ALBANIA

Highlights

- **The economy is facing a strong recession in 2020 due to the Covid-19 outbreak.** The main channels of influence are tourism, trade with Italy and remittances from Albania's workers abroad, which are all being hit severely.
- **The government has adopted two economic support packages, worth 2.8 per cent of GDP.** The packages consisted mainly of increased government expenditures, sovereign guarantees and one-off social transfers.
- **A contract for a large-scale solar park has been signed.** Besides helping the country in improving the energy mix by diversifying away from hydropower, the Karavasta solar park will also be the largest in the Western Balkans. In addition, Albania secured the lowest solar energy price in the region through a competitive capacity allocation process.

Key priorities for 2021

- **Fiscal adjustment will be needed to ensure public debt sustainability.** The government needs to strengthen public investment management and contain fiscal risks such as those relating to public-private partnership programmes. Simplifying the tax system and making it more transparent would help lead to higher budgetary revenues.
- **Measures should be stepped up to combat informality and level the playing field for private companies.** Key measures in this direction include a simplified tax system and procedures, strengthened capacities in public administration, further support and incentives for micro, small and medium-sized enterprises to formalise their activities, and a more decisive fight against corruption.
- **Further reforms are needed to support credit growth.** Resolution of issues with property rights and the bailiff system, implementation of the insolvency law and enhancement of property rights should all be high on the agenda.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.3	3.8	4.1	2.2	-9.0
Inflation (average)	1.3	2.0	2.0	1.4	1.6
Government balance/GDP	-1.8	-1.4	-1.3	-2.0	-8.5
Current account balance/GDP	-7.6	-7.5	-6.8	-7.6	-11.5
Net FDI/GDP [neg. sign = inflows]	-8.7	-8.6	-8.0	-7.6	-6.0
External debt/GDP	73.5	68.7	65.1	60.4	n.a.
Gross reserves/GDP	27.5	25.9	26.4	24.6	n.a.
Credit to private sector/GDP	36.6	34.8	33.0	34.4	n.a.

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Covid-19: macroeconomic implications

The economy is contracting severely in 2020. After the November 2019 earthquake, which caused damage of around €1 billion, the economic outlook was further worsened by the outbreak of the Covid-19 pandemic. The negative effects are being seen mainly in tourism, which normally contributes to more than one-fifth of Albania's GDP, and through the decline in trade with Italy (close to 50 per cent of exports) and remittances from Albanians abroad. Available data show that GDP declined by 6.6 per cent year-on-year in the first half of 2020, on the back of falling exports, investment and consumption. Sectors related to tourism (trade, transport and accommodation services) recorded an overall fall in activity of 16.1 per cent year-on-year. Also, the construction sector was hit strongly as well as manufacturing. In the period of most severe lockdown (March to May 2020), goods exports to Italy fell by 42.7 per cent year-on-year. Overall, total exports of goods in the first seven months of 2020 were lower by 16.8 per cent year-on-year.

Monetary policy responded with policy rate cuts and foreign exchange market interventions. At the end of March 2020 the Bank of Albania (BoA) lowered the key policy rate by 50 basis points, to a new record low of 0.5 per cent. The Covid-19 crisis also contributed to depreciation pressures on the domestic currency, mainly in the second half of March, when the Albanian lek lost around 7 per cent of its value against the euro. The pressures were eased by the BoA selling €20.4 million on the foreign exchange market at the end of March, and stability has returned since May. The weakening of the currency and a strong increase in food prices caused the inflation rate to pick up from 1.4 per cent in 2019 to 2.0 per cent year-on-year in June 2020, still below the central bank target of 3.0 per cent.

Public debt increased sharply in the first half of 2020, to 80 per cent of GDP. That is 14 percentage points higher than at the end of 2019. The biggest effect came from the seven-year €650 million Eurobond issuance in June 2020. In order to finance measures related to the pandemic and its economic consequences, Albania also borrowed from international lenders such as the European Union (€180 million, under the Macro-Financial Assistance) and the International Monetary Fund (€174 million, under the Rapid Financing Instrument).

A rebound is expected in 2021. GDP is forecast to drop by 9.0 per cent in 2020, and to rebound by 4.5 per cent in 2021. The resumption of normal economic activity and a boost from reconstruction after the November 2019 earthquake is expected in the second half of 2021. However, the forecast is subject to significant uncertainty over the possible return of the pandemic. The downside risks are associated with a potentially stronger impact of the pandemic on remittance inflows and the tourist season both in 2020 and next year.

Policy response to Covid-19

The government adopted two support packages to support businesses, healthcare and vulnerable people. The packages included: state aid to companies experiencing difficulties in paying workers' wages; emergency payments for employees in tourism and those dismissed from large companies; income support for micro businesses and the self-employed; cancellation or write-off of penalties on late payments of energy bills for more than 200,000 people; and additional funding for medical personnel. Additional measures adopted in July 2020 were the abolition of value-added tax for small companies with an annual turnover below Lk 8 million (€64,000) from 2021, and a 0 per cent profit tax for small companies with an annual turnover of up to Lk 14 million (€115,000).

Financial measures range from state guarantees to a loan payment moratorium. A sovereign guarantee fund has been established for companies to access overdrafts in the banking system to pay wages for their employees, for up to three months. In addition, a sovereign guarantee was provided for working capital loans for all private companies that were tax-compliant and solvent before the pandemic. Payment holidays for loans, for those applying, were extended until the end of August 2020. In addition, banks have been allowed to restructure loans in 2020 without additional provisioning or downgrades for borrowers. The BoA has temporarily suspended the distribution of dividends for banks until the end of the year, in order to support their capitalisation and lending

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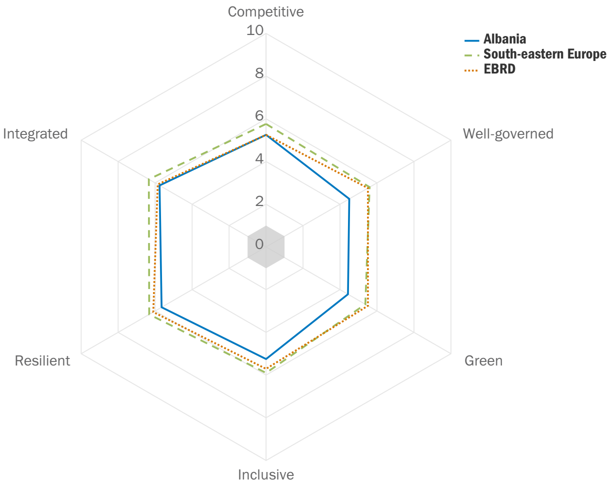
potential. The BoA also stated its readiness to provide unlimited liquidity to the banks. In July 2020 the BoA announced that it was setting up a €400 million repurchase agreement line with the European Central Bank, which will be in place until at least June 2021. The line would serve to provide euro liquidity to Albanian banks in case of need.

Assessment of transition qualities (1-10)



Structural reform developments

The banking sector remains well capitalised and liquid, but non-performing loans (NPLs) are still relatively high. At the end of June 2020 the capital adequacy ratio stood at 18.1 per cent, and one-third of banks' assets were liquid. The NPL ratio has continued to decline further in the past year, indicating improved asset quality, but at 8.1 per cent at the end of May 2020 it remains the highest in the Western Balkans and is at risk of increasing again once the moratorium on bank loan payments is lifted.

Albania is moving forward in diversifying away from hydro energy. The country has been making efforts to diversify its energy mix, which is dominated by hydropower, and decrease its dependence on weather conditions (rainfall). In August 2020 a contract was signed for the first large-scale solar park in Albania. The Karavasta park would be the largest in the Western Balkans and, through a competitive capacity allocation process, Albania secured the lowest solar energy price in the region. Further solar tenders are expected in the future through the same approach, and wind power will be developed under the same competitive principles. The completion of the offshore Trans Adriatic Pipeline connection between Albania and Italy in June 2020 could also open opportunities for the introduction of gas in the country's energy mix.

The country has narrowed the compliance gap in the electricity sector by reforming the regulatory framework. In May 2020 Albania amended the Power Sector Law with a view to improving compliance with the EU energy legislation and allowing for effective unbundling of the distribution system operator.

The European Council decided to open EU accession negotiations with Albania. In March 2020, the European Council, having assessed that the country fulfilled the conditions identified by the previous councils, decided to open accession negotiations with Albania. It invited the European Commission to prepare the framework for the negotiations, reflecting on the revised methodology (enhanced approach) of the accession process adopted by the council on the same day. Once the

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council adopts the negotiating framework, this should be followed “as soon as possible” by the first intergovernmental conference (the formal start of the negotiations). However, the council decided that before the first intergovernmental conference Albania ought to implement a number of specific conditions, including the adoption of electoral reform, continued implementation of judicial reform, and strengthening the fight against corruption and organised crime. Respective key priorities for Albania have been integrated into the draft negotiating framework, which the European Commission presented to member states on 1 July 2020.

ARMENIA

Highlights

- **Strong economic growth and macroeconomic stability have been challenged by the shock of the Covid-19 pandemic.** GDP growth of 7.6 per cent in 2019 was followed by a slowdown to 3.7 per cent year-on-year in the first quarter of 2020 and to a 13.7 per cent year-on-year decline in the second quarter.
- **A crisis response package has been supported by external financing.** To cope with rising financing needs the authorities drew on the existing International Monetary Fund (IMF) programme and augmented the financial assistance envelope.
- **The authorities took steps to tackle longstanding governance and business environment deficiencies.** Measures adopted in the past year are helping to institutionalise the fight against corruption, address labour market shortcomings and advance business environment reforms.

Key priorities for 2021

- **The government should continue steps towards a new growth model.** The Covid-19 pandemic has shown the limitations and weaknesses of a growth model based on consumption driven by remittances. Good domestic policies, drawing on the support of the diaspora, could be helpful in exploiting new opportunities in the post-pandemic world.
- **Reforms in the key areas of governance and competition need to continue.** The institutional fight against corruption, a better rule of law and a good business environment are key components in building an economy more resilient to external shocks.
- **Fiscal prudence should be continued with a clear focus on needs and priorities.** Once the Covid-19 crisis subsides and the flare-up in Nagorno-Karabakh calms, the fiscal prudence characteristic of the last year can help to reduce the elevated public debt level. However, that should not be at the cost of much-needed infrastructure investments.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth[1]	0.2	7.5	5.2	7.6	-5.0
Inflation (average)	-1.4	1.0	2.5	1.4	0.9
Government balance/GDP	-5.6	-4.8	-1.8	-1.0	-5.8
Current account balance/GDP	-1.0	-1.5	-6.9	-7.2	-8.8
Net FDI/GDP [neg. sign = inflows]	-2.5	-1.9	-2.0	-2.9	n.a.
External debt/GDP	94.4	91.3	87.6	90.3	n.a.
Gross reserves/GDP	20.9	20.1	18.1	20.8	n.a.
Credit to private sector/GDP	52.2	53.0	57.1	62.3	n.a.

[1] The GDP forecast for 2020 was determined prior to the flare-up of the conflict over Nagorno-Karabakh.

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Covid-19: macroeconomic implications

Covid-19 containment measures are weighing on the economy in 2020. GDP growth of 3.9 per cent year-on-year in the first quarter of 2020, following 7.6 per cent growth in 2019, turned to a 13.7 per cent year-on-year decline in the second quarter as household consumption contracted by nearly 20 per cent, investments by nearly 30 per cent and trade by approximately 35 per cent year-on-year in real terms. Household consumption, the largest growth driver in Armenia, was affected by a severe drop in money transfers from abroad (close to 24 per cent year-on-year in the second quarter) and containment measures being put in place. The state of emergency, introduced in March 2020 and extended for five consecutive months until the first half of September, was replaced by a nationwide quarantine that will be in force until 11 January 2021. Measures of social containment and low mobility affect Armenia's tourism sector, which is largely dependent on visits from the diaspora. The decrease in remittances nearly levelled off in June to July and increased in August, driven by a strong increase in transfers from the United States of America, which were balanced against the continued shrinking of remittances from Russia. High-frequency indicators of economic activity point to a 6.6 per cent year-on-year decline in economic output in the period January to September 2020.

Despite the crisis, macroeconomic stability was preserved in the first three quarters of 2020. In the first six months of 2020, a contraction of goods and services imports balanced out the decline in export revenues, helping to contain currency pressures and supporting exchange rate stability following a short period of depreciation at the onset of the pandemic. International reserves assets, propped up by external financing, stood at US$ 2.4 billion in September 2020, covering 4.3 months of imports. In the absence of significant inflationary pressure, the refinancing rate was decreased four consecutive times in 2020, reaching 4.25 per cent in September.

The authorities' crisis response was supported by external financing. The initially announced package of measures to support the economy and the population amounted to 2.2 per cent of GDP. To satisfy rising financing needs the authorities asked for augmentation of the IMF programme, which, together with the authorities' intention to draw on the purchase rights accumulated under the Stand-By Arrangement, made around US$ 280 million available to the authorities. Because of Covid-19 disruption, the IMF projects government debt to exceed 60 per cent of GDP by the end of 2020. However, with the authorities' commitments to the medium-term fiscal goal of debt sustainability, it is expected that the ratio will gradually decline over the medium term.

The sharp decline of economic output in 2020 is likely to be followed by a gradual recovery. The Armenian economy is expected to shrink by 5.0 per cent in 2020, followed by growth of 4.0 per cent in 2021, but with considerable uncertainty depending on the future path of the pandemic. The flare-up of the conflict over Nagorno-Karabakh adds to the uncertainty and its impact on the economic performance of Armenia depends on the duration and human and material costs.

Policy response to Covid-19

Immediate relief measures adopted by the authorities aim to preserve jobs and protect the most vulnerable. Between the onset of the pandemic in March 2020 and August 2020, the authorities implemented 24 different measures amounting to 2 per cent of GDP (US$ 300 million) to support the economy. Measures include subsidised loans of two- or three- year terms to the most affected sectors and businesses, in particular in tourism and agriculture, grants to the private sector and direct wage subsidies to micro, small and medium-sized enterprises (MSMEs), under the condition that they keep their employees. The authorities also strengthened their social assistance programme with additional lump sum transfers to socially vulnerable groups. Enabled by low inflationary pressures, the central bank lowered the monetary policy rate to ensure liquidity in the banking sector and made limited interventions in the foreign exchange market to avoid excessive dram volatility. The regulator recommended banks to consider voluntary loan restructuring and limited payment holiday periods.

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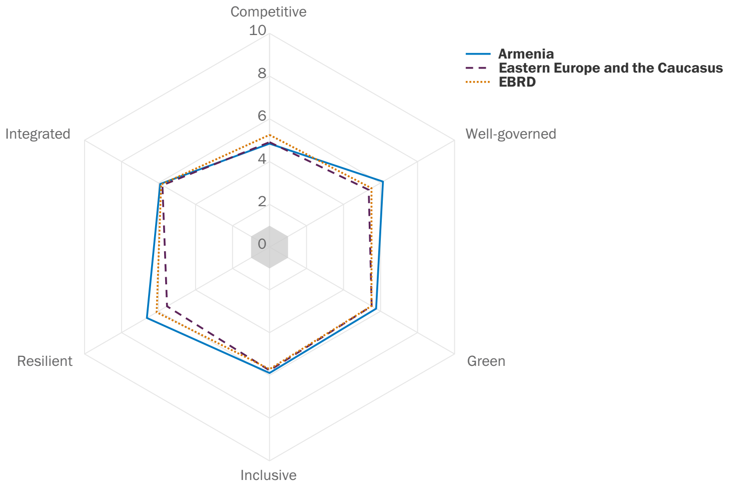
Assessment of transition qualities (1-10)



Structural reform developments

The authorities advanced their efforts to institutionalise the fight against corruption. An anti-corruption strategy for 2019-23, approved in October 2019, outlines the new institutional framework and proposes concrete actions. The strategy envisages setting up an Anti-corruption Committee, an independent entity in charge of detection and investigation of corruption offences, in 2021. Also in October 2019, the government approved the 2019-23 Strategy for Judicial and Legal Reforms aiming at enhancing the effectiveness of courts, the prosecutor's office and investigative bodies as they play a key role in the anti-corruption fight.

New labour market policies have been adopted. These include an employment strategy and an increase in the minimum wage. The employment strategy aims to address persistent labour market shortcomings. Armenia is facing skills mismatches despite rising educational attainment levels, and the private sector often has difficulty in finding skilled workers although the unemployment level is high. Adopted in December 2019, the employment strategy "Work, Armenia" proposes a set of active labour market policies in order to address labour market shortcomings and create sustainable and inclusive employment. At the same time, the government approved an increase in the minimum wage by 23 per cent to the equivalent of US$ 142 per month, effective from January 2020.

The authorities have adopted a new strategy for the development of capital markets. Implementation of the capital market development programme, adopted by the authorities in July 2020, would help better utilise domestic savings while increasing transparency in the corporate sector and enhancing the monetary transmission. The programme analyses the current state of the capital market in Armenia and proposes an action plan to strengthen the foundations, expand the market and achieve longer-term goals.

Improvements in the business environment have been made. At the end of 2019, the authorities created an Investment Support Office within the Ministry of Economy to promote domestic and foreign investments. The office acts as a one-stop-shop for investors, providing information on investment opportunities and the business environment, and supporting investors in accessing public services and in communicating with the state authorities. The government approved a set of measures for 2020-23 to address drawbacks in the business environment as identified in the World Bank *Doing Business 2020* report, while the strategy for the development of SMEs for 2020-24 and the associated action plan for 2020-22 aim to create a more favourable environment for smaller companies. Lastly, to strengthen state-owned enterprise (SOE) reporting requirements, audit and publication of financial reports of SOEs fulfilling certain criteria were made mandatory from January 2020.

AZERBAIJAN

Highlights

- **The economy has been hit by the twin shocks of the Covid-19 pandemic and a slump in oil prices in 2020.** GDP declined by 3.9 per cent year-on-year in the first nine months of the year. Amid soaring demand for foreign exchange, transfers by the sovereign wealth fund SOFAZ to local banks via central bank auctions kept the currency stable.
- **The authorities deployed a crisis response package of economic and social support.** The cost of the package exceeds 4 per cent of GDP and the widening budget deficit is expected to be financed by the sovereign fund rather than by external financing.
- **The crisis prompted the authorities to rethink their approach to the governance of state-owned enterprises (SOEs).** The establishment of a public holding company to centrally manage SOEs aims to increase the efficiency and transparency of the state sector.

Key priorities for 2021

- **Pursuing further governance reforms in the state sector would bring significant efficiency gains.** The creation of a public company to manage SOEs is an opportunity to introduce best international corporate governance and management practices across the SOE sector.
- **The shift in financial sector regulation back to the central bank is an opportunity to reinvigorate reforms.** The current economic downturn will further accentuate weaknesses in the banking sector, including the regulatory framework and its supervision. Promptly addressing these drawbacks would support a faster economic recovery.
- **Continued implementation of energy sector reforms is needed.** The development of a sustainable and competitive energy market with a sound regulatory framework and institutions will strengthen the economy's resilience to future shocks.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth[1]	-3.1	0.1	1.4	2.2	-3.0
Inflation (average)	12.4	12.9	2.3	2.7	3.0
Government balance[2]/GDP	-1.1	-1.4	5.5	8.1	-6.3
Current account balance/GDP	-3.6	4.1	12.8	9.1	-3.6
Net FDI/GDP [neg. sign = inflows]	-5.1	-0.7	1.7	2.9	-1.0
External debt[3]/GDP	20.4	22.8	19.0	18.9	n.a.
Gross reserves[4]/GDP	10.5	13.1	11.9	13.0	n.a.
Credit to private sector/GDP	27.2	16.7	16.3	18.7	n.a.

[1] The GDP forecast for 2020 was determined prior to the flare-up of the conflict over Nagorno-Karabakh.
[2] Includes central government and main extrabudgetary funds, including operations of the oil fund and the social protection fund.
[3] Public and publicly guaranteed external debt outstanding.
[4] Excluding assets of the State Oil Fund (SOFAZ).

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Covid-19: macroeconomic implications

The economy was hit by twin shocks: the Covid-19 pandemic and a slump in oil prices. After the robust growth at the beginning of 2020, output in the non-oil sector turned negative following the introduction in March 2020 of measures to protect public health. Containment measures were extended a few times since then and limitations on regular business activities maintained, particularly in the service sector, although they have been loosened. Output in the non-oil and gas sector reached a trough in June 2020 before slowly recovering. The slump in global demand hit Azerbaijan's export sector, which is dominated by hydrocarbons. With more than one-third of GDP, roughly two-thirds of government revenue and 90 per cent of exports generated by the hydrocarbon sector, the slump in oil prices on top of the Covid-19-induced crisis is taking a significant toll on the economy. Preliminary figures show GDP declined by 3.9 per cent year-on-year in the first nine months of 2020, with the non-oil and gas sector falling by 2.4 per cent. Capital investments were down by 3.8 per cent year-on-year and nominal income of the population remained flat (after many years of continued growth).

Macroeconomic stability is being preserved. Amid soaring demand for foreign exchange, SOFAZ sold US$ 6.2 billion until October 2020 to local banks, keeping the currency stable. The *de facto* currency peg is supporting low inflation, at 2.6 per cent in September 2020. Low inflationary pressures allowed the central bank to continue cutting the refinancing rate, which declined by 100 basis points to 6.5 per cent in September 2020. However, external and fiscal surpluses are turning negative on the back of significantly lower oil revenues.

Crisis response and the budget financing gap have been financed by reserves from SOFAZ. The authorities responded with a package of economic and social support measures amounting to 4.3 per cent of GDP. Higher expenditures and lower tax revenues are expected to widen the budget deficit to 6.3 per cent of GDP. However, the country prefers to rely on the sovereign fund for financing rather than on external financing. In the first half of 2020, the combined assets of SOFAZ and the central bank amounted to nearly US$ 50 billion, more than the country's projected GDP.

Economic contraction is expected to be followed by a mild recovery. We expect the economy to contract by 3.0 per cent in 2020, recovering by 2.5 per cent in 2021. Key risks to the near-term developments are related to a possible resurgence of the pandemic, continued weaknesses in the oil market and the ongoing conflict over Nagorno-Karabakh. Large liquidity buffers anchor the country's resilience to shocks, but the prolonged duration of the conflict could test the country's macroeconomic stability and have significant economic costs.

Policy response to Covid-19

The authorities prepared a large programme to support the non-oil and gas sector and vulnerable social groups. Support to businesses includes wage subsidies, various tax benefits, financial support to micro entrepreneurs, issuance of state guarantees on new loans with a subsidised interest rate to businesses in the most affected sectors, and subsidising interest rates on existing loan portfolios of companies operating in pandemic-affected areas. The transport sector is receiving significant support from the authorities as well. The Central Bank of the Republic of Azerbaijan adopted a package of measures to relax the regulatory burden and support the banking and insurance sectors as well as capital market participants. It reduced capital requirements, introduced a loan loss provisions holiday and restricted dividend payments until September 2020. To support vulnerable individuals, the state expanded unemployment benefits and introduced a scheme providing preferential mortgage loans, and it expanded the pool of households benefiting from consuming electricity under preferential prices.

The blanket deposit guarantee insurance was extended. The scheme was first adopted in 2016 to safeguard financial stability and boost confidence amid times of macro-financial volatility and an economic downturn. In March 2020, the authorities decided to extend the blanket guarantee for an additional nine months to strengthen confidence in the banks during the pandemic. The scheme covers all depositors' funds irrespective of the amount and currency denomination.

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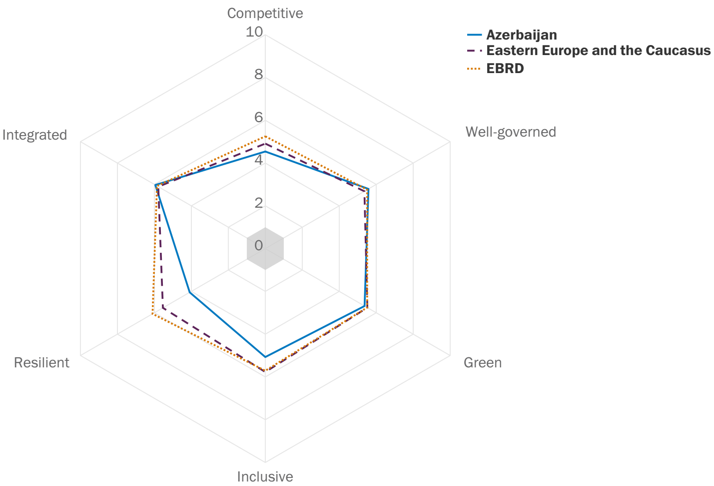
Assessment of transition qualities (1-10)



Structural reform developments

Regional support infrastructure for small and medium-sized enterprises (SMEs) was strengthened. The recently established Agency for the Development of SMEs in Azerbaijan opened the first House of SMEs in early 2020. Based in the Khachmaz region in the north of the country, this platform offers and coordinates services provided by the government and by private entities in a single space. Its offer includes support in launching start-ups via the development of business and marketing plans, improvement of business knowledge, and help in obtaining registration and various licences to access financial resources, logistics and infrastructure networks, internal and external markets and export promotion.

The authorities have partly liberalised the foreign currency operations regime. In February 2020, the central bank extended the period for submission of customs declarations and other documents confirming imports of goods and services from 270 days to two years. Under the new rules, imports with a total cost below US$ 10,000 are exempt from notifying the currency control authorities.

The central bank has regained its financial sector supervision function. The Financial Market Supervision Authority (FIMSA) was established in early 2016 with the onset of the banking sector crisis and tasked with the licensing, regulation and supervision of banks, the securities market, investment funds, insurance firms, credit organisations and payment systems. During its term, FIMSA implemented a number of reforms including initiating the cleaning up of the banking sector (11 banks closed in 2016), strengthening the monitoring and regulatory framework for the financial system, and setting up a credit bureau. At the end of 2019, the authorities closed FIMSA and transferred all of its functions back to the central bank. Following the transfer of power and following inspection of the banks, the central bank initially appointed temporary administrators in four banks in April 2020 and revoked their licences shortly thereafter.

The authorities initiated reforms to improve management of the SOEs. Recognising the cost of inefficient management, particularly with the budget tightening as the pandemic unfolds, in August 2020 the authorities established the Azerbaijani Investment Holding public company to manage SOEs. The establishment of the company aims to increase the efficiency and transparency of the SOEs to be placed under its umbrella. The governance and management structure of the holding as well as the list of public companies are yet to be determined.

Development of a major gas project advanced. In November 2019, the European segment of the Southern Gas Corridor, Trans Adriatic Pipeline (TAP) was linked to the Trans-Anatolian Natural Gas Pipeline (TANAP) at the Turkish-Greek border. With TANAP becoming operational in 2018, the first gas deliveries from Azerbaijan's Shah Deniz gasfield to Europe via TAP are expected by the end of 2020. The project almost triples Azerbaijan's annual gas production capacity.

BELARUS

Highlights

- **After a slowdown in 2019, economic growth turned negative in 2020.** GDP growth was just 1.2 per cent in 2019 and the decline of 0.2 per cent year-on-year in the first quarter of 2020 was largely driven by a supply shock in the petrochemical sector.
- **The Covid-19 pandemic has deepened the recession.** Support to the economy mainly came from limited tax measures and monetary and prudential counter-cyclical measures in the banking sector. Events following the presidential elections in August 2020 have created additional disruption and uncertainty in the economy.
- **The dire economic performance has been paired with limited progress in structural reforms.** The business environment has suffered from a near absence of reforms in the past year, hampering an economy overwhelmed by structural weaknesses in the face of the pandemic.

Key priorities for 2021

- **Corporate governance improvements and commercialisation of the state-owned sector are urgently required.** Inefficiencies and a lack of corporate governance of state-owned enterprises (SOEs) are negatively affecting valuations and seriously undermining the growth potential of the economy.
- **A regulatory level playing field would help unleash the full potential of companies in private ownership.** Private companies still face regulatory discrimination in many sectors of the economy. Liberalisation of economic governance and the introduction of appropriate market regulation are critical measures for restarting the stalled economy.
- **The authorities should start preparing the economy to benefit from long-term post-pandemic shifts in global supply chains.** A strong and diversified industrial base and a highly skilled labour force in near proximity to major European multinational companies can drive future growth provided they are complemented by a sound business environment and a free market economy.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	-2.5	2.5	3.1	1.2	-3.5
Inflation (average)	11.8	6.0	4.9	5.6	5.1
Government balance[1]/GDP	-1.7	-0.3	1.8	0.6	-4.7
Current account balance/GDP	-3.3	-1.7	0.0	-2.0	-3.3
Net FDI/GDP [neg. sign = inflows]	-2.3	-2.2	-2.3	-2.0	-1.4
External debt/GDP	78.0	72.8	65.5	64.4	n.a.
Gross reserves/GDP	10.2	13.4	11.9	14.9	n.a.
Credit to private sector/GDP	20.4	20.9	21.3	22.4	n.a.

[1] Includes central government, local government and social security funds.

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Covid-19: macroeconomic implications

The economy entered the Covid-19 pandemic in a weakened state, partly as a result of the delay in reaching a new oil agreement with Russia. GDP contracted by 0.2 per cent year-on-year in the first quarter of 2020 on the back of manufacturing and export declines, due to disrupted production at the oil refineries at the beginning of the year. The Covid-19 pandemic deepened the recession to 1.8 per cent year-on-year in the period January to May, before it moderated to a 1.3 per cent decline in the nine-month period from January to September. In the absence of a full lockdown, the negative impact on non-tradeable services was less severe than in other countries, with the heaviest decline being in transport (9.5 per cent). Agriculture, construction and information and communication technology services all enjoyed strong year-on-year growth. The large export sector was hit hard by reduced global demand, falling almost 18 per cent year-on-year in the period January to August 2020. The events following presidential elections in August caused additional disruptions in economic activity, and the currency came under renewed pressure. The Belarusian rouble depreciated by 8 per cent against the US dollar between the election and the end of August, adding to the currency weakening at the beginning of the year, with the total depreciation standing at 20 per cent in 2020 as of the end of October. Foreign reserves declined from an historical high of US$ 9.4 billion at the end of 2019 to US$ 7.3 billion in September 2020.

Fiscal constraints impeded a comprehensive financial response to the crisis. The combination of a lack of available foreign financing, substantial debt service obligations and the absence of rapid financing from the International Monetary Fund (IMF) has left policymakers with little room for manoeuvre. Support to the economy was limited to the use of prudential counter-cyclical measures in the banking sector, providing additional loan support to SOEs and temporary fiscal benefits for small and medium-sized enterprises. Eventually, benefiting from the liquidity that flooded financial markets, Belarus issued Eurobonds amounting to US$ 1.25 billion in June 2020, helping to ease the near-term financing obligations. In September 2020 a preliminary agreement was reached with Russia for an additional US$ 1.5 billion to ease the foreign currency liquidity constraints.

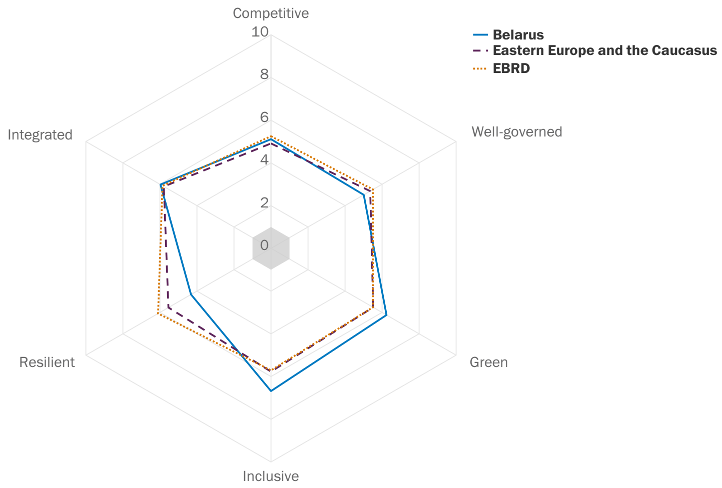
The post-election worsening of the business environment threatens the pace of recovery from the Covid-19 recession. The rapid deterioration of the macroeconomic environment during 2020 is visible in the scarcity of foreign currency liquidity and banking deposits withdrawals. An environment of uncertainty and intimidation threatens the vibrant export-oriented digital sector, one of the rare bright spots during the pandemic. Output is forecast to decline by 3.5 per cent in 2020 and then increase by a mere 1.0 per cent in 2021. Prolonged political instability remains the main risk for this scenario.

