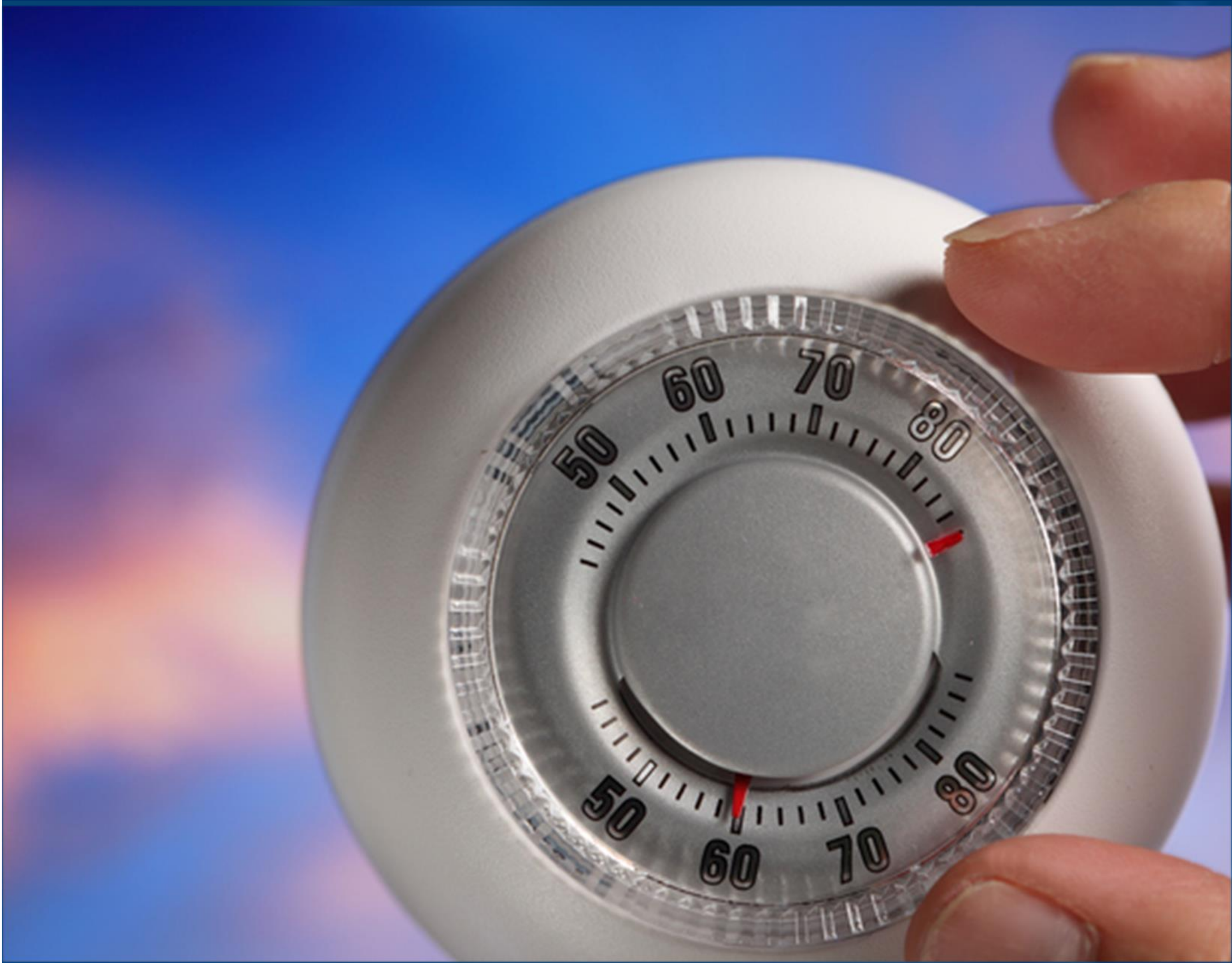
REGIONAL ECONOMIC PROSPECTS

European Bank
for Reconstruction and Development

SEPTEMBER
2023



Regional Economic Prospects in the EBRD Regions

European Bank
for Reconstruction and Development

Shifting gears

September 2023

Growth in the EBRD regions slowed from 3.3 per cent in 2022 to an estimated 1.7 per cent (year on year) in the first half of 2023 as high inflation weighed on the purchasing power of households.

Oil and gas prices have fallen back to below their pre-war levels, however gas prices in Europe remain almost 4 times the US price and are expected to pick up further during the winter. Gas consumption in Emerging Europe declined by more than 20 per cent during the winter of 2022-23 as reduced supply of gas from Russia resulted in much higher energy prices. The bulk of the adjustment to reduced supply of natural gas came from changes in the structure of industrial production—the shift away from gas-intensive industries, such as construction materials, chemicals and base metals to less gas-intensive industries such as car manufacturing and pharmaceuticals. In some economies, warmer weather and the shift to renewables in electricity generation also contributed to the reduction in gas consumption. In a few cases, reliance on coal also increased. Total industrial output was also weaker than could be otherwise expected, contributing to slower economic growth. So far large shifts in the structure of industrial production in Europe have by and large not been accompanied by reduced employment in industries with lower output, contributing to tight labour markets and high nominal wage growth amidst negative GDP growth numbers.

As increases in the prices of energy, and to a lesser extent food, moderated, inflation started coming down, averaging 9.7 per cent in the EBRD regions in July 2023, down from 17.5 per cent in October 2022. Core inflation (excluding food and energy) accounted for 68 per cent of inflation in June 2023. Disinflation is expected to become slower as core inflation dominates price increases.

Amidst high inflation, nominal wages (expressed in euros) increased rapidly in many economies. Real effective exchange rates, measuring the real value of a country's currency against a basket of the currencies of the country's trading partners, have also appreciated in most of the EBRD regions (Turkiye being a notable exception). In some cases, wage increases have been matched by labour productivity gains, for instance, in Poland. In other cases, notably in the Baltic States and Hungary, lack of corresponding improvements in productivity implies reduced competitiveness of those economies vis-à-vis their advanced European and emerging market peers.

Output in the EBRD regions is expected to grow by 2.4 per cent in 2023. This represents a 0.2 percentage point upward revision relative to the May 2023 forecast, reflecting large upward revisions in Turkiye and Central Asia, partially offset by a weaker growth outlook in Emerging Europe. Growth is expected to pick up to 3.2 per cent in 2024 as inflationary pressures gradually subside. A 0.2 percentage point downward revision relative to the May forecast reflects the base effect of higher growth now expected in 2023.

In much of central Europe and the Baltic states, the south-eastern EU and the Western Balkans, slow growth in advanced European economies weighs on the economic outlook though better-than-expected tourism seasons provided a boost to growth in tourism-dependent economies. The second half of 2023 is expected to be stronger than the weak outturns observed in the first half of the year, as real wages and consumer confidence recover on falling inflation and public investment is boosted by the disbursement of EU funds. Growth in central Europe and the Baltic states is expected to average 0.5 per cent in 2023 and pick up to 2.5 per cent in 2024. In the ***south-eastern EU*** *growth of 2 per cent is expected in 2023 as a whole, in line with outturns for the first half of the year, further picking up to 2.8 per cent in 2024. In the* ***Western Balkans****, GDP is projected to grow by 2 per cent in 2023. Growth is forecast to pick up to 3.4 per cent in 2024, in line with estimates of medium-term potential growth.*

In contrast, growth in Central Asia and parts of the Caucasus remained strong in 2022 and the first half of 2023, reflecting gains from trade and high levels of migration and remittances from Russia. Growth in ***Central Asia*** *is expected to remain robust at 5.7 per cent in 2023 and 5.9 per cent in 2024. In the* ***Caucasus****, there are signs of a slowdown following a strong first half of the year. Growth of 3.3 per cent is expected in both 2023 and 2024. Growth in* ***Ukraine*** *is expected at 1 per cent in 2023 (reflecting deeply negative growth in year-on-year terms in January-February) picking up to 3 per cent in 2024.*

In the southern and eastern Mediterranean rising fiscal vulnerabilities and weak reform momentum weigh on growth prospects, even as global food price inflation has become more muted. Output in the ***southern and eastern Mediterranean*** *is expected to grow by 3.7 per cent in 2023 and 3.9 per cent in 2024, with downward revisions reflecting delayed structural reforms and increased fiscal and external vulnerabilities. On 8 September 2023, a devastating earthquake in the Atlas mountains in Morocco resulted in widespread destruction of buildings and transport infrastructure in parts of Marrakesh and surrounding towns and villages. These forecasts do not incorporate the effects of the earthquake as the likely impact on overall economic activity remains difficult to judge at this stage. Reconstruction work set to begin in 2023 and continue in 2024 may provide a small boost to economic growth in Morocco, while at the same time increasing fiscal and external financing needs.*

Growth in ***Turkiye*** *is expected at 3.5 per cent in 2023 and 3 per cent in 2024. The upward revision for 2023 reflects the pre-election fiscal stimulus, though growth is expected to slow in the second half of the year.*

Table 1. GDP growth in real terms

	Actual				Forecast (Sep'23)		Revision since May'23	
	2021	2022	2023H1		2023	2024	2023	2024
EBRD Regions	**7.3**	**3.3**	**1.7**		**2.4**	**3.2**	**0.2**	**-0.2**
Central Asia	**5.1**	**4.5**	**5.5**		**5.7**	**5.9**	**0.5**	**0.5**
Kazakhstan	4.1	3.2	5.1		5.0	5.0	1.1	0.8
Kyrgyz Republic	3.7	7.0	3.9		4.6	7.0	-2.4	-0.2
Mongolia	1.6	4.8	6.4		7.2	7.5	0.0	0.0
Tajikistan	9.2	8.0	8.3		7.5	7.5	0.0	0.0
Turkmenistan	6.2	6.2	6.2		6.5	7.0	0.0	0.0
Uzbekistan	7.4	5.7	5.6		6.5	6.5	0.0	0.0
Central Europe and the Baltic states	**6.4**	**3.9**	**-0.5**		**0.5**	**2.5**	**0.0**	**-0.4**
Croatia	13.1	6.2	2.7		2.5	2.3	1.0	0.0
Czech Republic	3.6	2.4	-0.6		0.1	2.5	0.2	-0.4
Estonia	7.2	-0.5	-3.3		-1.8	2.0	-0.5	-0.8
Hungary	7.2	4.6	-1.7		-0.2	2.8	-0.6	-0.7
Latvia	4.3	2.8	0.1		0.3	2.0	0.3	-0.5
Lithuania	6.0	1.9	-0.8		-0.5	1.5	-0.5	-0.5
Poland	6.9	5.1	-0.8		0.6	2.7	0.0	-0.3
Slovak Republic	4.9	1.7	1.3		1.0	2.2	-0.4	-0.8
Slovenia	8.2	2.5	1.1		1.5	2.3	0.0	0.0
Eastern Europe and the Caucasus	**5.3**	**-13.0**	**-4.2**		**1.9**	**3.1**	**0.0**	**-0.2**
Armenia	5.8	14.2	11.4		6.5	4.5	1.5	-0.5
Azerbaijan	5.6	4.6	0.5		1.5	2.5	-1.0	-0.2
Georgia	10.5	10.1	7.6		6.0	4.5	1.0	-0.8
Moldova	13.9	-5.0	-2.4	e	0.0	3.5	1.3	0.0
Ukraine	3.4	-29.1	-10.5	e	1.0	3.0	0.0	0.0
South Eastern EU	**7.0**	**4.9**	**2.0**		**2.0**	**2.8**	**-0.3**	**-0.2**
Bulgaria	7.6	3.4	1.9		1.6	2.6	0.3	-0.3
Greece	8.4	5.9	2.4		2.4	2.3	0.0	0.0
Romania	5.8	4.7	1.7		1.8	3.2	-0.7	-0.3
Southern and Eastern Mediterranean	**6.2**	**3.3**	**3.7**		**3.7**	**3.9**	**0.1**	**-0.5**
Egypt	7.1	4.2	4.2		4.3	4.5	0.1	-0.7
Jordan	2.2	2.5	2.8	e	2.5	2.5	0.0	0.0
Lebanon	-10.0	0.0	1.0	e	0.0	3.0	-1.0	0.0
Morocco	8.0	1.3	3.4		3.1	3.0	0.0	-0.2
Tunisia	4.3	2.4	1.3		1.9	2.5	-0.1	0.2
Turkiye	**11.4**	**5.6**	**3.9**		**3.5**	**3.0**	**1.0**	**0.0**
Western Balkans	**7.8**	**3.2**	**1.8**		**2.0**	**3.4**	**-0.2**	**0.0**
Albania	8.9	4.8	2.7	e	2.5	3.3	0.0	0.0
Bosnia and Herzegovina	7.5	4.1	1.1	e	1.5	3.0	-0.5	0.0
Kosovo	10.7	3.5	3.9	e	3.5	4.0	0.0	0.0
Montenegro	13.0	6.1	6.1	e	3.5	3.7	0.2	0.0
North Macedonia	3.9	2.1	2.1	e	2.0	3.0	0.0	0.0
Serbia	7.5	2.3	1.2		1.8	3.5	-0.2	0.0
Memo: Egypt (fiscal year to June)	3.3	6.6	4.1		4.1	4.8	0.1	0.0
Caucasus	6.7	7.4	3.9		3.3	3.3	-0.2	-0.4
Belarus	2.4	-4.7	2.0		2.0	1.3	3.0	0.0
Russia	4.7	-2.1	1.4		1.5	1.0	3.0	0.0

Source: National authorities and EBRD. Notes: Weights are based on the values of gross domestic product in 2022 at market exchange rates. Where H1 is not yet available 'e' refers to Q1 numbers (and the May 2023 forecast for Lebanon).

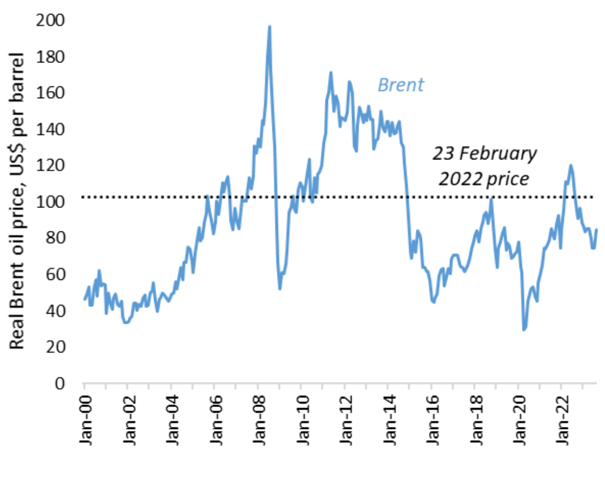
Growth in the EBRD regions slowed from 3.3 per cent in 2022 to an estimated 1.7 per cent in the first half of 2023

Growth in the EBRD regions slowed from 3.3 per cent in 2022 to an estimated 1.7 per cent year on year in the first half of 2023 as high inflation weighed on the purchasing power of households (see Table 1).

