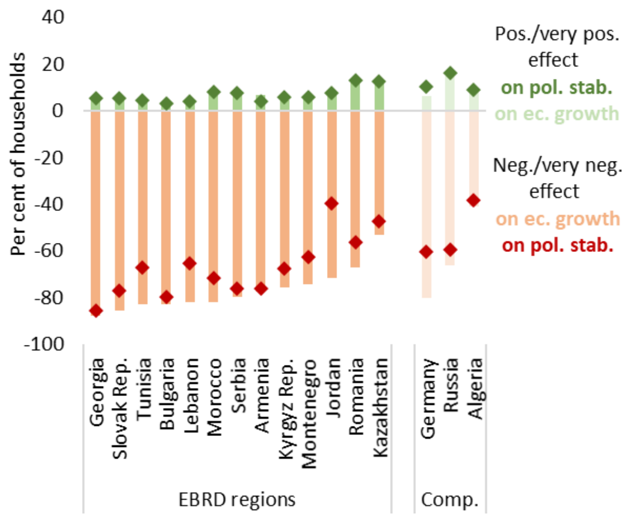
Chart 30. Most households in the EBRD regions expect to be severely affected by increases in energy prices



Source: Life in Transition Survey 2022 and authors' calculations.
Note: Select economies with at least 1000 completed interviews shown. The survey started in October 2022 and is expected to be finalized across all economies later in 2023.

In economies in the Caucasus and Central Asia, intermediated trade, increased inflows of capital and relocation of Russian businesses provided a significant boost to average income per capita in 2022 (see also Chart 32).[3] At the same time, household survey results point to limited spillovers from the benefitting sectors (such as IT, as well as accommodation) to the broader economy. In Armenia, Georgia and the Kyrgyz Republic, for instance, concerns about the economic fallout from the war on Ukraine loom large among the surveyed households (see Chart 31).

Chart 31. In economies with fast recent income per capita growth households are still overwhelmingly concerned about negative economic effects from the war on Ukraine



Source: Life in Transition Survey 2022 and authors' calculations.
Note: Select economies with at least 1000 completed interviews shown. The survey started in October 2022 and is expected to be finalized across all economies later in 2023.

Slow growth in advanced Europe

The International Monetary Fund expects growth in advanced economies to slow sharply in 2023 relative to 2022, reflecting persistent inflation and increased concerns about financial stability (April 2023 *World Economic Outlook*).

Weaker prospects for the global economy weigh on the outlook in central Europe and the Baltic states, as well as other economies that are closely integrated with advanced Europe through trade and investment linkages.

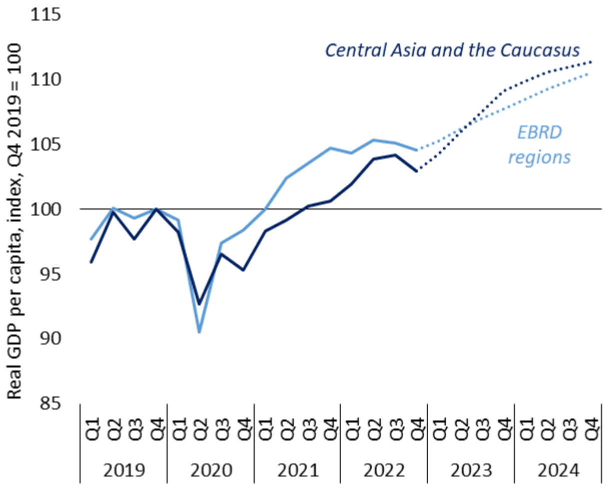
Output in the EBRD regions is expected to grow by 2.2 per cent in 2023

Growth in the EBRD regions is expected to slow further to 2.2 per cent in 2023 (see Chart 32 and Table 1), a 0.1 percentage point downward

[3] On intermediated trade—changing trade patterns via economies neighbouring Russia following the introduction of sanctions—see Chupilkin, Javorcik and Plekhanov (2023).

revision relative to the February 2023 forecast. Growth has been revised down in Turkiye reflecting the economic effects of the February 2023 earthquakes as well as the expected tightening of credit conditions later in the year, in the southern and eastern Mediterranean where reforms have been delayed and in central Europe and the Baltic states because of subdued growth in advanced economies, persistent inflation and tighter financing conditions. Growth is expected to pick up to 3.4 per cent in 2024 as inflationary pressures gradually subside (0.1 percentage point up relative to the February forecast).

Chart 32. Output in the EBRD regions is expected to grow by 2.2 per cent in 2023 and 3.4 per cent in 2024



Source: National authorities via CEIC and EBRD forecasts.
Note: EBRD average based on the values of gross domestic product in 2022 in current US dollars from the IMF.

Regional outlooks

Growth in **Central Asia** is forecast to remain strong at 5.2 per cent in 2023 (revised up since February) and 5.4 per cent in 2024. Projections reflect strong growth outcomes in year-on-year terms in the first quarter of 2023 and robust real wage growth in year-on-year terms. Relocation of Russian businesses and increased oil exports are providing a boost to growth in Kazakhstan while Mongolia is benefitting from expanded mining production and the reopening of China.

Output in **central Europe and the Baltic states** is expected to grow by a modest 0.5 per cent in 2023, revised down relative to February on slower-than-expected growth in advanced economies and persistent (in particular core) inflation. While the region proved resilient in 2022, the post-Covid recovery has largely run out of steam and growth has recently turned negative in quarter-on-quarter terms. Growth is expected to pick up to 2.9 per cent in 2024.

Growth is also expected to decelerate in the **Caucasus** as the extraordinary factors that boosted economic activity in 2022 provide limited additional stimulus. The region is forecast to grow by 3.5 per cent in 2023 and 3.7 per cent in 2024. The **Ukrainian** economy is expected to grow only modestly as businesses adapt to war circumstances.

Growth forecasts for 2023 have been revised up for the **south-eastern EU** economies, supported by the prospect of Eurozone accession boosting investor confidence in Bulgaria, higher public investment in Romania and the carry over effect of stronger outturns in Greece in the last quarters of 2022. The region is expected to grow by 2.3 per cent in 2023 and 3 per cent in 2024.

Output in the **southern and eastern Mediterranean** is expected to grow by 3.6 per cent in 2023 and 4.4 per cent in 2024. Downward revisions for 2023 reflect delays in reforms, spillovers from weak growth in advanced Europe and increased fiscal and external vulnerabilities in Egypt.

Growth is **Turkiye** is expected to slow to 2.5 per cent in 2023 and 3 per cent in 2024. The downward revision for 2023 reflects the impact of the February 2023 earthquakes (not reflected in the previous forecast) as well as expected credit tightening in the second half of 2023 (see also Aksoy et al., 2023 on the economic effects of the earthquakes).

Output in the **Western Balkans** is forecast to expand at the rate of 2.2 per cent in 2023 amidst headwinds from inflationary pressures and a subdued outlook for advanced economies in Europe, before picking up to 3.4 per cent in 2024. With the exception of an upward revision for Kosovo in 2023 the forecasts are unchanged relative to February.

Box 1. Reconstructing Ukraine: Insights from economic history

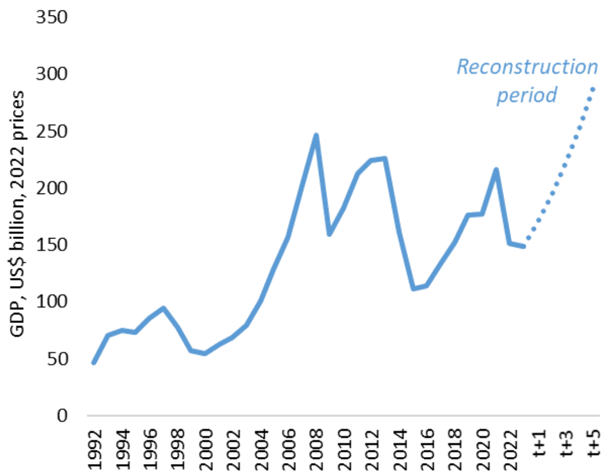
This box draws on the history of conflict and reconstructions analysed in Chupilkin and Kóczán (2023) and EBRD (2022) to distil implications for post-war reconstruction in Ukraine. Successful post-war reconstructions are observed in a minority of cases. In Ukraine, a successful reconstruction would require far greater investment-to-GDP ratios than those observed over the past 30 years. In this scenario, extra investment would largely need to be financed by inflows of capital from abroad, to the tune of US$ 50 billion per annum (in 2023 prices). The majority of this financing would need to be channelled to the private sector.