Policy response to Covid-19

Crisis-response measures have been limited and skewed towards recommendations instead of regulation. In April 2020 the authorities announced a package of fiscal measures, which include additional resources for the healthcare sector, and tax relief and tax deferral measures for companies in the sectors most affected by the pandemic. Tax measures are largely left to be designed and implemented at the local government level. The growth of prices and tariffs for socially important goods was capped in the initial period of the pandemic, and later extended until the end of 2020. Rent payment holidays and a moratorium on raising the base rent amount or the actual amount of rent were introduced for state property. In the state sector, the authorities delinked wages from productivity growth to avoid a strong decline in real wages. Public sector organisations are being subsidised in case their production was disrupted. During 2020, the amount of new directed loans to SOEs increased significantly, reversing the trend in recent years of phasing them out. Meanwhile, the National Bank of Belarus has decided to apply counter-cyclical measures related to the mitigation of a number of prudential requirements, and it issued guidance to the banks to offer loan holidays to targeted customers. It also partially released the capital buffers and extended the maturity of its refinancing loans.

CONTINUES

Assessment of transition qualities (1-10)



Structural reform developments

The halt of crude oil supply from Russia is forcing oil refineries to adapt. The oil and gas agreement with Russia expired in 2019. Delays in reaching a new agreement resulted in a temporary cessation of oil supplies from Russia to Belarus on 1 January 2020. This forced the oil refineries in Belarus to run their refineries at minimum load and to suspend exports. As a consequence, Belarus started exploring other oil suppliers. An agreement was reached in the second quarter of 2020, leading to a partial resumption of oil imports from Russia.

The government introduced an environmental tax on oil transit. Introduced by presidential decree in January 2020, the tax of 50 per cent will be applied on profits of companies providing transit for crude oil and petroleum products via Belarus. The proceeds will be used to create resources in case of environmental damage from potential future oil pipeline damage. The new tax comes less than a year after the contamination of the Druzhba pipeline, which caused disruptions in oil delivery and a strong negative impact on the Belarusian economy.

BOSNIA AND HERZEGOVINA

Highlights

- **A recession is expected in 2020 due to the Covid-19 pandemic.** Manufacturing sector output fell by 12 per cent year-on-year in the first seven months of the year. Tourism has also been hit hard, with a significant decrease in the number of foreign tourist arrivals.
- **Credit guarantee programmes have been introduced in the two entities.** The programmes help small and medium-sized enterprises (SMEs) access finance during the pandemic.
- **A controversial new coal-fired power plant is under European Union (EU) scrutiny, but energy diversification is slowly advancing.** The state aid case of the Tuzla 7 project has been referred to the highest decision-making body of the Energy Community: the Ministerial Council. A number of small solar and wind projects are under construction or planned, as well as the diversification of gas supply routes.

Key priorities for 2021

- **Reform of state-owned enterprises (SOEs) should be high on the agenda.** The large number of SOEs impose a significant fiscal burden and have negative effects on other businesses and competition. They should be depoliticised and restructured, followed in some cases by a renewed and credible push for privatisation.
- **Further movement towards a single economic area within Bosnia and Herzegovina would help improve the quality of the business environment.** Significant differences in business conditions and procedures in the two entities continue to hinder private sector development. Also, simplifying business registration, licensing and permitting, introducing e-signatures and improving bankruptcy laws would support the post-Covid-19 economic recovery.
- **The authorities should step up their efforts to conduct structural reforms.** The pandemic has exacerbated the structural weaknesses of the economy. In order to improve growth prospects, institutional and socio-economic reforms are needed.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.1	3.2	3.7	2.7	-5.0
Inflation (average)	-1.1	1.2	1.4	0.6	-0.8
Government balance/GDP	1.2	2.6	2.2	1.9	-5.5
Current account balance/GDP	-4.7	-4.3	-3.7	-3.5	-4.5
Net FDI/GDP [neg. sign = inflows]	-1.8	-2.1	-2.5	-2.7	-1.5
External debt/GDP	63.8	72.0	64.5	65.4	n.a.
Gross reserves/GDP	31.9	33.6	34.8	35.7	n.a.
Credit to private sector/GDP	54.3	55.6	55.1	55.8	n.a.

CONTINUES

Covid-19: macroeconomic implications

The economy has slowed further due to the pandemic-related lockdown measures. Before the outbreak of Covid-19, economic growth had been falling. A decline of industrial output and a slowdown in the main trading partners resulted in Bosnian GDP growth dropping to 2.7 per cent in 2019 (from 3.7 per cent in 2018). Growth fell further in the first half of 2020 to 3.8 per cent year-on-year, on the back of falling exports, investment and consumption. The crisis has seriously hit the manufacturing sector, with output in this sector falling by 12.3 per cent year-on-year in the first seven months of the year. Certain industries, such as base metals and furniture production, decreased their output by more than 30 per cent year-on-year during the same period. The tourism sector has also been severely affected. In July 2020, foreign tourist arrivals in both entities were more than 80 per cent lower than in July 2019. Because of the pandemic, remittances from the country's large diaspora are also being negatively affected. Available data show that in the first half of 2020 remittances were down by 16.9 per cent year-on-year.

Inflation dropped below zero. After falling to 0.6 per cent in 2019 (from 1.4 per cent in 2018), the inflation rate continued to trend downwards in 2020 and became negative in April, averaging -0.7 per cent year-on-year in the first seven months of the year. The deflationary pressures came from several factors: a fall in transport prices (related to the decline of oil prices globally); the continuing decline of clothing and footwear prices; and the entity governments' decisions to restrict margins on oil products and prices of basic food, hygiene products, medicines and protective equipment during the pandemic emergency.

Public debt is at a moderate level but is expected to increase. As a response to the crisis, the entity governments have adopted a set of measures to mitigate the economic consequences of the pandemic (see below). Public debt was 33.0 per cent of GDP as of the first quarter of 2020, but is on a rising path as a result of falling GDP, new loan arrangements with international institutions (including €333 million under the International Monetary Fund's Rapid Finance Instrument and €250 million under the European Commission's (EC's) Macro-Financial Assistance, which is currently under discussion), and increased borrowing by governments in the domestic financial market.

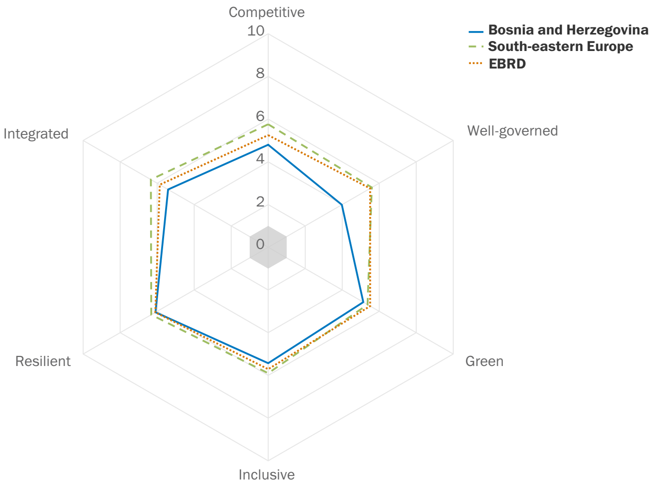
After the recession in 2020, a recovery is expected in 2021. GDP is forecast to fall by 5.0 per cent in 2020 and grow by 3.0 per cent in 2021. Risks to the projection are on the downside, related to the potential return of the pandemic, slow recovery in the main eurozone export markets and uncertainty about progress in the country's reform agenda.

Policy response to Covid-19

Support measures mitigating the effects of the crisis were introduced in both entities. In the Federation of Bosnia and Herzegovina (FBIH), a Stabilisation Fund helps cover minimum wages and social contributions in affected companies, while the FBIH Development Bank set up a guarantee fund to maintain and improve the liquidity of companies. Other measures include extra funds for cantons and municipalities in the Federation, exemptions from para-fiscal fees for affected businesses, and the cancellation of advance corporate income tax payments. In the Republika Srpska (RS), a Solidarity Fund was established to support businesses, corporate income tax payments were deferred, and a fixed pricing margin for certain staple products was temporarily introduced. In addition, the RS government covered gross minimum wages for April, along with income taxes and contributions for March wages for affected businesses, and the RS Investment Development Bank deferred overdue payments. Credit guarantee programmes for SMEs have also been introduced in both entities. In August 2020 the FBIH Banking Agency and RS Banking Agency extended the moratorium on loan repayment by a further six months. Both agencies introduced the moratorium initially in March 2020 and then prolonged it by two more months. In August 2020 the RS Banking Agency also banned banks in the entity from paying dividends from 2019 profits.

CONTINUES

Assessment of transition qualities (1-10)



Structural reform developments

The authorities are discussing a new arrangement with the International Monetary Fund (IMF). The previous Extended Fund Facility arrangement with the IMF (€553.3 million) officially expired in September 2020 but, because of the lack of economic reforms, only two tranches were disbursed. It is expected that talks between the country's authorities and the IMF on a new arrangement will start in November 2020. The new arrangement, if agreed, is likely to focus on reforms to the health sector and response to the Covid-19 crisis, and SOEs.

There has been little progress in EU accession negotiations over the past year. The country submitted an EU membership application in February 2016. In May 2019 the EC issued the Opinion on the application, which was subsequently endorsed by the Council in December 2019. The Opinion identifies 14 key priorities for the country to fulfil in order to be recommended for the status of EU candidate country. These priorities lie in the areas of democracy and functionality of institutions, rule of law, fundamental rights and public administration reform. The Commission encouraged the authorities to agree and implement socio-economic reform measures, in line with the Economic Reform Programme policy guidance, and to continue engaging in regional cooperation and strengthening bilateral relations with neighbouring countries.

The state footprint in Bosnia and Herzegovina remains large. Around 550 SOEs in Bosnia and Herzegovina employ 80,000 people or about 10 per cent of the total workforce. Many of them are loss-makers, characterised by weak transparency, accountability and performance, and suffer from political influence. Over the past year, there has been little progress in reforming these companies.

Construction of a controversial new coal-fired power plant is advancing. Initially, the project was planned to begin in March 2020, but was delayed by the pandemic. The new 450 MW unit (Tuzla 7) at the country's largest power plant is expected to produce around 2,750 GWh of electricity annually. The project, worth around €720 million, is to be implemented by a Chinese consortium and financed mainly by a loan from China's Exim Bank. Besides posing environmental concerns, the project is also controversial because of a potential breach of EU state aid rules, related to the loan guarantee for Tuzla 7 approved by the Federation government. After terminating negotiations related to the construction of the unit with FBIH representatives without having reached an agreement in late 2019, the Energy Community Secretariat referred the Tuzla 7 state aid case to the highest decision-making body of the Energy Community, the Ministerial Council, in June 2020.

CONTINUES

Steps have been taken to diversify the energy portfolio towards more renewables. One of the three state-controlled power producers Elektroprivreda BiH has started the construction of a 48 MW wind park Podveležje, worth €83 million and with an expected annual output of 130 GWh. The RS power utility (ERS) has submitted to the government of RS an offer to build a solar power plant Trebinje 1, a project worth around €50 million, but with somewhat lower installed capacity (73 MW) and power output (101.5 GWh annually) than initially planned. The company is also developing a project for a 48 MW wind farm Hrgud in eastern Herzegovina, whose construction should start by the end of the year. Other projects are in the process of receiving energy permits for their construction. In June 2020 the Federation parliament adopted conclusions calling for a prohibition of the construction of small hydropower plants on the territory of the Federation of Bosnia and Herzegovina.

Banking sector non-performing loans (NPLs) are down and regulatory reforms in the sector have progressed. The capital adequacy ratio of the banking sector stood at 18.4 per cent at the end of June 2020, well above the regulatory minimum of 12.0 per cent. Still, some (primarily local) banks have insufficient capital endowments and unfavourable credit portfolios. At the same time, the NPL ratio of the banking sector stood at 6.7 per cent (down from 8.0 per cent a year ago). The NPLs are concentrated in domestically owned banks and are largely a legacy issue. The new banking laws adopted in 2017 should support the soundness of the banking sector, but banking sector supervision is hampered by fragmented competences. In June 2020 the new Law on Deposit Insurance in Banks was adopted. The law envisages mandatory membership of banks in the deposit insurance programme, a shorter deadline for payout to depositors (20 days from the day the bank's licence is revoked, rather than the earlier 90 days) and use of funds of the Deposit Insurance Fund for bank resolution.

BULGARIA

Highlights

- **The Bulgarian economy has been negatively affected by the coronavirus crisis.** The economy is experiencing recession in 2020 after recording growth of 3.7 per cent in 2019, but a bounce-back is expected in 2021.
- **The government has taken crisis response measures similar to those in other peer countries, although somewhat smaller.** The focus has been on preserving jobs, helping vulnerable groups and providing support to firms.
- **Bulgaria has joined the European Union (EU)'s Exchange Rate Mechanism (ERM II), paving the way for euro adoption.** Bulgaria has also joined the Banking Union, and therefore the European Central Bank (ECB) will be in charge of supervision of the major banks in the country.

Key priorities for 2021

- **Supporting firms' liquidity and preserving jobs from crisis through recovery is needed.** Providing liquidity to the economy, particularly small and medium-sized enterprises (SMEs), and revenue support to vulnerable individuals affected by the crisis are important measures for a quicker post-Covid-19 recovery.
- **The authorities should focus on the key structural reforms required to improve the country's competitiveness.** While important reforms have been taken in recent years, as reflected by the country's entry into ERM II and the Banking Union, further progress is needed with regards to improving the overall quality of institutions and governance.
- **Further work is needed to improve the rule of law and strengthen anti-corruption efforts.** Progress under the EU's Cooperation and Verification Mechanism (CVM) has been praised in the previous years' reports. Nevertheless, proving the irreversibility of the reforms will be key to fulfilling the country's commitments to the EU.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.8	3.5	3.1	3.7	-5.5
Inflation (average)	-1.3	1.2	2.6	2.5	1.0
Government balance/GDP	0.1	1.1	2.0	1.9	-2.8
Current account balance/GDP	3.2	3.5	1.4	4.0	1.9
Net FDI/GDP [neg. sign = inflows]	-1.1	-2.5	-1.3	-1.3	-0.5
External debt/GDP	67.1	67.8	58.1	55.7	n.a.
Gross reserves/GDP	46.9	47.4	43.1	40.6	n.a.
Credit to private sector/GDP	51.5	49.5	49.7	49.3	n.a.

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Covid-19: macroeconomic implications

The coronavirus pandemic has hit the economy. Following growth of 3.7 per cent in 2019, which was driven mainly by private consumption, the country is experiencing a recession in 2020. The state of emergency, declared in mid-March, imposed tough restrictions on travel and economic activity, resulting in a sharp decrease in economic activity in March and April. Economic activity started to gradually recover from May onwards amid the lifting of most restrictions. In the first quarter of 2020, the economy was still expanding by 1.2 per cent year-on-year, and growth was broad-based. The full impact of the crisis was seen in the second quarter, when real GDP dropped by 8.7 per cent year-on-year. This resulted in a decline of 4.2 per cent year-on-year in the first half of the year, with private consumption decreasing by 2.4 per cent year-on-year and investments by more than 8 per cent year-on-year. The mitigating factor came from the government crisis response package of about 4 to 5 per cent of GDP, the focus of which was on preserving jobs and providing support to firms.

Exports and tourism have declined. Exports of goods, which account for about 50 per cent of GDP, making Bulgaria only moderately dependent on trade, decreased by about 3 per cent year-on-year in the first half of 2020. A more important impact on the balance of payments, as well as on the decline in economic activity, was the enormous disruption to the important tourism sector, which in normal times accounts for about 10 per cent of GDP. Foreign arrivals stopped almost completely in April and May 2020 and have been slow to recover since, declining by 75 per cent year-on-year in June and 65 per cent year-on-year in July. The government expects a decline of tourism revenues for the year as a whole of more than 50 per cent compared with last year.

The government redrafted the budget to accommodate a higher deficit. After four consecutive years of budget surpluses, and with public debt at 20 per cent of GDP, Bulgaria is among the least indebted countries in the EU. Notwithstanding the pandemic-induced economic slowdown, budget execution data up to mid-year show a cumulative surplus of 1.3 per cent of GDP in the first half of 2020. However, the Covid-19 crisis is putting great pressure on the fiscal account, and with a deterioration expected in the second half on the back of lower tourism receipts and government support measures employed, in April 2020 the government projected a new deficit at -2.9 per cent of GDP for the year as a whole (assuming a recession of 3 per cent), compared with a previously planned balanced budget. In April and May 2020, respectively, Fitch and Standard & Poor's maintained the BBB rating on Bulgaria's sovereign credit but downgraded the outlook from positive to stable on the back of Covid-19 related risks.

Economic activity is expected to recover in 2021. We project GDP to fall by 5.5 per cent in 2020 and bounce back with a 3.0 per cent growth rate in 2021. This is based not only on the assumption of a gradual normalisation of economic activity in Bulgaria in the second half of 2020, but also among its main economic partners. The main risks to the outlook are on the downside and are associated with a possible prolonged Covid-19 crisis, both in Bulgaria and elsewhere.

Policy response to Covid-19

Crisis response measures mainly focused on preserving jobs. The overall measures taken so far by the government are estimated at 4 to 5 per cent of GDP, and are similar to those in other countries. Government support during the pandemic mainly focused on sustaining employment. One of the key measures has been the coverage of 60 per cent of salary costs in the crisis-affected sectors, which has been extended until the end of the year. The government also introduced wage subsidies for hiring the unemployed, as well as for retaining jobs in the tourism and transportation sectors (a monthly subsidy of BGN 290 [€148] per employee for up to six months), and provided support for the self-employed (such as freelancers working in the cultural sector). Additional remuneration was provided to those in the ministries of health, interior and defence, as well as one-off transfers to parents forced to be on unpaid leave.

Several measures were taken to support firms. In April 2020, the government announced that the payment of corporate taxes would be deferred until 30 June, and the value-added tax rate reduced from 20 per cent to 9 per cent for certain categories including restaurant services, tourist operators, sports facilities, wine and beer, as well as books and baby food, until the end of 2021.

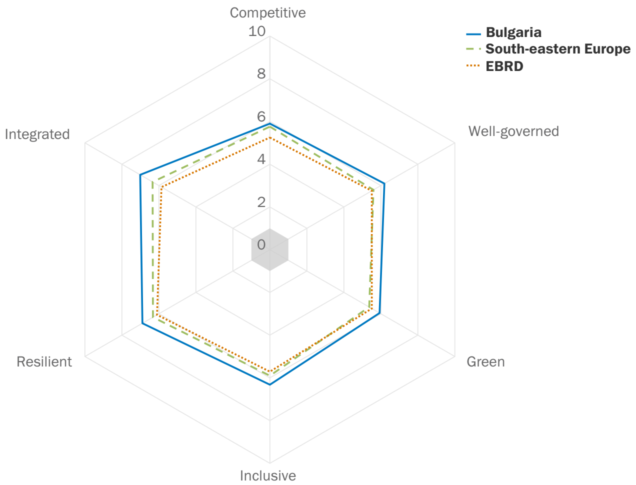
CONTINUES

In terms of direct firm liquidity support, the government increased the capital of the state-owned Bulgarian Development Bank (BDB) by BGN 700 million (€357 million) so that it could provide BGN 500 million (€255 million) of support for portfolio guarantees to commercial banks for the extension of corporate loans, and the remaining BGN 200 million (€102 million) for interest-free loans to employees on unpaid leave. The government also reallocated about BGN 350 million (€179 million) of EU funds to directly support companies affected by the Covid-19 crisis through grants, and an additional BGN 1,024 million (€532 million) to the state-owned company "The Fund of Funds" for further on-lending, particularly to SMEs.

Further measures were adopted in July 2020 under an additional crisis support package. Key measures, effective from 1 August, include additional payments to personnel involved in activities to contain the spread of the pandemic, an increase in subsidies to hospitals, extra payments for children's healthcare, and more money for social assistance and pensioners. In the tourism sector, state subsidies of €35 per seat for charter flights are provided, as well as BGN 210 (€105) worth of tourism vouchers for people involved in addressing the pandemic. The minimum amount of unemployment benefit was also increased (from BGN 9 to 12 [€4.6 to €6.1] per day) as well as the minimum payment period (from four to seven months), in effect since October.

The Bulgarian National Bank took measures to increase the liquidity of the banking sector. Key policy measures introduced during the Covid-19 crisis included: (i) capitalisation of 2019 profit in banking system (BGN 1.6 billion, 1.4 per cent of GDP); (ii) reduction of foreign exposures of commercial banks (BGN 7 billion, or 5.8 per cent of GDP); and (iii) cancellation of the increase of the countercyclical capital buffer planned for 2020 and 2021, in effect amounting to BGN 0.7 billion (0.6 per cent of GDP). In addition, the central bank, following guidance from the European Banking Authority, and after consultation with the Association of Banks in Bulgaria, approved the deferral of loan payments for up to six months for impacted firms and individuals. It also established a €2 billion swap line with the ECB until the end of 2020 or as long as necessary to ensure liquidity.

Assessment of transition qualities (1-10)



Structural reform developments

Bulgaria's eurozone membership has advanced following ERM II accession. In July 2020 the ERM II parties, that is, the ECB together with the eurozone member states and Denmark, decided to include the Bulgarian lev in the ERM II, following the request sent by Bulgaria in July 2018, at the central rate set at 1 euro = 1.95583 leva, the same rate Bulgaria has had under its currency board arrangement since 1997. After two years, a new assessment of the country's readiness for eurozone membership will be taken; if positive, Bulgaria would join the eurozone.

CONTINUES

The decision followed the introduction of a number of important reforms in the financial sector, which strengthened institutional quality and governance. In the same month, Bulgaria joined the Banking Union and therefore, from 1 October 2020, the ECB is in charge of the direct supervision of the major banks in Bulgaria, as well as the oversight of others.

Liberalisation and diversification of the gas market have advanced. Amendments to the Energy Act were adopted in October 2019 towards the liberalisation of the gas market, including rules on gas balancing and the setting up of an organised trading point, as well as those regarding the functioning of the public supplier. The new rules will allow for a gradual transition from a regulated market to one based on freely negotiated prices. The gas supply is also being diversified, following progress in the development of new transmission links with neighbouring countries. The construction of the gas pipeline connecting the country's existing gas transmission system with Turkey and with Serbia, with the aim of carrying gas from the Turkish Stream, is progressing. Moreover, the construction of the gas connection with Greece advanced with financial support from the European Investment Bank (EIB), and one with Serbia is also planned. In addition, in August 2020 Bulgartransgaz acquired a 20 per cent interest in a Greek liquefied natural gas terminal in Alexandroupolis.

Transport infrastructure development is progressing. Road infrastructure works have continued at the Hemus motorway (linking Sofia with the Black Sea port of Varna through the northern part of country), while the contract for the last pending section of 89 km between Veliko Tarnovo and Buhovtsi-Belokopitovo, was awarded to the state-owned Avtomagistrali in December 2019, with full completion expected in 2024. The Gabrovo bypass, part of the I-5 road (linking the Danube port Russe to the Greek border) including Bulgaria's longest concrete bridge, was finalised in June 2020. Contracts for railway modernisation, including the Plovdiv node, as well as the EIB-funded Elin Pelin-Kostenets railway line (part of the Sofia-Plovdiv route), were signed in July. Also in late July, the government and SofConnect, a consortium of the French-registered Meridiam Eastern Europe Investments, the Austrian construction company Strabag, and the Munich Airport operator, signed a deal on a 35-year concession of Sofia airport.

CROATIA

Highlights

- **Croatia has been severely affected by the coronavirus crisis.** In 2020, a sharp recession is under way, largely because of disruption in tourism, a mainstay of the Croatian economy, but a recovery is expected in 2021.
- **The authorities have employed considerable fiscal and monetary measures to mitigate the effects of the crisis.** Despite the country's high public debt, the government responded to the crisis with a sizeable and comprehensive crisis package, while the Croatian National Bank (CNB) focused on stabilising the kuna and providing liquidity to the banking sector.
- **Croatia has joined the Exchange Rate Mechanism II (ERM 2) and Banking Union.** This is one stage ahead of joining the eurozone, which may happen in two years at the earliest – contingent on the country meeting the Maastricht criteria.

Key priorities for 2021

- **The authorities should implement the key structural reforms needed to improve the country's competitiveness.** While important reforms have been undertaken so far, more progress is needed, particularly with regard to improving the overall quality of institutions and governance.
- **Business environment reforms should be prioritised.** Eliminating unnecessary red tape and facilitating doing business is important for economic recovery.
- **Additional efforts should be devoted to diversifying the economy.** The current pandemic has exposed the danger of relying on one or two key sectors. Supporting the development of, for instance, the export-oriented tradeable sector could decrease Croatia's dependence on tourism.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.5	3.4	2.8	2.9	-8.5
Inflation (average)	-0.6	1.3	1.6	0.8	0.4
Government balance/GDP	-0.9	0.8	0.2	0.4	-7.1
Current account balance/GDP	2.1	3.5	1.8	2.8	-3.2
Net FDI/GDP [neg. sign = inflows]	-4.3	-2.3	-1.6	-1.9	-0.6
External debt/GDP	91.4	94.6	80.3	75.7	n.a.
Gross reserves/GDP	27.6	34.0	32.8	34.4	n.a.
Credit to private sector/GDP	57.7	55.2	54.1	53.8	n.a.

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Covid-19: macroeconomic implications

Economic activity has been severely affected by the coronavirus crisis. After five years of economic recovery (2015-19), with average annual growth of 3 per cent, a sharp decline is under way in 2020 because of the coronavirus pandemic. GDP inched up by 0.4 per cent year-on-year in the first quarter, but in the second quarter, the crisis took full hold as the government introduced a strict lockdown in mid-March, with tough restrictions on travel and economic activity, to fight the pandemic. Output in the second quarter contracted by the highest decrease on record, of 15.1 per cent year-on-year. The resulting economic decline in the first half of 2020 was -7.8 per cent year-on-year, with private consumption expenditure falling by 7 per cent, investments by 6 per cent and exports by 26 per cent (driven by a 50 per cent drop of exports of services).

A key channel for disruption is tourism, a mainstay of the Croatian economy. Tourist activity has been badly hit by the travel restrictions and the lockdown imposed to curb the pandemic in Croatia and across the European Union (EU) and elsewhere. Tourist spending normally accounts for more than 20 per cent of GDP. There was a drop of more than 75 per cent in tourist arrivals in March year-on-year, and a near halt to tourism in April and May. A partial recovery followed in the third quarter, as travel within the EU was relaxed on 15 June, mitigated by the nature of Croatia's tourism industry, which is based on private accommodation and easily reachable by roads from the tourists' main countries of residence such as Germany, Austria, Slovenia, Hungary and the Czech Republic. In July tourist arrivals were down 40 per cent compared with 2019, and 30 per cent year-on-year in August. Spillover effects were felt in the labour market, with the unemployment rate rising to 8.6 per cent in July 2020 from about 6.2 per cent in February.

The fiscal accounts have deteriorated. As the 2020 recession has curbed fiscal revenue, due to the lockdown imposed in response to the pandemic and measures to tackle the crisis (see below), the budget deficit is expected to substantially increase in the short term. The government revised the 2020 budget in mid-May, keeping expenditures unchanged (but reallocating funds for new priorities), and thus projecting a deficit of 6.8 per cent of GDP rather than a near-balanced budget as originally planned (assuming a recession of 9.4 per cent). However, the country remains at investment grade with the main credit ratings agencies, and access to funding seems satisfactory so far. In June 2020, the government successfully issued an 11-year Eurobond, raising €2 billion with an annual coupon rate of 1.5 per cent. The bond was heavily oversubscribed, implying that investors valued the confirmation of Croatia's investment rating and its progress in the euro adoption process.

Economic performance is expected to recover in 2021. We expect GDP to fall by 8.5 per cent in 2020 but recover partially with 3.5 per cent growth in 2021. This is based on the assumption of a gradual normalisation of economic activity in Croatia and among its main economic partners. Nevertheless, the risks are strongly to the downside, including through a possible resurgence of Covid-19 infections.

Policy response to Covid-19

The government has adopted a considerable crisis response package. Despite the country's high public debt, the government responded to the Covid-19 pandemic with a relatively strong set of stimulus measures, costing about 7 per cent of GDP. Preserving jobs, keeping businesses in operation and improving the social position of vulnerable categories were at the core of the crisis response measures. Some of the key government measures adopted in the first months of the crisis included: (i) interest-free loans to local governments, health and pension insurance funds to cover deferred payments; (ii) salary increases in the healthcare sector; (iii) full subsidisation of net minimum wages and social contributions for the first three months of the crisis in the affected sectors; (iv) an increase in the minimum wage of 23 per cent (to €530), (v) early refund of taxes; (vi) deferral (or full exemption) of public obligations (that is, taxes and social contributions) for three months (or more) for firms, depending on their revenue impact and size; (vii) a loan repayment moratorium for three months; and (viii) further state support, including from the Croatian Bank for Reconstruction and Development (HBOR), in the form of liquidity loans and guarantees. In late June 2020, the government announced that it would support the preservation of jobs through part-time work for the second half of the year.

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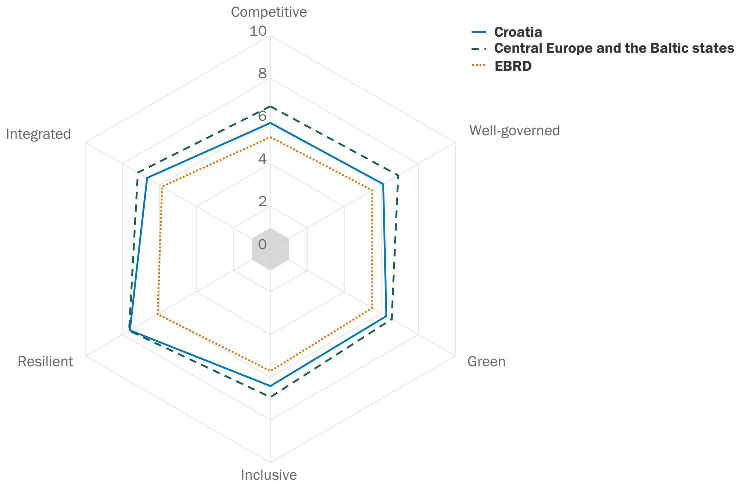
The Croatian National Bank (CNB) focused on stabilising the kuna and providing liquidity to the banking sector. The CNB has been using its foreign exchange reserves to intervene on the foreign exchange market to mitigate significant depreciation pressures and thus managed to preserve the stability of the kuna, which peaked at 7.62 HRK per euro in early April, compared with 7.45:1 during the pre-crisis period. In mid-April, the CNB agreed a precautionary currency swap line of €2 billion with the European Central Bank (ECB), to be in place until the end of the year and which can be activated if needed. The line allows the CNB quick access to euro liquidity, without using its own international reserves. In September 2020, the ECB's euro liquidity line was extended by six months. Liquidity was provided via: (i) the structural repurchase agreement (repo) facility (five-year HRK liquidity at 0.25 per cent); (ii) regular weekly repo (at 0.05 per cent); and (iii) a reduction of the reserve requirement ratio from 12 to 9 per cent. In addition, the CNB has introduced a repurchase of government bonds, in a quantitative easing-like move, to support the crisis response.