Oil and gas prices have fallen back to below pre-war levels

The Brent oil price has fallen back to below its February 2022 level (see Chart 1). Markets expect oil to trade below the August 2023 price, but still above its 2017-2021 average level. This reflects on the one hand, a weaker-than-expected outlook for China and longer-than-expected monetary policy tightening in the United States, and on the other hand supply limits by members of OPEC+, which groups the Organization of the Petroleum Exporting Countries with selected other producers.

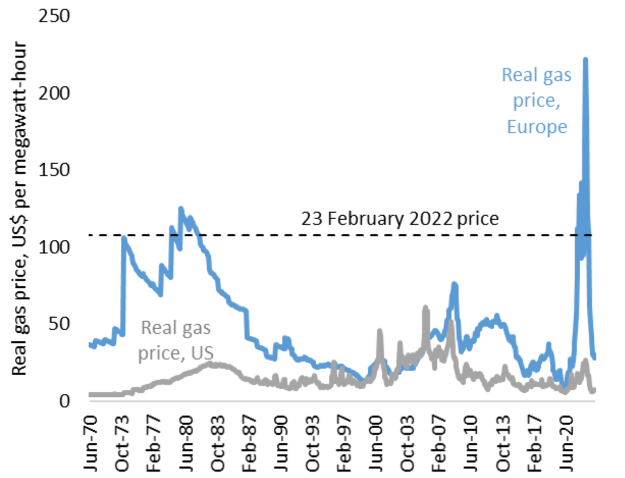
Chart 1. Oil prices back to below their pre-war levels



Source: Bloomberg, Refinitiv and authors' calculations.

The price of gas in Europe increased sharply in late 2022. It has eased since, to levels seen in early 2021 (see Chart 2).

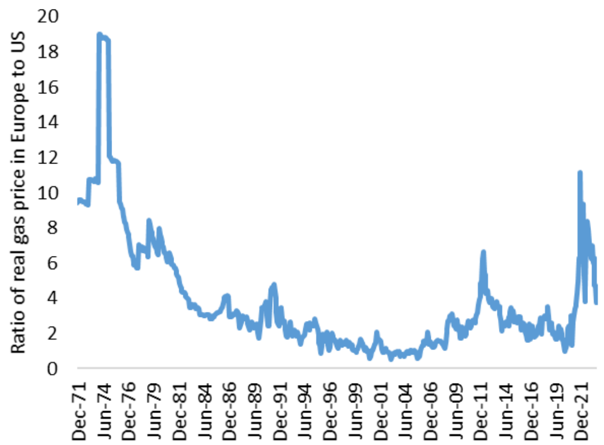
Chart 2. Gas prices in Europe have eased to levels seen in early 2021



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

Those levels are still almost 4 times the US price of gas, down from a peak multiple of 11 but exceeding the average difference between gas prices observed in Europe and in the US in 2017-21 (a factor of 2.6, see Chart 3).

Chart 3. Gas prices in Europe remain high relative to the gas price in the United States



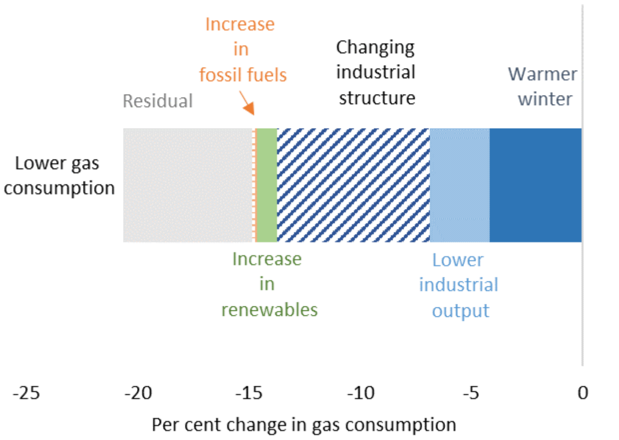
Source: Bloomberg, CEIC, IMF and authors' calculations.
Note: Prices adjusted for US inflation.

Reductions in gas consumption in Europe largely driven by shifts in industrial structures

As supplies of pipeline gas from Russia to Europe fell by more than 70 per cent year on year in the second half of 2022 and the price of energy rose sharply, consumption of gas in Europe fell by more than 20 per cent during the winter of 2022-23 (compared with the previous winter), with a milder-than-expected impact on overall economic activity. A forthcoming study by Plekhanov and Sassoon decomposes adjustments to the energy shock across European economies.

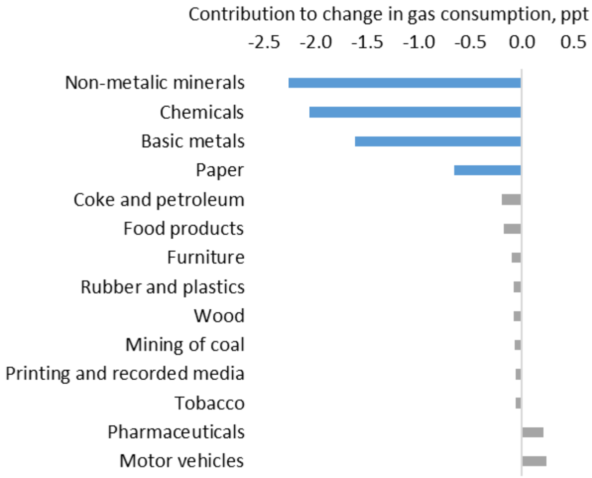
The bulk of the adjustment came from changes in the structure of industrial production—the shift away from gas-intensive industries (see Chart 4). Output reductions in gas-intensive industries, such as non-metallic minerals (including, for instance, bricks, glass and other construction materials), chemicals, base metals and paper explain about 33 per cent of the decline in gas consumption (see Chart 5).

Chart 4. Gas consumption in Emerging Europe fell by more than 20 per cent in the 2022-23 winter, driven by changes in industrial structure



Source: Plekhanov and Sassoon (forthcoming), Eurostat, IEA, national sources and authors' calculations.
Note: Year on year change. March 2023 missing for some economies. Simple averages across 12 economies in Emerging Europe and 11 economies in advanced Europe. Assumes annual energy efficiency improvements in industry of 1.8 per cent.

Chart 5. Output reductions in gas-intensive industries explain about 33 per cent of the decline in gas consumption

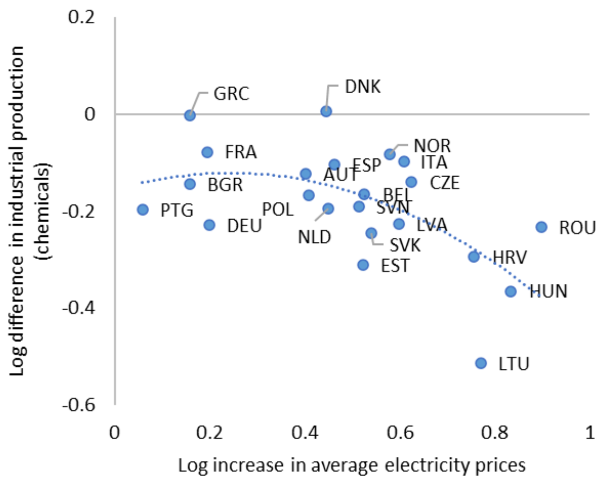


Source: Eurostat, IEA, national sources and authors' calculations.
Note: Simple average across economies. Sectors where the contribution was at least 0.05 percentage points shown.

At the same time, output expanded strongly in less gas-intensive industries, such as electrical equipment production, car manufacturing and pharmaceuticals. For instance, in Poland base metals production declined by 18 per cent, while electrical equipment production increased by 21 per cent year on year in October-March. This resulted in a net increase in industrial output of 0.6 per cent coupled with an estimated net reduction in gas consumption of 1.5 per cent (reflecting a decline of 1.6 per cent on lower base metals production and an increase of 0.1 per cent from electric equipment production).

Price incentives mattered. Carbon-intensive industries (such as chemicals, shown in Chart 6) experienced larger contractions in industrial production in economies with larger increases in electricity prices for industrial consumers (for example, Lithuania) than in economies where electricity price increases were more modest (such as in Bulgaria).

Chart 6. Carbon-intensive industries contracted more in economies with steeper increases in electricity prices



Source: Eurostat, IEA, national sources and authors' calculations.

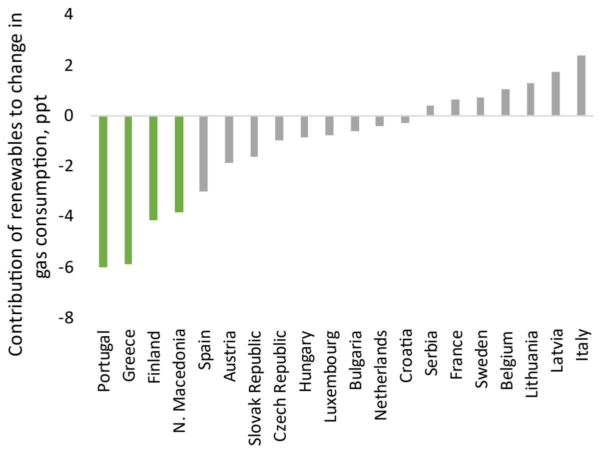
Notwithstanding shifts in industrial structure, total industrial output was lower than could be otherwise expected, contributing to slower economic growth in the last quarter of 2022 and the first quarter of 2023.

So far, large shifts in the structure of industrial production in Europe have by and large not been accompanied by reduced employment in industries with lower output, contributing to tight labour markets and high nominal wage growth amidst negative GDP growth numbers. Industry re-allocation was facilitated by some earlier slack (notably in the automotive industry) and the availability of imports from elsewhere (for instance, for construction materials). Capacity utilisation in the industry would typically be around 75 to 80 per cent, thus allowing for a temporary boost. In the longer term, however, capital expenditure and movement of workers would be needed to rebalance the structure of production. While there have been some early signs of layoffs, for instance in Lithuania in wood processing, so far these have not been widespread.

Warmer weather also contributed to the decline in gas consumption, explaining a further 20 per cent of the observed decline. The weather effect was especially pronounced in some economies in south-eastern Europe, such as Bulgaria, Romania and Serbia.

On average, the increased use of renewables and nuclear power in electricity generation accounted for less than 1 percentage point of the decline in gas consumption. The shift towards renewables, however, played an important role in Greece and North Macedonia, as well as Finland and Portugal (see Chart 7).

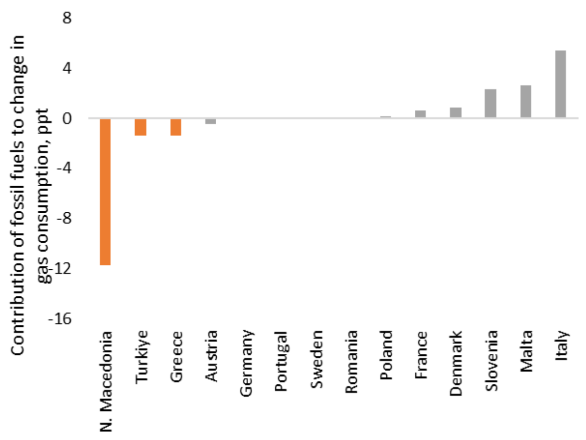
Chart 7. Increased use of renewables helped reduce gas consumption in Greece and North Macedonia



Source: Eurostat, IEA, national sources and authors' calculations.
Note: Economies where the contribution of renewables was at least 0.1 percentage points shown.

In some economies, the use of fossil fuels also increased, including a shift to coal (alongside a shift to renewables) in Greece, North Macedonia and Turkiye, and to a lesser extent in Austria and Germany (see Chart 8).

Chart 8. Some economies also increased reliance on coal

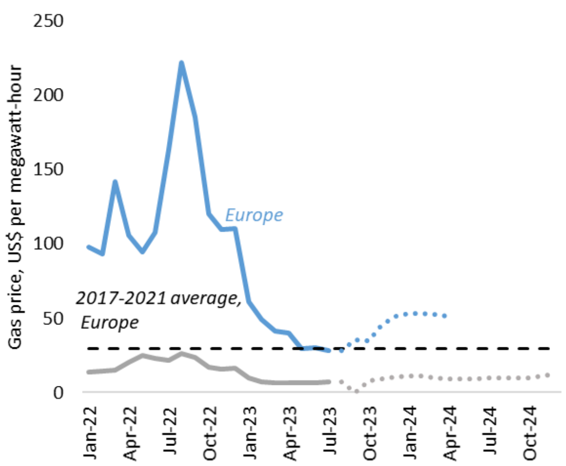


Source: Eurostat, IEA, national sources and authors' calculations.
Note: Economies where the contribution of fossil fuels was at least 0.05 percentage points shown.

Gas prices in Europe are expected to pick up in the winter

Gas futures markets imply an increase in the gas price in Europe during the heating season (see Chart 9), despite the fact that gas storage in Europe was over 90 per cent full in August 2023, compared with a five-year average of 78 per cent for the month of August.

Chart 9. Gas prices in Europe are expected to pick up again in the winter

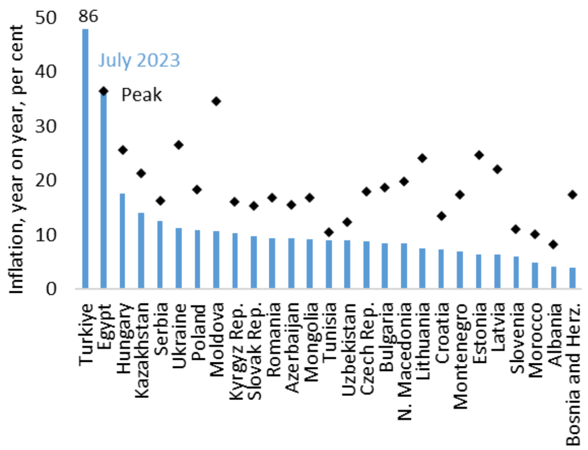


Source: IMF, World Bank via CEIC and authors' calculations.
Note: Prices adjusted for US inflation. Dashed lines denote futures.

Inflation coming down

Inflation has been coming down since October 2022 in most economies in the EBRD regions, averaging 9.7 per cent in July 2023 (see Chart 10). This is comparable to the level last seen in January 2022 and well below the peak of 17.5 per cent in October 2022.

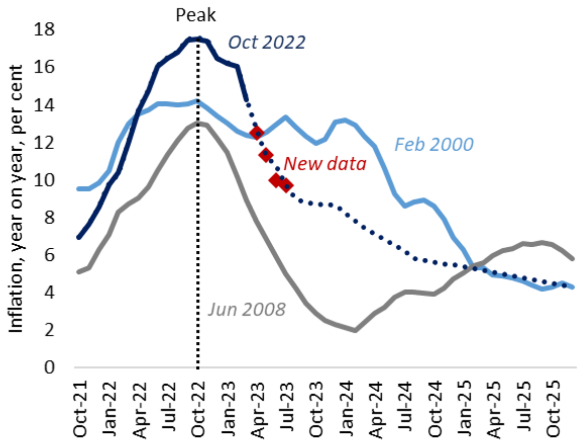
Chart 10. Inflation declined from its recent peak across the EBRD regions



Source: National authorities via CEIC and authors' calculations.
Note: Peak refers to the highest monthly inflation rate observed in the period January 2021 to July 2023. Select economies in the EBRD regions shown.