Post-conflict reconstructions present a daunting challenge reflecting widespread damage to capital stock and human capital as well as fragility of peace post-conflict (see Kappner, Szumilo and Constantinescu, 2022 or World Bank, the Government of Ukraine, the European Union and the United Nations, 2023 for early assessments of damages in Ukraine). The analysis in EBRD (2022) shows that historically only 1 in 5 economies emerging from an armed conflict enjoyed at least 25 years of lasting peace. As a result, the majority of economies do not recover to the income per capita trend observed in comparator economies even in the long term. However, experiences vary greatly and in 29 per cent of cases economies achieve the trend level of GDP per capita in comparators within 5 years after the end of a war on their territory.

This box distils some common features of such successful reconstructions with implications for Ukraine, while acknowledging that the resulting scenario is far from "central". It combines elements of successful post-war reconstructions and periods of exceptionally fast growth that historically have been the exception rather than the norm.

A swift recovery in Ukraine within a five-year period would require sustained rates of economic growth of around 14 per cent per annum, bringing average GDP over this period to US$ 225 billion at market exchange rates in today's prices (from an estimated level of around US$ 150 billion in 2022, according to the April 2023 *World Economic Outlook* of the International Monetary Fund, see Chart 1.1).

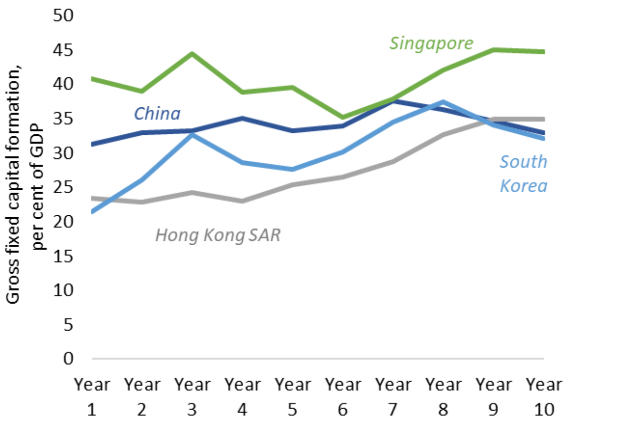
Chart 1.1. Swift recovery in Ukraine implies sustained economic growth in double digits



Source: IMF April 2023 World Economic Outlook, US Bureau of Labor Statistics and authors' calculations. Note: GDP is adjusted using US CPI inflation. The chart assumes a scenario in which the average GDP in the first five years of reconstruction reaches the 2021 level in real terms. t+1 refers to the year after the war ends.

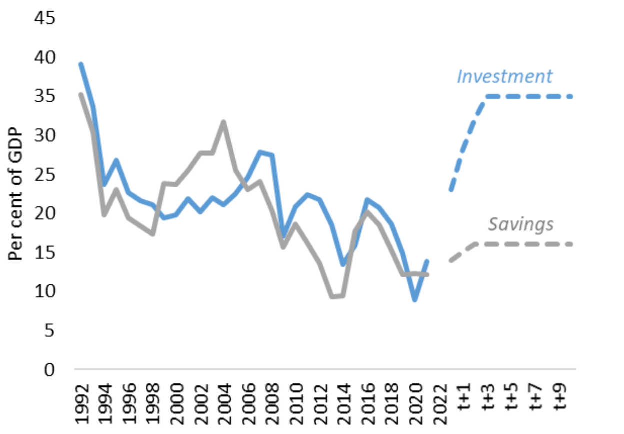
The main feature that periods of sustained exceptionally high economic growth have in common are high ratios of investment to GDP (see, for instance, EBRD, 2019, for an extended analysis of high-growth spells, and Young, 1995). The ratios of gross fixed capital formation to GDP typically averaged 30-35 per cent (see Chart 1.2) yielding investment ratios of around 35 per cent, compared with an average of 16 per cent in Ukraine in 2016-21 (see Chart 1.3 and a discussion in Gorodnichenko et al., 2022).

Chart 1.2. Episodes of exceptionally high growth tend to be accompanied by high ratios of gross fixed capital formation to GDP



Source: World Bank World Development Indicators and authors' calculations.
Note: Gross fixed capital formation is a key component of investment. The latter also includes changes in inventories. Growth spells start in 1961 for Singapore, 1990 for China, 1961 for South Korea, 1969 for Hong Kong SAR.

Chart 1.3. Levels of investment and domestic savings have been modest in Ukraine

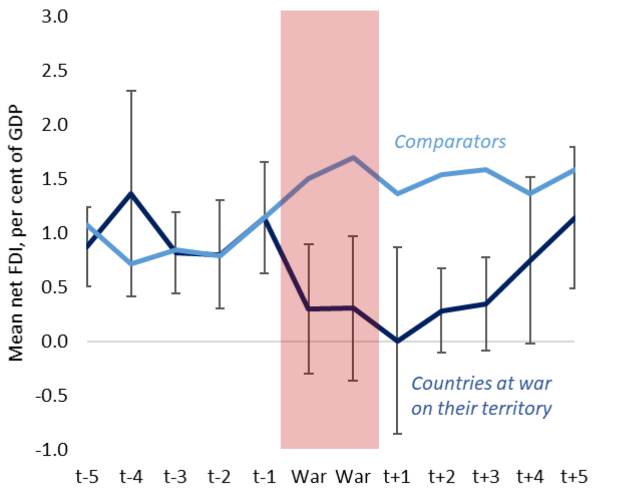


Source: IMF and authors' calculations.
Note: t+1 refers to the year after the war ends.

Sustaining high levels of investment would require a major increase in the economy's absorption capacity, from governance structures needed to design and contract out complex projects to various skills in the population. It will also require appropriate financing.

The moderate levels of investment in Ukraine before 2022 were largely financed by domestic savings, with modest net inflows of capital (3 per cent of GDP per annum over the period 2010-21), including foreign direct investment (gross inflows of 3 per cent of GDP per annum) and portfolio investment (gross inflows of 1.4 per cent of GDP per annum). At the same time, foreign direct investment typically drops substantially in the aftermath of a conflict and takes a long time to recover, reflecting high perceived risks and a difficult institutional environment. The foreign direct investment deficit, on average, reaches around 1.5 percentage points of GDP sustained over several years (see Chart 1.4).

Chart 1.4. Foreign direct investment typically drops substantially in the aftermath of a conflict and takes a long time to recover



Source: Transition Report 2022-23 based on Correlates of War, IMF, Penn World Tables and authors' calculations.
Note: Includes only wars fought on a country's own territory that were not preceded by another war in the previous five years. Comparators are synthetic controls based on economies that were not at war in the five years before or after the war in question.

In this scenario, the difference between the required levels of investment and the available domestic savings would likely need to be covered by external financing (net inflows of capital), to the tune of 20 per cent of GDP or US$ 50 billion per annum. In a similar vein, foreign financing played an important role in sustaining a number of investment booms in the past, including the one in central and south-eastern Europe in the 2000s (Friedrich et al., 2013).

The roles of the private sector and external donors

Evidence from past instances of post-conflict reconstruction points to the importance of a balance between private-sector and public-sector involvement as well as the important role played by external assistance from bilateral and multilateral agencies. Private and public investment tend to be highly complementary, in the post-conflict context and more generally. Beyond financing, the private sector contributes much-needed technological expertise, management know-how and a focus on cost-efficiency. In addition to the (energy-efficient) industrial capital stock and agricultural machinery, the private sector can make an important contribution to rebuilding housing stock as well as transport, energy and municipal infrastructure, provided individuals and firms have adequate access to finance (see Mac Sweeney, 2009, Mills and Fan, 2006 and De Haas and Pivovarsky, 2022).