Assessment of transition qualities (1-10)



Structural reform developments

Croatia has been admitted into the Exchange Rate Mechanism (ERM) II. In July 2020 the ERM II parties, that is, the ECB together with the eurozone member states and Denmark, decided to include the Croatian kuna in ERM II, following the request sent by Croatia in July 2019. The central rate of the Croatian kuna is set at 1 euro = 7.53450 kuna, and the standard fluctuation band of plus or minus 15 per cent may be observed. After two years, a new assessment will be taken, and if positive, Croatia will join the eurozone. Before entering the ERM II, Croatia carried out a number of important reforms, including: (i) further strengthening the supervision of the banking system; (ii) strengthening the framework for implementing macro-prudential policies; (iii) strengthening the framework for anti-money laundering; (iv) improving the system for collecting, processing and publishing statistical data; (v) improving public sector governance; and (vi) reducing the administrative and financial burden of red tape on the economy.

Croatia has joined the EU's Banking Union. In parallel to joining the ERM II, Croatia also became a member of the Banking Union. From 1 October 2020, the ECB is in charge of the direct supervision of the major banks in Croatia, as well as the oversight of others. As part of Croatia's application to the Banking Union, the ECB had performed a comprehensive asset quality review and stress test of major systematically important banks, including Zagrebačka banka (Italian UniCredit), Privredna banka Zagreb (Italian Intesa), (Austrian) Erste & Steiermärkische Bank, (Hungarian) OTP banka and the locally owned Hrvatska poštanska banka. The results of the assessment were published in early June 2020, showing that these banks do not face any capital shortfalls.

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New energy capacities are being developed. The construction of a liquefied natural gas (LNG) terminal on the island of Krk has continued. This project, worth €234 million, is partially covered by a €101 million grant from the European Commission, which has listed it as an EU project of common interest. The Krk LNG terminal will have a capacity of 2.6 billion cubic metres of natural gas per year as of 2021, and should have an important role in diversifying the natural gas supply as well as ensuring its security not only for Croatia but also for the wider region. In June 2020, the Croatian power company Hrvatska elektroprivreda laid the cornerstone of the Cres solar power plant, which is meant to be the largest solar power plant in Croatia. It will strengthen the security of energy supply of the islands of Cres and Losinj in the northern Adriatic Sea, and increase their self-sufficiency especially during their peak tourist season.

Croatia has advanced on a number of social reforms. The country has started the incremental implementation of curricular reform in all primary and secondary schools. In addition, the experimental programme Dual Education in VET is being expanded. However, the adoption of occupation and qualification standards is proceeding slowly. Ongoing investments in early childhood education and care aim to increase availability and access. The package of active labour market policy measures has been refocused to make them more effective, while the Croatian Employment Service has developed a new IT tool aimed at improving mediation and referrals.

The moratorium on the sale of agricultural land to foreigners has been extended. In June 2020, the European Commission gave the go-ahead to Croatia for an extension to the moratorium of three years. Croatia joined the EU in July 2013, and its EU accession treaty granted a transitional period of seven years, during which a ban on the sale of agricultural land to citizens of other EU member states applied. This transition period was agreed to prevent growth in the prices of agricultural land in Croatia after EU accession.

CYPRUS

Highlights

- **The economy is being severely hit by the Covid-19 pandemic.** A deep recession is under way in 2020 as key sectors such as tourism, shipping and construction are particularly affected by the pandemic and associated restrictions.
- **The authorities have responded to the crisis with a significant package of support.** Key measures introduced so far include value-added tax (VAT) deferrals, payment holidays and subsidies, along with enhanced use of European Investment Bank instruments to support enterprises.
- **The digitalisation agenda has advanced.** Measures have been introduced to accelerate and improve the level of access to digital services, both within the government and between the government, the public and businesses.

Key priorities for 2021

- **Targeted support for businesses will be needed as Cyprus enters the recovery phase.** The challenge will be to provide support to the most affected businesses and vulnerable groups without endangering the hard-earned stability of public finances.
- **Renewed efforts are needed to reduce non-performing loans (NPLs) once the economy picks up.** NPLs have come down steadily in recent years but remain well above average European Union levels. Further reductions will require the pursuit of existing plans as soon as the market environment permits, along with support to the banking sector via the Central Bank of Cyprus (CBC) where needed.
- **Accelerating reforms to improve the governance of state-owned enterprises (SOEs) and public administration remain a priority.** The pandemic has accelerated the reforms on digitalisation, such as the implementation of the e-justice system, but a number of reforms regarding the governance of SOEs and public administration have advanced only slowly in recent years and need to be accelerated.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	4.8	4.2	3.9	3.2	-7.5
Inflation (average)	-1.2	0.7	0.8	0.5	-0.5
Government balance/GDP	0.1	1.7	-4.4	2.7	-1.8
Current account balance/GDP	-4.2	-5.1	-4.4	-6.7	-10.6
Net FDI/GDP [neg. sign = inflows]	-10.7	-6.9	-34.5	-14.1	-13.2
External debt/GDP	1,147.8	1,074.5	990.9	972.2	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	218.3	194.4	139.6	114.0	n.a.

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Covid-19: macroeconomic implications

The robust economic performance of recent years has been halted by the pandemic. Strong GDP growth over several years, including 3.2 per cent in 2019, has shifted in 2020 into a deep recession. In the first quarter of 2020 GDP grew by just 0.8 per cent year-on-year as the effects of the virus started to take hold. The severe lockdown (schools and all non-essential businesses shut) implemented between March and May 2020 to limit the spread of the virus affected virtually all sectors of the economy, and GDP fell by 11.9 per cent year-on-year in the second quarter of 2020. Economic sentiment plummeted from 111.7 points in January 2020 to 72.9 points in May 2020 (the lowest point since 2013) and has increased to just 80.6 points since then (September 2020). However, government measures have supported household income and unemployment so far has remained close to pre-Covid-19 levels, at 6.9 per cent in July 2020.

Tourism has been particularly affected by the crisis. In 2019, the travel and tourism sector accounted for 13.8 per cent of GDP, according to estimates from the World Travel and Tourism Council. During January to May 2020, overnight stays in Cyprus were down by more than 80 per cent relative to the same period a year previously, as lockdown and quarantine measures in key source countries took a major toll on the sector. The shipping sector (7 per cent of GDP) has also been hit by the crisis.

Public finances are being stretched by the pandemic. Recent years have seen major improvements in the public accounts after the financial and economic crisis in 2013; in 2019, the headline government budgetary balance recorded a surplus of 1.7 per cent of GDP, and the ratio of public debt to GDP fell below 100 per cent of GDP (at 95.5 per cent) by the end of 2019. However, a substantial budget deficit in 2020, along with a corresponding rise in public debt, is inevitable in light of falling GDP and government revenues and rising spending to mitigate the negative effects of the pandemic. Access to funding is not an issue so far, as the government retains investment-grade level among the main international sovereign credit rating agencies.

The recession in 2020 should be followed by a partial recovery. We forecast GDP to fall by 7.5 per cent in 2020, followed by growth of 4.0 per cent in 2021 on the back of a general pick-up of economic activity next year and a return of tourism to something closer to normal levels. However, risks are weighted to the downside, with any recovery likely to be delayed if there is a resurgence of the pandemic.

Policy response to Covid-19

The authorities have responded to the crisis with a significant package of support. Since March 2020, the government introduced a set of financial support measures worth €899 million (4.5 per cent of GDP), including specific support to the health sector, tourism and shipping. The package includes a VAT deferral for most companies until November 2020, a general nine-month payment holiday on loans for those who have been affected by the Covid-19 pandemic, and the introduction of subsidies, especially targeted at micro- and small- and medium-sized enterprises (MSMEs). Households are also being supported by leave allowances, and workers by unemployment allowances. The government package also includes financing and guarantees/financing of credit facilities (up to €1.7 billion) via the Pan-European Guarantee Fund.

Further crisis-response measures are supported by the CBC. In March 2020 a set of additional measures was announced, including: a release of capital and liquidity buffers for banks directly supervised by the CBC (up to €100 million), the simplification of documentation requirements for new short-term loans and other credit facilities, and the simplification of approval processes for loan restructuring. Applying favourable interest rates to new loans and newly restructured loans is also encouraged by the central bank.

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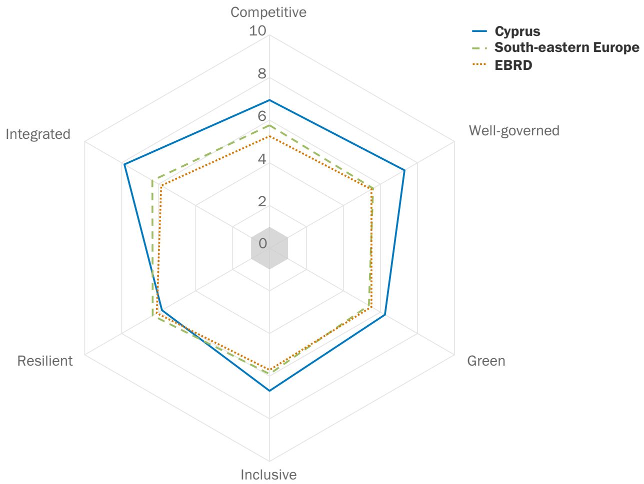
Assessment of transition qualities (1-10)



Structural reform developments

NPL reduction has slowed. In recent years, Cyprus had managed to improve significantly its banking system, after a deep crisis in the sector erupted in 2013. NPLs at one point accounted for more than half of all loans, but efforts to reduce the total have brought down the level significantly, to 27.8 per cent of total loans as of the end of April 2020. The banking sector was also significantly strengthened in 2019, with operations aiming at improving the balance sheets of the two major banks of the country (Cyprus Cooperative Bank and the Bank of Cyprus) and transferring NPLs to the state-owned management company KEDIPES. However, further sales envisaged in 2020 have had to be postponed given the challenge to determine the value of assets as well as the uncertainty about investors' appetite in the current pandemic. KEPIDES is not yet fully operational as the organisation set-up and governance framework have not been finalised, and the implementation of a business plan has not yet started. In addition, the take-up of ESTIA – the state support scheme for NPLs collateralised by primary residences – has been lower than expected.

The pace of digitalisation reforms has increased. In March 2020, a new Deputy Ministry on Research, Innovation and Digital Policy was established with the goal of improving digital access both within the government and between the government and the public and businesses. Some initiatives are focused on responding to the lockdown challenges of public administration and tracking. The implementation of digital services and electronic tools for the submission of applications by citizens, workers and SMEs regarding the support measures and grants announced by the government, has been introduced by the Ministry of Labour, Welfare and Social Insurance. Similarly, e-Banking credentials can now be used by citizens to access the government's systems and transact with the government. Existing initiatives have been accelerated, with for example the start of the tendering of the e-Justice system. Lastly, other initiatives are at the early stages of development, such as support to the development of e-Health initiatives and a new information system for the Cyprus Tax Department.

Reforms to the governance of SOEs and public administration are advancing slowly. Regarding the governance of SOEs, draft legislation pending since April 2015 was withdrawn in 2019, although a number of provisions were integrated in measures adopted by the government such as the application of the Code of Public Governance by SOEs. A new Action Plan for Better Regulation (2019-22), proposed in November 2019 and focusing on the reduction of administrative burdens and improved public sector efficiency, includes a number of ambitious objectives such as the modernisation of the tax department.

EGYPT

Highlights

- **Growth has slowed in the fiscal year 2019-20.** The Covid-19 crisis has contributed to a sharp rise in unemployment, but inflation has slowed, a primary surplus was achieved, and the current account deficit narrowed.
- **In response to the Covid-19 crisis, the authorities took a range of measures.** The government introduced a stimulus package and fast-tracked the release of overdue payments to contractors and export subsidies. The Central Bank of Egypt (CBE) announced a new debt relief initiative for those at risk of default, and issued loan guarantees to banks to on-lend to private sector companies active in the manufacturing, agriculture and contracting sectors.
- **Structural reforms advanced.** The government continued with subsidy reform through increases to electricity and public transport prices, and a series of laws were passed, including the new Banking and Central Bank Act, the SME law, the Unified Economic Operators Registry Act, and amendments to the Sovereign Fund Law and the Public Enterprises Act.

Key priorities for 2021

- **The authorities should step up measures to promote alternative water solutions.** Water security is at the forefront of Egypt's national security. To stem the worsening of its water shortage, systematic investments are required to promote efficient water utilisation in agriculture, industry and beyond.
- **Further steps to strengthen competition and promote a level playing field are needed.** Approving the revised Competition Law would ensure the institutional independence of the Egyptian Competition Authority and empower it to regulate mergers and acquisitions that meet certain thresholds.
- **Upgrading digital infrastructure and advancing digitisation would create much-needed job opportunities in a post-Covid-19 world.** The Covid-19 crisis has accelerated the move to remote working, online education and e-government services, and there is now an urgent need to upgrade available platforms.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020
GDP growth	4.3	4.1	5.3	5.6	3.6
Inflation (average)	10.2	23.5	20.9	13.9	5.7
Government balance/GDP	-12.5	-10.4	-9.4	-7.4	-7.5
Current account balance/GDP	-6.0	-6.1	-2.4	-3.6	-3.2
Net FDI/GDP [neg. sign = inflows]	-2.0	-3.3	-3.0	-2.6	-1.7
External debt/GDP	16.8	33.4	37.0	36.0	34.4
Gross reserves/GDP	5.1	13.0	17.4	14.5	10.3
Credit to private sector/GDP	26.3	28.3	24.4	22.9	25.0

* Fiscal year is July-June.

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Covid-19: macroeconomic implications

GDP growth slowed in the fiscal year 2019-20. The economy grew by 3.6 per cent, versus 5.6 per cent in the previous fiscal year and well below the initial target of 6.0 per cent. Growth in the first half of the fiscal year, before the Covid-19 crisis, was 5.6 per cent year-on-year, declining slightly to 5.0 per cent in the third quarter. In the last quarter (April to June 2020), GDP contracted by 1.7 per cent year-on-year, when a lockdown was imposed, thus negatively affecting both private consumption and investment. Unemployment rose sharply to 9.6 per cent in this quarter, reflecting the economic impact from the Covid-19 crisis on labour-intensive sectors, such as tourism. Inflation slowed to 3.7 per cent year-on-year in September 2020, reflecting a decrease in food prices and lower housing costs and utilities inflation. In a pre-emptive move to support the economy in the face of the Covid-19 crisis, the CBE cut its policy rate by 300 basis points in March 2020 and another 50 basis points in September 2020, the lowest level since early 2015.

The fiscal position continued to improve, despite the Covid-19 crisis. The budget deficit remained around 7.5 per cent of GDP in fiscal year 2019-20, slightly above the initial target of 7.2 per cent of GDP. The crisis saw tax revenues fall because of exemptions provided to businesses as part of the pandemic mitigation measures, but this was partly offset by strong revenues from state-owned enterprises (SOEs) and banks. Spending on subsidies declined, as most petroleum products have been indexed to actual procurement costs since April 2019, resulting in a sharp fall in energy subsidies. Overall, a primary surplus was achieved in the fiscal year 2019-20, amounting to 1.8 per cent of GDP. The latter, coupled with robust growth, led to a decline in the public debt-to-GDP ratio to 86.1 per cent.

External imbalances have fallen, but reserves declined. The current account deficit narrowed to 2.6 per cent of GDP in the first three quarters of fiscal year 2019-20 as imports fell due to weak commodity prices, the impact of Covid-19 and related measures on incomes and consumption, and supply disruptions. Exports also declined, as well as tourism revenues. Inflows of foreign direct investment to Egypt declined to US$ 2.1 billion in the same period. International reserves have dropped to US$ 38.4 billion in September 2020, but continue to comfortably cover over six months of imports.

Covid-19-related measures will hold back growth in the first half of the fiscal year 2020-21. GDP growth is projected at 3.5 per cent in the fiscal year 2020-21, due mainly to the weak outlook in the tourism sector, disruptions in global value chains, weaker demand from trading partners and the slowdown in foreign direct investment. However, large public construction projects and the boom in the telecommunications sector have so far sustained growth. The main risks to the outlook arise from the need for a tougher lockdown should the spread of Covid-19 accelerate, and from the negative outlook in Egypt's main trading partners.

Policy response to Covid-19

In response to the Covid-19 crisis, the government undertook a range of measures. A stimulus package of EGP 100 billion (US$ 6.4 billion) was announced in March 2020, of which EGP 50 billion (US$ 3.2 billion) was dedicated to the tourism sector. The petroleum and tourism ministries gave airlines a US$ 0.10-per-gallon discount on fuel, and several airlines were reportedly in negotiations with the government in pursuit of measures to mitigate the economic repercussions of the pandemic, including talks with banks and Egypt's Sovereign Wealth Fund over potential stake sales and zero-interest loans. Fiscal measures introduced by the government included: lower energy costs for the industrial sector; real estate tax relief for the industry and tourism sectors; an extended moratorium on agricultural land tax for two years; reduced stamp duty on transactions and dividend tax; postponed capital gains tax; and deferred utility payments for tourism and airline companies. On the social front, the government expanded Takaful and Karama (the national social protection programmes) to reach more families; and implemented a targeted support initiative for irregular workers (EGP 500, or US$ 32, in monthly grants for three months).

The CBE has also intervened with crisis-mitigation measures. In March 2020, the CBE increased the limit for electronic payments via mobile phones, announced a new debt relief initiative for those at risk of default, implemented an EGP 20 billion (US$ 1.3 billion) stock-purchase

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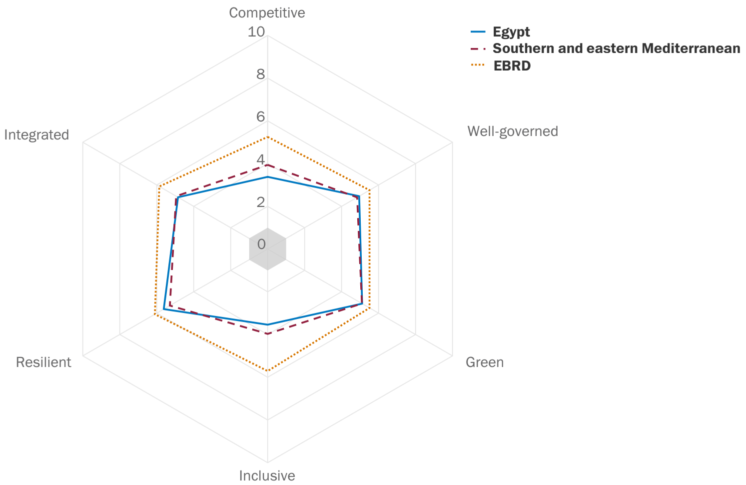
programme, suspended blacklists of loan defaulters, and provided loans with two-year grace periods to the aviation sector. The CBE also issued EGP 100 billion (US$ 6.4 billion) in loan guarantees to banks to on-lend to private sector companies active in the manufacturing, agriculture and contracting sectors, in addition to a EGP 3 billion (US$ 190 million) guarantee on three-year loans to tourism companies and hotels at a subsidised rate of 5 per cent with a one-year grace period.

Assessment of transition qualities (1-10)



Structural reform developments

A new International Monetary Fund (IMF) programme is in place. The programme, a US$ 5.2 billion one-year standby arrangement, was signed in June 2020. Coupled with a US$ 2.8 billion rapid financing instrument approved by the IMF in early May, this will help the government tackle the economic impact of the Covid-19 crisis and reinforce the progress on macroeconomic stabilisation and structural reforms carried out under the previous US$ 12 billion extended fund facility (EFF), which ended in 2019. The new programme's primary focus will be on enabling the government to finance spending on health services and social protection by bolstering the balance of payments and the state budget. Among the other pertinent features of the IMF programme is reforming the National Investment Bank, the state development bank, through the hiring of an international auditor to evaluate its financial position.

The parliament approved a new Banking and Central Bank Act. The legislation, approved in May 2020, gives the CBE increased discretionary powers to regulate the banking sector. Another provision of the law puts the CBE in charge of licensing companies that want to offer credit risk guarantees. The law will also allow the CBE to provide short-term bailout funding to struggling banks. Under the legislation, future boards and chairpersons of state-owned banks will be appointed by the prime minister and will be subject to some form of competency approval from the CBE.

Reforms to subsidies have advanced. In June 2020, the government announced increases in electricity prices, which went into effect in July. Residential users will face an average increase of 19.1 per cent, following a 21.2 per cent rise in July 2019. Electricity prices remain subsidised, and the plan for abolishing electricity subsidies completely was extended from 2021 until 2025. In August 2020, the metro fares on all lines in Cairo were increased by 50 per cent on average, following a previous increase in May 2018. The fuel indexation mechanism that was introduced in 2019 ensures that retail fuel prices remain at cost recovery and that the budget is unaffected through regular quarterly adjustments to reflect changes in world oil prices and movements in the exchange rate.

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The long-awaited SME (small and medium-sized enterprise) law was approved. Under the new law, approved in August 2020, the government will grant tax and custom incentives to the micro, small and medium-sized enterprises (MSMEs) sector. MSMEs will be given preferential tax rates ranging from 0.5 to 1.0 per cent according to the volume of their revenues, and will be excluded from stamp duty taxes and fees for registration of articles of association for five years. The law includes a range of tax exemptions for MSMEs, and provides support in securing land and credit, and in marketing their goods and services. Companies will be entitled to exemptions from stamp duty and fees for company registration, land contracts and credit agreements for five years from the date of their registration and will not be liable for capital gains tax. The law will also create a special income tax regime for MSMEs. One of the key advantages cited for the new law is that it would help MSMEs to gain better access to credit, as the process of formally registering these businesses for tax purposes would make it easier for banks to make risk assessments.

The Sovereign Fund Law and the Public Enterprises Act have been amended. The amendments, approved by parliament in June 2020, provide value-added tax refunds to any company that is more than 50 per cent owned by the Sovereign Fund of Egypt (SFE) and its sub-funds, and limits the scope of legal action that can be taken against the fund, shielding the SFE and its co-investors from third-party lawsuits. The Public Enterprises Act amendments reclassify listed companies in which the government holds up to a 75 per cent stake and brings them within the scope of the Companies Act, introduces a cap on board compensation, and puts in place new regulations requiring SOEs to provide evidence that their subsidiaries are economically viable.

ESTONIA

Highlights

- **GDP is falling sharply.** Containment and lockdown measures have strongly affected private consumption, exports and investments, but a fiscal stimulus of around 9 per cent of GDP is mitigating the impact by supporting employment, firm liquidity and local development.
- **The government has prioritised an insolvency framework reform.** The authorities have made progress on facilitating insolvency-related proceedings by establishing a new monitoring unit and partially increasing the efficiency of the process.
- **The pension system has been altered, with uncertain effects on capital markets development.** The adopted change to voluntary contributions to the second pillar brings short-term fiscal benefits but limits liquidity in the capital markets and makes the stability of the system crucially dependent on statutory retirement and minimum pension decisions.

Key priorities for 2021

- **EU recovery funds should be used to stimulate the recovery by boosting innovation and greening the economy.** Around €6.8 billion has been earmarked for Estonia in the next European Union (EU) budget, including the EU recovery instrument. The authorities should use these funds in investments that would improve the long-term growth potential of the economy, including the reduction of the carbon footprint of its energy sector.
- **Anti-money laundering and countering the financing of terrorism implementation needs to be finalised.** Despite some noteworthy progress and political commitment to address the shortcomings flagged by the European Commission (EC), gaps still exist and should be addressed, including cooperation at the level of the three Baltic states.
- **Addressing inequality gaps, especially following the coronavirus crisis, will become more important.** Income inequality and relative poverty remain elevated, and the risk of an increasing gap is high as containment measures significantly affected those in lower-paid jobs.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.2	5.5	4.4	5.0	-4.0
Inflation (average)	0.8	3.7	3.4	2.3	0.2
Government balance/GDP	-0.5	-0.8	-0.6	-0.3	-6.8
Current account balance/GDP	1.2	2.3	0.9	2.0	4.0
Net FDI/GDP [neg. sign = inflows]	-2.4	-3.9	-4.7	-3.5	-2.0
External debt/GDP	88.0	83.4	77.4	73.8	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	69.4	64.3	62.3	59.4	n.a.

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Covid-19: macroeconomic implications

Estonia entered the Covid-19 crisis after a year of robust growth. GDP grew by 4.3 per cent in 2019, with investments and net exports driving most of this growth. However, in the first half of 2020, the economy was significantly affected by the pandemic, with GDP declining by 3.9 per cent year-on-year, and by 6.9 per cent in the second quarter year-on-year. Although consumption expenditure edged up by 0.2 per cent, investment fell by 13.1 per cent and exports dropped by 2.6 per cent in the first half of 2020. Nevertheless, good economic fundamentals, such as the solid fiscal stance, current account surplus, and a financial sector in good shape, have enabled a strong policy response to the crisis so far, which together with an effective health response allowed the economy to swiftly begin recovering. Retail turnover declined by 15.8 per cent year-on-year in April 2020, the lowest point, but started gradually recovering as of May. On the other hand, industrial production declined by 16.9 per cent in April, but was slower to recover because of similar difficulties in trading partners.

Unemployment has risen while prices declined. The unemployment rate reached 8.0 per cent in July, triggering a slowdown of wage growth in the first half of the year to 2.9 per cent year-on-year. Prices have been declining during the lockdown and in the months following it, given the shock to demand. The steepest fall was recorded in May at -1.7 per cent year-on-year, driven mainly by price drops in transport, housing, and catering services.

The fiscal deficit has widened considerably. In the first half of 2020, the deficit had already reached 3.3 per cent of GDP (versus 0.3 per cent in 2019) and it is expected by the International Monetary Fund (IMF) to reach -6.8 per cent for the year as a whole. Public debt is forecast by the IMF to be 18.7 per cent of GDP by the end of 2020, up from 8.4 per cent at the end of 2019 but still exceptionally modest by EU standards. To finance the deficit, the government raised €1.5 billion through a 10-year bond in June 2020, and borrowed €750 million from the Nordic Investment Bank as a 15-year loan and €200 million from the Council of Europe Development Bank.

GDP growth is expected to recover in 2021 but uncertainty remains. As the bottom of the crisis was likely reached in April 2020, the economy has started to go through a long recovery phase since the relaxation of containment measures. As such, we forecast a 4.0 per cent fall in GDP in 2020, followed by a strong recovery of 4.0 per cent in 2021. This is of course contingent on, among other things, whether other Covid-19 outbreaks will happen this year or in 2021 in Estonia and elsewhere.

Policy response to Covid-19

A significant stimulus package was adopted. In addressing the socio-economic impact of the health crisis, the parliament approved a supplementary budget on 15 April 2020. Under this budget, the government earmarked a support package of almost 9 per cent of GDP. Key measures include support to the Unemployment Insurance Fund to finance the job retention scheme, covering 70 per cent or up to €1,000 per month for affected companies, and reduced to 50 per cent or €800 in June (at a total cost of €250 million). The health system will also receive about €200 million. In terms of liquidity support, the government, both directly and through the state-owned KredEx, will offer guarantees for bank loans to allow for rescheduling of payments (€1 billion), subsidised working capital loans (€500 million), and investment loans (€50 million). Budgetary support to local authorities was also earmarked (€130 million), while rural companies will be able to receive business loans, guarantees and land capital through the rural development fund (€200 million).

The central bank has released additional liquidity in the banking sector. As part of the eurozone, Estonia has benefited from the quantitative easing mechanism adopted by the ECB, the €1,350 billion pandemic emergency purchase programme (PEPP). Additionally, the Eesti Pank reduced the systemic risk buffer for the commercial banks from 1 per cent to 0 per cent to release liquidity in the banking sector, with a total impact estimated at about €110 million. The Eesti Pank also announced that it would allocate three-quarters of its 2019 profits, equivalent to €18.9 million, to support the state budget in addressing the Covid-19 crisis.

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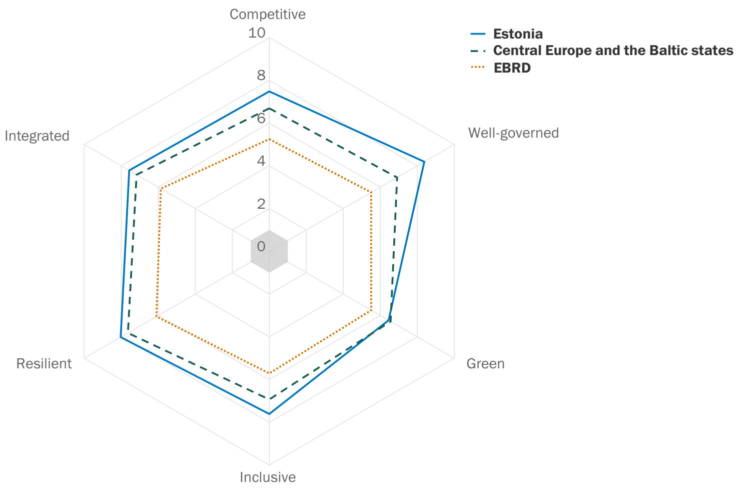
Assessment of transition qualities (1-10)



Structural reform developments

The parliament fully transposed the fifth EU Anti-money laundering Directive. The government initiated the Act on Amendments to the Money Laundering and Terrorist Financing Prevention Act, which was passed by parliament in June 2020. The act aims to strengthen the prevention of money laundering, and it transposes the remaining EU recommendations into national law. The key provisions are focused on whistle-blower protection, the development of a register of bank accounts which can be accessed by the Financial Intelligence Unit (the agency responsible for the supervision and prevention of money laundering), and more information exchange between entities. In addition, the Financial Intelligence Unit will become an autonomous institution under the Ministry of Finance. The EC and the IMF, however, have suggested that gaps remain in the capacity of the Financial Supervision Authority and in the overall implementation of regulation, such as the number of onsite inspections.

The insolvency framework reform is progressing. The government has prioritised the reform of the insolvency regime and proposed amendments, which passed the first reading in parliament in June 2020. The revised bill established, among other things, an insolvency service, greater specialisation of courts and more transparent remuneration of trustees. Resolving insolvency is the second-lowest ranked dimension for Estonia in the World Bank's *Doing Business 2020* report, and institutions such as the EC, IMF and OECD have all highlighted the need to streamline the restructuring process, debt discharge and, ultimately, to transpose the EU Restructuring and Insolvency Directive.

The pension system has been amended, stimulating consumption but possibly holding back capital markets development. Under the new rules, joining and leaving the second pillar will be voluntary. Requests to be released from payment will be accepted starting January 2021, while the payments will become voluntary as of October 2020. The change may result in a short-term consumption stimulus, but it will likely hold back capital markets development.

The gender pay gap is being addressed. The authorities have initiated several measures aimed at decreasing the gender pay gap, which reached an estimated 22.7 per cent in 2018 according to Eurostat. As of July 2020, parental leave will increase from 10 to 30 days, while the leave period will be flexible for the first three years. This is to help women return to work by encouraging a more flexible leave system. These two regulations are the final provisions of the reform of the parental leave and benefits system, which was approved at the end of 2017 and introduced gradually from 2018 to 2020.

GEORGIA

Highlights

- **Economic growth remained strong in 2019, but is contracting in 2020.** The hospitality sector, the main driver of robust economic growth in recent years, has become a key source of vulnerability during the Covid-19 pandemic.
- **The policy response to Covid-19 went hand in hand with securing support from international partners.** Total funding pledged by official creditors, including under the augmented International Monetary Fund (IMF) programme, is expected to cover the external and budget gaps in the near term.
- **The adoption of key energy laws marks a new stage in the sector's development.** The laws outline the upcoming energy market reform, establish a renewable energy framework and support energy efficiency in construction.