Disinflation has so far been broadly in line with expectations. Chart 11 illustrates the latest few months of data releases relative to the projections published in May 2023 Regional Economic Prospects based on the April 2023 *World Economic Outlook* database of the International Monetary Fund. The data releases point to the pace of disinflation slowing, as expected, as core inflation (which excludes food and energy prices) increasingly dominates price pressures.

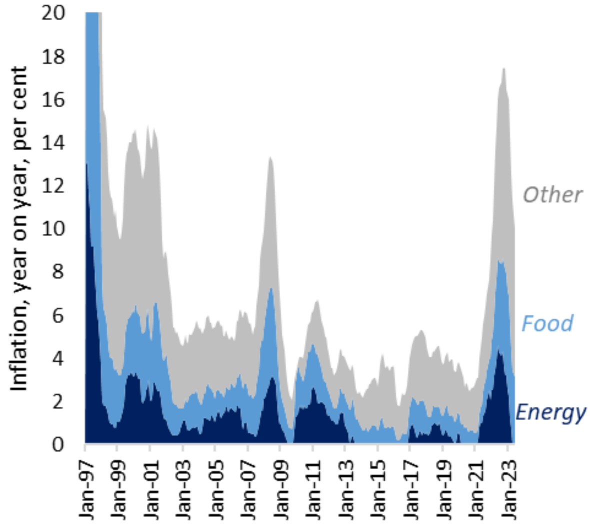
Chart 11. Disinflation has so far been broadly in line with expectations, slowing down recently



Source: May 2023 Regional Economic Prospects based on IMF, national authorities via CEIC, World Bank Global Inflation database and authors' calculations.
Note: 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 a month-to-month curve fitted based on end-of-year and annual average April 2023 IMF inflation forecasts. Curves corresponding to previous disinflation episodes are superimposed in a way that peak inflation (February 2020 and June 2008) coincides with the recent inflation peak observed in October 2022. For example, November 2022 corresponds to July 2008 for the 2008 episode, and so on. Diamonds denote data releases after the May 2023 Regional Economic Prospects.

As increases in the prices of energy, and, to a lesser extent, food, moderated, core inflation accounted for 68 per cent of inflation by June 2023 (see Chart 12).

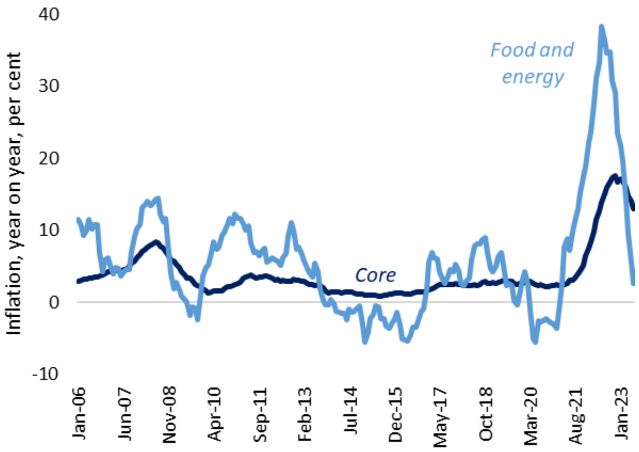
Chart 12. Core inflation (excluding food and energy) accounts for the bulk of inflation



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.

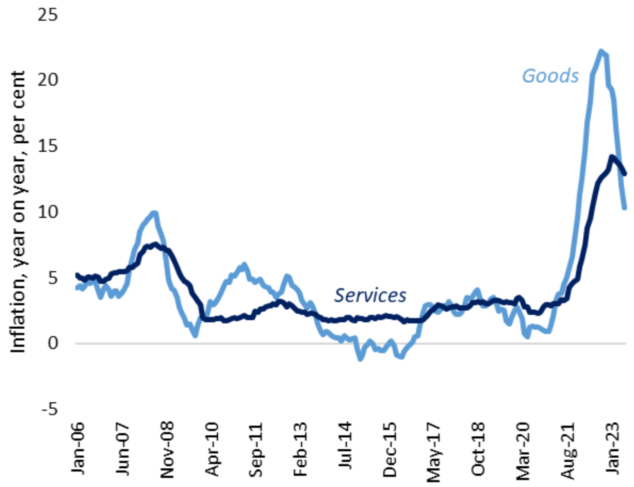
Service price inflation remained high in Emerging Europe, while goods inflation has come down as energy prices fell (see Charts 13 and 14). Spikes in food inflation (including, for instance, bread, milk, cheese and dairy, fish, meat and oils) were relatively short-lived. In contrast, drinks prices (coffee, tea, beer and wine) behaved more like the prices of services, characterised by more persistent inflation.

Chart 13. Food and energy price inflation have come down in Emerging Europe, but core inflation remains high



Source: Eurostat and authors' calculations.
Notes: Based on unbalanced samples of at least 14 economies in the EBRD regions.

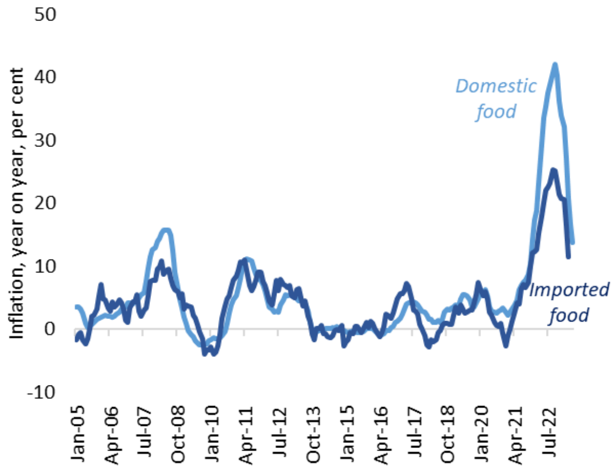
Chart 14. Service price inflation in Emerging Europe remains high



Source: Eurostat and authors' calculations.
Note: Based on unbalanced samples of at least 14 economies in the EBRD regions.

In Emerging Europe, imports played a stabilising role in the food market by increasing less in prices than domestically produced food staples (see Chart 15).

Chart 15. Food imports played a stabilizing role in Emerging Europe



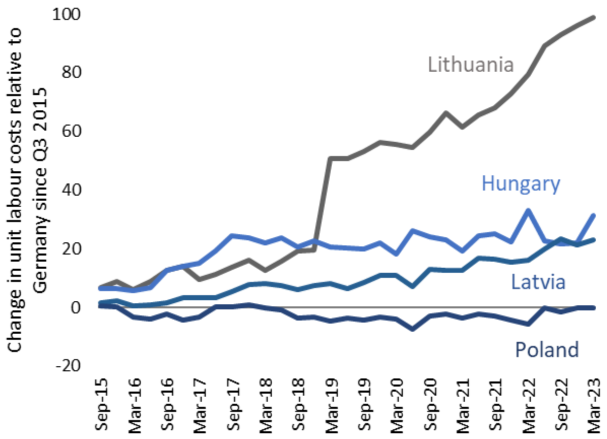
Source: Eurostat and authors' calculations.
Note: Based on a balanced sample of 10 economies (Bulgaria, Croatia, Czech Republic, Greece, Hungary, Lithuania, Poland, Romania, Slovenia, Turkiye).

Wage increases have not always been matched by productivity gains in Emerging Europe

With high inflation and relatively stable exchange rates, nominal wages expressed in euros have risen rapidly in many economies in Emerging Europe. In some cases, wage increases have been matched by rising labour productivity (for instance, in Poland) while in other cases wage increases outpaced productivity gains, resulting in lower competitiveness in the respective economies (with a higher price of a unit of labour, adjusted for productivity gains, relative to international peers).

For instance, in the Baltic states the gaps between wages and productivity have been widening relative to Germany (see Chart 16, which shows the growth in local currency nominal wages converted at market exchange rates and adjusted for productivity growth). In other words, Latvia, Hungary and Lithuania have become less competitive relative to Germany since 2015, while labour productivity growth in Poland has largely kept pace with rising wages.

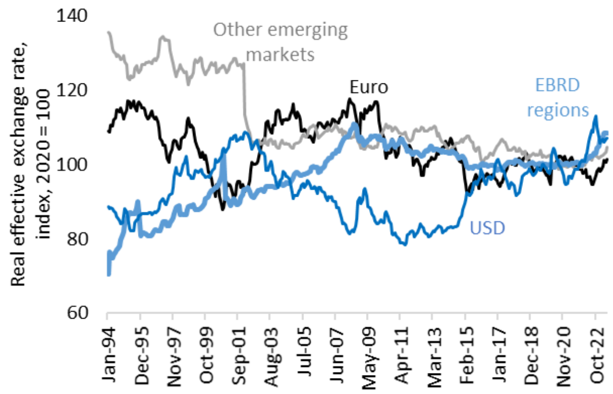
Chart 16. In most economies in Emerging Europe unit labour costs have been rising faster than in Germany



Source: CEIC and authors' calculations.

Real effective exchange rates paint a similar picture. These measure the real value of a country's currency against a basket of the currencies of the country's trading partners, a measure of the competitiveness of the country's exports. Real effective exchange rates appreciated in most economies in the EBRD regions between the 1990s and 2008, as well as recently, since the summer of 2022 (see Chart 17). While high inflation in a context of relatively stable nominal exchange rates comes hand in hand with income convergence (wages rise when expressed in euros or US dollars), it also involves a loss of competitiveness if productivity does not catch up. Loss of competitiveness may, in turn, lead to lower investment, slower growth and reversals in terms of income convergence over time.

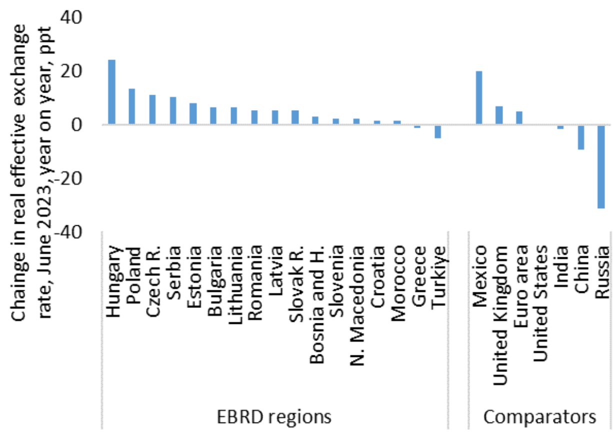
Chart 17. Real effective exchange rates appreciated in the EBRD regions



Source. BIS and authors' calculations.
Note: Balanced samples of 16 economies in the EBRD regions, 17 other emerging markets. BIS Eurozone variable. Simple averages.

Turkiye, in contrast, has seen a real effective exchange rate depreciation, which has boosted export competitiveness (see Chart 18).

Chart 18. In Turkiye, a real effective exchange rate depreciation has boosted export competitiveness

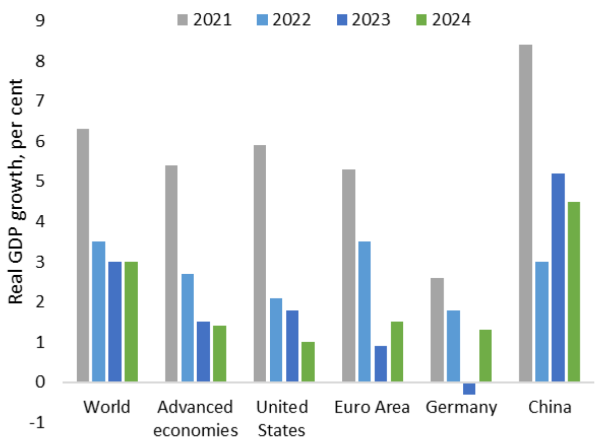


Source. BIS and authors' calculations.

Slowing global growth

The International Monetary Fund expected global growth to slow from an estimated 3.5 per cent in 2022 to 3 per cent in both 2023 and 2024 in the July 2023 *World Economic Outlook Update* (see Chart 19*)*. The rise in interest rates in response to persistent inflation continues to weigh on the economic outlook.

Chart 19. Growth in advanced economies expected to slow sharply in 2023-24 relative to 2022

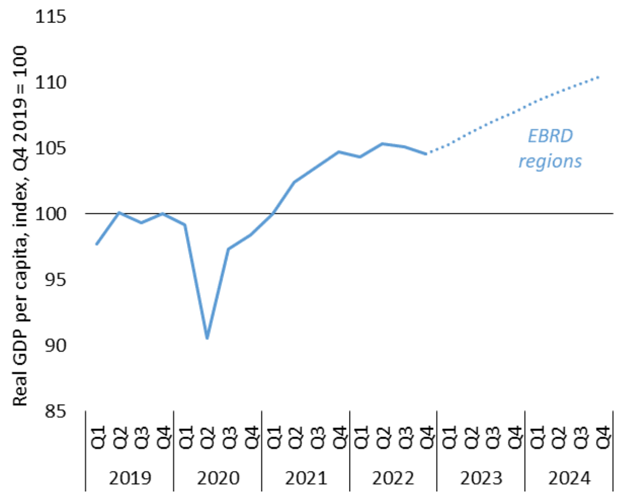


Source: IMF July 2023 World Economic Outlook Update.

Output in the EBRD regions is expected to grow by 2.4 per cent in 2023

Growth in the EBRD regions is expected to slow to 2.4 per cent in 2023 from 3.3 per cent in 2022 (see Chart 20 and Table 1). This represents a 0.2 percentage point upward revision relative to the May 2023 forecast, reflecting expectations of faster growth in Turkiye and Central Asia partially offset by weaker growth in Emerging Europe. Growth is expected to pick up to 3.2 per cent in 2024 as inflationary pressures gradually subside. A 0.2 percentage point downward revision relative to the May forecast reflects the base effect of higher growth now expected in 2023.

Chart 20. Output in the EBRD regions is expected to grow by 2.4 per cent in 2023 and 3.2 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.

Diverging trajectories

Slow growth in advanced economies weighs on growth in much of central Europe and the Baltic states, the south-eastern EU and the Western Balkans.

In contrast, growth in Central Asia and parts of the Caucasus remained strong in 2022 and in the first half of 2023 (measured in year on year terms), reflecting gains from intermediating trade to and from Russia and high levels of migration to and remittances from Russia, which, in turn, underpin robust real wage growth in these economies.

In the southern and eastern Mediterranean rising fiscal vulnerabilities and weak reform momentum weigh on growth prospects, even as global food price inflation has become more muted.