Foreign assistance can help to alleviate funding shortages in the short term and help formulate and enforce structural reform conditionality. In the absence of such conditionality and wider efforts to building strong, robust economic and political institutions, private investment in a post-war context may face bureaucratic gridlock, corruption or a high degree of informality caused by an institutional vacuum. The wartime focus on delivering critical outputs at any cost, while essential during the war, may weaken governance and competition frameworks for the private sector in the post-conflict context (see Peschka, 2011).

Regional updates

Central Asia

Central Asian economies have proven resilient to adverse geopolitical developments related to Russia's war on Ukraine. All economies in this region strengthened their trade cooperation with Russia as a result of its forced pivot to Asia, serving as intermediaries and supplying their own products into the vacuum created by the withdrawal of Western firms from serving the Russian market. The volume of money transfers to Central Asia has skyrocketed, increasing deposits in the banking sector and boosting bank profits. The relocation of Russian firms and individuals strengthened demand in the retail, real estate, and hospitality sectors. Meanwhile, labour remittances have also increased on sustained labour demand in Russia and a stronger Rouble. In the first quarter of 2023, growth continued across the region, while CPI inflation in most economies was still far above the target ranges set by central banks. Tajikistan – the only country in the region with single-digit inflation – has recently started to see its monthly CPI accelerating. The region's economies are likely to continue growing rapidly in the short term, but uncertainty over global trends in interest rates, inflation and commodity prices is clouding the outlook.

Kazakhstan

In 2022, the economy grew by 3.2 per cent year-on-year despite intermittent technical disruptions at the Caspian Pipeline Consortium's terminal in Novorossiysk threatening Kazakh oil exports. Exports demonstrated remarkable resilience amid high oil prices (up 39.9 per cent year-on-year). Growth accelerated to 4.9 per cent year-on-year in the first quarter of 2023, led by significant gains in construction (18 per cent year-on-year), fixed capital investment (16.1 per cent) and retail trade turnover (12.1 per cent). Industry (2.8 per cent) and agriculture (3.5 per cent) posted smaller growth rates. Despite efforts by the National Bank to tighten its monetary policy and scale back its involvement in financing post-Covid-19 stimulus programmes, inflationary pressures persisted amid rising transport, food and commodity prices. Annual CPI inflation peaked at 21.3 per cent in February 2023, before dropping to 18.1 per cent in March. Kazakhstan's economic outlook stands to benefit from the relocation of foreign firms, investment in new activities related to exit of major global players from Russia and ongoing efforts to diversify transport and oil transit routes. Planned reforms to improve the business climate, reduce barriers to entry (for instance, in the mining sector) and reduce the footprint of politically exposed persons in the economy are likely, if implemented, to promote foreign direct investment and development of small and medium-sized enterprises in the medium term. Downside risks include persisting inflationary pressures and uncertainty surrounding oil and commodity prices. Overall, the economy is expected to expand by 3.9 per cent in 2023 and 4.2 per cent in 2024.

Kyrgyz Republic

The Kyrgyz economy expanded by 7.0 per cent in 2022 despite a major drop in gold exports. An uptick in Russia's demand for migrant workers, the massive relocation of Russian capital and highly qualified labour to the Kyrgyz Republic and a major increase in intermediated trade more than compensated for the war's adverse effects. Growth continued in the first quarter of 2023, with strong external and domestic demand leading to gains in industrial production (7.6 per cent year-on-year), hospitality (24.1 per cent), retail and wholesale trade (11.8 per cent) and trucking (18.7 per cent). Imports rose by 27.2 per cent year-on-year in January-February 2023 on the back of higher prices of food and energy, as well as an increase in re-exporting activities. Of special note is the doubling in the importation of trucks in the first two months of 2023, reflecting the country's outsized role in transit and intermediated trade. Overall, real GDP grew by 4.6 per cent year-on-year in the first quarter of 2023 despite a 34 per cent decline in net remittances. After peaking at 15.6 per cent in July 2022, inflation moderated to 12.7 per cent in March 2023. In 2022, the general government deficit reached 1.3 per cent of GDP (up from 0.8 per cent of GDP in 2021). Ongoing tax administration and tariff reforms will help keep the deficit in check over the medium term. The Kyrgyz economy is projected to grow at 7.0 per cent in 2023 and 7.2 per cent in 2024. In the short term, the economy will continue to gain from expanded re-export opportunities, elevated remittances from Russia and relocation of Russian companies and individuals, including IT developers and entrepreneurs. Investment in major energy and infrastructure projects, such as Kambar-Ata I hydro power plant and the China-Kyrgyzstan-Uzbekistan railway are likely to contribute to growth in the medium term. Nevertheless, vulnerabilities related to tightening credit conditions and reliance on remittances from Russia remain.

Mongolia

Despite weak performance in the early months of the year, Mongolia's economy grew by 4.8 per cent in 2022. China's re-opening in the second half of 2022 enabled a rapid expansion of mining and quarrying activities, providing a major boost for coal exports. The strong recovery continued in January-February 2023, as reflected in gross industrial output growing by 124.1 per cent year-on-year, and the volume of railway cargo adding 134.7 per cent. Meanwhile, exports almost doubled in the first quarter of 2023, reflecting a surge in coal shipments. As Covid-19-related travel restrictions have been finally rescinded, the number of incoming travellers has come back to its pre-pandemic level in the first quarter of 2023 (a five-fold increase compared with a year ago). Inflation has become a key concern for the economy, however, reaching 13.2 per cent year-on-year in 2022. The rise was fuelled by currency depreciation, a spike in global commodity prices, generous stimulus spending and an initially-accommodative monetary policy stance by the Bank of Mongolia (BoM). As tighter monetary policy has helped to dampen inflationary pressures, CPI inflation decreased to 12.2 per cent year-on-year in March 2023. Overall, Mongolia's real GDP is forecast to grow by 7.2 per cent in 2023 and 7.5 per cent in 2024, supported by the recovery of the tourism and full production starting at the Oyu Tolgoi underground mine in March 2023. Downside risks to the outlook relate to external developments such as the war on Ukraine further disrupting transportation and transit through Russia, a tightening of global credit conditions, and uncertainty surrounding commodity prices and China's demand for Mongolia's exports.

Tajikistan

Tajikistan's economy has proven extremely resilient to adverse external shocks such as Covid-19 and Russia's war on Ukraine. The economy expanded by 8 per cent in 2022, primarily on the back of consumer demand backed by the inflows of remittances. The banking sector was among the primary beneficiaries, enjoying strong growth in liquidity and fee-based earnings. Growth continued in January-February 2023, as fixed capital investment added 4.6 per cent year-on-year. Sectors that continue to perform strongly include industrial production, agriculture, trucking, hospitality and retail trade. Meanwhile, a combination of restrictive monetary policies, local currency appreciation and effective regulation of food and energy prices has kept inflation low, at 3.6 per cent year-on-year as of March 2023, the lowest level in Central Asia. The country's fiscal performance in 2022 was also good: the government's budget deficit narrowed to 1.4 per cent of GDP on the back of strong growth in revenues (up 23.2 per cent year-on-year). Concurrently, the public-debt-to-GDP ratio dropped from 42.5 per cent in 2021 to 34.6 per cent in 2022. As of February 2023, international reserves reached US$ 3.5 billion, up 43.7 per cent year-on-year. Strong GDP growth is expected to continue in 2023 and 2024, reaching 7.5 per cent in both years on the back of Russia's demand for Tajik labour, China's re-opening, as well as continued development of the Roghun hydro power plant and transport infrastructure. The recently introduced Business Support Programme for 2023-2027 coupled with reforms to tax administration and construction licencing may further facilitate private-sector investment and growth. Downside risks relate to a worsening of external conditions related to the situation in Afghanistan or Russia's war on Ukraine, as well as infrastructure bottlenecks (trucks, storage facilities) hampering trade.