Key priorities for 2021

- **The authorities should strengthen the resilience of the economy through diversification.** Policies to support the export of information technologies services and to benefit from the expected post-Covid-19 shifts in global supply chains could enhance the growth potential of the economy and its resilience.
- **Governance standards need to remain high on the reform agenda.** Strong institutions, an impartial judicial system and independent market regulatory bodies are key for attracting investments in higher value-added sectors and speeding up the convergence process.
- **Human capital development through investments in education would help improve the overall productivity of the economy.** Digital technologies capabilities and vocational skills will become important factors in directing post-Covid-19 investments.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.9	4.8	4.8	5.1	-5.0
Inflation (average)	2.1	6.0	2.6	4.9	5.3
Government balance[1]/GDP	-1.3	-0.9	-0.7	-2.7	-8.1
Current account balance/GDP	-12.5	-8.0	-6.8	-5.4	-10.8
Net FDI/GDP [neg. sign = inflows]	-8.2	-10.5	-5.5	-5.8	-5.2
External debt/GDP	105.3	106.6	101.3	105.0	n.a.
Gross reserves/GDP	18.2	18.7	18.7	19.8	n.a.
Credit to private sector/GDP	51.7	53.4	58.1	62.2	n.a.

[1] According to the definition by the Ministry of Finance (GFS-2001).

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Covid-19: macroeconomic implications

The Covid-19 pandemic is particularly disruptive for the small and open Georgian economy. The impact of the external pandemic shock was wide-ranging, hitting export of goods, tourism and remittances, all very important pillars of the Georgian economy. Strict virus containment measures, imposed in March 2020, hit domestic demand and many small service providers. Growth slowed from 5.1 per cent in 2019 to 2.2 per cent year-on-year in the first quarter of 2020, and GDP fell by 12.3 per cent year-on-year in the second quarter, with the trough of the cycle reached in April. Preliminary indicators show that economic output contracted by 5.0 per cent year-on-year in the first nine months of 2020. Tourism, which brought foreign exchange inflows close to one-fifth of GDP in 2019, recorded a 78 per cent year-on-year fall of foreign visitors in the period January to September 2020, as international borders remained largely closed. An increase in domestic tourism helped to somewhat soften the blow to the sector. After growing by four consecutive years, money transfers fell by more than 40 per cent year-on-year in April 2020, before returning to growth in June. Depreciation pressures prevailing throughout 2019 resumed in March 2020 on the back of looming uncertainty. This added to the inflationary pressures and the consumer price level remained above the 3 per cent level targeted by the National Bank of Georgia (NBG). However, on the back of significantly subdued demand, the NBG cautiously lowered the policy rate three consecutive times, from 9.0 to 8.0 per cent, between March and August 2020.

The authorities secured substantial foreign financing to help fund the crisis response. An increase in government expenditures combined with weaker economic activity led to a sharp rise in the budget deficit, and the loss of tourism revenues has resulted in a widening of the current account deficit. To help stabilise internal and external imbalances and provide an additional liquidity buffer, the authorities asked for augmentation of the Extended Fund Facility programme with the IMF, thus securing finances of more than US$ 400 million for 2020-21. This is expected to more than cover the external and budget gaps in the near term.

Economic recovery depends on the rebound of tourism. We project a GDP contraction of 5.0 per cent in 2020 followed by a recovery of 3.5 per cent in 2021. The speed of recovery and overall economic health in 2021 will be dictated by the developments in the hospitality sector and the inflow of foreign visitors, both of which are highly uncertain at present. The crisis emphasises the need for advancing structural reforms that would attract stronger efficiency-enhancing foreign investments, and lead to productivity increases and economic diversification.

Policy response to Covid-19

The government prepared a comprehensive package of measures to support the economy. The measures first adopted in March and then extended in May 2020 include increased health sector funding, postponement of certain tax payments, doubling of value-added tax refunds by the end of 2020, a scaling up of the credit guarantee scheme and the state programme 'Produce in Georgia', and exemption from income tax for low-paid jobs. Social assistance measures include coverage of utility fees for smaller household users, deferred loan repayments for household loans and support for those affected by the pandemic, the self-employed and vulnerable groups. The NBG lowered capital and liquidity requirements, relaxed regulatory requirements to support loan restructuring and loosened monetary policy in light of lower inflationary pressures.

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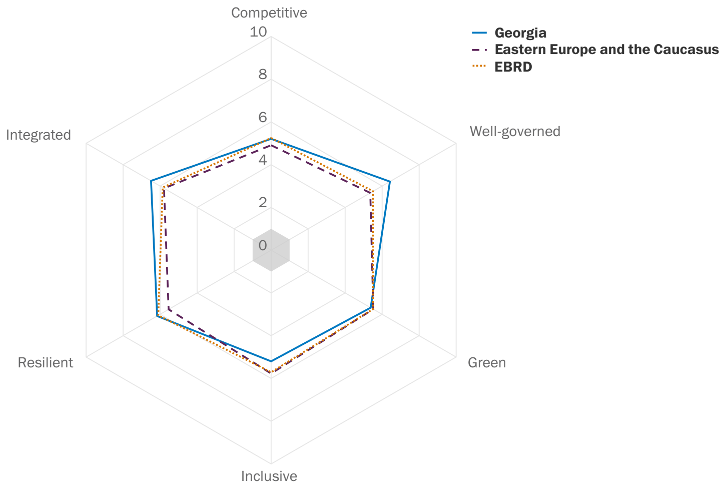
Assessment of transition qualities (1-10)



Structural reform developments

A number of key energy laws and regulations were adopted. The Law on Energy and Water Supply outlines the overarching energy sector reform while the Renewable Energy Law sets renewable energy targets. Both were adopted at the end of 2019 and define the general framework for the upcoming markets, set deadlines and determine the government bodies responsible for their implementation. Secondary legislation setting out the details of the new market organisation and implementation action plans is being developed. Following the adoption of the National Energy Efficiency Action Plan, also at the end of 2019, the authorities adopted the Law on Energy Efficiency and the Law on Energy Performance of Buildings in May 2020. The regulation will help improve the energy performance standards for new constructions and building retrofits, in line with European Union (EU) standards. All these laws are important milestones in meeting requirements under the EU-Georgian Association Agreement as well as Georgia's membership of the Energy Community.

The NBG has strengthened its regulatory power. In a series of moves in the past year the NBG amended regulations on consumer lending to give more discretionary power to the banks and enhanced its transparency and communication. The framework for the recovery of banks and resolution, approved in December 2019, strengthens Georgia's financial resilience. The resolution framework is an alternative to bank liquidation, to be used in cases where liquidation would lead to significant risks to financial system stability. The framework will become effective by the end of 2020. The regulation on consumer lending, adopted at the end of 2018, was adjusted with the aim to move from a rules-based to a principle-based approach, giving banks more freedom to manage risks. The amendments include deregulating the way the borrower's income is determined while keeping the obligation of income verification, introducing risk management requirements for consumer lending in banks and microfinance institutions, reducing the number of income brackets for payment-to-income limits, and increasing the maturity for mortgages in local currency. Publication of the Financial Stability Report, an annual assessment of risks and vulnerabilities in the financial system, resumed in September 2019 after eight years. In the same month, the NBG published a macro-prudential policy strategy, which identifies intermediate objectives to promote financial stability. The Supervisory Strategy 2020-22 sets the strategic priorities for the regulator and lays out specific activities for the execution of those priorities.

GREECE

Highlights

- **The pandemic has abruptly interrupted economic recovery.** Modest but steady GDP growth in recent years was brought to a halt by the outbreak of Covid-19 in March 2020 and the introduction of strict containment measures, pushing the economy into a deep recession.
- **A comprehensive fiscal response to the crisis is being implemented.** One-off fiscal measures to mitigate the impact of the crisis amount to more than 9 per cent of GDP and include deferral of tax obligations, enhanced liquidity for businesses, increased spending on public healthcare and extra support for the unemployed.
- **Important reforms are advancing.** Despite the pandemic the government is pushing ahead with important reforms in a range of areas, such as insolvency, public administration, pension reform, land reform, public procurement and digitisation – all anchored within the post-programme enhanced surveillance procedure.

Key priorities for 2021

- **Strong support for the economy is needed for a fast recovery.** Although the stock of public debt remains one of the highest (relative to GDP) in the world, long maturities and a strong fiscal position will allow for further targeted support to local businesses and individuals affected by the pandemic.
- **Ensuring the soundness of the financial system is crucial.** The pandemic has put additional strains on the banking system, which still suffers from high levels of non-performing loans (NPLs), and new NPLs are likely to arise in the short term. Schemes to reduce NPLs are now in place and implementation will need to be stepped up once the economic recovery is well under way.
- **Energy sector reform should be pursued vigorously.** Greece has strong potential in renewables, and has an ambitious programme to close coal mines by 2023. This programme should be accompanied by a comprehensive package, in cooperation with international partners, to support the development of new energy sources and the retraining and upskilling of workers displaced by the closure of existing energy sources.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	-0.2	1.5	1.9	1.9	-9.5
Inflation (average)	0.0	1.1	0.8	0.5	-0.5
Government balance/GDP	0.6	1.0	0.9	0.4	-9.0
Current account balance/GDP	-2.3	-2.5	-3.5	-2.1	-7.7
Net FDI/GDP [neg. sign = inflows]	-2.4	-1.5	-1.6	-1.7	-1.8
External debt/GDP	236.1	227.2	222.4	219.3	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	107.3	99.0	89.1	79.2	n.a.

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Covid-19: macroeconomic implications

The Covid-19 pandemic has abruptly interrupted a steady economic recovery. Before the pandemic, all economic indicators were moving in the right direction: positive growth (1.9 per cent in 2019), steadily falling unemployment, strong fiscal surpluses and economic sentiment at a 12-year high in early 2020. The lockdown (schools and all non-essential businesses closed) imposed from 23 March to 4 May 2020 severely affected local business and economic activity, as well as consumption levels. Nominal (real) disposable income of households declined by 0.4 per cent year-on-year in the first quarter of 2020, reflecting the impact of the Covid-19 pandemic mainly from mid-March 2020 onwards, when restrictions were put in place. The full effect of the crisis was seen in the second quarter, when GDP contracted by 15.2 per cent year-on-year. The halt of virtually all travel to Greece from March until 1 July heavily affected the tourism sector, which normally represents more than a fifth of GDP. Revenues from foreign tourism in August 2020 amounted to between 30 and 35 per cent of those in August 2019, and the industry expects heavy losses in 2020.

Fiscal targets have been temporarily relaxed. For several years, Greece has been running primary fiscal surpluses, meeting the target of 3.5 per cent of GDP in 2018 and 2019 in line with commitments made to international creditors. By agreement with the European Commission the same target for 2020 was suspended because of the Covid-19 crisis, and the government has responded to the pandemic with a major support programme amounting to more than 9 per cent of GDP (see below for more details). However, the stock of general government arrears remains large at €2.6 billion as of the end of August 2020, significantly above the target adopted in October 2019.

Sovereign access to capital remains on favourable terms. Greece's inclusion in the European Central Bank's emergency Pandemic Emergency Purchase Programme (PEPP) asset purchase scheme has reduced the previous risk premium on Greek government bonds and made access to capital markets easier. On 2 September 2020 the sale of €2.5 billion of 10-year Greek bonds was heavily oversubscribed, with a yield of 1.187 per cent, the lowest of any Greek bond transaction. However, as of October 2020 Greece's sovereign rating is still at least two notches below investment grade status.

A deep recession in 2020 should be followed by a partial recovery in 2021. We project GDP to fall in 2020 by 9.5 per cent, with a bounce-back of 4.0 per cent growth in 2021 as confidence returns, businesses reopen and tourism numbers start to recover to something closer to pre-pandemic levels. Risks are tilted to the downside amid extreme uncertainty about the future path of the pandemic and associated economic and social restrictions.

Policy response to Covid-19

A strong Covid-19 response is being implemented. The government has introduced a set of one-off fiscal measures estimated at around €15.6 billion (9.1 per cent of GDP), financed from national and EU resources. The measures focus on supporting vulnerable individuals and businesses affected by the pandemic. For vulnerable individuals, there is income support (extension of regular unemployment benefits, 40 per cent reduction in rent for primary residence or €800 allowance for the self-employed and freelancers affected by the crisis). For businesses facing a drop in demand, the government is injecting liquidity into the economy via tax deferrals and guarantees to commercial banks by way of new loans (including a sovereign guarantee scheme of €2 billion in total for working capital loans from the Hellenic Development Bank). Enterprises can defer principal payments up to the end of 2020, while individuals affected by the crisis can receive a state subsidy of up to nine months of instalments (backed by primary residence as collateral). The package also includes strong budgetary support for the health sector and value-added tax reductions for goods needed for protection against Covid-19.

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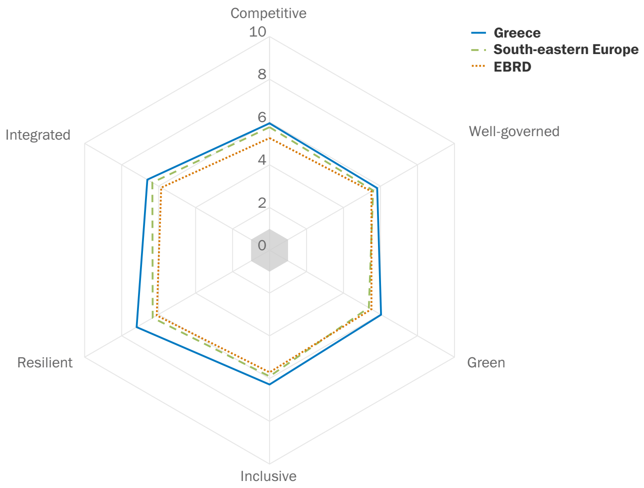
Assessment of transition qualities (1-10)



Structural reform developments

Reforms under the post-programme enhanced surveillance procedure remain largely on track. Following the conclusion of the third economic adjustment programme in August 2018, Greece entered a post-programme enhanced surveillance framework, with regular reports by the European Commission (EC) including contributions from the European Central Bank, International Monetary Fund and European Stability Mechanism. In the seventh enhanced surveillance report, published by the EC in September 2020, Greece was deemed to have made significant progress on a number of major reforms, notably in insolvency, investment licensing, energy policy and public administration, despite the difficult circumstances caused by Covid-19. However, the crisis has led to delays in some areas, including clearance of public sector arrears, public revenue administration, healthcare, land reform and privatisation.

A new insolvency framework is being prepared. In late October, parliament passed the relevant legislation. The new code is based on best international practice in terms of simplifying requirements for effective restructuring, thus helping to preserve viable businesses. Scheduled to enter into force in January 2021, it introduces a unified code for bankruptcy and the restructuring of individual and corporate debt. The new code will be combined with other mechanisms, including the new "Hercules" asset protection scheme introduced in early 2020, to tackle the persistent problem of non-performing loans which, as of June 2020, amounted to 36.7 per cent of total loans in the banking system. E-auctions were temporarily suspended during the pandemic but they resumed in September 2020.

The pace of privatisation has slowed but the commitment to make progress remains intact. The Hellenic Corporation of Assets and Participations, which is in charge of maximising the value of major public corporations through privatisation and other means, has prepared a new business plan for the period 2020-22. The Covid-19 pandemic has adversely affected previous plans, but work is ongoing to bring major assets to sale in the coming months and years. Among other developments, closure of the financial transaction for Hellinikon (the former Athens airport) depends on the resolution of certain legal cases. A concession agreement was signed in May 2020 for Alimos Marina (one of the largest marinas in the south-eastern Mediterranean) and the tenders for the infrastructure and commercial parts of the Public Gas Corporation, DEPA, were launched in late 2019 and early 2020, respectively.

The energy sector is undergoing a number of reforms. The government remains committed to reforming the governance of the loss-making public energy provider, PPC, which continues to dominate the retail market, and introduce further competition by allowing other providers access.

CONTINUES

A number of energy market reforms have already been implemented, including the launch of a forward market for electricity. There are also ambitious targets to phase out lignite and promote renewables. Greater energy efficiency is also being targeted; in August 2020 the government launched a new €1 billion programme to improve the energy efficiency of buildings and develop additional infrastructure via state subsidies of up to 85 per cent of the cost of small-scale works to improve energy inefficiencies in residential properties and introduce electric car charging stations.

The digital agenda is advancing. A new national digital strategy is being prepared, which will set out a lengthy pipeline of projects designed to move Greece towards being an advanced digital economy. A public portal for government services (gov.gr) offers more than 600 services (as of September 2020), with further services in the pipeline. The digital agenda is part of a broader public administration reform, which is progressing despite the challenges of the pandemic. Important steps have been taken in the past year in the recruitment of public officials and codification of the rules relating to the recruitment of public officials. Judicial reform continues, with the completion of a mandatary mediation framework in March 2020 and progress in the e-justice system. Cutting red tape remains a priority for the authorities, with a focus on improving the investment licensing regime.

HUNGARY

Highlights

- **The coronavirus crisis has pushed the economy into recession.** Hungary had already entered a cyclical slowdown in 2019, although GDP growth had been impressive relative to its regional peers. A stringent lockdown introduced in March 2020, including shutdown of businesses and schools, halted much economic activity and resulted in the first recession in the country since 2012.
- **A comprehensive set of crisis response measures was introduced.** The expected total value of all government measures for tackling the economic effect of the pandemic is between 18 and 20 per cent of GDP.
- **The banking sector has softened loan repayment conditions.** Domestic banks were instructed by the central bank to ease loan repayment conditions for all borrowers (individuals and businesses). Interest and amortisation payments on loans were suspended until the end of 2020, short-term loans were extended and interest rates on consumer loans were capped at five percentage points above the base rate.

Key priorities for 2021

- **Fiscal measures to restart growth should target innovation and upskilling of the labour force.** The current scarcity of skilled labour suggests that boosting education and employment opportunities would go a long way to addressing private sector needs.
- **A funding ecosystem to manage the rising wave of corporate succession should be further developed.** In September 2019, the Hungarian Development Bank set up the first fund to provide financing for corporate succession. Currently, about 75 per cent of Hungarian private companies are first-generation businesses, versus 33 per cent globally.
- **Further financing is needed to develop the green economy and promote environmental sustainability.** The demand-side interest for green products has soared for both the first government green bond and those provided by corporates.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.1	4.3	5.4	4.6	-5.0
Inflation (average)	0.4	2.4	2.9	3.4	3.7
Government balance/GDP	-1.8	-2.5	-2.1	-2.0	-8.3
Current account balance/GDP	4.5	2.0	0.3	-0.2	-1.6
Net FDI/GDP [neg. sign = inflows]	-2.2	-1.6	-2.0	0.1	0.0
External debt/GDP	95.4	83.5	80.1	73.6	n.a.
Gross reserves/GDP	20.1	19.5	19.6	19.5	n.a.
Credit to private sector/GDP	69.4	64.3	62.3	59.4	n.a.

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Covid-19: macroeconomic implications

Pandemic-related containment measures have led to a recession. Hungary had registered the strongest GDP growth in the central Europe and Baltic states (CEB) region, at 4.9 per cent, in 2019, largely induced by a solid double-digit investment growth and strong household consumption. Nevertheless, the lockdown, introduced by the government in March 2020 to prevent uncontrolled transmission of Covid-19, brought much economic activity to a halt. In the first half of 2020, the economy shrank by 6.1 per cent, weighed by a massive slide in net exports (the drop in exports was higher than that of imports), investment and tourism revenues. The unemployment rate increased to 4.9 per cent in June 2020, after registering an historic low of 3.4 per cent in January 2020. Tourism and exports represent 13 and 98 per cent of GDP, respectively. The automotive industry (28 per cent of manufacturing output) is at the core of the country's high global value chain integration. The temporary closures of all four car plants weighed significantly on short-term GDP growth and employment. (For illustration, a one-month closure of the car plants is estimated to cost 0.4 per cent of annual GDP.) Some car plants restarted production at the end of April, and the majority of lockdown restrictions were gradually lifted from May. Moreover, some automotive suppliers started complaining again about labour shortages in September 2020.

Investment has dropped from high rates, but large projects remain in the pipeline. In 2019, investment to GDP amounted to 28.6 per cent, above regional peers, but it then dropped by 9.2 per cent in the first half of 2020 as a result of the pandemic and associated lockdowns and disruptions. The fall in investment, especially in the second quarter of 2020, was severe, despite the lending support by government and the central bank. However, the pipeline of large investment projects remains promising. Scheduled (but delayed) projects include South Korean investments in the electric car industry, the construction of a BMW car plant in eastern Hungary, a Lidl logistics base near Budapest, and the Budapest-Belgrade railroad upgrade, completion of which is scheduled in 2025.

The fiscal deficit is rising because of the weaker economy and generous economic stimuli measures. The expected total value of all government measures (see below) for tackling the economic effects of Covid-19 is between 18 and 20 per cent of GDP. According to the International Monetary Fund's October 2020 estimates, the general government deficit is expected to rise to 8.3 per cent of GDP in 2020, before falling again in 2021 as the economy rebounds. Similarly, public debt is expected to jump to 77.4 per cent of GDP in 2020 but projected to return to a downward trend as of next year.

Positive GDP growth is likely to return in 2021. Given Hungary's exposure to trade and global value chains, the magnitude of the expected recovery will largely depend on external developments in the EU (European Union) and outside the EU. GDP is forecast to fall by 5.0 per cent in 2020 and then recover to 4.0 per cent growth in 2021. The forecasts are subject to major uncertainty, and depend to a large extent on whether targeted shutdowns of economic activities are needed because of a possible resurgence of Covid-19 cases.

Policy response to Covid-19

The Covid-19 pandemic-related restrictions were rapidly followed by protective measures. The government and the National Bank of Hungary launched various relief measures to preserve employment, support companies in a state of hibernation and support household incomes to soften the already historically deep recession in 2020. Under measures announced by the government in April 2020, businesses that suffered more than a 40 per cent drop in revenues were able to delay payroll deductions for their staff and advance corporate income tax (CIT) payments. Employers and the compulsorily insured self-employed, who saw their turnover or income fall by 40 per cent or more, were able to delay the owed social security contributions, unemployment and health insurance payments until the end of July. In May 2020, the government launched another wage subsidy programme to enhance new employment. If a newly employed person remains on the job for a period of nine months, the monthly salary is subsidised by HUF 200,000 (€570).

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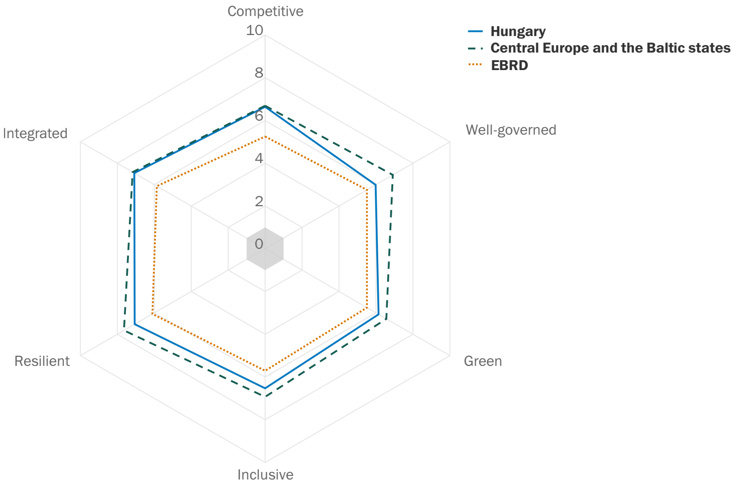
Further changes to the economic protection package were adopted by parliament in June 2020. These included a cut in social contributions by 2 percentage points to 15.5 per cent and a reduction in small business taxes. At the same time, the exemption from CIT for reinvested profits was expanded from 50 to 100 per cent for a period of four years and capped at HUF 10 billion (€28.5 million). Financing of the economic protection package comes partly from new and relatively small retail and banking taxes. In addition, in June 2020 the government created an economic protection operating committee, consisting of up to 10 state institutions such as the tax administration or the consumer protection office, to work on a further reduction of administrative burden on companies.

Domestic banks softened loan repayment conditions for all borrowers. In March 2020, the National Bank of Hungary (NBH) introduced a moratorium on corporate and retail loan repayments under its Funding for Growth Scheme + until the end of 2020 and instructed other banks to do the same for other borrowers. As a result, the interest and amortisation payments on loans were suspended until the end of 2020, short-term loans were extended and interest rates on retail loans capped at 5 percentage points above the base rate. According to the NBH's estimates, a full use of the moratorium will mean a deferral of HUF 3,600 billion (€10.2 billion) of loan payments by the end of 2020. However, the actual impact of the moratorium is likely to be lower as between 30 and 50 per cent of those loans have remained serviced so far. In April 2020, the NBH launched a new cheap lending scheme called Funding for Growth Scheme Go! to support small and medium-sized enterprises from the impact of the coronavirus pandemic. The scheme is available through the banking system with a fixed interest rate capped at 2.5 per cent. In May 2020, the NBH launched quantitative easing, targeting mainly government bonds with at least three years to maturity. In July 2020, the NBH eliminated capital requirements for eight systemically important banks, to be gradually rebuilt over a three-year period starting from 2022.

Some of the 2014-20 EU funds were re-allocated to economic protection. In May 2020, the government re-allocated HUF 420 billion (€1.2 billion) of unused EU funds to economic support measures related to the pandemic. About 75 per cent of the funds will be spent in the form of grants, while the remaining resources will be used for interest-free loans under the economic development programme. The larger part of the funds will finance the government's wage subsidy scheme. The upcoming 2021-27 EU funds will consist of two pillars, the regular multiannual financial framework (MFF) and an extraordinary Covid-19 recovery fund. Hungary is expected to receive a total of about €41 billion from both pots, and the rule of law conditionality is expected to be in place.

Assessment of transition qualities (1-10)



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Structural reform developments

Magyar Bankholding was created. In June 2020, three domestic banks – MKB, Takarekbank and Budapest Bank – set up Magyar Bankholding. The new structure is expected to be a vehicle for the potential merger of the three institutions, and potentially a privatisation of Budapest Bank. Nevertheless, according to the government, the state, which is the sole owner of Budapest Bank, is likely to keep a minority stake in the new bank. MKB and Takarekbank are privately owned and controlled by domestic entrepreneurs. Should a potential merger materialise, the new bank would be the second largest in terms of assets (HUF 5,800 billion or €16.5 billion) and would have the largest branch network, accounting for almost half of the total network in Hungary.

Disagreement over the rule of law has remained unresolved. The European Parliament (EP) and the Hungarian government have continued to engage in the rule-of-law dialogue in the framework of the Article 7(1) procedure of the Treaty on European Union triggered by the EP on 12 September 2018. Changes adopted with the Act CXXVII on 17 December 2019 have allowed the introduction of structural changes that may have a significant impact on the organisation of the justice system. This has caused concern from the Council of Europe Commissioner for Human Rights and a number of other international bodies over their possible impact on judicial independence. The European Commission took action against Hungary on 8 November 2019 at the European Court of Justice (ECJ) on the asylum legislation adopted in 2018. On 18 June 2020, the ECJ concluded that Hungarian law on foreign-funded non-governmental organisations violates EU law on the free movement of capital and fundamental rights.

JORDAN

Highlights

- **The economy is being impacted by the Covid-19 crisis.** The pandemic and related containment measures have led to a deteriorating fiscal balance, rising public debt and a further increase in the already-high rate of unemployment.
- **The authorities have implemented a range of fiscal, social and monetary measures to combat the crisis.** The Central Bank of Jordan (CBJ) increased liquidity and lowered interest rates, while the government postponed tax and other contributions, and allocated support to those sectors and segments of the economy most in need.
- **The authorities have agreed a new programme with the International Monetary Fund (IMF).** The third consecutive IMF-supported programme since 2012 will help the authorities build on the implementation of the authorities' five-year matrix, launched at the 2019 London Initiative.

Key priorities for 2021

- **Swift implementation of key reforms envisaged under the IMF-supported programme are necessary.** These include electricity tariff reform, labour market reforms and improvements in governance to strengthen public sector transparency and accountability.
- **Improving the fiscal situation is needed to stabilise public debt and bring it towards more sustainable levels.** Broadening the tax base, reducing tax exemptions, overhauling investment incentives and reforming the governance of tax and customs administrations should be complemented by spending containment and subsidy reforms, in addition to improving the targeting of social safety nets.
- **Implementation of the government's anti-corruption campaign should be prioritised.** The newly empowered Integrity and Anti-Corruption Commission (JIACC) should pursue corruption-related issues, especially those related to tax evasion, money laundering, abuse of power and embezzlement.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.0	2.1	1.9	2.0	-6.0
Inflation (average)	-0.6	3.6	4.5	0.8	0.5
Government balance/GDP	-3.7	-3.6	-4.7	-6.0	-9.1
Current account balance/GDP	-9.7	-10.6	-6.9	-2.3	-6.8
Net FDI/GDP [neg. sign = inflows]	-3.9	-4.9	-2.2	-1.8	-1.7
External debt/GDP	65.1	68.4	67.9	68.0	n.a.
Gross reserves/GDP	38.9	37.6	33.9	34.6	n.a.
Credit to private sector/GDP	75.2	79.3	80.9	81.4	n.a.

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Covid-19: macroeconomic implications

The economy is being hit by the crisis. After just 2.0 per cent growth in 2019, GDP decelerated further to 1.3 per cent year-on-year in the first quarter of 2020 and contracted by 3.6 per cent in the second quarter. Tourism, usually a major driver of growth, declined by 62 per cent in the first half of 2020, directly impacted by the Covid-19 crisis. The unemployment rate increased to 22.9 per cent in the second quarter of 2020, but annual inflation has remained low in the first eight months of 2020, at an average of 0.5 per cent.

The fiscal balance deteriorated, and debt is approaching 100 per cent of GDP. The overall fiscal deficit (excluding foreign grants) widened to 7.3 per cent of GDP in the first quarter of 2020, from 5.0 per cent in the same period of 2019, reflecting the drop in non-tax revenues and higher current expenditure (and despite the increase in tax revenues and lower capital expenditures). Public debt remains elevated at 95.4 per cent of GDP. Meanwhile, the current account deficit narrowed to 4.2 per cent of GDP in the first quarter of 2020, down from 4.6 per cent a year earlier. The reduction was driven by the decrease in imports of goods, which more than compensated for the decline in exports. Gross official reserves increased in September 2020 after the issuance of the US$ 1.75 billion Eurobonds and reached US$ 17.9 billion, covering more than 10 months of imports.

Monetary policy has been accommodative. The CBJ continued to lower interest rates in 2020, following three cuts in 2019. The two cuts to the main policy rate in March, by a cumulative 150 basis points, were a response to the growing Covid-19 crisis, and in line with interest rate changes in the United States of America and in regional markets, given the Jordanian dinar peg to the US dollar and the comfortable level of reserves.

Negative growth in 2020 should be followed by a recovery in 2021. We currently project that GDP will fall by 6.0 per cent in 2020, due mainly to the contraction in tourism and cross-border trade. Growth is expected to pick up again in 2021 to 4.0 per cent, sustained by the lower cost of imported energy, increased finance provided to small and medium-sized enterprises (SMEs) under various schemes from the CBJ, and reforms anchored in the new IMF-supported programme. Risks to the outlook include an erosion of real competitiveness stemming from the strengthening of the dinar (in light of the peg to the US dollar). Regional instability, delays in reforms in the run-up to the parliamentary elections in November, and the possibility of slower-than-expected recovery of partner economies also pose risks to the outlook.

Policy response to Covid-19

In response to the Covid-19 crisis, the authorities implemented a range of fiscal, social and monetary measures. In March 2020, the CBJ introduced several measures. It allowed banks to postpone the credit facilities instalments granted to clients of sectors affected by the virus, waived penalties on bounced cheques and pumped JOD 550 million (US$ 776 million) in additional liquidity to the banks by reducing the compulsory reserve ratio on deposits with banks from 7 per cent to 5 per cent. At the same time, the government postponed until the end of 2020 the collection of sales tax on all domestic sectors, imports related to health, and the supply of medicines. It also allocated 50 per cent of the maternity insurance revenues (JOD 16 million or US$ 23 million equivalent) to material assistance for the elderly and the sick, introduced price ceilings on essential products, postponed 70 per cent of the value of customs duties for selected companies, and reduced social security contributions from private sector establishments. In addition, it allocated up to JOD 30 million (US$ 42 million) to the tourism sector and JOD 150 million (US$ 212 million) in liquidity to enable the private sector to continue the production process with efficiency and revitalise the economy.