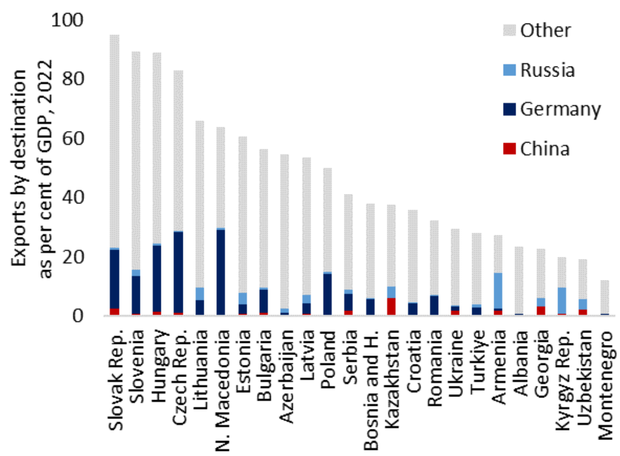
Slow growth in advanced Europe weighs on the outlook for Emerging Europe

Growth in advanced economies is expected to slow between 2022 and 2023. High-frequency indicators for the second quarter of 2023 pointed to a broad slowdown in manufacturing activity as firms scaled back investments amid softening consumption of goods, continued uncertainty, weak productivity growth and more challenging financing conditions. Gross fixed capital formation and industrial production slowed sharply or contracted in major advanced economies.[1]

In Germany, the International Monetary Fund revised growth forecasts down to -0.3 per cent in 2023 and 1.3 per cent in 2024 in its July 2023 *World Economic Outlook Update*. More generally, world trade growth is projected to decline from 5.2 per cent in 2022 to 2 per cent in 2023, well below the 2000-19 average of 4.9 per cent.

Weaker global demand for manufactured goods weighs on the outlook for economies in Emerging Europe closely integrated with advanced Europe through trade linkages (see Chart 21). The exports of central European countries tend to strongly follow the export trends of Germany, with correlations reaching 70-80 per cent in Hungary, the Slovak Republic and Slovenia.[2]

Chart 21. Slow growth in Germany weighs on Emerging European economies



Source: UN Comtrade and authors' calculations.

In Emerging Europe, Covid-19 savings appear to have been largely run down

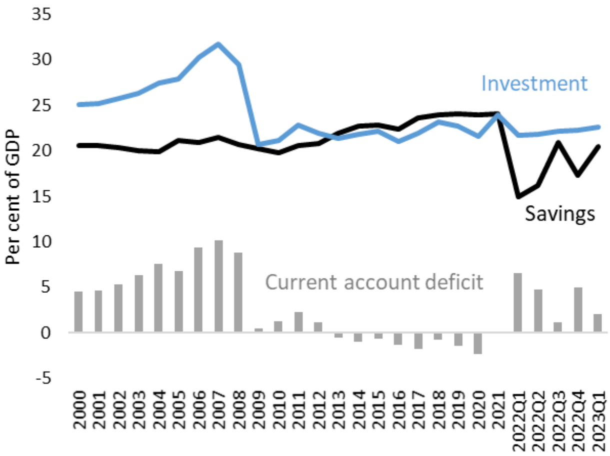
As private savings accumulated during the Covid-19 lockdowns were actively spent in Emerging Europe, consumption growth in 2022 held up despite falling real wages. This resulted in a sharp widening of current account deficits in central Europe (the current account representing the difference between domestic savings and investment).

However, savings levels in Emerging Europe are now approaching their pre-Covid levels, with narrowing current account deficits in the second half of 2022 and first quarter of 2023 (see Chart 22).

[1] See IMF (2023).

[2] See EBRD (2019).

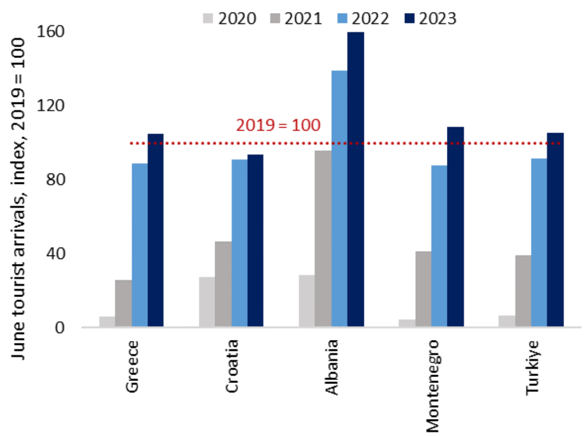
Chart 22. In Emerging Europe, savings are returning to their pre-Covid levels



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

In tourism-dependent economies, a strong tourism season has boosted growth, partly offsetting the drag from high energy prices (see Chart 23).

Chart 23. Tourism seasons started strongly



Source: National authorities via CEIC and authors' calculations.

The second half of 2023 is expected to be stronger than the weak outturns observed in the first half of the year, as real wages and consumer confidence recover on falling inflation and public investment is boosted by the disbursement of EU funds. While output in central Europe and the Baltic states declined by an estimated 0.5 per cent year on year in the first half of 2023, growth is expected to pick up to 0.5 per cent in 2023 as a whole and 2.5 per cent in 2024.

In the south-eastern EU growth of 2 per cent is expected in 2023 as a whole, in line with outturns for the first half of the year, further picking up to 2.8 per cent in 2024.

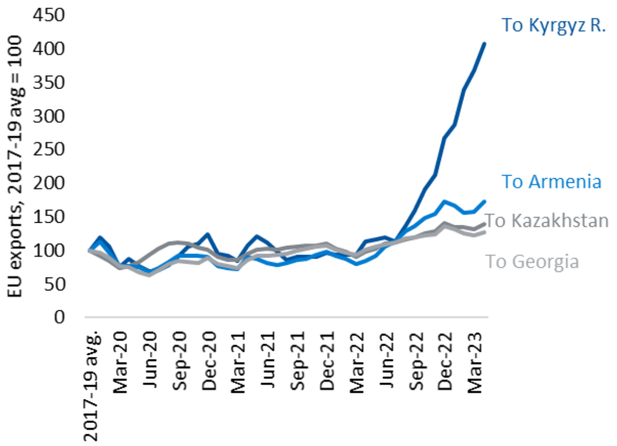
In the Western Balkans, GDP is expected to grow by 2.0 per cent in 2023, revised down in Bosnia and Herzegovina and Serbia on weak consumption growth and up in Montenegro on a better-than-expected tourism season. Growth is forecast to pick up to 3.4 per cent in 2024, around medium-term potential.

In Central Asia and parts of the Caucasus, trade continued to boost growth

In contrast with the experience of Emerging Europe, in Central Asia growth has remained strong, supported by the relocation of Russian businesses, strong trade flows and high remittance receipts.

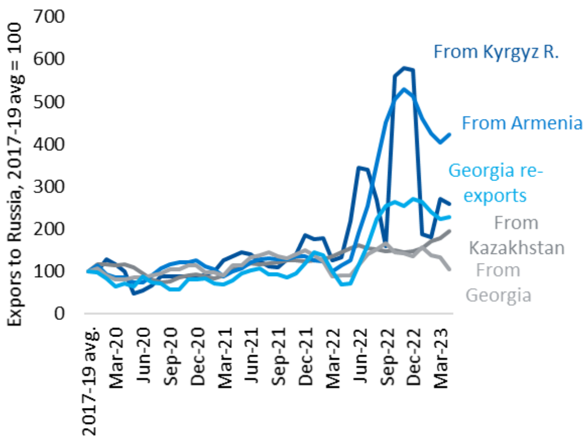
EU exports to Central Asia and the Caucasus continued to increase (through April 2023) and exports and re-exports from Central Asia and the Caucasus to Russia have more than doubled since 2021. EU exports to the Kyrgyz Republic were 307 per cent higher than in 2017-21, to Georgia they were 26 per cent higher (see Charts 24 and 25; see also Chupilkin et al. 2023a, for a discussion of Russia's trade routed via Central Asia and the Caucasus).

Chart 24. EU exports to Central Asia and the Caucasus continued to increase through April



Source: Refinitiv and authors' calculations.
Note: 3-month moving averages.

Chart 25. Exports and re-exports from Central Asia and the Caucasus to Russia more than doubled between early 2022 and early 2023



Source: Refinitiv and authors' calculations.
Note: 3-month moving averages.

Beyond 'intermediated trade', exports from Central Asian economies have also risen, including sharp increases in textile exports from the Kyrgyz Republic and home electronics from Uzbekistan. Significant investments in warehousing, logistics and transportation on the back of rising trade flows have also boosted growth.

Trade with Russia has undergone changes not only in terms of the geography of trading partners (with an increasingly important role played also by China and Turkiye) but also in terms of currencies of invoicing of export and import transactions.[3]

The Chinese yuan (CNY), in particular, became increasingly used in trade with China as well as third countries, especially with those economies that did not impose sanctions on Russia and at the same time have active currency swap lines with the People's Bank of China (for example, Mongolia and Tajikistan). Such swap lines make it easier for an exporter to use CNY received from, say, a Russian importer.[4] Over the course of 2022, the share of Russia's imports invoiced in CNY increased by 17 percentage points, to around 20 per cent.

Labour migration from Central Asia to Russia and associated remittances further supported growth. In Russia, sanctions encourage import substitution and a shift towards more labour-intensive technologies, while outmigration of working age population has further contributed to tight labour markets, with the unemployment rate down to 3 per cent in July 2023. In 2022, the number of newly registered labour migrants to Russia reached almost 3.5 million, with Central Asia accounting for about 90 per cent of these arrivals. The Kyrgyz Republic, Tajikistan and Uzbekistan all saw sharp increases in their number of migrants to Russia. For these economies the numbers of migrants newly registered in Russia in 2022 were 18 to 52 per cent higher than in 2021.

Growth in Central Asia is expected to remain robust at 5.7 per cent in 2023 and 5.9 per cent in 2024. Since May 2023, forecasts have been revised up for Kazakhstan for both years, reflecting expectation of strong investment and growth in construction. The forecast for 2023 growth in the Kyrgyz Republic has been revised down on weak gold production.

[3] See Chupilkin et al. (2023b).

[4] See Bahaj and Reis (2020).

In the Caucasus, there are signs of a slowdown following a strong first half of the year. Growth of 3.3 per cent is expected in both 2023 and 2024.

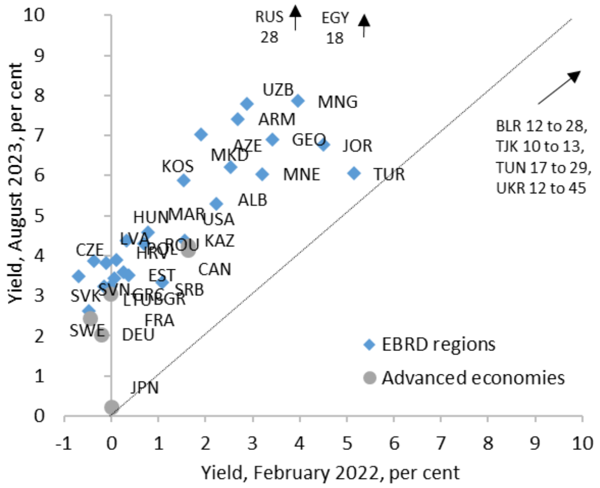
Growth in Ukraine is expected at 1 per cent in 2023. This reflects deeply negative growth in year on year terms in the first two months of the year relative to January-February 2022, which were largely unaffected by the war, but a pick-up later in the year on more businesses resuming operations and improved energy supply. Growth is expected to increase to 3 per cent in 2024.

In the southern and eastern Mediterranean reforms lagged and fiscal vulnerabilities increased further

In the southern and eastern Mediterranean weak reform momentum and rising fiscal vulnerabilities weigh on growth prospects, even as global food price inflation has become more muted.

Fiscal vulnerabilities in the region have increased further. Between early February 2022 and mid-August 2023 yields on sovereign bonds increased most in Egypt, Lebanon and Tunisia (as well as Belarus, Russia and Ukraine, see Chart 26). In the EBRD regions as a whole, the median yield on 5–year government bonds increased by 3.7 percentage points. Most of this increase reflects tightening of monetary policy in advanced economies (yields on German and US bonds increased by 2.8 percentage points, on average, over the same period). A further 0.9 percentage points are due to a widening of the spread between the EBRD regions and Germany/ the United States because of a reassessment of economic and geopolitical risks faced by individual borrowers.

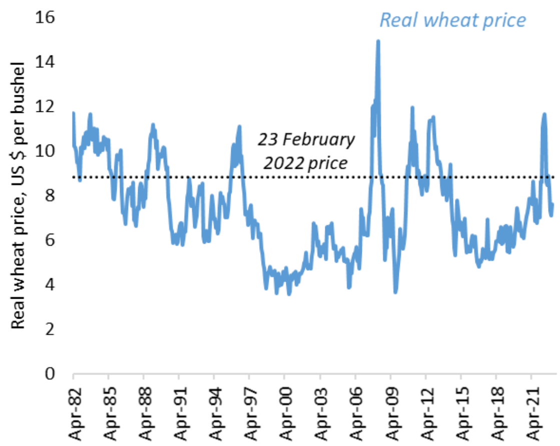
Chart 26. Yields increased sharply in Egypt, Lebanon and Tunisia



Source: Bloomberg and authors' calculations.
Note: Yields on 5-year government bonds in US dollars or closest benchmark available. As of 1 February 2022 (horizontal axis) and 17 August 2023 (vertical axis).

Prices in global food markets have normalized somewhat. Wheat prices have fallen back to their 2017-21 average (see Chart 27). While the war on Ukraine led to temporary price increases, large harvests in the northern hemisphere and increased exports from Russia have eased supply concerns. Futures markets expect a small increase in the price of wheat (of around 5-10 per cent) by the end of 2024.

Chart 27. Wheat prices have returned to their 2017-21 average levels



Source: Refinitiv and authors' calculations.
Note: Adjusted for US consumer price inflation.

On 8 September 2023, a devastating earthquake in the Atlas mountains in Morocco resulted in widespread destruction of buildings and transport infrastructure in parts of Marrakesh and surrounding towns and villages. At the time of writing, the death toll was estimated to surpass 2,900 people. Reconstruction work set to begin in 2023 and continue in 2024 may provide a small boost to economic growth in Morocco, while at the same time increasing fiscal and external financing needs.[5] The forecasts here do not yet incorporate the effects of the earthquake as the likely impact on overall economic activity remains difficult to judge at this stage.

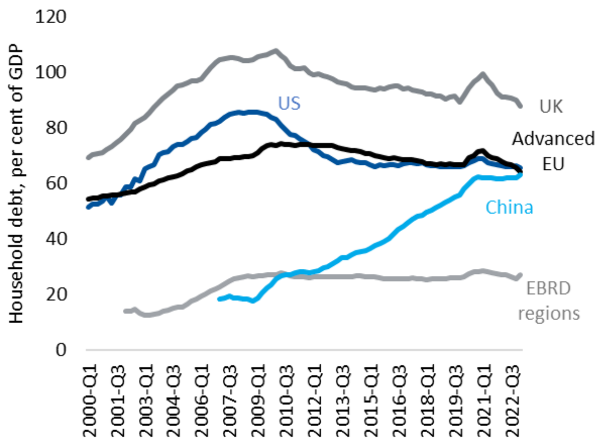
With that, output in the southern and eastern Mediterranean is expected to grow by 3.7 per cent in 2023 and 3.9 per cent in 2024, with downward revisions reflecting reform delays and increased fiscal and external vulnerabilities. In the medium term, the development of an electric vehicle cluster could provide a boost to growth in Morocco (see Box 1).