Turkmenistan

The Turkmen authorities continue to report remarkable growth rates, of 6.2 per cent in 2022 and in the first quarter of 2023, driven by higher-than-planned natural gas production and exports. In January 2023, a new gas well became operational at Galkanysh, one of the world's largest fields, facilitating a further expansion of gas extraction and exports. In spite of positive economic developments, there was little change in Turkmenistan's rationing approach when it comes to foreign currency. The official exchange rate peg continues to be maintained at 3.5 manat per US dollar. The parallel-market exchange rate fluctuated in the range of 19.5 to 18.5 in the first quarter of 2023. Russia's war on Ukraine created significant opportunities for Turkmenistan's participation in new transport and communication projects in the region as it provides alternative access to the Caspian Sea and Iran. The volume of transit cargo transported through the Seaport of Turkmenbashi increased by a factor of 2.5 in 2022 mainly due to the transit of petroleum products, chemical cargo, construction materials, metals, food, machinery and spare parts. The road-based Southern Corridor through Turkmenistan and Iran has been rapidly gaining popularity among operators as it avoids the Caspian Sea. Strong growth is expected to continue in the short term, at 6.5 per cent in 2023 and 7.0 per cent in 2024. The opportunity to play a more central role in serving trade between China, Iran, Central Asia, Türkiye and southern Europe could lead to a gradual modernisation of the country's transportation networks and logistics capabilities, including border management.

Uzbekistan

In 2022, the Uzbek economy posted broad-based growth of 5.7 per cent, reflecting a significant improvement in external and domestic demand conditions. Exports of goods and services added 15.9 per cent, with particularly large increases in shipments of textile, fruit, copper pipes, and electrical appliances (mostly to Russia). Domestic demand was boosted by a surge in money transfers and remittances (up 110 per cent) and relocation of Russian companies and individuals. GDP grew by 5.5 per cent year-on-year in the first quarter of 2023, despite electricity and heating disruptions due to extremely cold winter conditions, supported by growth in services (+10.9 per cent year-on-year). However, inflation reached double digit levels in the past year and stood at 11.6 per cent as of March 2023. As inflationary pressures were seen to be receding, the central bank lowered the policy rate by 100 basis points to 14 per cent on March 16, 2023, to support economic activity. Banks have been among the primary beneficiaries of the surge in money transfers, adding to their deposit base and profits, and the ratio of non-performing loans to total loans dropped to 3.8 per cent at end-February 2023.

With its strong fundamentals (external and fiscal buffers, low government debt and high growth), the economy is projected to grow at 6.5 per cent in both 2023 and 2024. Continued relocation of foreign companies, well-managed privatisations and business climate reforms are potential upsides (particularly when it comes to the development of small and medium-sized enterprises). At the same time, any further escalation of Russia's war on Ukraine and moderation of inflows of remittances would worsen the outlook.

EU economies

In the EU economies, where the EBRD invests, the impressive post-Covid recovery has slowed down. Elevated inflation sharply hit households' disposable incomes and consumption, whereas accumulated savings during the lockdowns allowed private consumption to stay afloat. Increased interest rates in response to high inflation, and the resulting tighter financial conditions hampered private investment. Some economies managed to advance in speeding up their national recovery plans, largely financed via the EU's recovery and resilient facility (RRF), which is supporting public sector investment. While headline inflation, measured year-on-year, declined, in line with lower energy prices, core inflation has remained high, sapping consumer spending power, especially in Hungary, where the headline HCPI inflation has remained above 25 per cent since December 2022 and the core inflation rate exceeded 17 per cent in March 2023. GDP growth is expected to decelerate in 2023, before bouncing back in 2024, as external *demand and household purchasing power improve.*

Bulgaria

Economic growth in Bulgaria decelerated to 3.4 per cent in 2022, with negative investment and net export growth rates weighing on economic performance for the second consecutive year, as financing conditions have tightened and new tranches of the EU funds under the RRF programme have been delayed. GDP growth is expected to decelerate further to 1.3 per cent in 2023, before bouncing back to 2.9 per cent in 2024. Investment is expected to pick up, as projects from the recovery plan should gather steam, supported by the positive outlook related to Bulgaria's euro area accession which is anticipated in 2025, and improved political stability. The HICP (harmonised index of consumer prices) inflation rate peaked in September 2022, at 15.6 per cent, and dropped to 12.1 per cent in March 2023. Falling inflation will support the recovery of real wages and the purchasing power of households.

Croatia

GDP growth in 2022 in Croatia was the highest among EU economies in the EBRD regions, at 6.3 per cent, propelled by robust consumption and investment expenditures. Following the Euro area accession in January 2023, investor sentiment has improved and Croatia has not experienced any significant price increase shocks directly related to the switchover from Kuna to Euro. Nevertheless, HICP inflation was still in double digits as of March 2023, at 10.5 per cent year-on-year. In light of the weaker global economic environment, a substantial growth slowdown is expected in 2023, to 1.5 per cent, followed by a gradual recovery in 2024, to 2.3 per cent. The disbursements to date of funds under the EU's Recovery and Resilience Facility (RRF) has been impressive in Croatia and, together with the cohesion funds, the RRF will substantially boost investment in the coming years, especially in the public sector which finances more than 70 per cent of investment from EU sources.

Czech Republic

The Czech economy grew by 2.5 per cent in 2022, driven largely by an impressive investment growth rate of 6.2 per cent, despite tightened bank lending and elevated financing costs. At the same time, the economy suffered a technical recession in the second half of the year, mostly driven by shrinking household consumption, due to falling disposable incomes. The HICP inflation rate moderated from 18.4 per cent year-on-year in February to 16.5 per cent in March 2023, with core inflation at 12.8 per cent. A period of economic stagnation is expected in 2023, with GDP dropping by 0.1 per cent. A growth of 2.9 per cent is expected in 2024, underpinned by higher exports. Household consumption is expected to be boosted through a strong increase in nominal wages reflecting tight labour markets and significant nominal wage growth in the automotive industry. Lower inflation should improve consumer confidence and boost private and public investment.

Estonia

Estonia was the only EU economy in the EBRD regions to experience recession in 2022, with GDP shrinking by 1.3 per cent as investment contracted by 10.9 per cent. Public sector expenditures and net exports also contributed negatively to GDP growth. GDP is expected to shrink by 1.3 per cent in 2023, although the economic outlook is gradually improving relative to a year ago. The annual HICP inflation rate peaked in August 2022 at 25.2 per cent and has since come down to 15.6 per cent year-on-year in March 2023. External demand is expected to recover gradually in Estonia's main trading partners, providing a boost to exports later this year and next. Public investment, much of it co-financed with the EU, is expected to add to GDP growth in 2024, projected at 2.8 per cent, with the economy also supported by recovering private consumption, though this may be tempered by expected tax increases in 2024.

Greece

In Greece, the strong post-Covid economic recovery continued in 2022 but slowed down in the second half of the year. GDP grew by more than 8 per cent year-on-year in the first six months of 2022, driven by buoyant private consumption, rising government spending and strong export growth. Tourism also performed exceptionally well in 2022, with non-residents' receipts almost matching the pre-Covid record year of 2019. However, confidence among consumers and producers became increasingly fragile in the second half of the year, contributing to a sharp drop in growth in the third quarter, as global energy markets faced increasing uncertainty and turbulence and as the Eurozone economy slowed down markedly. Overall, GDP grew by 5.9 per cent in 2022, somewhat higher than expected on strong end of year performance. High-frequency indicators on industrial production and confidence in the first months of 2023 were mostly positive. Annual inflation is falling rapidly after exceeding 12 per cent at one point in 2022, dropping to 5.4 per cent in March 2023 (HICP measure). The government responded to the energy crisis with mitigating measures, which have a significant fiscal cost, but the budget is on track for a return to primary surpluses in 2023. Public debt remains the highest in Europe (as a per cent of GDP) but the ratio fell sharply in the past two years, from more than 200 per cent of GDP (end-2020) to around 170 per cent at end-2022, as a result of high nominal GDP growth and further debt relief measures. While the economy is slowing down, the overall short-term outlook remains a positive one. A moderate growth slowdown, reflecting global developments, is projected in 2023 (GDP growth of 2.4 per cent), as well as 2024 (2.3 per cent). The implementation of projects, funded by both loans and grants, under the EU's Recovery and Resilience Facility is advancing well and is mitigating the downside risks coming from global and regional turbulence.