Support to SMEs has been stepped up during the crisis. The Jordan Loan Guarantee Corporation guaranteed JOD 500 million (US$ 705 million) under a Finance Facilitation Programme for SMEs, which was later expanded to include larger firms. Moreover, the Jordan Enterprise Development Corporation launched two programmes aimed at providing small and medium-sized and industrial enterprises in sectors directly affected by, or involved in responding to, the epidemic with a total of JOD 680,000 (US$ 960,000) in funding.

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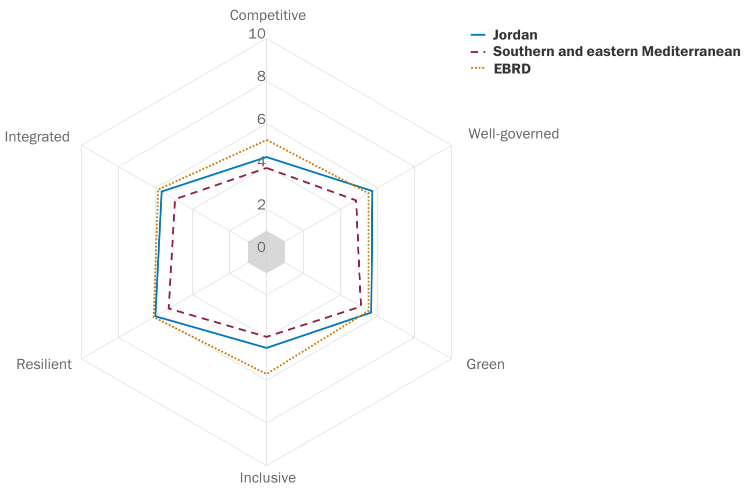
Assessment of transition qualities (1-10)



Structural reform developments

A new IMF programme has been signed. The new programme, approved by the IMF board in March 2020, is a four-year US$ 1.3 billion Extended Fund Facility. This is the third consecutive IMF-supported programme since 2012. The new programme aims at achieving stronger and more inclusive growth and creating jobs, with implementation centred on growth-enhancing structural reforms and a gradual reduction in the budget deficit. Key reforms envisaged under the programme include electricity tariff reform, labour market reforms to promote greater employment opportunities for women and young people, and the swift implementation of the authorities' five-year matrix, launched at the 2019 London Initiative, to improve the business climate, boost competitiveness, and attract foreign investment. These efforts are supported by governance reforms to strengthen public-sector transparency and accountability. The IMF also approved in May 2020 Jordan's request for emergency financial assistance under the Rapid Financing Instrument, equivalent to US$ 396 million, to cover about a quarter of Jordan's external financing needs stemming from the Covid-19 shock.

An ambitious green growth plan has been launched. The National Green Growth Plan 2021-25, launched in July 2020, is part of a broader national drive towards a green economy and sustainable development. It comprises executive plans targeting the key sectors of water, waste management, energy, agriculture, tourism and transport. In part, the blueprint is intended to help build sustainable sectors that are more resilient and adaptive to adverse phenomena, including climate change and the fallout of emergencies, such as the coronavirus pandemic. It was drawn up in collaboration with the Global Green Growth Institute. Already, the government has cut taxes on cars imported into Jordan's free zones, including eliminating a weight tax on vehicles and lowering customs duties on electric vehicles.

A new legislative framework for public-private partnerships (PPPs) is in place. The new legislation, which came into effect in August 2020, strengthens the identification, approval, implementation and evaluation process of PPPs in several ways. Under the new rules, the PPP unit is moved to the prime minister's office, a new ministerial committee will select suitable projects and refer them to cabinet, and another committee will assess contingent liabilities and thereby financial risk to the government. The new legislation also ends the exemption under the previous law of the water and energy sectors, which had hindered sound project selection and risk analysis.

The government has launched an anti-corruption campaign. As part of the campaign, the government approved in June 2020 a draft law amending the Integrity and Anti-Corruption Law of 2020. The campaign is targeted against former officials, businesspeople and companies

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suspected of tax evasion, money laundering, abuse of power and embezzlement. The government also announced that tax evasion would be treated as money laundering, which carries a harsher sentence. The amendments to the law give the Integrity and Anti-Corruption Commission (JIACC) more financial and administrative independence to enable it to perform its duties and enhance its capabilities in pursuing corruption-related issues. They also give the JIACC the right to conduct investigations related to money-laundering crimes resulting from corruption cases and to reconcile with those who commit these crimes if they return the money they obtained.

A new agricultural strategy has been announced. The Ministry of Agriculture announced the 2020-25 National Agricultural Development Strategy in August 2020. The strategy focuses on the restructuring and digitisation of the agricultural sector, the utilisation of modern technology, enhancing production and productivity, focusing on strategic crops, and developing the logistics chain of operations. It also prioritises uplifting the agro-processing chain, developing the export chain, and expanding forest and pasture areas.

KAZAKHSTAN

Highlights

- **The economy is contracting in 2020.** Real GDP fell by 2.8 per cent year-on-year in the first three quarters of 2020, driven by weak domestic and external demand caused by lower commodity prices, a cut in oil production, as well as Covid-19-related disruption of domestic economic activity.
- **The government has put in place a comprehensive anti-crisis package.** The list of adopted measures is extensive and includes liquidity support to individuals, firms and the banking sector, and extra spending on healthcare and public works.
- **Progress has occurred on longer-term diversification of the economy and the renewable energy reform agenda.** The government rejected a proposal to introduce local content premia in the renewable energy sector and, in August 2020, issued a green bond on the Astana International Exchange, representing the first listing of green bonds in Kazakhstan.

Key priorities for 2021

- **The immediate priority is to continue providing support to sectors affected by Covid-19 disruptions and sustain private sector employment.** To help businesses stay afloat, support measures should combine tax/liquidity measures to smoothen income shocks and boost consumption in the hardest hit sectors, such as recreation and hospitality. Measures should be well-targeted to optimise the use of scarce financial resources.
- **The authorities should step up efforts to build resilience.** The healthcare system's capacity should be further strengthened with an emphasis on commissioning new hospitals, and increasing supply of medical equipment. To further food security, it is also desirable to improve the organisation, and enhance the climate resilience, of the agriculture sector.
- **Efforts are needed to improve inclusion across regions and for vulnerable population groups.** Reforms in education and vocational education need to accelerate, with a focus on digital skills. The government should take advantage of the opportunities offered by rapid advances in remote working and learning to improve the quality of training and education, and boost job creation in the modern sector of the economy.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	1.1	4.1	4.1	4.5	-4.0
Inflation (average)	14.6	7.4	6.0	5.2	6.8
Government balance/GDP	-4.5	-4.3	2.6	-0.6	-5.0
Current account balance/GDP	-5.9	-3.1	-0.1	-3.6	-4.0
Net FDI/GDP [neg. sign = inflows]	-12.5	-2.8	-0.1	-2.0	-0.5
External debt/GDP	118.5	100.7	90.0	87.5	n.a.
Gross reserves/GDP	21.6	19.3	18.1	16.1	n.a.
Credit to private sector/GDP	33.0	29.2	25.9	24.5	n.a.

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Covid-19: macroeconomic implications

The outbreak of the coronavirus crisis and the subsequent collapse of commodity prices has put the economy under pressure. On the external side, Kazakhstan faces lower commodity prices and lower demand for its exports. In line with its OPEC+ commitments, Kazakhstan agreed to reduce domestic oil production by around 6 per cent year-on-year in 2020. At the same time, domestic containment measures undertaken by the authorities to reduce the spread of the virus are negatively weighing on private consumption and investment. Nevertheless, the economy is reasonably resilient to external shocks, thanks to significant fiscal buffers.

Real GDP contracted by 2.8 per cent year-on-year in the first three quarters of 2020. With the state of emergency declared on 16 March until 1 June, and mild quarantine re-introduced from 1 July until mid-August, the retail trade, transport and hospitality industries were strongly affected by the lockdown. Trade and transportation declined by 9.5 per cent and 17.1 per cent year-on-year, respectively, in the first three quarters of 2020. Construction, however, continued to grow during the same period (up by 10.5 per cent year-on-year). Fixed investment declined by 4.9 per cent year-on-year in the first three quarters of 2020, mostly due to investment into the Tengiz oilfield being put on hold due to Covid-19. This has led to a contraction in imports, primarily of capital goods, generating a current account surplus in the first half of 2020 of around US$ 2.1 billion (3 per cent of GDP) versus a deficit of US$ 1.9 billion a year earlier.

The exchange rate depreciated in response to lower oil prices. A depreciation of 15 per cent in the first three months of 2020 prompted the central bank to raise the policy rate from 9.25 per cent to 12.0 per cent in March 2020 and intervene in the foreign exchange market. In addition, the government instructed state-owned enterprises to sell their export earnings in the domestic foreign exchange market. After exchange rate pressures subsided, the policy rate was lowered to 9.5 per cent in April and 9.0 per cent in July 2020. As of October 2020, the Kazakh tenge/US dollar rate is down 11 per cent since the start of the year.

A moderate recession in 2020 is expected to be followed by a rebound in 2021. Real GDP is expected to contract by 4 per cent in 2020 before growing by 3 per cent in 2021. The upturn next year will be supported by recovery of private consumption and higher oil prices, but significant downside risks remain, notably a possible resurgence of the pandemic which would likely keep oil prices depressed in the short term.

Policy response to Covid-19

The authorities put in place a comprehensive crisis mitigation package. In May 2020, the government approved a Comprehensive Plan for Economic Recovery in 2020, worth about 9 per cent of GDP. The list of adopted measures is extensive, covering liquidity support to individuals, firms and the banking sector, as well as spending on healthcare and public works. To finance this, the government increased the guaranteed transfer from the National Fund by KZT 2 trillion (US$ 4.7 billion) and intends to issue bonds, including in roubles, on the Moscow Exchange and Astana International Exchange. In addition, the government received a US$ 1 billion assistance package from the Asian Development Bank to help mitigate the health, social and economic impacts of the Covid-19 pandemic. The authorities plan to introduce further measures in case of prolonged economic disruption.

Government support to individuals includes cash payments to the self-employed and unemployed, an extension of the social safety net and programmes to create more jobs. Cash transfers amounting to the minimum wage of around US$ 95 per month were made to around 4.5 million affected individuals during the state of emergency starting from March 2020. The government raised pensions and social benefits by 10 per cent and provided food and utilities support. Furthermore, 2.7 per cent of GDP has been allocated to support employment under an "Employment Roadmap" programme, aiming to create 242,000 jobs through implementation of large-scale infrastructure and construction projects. The government also introduced a subsidised mortgage programme for young families (that is, those married for less than three years). In order to ensure food security, the authorities resorted to wheat and flour export quotas and banned exports of such foodstuffs as buckwheat, potatoes, sugar and sunflower oil in March to June 2020.

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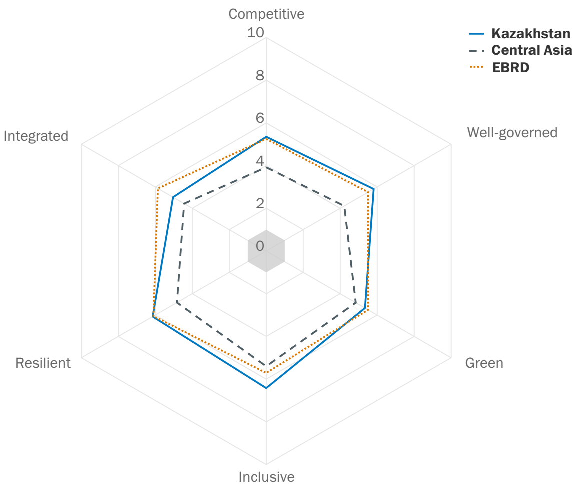
Firms were helped by tax exemptions and incentives, concessional lending and loan deferrals. The government is supporting import-substitution activities by manufacturing and agribusiness firms through subsidised lending of 1.5 per cent of GDP under the State Programme "Economy of Simple Things". Additional financing of 0.6 per cent of GDP is made available to small and medium-sized enterprises (SMEs) to finance short-term working capital needs. Farmers are offered forward contracts and fuel subsidies on top of concessional lending. Fiscal measures include exemption from income tax and social payments for six months, tax deferrals and value-added tax reduction on essential food products from 12 per cent to 8 per cent. Moreover, eligible borrowers are granted loan repayment deferral by banks and other lenders.

Prudential requirements have been loosened to encourage bank lending. In March 2020, the financial market regulator lowered risk weights for SMEs for loans in local currency from 75 per cent to 50 per cent and for loans in foreign currency from 100 per cent to 50 per cent. The regulator also reduced the liquidity coverage ratio requirement and the capital conservation buffer. The list of eligible collaterals for lending was expanded. Overall, as confirmed by the asset quality review (AQR) completed in February 2020, Kazakhstan's banking system is not facing serious downside risks, as capitalisation is sufficient both at the systemic level and at the level of the 14 individual banks included in the AQR.

Assessment of transition qualities (1-10)



Structural reform developments

Two new agencies were set up in September 2020 to give a fresh impulse to economic reform. These are an Agency for Strategic Planning and Reforms and an Agency for the Protection and Development of Competition. The former will include the Committee on Statistics and the Supreme Presidential Council for Reforms, whose decisions will be final. The latter will play a key role in regulating "monopolistic players" and in bringing order to "commodity trading", particularly in the areas of oil products, electricity and coal.

Privatisation of several key assets has been postponed. Due to the pandemic and the associated decline in market sentiment, initial public offerings (IPOs) of KazMunaiGas (the national oil and gas company), Air Astana, KazPost and Kazakhstan Temir Zholy (the national railways), initially planned for early 2020, were postponed until 2021-23. Kazatomprom, the national nuclear company of Kazakhstan, was the first "blue chip" to be partially privatised via IPO on the London

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Stock Exchange and at the Astana International Financial Centre in 2018-19. In June 2020, the authorities sold another 6.3 per cent stake in Kazatomprom, leaving the remaining government stake at 75 per cent. In addition, the government aims to proceed with the sale of KazPost to a strategic investor by the end of 2020.

The government remains committed to longer-term diversification and a renewable energy agenda. The government is revising its Strategic Development Plan 2025 to address new development challenges and opportunities in the post-Covid-19 world, with a strong emphasis on digitalisation, investing in human capital and diversifying the economy. And although coronavirus risks diverting attention away from climate change mitigation, the authorities are pressing ahead with renewable energy reforms. In April 2020, the government rejected a proposal to introduce local content premia in the renewable energy sector as it contradicts the country’s commitments under the Enhanced Cooperation Agreement with the European Union, World Trade Organization terms and other international agreements. In addition, a new methodology for regulatory asset-based tariffs was approved in May 2020, ensuring gradual repayment of the capital invested, including an estimated return on capital. Furthermore, a green bond was issued by Damu Fund on the Astana International Exchange in August 2020 – the first listing of green bonds in Kazakhstan. This represents an important step towards developing a green economy.

A landmark public-private partnership (PPP) project is set to begin. In August 2020, the financial closure of Big Almaty Ring Road (BAKAD) marked the conclusion of an eight-year effort to put in place the legal framework for foreign-invested, international-standard PPP projects in Kazakhstan. The largest infrastructure project in Kazakhstan outside the oil and gas sector, BAKAD, involves the construction of a 66 km ring road around Almaty. The project will be implemented by a Turkish-Korean consortium, and financed by the EBRD, Bank of China, PGGM, the Eurasian Development Bank and the Islamic Development Bank. Once completed, it is expected to help remove a major transport bottleneck in Almaty and increase the transit throughput capacity, while reducing local air pollution.

KOSOVO

Highlights

- **Growth has slowed and a recession is expected in 2020.** After growing by 4.2 per cent in 2019, the economy contracted by 4.8 per cent year-on-year in the first half of 2020 due to a severe drop in investment and exports.
- **The government adopted an emergency relief package.** The package, adopted in April 2020, supports employment, municipalities and people in need, and has since been followed by a medium-term economic recovery package and a plan for implementing the latter.
- **Kosovo removed the 100 per cent tariff imposed on goods imported from Serbia and Bosnia and Herzegovina.** Also, the requirement of "reciprocity", including requesting the use of the name of the Republic of Kosovo on documents on imported goods, has been withdrawn.

Key priorities for 2021

- **Governance and economic performance of state-owned enterprises (SOEs) should be improved.** Updating the state ownership policy, clarifying further the responsibilities of the board of directors and improving the legal and institutional framework for measuring and monitoring SOE performance can help raise their economic performance, which was weak even before the pandemic and has worsened further since then. Also, the new Law on Publicly Owned Enterprises should be adopted.
- **Acceleration of reforms in the business environment would enable a swifter recovery.** Decreasing the (widespread) informality and tax evasion, which would also facilitate access to finance for small and medium-sized enterprises (SMEs), could improve the growth outlook.
- **Raising competitiveness and economic diversification through smart specialisation is warranted.** This would enable the economy to build further capacity and enhance the value-added content of exports. In addition, accelerating sustainable investments in infrastructure and energy would enable Kosovo to speed up its green transition.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	4.1	4.2	3.8	4.9	-5.0
Inflation (average)	0.3	1.5	1.1	2.7	0.3
Government balance/GDP	-1.7	-1.4	-2.9	-2.8	-7.0
Current account balance/GDP	-7.9	-5.4	-7.6	-5.5	-6.0
Net FDI/GDP [neg. sign = inflows]	-2.9	-3.3	-3.4	-2.9	-3.0
External debt/GDP	33.2	32.6	30.3	31.0	n.a.
Gross reserves/GDP	10.0	10.7	11.4	12.2	n.a.
Credit to private sector/GDP	36.5	38.6	40.8	42.5	n.a.

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Covid-19: macroeconomic implications

The solid economic growth of previous years has disappeared because of the pandemic. GDP grew by 4.2 per cent in 2019, driven by investment and consumption. Strong exports (at over 10 per cent) and subdued imports growth (below 5 per cent) helped reduce the current account deficit from close to 8 per cent of GDP in 2018 to below 6 per cent in 2019. Higher growth in 2019 resulted in some employment gains, as the employment rate increased in 2019 by one percentage point (to 30 per cent). Despite falling somewhat, the unemployment rate stayed high, at 25.7 per cent, especially for youth (49.4 per cent). With the onset of the pandemic, the economy contracted by 4.8 per cent year-on-year in the first half of 2020. Investments and exports declined sharply, by 28.3 and 21.0 per cent year-on-year, respectively. Available figures for the second quarter show that manufacturing output declined by 16.9 per cent year-on-year and was accompanied by a fall in the number of employees in the sector (3.3 per cent year-on-year).

Inflation has slowed in 2020. Inflation in 2019 picked up to 2.7 per cent from 1.1 per cent in 2018. Prices, especially those of food, rose significantly, possibly reflecting the imposition of a 100 per cent tax on goods imported from Serbia and Bosnia and Herzegovina in November 2018. However, year-on-year inflation started to decelerate from the second half of 2019, dropping below zero in July 2020, in part due to the negative demand effects of the lockdown measures.

The fiscal stance is being loosened significantly. Budgetary revenues, especially taxes, are on track to fall by more than 10 per cent in 2020, as household and corporate revenues decline. Expenditures may stay constant but the internal structure is set to change, with current spending (mostly subsidies and grants to companies and individuals) increasing and capital spending decreasing. As a result, the overall fiscal deficit is forecast to rise to 6.5 per cent of GDP (according to the amended 2020 budget) from 2.8 per cent in 2019. Public debt may increase from below 18 per cent of GDP in 2019 to close to 21 per cent in 2020. The additional public financing needed is mainly covered by funding from international institutions, including the International Monetary Fund (IMF) and the European Union.

A relatively fast recovery is possible. After a forecast recession of -5.0 per cent in 2020, a rebound of 4.0 per cent GDP growth is expected in 2021, with domestic demand continuing to be the main growth driver. The risks to the projection are on the downside as the pandemic and associated economic disruption may last longer than expected. Further risks are in the weak public investment management and the potential slow recovery of European Union (EU) countries and main trading partners. Regarding the former, a swifter recovery would be helped by the acceleration of the hitherto-slow implementation of key infrastructure projects.

Policy response to Covid-19

The government has put in place a Covid-19 emergency relief package. The package, adopted in April 2020, amounted to nearly €180 million (more than 2.5 per cent of GDP). The measures included support to affected sectors through liquidity provision, wage subsidies and corporate and personal income tax deferrals. Health expenditures were also increased, as well as assistance to socially vulnerable people (for example, double payment of the value of the social assistance for three months, and monthly assistance to vulnerable groups and those who lost their job for two to three months). In addition, the package envisaged the provision of interest-free loans to publicly owned enterprises (with a maturity period until the end of 2020) and financial support to municipalities. Companies could benefit from support to salaries of €170 per month, lasting for two months, and to pension contributions, and SMEs became entitled to a rent subsidy of up to 50 per cent of the rent value. Micro enterprises and the self-employed could receive credit guarantees through the Kosovo Credit Guarantee Fund of up to €10,000. Grants and subsidies to increase agricultural production and to support exporters and sports and cultural activities have also been envisaged. Furthermore, the central bank allowed the submission of loan restructuring applications until the end of September 2020 for borrowers with payment difficulties due to the pandemic.

The government has adopted a medium-term economic recovery package. The new package, adopted in June 2020, is worth €1.2 billion and covers the period 2020-23. The package aims

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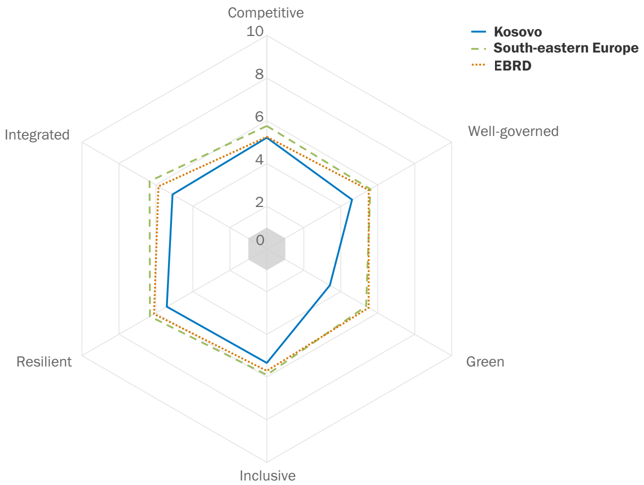
to facilitate access to finance, reduce the tax burden, and support employment in the agriculture sector and public enterprises. In August 2020 it was followed by a plan to implement the package, totalling €365 million. The plan contains 15 measures and among other things envisages supporting the Kosovo Credit Guarantee Fund, covering the minimum operating costs of publicly owned enterprises and providing financial support for youth employment.

Kosovo is receiving significant international assistance to help cope with the Covid-19 crisis. Since the outbreak of the pandemic, the EU, the IMF and other international financial institutions provided special assistance to finance the additional costs of the pandemic. The Macro-Financial Assistance from the EU amounted to €100 million, while the IMF's Rapid Financing Instrument was €51.6 million. Other international organisations and some countries also offered financial support to the country.

Assessment of transition qualities (1-10)



Structural reform developments

There has been little progress in EU accession negotiations over the past year. Kosovo signed the Stabilisation and Association Agreement (SAA) with the EU in October 2015 and it formally entered into force on 1 April 2016. While the European Commission has repeatedly stressed that Kosovo shares the European perspective of the Western Balkans, the question of its integration into the EU remains contentious due to the fact that five member states do not recognise Kosovo bilaterally. Although the European Commission confirmed that Kosovo fulfilled outstanding visa liberalisation benchmarks, the decision for visa liberalisation is pending in the European Parliament and the council, and citizens of Kosovo remain the sole among Western Balkans countries unable to travel without a visa to the Schengen area.

The 100 per cent tariff on goods from Bosnia and Herzegovina and Serbia has been revoked. The government of Kosovo originally introduced the tariff in November 2018 as a response to what it called Serbia's "aggressive campaign" to revoke Kosovo's international recognition. In April 2020 the previous government revoked the 100 per cent tariff imposed on goods imported from Bosnia and Herzegovina and Serbia, but imposed reciprocity measures from May, consisting of trade restrictions and customs requirements. This included requesting the use of the name of the Republic of Kosovo on documents on agricultural and industrial products, as well as an entry permit for vehicles transporting goods to Kosovo from the Liaison Office of the Republic of Kosovo in Serbia. In June 2020 the incoming new government revoked the reciprocity measure.

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Kosovo has joined the newly formed Kosovo-Albania Control Block within the European transmission network. Accession to the network took place in May 2020. Kosovo has left the SMM (Serbia, Montenegro and North Macedonia) block. This formation of a new link with Albania may increase electricity transmission between the two countries and improve the stability of supply. On the green agenda, work has now started in cooperation with the Energy Community to introduce an auctions scheme to allocate licences for renewables as a successor to feed-in tariffs.

KYRGYZ REPUBLIC

Highlights

- **Real GDP contracted sharply in the first three quarters of 2020.** A drop of 6.0 per cent in GDP year-on-year in this period was partly influenced by a 7 per cent year-on-year drop in remittances in the first eight months of 2020, and by strong social distancing measures which had a severe impact on services and construction.
- **Bilateral and multilateral creditors have provided support.** The Kyrgyz Republic was the first country to receive Covid-19-related emergency financial assistance from the International Monetary Fund (IMF), amounting to a Rapid Credit Facility of US$ 241.8 million, while major bilateral creditor countries have agreed to postpone debt repayments.
- **The government responded to the pandemic with a package of economic stimulus measures.** An anti-crisis fund, amounting to 2 per cent of GDP in 2020 and 7 per cent of GDP in 2021, was created to provide concessional financing to enterprises in the hardest-hit sectors and encourage digitalisation.

Key priorities for 2021

- **The authorities should continue providing targeted support to vulnerable households and small and medium-sized enterprises (SMEs).** This will be particularly vital in the hardest-hit sectors, such as hospitality and construction, with a focus on preserving existing, and creating new, jobs for returning migrants and young workers, including through public work programmes.
- **Further efforts are needed to digitalise the economy.** Measures should be taken to upgrade internet connectivity, particularly in the regions, and develop digital skills to enable remote learning and working.
- **Maintaining macroeconomic stability while exercising fiscal discipline will be important.** The government has committed to stabilise public debt at a sustainable level, and the authorities should therefore refrain from non-priority spending in order to bring the fiscal deficit below 3 per cent of GDP in 2021.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	4.3	4.7	3.5	4.5	-9.5
Inflation (average)	0.4	3.2	1.5	1.1	6.0
Government balance/GDP	-5.8	-3.7	-0.6	-0.1	-7.0
Current account balance/GDP	-11.6	-6.2	-12.1	-5.6	-14.0
Net FDI/GDP [neg. sign = inflows]	-9.1	1.4	-1.7	-2.5	-0.5
External debt/GDP	100.2	91.0	83.8	82.7	n.a.
Gross reserves/GDP	28.9	28.3	26.6	28.7	n.a.
Credit to private sector/GDP	20.6	21.4	23.4	25.8	n.a.

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Covid-19: macroeconomic implications

The economy is being severely affected by Covid-19 disruptions. This is due to the country's high external vulnerability, strict lockdown measures crippling domestic demand, and the government lacking the means for significant stimulus spending. With travel restrictions in place and bleaker economic prospects in Russia, the Kyrgyz Republic is seeing a significant reduction in remittances and a worsening of domestic demand conditions. Remittance inflows from Russia declined by 7 per cent year-on-year in US dollar terms in the first eight months of 2020, severely affecting domestic consumption and construction activities. The state of emergency from late March until mid-May 2020, and milder social distancing measures in place since June 2020, have depressed domestic demand; a dramatic drop in imports from China (65 per cent year-on-year in the first five months of 2020) hit associated domestic production, re-export activities, and budget revenues. A particular concern is that many households rely on the large informal economy (23 per cent of GDP in 2018 according to official estimates), comprising mostly micro enterprises that are difficult to target by the government's fiscal stimulus and other support measures.

Real GDP dropped 6.0 per cent year-on-year in the first three quarters of 2020, driven by contractions in construction, retail trade and the hospitality industry (down 7.7, 16.2 and 45.4 per cent year-on-year, respectively). Agriculture grew by 2.1 per cent year-on-year during the same period. Industrial production shrank by 1.9 per cent year-on-year as mining recorded a decline of 5.9 per cent. Excluding the Kumtor gold mine, GDP declined by 7.1 per cent year-on-year during this period.

The exchange rate depreciated after a lengthy period of stability since mid-2016. In March 2020, the weakening of oil prices and the fall in remittances led to a significant weakening of the som by 16 per cent over the month. The som has somewhat strengthened since then, supported partly by foreign exchange interventions. Inflation spiked at 8.6 per cent year-on-year in April 2020, but gradually decelerated to 5.4 per cent in September (within the central bank's target corridor of 5-7 per cent), as restrictive measures weigh on domestic demand and the earlier impact of panic hoarding subsided.

The economy is facing a deep recession in 2020 but some growth in 2021. With domestic demand remaining subdued and tourism activities not materialising in the third quarter of 2020, we expect a GDP contraction of 9.5 per cent in 2020. In 2021, the economy is forecast to grow by 3.0 per cent with domestic demand picking up and international trade, transport and tourism linkages being partially revitalised. This forecast is subject to very significant downside risks stemming from the political turmoil in the wake of the October 2020 elections.

Policy response to Covid-19

The government's anti-crisis measures are aimed at protecting public health, stabilising the socio-economic situation and re-launching economy activity. Reflecting the tight fiscal space, the policy response has focused mostly on supporting enterprise liquidity rather than on social protection for households. In May 2020, an anti-crisis fund was created to provide concessional financing to enterprises of around 2 per cent of GDP in 2020 and 7 per cent of GDP in 2021. The main targeted sectors are tourism, light industry, the pharmaceutical industry, manufacturing, agribusiness and freight transportation. In order to promote digitalisation, concessional loans are also available to SMEs transitioning to digital systems with transparent accounting and reporting of operations. Other measures include reduced social contributions by businesses, a moratorium on business inspections and a temporary ban on bankruptcy procedures of businesses until 2021.

The central bank loosened prudential requirements and postponed enactment of several financial regulations. As of March 2020, the National Bank of the Kyrgyz Republic recommends banks and non-bank financial institutions (NBFIs) to provide a grace period for loan repayments of at least three months, it prohibits the imposition of fines and penalties for non-fulfilment of loan obligations, and it allows banks and NBFIs not to downgrade the loan classification category when changing the terms of contracts of the affected borrowers. In addition, the liquidity ratio has been lowered from 45 per cent to 30 per cent, short-term liquidity ratio requirements are removed and

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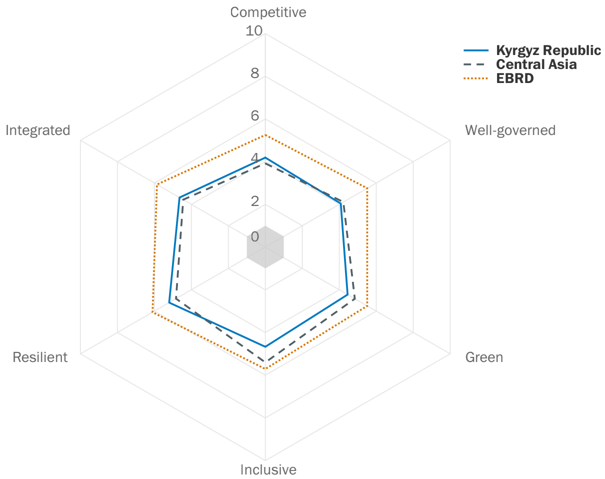
risk-weights of corporate and retail loans in foreign currency are reduced from 150 per cent to 100 per cent. According to government estimates, half of the banks' loan portfolios have undergone loan restructuring since the start of the Covid-19 crisis.