Growth in Turkiye is expected at 3.5 per cent in 2023 and 3 per cent in 2024. The upward revision for 2023 reflects strong growth in the first half of the year on account of the pre-election fiscal stimulus, though growth is expected to slow in the second half of the year.

Risks to the outlook

Slowing growth in China constitutes a notable risk to the outlook, in particular for Central Asia and the Caucasus. In early 2023, manufacturing activity and consumption of services in China rebounded as strict Covid-19 lockdown policies were lifted. However, continued weakness in China's real estate sector is weighing on investment. With lower investment levels, growth may be structurally lower than in the past decade. The previous construction-led boom was in part underpinned by a rapid build-up in household debt, which has now reached levels comparable to those seen in the United States and advanced EU (see Chart 28). Structurally slower growth in China may, in turn, result in weaker demand for the EBRD regions' exports, directly and indirectly through global supply chains.

Chart 28. The earlier construction boom in China was in part underpinned by a rapid build-up in household debt



Source: National authorities via CEIC and authors' calculations.
Note: Unbalanced sample of up to 27 economies in the EBRD regions; balanced sample of 9 economies in advanced EU.

[5] See Aksoy, Chupilkin, Koczan and Plekhanov (forthcoming) for a detailed discussion of the economic consequences of earthquakes.

Box 1. Transition to electric vehicles

Car industries have been important employers in Emerging Europe. The shift to electric vehicles will therefore have considerable implications for the labour market, reducing employment in the automotive sector, but possibly creating jobs in other sectors, such as batteries and raw materials. Electric-vehicle-related greenfield FDI projects are estimated to have created around 48,000 jobs in the EBRD regions over the period 2020-2023.

Car industries have been important employers in Emerging Europe. Relative to its population, the Slovak Republic is the world's largest car producer. Other economies in central and south-eastern Europe, such as Hungary, Poland, Romania and Slovenia, are also highly dependent on the automotive industry.[6]

The shift from combustion-engine to electric vehicles will thus have important labour market implications. As electric vehicles have fewer moving parts and are less complicated to assemble than combustion-engine cars, they require about 30 per cent less labour as well as different skill sets. Suppliers of major assemblers are especially vulnerable as many of these companies are smaller and highly specialised in the production of a particular part.

The shift to electric vehicles would, however, increase demand for jobs in other sectors, such as in chemicals, battery manufacturing and software engineering, as well as demand for raw materials, including lithium, cobalt, nickel, and graphite, as discussed in the forthcoming EBRD Transition Report 2023-24.

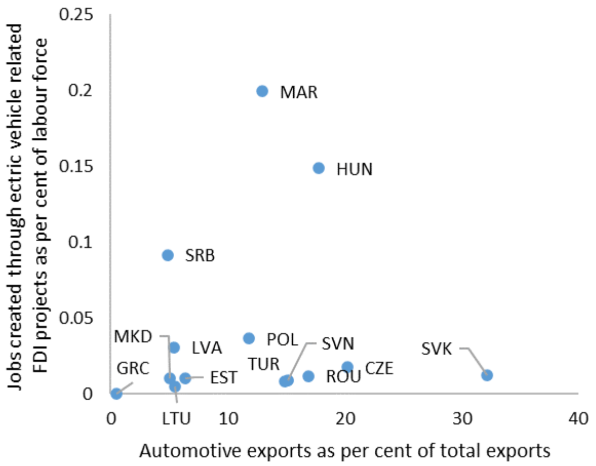
Notwithstanding the expansion of these supporting industries, the net effect on employment may still be negative. Boston Consulting Group estimates that the shift to electric vehicles in Europe will result in 630,000 fewer jobs at automakers and suppliers of parts specifically for combustion-engine vehicles by 2030, while increased demand for batteries, charging infrastructure and other supporting services could create 580,000 new jobs. The European Association of Automotive Suppliers (CLEPA) points to a net loss of 275,000 auto-industry jobs by 2040, with most of the drop-off expected between 2030 and 2035. In contrast, the European Commission expects up to 4 million battery-related new jobs to be created by 2025.

Electric-vehicle-related greenfield FDI projects are estimated to have created around 48,000 jobs in the EBRD regions over the period 2020-2023 (based on the FT fDi Markets database). Relative to the size of countries' labour forces, the rate of electric vehicle job creation was highest in Hungary, Morocco and Serbia, which are home to existing strong car manufacturing clusters. Morocco additionally has an import ban on used internal combustion engine vehicles to strengthen its manufacturing industry (similar import bans are in place for instance in Egypt and Turkiye).[7] Electric vehicle related investments in some other economies with large car industries, notably the Slovak Republic, have so far been much more limited, though there have been announcements related to electric vehicle plants to start operations in the coming years (see Chart 1.1).

[6] See EBRD (2019).

[7] See EBRD (2021).

Chart 1.1. Electric vehicle related greenfield FDI created most jobs as a share of the labour force in Morocco, Hungary and Serbia



Source: FT fDi database, IMF WEO and authors' calculations.
Note: The fDi Markets database tracks company investments (without information on the equity participation by investors) by date of announcement. This analysis includes announced, opened and closed projects, so numbers on jobs created refer to announcements in a given period, all of which may not have been realised to date. Greenfield FDI in pure electric vehicle investments, that is investments in parts for electric cars that would not typically be used in combustion-engine vehicles, but could be used in other industries. Incorporates data for the period January 2020 to June 2023. Expressed as a share of the 2022 labour force. Exports refer to 2019.

So far, electric and hybrid vehicles remain much less commonly used in the EBRD regions than in advanced Europe, resulting in more limited demand for associated infrastructure, such as charging points.

Tax benefits (including, for instance, customs, road tax and even VAT exemptions) and purchase subsidy schemes (for instance, as introduced in Poland and Serbia) for electric vehicles are common in the EBRD regions. Most economies in the EBRD regions, however, lack a comprehensive policy framework for electric vehicle promotion, though some, including Poland and Turkiye, have e-mobility strategies in place, which set targets for public procurement and charging infrastructure.[8]

Electric vehicle adoption is hindered by high initial costs relative to internal combustion engine vehicles. Although operating costs are lower, a person on median income would have to work on average 1.4 years more to purchase a new electric rather than internal combustion engine vehicle (based on an average across Egypt, Kazakhstan, Morocco, Poland, Serbia, Ukraine and Turkiye). Battery costs—the main driver of electric vehicle costs—are, however, expected to continue declining.[9]

Ultimately, the fate of economies highly dependent on the automotive industry, such as the Slovak Republic or Hungary, will be an amplified reflection of how the EU's car industry fares amidst rapid technological change. In the best-case scenario considered by Globsec, if the EU remains competitive amidst China's electric vehicle push, electric vehicle production in the Slovak Republic would reach EUR 3.4 billion and battery production EUR 5.6 billion, with employment down only marginally, by 0.3 per cent. In contrast, in a 'missed opportunity' scenario, GDP could be 10 per cent lower than in the best case scenario and employment down by 4.5 per cent on its 2020 level.

[8] See EBRD (2021).

[9] See EBRD (2021).

References

Aksoy, C. G., M. Chupilkin, Zs. Koczan and A. Plekhanov, forthcoming. “Unearthing the economic consequences of earthquakes and policy responses”

Bahaj, S. and R. Reis, 2020, “Jumpstarting an international currency”, Bank of England working paper 874.

Chupilkin, M., B. Javorcik, and A. Plekhanov, 2023a. “The Eurasian roundabout: Trade flows into Russia through the Caucasus and Central Asia”, EBRD Working Paper 276.

Chupilkin, M., B. Javorcik, A. Peeva and A. Plekhanov, 2023b. “Exorbitant privilege and economic sanctions”, EBRD Working Paper, Forthcoming.

EBRD, 2019. “Stalling engines of growth”, Regional Economic Prospects in the EBRD Regions, November 2019.

EBRD, 2021. “EBRD EV Business Approach: EV market characterization in selected COO”, Background Study.

IMF, 2023. “Near-term resilience, persistent challenges”, World Economic Outlook Update, July 2023.

Plekhanov, A. and J. Sassoon, forthcoming. “Gas consumption in Europe during the winter of 2022-23”, EBRD Working Paper.

Regional updates

Central Asia

Central Asian economies posted strong growth in the past year, driven by government spending, China's reopening and its demand for Central Asian commodities, intermediated trade with, and exports to, Russia, as well as remittances and relocation of companies and individuals from Russia. As inflation receded across all countries, central banks started lowering policy rates. Continued strong growth is expected, though higher borrowing costs could weigh on investment. On the upside, recent water and energy supply disruptions may stimulate long-overdue tariff reforms as a means of rationalising resource use and encouraging private sector investment.

Kazakhstan

In the first half of 2023, the economy grew by 5.1 per cent year on year despite the value of exports declining by 10.3 per cent year on year on lower oil prices. The uptick in growth relative to the first half of 2022 can be attributed to strong domestic demand driving a significant expansion in retail and wholesale trade (up 10.4 per cent year on year, contributing 1.5 percentage points to GDP growth) and construction (up 12.3 per cent, contributing 0.6 percentage points to GDP growth). When viewed from the expenditure side, growth was driven by fixed capital investment (up 13.1 per cent year on year), with investment in transport and warehousing capacity (up 56.8 per cent year on year) leading the way. Public investment was also a strong factor (up 34.9 per cent year on year). Having peaked in February 2023, inflation has gradually come down to 13.1 per cent in August 2023, on the back of a high central bank policy rate (16.0 per cent) and lower imported inflation. A strong increase in foreign demand for Kazakhstani government securities (up 46.7 per cent in the year to date as of July 2023) led to the Tenge's gradual appreciation against the US dollar in the first half of 2023. However, in August the Tenge returned to its January 2023 value following the government's decision to suspend the requirement of mandatory sale of export revenues. The depreciation of the Russian rouble in the second half of August was also a contributing factor. The economy is forecast to grow by 5.0 per cent in 2023 and 2024, with some uncertainty related to oil prices. Accelerated public investment in infrastructure and market-oriented reforms are the main upside. The recent escalation of security risks in the Black Sea region presents a serious threat to operations of the Caspian Pipeline Consortium (CPC) terminal in the port of Novorossiysk (a major oil export route for Kazakhstan), potentially affecting insurance costs and hindering Kazakhstan's oil exports.

Kyrgyz Republic

Economic growth slowed to 2.9 per cent year on year in the first seven months of 2023, due to an output contraction of 11.7 per cent year on year in base metals (mostly gold), which account for more than 58 per cent of the country's manufacturing output. Agriculture contracted as well (by 1.7 per cent year on year). In contrast, the textile sector boomed (up 40.2 per cent) on very strong external demand. A major expansion in tourism led to strong growth in food production (up 22.5 per cent in January-July 2023), hotels, restaurants and catering (up 26.7 per cent year on year) and retail and wholesale trade (up 14.5 per cent). A 29.1 per cent year on year increase in average nominal wages in the first half of 2023 points to strong labour demand in the formal sector of the economy, which supports domestic consumption. Concurrently, the country's foreign trade turnover expanded notably, with exports and imports rising by 34.3 per cent and 30.3 per cent year on year, respectively, in the first half of 2023, primarily reflecting intermediated trade to and from Russia. Inflation gradually decreased to 10.5 per cent in June 2023 on tight monetary policy and mirroring global trends. The Kyrgyz som remained stable throughout the year, helped by the central bank's foreign exchange interventions, though as a result the country's gross international reserves shrank by 9.8 per cent between December 2022 and July

2023. Improvements in tax administration led to a strong fiscal performance (revenues increased by 31.6 per cent year on year in the first half of 2023). Recent increases in utility tariffs will help the authorities to partially mitigate budgetary pressures stemming from ambitious infrastructure investment plans. The economy is expected to grow by 4.6 per cent in 2023, and 7.0 per cent in 2024. Windfall gains from intermediate trade could provide a major upside. However, water shortages and secondary sanctions on Kyrgyz companies cloud the outlook.

Mongolia

GDP increased by 6.4 per cent year on year in the first half of 2023 on strong domestic demand and China's re-opening. Monthly average household expenditure increased by 21.7 per cent year on year in the second quarter of 2023, supported by growth in nominal wages (up 26 per cent year on year). China's demand for Mongolian commodities, the launch of two new rail lines connecting Tavan Tolgoi coal deposits with China and the start of underground production at Oyu Tolgoi resulted in a 34.5 per cent year on year growth of exports in January-July 2023. The number of incoming travellers in the first half of 2023 increased three-fold year on year as tourism fully recovered, helping business performance in the hospitality and cashmere industries. With Mongolia's systemically important banks having been transformed into publicly traded companies, the country's stock market capitalisation exceeded US$ 3 billion, while trading volumes in the first half of 2023 nearly doubled year on year. Concurrently, the ratio of non-performing loans decreased to 8.7 per cent in July 2023 from 9.1 per cent a year ago but remains elevated. Having peaked in June 2022, inflation dropped to 9.2 per cent in July 2023. On the back of elevated export revenues, the tugrik has started to appreciate since March 2023, while gross international reserves added 15.7 per cent year to date. Meanwhile, the country was able to partly refinance US$ 1.1 billion of debt maturing in 2023 and 2024 by issuing a new US$ 650 million bond. The economy is expected to grow by 7.2 per cent in 2023 and 7.5 per cent in 2024. Stronger growth in exports, mining and tourism may strengthen the outlook, while tightening of global credit conditions and slowdown in China may limit growth.

Tajikistan

Impressive economic growth continued in the first half of 2023 when real GDP increased by 8.3 per cent year on year, supported by elevated public expenditures and the inflow of remittances from Russia. As of May 2023, real wages were up by 14.4 per cent year on year, helping domestic demand, as reflected in growing retail trade turnover (up 10.4 per cent year on year in the first half of 2023) and hotels, restaurants and catering (up 14.4 per cent). Manufacturing also expanded (by 14.2 per cent) despite a lacklustre performance in metals (including gold). Agriculture (up 7.9 per cent) and trucking (up 12.3 per cent) also posted strong growth. Services, on the other hand, expanded at a more modest rate of 5.5 per cent. On the downside, in the first half of 2023, exports fell by 44.2 per cent year on year, as exports of precious and semi-precious metals and stones came to a halt on lower global prices. Inflation was 2.3 per cent in July 2023, the lowest rate in the region, but the National Bank of Tajikistan has maintained a tight monetary policy stance, with the base rate set at 10 per cent since May 2023. Fiscal accounts improved in January-May 2023 on the back of strong tax receipts. The economy is expected to post 7.5 per cent growth in 2023 and 2024. Stronger regional cooperation, resumption of gold exports and public investment in water and energy infrastructure are key upsides. Uncertainty over external demand related to China's slowdown, as well potential conflicts over transboundary water resources, remain key risks to the outlook.