Latvia

The Latvian economy expanded by 2.8 per cent in 2022, mostly fuelled by robust levels of household and government expenditures. On the flip side, destocking of inventories and a negative trade balance both weighed on GDP performance last year. The HICP inflation rate slowed from a peak of 22 per cent in September 2022 to 17.2 per cent year-on-year in March 2023, but it remains the second highest in the EU. As a result, households' disposable incomes are not expected to recover until next year, though labour shortages and minimum wage hikes will likely contribute to nominal wage growth in 2023 and 2024.

Higher financing costs and tighter bank lending have negatively impacted investment, but the prospects of accelerated absorption of EU funds later this year and next are likely to boost investment, particularly through the RRF initiative. Output is projected to remain flat (zero growth) in 2023, with GDP rising by 2.5 per cent in 2024.

Lithuania

GDP growth in Lithuania slowed to 1.9 per cent in 2022, dragged down by a 2.2 per cent drop in private consumption and stagnating public sector spending. Investment surprised on the upside, however, despite shrinking bank credit and increased financing costs, while relatively strong exports were balanced by high imports. In 2023, GDP growth is expected to remain flat, as high inflation has hit households' disposable incomes and savings accumulated during the Covid-induced lockdowns have already been spent. The HICP inflation rate slowed to 15.2 per cent year-on-year in March 2023 and is expected to decelerate further. An economic recovery is expected to kick-off by the end of 2023, as investments accelerate under the RRF programme and the government's multilateral green energy investment programme. In 2024, output is expected to grow by 2.0 per cent, with household consumption recovering.

Hungary

Hungary's economy expanded by 4.6 per cent in 2022, largely driven by relatively strong household consumption as the government regulated prices of fuel and food staples. Annual HICP inflation has, however, remained above 20 per cent since December 2022, reaching 25.6 per cent in March 2023, the highest rate in the EU. The core HICP inflation was also the highest in the EU, at 17.6 per cent, and far above the central bank's target of 3 per cent, plus/minus one percentage point. GDP growth is expected to moderate to 0.4 per cent in 2023, as households' purchasing power declines and government consumption shrinks due to the budgetary restraint. Foreign direct investment inflows and other private investment is expected to support GDP growth this year, but EU funds, especially those from the RRF, will likely reach Hungary only in late 2023 or 2024. In 2024, GDP growth should accelerate to 3.5 per cent, as external demand improves and real incomes recover.

Poland

The Polish economy proved resilient in 2022, growing by 5.1 per cent, as investment expenditures expanded by 4.5 per cent, despite elevated financing costs and tightening bank lending. The growth momentum significantly slowed down towards the end of 2022 and in the first months of 2023. Weaker private consumption, reflecting the rapidly rising cost of living, slowdown in public expenditure growth and negative net exports, have been weighing on growth. Annual HICP inflation stood at 15.2 per cent in March 2023 while core inflation, which excludes energy, food and tobacco, reached 11.6 per cent. Although inflation is expected to return to single-digit levels before the end of 2023, it is likely to stay above the 2.5 per cent target of the National Bank of Poland well into 2025. Unemployment remains close to multi-year lows, but declining real wages took a toll on retail sales. GDP growth in Poland is forecast to drop to 0.6 per cent in 2023, recovering to 3.0 per cent in 2024. The second half of 2023 could see improved economic figures, as tax cuts passed in 2022, together with a potential pre-election spending spree, could boost domestic demand. The Polish banking system appears to be resilient in terms of capital coverage, supervision and liquidity. In the longer term, unresolved legacy issues related to Swiss franc-denominated mortgages, and the practice of ad-hoc regulatory changes such as mortgage moratoria may weigh on banks' lending appetite. This is a source of concern given the large private-sector investment needs, including to fund energy generation projects.

Romania

GDP growth in Romania reached 4.7 per cent in 2022, driven by vigorous investment which increased by 8.0 per cent, contributing almost 25 per cent to the overall value added. Household consumption was also robust, growing by 4.3 per cent, despite high inflation, which peaked in November 2022, at 14.6 per cent year-on-year (HICP measure), and dropped to 12.2 per cent in March 2023. At the same time, its core component reached 8.4 per cent, above the EU average of 6.6 per cent but lower than in many central European economies. GDP growth is expected at 2.5 per cent in 2023, rising to 3.5 per cent in 2024. Falling inflation, easing financing conditions, an improving external environment and speeder EU funds absorption, including for the national recovery programme, should all underpin strong economic performance next year.

Slovak Republic

Economic activity in the Slovak Republic expanded by 1.7 per cent in 2022, propelled by strong investment (growing at 6.5 per cent), solid household consumption (5.1 per cent) and foreign direct investment inflows totalling 3.6 per cent of GDP and concentrated in the automotive sector. Household consumption was supported by savings accumulated during the Covid-19 epidemic, while real household incomes declined as high inflation exceeded nominal wage increases. Nominal wages also experienced downward pressure from an influx of working-age Ukrainian refugees. The HICP inflation rate appears to have peaked in February 2023, at 15.4 per cent year-on-year, and slowed to 14.8 per cent in March. Amidst inflationary pressures, GDP growth is expected to decelerate to 1.4 per cent in 2023, supported by public investment co-financed by the EU. In 2024, GDP growth is forecast to accelerate to 3.0 per cent, amid improving external demand and falling global inflation.

Slovenia

In 2022, Slovenia saw one of the highest GDP growth rates central Europe region, of 5.4 per cent, propelled by robust household consumption and strong investment. The trade balance was negative, reflecting elevated energy prices. The HICP inflation rate peaked in July 2022 at 11.7 per cent year-on-year, the lowest peak value in central Europe, and fell to 10.4 per cent in March 2023, with core inflation at 7.2 per cent. As the labour market has remained tight, real wage growth is expected to pick up, boosted by the minimum wage hike from January 2023. GDP growth is expected to decelerate to 1.5 per cent in 2023, before rising to 2.3 per cent in 2024, as external demand improves and public investment benefits from increased absorption of EU funds.

Eastern Europe and the Caucasus (EEC)

In 2023, economies in Eastern Europe and the Caucasus will continue to adjust to the shock caused by the war on Ukraine. After a dramatic drop in output in 2022, the economy in Ukraine is likely to experience only modest growth, unless hostilities cease and reconstruction begins (see Box 1). Moldova is likely to see a further GDP contraction in 2023on top of the severe recession last year. In the Caucasus, the factors that caused high growth in 2022 have largely dissipated, bringing expected GDP growth rates closer to their medium-term potential. Inflation is gradually declining everywhere, but the annual level ranges from single digits in the Caucasus to around 20 per cent in Ukraine and Moldova. In the short term the region remains highly exposed to geopolitical risk. In the long term, the prospect of EU accession for Ukraine, Moldova and Georgia could be an important driver of reform and productivity improvements.

Armenia

Economic growth reached 14.2 per cent in 2022. The manufacturing sector recorded growth of 7.8 per cent and services increased by 28.2 per cent, with construction and trade growth in double digits. The services sector benefitted from the exceptional increase in non-resident demand, especially for information, communication and tourism-related services. At the same time, the net inflow of money transfers nearly doubled in 2022 due to an almost seven-fold increase in transfers from Russian citizens who found a refuge in Armenia, including many of Armenian origin. As a result, economic growth in the first three months of 2023 stood at 12.2 per cent year-on-year, but signs of a slowdown are emerging. Annual inflation subsided to 5.4 per cent in March 2023 reflecting monetary tightening and exchange rate appreciation during 2022. GDP growth of 5.0 per cent is expected in both 2023 and 2024, subject to major geopolitical downside risks.