The Kyrgyz Republic was the first country to receive Covid-19-related emergency financial assistance from the IMF. The IMF provided US$ 120.9 million in March 2020 and another US$ 121.1 million in May 2020 after doubling the country's quota under the Rapid Credit Facility. The loan is helping the country close a balance-of-payments gap estimated at about US$ 500 million. Given strong pressures on the fiscal account, the IMF support helps to preserve fiscal space for essential Covid-19-related health expenditures. In addition, the government received US$ 50 million in loan and grant financing from the Asian Development Bank and a US$ 100 million loan from the Eurasian Development Bank. The state budget recorded a deficit of 7.1 per cent of GDP in May 2020 (compared with a surplus of 1 per cent a year ago) reflecting significant healthcare spending and loss of taxes on ailing enterprises and international trade.

Major bilateral lenders have agreed to a postponement of external debt repayments. In June 2020 a memorandum was signed by the government with Paris Club countries – Germany, France, Denmark, Japan and South Korea – to delay repayments until 2022-24. Debt restructuring is also being considered with these countries. Similar agreement was reached with China, Saudi Arabia and Kuwait and the G20 economies. The IMF assesses the Kyrgyz Republic's risk of debt distress as moderate, and the authorities have committed to keep the general government deficit at or below 3 per cent of GDP in the short and medium term. Public debt is estimated at 62.2 per cent of the forecasted GDP in June 2020, up from 54 per cent in 2019.

Assessment of transition qualities (1-10)



Structural reform developments

Banking sector indicators remain stable, partly helped by the relaxation of prudential regulations. The capital adequacy ratio was 25.6 per cent at 30 June 2020 (compared with 24 per cent in 2019). The liquidity ratio stood at 63 per cent at 30 June 2020 (compared with 64 per cent in 2019). The non-performing loan ratio increased slightly to 8.8 per cent in July 2020 from 7.9 per cent a year ago. Nevertheless, the sector's capitalisation and asset quality are expected to worsen somewhat, reflecting the economic contraction in 2020.

The Kyrgyz Republic has to import electricity in 2020 and early 2021 because of a shortage of water in the Toktogul reservoir. The country is planning to purchase 1 billion kWh of electricity from Kazakhstan, Tajikistan and Turkmenistan. The cost of imported electricity exceeds revenues

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from residential tariffs, necessitating cross-subsidisation by other sectors. Residential tariffs are to remain unchanged in 2020, thus failing to encourage households to save energy. Consequently, electricity consumption in the Kyrgyz Republic exceeds that of peer countries with similar weather conditions, according to an IMF study. Low tariffs also lead to suboptimal investment in the sector, inefficient use of energy, and financial losses. Energy sector companies' cumulative debts reached KGS 110 billion as of May 2020 (US$ 1.5 billion, 19 per cent of GDP).

E-government reforms have progressed thanks to steps taken under the digital transformation concept "Sanarip Kyrgyzstan 2019-2023". In the UN Global E-Government Development Index for 2020, the Kyrgyz Republic ranked 83rd out of 193 countries, second after Kazakhstan in Central Asia. The country advanced eight notches from last year. In particular, the Kyrgyz Republic posted a 73 per cent improvement in telecommunications infrastructure.

The new Business Ombudsman Institute is operational. The institute, established to defend the rights, interests and freedoms of entrepreneurs, accepted its first complaints in April 2020 in the midst of the crisis. As of the end of September 2020, 17 investigations had been completed, with five cases resolved with an overall monetary value of around KGS 7 million (US$ 86,000).

LATVIA

Highlights

- **The Covid-19 crisis halted economic growth in 2020.** After moderate growth in 2019, GDP is falling significantly in 2020 due to the coronavirus-induced effects on domestic demand, investments and exports.
- **Anti-money laundering/combating the financing of terrorism (AML/CFT) reform is progressing.** A Moneyval assessment concluded that the regulatory framework updated in 2019 is generally compliant with Financial Action Task Force (FATF) standards.
- **The administrative-territorial reform has been passed.** Under this reform, the number of municipalities will be reduced from 119 to 42 following the next municipal elections in 2021. The reform aims to streamline local and regional development and improve public service delivery.

Key priorities for 2021

- **Stimulating infrastructure investments, including through effective EU funds absorption, will be critical for the recovery phase.** Besides financing public infrastructure projects to address existing gaps and stimulating private investment, the authorities should ensure that regional and income inequalities are addressed, including through improving access to quality healthcare and education.
- **Effective implementation of new AML legislation is needed.** This will contribute to a sound banking sector, which is crucial for the resumption of credit growth, as well as the development of capital markets and alternative financial instruments.
- **Education reform should continue in spite of limited fiscal space.** Structural reforms targeting vocational and adult education are critical in increasing employment and productivity, given the country's unfavourable demographics. As such, the authorities and stakeholders should prioritise and ensure the implementation of ongoing reforms and projects, such as the OECD-led skills strategy.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.4	3.3	4.0	2.1	-5.0
Inflation (average)	0.1	2.9	2.6	2.7	0.6
Government balance/GDP	0.2	-0.8	-0.8	-0.2	-5.4
Current account balance/GDP	1.3	0.7	-0.3	-0.6	2.0
Net FDI/GDP [neg. sign = inflows]	0.0	-2.0	-2.2	-2.9	-0.5
External debt/GDP	149.1	142.3	123.7	117.1	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	48.6	43.5	38.0	36.8	n.a.

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Covid-19: macroeconomic implications

The economy declined sharply in the first half of 2020. GDP growth had already been slowing in 2019 (2.2 per cent growth), and in the first half of 2020 Latvia had the steepest decline in GDP among the Baltic states. In the latter period, Latvia's GDP decreased by 5.4 per cent year-on-year, on the back of a significant fall in output in the second quarter of 8.9 per cent year-on-year. The drop in output was driven by the decrease in private consumption, which fell by 20.9 per cent year-on-year in the second quarter, caused by the imposed containment measures. Nevertheless, the relatively successful management of the epidemic led to a swift recovery of private consumption, as retail turnover recovered to 2019 levels by June 2020 on the back of pent-up demand. On the other hand, industrial production has been slower to recover.

The unemployment rate has ticked up considerably despite robust wage growth. The unemployment rate reached 8.6 per cent in June 2020 compared with 6.3 per cent before the pandemic, mainly due to the affected services sector. Nevertheless, in July 2020, driven by recovering labour demand, unemployment decreased to 8.2 per cent. As the employment support schemes will be discontinued by the end of the year, unemployment is likely to stabilise at current levels. On the other hand, wage growth was still positive in the first half, but did not have an effect on prices as deflation continued by August.

The general government budget deficit will widen considerably. The government deficit was just 0.2 per cent of GDP in 2019 but, given the significant fiscal stimulus package to address the coronavirus crisis, the International Monetary Fund (IMF) expects the fiscal deficit to be 5.4 per cent of GDP in 2020. The IMF also forecasts government debt to increase from 36.9 per cent of GDP in 2019 to 44.1 per cent of GDP by the end of 2020. The government is able to access diversified sources of financing, including eurobonds, the Nordic Investment Bank and the Council of Europe Development Bank.

The medium-term outlook is tilted to the downside. In line with the relaxation of measures, a rebound in the third quarter of 2020 took place on the back of recovering private consumption, but the recovery will likely be subdued by the end of 2020, in line with the wider EU economy. As such, the EBRD projects GDP to decline by 5.0 per cent in 2020 and recover by 3.5 per cent in 2021. This is nonetheless contingent on no other major outbreaks of Covid-19 in the second half of 2020. In the medium term, adverse demographics and the limited availability of financing may hold back output growth.

Policy response to Covid-19

The economic stimulus package has been comprehensive. In March 2020 the government announced a support package of about €2 billion (7 per cent of GDP). Key measures include: loans and guarantees amounting to €250 million; a sectoral support package of €875 million covering the air and transport industry, the health and education sectors as well as infrastructure projects; deferral of tax payments worth €196 million; and the job retention scheme covering 75 per cent of salaries or €700 per month for affected firms. Other measures include subsidised working capital loans and export credit guarantees through the state-owned development institution ALTUM. ALTUM will also manage a €100 million investment fund targeted at impacted large enterprises. Lastly, the EC approved the state's €250 million investment in airBaltic, which was aimed at stabilising the aviation industry, alongside state aid earmarked for the agricultural, forestry and tourism sectors.

The economy will likely benefit from the expected EU stimulus. Following the EU recovery fund deal, Latvia has been earmarked around €10.5 billion for the 2021-27 period. A plan to absorb these funds towards improving the innovative potential of the economy, addressing infrastructure, education and healthcare gaps, and accelerating the green transformation will be crucial, on top of ensuring the recovery post-2020. At the same time, it will require state capacity to effectively deploy such funds.

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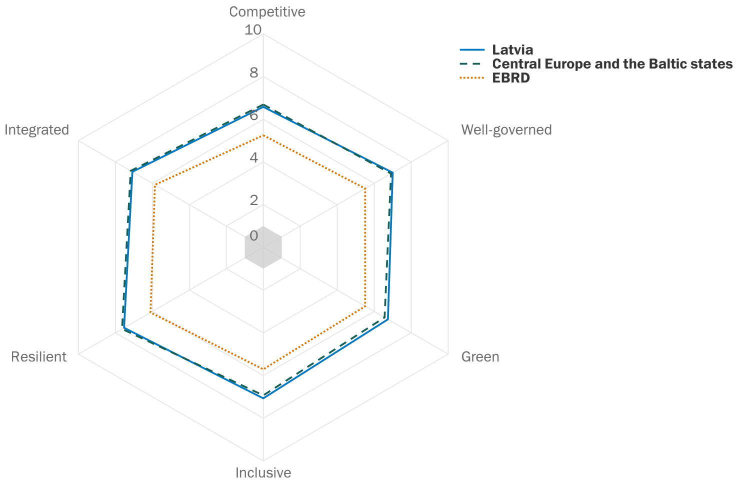
Assessment of transition qualities (1-10)



Structural reform developments

Latvia has improved the AML framework, as per the latest Moneyval evaluation. Following the adoption of new laws in 2019, Latvia has strengthened the Financial and Capital Market Commission, enabled the government to expel banks involved in money laundering, and focused the courts and prosecutors on more serious financial crimes. The number of sanctions and investigations has increased, although the EC has noted the need for further efforts to ensure effective supervision and enforcement. A generally positive report from Moneyval, published in January 2020, rating Latvia as largely compliant with EU regulations, means that the country avoided being placed on the FATF grey list.

The territorial administrative reform is consolidating local administration. In June 2020 the parliament adopted the administrative-territorial reform for consolidating local authorities from 119 to 42 municipalities. This reform is intended to create economically viable administrative territories that are able to provide cost-effective public services. The reform has been met by calls from municipalities and the Chamber of Local Authorities to postpone the process until sufficient consultations are conducted. The comprehensive reorganisation of local administration will enter into force after the local elections in mid-2021.

Tax system reform is ongoing despite a lack of political consensus and economic uncertainty. The current government recently proposed the reform of the tax system aimed at reducing the labour force tax burden, which includes lowering the social tax by 1 per cent, increasing the differentiated non-taxable minimum application threshold, as well as adopting minimal social contributions. The labour tax burden in Latvia is one of the highest in the OECD region, while additional tax revenue sources are needed to ensure enough funding for supporting the healthcare and education systems.

Regional gas market integration has progressed along with greening of the energy market. The roadmap for the regional gas market integration with Finland and the Baltic states was adopted in April 2020, and further progress is expected based on the common gas market that became operational in January 2020 between Finland, Estonia and Latvia. The reform aims to create a more competitive regional market that also supports the energy security of the Baltic states. In January 2020 the government adopted the national energy and climate strategy for 2030, which targets greater energy efficiency, an increase in the share of renewable sources in final consumption to 50 per cent, and reduced emissions by 6 per cent compared with levels in 2005.

LEBANON

Highlights

- **Lebanon has entered a deep economic crisis.** The pound is depreciating sharply, the government is struggling to manage the parallel foreign exchange market, inflation continues to spiral, and current economic trends point to hyperinflation and further economic decline.
- **A default on external debt occurred in March 2020, and all credit rating agencies downgraded Lebanon's sovereign ratings.** Major sources of external funding have dried up, including non-resident deposits, remittances and foreign direct investment, and all major ratings agencies have downgraded the sovereign rating.
- **Some reforms have advanced, but progress has been slow.** Several reforms requested by the International Monetary Fund (IMF), as part of their discussions with the government, have started, including auditing the central bank and embarking on subsidy reforms. Other reforms have stalled, notably the passage of a capital control law and the reform of the ailing electricity sector.

Key priorities for 2021

- **Agreeing on an IMF-supported stabilisation and structural reform programme is essential.** The priority should be to rebuild credibility though implementing concrete actions to reach an agreement with the IMF. This will need to include banking sector restructuring and restructuring of the government's debt obligations following its default on Eurobond payments in March. The reform programme should also involve other international financial institutions to ensure complementarity and coordination and help unlock around US$ 11 billion in commitments pledged during the CEDRE conference in 2018.
- **A social safety net needs to accompany the reform programme.** The sharp drop in economic activity, coupled with the exchange rate depreciation, record inflation and the Covid-19 crisis, have led to a surge in unemployment and poverty. There is a need to set-up a targeted social safety net to provide support for the most vulnerable segments during the painful reform process.
- **The campaign to combat corruption needs to take place, and a programme to recover stolen assets is essential.** Protests in October 2019 were triggered by discontent towards corruption in the ruling parties. Combating corruption needs to happen at all levels, starting from tax and revenue collection and procurement.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	1.5	0.9	-1.9	-6.7	-22.0
Inflation (average)	-0.8	4.5	4.6	2.9	80.0
Government balance/GDP	-8.9	-8.6	-11.3	-10.5	-16.5
Current account balance/GDP	-23.5	-26.3	-28.2	-27.4	-16.3
Net FDI/GDP [neg. sign = inflows]	-3.1	-2.3	-3.7	-3.6	0.5
External debt/GDP	182.1	190.3	192.8	197.8	n.a.
Gross reserves/GDP	78.6	76.5	66.4	45.7	n.a.
Credit to private sector/GDP	103.8	107.4	100.3	89.4	n.a.

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Covid-19: macroeconomic implications

Lebanon is embroiled in multi-dimensional economic crises. The economy is estimated to have fallen into a recession of -6.7 per cent in 2019, reflecting regional and domestic political uncertainties, social unrest, slow implementation of reforms and lower capital inflows. Expectations for 2020 are even worse, as a deeper recession is exacerbating unemployment and poverty. The unemployment rate is estimated to be above 40 per cent, and 75 per cent of the population could be living below the poverty line by the end of 2020. The pound has continued to depreciate and the central bank is struggling to manage the parallel foreign exchange market. The official pegged exchange rate (of 1,507.5 Lebanese pounds per US dollar) is being used only for vital imports, while the rest of the economy is subject to multiple exchange rates in the parallel market, often reaching 9,000 Lebanese pounds per US dollar.

Inflation continues to spiral. Annual inflation reached record levels of 120 per cent in August 2020 year-on-year, as the pound continued to depreciate. Given Lebanon's import dependence, the depreciation, coupled with dollar shortages, is making imports more expensive and difficult to get. Food and non-alcoholic beverages were the main drivers of inflation, in addition to rising prices of clothing and footwear, furniture, household equipment and transport. Following the August 2020 explosion, imported building materials are in high demand requiring fresh dollars thus putting pressure on those imports. At the same time, purchasing power is quickly evaporating, notably for the many Lebanese earning in local currency and spending in US dollars on imported goods.

Lebanon has ceased servicing all of its external debt. This decision in March 2020, together with the ongoing political, economic and social crisis, contributed to a narrowing in the fiscal deficit. Revenues declined, with both non-tax and tax revenues dropping significantly due to a worsening economic crisis. Expenditures also fell, mainly owing to lower debt service costs, traditionally the main expenditure component; and to a decline in transfers to Electricité du Liban (EdL), usually around 4 per cent of GDP. The debt-to-GDP ratio reached 175 per cent at the end of 2019, and is rising further as the economy is collapsing. Meanwhile, Lebanon is struggling to access capital markets and is opting for domestic borrowing, with domestic debt accounting for approximately two-thirds of total debt (evaluated using the official exchange rate).

External imbalances remain wide. The current account deficit was over 20 per cent of GDP in 2019, one of the highest in the world. This was due to the continued appreciation of the real effective exchange rate (5.5 per cent year-on-year in December 2019) and a large import bill (59.3 per cent of GDP), which was only partially compensated for by exports of services (25.5 per cent of GDP) – mainly tourism and financial services. The external situation deteriorated further in the first half of 2020, with an additional 77 per cent appreciation in the real effective exchange rate and a 13 per cent decline in non-resident deposits compared with the end of 2019. The foreign currency reserves of Banque du Liban (BdL) dropped by 26 per cent year-on-year in August 2020 to US$ 22.8 billion, as the foreign currency was used to subsidise a basket of essential imports. The actual net assets of the BdL are estimated to be negative.

The outlook remains uncertain and the recovery depends on the speed of implementation of reforms. A further contraction of 22 per cent is expected in 2020 - the result of the ongoing economic crisis, the default on debt repayments, the Covid-19 crisis and the associated containment measures, in addition to the August 2020 warehouse explosion, which caused enormous damage. A recovery in 2021 is contingent on the government embarking on a comprehensive economic reform programme in collaboration with the IMF and in the context of an IMF programme, including debt restructuring, which would lead to increased international support and follow-up on the CEDRE commitments. However, any delay in the implementation of reforms will lead to a fourth successive year of deep GDP contraction.

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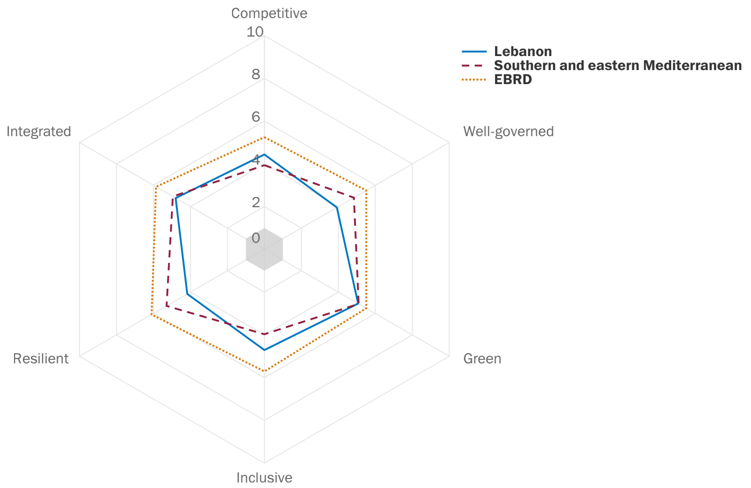
Policy response to Covid-19

In response to the Covid-19 crisis, the authorities undertook a variety of measures. In March 2020, the government established a national solidarity fund, accepting in-kind and monetary donations. It also allocated LBP 1.2 trillion (US$ 796 million at the official rate) for social support, extended all deadlines related to payment of taxes and fees, and provided a solidarity basket of food, sanitisers and financial assistance of LBP 400,000 (US$ 265 at the current official rate) to families most in need. Some of the announced measures were likely not implemented, attracting criticism. A BdL circular in March 2020 allowed banks and financial institutions to extend exceptional five-year zero per cent interest rate loans in Lebanese pounds or US dollars to customers that already have credit facilities but were unable to meet their obligations, operating expenses, or pay salaries to their employees during March, April and May 2020. The BdL also reduced the Beirut Reference Rate in April 2020 to 5.75 per cent for US dollars and 7.75 per cent for Lebanese pounds, and suspended US dollar withdrawals until the airport reopens.

Assessment of transition qualities (1-10)



Structural reform developments

Lebanon has entered discussions for an IMF-supported programme. The discussions began in April 2020. However, progress has been slow and did not progress to negotiations, with almost none of the reforms requested by the IMF fully implemented. The discussions were placed on hold subsequently in July 2020 and the IMF has made it clear it is ready to resume discussions once the government agrees on a common approach towards – and starts implementing – reforms in key sectors. Without the IMF's backing, Lebanon will likely be unable to gain access to external financing, as creditors will want to see a firm commitment to reforms.

The authorities have made progress on some of the reforms urged by the IMF in advance of a programme and major international counterparts. Audits of BdL have been launched, while a capital control law was drafted awaiting parliamentary approval. In July 2020, the cabinet chose a US-based company for the forensic audit of BdL, while two other companies were selected to carry out the accounting audits. In early July 2020, a capital control draft law was introduced in parliament after taking into account comments from various parties. Formal capital controls could help Lebanon curb currency depreciation and rapidly decreasing foreign reserves which follows *de facto* capital controls by the banking sector starting in late 2019. Given the fiscal constraints, the government needs to reform the electricity sector. Some progress was recently made with the appointment of a new board of directors of EdL,

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the state-owned utility, but the appointments were criticised by several groups who viewed these as still reflective of sectarian affiliations. Subsidy reforms continued, with the increase in the price of subsidised bread in June 2020. For the first time since October 2019, bread prices increased by 33 per cent, after previous weeks saw long lines in front of bakeries as some owners had decreased production due to the rising costs of imports. Meanwhile, reforming the electricity sector and subsidies will require a concerted effort by the government.

A new trade finance fund has been launched. Cedar Oxygen, a US$ 175 million independent Trade Finance Impact Fund supported by BdL, was launched in July 2020 to provide trade finance solutions to manufacturing companies. The support of the industrial sector through Cedar Oxygen aims to stabilise the economy and the banking sector, and ultimately attract foreign capital investments to Lebanon. Cedar Oxygen will be working in partnership with selected Lebanese banks, which will identify those eligible for financing.

LITHUANIA

Highlights

- **The Covid-19 crisis has brought a period of robust macroeconomic performance to a halt.** With strong GDP growth, current account surpluses and fiscal stability, Lithuania had made progress towards European Union (EU) convergence in the past few years, but the coronavirus crisis has reversed this positive trend in 2020, as containment measures strongly affected consumption, investment, trade and the fiscal account.
- **The policy response to the Covid-19 crisis has been comprehensive.** The government announced an economic stimulus package of 11 per cent of GDP, which together with an effective control of the epidemic, allowed the economy to start its economic recovery relatively quickly.
- **A plan facilitating large investment has been announced.** In July 2020 the government announced a comprehensive plan of amendments that will create a "green corridor" for large investments in regional development.

Key priorities for 2021

- **Addressing inequalities should continue, including through education and healthcare reform.** As levels of poverty and income inequality are still among the highest in the EU, the minimum wage, universal child benefits and pensions have been increased. There is a risk that the Covid-19 crisis will exacerbate existing inequalities, both at social and regional levels, which reinforces the case for comprehensive reforms of education and healthcare.
- **Increasing tax collection is critical for a balanced fiscal stance.** As social spending is expected to increase, fiscal revenues will have to increase likewise. Improved tax collection is seen as one of the main solutions, as the shadow economy is still considerable in size, while the value-added tax gap is one of the highest in the EU.
- **An enhanced focus on innovation could stimulate the economic recovery.** The announced investment plan up to 2022, which focuses on innovation, human capital, energy transformation and infrastructure, is an important step forward, but its success will rely on effective implementation.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.5	4.3	3.9	4.3	-2.0
Inflation (average)	0.7	3.7	2.5	2.2	1.3
Government balance/GDP	0.2	0.5	0.6	0.3	-6.7
Current account balance/GDP	-1.1	0.5	0.3	4.2	7.2
Net FDI/GDP [neg. sign = inflows]	-0.9	-2.0	-0.8	-1.5	-0.5
External debt/GDP	86.2	82.6	78.1	67.7	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	42.7	41.0	40.5	39.5	n.a.

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Covid-19: macroeconomic implications

The economy is in recession but has shown resilience. Services such as retail trade, transport, accommodation and catering account for a relatively large share of economic output (32 per cent of GDP) and have been the most affected branches of the economy during the Covid-19 crisis. Disruptions in global value chains have affected manufacturing, reflected by the decrease in industrial production, which, nonetheless, almost recovered to 2019 levels by July 2020. Private consumption has also been hit, but the effect was short-lived, as in June 2020, retail sales have increased relative to 2019. The impact on exports has also been relatively shallow, thanks to the high share of food products in its exports structure. Investment activity has been most affected, declining by 20 per cent year-on-year in the second quarter, and remains a drag on recovery as credit growth has been negative in the summer months. As such, GDP growth dropped by only 1 per cent year-on-year in the first half of 2020.

Wage growth is expected to slow amid rising unemployment. Boosted by public sector and minimum wage increases, wage growth remained high in the first quarter of 2020 at 9.4 per cent year-on-year after rising by 8.8 per cent in 2019. However, Lithuania's first-quarter unemployment rate rose to 7.1 per cent, up by 0.6 percentage points compared with 2019, and further increased to 8.5 per cent in the second quarter.

A significant fiscal deficit has emerged. After the government recorded a surplus of 0.3 per cent of GDP in 2019, the situation has changed in 2020 as a result of a significant fiscal stimulus package and lower economic activity and revenues. Government revenues were 8.8 per cent lower than planned in January to April 2020, and the International Monetary Fund (IMF) forecasts the fiscal deficit for 2020 at -6.7 per cent of GDP in 2020 and -3.8 per cent in 2021. The IMF also forecasts that public debt will reach 48.3 per cent of GDP by the end of 2020.

The short-term outlook is positive but significant uncertainty remains. Currently, the EBRD forecasts GDP to fall by 2.0 per cent in 2020, given the resilience shown in the first half of the year but remaining uncertainty about the evolution of the pandemic. In 2021, a rebound by 4.0 per cent in 2021 is expected, driven by already-announced significant investments in infrastructure and innovation. However, these forecasts are contingent on no further major outbreaks of the pandemic that could halt the path of recovery.

Policy response to Covid-19

A major economic stimulus package was adopted. The package amounts to about 11 per cent of GDP and is focused on firm liquidity and employment support. In the first stage, a fiscal package of €2.5 billion (5 per cent of GDP) was announced in March 2020. Key measures include additional funds to the healthcare system, income support for the self-employed, wage subsidies for employees in affected firms, and expansion of state guarantee schemes. Support was extended by €1 billion in May with a focus on economic recovery, and includes wage subsidies for returning from unemployment, and increased unemployment benefits and social benefits. Monetary policy was also relaxed, as the Bank of Lithuania lowered the counter-cyclical capital buffer from 1 to 0 per cent and offered loans to liquidity-strained financial institutions.

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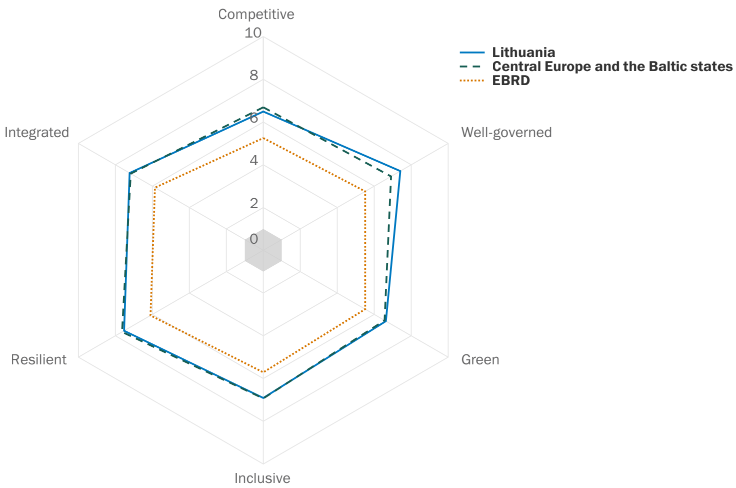
Assessment of transition qualities (1-10)



Structural reform developments

A new investment plan has been announced. In June 2020, the government published its public investment plan, called "The DNA of the Future Economy" worth €6.3 billion (13 per cent of 2019 GDP) to be invested between July 2020 and January 2022. Of the total amount, €2.2 billion will be new investments and the remainder is already-planned investment that will be accelerated, including by absorbing EU funds. The plan covers investments in human capital, the digital economy and business, innovation and research, infrastructure and climate change and energy.

Reforms to the business environment are advancing. The investment climate is being enhanced by a package of amendments to attract large investments through faster procedures in construction, land use, migration, as well as tax incentives, which will enter into force in January 2021. The goal of the "green corridor" is to attract investments in the post-Covid-19 possible reconfiguration of global value chains.

A new insolvency framework has entered into force. The new law came into force in January 2020 and aims to increase the efficiency of insolvency proceedings of legal persons, create conditions for the timely initiation of bankruptcy proceedings and greater satisfaction of creditors' claims, and promote the restructuring and preservation of viable legal persons in financial difficulty. The law states that insolvency occurs when liabilities are equal to assets or when a firm fails to meet its obligations, instead of overdue liabilities exceeding half of assets in the previous version. Thus, there is a risk that the new concept will create bankruptcy proceedings for firms in temporary financial difficulty, increasing the number of insolvencies.

The authorities have initiated plans to establish a National Development Bank and an Innovation Promotion Fund. The parliament has recognised the establishment of a state development bank as a project of national importance. The government has requested the EC's technical assistance in establishing this institution. Separately, a law initiated by the government will enable the Innovation Promotion Fund to be established in 2021. The idea is to facilitate innovative ideas for the financing of businesses.

The tax regime has been adjusted to cover additional social spending. To increase tax revenues, the Law on the Vehicle Registration Tax was adopted in December 2019, which introduces passenger vehicle taxation based on CO_2 emissions from July 2020. Second, the real estate tax brackets were adjusted downwards to cover up to 75 per cent of properties in Vilnius. Lastly, as of January 2020, the progressive personal income tax rate was reintroduced, increasing the rate from 27 per cent to 32 per cent for high earners.

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Progress in the energy sector has been notable. In May 2020 the parliament approved the liberalisation of the retail electricity market, which brings competition to the sector in a staged way depending on households' consumption levels. Energy security is also improving, as Lithuania has already reached interconnection targets for electricity and is now developing a new electricity interconnector with Poland. The development of a natural gas interconnector pipeline is also advancing, boosted by a state guarantee in Klapeida LNG terminal. Moreover, there has been progress in identifying the location of a new 700 MW offshore wind farm.

MOLDOVA

Highlights

- **The Covid-19 crisis hit a stable but already decelerating economy.** Economic activity plummeted in the second quarter of 2020 by 14 per cent year-on-year. However, the relatively good macroeconomic position before the crisis, and access to external financing, helped the economy to cope with the shock.
- **The authorities adopted a package of measures to safeguard the economy.** These include tax deferrals, an increase in social benefits, monetary policy easing and measures to support liquidity in the banking sector.
- **Finalisation of the new gas pipeline increases Moldova's energy security.** The inauguration of the Ungheni-Chisinau gas transmission pipeline, connecting the Moldovan gas network to the European Union via Romania, is an important step towards geographical diversification of energy supplies.

Key priorities for 2021

- **Moldova should start preparing for opportunities from the expected post-Covid-19 shift in global value chains.** One of the long-term consequences of the pandemic is expected to be the restructuring of global supply chains, and Moldova, with its geographical proximity to western Europe, should strengthen its position by pursuing long overdue structural reforms to improve the business environment.
- **The authorities should advance institutional reforms and improve governance.** The success achieved in recent years in financial sector reform would not be sustainable without improvements in the rule of law and the fight against corruption. The creation of a level playing field, guaranteed by strong regulatory institutions, will be critical for investments.
- **The independence of the National Bank of Moldova (NBM) should be preserved.** The continued strengthening of professional capacities of the NBM and respect for its institutional independence are the best guarantees of financial system stability.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	4.4	4.7	4.3	3.6	-5.5
Inflation (average)	6.4	6.6	3.1	3.8	2.8
Government balance/GDP	-1.5	-0.6	-0.8	-1.4	-8.0
Current account balance/GDP	-3.5	-5.7	-10.4	-9.3	-8.3
Net FDI/GDP [neg. sign = inflows]	-0.9	-1.4	-2.2	-3.9	-1.0
External debt/GDP	75.0	70.6	63.9	62.0	n.a.
Gross reserves/GDP	27.3	29.0	26.1	25.6	n.a.
Credit to private sector/GDP	21.6	18.7	18.4	19.2	n.a.