Turkmenistan

The Turkmen authorities report that the economy grew by 6.2 per cent year on year in the first half of 2023. Growth was broad-based supported by elevated public spending and higher gas exports. Wages increased, leading to an expansion in retail trade turnover. Encouraged by import substitution policies, agriculture and manufacturing grew on the back of domestic demand. Fixed capital investment rose by 24.6 per cent year on year. Turkmenistan has recently established new air connections in an attempt to strengthen ties with potential trading partners, resulting in a more than tripling of cargo operations by Turkmen Airlines. Concurrently, the cargo turnover at the International Seaport in Turkmenbashi more than doubled in January-July 2023 (up 125.7 per cent year on year). The port's recent inclusion in the list of green ports and its international certification by Eco port bode well for the country's transit attractiveness. Supported by higher tax revenues, the government's budget achieved a surplus of 2.3 per cent of GDP in the first half of 2023. In August 2023, Fitch affirmed Turkmenistan's "B+" rating with "Positive" outlook, citing a strong fiscal position and low public debt in the presence of structural challenges. The economy is forecast to grow at 6.5 per cent in 2023 and 7.0 per cent in 2024. While the country benefits from windfall gas revenues in the short term, overreliance on a single export product (gas) and a single market (China) is a major vulnerability.

Uzbekistan

The economy grew by 5.6 per cent year on year in the first half of 2023. Elevated external demand strengthened the country's exports (up 31 per cent year on year). However, remittances dropped in the first half of 2023 (by 21.5 per cent year on year), albeit from a high level. Nevertheless, domestic demand was supported by a 21.9 per cent year on year increase in nominal wages in the second quarter and buoyant credit growth. Retail trade expanded at the rate of 6.9 per cent year on year in the first half of 2023. Other sectors, including industry (up 5.6 per cent year on year), construction (up 4.8 per cent), services (up 12.3 per cent year on year), and agriculture (up 3.8 per cent year on year) grew as well. Having peaked in July 2022, inflation moderated to 9 per cent in June 2023 mirroring global trends and reflecting tight monetary policy (the central bank's policy rate has been set at 14 per cent since March 2023). In August 2023, the Uzbek sum lost 4.0 per cent of its value against the US dollar as Russia's rouble depreciated sharply. Between end-2022 and July 2023, Uzbekistan's international reserves declined by 5.7 per cent but remain broadly sufficient. GDP growth is expected to reach 6.5 per cent in 2023 and 2024. Well-managed IPOs and privatisations may strengthen the outlook. A further plunge in remittances, however, is a key downside risk in the short run. In the longer run, the country's development is constrained by aging infrastructure and water supply issues.

Central Europe and the Baltic states

In central Europe and the Baltic states, economic activity slowed in 2022, followed by negative growth in the first half of 2023. Elevated price levels, especially of food and energy, have weighed on households' purchasing power. Tight financing conditions have discouraged many companies, especially small and medium-sized enterprises (SMEs), from going ahead with significant investment projects, and the situation has been aggravated by higher energy costs and weakening orders. Sluggish external demand from Western Europe has negatively hit the manufacturing sector. Nevertheless, the labour market has remained resilient, with companies preferring to retain staff, and unemployment rates continue to remain at their historical lows. The second half of 2023 is expected to see some improvements in economic activity, supported by real wage growth and accelerated investment, including co-financed by the terminating 2014-2020 EU budget and the Recovery and Resilience Facility (RRF).

Croatia

The Croatian economy expanded by 6.2 per cent in 2022, among the highest growth rates in the EU. Growth was driven by domestic demand, including accumulation of inventories, while net exports had no overall effect on growth. In the first two quarters of 2023, GDP grew by 2.8 per cent and 2.7 per cent year on year, respectively. While private consumption accelerated in the second quarter amid declining inflation, exports recorded an annual decline in April and May 2023, mainly due to lower exports of fuels and crude materials. Industrial production also fell for six months in a row until May 2023, reflecting weak foreign demand and supply-side shocks. On a positive note, tourist nights in the first half of 2023 were 5 per cent higher than the record levels in 2019, and revenues are well up on the 2022 levels, reflecting price increases. GDP is forecast to grow by 2.5 per cent in 2023, with weak external demand and tighter financial conditions weighing on growth. Upside risks to the forecast are a stronger-than-expected tourism season, recovering domestic demand supported by a tight labour market and an EU funds-driven investment acceleration. In 2024, GDP could expand by 2.3 per cent, as domestic demand moderates while demand from key trading partners recovers.

Czech Republic

The economy continues to suffer from the negative effects of high inflation. Despite the economy avoiding a technical recession (two quarters of consecutive negative growth), GDP declined by 0.6 per cent in annual terms in the first half of the year. The contraction was caused by subdued domestic demand as private consumption declined for the fifth quarter in a row year on year. Nevertheless, positive quarterly growth of household consumption in the second quarter suggests that abating inflation bodes well for a gradual recovery. Exports also recorded a quarterly decline in April-June 2023 after strong growth in the previous three quarters, reflecting potential weaknesses ahead. On a positive note, investments rebounded in the second quarter. Inflation remained high at 8.8 per cent in July 2023, but is on a clear downward path. Real wages fell by 3.1 per cent in the second quarter of 2023. Financial conditions will remain tight as upside risks to inflation are strong. The Czech economy is expected to grow by 0.1 per cent in 2023 as the second half of the year could bring some rebound of consumption amid a still tight labour market. Weakening foreign demand is a key downside risk to the forecast. In 2024, amid easing monetary policy, growth is expected to return towards its potential, at about 2.5 per cent.

Estonia

Following a contraction of 0.5 per cent in 2022, economic activity fell further by an estimated 3.3 per cent year on year in the first half of 2023. High inflation, despite its recent deceleration, has taken its toll on disposable incomes of households, with real wages recovering slowly and unequally, depending on sector-specific nominal wage adjustments. Estonia's key trading partners in the EU, especially the Nordic economies, are stagnating, which has resulted in a sharp fall in Estonian exports in 2023. A drop in demand hit the manufacturing sector, including furniture production, aggravated by weaker activity in the construction sector. A further reduction in GDP is anticipated this year, by 1.8 per cent, before a return to growth of 2.0 per cent in 2024. Uncertainty related to external demand constitutes the key risk to this scenario, but an expected recovery in investment, including RRF-funded investment in green energy and infrastructure, is expected to support the economy in the coming years.

Hungary

Following GDP growth of 4.6 per cent in 2022, economic activity shrank by 1.7 per cent year on year during the first half of 2023. The previous year's strong household consumption was largely fuelled by pre-election fiscal expansion and measures to contain inflation. The base effect relating to these measures, combined with increased energy and food prices, caused inflation to accelerate, suppressing households' purchasing power since late 2022. Ongoing fiscal consolidation and slower investment growth have weighed on GDP performance since the fourth quarter of 2022. While the annual HICP inflation rate peaked at 26.2 per cent in January 2023, it remained the highest among EU members in July 2023, at 17.5 per cent. As a result, real wages have been decreasing since mid-2022, even as nominal wages continued rising at double-digit levels. Unemployment has remained below 4 per cent since summer 2021; the government re-launched its job creation programme in January 2023 with the aim of maintaining employment levels during the current slowdown. Weak external demand, tight financing conditions and delayed disbursement of EU funds, will likely result in a 0.2 contraction of GDP in 2023, notwithstanding various government stimuli programmes. Growth is expected to recover to 2.8 per cent in 2024, on the back of recovering domestic demand.

Latvia

Among its Baltic peers, Latvia's economy has seen a soft landing, with GDP growth decelerating to 0.1 per cent year on year in the first half of 2023, after 2.8 per cent growth in 2022. Real wages are set to start recovering by end-2023. Following a peak of 21.7 per cent in November 2022, the HICP inflation rate has been falling steadily, to 5.6 per cent in August 2023. Elevated financing costs have weighed on investment, but accelerated EU funds absorption, including from the RRF, is likely to support investment during the coming years. Among large upcoming projects are investments in electricity transmission, solar and wind energy as well as rehabilitation of hydropower plants. Latvia is expected to be the only Baltic economy to see positive GDP growth this year, at 0.3 per cent, accelerating to 2.0 per cent in 2024 as real wages and investment recover.

Lithuania

Following a sharp slowdown in 2022, when GDP grew at the rate of 1.9 per cent, the economy shrank by 0.8 per cent year on year in the first half of 2023. The slowdown has been largely driven by sustained inflationary pressures on households' real incomes, worsened economic ties with China and weak demand from the EU, all weighing on industrial activity and consumer confidence. While the unemployment rate, at around 6.0 per cent in mid-2023, has remained low, weaker performance of industry has started to take its toll on the labour market, with the wood industry laying off about 20 per cent of staff amid low orders. Investment expenditures, both public and private, will likely rebound as Lithuania has an ambitious plan to turn from being an electricity importer into an electricity exporter by 2030. The €1 billion investment plan for green energy development and energy efficiency, partially co-financed by EU funds including from the RRF, is expected to stimulate the Lithuanian economy in the coming years. Amid slowly recovering real wages and weak external demand, GDP is expected to contract by 0.5 per cent this year, followed by economic growth of 1.5 per cent in 2024.

Poland

Economic activity remained robust in 2022, growing at 5.1 per cent, before dropping sharply by 0.8 per cent in annual terms in the first half of 2023. High growth in inventories has been the key economic growth driver for the last two years, triggered by uncertainty related to value chains and weakening, inflation-hit household consumption. Increased financing costs and a further delay in RRF transfers have hampered investment, though military spending has risen. Subdued external demand has negatively affected exports, while recently stabilised energy prices have provided some relief to the current account, which turned to a surplus in the first half of 2023. While HICP inflation peaked in February 2023, at 17.2 per cent, it is still among the highest in the EU at 10.3 per cent in July 2023. In June 2023, however, economy-wide real wage growth turned positive for the first time since end-2021. Structurally, labour market pressures are eased by the inflow of refugees and migrants, counterbalancing unfavourable demographic trends. Given the overall subdued economic activity in 2023, GDP is forecast to rise at just 0.6 per cent. The expected return to positive real wage growth, low unemployment and an improvement in consumer sentiment are all expected to lift GDP growth to 2.7 per cent in 2024. The central bank's larger-than-expected cut in the main policy rate, by 0.75 percentage points to 6.0 per cent in early September will likely provide some relief to indebted households and companies, though disinflation is expected to be slower, also reflecting the depreciation of the zloty against the euro. Further delays in RRF transfers and uncertainty about potential increases in energy prices constitute the main risks to improvements in investment, which stood at 16.7 per cent of GDP in 2022, below the EU-average level of 22.5 per cent.

Slovak Republic

After an impressive GDP growth of 4.9 per cent in 2021, the rate of economic growth in the Slovak Republic slowed to 1.7 per cent in 2022 and 1.3 per cent year on year in the first half of 2023. High inflation rates have weighed on households' disposable incomes, while elevated prices of imported energy have negatively impacted the terms of trade. Increased financing costs, triggered by higher policy rates and an increased risk premium amid uncertainty related to the war on Ukraine, together with slow utilisation of EU funds, weighed on domestic investments. In 2022, the number of personal bankruptcies increased by almost 12 per cent compared with 2021, to 9,674 individuals, according to the Slovak Credit Bureau CRIF. Rising prices of energy and high personal indebtedness levels have worsened households' economic situation during the past two years. The labour market is expected to remain tight, with unemployment rates at historically low levels, but skills mismatches and deteriorating demography weigh on the country's growth potential. GDP growth is anticipated to slow to 1.0 per cent this year, accelerating slightly to 2.2 per cent in 2024 as households' purchasing power starts to improve.

Slovenia

After expanding by 2.5 per cent in 2022, the economy has entered a phase of milder growth as GDP grew by 1.1 per cent year on year in the first half of 2023. Behind the slowdown were lower private consumption and weaker exports. Nevertheless, a sharp drop in imports resulted in a strong increase in the trade surplus, while investments expanded by almost 10 per cent year on year. Inflation was 6.2 per cent in August 2023, and despite relatively strong nominal wage growth of 10.4 per cent in the first quarter of 2023, private consumption remains depressed, with retail sales recording annual declines since March 2023. Flash floods in early August caused damages of up to €5 billion, forcing the government to revise the 2023 budget deficit to 4.9 per cent of GDP, with most relief expenditure expected in 2024. The government also provided financial support to affected municipalities. To finance reconstruction, the government introduced a tax of 0.3 per cent of income for citizens and 0.8 per cent for firms. GDP growth of 1.5 per cent is forecast in 2023, with significant downside risks, and 2.3 per cent growth is expected in 2024. On the upside, investment will likely accelerate as reconstruction starts and EU funds are disbursed.

Eastern Europe and the Caucasus

In 2023, economies in Eastern Europe and the Caucasus have been adjusting to the extreme shock to their economies caused by the war on Ukraine. The Ukrainian economy is likely to show modest growth in 2023, subject to high uncertainty related to the war's intensity. Moldova is struggling to leave recession behind in the face of multiple structural challenges. In the Caucasus, growth decelerated in 2023, from the extraordinary levels observed in 2022, to rates closer to long-term potential. Inflation has slowed down considerably throughout the region, though at a different pace in different countries. In Armenia and Georgia, inflation is already below the target level, but it remains in high single-digits in Ukraine, Moldova and Azerbaijan. In all economies, the war on Ukraine remains a major risk to the economic outlook.

Armenia

The economy continued its exceptionally strong performance in 2023, but the first signs of a slowdown are already visible. GDP growth reached 10.4 per cent year on year in the period from

January to July 2023, driven by the strong performance of service industries in particular. Net inflows of money transfers, which have been driving demand for services, declined by 10 per cent year on year in the first half of 2023, but the growth rates of exports and imports of goods remained robust. The exchange rate and foreign reserves have been broadly stable since the beginning of 2023. At the same time, the inflation rate fell below zero in July 2023, contributing to the reversal of the real effective exchange rate appreciation seen in the past two and a half years. The Central Bank of Armenia has started a gradual reduction in the policy rate, with two 25-basis point cuts in June and August 2023, bringing the policy rate to 10.25 per cent. Growth is likely to moderate in the second half of the year, as the temporary factors that contributed to Armenia's double-digit growth are dissipating. Therefore, GDP is expected to grow by 6.5 per cent in 2023 and 4.5 per cent in 2024. Geopolitical developments remain an important source of downside risks. The isolation of Russia, a major trading partner for Armenia, from western markets could have negative long-term consequences for the Armenian economy. Further escalation of the conflict with Azerbaijan is another major risk to economic prospects. On the upside, progress in re-opening the land border with Turkiye could yield economic benefits in the medium term.