Azerbaijan

Strong economic growth in the past two years was driven by a post-Covid-19 rebound and high hydrocarbon revenues. In 2022, output grew by 4.6 per cent, with growth of 9 per cent in the non-oil and gas sector, as the economy benefitted from large foreign-currency inflows. High prices of oil and gas boosted export revenues, while at the same time net money transfers increased six-fold, mostly linked to Russian citizens including many of Azerbaijan origin. During the first three months in 2023, economic growth sharply decelerated, to 0.4 per cent year-on-year, with output in the oil and gas sector falling by 4.0 per cent, even though gas production has benefitted from rising European demand for alternative gas supplies. Inflation has been gradually slowing down but remained high, at 13.8 per cent year-on-year, in March 2023. The Central Bank of Azerbaijan continued to raise the policy interest rate, the latest rise bringing it to 8.75 per cent in March 2023. The recent sharp deceleration of real income growth should reduce inflationary pressures. GDP growth will likely ease to 2.5 per cent in 2023 and 2.7 per cent in 2024, with downside risks on account of persistent inflation and commodity dependence.

Georgia

Robust double-digit economic growth observed for the past two years began to moderate at the beginning of 2023. Construction, trade and financial services expanded in the first months of 2023, but the manufacturing and real estate sectors were contracting. The post-pandemic rebound of tourism, however, has continued in 2023. In 2022, the Georgian economy benefitted from huge capital inflows and high demand for services boosted by significant inflows of high-skilled people from Russia, including many of Georgian origin. Income from foreign travel surpassed the pre-pandemic level in 2022 and the net inflow of money transfers almost doubled. Large foreign capital inflows covered the trade deficit. Domestic currency appreciation, together with timely monetary policy tightening by the central bank, contributed to a steady reduction of annual inflation, to 5.3 per cent in March 2023. Economic growth is likely to moderate to 5.0 per cent in 2023 and 5.3 per cent in 2024. Growth prospects are, however, clouded by the high geopolitical risks. On the other hand, a potential start of the EU accession process in the coming years could invigorate growth-enhancing reforms.

Moldova

Spillovers from the war on Ukraine and energy-supply shocks caused the economy to contract by 5.9 per cent in 2022. The same factors are continuing to affect the economy in 2023, though some improvement is likely in the second half of the year. Risks arising from the proximity to the war zone continue weighing on investment activity, which compounds the effect of a sharp drop in real incomes. On the positive side, inflation has been falling rapidly on the back of monetary tightening and weak domestic demand. External financing provided by the official sector closed the external and fiscal financing gaps in 2022, supported the exchange rate and helped to replenish foreign reserves. Such support is likely to continue in 2023, combined with the augmented IMF programme, contributing to macroeconomic stability. However, GDP is likely to decline by a further 1.3 per cent in 2023, before growth returns in 2024 (projected at 3.5 per cent). In the short term, there are significant downside risks arising from the war in the neighbourhood and energy vulnerability. In the medium and long term, prospects of EU accession can be a powerful catalyst for structural reforms and stronger economic growth.

Ukraine

After an unprecedented fall in GDP in 2022, estimated at 29.1 per cent, economic output has stabilised at around 70 per cent of the pre-war level in real terms. Most businesses continue operating, though with reduced capacity in an environment characterised by a war of attrition concentrated in the east and south-east of the country. Producers have to cope with frequent electricity shortages, damages to capital stock and infrastructure, logistical challenges, skill shortages and occasional air raids. In this tough environment, macroeconomic stability has been preserved, supported by clearer timelines of external financing and the long-term IMF programme approved in March 2023. External financing seems to be sufficient to cover large external and fiscal financing gaps and eliminate the need of monetary financing of budget deficits in 2023. Inflation dropped to 21.3 per cent year-on-year in March 2023 and is likely to decline further. Foreign reserves are expected to remain at adequate levels, supporting the exchange rate peg. Output is expected to increase by 1.0 per cent in 2023 and 3.0 per cent in 2024, on the assumption that the war continues throughout this period at a similar intensity to that observed in early 2023. The forecast is subject to high uncertainty and downside and upside risks depending on the war dynamics.

Southern and Eastern Mediterranean (SEMED)

In the southern and eastern Mediterranean region, growth decelerated sharply in 2022, as adverse external conditions interacted with country-specific vulnerabilities. The war on Ukraine negatively affected all economies through higher imported inflation and increased fiscal and external vulnerabilities. Tighter global monetary conditions exerted pressure on external accounts, and global supply chain disruptions and the economic slowdown in Europe further held back growth in some economies. In some economies, implementation of much-needed reforms has been delayed, while reliance on volatile drivers of growth such as agriculture and tourism held back growth. In 2023, a slight pick-up in average regional growth is expected as economies adapt to the impact of the war on Ukraine, agriculture rebounds and reforms progress. Downside risks reflect challenging global inflation outlook and political uncertainty. Recovery is expected to gather pace in 2024, with average growth above 4 per cent, as reforms advance in all economies.

Egypt

Growth in Egypt decelerated to 4.2 per cent year-on-year in July-December 2022 (the first half of fiscal year 2022/23), down from 9.0 per cent in the same period of the previous year. The slowdown was driven by the deceleration in the manufacturing and construction sectors (which were affected by foreign currency shortages), as well as lower Suez Canal and tourism revenues (which were affected by the war on Ukraine). The Egyptian pound lost more than 50 per cent of its value against the U.S. dollar between March 2022 and April 2023, amid heightened external vulnerabilities and the central bank's decision to shift to a flexible exchange rate regime. This depreciation, coupled with elevated international commodity prices (Egypt is a net importer of food and oil), pushed inflation close to 33 per cent, despite cumulative policy rate hikes of 1000 basis over the last year. The slowdown in growth is expected to continue and GDP is projected to increase by 4.0 per cent in fiscal year 2022/23. Growth is expected to pick up to 4.8 per cent in fiscal year 2023/24. Tailwinds include higher gas exports, Egypt's role as an energy hub for the Eastern Mediterranean and the boost from implementing business-environment reforms under the IMF-supported programme, including empowering the private sector, fostering competition and addressing fiscal and external vulnerabilities. However, headwinds could arise from further inflationary pressures, tighter monetary conditions, challenges in obtaining external financing (notably from the Gulf Cooperation Council members), and any slowdown in the implementation of structural reforms, including delays in the sale of state assets. On a calendar year basis, growth is projected at 4.2 per cent in 2023 (similar to 2022) and 5.2 per cent in 2024.

Jordan

Growth in Jordan reached 2.5 per cent in 2022, as acceleration in tourism was offset by slower growth in the mining sector. Inflation rose to 4.2 per cent in 2022, from 1.3 per cent in 2021, driven mainly by rising global food and energy and reflecting electricity tariff adjustments introduced in April 2022. Policy interest rate hikes (by a cumulative 425 basis points) mirrored the decisions of the US Federal Reserve. GDP growth is expected to remain unchanged at 2.5 per cent in 2023 as global headwinds linger and tight monetary conditions weigh down on private investment. Medium-term growth will depend on the successful implementation of the government's "Economic Modernisation Plan" to attract foreign direct investment. In 2024, stronger structural reforms momentum, more accommodative monetary policy and recovering trade flows could support growth at 2.5 per cent. The main risks to the outlook include the erosion of competitiveness stemming from an overvalued exchange rate, potential disruption to global trade, regional instability and delayed implementation of structural reforms.