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Covid-19: macroeconomic implications

The Covid-19 crisis hit an already-decelerating economy. Due to a near-standstill in the last quarter of the year, economic growth decelerated to 3.6 per cent year-on-year in 2019. This declining trend in growth continued in the first quarter of 2020 when GDP growth slowed further to 0.9 per cent year-on-year, driven by a fall in exports and stagnating private consumption. Investments in fixed assets remained strong, helped by construction activity picking up again on the back of an increase in the state subsidy for the First House programme. GDP plummeted in the second quarter of 2020 by 14 per cent year-on-year, on the back of a 17 per cent year-on-year drop in private consumption and a 15.6 per cent year-on-year fall in investments. However, net exports had a positive contribution to GDP due to a deeper drop in imports than exports. The exchange rate remained broadly stable and the inflation rate decelerated to 2.3 per cent in September 2020, below the target rate of 5.0 per cent, prompting the central bank to set a new historical low policy rate at 2.75 per cent.

Fiscal prudence and access to external financing have helped the economy cope with the shock. Public debt is estimated at around 28 per cent of GDP in 2019, leaving ample fiscal space for policy response. Multi-year efforts to clean up the financial system succeeded in putting it on a significantly better footing, with tightened regulatory and governance frameworks, a stronger regulator, and foreign strategic investors in the banking sector. At nearly US$ 3.5 billion in September 2020 and covering over six months of imports, international reserves held by the NBM are at comfortable levels. To help cover the widening external and fiscal gaps and anchor macroeconomic stability, the government secured US$ 235 million rapid financing from the International Monetary Fund (IMF) in April 2020.

Economic recovery is likely to be gradual and dependent on the recovery of global demand. Subdued demand for new cars is likely to weigh down demand for the automotive components industry, which is well integrated into global supply chains. On the other hand, a strong increase of remittances since May 2020 will most likely support the recovery of private consumption. After reaching a trough in the second quarter of 2020, the economy will likely remain in negative growth territory until early 2021. Taking all factors into account, we expect GDP to decline by 5.5 per cent in 2020 followed by a moderate recovery of 3.5 per cent in 2021, but downside risks to the forecast remain significant.

Policy response to Covid-19

The authorities have introduced significant mitigation measures to combat Covid-19. The initial emergency policy response of 2 per cent of GDP in April 2020 focused on tax deferrals, a temporary increase in social benefits, monetary policy easing and liquidity provision. The government reduced the value-added tax (VAT) rate for the hospitality sector from 20 per cent to 15 per cent, announced faster VAT reimbursements and provided subsidised lending to small and medium-sized enterprises. Tax payment deadlines were delayed to mid-2020 and tax audits and other controls were temporarily suspended. Firms that ceased operations during the state of emergency had their payrolls (personal income tax and social contributions) fully compensated by the state, and those that continued operating received up to 60 per cent. Social assistance to vulnerable groups includes expanding unemployment benefits and targeted social help. The NBM cut the policy rate in the face of shrinking aggregate demand and lowering inflationary pressures. It also allowed banks to defer loan payments and decreased the Moldovan leu reserve requirements to support liquidity in the banking sector.

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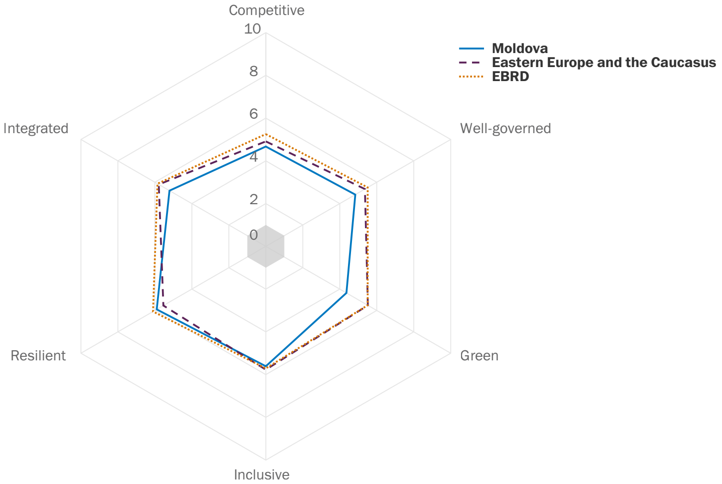
Assessment of transition qualities (1-10)



Structural reform developments

Reforms in the financial sector to ensure its stability continued. To prevent migration of risks from the banking to the non-bank financial sector, the authorities have been improving the regulatory and supervisory framework for the sector. According to new regulations introduced in February 2020, the non-banking sector is not allowed to accept deposits from the general public, all entities in the sector need to report the new credit activity to the credit bureaus, and the minimum share capital is increased to MDL 1 million (around US$ 60,000) from January 2021. Prudential requirements have been enhanced and a sanctioning regime introduced. The banking sector also saw the adoption and implementation of the enhanced Emergency Liquidity Assistance to solvent and viable banks from December 2019. On the NBM's approval of the new supervisory and management boards, a systemic bank exited temporary administration in February 2020.

Continued engagement with the IMF supports Moldova's reform agenda. The authorities finalised the sixth and final review under the three-year Extended Credit Facility and Extended Fund Facility arrangement with the IMF in March 2020. Negotiations for a new economic reform programme resulted in a staff-level agreement in July 2020 for a US$ 558 million three-year arrangement. When approved by the IMF Board, the new programme will support the Moldovan authorities in advancing institutional reforms aimed at tackling vulnerabilities in fiscal governance, non-bank financial sector oversight, market regulation, anti-corruption and the rule of law.

Finalisation of the Ungheni-Chisinau gas pipeline increases Moldova's energy security. The inauguration of the 120-kilometre-long Ungheni-Chisinau gas transmission pipeline in August 2020 marks the completion of the second stage of the Ungheni-Chisinau strategic infrastructure project, connecting the Moldovan gas network to the European Union via Romania. Construction of the interconnector between the Romanian city of Iasi and the Moldovan town of Ungheni was the first stage of the project. The Ungheni-Chisinau pipeline will add up to 1.5 bcm/year of gas supplies and support the geographical diversification of natural gas supply routes to Moldova. This project increases Moldova's energy security, because up until now the country has been nearly fully dependant on Russia for the import of gas.

A new customs code was adopted. The new code merges three laws into a single legal act in an effort to systematise and streamline the previous customs legislation. It also aims to liberalise and simplify certain customs procedures as well as promote the use of electronic documentation. Adopted in July 2020, the code will take effect in January 2022 with a transitional period provided for some of the articles.

MONGOLIA

Highlights

- **The Covid-19 pandemic has exposed Mongolia's key economic vulnerabilities.** The economy's extreme dependence on China as its main export market and a narrow specialisation in a small number of mineral commodities have contributed to a 9.7 per cent year-on-year fall in GDP in the first half of 2020.
- **The authorities adopted two packages of anti-crisis fiscal measures to stimulate economic activity and save jobs.** Measures include tax exemptions, increases in child allowances and unemployment benefits, credit guarantees to small and medium-sized enterprises (SMEs) and soft loans for cashmere producers.
- **Mongolia received substantial assistance from international financial institutions.** Among other support, a US$ 99 million emergency assistance package from the International Monetary Fund (IMF) is helping the country meet urgent budgetary and balance-of-payments needs and support the most affected sectors and vulnerable groups.

Key priorities for 2021

- **A key priority is to mitigate the social and economic impacts of the pandemic.** The government should continue protecting those most affected by the crisis through job creation and expanded social protection, while improved access to digital technologies and skills will increase inclusion, especially for those in remote areas and migrants living on the outskirts of large cities.
- **Macroeconomic stability and fiscal discipline should be maintained.** The authorities should stick to their commitment to unwind fiscal loosening in 2021 once the immediate impact of the pandemic subsides.
- **Investment climate and governance issues need to be addressed.** The Investment Protection Council can be used as an effective tool to protect the rights and interests of investors. Public investment in physical and human capital is also key for attracting foreign direct investment and achieving longer-term diversification of the economy.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	1.2	5.3	7.2	5.1	-6.5
Inflation (average)	0.7	4.3	6.8	7.3	5.0
Government balance/GDP	-15.3	-3.8	3.0	0.9	-12.0
Current account balance/GDP	-6.3	-10.1	-16.8	-15.6	-13.0
Net FDI/GDP [neg. sign = inflows]	37.2	-13.1	-14.9	-17.6	-8.0
External debt/GDP	183.9	245.4	235.3	221.0	n.a.
Gross reserves/GDP	11.7	26.4	27.1	31.4	n.a.
Credit to private sector/GDP	56.9	53.1	55.7	50.1	n.a.

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Covid-19: macroeconomic implications

The pandemic has exposed the Mongolian economy's key vulnerabilities. These are, first: the extreme dependence on China as the main export market (accounting for 93 per cent of total exports in 2019), and second, the narrow specialisation in a very small number of mineral commodities (around 87 per cent of total exports). In the first eight months of 2020, as a result of the partial border closure in February 2020 for freight cargo and weaker demand, exports declined by around 17 per cent year-on-year, with coal exports contracting by 45 per cent and copper by 24 per cent. In contrast, gold exports rose by 233 per cent year-on-year in the same period. The drop in export revenues and the introduction of tax relief measures have resulted in a 19 per cent contraction year-on-year of fiscal revenues in January to August 2020, and the delay in the production schedule of Oyu Tolgoi's phase 2 may put further pressure on the budget. Public debt had already reached 69 per cent of GDP at the end of 2019, and Mongolia faces large bond maturities in 2021-24 equal to roughly half of international reserves.

Mongolia's economy is one of the most severely affected by Covid-19 in Central Asia. Real GDP fell by 9.7 per cent year-on-year in the first half of 2020, as partial lockdown measures from mid-February 2020 until 30 April 2020 significantly constrained household demand. This period also included a temporary suspension of coal exports to China in February and March, tight restrictions on international flights and railways, and strict social-distancing measures. The transportation, trade and services sectors posted losses. Mining was down by 30 per cent year-on-year in the first half of the year, with production of most commodities shrinking, except for gold.

Credit to the economy is declining due to lower levels of economic activity and higher risks. Total outstanding loans shrank by 4 per cent year-on-year in September 2020 compared with 11 per cent growth a year ago. Both retail and corporate loans dropped despite steps taken by the central bank to soften prudential regulations (and hence support bank lending to the private sector) and reduce the policy rate (stepwise from 11.0 per cent in February 2020 to 9.0 per cent in April 2020 and further to 8.0 per cent in September). Inflation decelerated significantly to 1.7 per cent year-on-year in September 2020, well below the target rate of 8 per cent, amid sluggish domestic demand. The exchange rate depreciated by a modest 5 per cent between the beginning of 2020 and 30 September 2020, as the central bank regularly intervened in the foreign exchange market. As a result, gross international reserves dropped from an historic high of US$ 4.4 billion in February 2020 to US$ 3.6 billion by 31 August 2020.

A strong recession in forecast in the short term, but with some recovery in 2021. With tourism activities not materialising in the third quarter of 2020 (severely affecting the hospitality sector and cashmere exports), Mongolia's GDP is expected to contract by 6.5 per cent in 2020. The economy is forecast to grow by 5.0 per cent in 2021 as tourism and China's demand for Mongolia's key exports gradually recover, but significant downside risks remain, to do mainly with a possible resurgence of the pandemic.

Policy response to Covid-19

The authorities adopted two packages of anti-crisis fiscal measures to stimulate economic activity and save jobs. The first set of measures (amounting to 14 per cent of GDP), approved in April 2020, include tax exemptions on selected imported food and medical items, exemptions on income tax and social security contributions, an increase in child allowances and unemployment benefits, credit guarantees to SMEs and soft loans to cashmere producers. The second package (2 per cent of GDP), approved in May, provided additional support to households (increasing social welfare pensions and food stamp allowances for the elderly, disabled and orphans), as well as subsidies to the cashmere sector.

The central bank implemented prudential measures to support the banking sector and stimulate lending. In March 2020, the central bank reduced reserve requirements in local currency and banks' liquidity ratios. In addition, the central bank has taken temporary financial forbearance measures to ease the financial pressure on distressed businesses and households. These involve easing loan classifications, restructuring standards allowing a deferred payment of consumption

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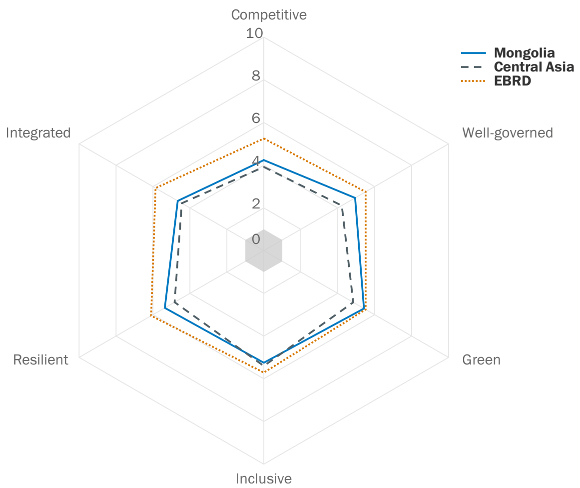
loan principals and interests, and suspending corrective actions against breaches of the capital conservation buffer. Furthermore, the central bank temporarily resumed a subsidised mortgage loan programme for an estimated MNT 150 billion (US$ 52 million) until the end of 2020.

Mongolia received US$ 99 million emergency financial assistance from the IMF. This is to help the country meet urgent budgetary and balance-of-payments needs stemming from the outbreak of Covid-19, and to support the most affected sectors and vulnerable groups. The IMF's previous Extended Fund Facility (EFF) arrangement with the government of Mongolia went off track due to insufficient progress on the recapitalisation of banks and expired in May 2020. Only five out of 11 reviews were completed under the EFF programme. The authorities have reiterated their commitment to ensure a fully capitalised banking system after Covid-related pressures subside and to address the outstanding commitments under the EFF. In addition, in May 2020 the Asian Development Bank provided a US$ 100 million loan to mitigate the severe health and economic impacts of the Covid-19 pandemic.

Assessment of transition qualities (1-10)



Structural reform developments

Mongolia is making progress with addressing deficiencies in anti-money laundering and combating the financing of terrorism (AML/CFT). Mongolia was added to the Financial Action Task Force's (FATF) grey list in October 2019 after the country failed to pass the necessary requirements related to AML/CFT. The FATF's June 2020 plenary meeting recognised that Mongolia has successfully addressed all six high priority actions and warrants an onsite assessment to verify that the implementation of Mongolia's AML/CFT reforms has begun and is being sustained, and that the necessary political commitment remains in place to sustain implementation in the future. Some key reforms conducted by the government include applying a risk-based approach to supervision and applying proportionate and dissuasive sanctions for breaches of AML/CFT obligations, along with demonstrating increased investigations and prosecutions of different types of money laundering activity in line with identified risks.

The government intends to take measures to amend the Oyu Tolgoi investment agreement. In December 2019 the parliament issued a resolution that directed the cabinet to seek discussions with Rio Tinto to amend the investment agreement and the Oyu Tolgoi Underground Mine Development and Financing Plan, and develop an option to convert the 34 per cent government share ownership into a royalty or production-sharing arrangement. This is regarded as a negative signal for investors and underscores the longstanding strained relations over taxation, delays and other aspects of the large-scale copper mining project between the government and Rio Tinto, the operator of the copper and gold mine.

MONTENEGRO

Highlights

- **The Covid-19 pandemic is weighing strongly on growth in 2020.** The economy relies heavily on tourism, and foreign tourist arrivals declined by over 80 per cent year-on-year in the first half of 2020, contributing to a sharp fall in GDP.
- **The government adopted three packages of economic support measures as a response to the coronavirus crisis.** The packages are worth over €1.5 billion (more than 30 per cent of GDP) and aim to maintain the liquidity of companies, saving jobs and supporting vulnerable groups.
- **The country is progressing on greening energy generation.** The decarbonisation agenda of the state electricity company (EPCG) relies on an extensive renewable investment plan.

Key priorities for 2021

- **Fiscal adjustment should be resumed as soon as Covid-19 concerns recede.** Besides maintaining a primary surplus over the medium term, further strengthening of budgeting procedures, public investment management and public and tax administration is needed. Construction of further sections of the major cross-country highway should be preceded by a careful cost-benefit analysis.
- **Informality needs to be tackled through further measures.** Unfair competition from the informal sector weighs primarily on local micro, small and medium-sized enterprises. Government measures should be focused on underlying causes such as the regulatory burden, weak enforcement capacity and corruption, and simplifying tax legislation and reducing para-fiscal charges would also be beneficial.
- **The bank asset quality review should be completed.** This would help give a clear picture of the underlying strengths and weaknesses of the banking sector. In addition, the central bank should closely monitor financial stability and issues arising from the Covid-19 crisis.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.9	4.7	5.1	4.1	-9.0
Inflation (average)	-0.3	2.4	2.6	0.4	-0.1
Government balance/GDP	-6.2	-6.9	-6.2	-2.4	-10.0
Current account balance/GDP	-16.2	-16.1	-17.0	-15.2	-14.0
Net FDI/GDP [neg. sign = inflows]	-9.4	-11.3	-6.9	-7.0	-5.0
External debt/GDP	162.6	160.6	164.7	170.2	n.a.
Gross reserves/GDP	18.1	20.8	21.9	27.9	n.a.
Credit to private sector/GDP	48.8	48.7	49.6	49.4	n.a.

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Covid-19: macroeconomic implications

The economy has entered a strong recession in 2020. GDP growth slowed to 3.6 per cent in 2019, primarily due to large investment projects approaching completion (the Bar-Boljare highway) or being completed (power link to Italy), although the tourist season was the strongest on record. In Montenegro, around one-fifth of GDP normally comes from tourism, and most tourists visit the country in the summer months. In June 2020, the government announced that the Covid-19 virus had been eliminated on the territory, but in mid-July the government acknowledged that new cases had emerged throughout the country. In the first half of 2020 GDP contracted by 10.3 per cent year-on-year, while foreign tourist arrivals declined by over 80 per cent year-on-year. Exports recorded a fall of 35.5 per cent. The economy also entered deflation in the second quarter, with year-on-year inflation averaging -0.7 per cent in April to June 2020.

Public debt will likely reach a record high level in 2020. As in other countries, economic support measures (described below) aimed at mitigating the negative effects of the coronavirus pandemic, combined with falling revenues, will lead to an increased budget deficit in 2020. According to the government, the deficit will be 7.3 per cent of projected GDP in 2020, but other estimates suggest it could be as high as 10 per cent of GDP. Besides coronavirus-related measures, the previous government announced a pension hike (raising minimum pensions by around 13 per cent retroactively from 1 January 2020) ahead of the parliamentary elections at the end of August.

The current account deficit declined only marginally in the first half of 2020. Montenegro has run high current account deficits for many years, reaching 15 per cent of GDP in 2019. In the first half of 2020, it declined by only one percentage point, as the fall in goods imported was more than compensated for by the decline in tourism exports.

A sharp recession in 2020 is expected to be followed by a recovery in 2021. GDP is forecast to fall by 9.0 per cent in 2020 as the tourist season was significantly affected by the crisis. Provided the pandemic loses its power both locally and globally in the second half of 2021, the economy should return to growth in 2021, which is projected at 5.0 per cent. The downside risks are associated with potentially longer duration and stronger impact of the pandemic on the economy than envisaged, and further deterioration of the fiscal position.

Policy response to Covid-19

The government adopted three packages of economic measures between mid-March and August 2020. The overall aims were to maintain the liquidity of companies and citizens, save jobs and support the vulnerable. While the government spent around €320 million on the first two packages, the third is far larger, estimated at €1.2 billion, and will span over four years. Fiscal measures ranged from deferral of wage taxes and social contribution payments, to wage subsidies for employees in troubled sectors (such as tourism, hospitality and transport) and for new employment, to assistance to the agricultural and fisheries sectors. The government provided farmers with access to soft loans worth up to €20,000 and announced it would purchase and store surplus agricultural products as well as assist producers to transport those products to public institutions. Measures also included shorter value-added tax (VAT) refund deadlines, financial aid to pensioners and the unemployed, power subsidies for vulnerable groups, and higher wages for healthcare workers and police officers. Among the latest actions was a one-year reduction of VAT for catering activities (from 21 to 7 per cent), additional support for the tourism sector as well as incentives for the agriculture, fisheries and information technology sectors.

Financial measures ranged from loan payment holidays to soft loans. In March 2020, a 90-day moratorium on the repayment of bank loans for citizens and companies was announced. In May 2020, the central bank of Montenegro (CBCG) allowed a new 90-day moratorium for troubled borrowers and doubled its repurchase agreement line with the Bank for International Settlements to €100 million. In order to support banks' liquidity and lending potential, the CBCG reduced reserve requirement rates for banks by two percentage points (to 5.5 per cent for deposits with a maturity of less than one year and to a 4.5 per cent for deposits with a maturity longer than one year). In order to strengthen the capitalisation of banks, in April 2020 the central bank temporarily prohibited

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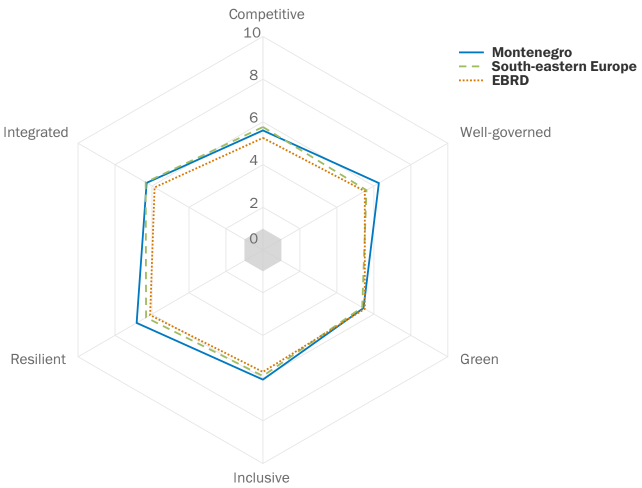
commercial banks from paying dividends to shareholders. In addition, the CBCG allowed banks to raise their exposure to a single entity beyond the regulatory limit of 25 per cent of the bank's own funds, under certain conditions. Lastly, a credit line has been opened by the state-run Investment-Development Fund, offering help to affected companies with soft loans of up to €3 million per beneficiary (two-year grace period, 1.5 per cent interest rate).

Assessment of transition qualities (1-10)



Structural reform developments

Government measures have been financed by the previous Eurobond issuance and external borrowing. The €500 million Eurobond issuance from September 2019 has helped the government secure a part of the budgetary funding need for 2020. The rest of the financing mainly comes from external borrowers. Among the rest, the government secured a €250 million syndicated loan from commercial banks with an €80 million World Bank guarantee in May 2020. In addition, the International Monetary Fund provided a €74 million loan under the Rapid Financing Instrument, the European Commission approved €60 million in macro-financial assistance, and further loans have been granted by other international financial institutions.

Montenegro opened the last negotiating chapter with the European Union (EU). The year 2020 saw the opening of the last remaining chapter of the EU accession negotiating framework, bringing the number of opened chapters to 33 in total. The focus will now be on closing the chapters — only three chapters have been provisionally closed since the opening of accession negotiations in June 2012. According to the council and European Commission (EC), further progress in negotiations will depend on meeting the interim benchmarks set in the rule-of-law chapters (23 and 24).

The government has provided support to some troubled sate-owned enterprises. In December 2019 *a lex specialis* on Montenegro Airlines was adopted, allowing the government to provide support to the national air carrier so that it could pay its debt. The Agency for the Protection of Competition was not able to assess the compliance of the law with state aid rules. According to the EC, this may have long-lasting negative effects on the perception of the regulatory environment and unfairness of the state as a regulator. As a consequence of Covid-19, Montenegro Airlines has accumulated losses worth several million euros since halting its operations in mid-March 2020.

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In May 2020, the government approved €0.5 million support to the company. In addition, in March 2020, it was announced that the government will take over debt worth €5.5 million from the state railway infrastructure operator ZICG and the railway transport operator ZPCG.

Works on transport infrastructure continue, with some delays. Due to Covid-19-related factors, the deadline for completing the first section of the Bar-Boljare highway has been changed from the end of September 2020 to June 2021. The construction of the 41-kilometre long first section is estimated to cost €895 million (or around 18 per cent of 2019 GDP).

Energy linkages and renewables are advancing. In November 2019, the 455-kilometre power link between Montenegro and Italy was launched, marking the completion of one of the largest investment projects in recent years. In August 2020 the state electricity company (EPCG) started a one-month overhaul of one of two main hydropower plants (the 307 MW Perucica). The works are part of EPCG's investments aiming to improve the safety and efficiency of its power plants and ensure the stable functioning of the power system in the country. In June 2020, EPCG signed a €54 million deal for the ecological revamp of the Pljevlja thermal power plant, which will allow it to keep operating in line with the Paris Agreement and the Green Deal. In December 2019, the government completed the acquisition of the Italian A2A company's shares in EPCG, raising its stake in EPCG to 88.6 per cent, and in February 2020, it launched the first CO_2 emissions trading scheme in the Western Balkans. Its decarbonisation agenda includes an extensive renewable investment plan for EPCG. In August 2020, the government signed a contract worth over €100 million for the construction of a 70 MW wind farm. The farm will be located in the coastal area and will produce 220 GWh of electricity per year.

MOROCCO

Highlights

- **The economy is contracting in 2020 as a result of the Covid-19 crisis and related containment measures.** Unemployment is growing, the fiscal deficit is widening and public debt is increasing, but inflation has remained low.
- **To combat the Covid-19 crisis, the authorities implemented a range of response measures.** A US$ 1 billion special fund was established, the government announced a programme to support micro, small and medium-sized enterprises (MSMEs) in certain sectors, and Bank Al-Maghrib extended credit lines guaranteed by the Central Guarantee Fund.
- **The government has advanced structural reforms.** A draft law on crowdfunding was submitted to parliament, a national programme for water was signed, a new strategy for the agricultural sector was launched and the government announced a fiscal stimulus package.

Key priorities for 2021

- **Reforms to achieve digital transformation are urgent in light of the Covid-19 crisis.** Measures are needed to promote the universal access to telecommunications and broadband networks and provide opportunities for the digital transformation of enterprises and administration. The focus should also be on e-government and digital and financial services access for small and medium-sized enterprises (SMEs) and entrepreneurs.
- **Measures to improve the banks' lending portfolios need to be prioritised.** The value of outstanding bank loans is rising, reflecting the government's efforts to ensure continued bank credit availability for borrowers and avert repayment difficulties during the Covid-19 crisis. The quality of banks' lending portfolios appears to be deteriorating, and, coupled with the rising cost of risk for banks, this suggests that systemic stresses in the banking sector need to be mitigated.
- **There is a need to promote trade integration and global value chains.** This would be achieved through removing current impediments to trade integration, boosting trade agreements with the European Union, sub-Saharan Africa and the Arab Maghreb Union, and defining appropriate policies and support to global value chains.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	1.0	4.2	3.0	2.2	-5.0
Inflation (average)	1.5	0.7	1.8	0.2	0.7
Government balance/GDP	-4.5	-3.5	-3.7	-4.1	-7.8
Current account balance/GDP	-4.1	-3.4	-5.3	-4.1	-7.3
Net FDI/GDP [neg. sign = inflows]	-1.5	-1.5	-2.4	-0.5	-0.1
External debt/GDP	33.7	35.0	32.1	33.1	n.a.
Gross reserves/GDP	24.3	23.9	20.7	22.3	n.a.
Credit to private sector/GDP	62.5	61.6	60.9	62.4	n.a.

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Covid-19: macroeconomic implications

The economy is contracting as a result of the Covid-19 crisis and related containment measures. Stagnant growth in the first quarter of 2020 was followed by a 13.8 per cent contraction year-on-year in the second quarter. The main sectors affected by the lockdown were retail, tourism, restaurants and construction. The agriculture sector continued to contract because of a drought during the early planting season. Unemployment increased substantially to 12.3 per cent in the second quarter of 2020, but annual inflation remained low at 0.6 per cent on average in the first nine months of 2020, due to a drop in the prices of food and transport.

The fiscal deficit is widening, reflecting the fallout from the Covid-19 crisis. The deficit is expected to reach 7.8 per cent of GDP in 2020, compared with 4.1 per cent in 2019. Both tax and non-tax revenues are decreasing, the result of the disruption of economic activity from the lockdown in key sectors. Meanwhile, fiscal stimulus packages are increasing expenditures, although many of the measures were financed by voluntary donations. Moreover, public debt is expected to increase to 75 per cent of GDP at the end of 2020, and to account for 90 per cent of GDP when including guaranteed debt for public economic agents.

Both imports and exports have fallen, and tourism and remittances are also down. Lower demand for consumption and investment reduced imports in the first half of the year (except food products, which increased because of the drought). Exports also declined, mainly those from the agricultural, agribusiness and automotive sectors, which in recent years were Morocco's largest exports. The most negative economic effects of Covid-19 are the decline in tourism receipts and the fall in remittances. Nevertheless, international reserves increased to US$ 32.0 billion in October 2020, covering over 10 months of imports. Relying on its large reserves, which provide stability to the exchange rate, Bank Al-Maghrib (the central bank) broadened the dirham's fluctuation band in March 2020 to +/- 5 per cent (from +/- 2.5 per cent), and cut interest rates by a cumulative 75 basis points in March and June 2020 in response to the Covid-19 crisis.

The contraction in GDP in 2020 will likely be followed by a robust recovery in 2021. We expect GDP to contract by 5.0 per cent in 2020, before rebounding to 3.5 per cent growth in 2021. The recovery in 2021 may be helped by an expansion in mining, as the decline in China's production of phosphate may benefit Morocco, the world's second-largest producer of this substance. Downside risks include rising social discontent, a slower-than-expected recovery in the main trading partners in Europe, and the continued vulnerability of agricultural production to adverse weather and fluctuations in agricultural commodity prices.

Policy response to Covid-19

To combat the Covid-19 crisis, the authorities implemented a range of response measures. A US$1 billion special fund, financed by the government and by tax-deductible voluntary contributions from public and private entities, was established in March 2020 to cover the costs of upgrading medical facilities and support businesses and households. The government also announced a programme to support MSMEs who manufacture medical products and equipment with up to 30 per cent refunds. Meanwhile, to reduce volatility on the market, the Bank Al-Maghrib called on credit institutions to suspend all distribution of dividends or shareholder profits for the 2019 financial year and reduced the maximum variation thresholds applicable to financial instruments listed on the Casablanca Stock Exchange. Moreover, it created a banking credit line to finance businesses' operational expenses, guaranteed by the Central Guarantee Fund, and tripled the refinancing capacity of banks with Bank Al-Maghrib by providing dirham and foreign exchange liquidity, widening the scope of securities accepted for bank refinancing and extending the duration of loans.

A new fiscal stimulus package is in place. In July 2020 the government announced a MAD 120 billion (US$ 13 billion, 11 per cent of GDP) fiscal stimulus package. The bulk of the package will consist of state-guaranteed bank loans to businesses, including public-sector enterprises. The remaining part will take the form of a strategic investment fund that will finance public-private partnership infrastructure projects. One-third of the total value of the fund will be financed directly from the state budget, while the remaining amount is to be raised from domestic and international institutional investors.