Azerbaijan

After two strong years, GDP growth decelerated to 0.7 per cent year on year between January and July 2023. Growth in the non-oil sector slowed to 3.4 per cent from 9.0 per cent in 2022, mainly due to weaker growth of disposable incomes. The oil and gas sector continued to decline, by 2.2 per cent year on year over the same period. Nevertheless, export and fiscal revenues remained robust amid an oil price above the pre-war level and rising demand for Azerbaijan's gas. In mid-2023, the government amended the budget to increase public sector wages and public investment, providing fiscal stimulus to the sluggish economy. Domestic demand also benefited from the strong increase in loans to households by 25.8 per cent (year on year) between January and July 2023. However, demand pressures have kept inflation relatively high at 9.4 per cent in July 2023 and the Central Bank responded by increasing its policy rate to 9.0 per cent in May 2023. High energy export revenues are likely to support GDP growth in the short term. Therefore, GDP is forecast to increase by 1.5 per cent in 2023, with growth strengthening to 2.5 per cent in 2024. The forecast is highly dependent on developments in the oil and gas markets.

Georgia

The economy grew at a robust rate of 7.6 per cent year on year in the period from January to July 2023. Financial services, tourism, construction, and trade were the main drivers of growth, while the manufacturing and mining sectors registered declines. Income generated by foreign travellers increased by 57.9 per cent year on year in the first half of 2023 and tourism revenues are now well above pre-pandemic levels. Net money inflows continued growing at 29.4 per cent year on year in the first half of 2023, playing a crucial role in covering a significant part of the trade deficit and helping to bring down the current account deficit. Annual inflation fell to 0.9 per cent in August 2023, well below the National Bank of Georgia's (NBG) 3 per cent target. However, as domestic demand and cash inflows from migrants remain strong, the NBG has been cautious about rate cuts. It reduced its policy rate by 50 basis points in May 2023 and by a further 25 basis points in August, to 10.25 per cent. Given the continued strength of the economy in the first half of 2023 and the expected slowdown in the second half of the year, GDP is projected to grow by 6.0 per cent in 2023 and 4.5 per cent in 2024. The main downside risks stem from geopolitical developments. On the upside, the possibility of gaining EU candidate status could give a new impetus to structural reforms enabling growth and promoting economic stability.

Moldova

The economy continued to struggle in the first half of 2023 after a steep decline in economic activity in 2022. GDP decreased by 2.4 per cent year on year in the first quarter of 2023 mostly due to the continued drop in private consumption. Industrial production fell by 7.6 per cent year on year in the first half of 2023 and agricultural production declined by 1.0 per cent, both on top of deep contractions in 2022. On the other hand, annual inflation came down sharply, to 9.7 per cent in August 2023 on the back of stabilised global energy prices, allowing the National Bank of Moldova to implement a series of cuts to the policy rate, from 21.5 per cent in November 2022 to 6.0 per cent in June 2023. Significant official sector external financing in 2023 has supported the domestic currency, boosted foreign reserves and eased the pressure on the overstretched government budget. The government has raised public sector wages and pensions and expanded social support to the most vulnerable. Together with falling inflation, this led to real income growth turning positive in the second quarter of 2023, paving the way for a rebound of the economy in the second half of 2023. Therefore, GDP is expected to remain flat in 2023 and grow by 3.5 per cent in 2024, supported by policy reforms in the context of EU accession and continued robust external financing.

Ukraine

GDP fell by 10.5 per cent year on year in the first quarter of 2023 (a sharp contraction in year-on-year terms as January-February 2022 were largely unaffected by the war), though inflows of external financing and a new IMF programme supported some macroeconomic stability. Financial support from partner countries and international organisations so far in 2023 has equalled the amount received in the whole of 2022. This has helped to alleviate the pressure on the currency and lift official foreign reserves to US$ 41.7 billion at the end of July 2023. The inflation rate dropped to 8.6 per cent in August 2023 from a peak of 26.6 per cent in December 2022. These positive developments opened the way for the National Bank of Ukraine to start easing monetary policy and gradually remove some of the foreign exchange restrictions introduced in the aftermath of the invasion. At the same time, war-related uncertainty remains exceptionally high. The war negatively affected the finances of most businesses and domestic demand remains depressed due to the displacement abroad of more than 8 million people. The recent non-extension of the grain export corridor and the wave of destruction of grain port infrastructure add to the uncertainty when it comes to the short-term outlook. GDP is forecast to grow by 1.0 per cent in 2023 as growth is expected to pick up later in the year on more businesses resuming operations and improved energy supply, and 3.0 per cent in 2024, on the assumption that the war continues at the current intensity.

South-eastern EU

Economies in the south-eastern EU have seen a significant deceleration of growth in 2023, mostly reflecting a weaker external environment and the impact of inflation on household spending and confidence. However, investment trends remain positive and the availability of substantial EU funds in the coming years will be an important driver of short- and medium-term growth.

Bulgaria

After expanding by 3.4 per cent in 2022, the Bulgarian economy is cooling down amid weaker external demand and an inflation-caused consumption deceleration. In the first two quarters of 2023, GDP grew by 2.1 per cent and 1.8 per cent year on year, respectively, with private consumption growth decelerating to 1.3 per cent year on year in the second quarter. Moreover, exports recorded a year on year decline of 0.8 per cent as raw materials and energy exports slumped in the first months of 2023 after a strong outturn in 2022. This was caused by the fall of coal and nuclear electricity production and moderation of market prices, rendering Bulgarian electricity less competitive. The decline in exports is also reflected in the decline of manufacturing since March 2023. The effect of the export contraction on GDP was outweighed by a 6.7 per cent decline in imports. On a positive note, investment has been on a recovery path after three years of underwhelming performance. GDP growth for the year as a whole is expected at 1.6 per cent, as the effect of weaker consumption may be offset by greater investor confidence on account of the newly formed coalition government paving the way to improved political stability. Notwithstanding the planned fiscal consolidation and lower government spending, EU funds could further support investment. In 2024, growth is forecast to pick up to 2.6 per cent, supported by moderating inflation, accelerating EU funds absorption, and stronger foreign demand. Key downside risks to the forecast are another energy price shock and protracted weakness in key trading partners, while political risks remain elevated.

Greece

The economic performance of Greece has remained robust in 2023, albeit well below the high growth rates of the previous two years. GDP rose by 2.0 per cent year on year in the first quarter, boosted by strong export growth as well as rising private consumption and investment. Provisional data for the second quarter show a GDP rise of 2.7 per cent year on year. The country is also on track for a record tourism season in 2023. Economic confidence is steadily improving, with the Purchasing Managers Index (PMI) on an upward trend since December 2022 (at 52.9 in August 2023), and the Economic Sentiment Indicator (ESI) reaching a 17-month high (111.7 points in August 2023). Unemployment continues on a steady downward path, at 10.8 per cent in July 2023. Despite some concerns around the current account deficit (9.7 per cent of GDP in 2022), exports rose by 8.9 per cent year on year in the first quarter of 2023. The ratio of investment to GDP is rising sharply, and substantial EU funds are available for further investments in the coming years. Annual inflation is falling rapidly after exceeding 12 per cent at one point in 2022, dropping to 2.5 per cent in July 2023 (HICP measure). The government responded to the energy crisis with mitigating measures, which had a significant fiscal cost, but the budget recorded a small primary surplus in 2022 and is on track for a larger primary surplus 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 at end-2020 to around 170 per cent at end-2022, as a result of high nominal GDP growth and further debt relief measures. A moderate growth slowdown, reflecting global developments, is projected in 2023, with GDP growth of 2.4 per cent, followed by 2.3 per cent growth in 2024. The implementation of projects, funded by 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.

Romania

The economy proved resilient in 2022 and expanded by 4.7 per cent, driven by robust domestic demand and accumulation of inventories. In the first half of 2023, growth decelerated to 1.7 per cent year on year, reflecting a sharp slowdown in the second quarter. Domestic demand remained robust amid higher government spending and investment, but depletion of inventories and a decline in exports of goods in year-on-year terms dragged down growth. Industrial production has failed to return to growth so far, reflecting the energy price shock as well as weaker foreign demand. Although inflation is still high, at 9.4 per cent in July 2023, real wage growth has been positive since March 2023, reflecting tight labour market conditions. The fiscal position has worsened, however, and the authorities are preparing a fiscal consolidation plan to be agreed with the European Commission. The fiscal deficit could inch up to 7 per cent of GDP in 2023, much higher than the budgeted 4.4 per cent of GDP. As such, moderating private consumption, together with potential tax adjustments, will likely define the growth path this year. Considering the slowdown in the first half of the year, GDP growth is forecast at 1.8 per cent in 2023 as a whole. Strong agricultural production and exports and robust EU-funded investments are sources of upside risks to the forecast, while weaknesses in industry and construction are expected to weigh on growth. In 2024, as inflation moderates and financial conditions ease, growth could accelerate to 3.2 per cent, absent any major shocks.

Southern and eastern Mediterranean

Overall, economies in the southern and eastern Mediterranean weathered the challenging global environment relatively well, although high inflation and tighter financing conditions have increased sovereign stress. Higher oil and food prices continue to weigh on household and government finances, although most economies have reverted to fiscal consolidation in 2023. Increases in the cost of servicing domestic and foreign debt raised concerns about debt sustainability in Tunisia and Egypt. On the positive side, tourism recovered across the region and agricultural conditions improved. The region's growth is expected to pick up to 3.7 per cent in 2023, after a curtailed recovery of 3.3 per cent in 2022. Risks across the region relate to food and energy security, as well as the limited role of private sector growth drivers in most economies in the region (especially in Tunisia, Egypt and Jordan). This underscores the need to continue with structural reforms, building on progress made in the past year. Growth is expected to pick up to 3.9 per cent in 2024 as the recovery continues and reforms advance in all economies.

Egypt

GDP growth fell short of expectations in 2022 at just 4.2 per cent and is forecast to remain at a similar level in 2023, as fiscal and financing pressures mount. Despite the recovery in the Suez Canal and tourism revenues, growth was weighed down by the deceleration in construction and manufacturing activities and the contraction in gas production. Natural gas output is estimated to have declined by 9.3 per cent year on year in the first half of 2023, reaching a three-year low. Meanwhile, unemployment dropped slightly to 7.0 per cent in the second quarter of 2023, with higher rates among women (19.2 per cent) and in urban areas (10.3 per cent). The Egyptian pound has lost almost 50 per cent of its value against the U.S. dollar since March 2022 and, coupled with elevated international commodity prices, this pushed inflation to a record high of 36.5 per cent in July 2023, despite a cumulative 1100 basis points hike in the central bank's policy interest rate since April 2022. Foreign exchange reserves stabilised, partly thanks to an IMF-supported programme that improved access to finance, but the currency remains under pressure and a significant differential remains between the official and black-market exchange rates. Growth in the calendar year 2024 is expected to remain stable at 4.5 per cent, held back mainly by structural constraints in non-resource sectors, high inflation and limited fiscal space. Downside risks include continued volatility in global energy and food prices and potential delays in the implementation of the reforms aimed at boosting private sector growth. Growth is estimated to have slowed to 4.1 per cent in the fiscal year ending June 2023 (FY 2022-23) and is projected to pick up to 4.8 per cent in FY 2023-2024.

Jordan

Economic growth in Jordan reached 2.5 per cent in 2022, led by a broad-based acceleration in most sectors, including tourism, but slower growth in the mining sector. Growth picked up to 2.8 per cent year on year in the first quarter of 2023, driven by improved performance in agriculture, construction, transport, and tourism (as tourism receipts finally surpassed pre-pandemic levels). Unemployment remained high at 21.9 per cent in the first quarter of 2023, with higher rates among women (26.7 per cent) and youth (43.7 per cent). Meanwhile, inflation eased to 0.9 per cent in July 2023, following a peak of 5.4 per cent in September 2022, on the back of elevated global food and energy prices. The Central Bank of Jordan has raised its main policy rate by a cumulative 500 basis points since February 2022, in line with decisions of the Federal Reserve. GDP growth is expected to stabilise at 2.5 per cent in 2023 and 2024, supported by a continued recovery in tourism and robust growth in non-service sectors. Nevertheless, downside risks include further increases in energy and food prices, muted private investment due to tighter monetary conditions, and possible delays in the implementation of structural reforms. Successful implementation of the announced reforms under the Economic Modernisation Plan aimed at attracting foreign direct investment could unleash new drivers of growth.

Lebanon

Political deadlock continued to hold back Lebanon's economy in 2022, as little progress was achieved on critical reforms. The economy is estimated to have recorded zero growth during 2022, following two years of deep recession (a 10.0 per cent GDP contraction in 2021, on top of a decline of 25.9 per cent in 2020). Uncertainty surrounding a potential IMF-supported programme has increased as key prerequisite reforms stalled, keeping Lebanon locked out of international markets and further depleting official reserves. Against this backdrop, and despite the official devaluation of the currency by 90 per cent to 15,000 LBP per US dollar in February 2023, multiple rates remain in place. The parallel exchange rate plummeted further during the first half of 2023, reaching 134,800 Lebanese pounds per US dollar before stabilising at around 89,500 pounds per dollar at the end of August. Coupled with rising energy and food prices and supply chain disruptions, the depreciation of the pound pushed inflation to 251 per cent in July 2023. High inflation and repeated reductions in subsidies have left large segments of the population in poverty, aggravated by electricity and fuel shortages, and with limited access to basic commodities. Unemployment is estimated at 29.6 per cent as of January 2022, and more than 80 per cent of the population were estimated to be living in poverty as of end-2021. No GDP growth is expected in 2023, amid political inaction and stalled reforms. The economy could return to growth in 2024, forecast at 3.0 per cent, conditional on overcoming political hurdles, progressing on reforms, and successfully implementing an IMF-supported programme, which would also allow negotiations with international partners to resume.

Morocco

Morocco's economy has recovered from a difficult 2022, with growth rising to 3.4 per cent year on year in the first half of 2023. On 8 September 2023, a devastating earthquake in the Atlas mountains resulted in widespread destruction of buildings and transport infrastructure in parts of Marrakesh and surrounding towns and villages. At the time of writing, the death toll was estimated to surpass 2,900 people. Reconstruction work set to begin in 2023 and continue in 2024 may provide a small boost to economic growth while at the same time increasing fiscal and external financing needs.[10] The following forecasts do not yet incorporate the effects of the September 2023 earthquake as the likely impact on overall economic activity remains difficult to judge at this stage. With that, overall, growth in 2023 is expected to be around 3.1 per cent, up from the 1.3 per cent rate recorded in 2022 when a draught compounded the adverse impact of tighter global financing conditions. Growth in 2023 was so far supported by an improved harvest, a tourism boom, as well as slower inflation and recovering domestic demand. As a result, unemployment decreased slightly to 12.4 per cent in the second quarter of 2023, with higher rates among women (17.0 per cent), youth (33.6 per cent) and in urban areas (16.3 per cent). The government increased social expenditures in 2022 and 2023 thanks to

[10] See Aksoy, Chupilkin, Koczan and Plekhanov (forthcoming) for a detailed discussion of the economic consequences of earthquakes.

improved tax collection and non-tax revenues, and the budget deficit is expected to continue to shrink (from 5.1 per cent of GDP in 2022 to 4.9 per cent in 2023). Overall, the country's fiscal and debt situation remain sustainable owing to sound macroeconomic policy frameworks, and an IMF Flexible Credit Line (FCL) was agreed in early 2023. Growth is expected to reach 3.0 per cent in 2024, reverting to pre-pandemic levels in the medium run, with accelerated reform momentum potentially improving the outlook further. Better weather conditions, easing inflation, the relative pickup in domestic and external demand, and higher investor confidence due to Morocco's removal from the Financial Action Task Force's (FATF) Grey List are expected to support economic activity. Still, Morocco remains vulnerable in the medium term to sharp increases in hydrocarbon prices as it imports most of its energy needs, as well as to volatility in the agricultural sector.