Lebanon

The unyielding political deadlock continued to deepen Lebanon's economic and financial woes in 2022. The economy is estimated to have contracted by 4 per cent in 2022, with little progress on critical reforms and challenges exacerbated by rising energy and food prices, as well as supply chain disruptions. A partial recovery in tourism offered some reprieve from the otherwise bad economic news. Uncertainty surrounding a potential IMF-supported programme has increased as key requisite reforms stalled, thus keeping Lebanon locked out of international markets, with official reserves being further depleted. The official exchange rate was devalued by 90 per cent to LBP 15,000 per US dollar on 1 February 2023. This did not eliminate multiple exchange rates as the parallel exchange rate plummeted further to LBP 131,500 per US dollar in March 2023. Global inflation and repeated reductions in the few remaining subsidies have left large segments of the population in poverty, facing electricity and fuel shortages and with limited access to basic commodities. Inflation continued to be at triple-digit levels, averaging 183.8 per cent in 2022. The economy could return to growth in 2023, projected at 1.0 per cent, conditional on overcoming political hurdles and progressing towards an IMF-supported programme, which would also allow negotiations to resume with international partners. In 2024, GDP is expected to grow by 3.0 per cent provided the reform momentum gathers pace.

Morocco

Morocco's economy slowed in 2022, with growth of just 1.1 per cent, following a strong rebound of 7.9 per cent in 2021. The agriculture sector contracted because of a severe drought, while non-agricultural growth was 3.1 per cent, mainly driven by tourism and trade. As inflation accelerated to 6.6 per cent in 2022 on average (from 1.4 per cent in 2021), owing to rising food and transport prices, Bank Al-Maghrib raised its policy rate three times by a cumulative 150 basis points to 3 per cent, the first monetary tightening in 14 years. GDP growth is projected to pick up to 3.1 per cent in 2023, as agriculture recovers and inflation moderates, while Morocco's removal from the Financial Action Task Force's (FATF) Grey List provides a boost to investor confidence. Growth in 2024 is projected to be in line with pre-pandemic levels (at 3.2 per cent), and progress with reforms could give it an additional boost. However, the country remains vulnerable to increases in hydrocarbon prices, as it imports most of its energy. Global supply-chain disruptions may continue to provide further headwinds to growth, and a worsening of global conditions could affect Morocco through lower demand from Europe and tighter financial conditions.

Tunisia

Tunisia's economic growth decelerated to 2.4 per cent in 2022 from 4.3 per cent in 2021. The slowdown was driven by a contraction in the construction, mining and energy sectors and a slowdown in manufacturing, partially offset by the recovery in tourism, transport and agriculture. Inflation increased to an average of 8.3 per cent in 2022 and a 40-year high of 10.4 per cent in February 2023, mostly driven by increasing food and energy prices. In response, the Central Bank of Tunisia hiked interest rates by a cumulative 175 basis points in 2022. Growth is projected to decelerate further to 2.0 per cent in 2023, before slightly picking up to 2.3 per cent in 2024. The political instability, economic slowdown in Europe, limited fiscal space, lack of access to external financing, restrictive business environment and delays in the implementation of reforms are all expected to continue to weigh on the economy. The economy also remains vulnerable to external shocks, given its relative dependence on tourism, imported food and energy and Europe as a market for its exports. Meanwhile, a final agreement on an IMF-supported programme, if reached, could unlock the necessary external financing and accelerate reforms including removing fuel subsidies, reducing the public wage bill, narrowing the fiscal deficit and improving the business environment.

Turkiye

Türkiye's economy grew by 5.6 per cent in 2022, driven mainly by household consumption and supported by unorthodox and loose monetary policy, which saw inflation peak at 85 per cent year-on-year in October 2022. A growing range of regulations controlling the allocation of credit, together with base effects, have contributed to a decline in inflation since then, though the rate remains very high at around 50 per cent. A fiscal and credit stimulus implemented since the start of 2023, as well as a significant minimum wage hike effective from 1 January 2023, are ensuring that price pressures remain. Leading economic indicators suggest a strong start to 2023, though the adverse impact of the earthquakes in February are becoming apparent. While the output shock associated with the disasters is expected to be less than 1 per cent this year, official estimates put the damages inflicted by the earthquakes at over US$ 100 billion, implying a significant reconstruction burden.

External vulnerabilities have continued to increase, fuelling investor concerns amid political uncertainty. Driven by rising energy prices and gold imports, the current account deficit rose to 5.4 per cent of GDP in 2022 and has continued to widen further in the first few months of 2023. Meanwhile the large stock of short-term external debt has been increasing, with the volume of obligations maturing over the next year reaching a record high in February 2023, indicating external financing needs of around 25 per cent of GDP. Concerns over the country's external liabilities, low levels of foreign exchange reserves and the post-election policy outlook have been increasing the pressure on the lira, which has depreciated by 4 per cent against the dollar since the start of the year despite several measures to curb foreign exchange demand. Contingent liabilities such as state guarantees provided through the exchange-rate-protected deposits scheme suggest that any major depreciation of the currency could have an adverse impact on international reserves and the fiscal balance.

While robust household and government spending will continue to support growth in the run up to the presidential and parliamentary elections in May 2023, there is considerable uncertainty regarding the direction of economic policies after the vote. Regardless of the elections' outcomes, the authorities will need to take steps to address the growing external imbalances, which are likely to weaken economic activity during the second half of the year. Output is projected to grow by 2.5 per cent in 2023. Earthquake-related reconstruction is likely to support growth in 2024, and the economy is expected to expand by 3.0 per cent.

Western Balkans

The Western Balkans economies fared better than expected in 2022 as a strong beginning of the year partially offset a slowdown in the second half of the year. Household consumption proved resilient to rising inflation, as governments implemented sizeable fiscal packages to protect citizens' living standards and robust external demand boosted exports and tourism revenues. Economic growth slowed down in the first months of 2023, as wage increases largely failed to keep up with double-digit inflation. The slowdown of key European trading partners is set to weigh on exports, investment and remittances, but a successful tourism season could provide a boost to economic activity in some countries. Global monetary policy tightening is restricting the space for external market financing, raising the need for fiscal vigilance. North Macedonia and Serbia have managed a successful return to external markets recently and both countries initiated programmes with the International Monetary Fund, while Kosovo reached a staff-level agreement with the International Monetary Fund in April 2023. Growth is expected to pick up moderately in 2024 as downside risks subside and the global outlook turns more favourable.

Albania

Economic growth reached 4.8 per cent in 2022. Albania's tourism sector was one of the fastest in Europe to recover to pre-pandemic levels, with 2022 becoming the best year on record in terms of tourist arrivals and overnight stays. Household consumption, boosted by two minimum wage increases and robust remittance inflows, proved robust in spite of inflation, which peaked at 8.3 per cent year-on-year in October 2022, the highest level in several decades. Inflation declined to 5.3 per cent in March 2023, partly on the back of gradual appreciation of the local currency against the euro since summer 2022. Economic growth is expected to moderate to 2.5 per cent in 2023 given lower real disposable incomes, tighter monetary policy locally and the muted growth prospects of Albania's key trading partner, Italy. On the other hand, the strong performance of the hospitality sector tilts the near-term risks to the outlook towards the upside. Growth is set to pick up at 3.3 per cent in 2024, closer to the economy's medium-term potential.

Bosnia and Herzegovina

GDP growth in Bosnia and Herzegovina decelerated to 3.9 per cent in 2022. The slowdown occurred in the second half of the year when industrial activity entered a deepening contraction and rising inflation weighed on purchasing power of households. The net export position deteriorated in the second half of 2022 and the first quarter of 2023 (in year-on-year terms), reflecting the deteriorating external environment from the third quarter of 2022. Inflation moderated from a peak of 17.4 per cent year-on-year in October 2022 to 12.9 per cent in February 2023. GDP Growth is expected to moderate further to 2 per cent in 2023, as the growth slowdown in Eurozone markets continues to weigh on exports and private consumption growth remains muted, before rising to 3 per cent in 2024 on the back of an improved global outlook.

Kosovo

The economy expanded by 3.5 per cent in 2022, as external demand supported strong export growth, but domestic demand weakened on rising prices. A gradually deepening contraction of investment throughout the year was due to low public investment in infrastructure, reflecting bottlenecks in public management (which are now being addressed). The construction sector contracted reflecting lower investment. Disposable incomes of the population will continue to be boosted by high remittances (totalling around 15 per cent of GDP), credit growth in double-digits in spite of higher borrowing costs, and a hike in public sector wages at the beginning of 2023. GDP growth is expected to remain similar in 2023, at 3.5 per cent, and to accelerate to 4 per cent in 2024. Downside risks to the outlook include stickier-than-expected inflation and slower-than-planned implementation of public investment projects. On the upside, renewed engagement with the IMF lends confidence to the medium-term outlook as the authorities have reached a staff-level agreement on two programmes: a two-year precautionary Stand-By Arrangement (SBA) which is expected to provide liquidity in case downside risks materialise, and a Resilience and Sustainability Facility (RSF) supporting Kosovo's climate change mitigation and adaptation efforts.

Montenegro

Economic recovery continued in 2022 with the economy expanding by 6.1 per cent, driven by strong household consumption and robust performance of the hospitality sector, notwithstanding a deceleration in the second half of the year. Household consumption drove growth in the first three quarters of the year, boosted by a minimum wage hike and labour taxation reform at the beginning of 2022, an inflow of temporary immigrants and strong employment indicators, but slowed by year-end as inflation surged to a record 17.5 per cent in November 2022. Investment remained weak and construction activity strongly contracted as political turmoil delayed new public investment projects. Last year's robust performance of the hospitality sector and increasing diversification of Montenegro's tourists bode well for the upcoming summer tourism season, which still has further scope to recover as the number of foreign visitors in 2022 remained below record 2019 levels. The economy is forecast to continue growing, albeit at a slower pace of 3.3 per cent in 2023 and 3.7 per cent in 2024, as the global growth outlook remains weak. A potential resolution of the political deadlock represents an upside risk, provided the implementation of necessary public investment and the reform agenda speeds up. Large Eurobond repayments are coming due in 2025 and 2027 against the backdrop of increased borrowing costs.

North Macedonia

GDP grew by a modest 2.1 per cent in 2022 as rising prices of some inputs, including of largely unregulated electricity prices for companies, and a slowdown in key external markets brought a contraction of industry and construction activity. Despite a strong increase in imports, reflecting the fallout from the energy crisis, external stability was maintained thanks to robust export performance, inflows of foreign direct investment and external financing. To ensure liquidity in the face of large gross financing needs in 2023, North Macedonia reached an agreement with the IMF in November 2022 on a two-year €530 million Precautionary and Liquidity Line (PLL) and returned to external markets in March 2023 via a four-year €500 million Eurobond, issued at a yield of 6.96 per cent. GDP growth is likely to remain modest in 2023 at around 2 per cent, before rising to 3 per cent in 2024 as the expected global recovery firms up. Despite a further increase in minimum wages from April 2023, increases in pensions and price caps on some basic goods, household demand is set to remain subdued in 2023 as high levels of inflation erode real incomes. The slowdown in the main trading partners will affect exports, while increased uncertainty and tighter financing conditions may weigh on investor confidence.

Serbia

GDP growth slowed to 2.3 per cent in 2022 as household consumption growth moderated in the face of inflationary pressures. A decline in government consumption in the middle of 2022, coupled with weak investment growth, contributed to a sharp drop in construction activity. The current account deficit widened on account of higher energy imports but was entirely covered by inflows of foreign direct investment, which reached a record-high in nominal terms and a third of which came from China. The milder than expected winter of 2022-23 and stabilisation of electricity production softened the impact of high energy prices on external and fiscal accounts. GDP growth is expected to slow down further to 2 per cent in 2023 before recovering to 3.5 per cent in 2024, a level closer to the medium-term potential growth. Household consumption is set to remain subdued given persistent price pressures and a slowdown of credit growth in line with tight financing conditions. Inflation has yet to peak in Serbia as of March 2023, as ongoing increases of regulated energy prices feed into prices of other goods and services. In an environment of large financing needs and tight financial markets, liquidity is supported through a two-year Stand-By Arrangement with the IMF, which is focused on energy sector reforms, and a successful return to the external markets via two issuances in January 2023: a five-year Eurobond of US$ 750 million at a yield of 6.25 per cent and a 10-year Eurobond of US$ 1 billion at a yield of 6.50 per cent, both heavily oversubscribed.

Belarus

Widespread sanctions introduced as a result of Belarus's close cooperation with Russia have constrained business activity and limited export opportunities. As a result, output declined by 4.7 per cent in 2022. The fall was broad-based, involving the usually-resilient information and communication technology sector after many years of consistently high growth in this sector. The uncertainty resulting from the war on Ukraine and export and financing constraints caused a substantial contraction of investment and net exports. Annual inflation dropped to 6.0 per cent in March 2023 on the back of price controls and a strong base effect. As the economy has been gradually adjusting to the restrictive external environment, GDP decline eased to 2.1 per cent year-on-year in the first quarter of 2023. A GDP decline of 1.0 per cent is expected in 2023, followed by a modest recovery in 2024, with growth of 1.3 per cent, subject to significant downside risks.

Russia

Russia's economy contracted by 2.1 per cent in 2022, less than initially expected, as high energy prices partially mitigated the impact of widespread sanctions. However, lower energy prices and EU-imposed price caps on Russian oil and oil-derived products since December 2022 have negatively affected exports and government revenues. Weak consumer demand and a tight monetary policy have contained an initial rise in inflation, which, owing also to base effects, fell below pre-invasion levels in March 2023. However, the rouble has weakened by over 10 per cent against the dollar since the start of 2023, driven by lower foreign exchange revenues and sales of foreign-owned businesses, and this depreciation will contribute to inflation in the coming months. The economy is expected to contract again in 2023, by 1.5 per cent, reflecting the impact of the new sanctions. This nonetheless constitutes an upward revision relative to the forecasts made in February, driven by higher oil price expectations and redirection of oil trade to alternative destinations. A return to growth, forecast at 1.0 per cent, is expected for 2024, although this is dependent on how the war on Ukraine and the related economic sanctions will evolve.

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About this report

The Regional Economic Prospects are published twice a year. The report is prepared by the Office of the Chief Economist and the Department for Policy Strategy and Delivery and contains a summary of regional economic developments and outlook, alongside the EBRD's growth forecasts for the economies where it invests. The estimates and projections are based on statistical information available through April 27, 2023.

For more comprehensive coverage of economic policies and structural changes, see the EBRD's country strategies and updates, as well as the Transition Report 2023-23, which are all available on the Bank's website at www.ebrd.com.

Acknowledgements

The report was edited by Zsóka Kóczán (koczanz@ebrd.com) and Alexander Plekhanov (plekhana@ebrd.com), under the general guidance of Beata Javorcik, Chief Economist. Box 1 was prepared by Alexander Plekhanov and Joseph Sassoon.

Colleagues in the Communications Department, Policy Strategy and Delivery Department, the Office of the Chief Economist and other departments of the EBRD provided valuable comments and suggestions. Maxim Chupilkin and Joseph Sassoon provided research assistance.

Regional updates were edited by Peter Sanfey (sanfeyp@ebrd.com). The writing teams covering individual countries and regions were:

Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia: Ana Kresic and Olja Belic

Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine: Dimitar Bogov and Jongwoo Lim

EU member states (excluding Greece): Mateusz Szczurek and Marcin Tomaszewski

Greece: Peter Sanfey and Julia Brouillard

Egypt, Jordan, Lebanon, Morocco and Tunisia: Rafik Selim, Gretchen Biery, Soha Ismail and Reem Jodeh

Kazakhstan, the Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan and Uzbekistan: Eric Livny and Kamilla Mamatova

Russia and Turkiye: Roger Kelly and Ali Sokmen

European Bank for Reconstruction and Development
Five Bank Street London
E14 4BG
United Kingdom

Tel: +44 20 7338 6000

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