Tunisia

Tunisia's economic performance has been on a downward path since 2021. A modest post-pandemic recovery of 2.4 per cent in 2022 is expected to be followed by growth of 1.9 per cent in 2023, as adverse external conditions, high inflation and social unrest weigh on the economic outlook. Despite an expansion in tourism, financial services, and the industrial sector, the slowdown was driven by the contraction in agriculture and mining. Unemployment declined slightly to 15.6 per cent in the second quarter of 2023 but inflation reached 9.1 per cent year on year in July 2023. As government spending increased (including on the wage bill and subsidies), the budget deficit remained large at 7.6 per cent of GDP and public debt reached 80 per cent of GDP in 2022. As a result, the country saw downgrades by rating agencies while an agreement on an IMF-supported programme has been delayed further. Growth in 2024 could pick up to 2.5 per cent on the back of strong tourism, phosphate sales and an agreement with the IMF. However, downside risks are high, reflecting limited fiscal space, lack of access to external financing, a restrictive business environment, delays in reform implementation, dependence on tourism and climate risks.

Turkiye

Expansionary policies undertaken in the context of the New Economic Model over the past two years contributed to a relatively strong economic performance by Turkiye, but they also exacerbated existing macroeconomic vulnerabilities. GDP growth decelerated from 5.6 per cent in 2022 to 3.9 per cent year on year in the first half of 2023. Inflation has declined from a peak of over 80 per cent recorded in October 2022 but remains elevated and is expected to increase to almost 60 per cent by the end of 2023. Furthermore, the government has posted record high fiscal deficits due to commitments made prior to the 2023 elections such as public sector wage and pension hikes and a rise in expenditures due to the earthquakes of February 2023.

Large external imbalances persist. Short-term external debt has exceeded US$ 200 billion and the current account deficit stands at US$ 60 billion, implying gross external financing needs in excess of 25 per cent of GDP for the coming year. Foreign exchange reserves, albeit increasing are modest in relation to refinancing needs.

The appointment of officials known for their market-friendly views following the elections of May 2023 saw a shift to more orthodox economic policies. Key appointments included former Deputy Prime Ministers Mehmet Simsek and Cevdet Yilmaz, and a new governor and deputy governors at the central bank. Measures enacted by the new economic management include consecutive interest rate hikes, taking policy rates from 8.5 per cent in May to 25 per cent in September 2023, increases in taxes including raising the base rate of the value added tax from 18 per cent to 20 per cent, and a gradual unbundling of restrictive and costly regulations affecting the banking sector adopted over the past year. These developments signalled an end to the unorthodox New Economic Model adopted in 2021 and have been received with cautious optimism by the markets, as demonstrated by Turkiye's CDS premium which has been declining from its historic peak in May 2023.

These steps are positive, although there is a risk that the adoption of orthodox policies may prove short-lived, as the local elections of March 2024 draw nearer and authorities may face growing pressure to sacrifice stability in favour of growth. A growth rate of 3.5 per cent is expected for 2023, declining to 3.0 per cent in 2024.

Western Balkans

The Western Balkan economies faced weakening external demand from key Eurozone trading partners at the beginning of 2023, but this was partially offset by strong performance of the tourism sector in the service-based economies of Albania, Montenegro and Kosovo. Annual inflation rates peaked at high rates driven by the large shares of food and energy in the consumer basket, institutional factors such as market power in some sectors (including retail), and in some cases expansionary fiscal policies. GDP growth is expected to slow further in 2023 as key Eurozone trading partners post sluggish growth rates (with a recession forecast in Germany) and inflation, while decelerating, continues to take a toll on household consumption. Economies in this region are increasingly turning to external market financing following years of elevated fiscal spending, with Serbia, North Macedonia and Albania issuing eurobonds in the first half of 2023, and Kosovo, North Macedonia and Serbia engaged in ongoing financing programmes with the International Monetary Fund. Growth is forecast to accelerate closer to medium-term potential rates from 2024 as the global recovery strengthens and reform efforts are stepped up.

Albania

Economic growth stood at 2.7 per cent year on year in the first quarter of 2023 as domestic demand weakened on account of high, albeit falling inflation. Goods exports contracted sharply because of lower external demand and strong appreciation of the Albanian lek. The lek's value was 12 per cent higher in July 2023 than a year earlier, reaching its highest level on record, supported by high tourist arrivals as well as consistently strong inflows of remittances and foreign direct investment. The appreciation of the currency offset a portion of the inflationary shock, resulting in an annual inflation rate of 4.2 per cent in July 2023, below levels seen in other Western Balkan countries and the eurozone, and allowing for a relatively accommodating central bank policy rate of 3 per cent as of end-August 2023. A €600 million eurobond issued in June 2023 was significantly oversubscribed. Growth is expected to continue at a moderate pace of 2.5 per cent in 2023, given the muted growth prospects of Albania's key trading partner, Italy, and still high food inflation which is eroding disposable incomes. On the other hand, the exceptionally strong performance of the hospitality sector, with tourist arrivals increasing by 30 per cent on the year in the first seven months of 2023, is expected to support growth in both the short and medium term. In line with the anticipated global recovery, economic growth is forecast to return closer to its potential, reaching 3.3 per cent in 2024.

Bosnia and Herzegovina

The economy expanded by a modest 1.1 per cent year on year in the first quarter of 2023, on account of a slowdown in both external and domestic demand. Industrial output contracted in year-on-year terms, and the net export position worsened as the growth of imports exceeded that of exports. The current account deficit remained elevated in the first quarter. As household consumption contracted in the face of high inflation, growth relied on investment and services such as retail trade, tourism and information and communications. Annual inflation moderated to 4 per cent in July 2023 from 14.1 per cent in January 2023, mirroring global disinflation and reflecting slowing domestic demand. In order to protect disposable incomes, the Federation of Bosnia and Herzegovina set a maximum retail margin on certain foodstuffs, valid from September 2023. Fiscal policy remains expansionary overall as the authorities have increased the minimum wage and pensions in both entities. GDP growth is expected at just 1.5 per cent in 2023, with significant downside risks, before recovering to 3.0 per cent in 2024. The short-term outlook is dimmed by the ongoing slowdown in key export markets, with industrial production contracting in year-on-year terms in the first half of 2023.

Kosovo

Output expanded at a rate of 3.9 per cent year on year in the first quarter of 2023, as strong service exports offset a contraction in the exports of goods. Services were also driving growth on the production side, as diaspora inflows (counted as part of tourist arrivals) led to a double-digit expansion in the retail and tourism sectors. Investment growth remained muted, reflecting in part limited implementation of the public investment programme. Household consumption weakened, but growth remained positive as strong remittance inflows, credit growth and a hike in public sector wages in February 2023 bolstered disposable incomes. Inflation moderated to 2.4 per cent in July 2023, mirroring the global inflationary slowdown. In line with the two ongoing IMF programmes (a 24-month Stand-By-Arrangement and a Resilience and Sustainability Facility), the government scaled up fiscal measures supporting the economy while making them more targeted (including by providing subsidies for households saving electricity and for purchases of energy efficient equipment while the energy regulator approved an electricity tariff increase of almost 15 per cent, effective from April 2023). In response to tensions in the north of Kosovo, the EU has put in place reversible sanctions, including suspension of the work of the Stabilisation and Association Agreement bodies and the availability of IPA (Instrument for Pre-Accession Assistance) funding, delaying the submission of the country's proposals under the Western Balkans Investment Framework (WBIF) and temporarily suspending bilateral visits. GDP growth is forecast at 3.5 per cent in 2023, rising to 4.0 per cent in 2024, with downside risks stemming from the potential continuation of domestic and regional tensions, negatively affecting trade flows and investor confidence.

Montenegro

The economy continued to grow strongly year on year in the first quarter of 2023, with growth of 6.1 per cent year on year, driven by robust household consumption, large tourism inflows and the arrival of many Russians and Ukrainians. Growth was also supported by strong investment activity and a rebound in electricity production, aided by favourable weather conditions. The tourism season in 2023 is set to surpass the pre-pandemic level; tourism arrivals in the first half of the year were 13 per cent higher than the record 2019 levels. Real wages in net terms, boosted by the minimum wage increase and abolition of healthcare contributions in 2022, continued to post double-digit growth rates in the first six months of 2023 even as inflation remained high, at 6.9 per cent in July 2023. Other fiscal measures to support the economy included lower excise duties on fuel for farmers and transport companies and an extraordinary adjustment to the minimum pension, implemented alongside a set of tax changes, effective July 2023, with the goal of boosting government revenues. Growth is forecast to reach 3.5 per cent in 2023 and 3.7 per cent in 2024, based on the strong performance of the hospitality sector. The forthcoming appointment of a new government has the potential to unlock the reform agenda and lead to higher public investment.

North Macedonia

Economic growth stood at 2.1 per cent year on year in the first quarter of 2023, as a favourable net export position, driven by a decline in imports, was partly offset by a significant drop in investment. Industrial output remained muted, as a contraction in the manufacturing sector was balanced by strong electricity production. The current account deficit widened significantly in 2022 due to high prices of imported energy. In the first half of 2023, the current account came in at near balance, reflecting a lower trade deficit and robust remittance inflows. Household consumption, boosted by remittances, remained resilient in the face of still high, albeit gradually moderating, annual inflation (8.4 per cent in July 2023) and significant monetary policy tightening (with the central bank's key interest rate at 6.15 per cent as of end-August 2023). Price caps on basic foodstuffs were imposed from April to June 2023. Pensions were increased effective from March and a hike in the minimum wage became effective from April. A €500 million eurobond was issued in March 2023, and the EU provided a budget support grant of €80 million. The first review of the ongoing Precautionary and Liquidity Line (PLL) arrangement with the IMF, initially envisaged for May 2023, had not yet taken place as of end-August. The €100 million in macro-financial assistance (MFA) by the EU, approved in June 2023, has not yet been disbursed as it is tied to satisfactory implementation of the IMF programme. Growth is forecast to remain modest at 2.0 per cent in 2023 as external demand is expected to remain sluggish and measures to contain inflation take their toll on household consumption. Output growth is set to accelerate to 3.0 per cent in 2024.

Serbia

Growth moderated to 1.2 per cent year on year in the first half of 2023 as household consumption and retail trade contracted in line with elevated inflation. Agriculture posted strong annual growth rates, from a low base in 2022, a year which was marked by drought, while industrial output was muted, reflecting weak external demand. Following a protracted contraction in construction, the sector rebounded and supported growth in the second quarter of 2023 as several large public infrastructure projects were launched. The current account deficit narrowed significantly in the first half of 2023 thanks to declining imports, lower global energy prices, and significant electricity exports. Inflation remained elevated, at 12.5 per cent in July 2023, peaking later in Serbia than in other Western Balkans economies and the eurozone. Inflation has been slower to decelerate, partly because of upward adjustments in regulated energy prices, a structural benchmark under the Stand-By-Arrangement (SBA) with the IMF. The first review under the SBA was completed in July 2023, with energy sector reforms progressing as envisaged but with a delay in adopting a new law on state-owned enterprises, one of the benchmarks of the programme. Fiscal policy remained expansionary, as the authorities increased pensions and some public sector wages, set a price cap on 20 essential food and household items and provided one-off financial support to individuals. An increase in excise duties on fuel, tobacco, alcohol and coffee from October 2023 is expected to boost revenues. GDP growth is forecast to reach 1.8 per cent in 2023, reflecting muted global growth prospect and high inflation, before rising to 3.5 per cent in 2024, a rate closer to the medium-term potential.

Belarus

After a deep recession in 2022, GDP increased by 2.0 per cent year on year in the first half of 2023. A rebound in manufacturing, construction and retail trade drove the recovery, but the information and communication technology and transport sectors continued to decline. Exports rose by 12.4 per cent year on year in the period January to June 2023 and shifted away from western countries towards those in the Commonwealth of Independent States (CIS). At the same time imports increased by 22.6 per cent, indicating a revival of domestic demand. The authorities provided more than US$ 70 million in financial support to over 600 SMEs in the form of subsidies, soft loans and liquidity lines in the first half of 2023. Inflation came down sharply to 2.7 per cent in July 2023, a level not seen in many years, supported by a stable exchange rate. Nevertheless, economic uncertainty remains high. The impact of heavy sanctions on trade and logistical disruptions with EU economies are constraining export-oriented and high-tech sectors. The modest economic rebound in the first half of the year is thus likely to be short-lived, with growth moderating to 2.0 per cent in 2023 as a whole and 1.3 per cent in 2024.

Russia

GDP contracted by 2.1 per cent in 2022, less than initially expected, as the economy proved resilient to sanctions in the short term. High energy prices boosted export revenues and the current account surplus. This strengthened the rouble and helped lower inflation. More recently, loose fiscal policy has resulted in an overheating of the economy, in the context of a tight labour market and high rates of capacity utilisation. In the context of the ongoing war and presidential elections in 2024, tightening fiscal policy is challenging. The loose fiscal policy has drawn in imports, while falling energy prices and EU-imposed price caps on Russian oil and oil-derived products have hit export revenues. As a result, the current account surplus shrank significantly in 2023. Financing a current account deficit would present a challenge, with much of the central bank's foreign exchange reserves frozen and minimal private capital inflows. These challenges have weighed on the rouble, which has weakened by 30 per cent against the US dollar in 2023, further adding to inflationary pressures. In response, the central bank has been tightening monetary policy. A 100 basis points increase in July 2023 was followed by a 350 basis points hike in August, bringing the policy rate to 12 per cent. GDP growth of 1.5 per cent is projected for 2023 as a whole. The outlook for 2024 will depend heavily on how the war on Ukraine and the related economic sanctions evolve; at this stage growth of 1.0 per cent is projected.

About this report

The Regional Economic Prospects report is 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 September 12, 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 Victor Bonilla, Maxim Chupilkin, Zsoka Koczan 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: Peter Tabak and Olja Belic

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

EU member states (excluding Greece): Mateusz Szczurek, Marcin Tomaszewski, Radu Cracan and Dominika Kroschel

Greece: Peter Sanfey and Julia Brouillard

Egypt, Jordan, Lebanon, Morocco and Tunisia: Alexa Tiemann, Rafik Selim, 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 Altan Olgun

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

Tel: +44 20 7338 6000

www.ebrd.com

Discover more at tr-ebrd.com

Find us on:

@EBRD

ebrdhq

EBRD

ebrd_official

ebrdtv