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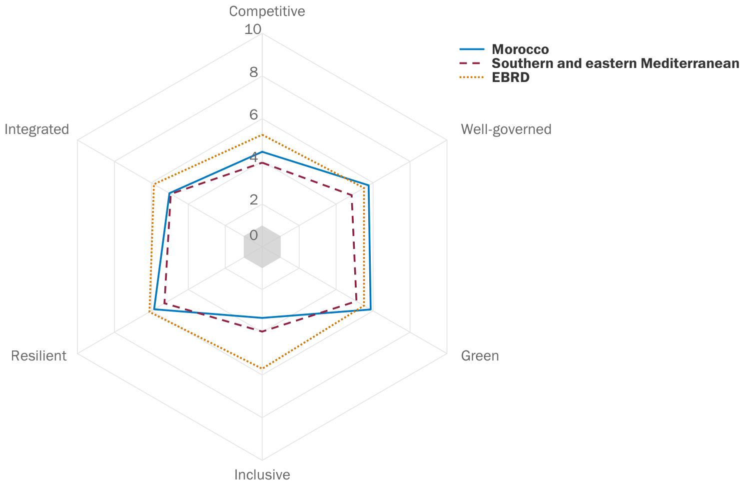
Assessment of transition qualities (1-10)



Structural reform developments

A draft law on the establishment of electronic crowdfunding platforms has been prepared. The new law was submitted to parliament in November 2019. The law, which has been in development since 2017, would allow large numbers of people to finance projects in small increments and allows platform operators to facilitate three different types of crowdfunding transactions: loans, equity investments and donations. The legislation would bolster the availability of financing for micro and small businesses in particular, as well as helping to bring funds from Moroccans living abroad into the national economy. Moreover, this move to introduce crowdfunding comes against a backdrop of wider efforts to boost financial inclusion.

The government fully drew down the US$ 3 billion IMF Precautionary and Liquidity Line (PLL) in April 2020. This is the first time the authorities are drawing on funds available under their fourth consecutive two-year PLL since 2012. The funds were used to maintain an adequate level of official reserves and mitigate pressures on the balance of payments stemming from the economic impact of the Covid-19 crisis.

The preparation of a new development model has been delayed. In December 2019, the King formed a commission, headed by a former interior minister and ambassador to France and comprising 35 members, responsible for designing a new model of socioeconomic development. It consists of a combination of senior political figures, business and public-sector representatives, economists and other specialists and academics, members of civil society organisations, public intellectuals and journalists. Recent signs of socioeconomic and political discontent, as well as the anaemic medium-term economic performance, spurred the need for a new development model. Given the Covid-19 crisis and related measures, the commission has yet to deliver its conclusions and recommendations.

The Green Generation 2020-2030 strategy was launched in February 2020. The new strategy for the agricultural sector aims to create jobs, promote income-generating activities in rural areas, support the agricultural middle class and bolster farming exports and agricultural production, and is based on two pillars. First, it aims to enhance the human element, by promoting the emergence of a new generation of agricultural middle class (some 400,000 households). Second, it encourages young entrepreneurs, through the development of one million hectares of collective land and the creation of 350,000 jobs for the benefit of young people. The new strategy builds on achievements accomplished by the Green Morocco Plan (Plan Maroc Vert), which was launched in 2008 and boosted agricultural exports and investments, created jobs, improved the resilience of agriculture against droughts and contributed to the expansion of SMEs in the agribusiness sector.

NORTH MACEDONIA

Highlights

- **The economy has entered recession in 2020.** After expanding by 3.6 per cent in 2019, GDP is falling sharply as a result of the Covid-19 pandemic, with industry, trade, transport and tourism being particularly affected.
- **Sizeable and targeted support packages are mitigating the impact of the crisis.** The government is supporting individuals and companies, and protecting employment and poor households through targeted measures including temporary payments of minimum wages in coronavirus-affected companies and loan repayment holidays.
- **The country has stepped up its green economy transition.** A comprehensive law on energy efficiency in line with EU directives has been adopted, and the government is seeking investors to transform an abandoned coal mine into a 100 MW solar park.

Key priorities for 2021

- **Raising the level and quality of public investment is key to increasing productivity and economic convergence.** There are still significant infrastructure and private sector productivity gaps that could be narrowed through higher public investments in transport, energy, education and sustainable environmental infrastructure (for example, water and wastewater treatment, and solid waste management), along with improved planning and implementation.
- **Fiscal sustainability should be prioritised as the short-term crisis response measures expire.** The government should create fiscal buffers, raise the efficiency of tax collection and execute capital expenditures in a timely manner. An enhanced fiscal governance framework would strongly support debt sustainability.
- **Better quality of education is needed to reduce skills mismatches in the labour market.** The persistently high level of youth unemployment indicates that the education system does not meet the needs of businesses. Ongoing reforms in education, if stepped up, can help improve the situation.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.8	1.1.	2.7	3.6	-5.0
Inflation (average)	-0.2	1.4	1.5	0.8	0.9
Government balance/GDP	-2.7	-2.7	-1.8	-2.0	-7.5
Current account balance/GDP	-2.9	-1.0	-0.1	-3.3	-4.5
Net FDI/GDP [neg. sign = inflows]	-3.3	-1.8	-5.6	-3.2	-1.5
External debt/GDP	74.7	73.4	73.3	71.9	n.a.
Gross reserves/GDP	27.1	23.3	26.8	28.8	n.a.
Credit to private sector/GDP	49.0	49.9	50.5	50.9	n.a.

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Covid-19: macroeconomic implications

Economic recovery has been halted by the pandemic. Growth of 3.6 per cent in 2019 was driven mainly by domestic demand, while exports were also robust, growing by 9 per cent, although offset by similar growth in imports. In the first half of 2020 GDP declined by 6.4 per cent year-on-year, with sharply falling activity in industry and trade, transport and tourism. On the expenditure side, only government consumption recorded growth, while private consumption, investments, exports and imports all contracted strongly. Unemployment increased slightly in the second quarter of 2020, to 16.7 per cent, reflecting the impact of the pandemic on the economy, but youth unemployment continued to decline, albeit remaining high at 33.8 per cent. Year-on-year inflation remains low at 0.7 per cent in January to July 2020.

Fiscal deficits and public debt are rising. After a marginal increase in 2019, to 2.0 per cent of GDP, the general government deficit is expected to reach close to 7 per cent of GDP in 2020 due to the combination of falling GDP and revenues and rising costs as a result of the measures adopted to mitigate the effects of the crisis. Lockdown measures and lower external demand have reduced economic activity, resulting in revenue shortfalls, while current spending on health, economic subsidies and social transfers are higher than budgeted, and only partially offset by lower capital expenditure. General government debt is increasing significantly in 2020. In June 2020, general government debt stood at 50.7 per cent of GDP (10.5 percentage points higher than at the end of 2019), while the guaranteed debt accounted for another 8.4 per cent of GDP. Financing for the crisis response measures is mostly external, including funding from the International Monetary Fund (IMF), the European Union (EU), international financial institutions and a €700 million Eurobond issuance in May 2020.

After recession in 2020, a recovery is expected in 2021. GDP is projected to drop by 5.0 per cent in 2020 and recover by 3.0 per cent in 2021. However, risks to the projection are weighted to the downside, and any recovery will be much more protracted if the pandemic persists, both in North Macedonia and among its main trading partners.

Policy response to Covid-19

Four economic packages were introduced to lessen the negative impact of the crisis. The total size of the packages was above €1 billion (around 9.0 per cent of GDP). The first two sets of actions, implemented between March and May 2020, mitigated the impact of the crisis on the economy and the population, while the third package focused on economic recovery and incentivising consumption and industrial production, starting from May 2020. Measures adopted included: the government paying minimum wages of workers between April and June in coronavirus-affected companies and subsidising 50 per cent of social contributions; exempting from tax advances firms and the self-employed until July 2020; providing interest-free loans (€3,000 to €90,000 per company, six-month grace period and two-year repayment period) and soft loans (at a 1.5 per cent interest rate) through the Development Bank of North Macedonia and commercial banks to companies; and increasing value-added tax (VAT) refunds for buying domestic products. The fourth package, adopted in late October 2020, introduced some novelties such as payment cards for vulnerable citizens and a reduction of VAT on the products and services of artisans and restaurants. The central bank has cut its policy rate three times so far in 2020 (from 2.25 to 1.5 per cent). It has also allowed banks to change loan terms faster and through more straightforward procedures, and it extended the time to classify a loan as non-performing from 90 to 150 days by the end of September 2020. In addition, the central bank has set up a €400 million repurchase agreement line with the European Central Bank to provide euro-denominated liquidity to the country's financial sector. The line is to stay in place at least until June 2021.

International institutions are helping to finance the additional costs due to the pandemic. Macro-Financial Assistance from the EU amounted to €160 million, while the IMF's Rapid Financing Instrument was €176.5 million. Other international organisations and some countries also offered financial support to the country.

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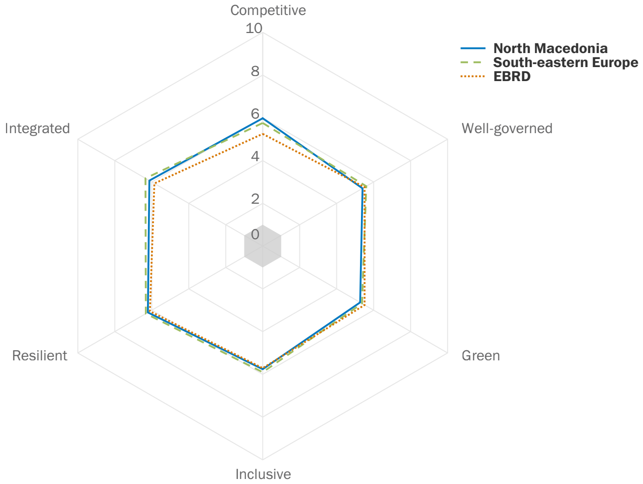
Assessment of transition qualities (1-10)



Structural reform developments

The European Council decided to open EU accession negotiations with North Macedonia. In March 2020 the European Council decided to open accession negotiations in light of the progress achieved in comprehensive reforms and the fulfilment of the conditions identified by the June 2018 Council. It invited the European Commission to prepare the framework for the negotiations, reflecting on the revised methodology (enhanced approach) of the accession process adopted by the council on the same day. Once the council adopts the negotiating framework, this should be followed "as soon as possible" by the first intergovernmental conference (the formal start of the negotiations). The European Commission presented to member states a draft of the negotiating framework on 1 July 2020.

Implementation of the law on inspection supervision has advanced. The law, adopted in May 2019, aims to streamline the inspection procedure and make it more business friendly, including through warnings for minor breaches, and it provides grace periods for corrective actions. The law entered into force at the end of 2019 and the Inspection Council has in the meantime overseen the completion of checklists and risk-based inspection methodologies for each Inspectorate. This will create the conditions for more transparent and less intrusive inspections for legal businesses. The full implementation of the law, including proper procedural rules, may significantly enhance the quality of the business environment.

The authorities have taken some steps towards improving the energy mix. To diversify the country's energy mix away from coal, increase the share of renewables and fight air pollution, North Macedonia has initiated plans to develop a solar park on the site of an abandoned coal mine in the western part of the country. In February 2020 the government launched a public tender for investors to construct two photovoltaic units of up to 100 MW in total. In the same month, the country also adopted a comprehensive Law on Energy Efficiency, transposing the relevant EU directives.

The banking sector has remained resilient. At the end of March 2020, liquid assets of the banking sector made up around 30 per cent of total assets, while capital adequacy was at 16.5 per cent, exceeding the regulatory minimum. Lending growth picked up from 5.8 per cent year-on-year in March 2020 to 8.2 per cent in July, on the back of faster lending to the corporate sector. Non-performing loans (NPLs) have declined from 5.4 per cent in June 2019 to 4.7 per cent in March 2020, but may increase as the measure allowing banks to extend the time to classify a loan as an NPL from 90 to 150 days expires at the end of September. Foreign currency (euro) lending has stayed high, at over 40 per cent of total lending in July 2020. In August 2020 the central bank revoked the licence of a small bank without any systemic impact on the sector.

POLAND

Highlights

- **Poland entered a recession in 2020.** Nevertheless, the drop in economic activity in the first half of 2020 turned out to be less severe than anticipated by most forecasters.
- **Several anti-crisis measures have been introduced to fight the negative impact of the pandemic.** The estimated value of the measures exceeds 15 per cent of GDP, including guarantees, to support employment, businesses and the healthcare sector.
- **The central bank launched its first quantitative easing (QE) programme.** The National Bank of Poland has been buying treasury bonds and government-guaranteed debt instruments on the secondary markets.

Key priorities for 2021

- **Tapping the EU recovery fund and implementing the Just Transition initiative can support Poland's green economy transition.** Investment in digitalisation and green technologies can boost the post-recession recovery. This also includes investing in human capital and reskilling the workforce in the most polluting sectors, such as electricity production from coal.
- **Further business environment reforms are needed to attract investment.** The pandemic-driven restructuring of production locations of multinationals constitutes an opportunity for Poland, especially for enhanced usage of modern smart technologies and automation.
- **Policies that enhance inclusivity should be strengthened.** A diverse workforce can improve the bottom line of a business, lead to happier and more productive teams and drive innovation among employees. Any discriminatory language and measures, for example regarding sexual orientation, by the central and local governments will likely play against that.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.1	4.9	5.3	4.5	-3.5
Inflation (average)	-0.2	1.6	1.2	2.1	3.3
Government balance/GDP	-2.4	-1.5	-0.2	-0.7	-10.5
Current account balance/GDP	-0.8	-0.3	-1.3	0.5	3.0
Net FDI/GDP [neg. sign = inflows]	-0.9	-1.4	-2.6	-1.6	-0.5
External debt/GDP	76.4	67.0	63.8	58.8	n.a.
Gross reserves/GDP	24.3	21.4	19.9	21.7	n.a.
Credit to private sector/GDP	52.4	52.1	50.9	50.6	n.a.

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Covid-19: macroeconomic implications

The Covid-19 outbreak and resulting restrictions pushed the economy into recession. GDP growth had continued strongly in 2019 at 4.5 per cent but the outbreak of the coronavirus pandemic and the imposed administrative lockdown caused GDP to fall in the first half of 2020, by 3.2 per cent year-on-year, pushing the economy into recession for the first time since early transition. While Poland is highly integrated into global value chains and has a large exposure to trade, it still managed to show a positive net export contribution to growth in the first half of 2020. The Labour Force Survey unemployment rate remained stable, reaching 3.1 per cent in August 2020, helped by companies retaining employees thanks to the support measures introduced by the government.

Investment remains subdued. The investment-to-GDP ratio, which reached 18.5 per cent in 2019, has continued to be the lowest in central Europe and the Baltic states and has fallen during the first half of 2020. The investment growth rate in this period was down by 6.0 per cent year-on-year, and outlays on means of transport dropped by 24.6 per cent. According to various surveys referenced by the National Bank of Poland's July 2020 report on the conditions of enterprises in Poland, 80 per cent of companies were planning to reduce investments and 75 per cent of small and medium-sized enterprises (SMEs) had not planned any investments during the 2020 summer months.

Public finances have deteriorated. The deterioration of the general government balance in 2020 stems mainly from the new measures undertaken by the government in response to the Covid-19 pandemic and the macroeconomic slowdown. According to the International Monetary Fund's October 2020 estimates, the general government deficit is expected to rise to 10.5 per cent of GDP in 2020, before falling to a deficit of 4.3 per cent of GDP in 2021 as the economy rebounds. At the same time, gross public debt is expected to reach an historic high of 60 per cent of GDP by the end of 2020 and rise further in 2021.

A recovery is expected in 2021 but significant risks remain. The domestic market has proved to be relatively resilient to the effects of Covid-19, but the magnitude of the recovery will depend largely on external factors next year. We anticipate GDP will fall by 3.5 per cent in 2020, and rise by 3.0 per cent in 2021. Key risks to the forecast refer to the direction and magnitude of the development of the pandemic. No severe country-wide lockdowns are expected, although the financial capability of the state to offset any potential local and temporary closures of businesses remains limited. The unemployment rate is likely to rise, weighing somewhat on the recovery of household consumption.

Policy response to Covid-19

The Covid-19 pandemic-related restrictions triggered rapid crisis protective measures. At the beginning of March 2020 the government put in place strict containment measures, including a shutdown of businesses and schools, causing a sharp reduction in economic activities. As a result, the government and the National Bank of Poland launched various relief measures to preserve employment, support companies in a state of hibernation and support household incomes – all designed to dampen the effects of the pandemic. While the majority of restrictions were gradually lifted from May 2020, including those on international travel, some were re-imposed in the third quarter of 2020 on a regional basis where a surge of new cases became evident.

A series of anti-crisis measures have been introduced. In March 2020 the president signed the first of the anti-crisis shields into law, worth about 10 per cent of GDP and comprising dozens of measures to support employment, companies and the healthcare sector, and widen the competences of the state-run Polish Development Fund (PFR). The announced measures include furloughs and preferred loans (with a grant option) for companies with a decline in turnover due to Covid-19 that maintain employment, social security breaks for micro enterprises and reductions for small companies, and cash stipends for the self-employed. The crisis legislation was extended in April to include a PLN 100 billion (about 4.5 per cent of GDP, €23 billion) liquidity scheme, called "the PFR financial shield for companies and employees", managed by the PFR. The scheme includes loans to micro companies, SMEs and large firms, of which some 75 per cent are in the form of grants. Guarantees mostly come from the Polish Development Bank (BGK), announced

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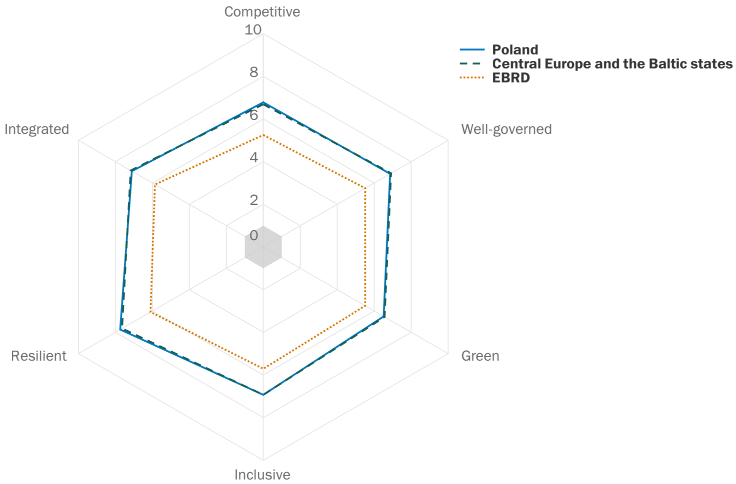
at PLN 100 billion (€23 billion). In June 2020 the president signed into law "anti-crisis shield 4.0", which includes subsidised interest rates on bank loans, support for local government finances, protection for Polish firms from takeover by investors outside the EU, credit holidays and extended care allowances. Financing of the BGK and PFR programmes has been mostly provided through bond placements, also acquired in the secondary market by the central bank through its QE programme. The ultimate value of the anti-crisis measures may differ from the announced figures, in line with policy changes and emerging financial needs.

Assessment of transition qualities (1-10)



Structural reform developments

The government introduced a two-year voucher programme to support the tourism sector. In July 2020 parliament approved a bill to give families tourism vouchers worth PLN 500 (€115) per child, in a programme that will cost an estimated PLN 4.0 billion (€0.9 billion). About 6.5 million Poles are eligible to receive the vouchers, and disabled children receive an additional PLN 500 each. Initial take-up of the programme was slow. However, its fully electronic form should contribute to digital inclusion and take-up of the e-government services. The tourism sector in Poland normally accounts for about 5 per cent of GDP.

The central bank launched its first QE programme. The National Bank of Poland (NBP) started its first QE programme, announced in mid-March 2020, through buying treasury bonds and, since April 2020, government-guaranteed debt instruments on the secondary markets from banks. The ultimate size of the QE was not announced. In addition, through its three rate cuts, the reference rate went down to an historically low rate of 0.1 per cent in May 2020 (from 1.5 per cent in March). The NBP has also conducted repurchase agreement operations to extend liquidity to banks. Other measures introduced by the NBP include bill discount credit aimed at refinancing bank loans granted to enterprises. Furthermore, the Minister of Finance, based on the recommendation of the Financial Stability Committee (KSF), fully released the systemic risk buffer (from 3 per cent to zero).

More EU funds became available to fight the impact of the pandemic, but some funds have been blocked. In July 2020 the European Commission (EC) approved the redirection of about €2.2 billion from cohesion funds to anti-pandemic measures, especially to support SMEs, to enable the remuneration of professions at risk in healthcare, and to purchase medical equipment. The upcoming 2021-27 EU funds will consist of two pillars: the regular multiannual financial framework (MFF) and an extraordinary Covid-19 recovery fund. Poland is expected to receive €139 billion as grants and €34 billion as loans. In July 2020, however, the EC blocked some payments (a total of less than €0.2 million) to six municipalities which had announced themselves as "LGBT-free zones". In September 2020 the European Parliament adopted a resolution that, among others, expresses concerns regarding fundamental rights in Poland.

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Disagreement raised by judicial reform has remained unresolved. The EC and the Polish government have continued to engage in a rule-of-law dialogue within the framework of the Article 7(1) procedure of the Treaty on European Union triggered by the EC in December 2017. On 29 April 2020 the EC launched its fourth infringement procedure against Poland, this time regarding the new law on the judiciary, which was adopted in December 2019 and entered into force in February 2020. The EC concluded that several elements of the new law undermined the judicial independence of Polish judges and violated EU law. On 8 April 2020 the European Court of Justice (ECJ) ruled that Poland must suspend the application of the law until the ECJ's final judgment.

ROMANIA

Highlights

- **The economy is being hit hard by the coronavirus crisis.** GDP grew by a robust 4.2 per cent in 2019, but the economy is experiencing a sharp recession in 2020 with the export-dependent manufacturing sector being severely affected.
- **The government has introduced a support package similar to those in other peer countries, although somewhat smaller.** Adopted measures include employment support schemes, as well as loan guarantees to small and medium-sized enterprises (SMEs), on top of fiscal relief measures.
- **Structural reforms have been hampered by parliamentary fragmentation and the Covid-19 crisis.** Not only has there been limited progress in reforms, but there have also been some reversals in the past year, including in the areas of privatisation and the banking sector.

Key priorities for 2021

- **Further actions to strengthen good governance should be undertaken.** Public administration and governance reform, and improvements in policymaking processes, including through digitisation, and in strengthening corporate governance of state-owned enterprises, should remain priorities.
- **Investments in infrastructure should be stepped up.** Given significant infrastructure gaps, the positive trend of public capital spending in the past year should continue. Ensuring administrative capacity, including for absorbing the allocated European Union (EU) funds, is critical.
- **Medium-term fiscal sustainability is important for the country's further transition.** The additional crisis-related fiscal stimulus in 2020 and curbed revenues, on top of an already unbalanced budget, will require the authorities to devise a medium-term fiscal strategy to reduce the deficit.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	4.7	7.3	4.5	4.2	-5.0
Inflation (average)	-1.1	1.1	4.1	3.9	2.5
Government balance/GDP	-2.6	-2.6	-2.9	-4.3	-9.2
Current account balance/GDP	-1.4	-2.8	-4.4	-4.6	-5.3
Net FDI/GDP [neg. sign = inflows]	-2.6	-2.6	-2.4	-2.4	-1.2
External debt/GDP	52.0	55.4	49.1	48.5	n.a.
Gross reserves/GDP	21.2	20.7	17.3	16.6	n.a.
Credit to private sector/GDP	28.1	26.3	25.6	24.7	n.a.

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Covid-19: macroeconomic implications

Romania is being severely affected by the coronavirus crisis. After robust growth of 4.2 per cent in 2019, on the back of expanding domestic demand, Romania is experiencing a recession in 2020. Key transmission channels are lower consumption and a drop in exports. A domestic lockdown and state of emergency were introduced in mid-March 2020, lasting until mid-May and severely affecting travel, economic activity and consumer and business sentiment. The lockdown heavily affected private consumption: retail sales dropped by almost one-fifth in April on a year-on-year basis, although some recovery has taken place in the following months. Industrial production collapsed in April by almost 40 per cent year-on-year, causing, among other things, exports of goods to drop. GDP fell in the first half of 2020 by 4.6 per cent year-on-year, with private consumption expenditure falling by 5 per cent and exports by 15 per cent. The unemployment rate has risen to 5.4 per cent in July 2020 (up from 3.7 per cent in January 2020), with further job losses likely in the coming months, as government support schemes are phased out. Inflation has picked up to 2.2 per cent year-on-year in June, which is within the central bank's target of 2.5 per cent +/- 1 percentage point.

The fiscal position has deteriorated further, requiring a budget revision. Romania entered the Covid-19 crisis with a significant fiscal deficit (4.3 per cent of GDP in 2019). The combination of a declining economy and revenues, a fiscal stimulus programme amounting to around 4 per cent of GDP, and another increase in pensions (on top of that in 2019) in September 2020, is expected to raise the fiscal deficit in 2020 to an estimated 8.6 per cent of GDP, as per the August 2020 revised budget. However, market access to funding on favourable terms remains strong. Romania still has a relatively moderate level of public debt of 35 per cent at the end of 2019, which is another mitigating factor, although this ratio is rapidly increasing. Because of the widening budget deficit, Fitch and Moody's downgraded their outlook on Romania's sovereign credit rating to negative in April 2020, but the country remains in investment-grade territory with all of the main credit ratings agencies.

The National Bank of Romania (NBR) has reacted promptly to loosen monetary policy. In a first reaction to the pandemic, the NBR reduced the monetary policy rate by a total of 1 percentage point to 1.5 per cent through three cuts (the latest in August 2020), and narrowed the related interest rates corridor to ±0.5 percentage points from ±1.0 percentage points, thus lowering further the lending facility rate. It also provided liquidity to credit institutions via repo transactions (repurchase of government securities). The NBR has also agreed with the European Central Bank to establish a repo (repurchase agreement) line for euro liquidity of up to €4.5 billion, to address possible euro liquidity needs in the event of market failures, in exchange for high-quality euro-denominated collateral. The repo line was first meant to be in place until the end of 2020, but in late August was renewed until 30 June 2021. The NBR also intervened in the foreign exchange markets to stabilise the Romanian leu-euro rate, given the high depreciation pressures.

Economic performance is expected to recover in 2021. Currently we forecast GDP to drop in 2020 by 5 per cent but rebound in 2021 by 3 per cent. The recovery is contingent on a gradual normalisation of economic activity in both Romania and its main economic partners, and a resumption of structural reforms. However, this would be hard to achieve should other major Covid-19 outbreaks emerge later in 2020 or early 2021.

Policy response to Covid-19

The government intervened to support liquidity and preserve jobs. The announced fiscal package in March 2020 of about 3 to 4 per cent of GDP includes: (i) additional funds for the healthcare system; (ii) partial coverage of wages for individuals who are technically unemployed (up to 75 per cent of the average gross wage), as well as for parents staying at home; and (iii) guarantees for supporting lending to SMEs, and a separate mechanism for large companies. Other measures include a deferral of loan payments for both firms and citizens of up to nine months (until the end of 2020), faster reimbursement of value-added tax, suspending foreclosures on overdue debtors, and postponement of property tax by three months. In June 2020 the government introduced a temporary measure to cover up to 45 per cent of the average gross wages for employees who return to work from technical unemployment, while firms employing people over 50 or under 30 years of age will receive subsidies of up to RON 2,500 (€515) per month for a year. In addition, a *Kurzarbeit*

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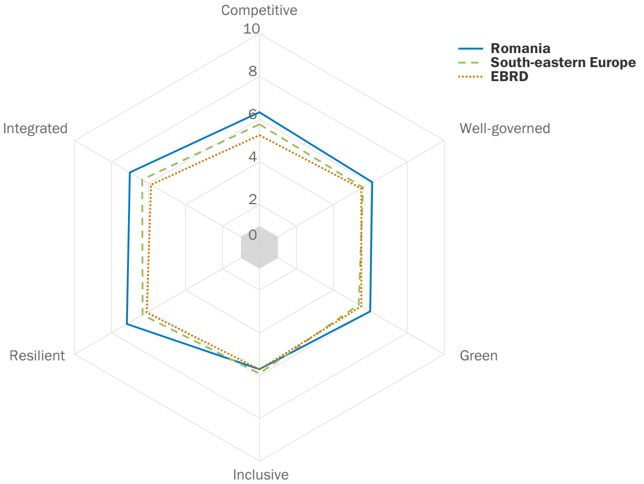
scheme, where the employer pays part of the wage proportional to the work hours, and the state tops up the payments to employees up to 75 per cent, was approved by the government. The government has also further relaxed procedures to smooth state-guaranteed loans to SMEs, under the IMM Invest programme, with the aim of accelerating the processing of loan requests. On top of the state-guaranteed lending from banks, the government decided also to directly finance SMEs from unused EU funds.

Assessment of transition qualities (1-10)



Structural reform developments

The government has unveiled an Economic Relaunch Plan focused primarily on public investments. In July 2020 the government unveiled the National Investment and Economic Relaunch Plan, which includes €100 billion worth of public investments and improved social protection over the next 10 years. The government envisions setting up a sovereign investment fund and a national promotional bank as the institutions in charge of implementing the plan. Investments in transport infrastructure remain a priority, but the plan also includes financial support to companies and sizeable state aid to greenfield investments that will contribute to regional development. The overall aim of the plan is to raise the country's GDP per capita, at purchasing power parity, to 87 per cent of the EU average by 2025, from the current 69 per cent.

Progress under the EU's Cooperation and Verification Mechanism (CVM) continues to be uneven. The latest CVM report, published in October 2019, noted reversals on Romania's progress in the areas of the rule of law and the fight against corruption. However, the European Commission welcomed the fact that the new government expressed a wish to reset the approach.

FTSE Russell has upgraded Romania's equity market to (Secondary) Emerging market status. The upgrade is effective from September 2020. This is a significant change and should have a positive impact on market development, investor sentiment and overall investment inflows. This move could give a boost to the privatisation process for state-owned enterprises, which has stalled and even reversed in the past year (see below). More recently, Nuclearelectrica and Banca Transilvania met the FTSE Global All Cap Index eligibility requirements as of the end of June 2020.

A new law temporarily freezing the sale of state assets has been adopted. Initiated by the opposition, the "Bill on certain measures to protect national interests in the economic sector" (or "anti-privatisation law") was passed by parliament in June 2020. It bans any sale of state-owned assets for two years, as well as stalling current privatisation procedures. The intention of the law was to postpone the privatisation for the period after the Covid-19 crisis, as those backing the law claimed that sales carried out now (or in the near future) would be at low prices because of the effects of the crisis. The government appealed the bill and the Constitutional Court is expected to review it.

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Several bills targeting consumer credit, with a potential negative impact on the banking sector, have been adopted. One bill, approved by parliament in May 2020, sets interest rate caps on mortgage and consumer loans. The law states that in the case of mortgage loans, the effective interest rate cannot exceed the policy rate by more than 2 percentage points, and in the case of consumer loans by more than 15 percentage points. The Giving in Payment Law, also adopted in May 2020, allows a debtor to be discharged of any obligations towards their creditor by handing over the property subject to the mortgage loan. Another new law is aimed at limiting the value of claims that can be recovered in the case of banks selling a claim to a distressed credit manager. On a more positive note, the bank tax on total assets introduced in December 2018 by Government Emergency Ordinance 114/2018, was removed, effective from the beginning of 2020.

RUSSIA

Highlights

- **The Covid-19 pandemic has dealt a serious blow to the economy.** The collapse of the price of oil, which accounts for a major share of Russia's exports, has exacerbated the situation.
- **Russia's strong macroeconomic situation entering the crisis has helped to limit the damage.** Several years of conservative macroeconomic policies to protect the economy in the face of international sanctions mean it is well placed to weather external shocks.
- **A comprehensive recovery plan is being implemented.** The plan includes a range of measures to strengthen the health system, support households, small and medium-sized enterprises (SMEs) and large-scale investments. However, the timetable for broader, medium-term national development goals and projects has been extended.

Key priorities for 2021

- **Efforts to diversify away from commodity exports should be intensified.** A renewed focus is needed on investing in technology and digitisation of the economy in order to improve the competitiveness of non-military sectors, such as manufacturing, agriculture and services.
- **Further reforms to improve the business environment are needed.** Priorities include reducing the state's role in the economy, addressing physical infrastructure gaps and implementing business-friendly measures to enhance private-sector competitiveness.
- **Planned public investments need to be well targeted to contribute to growth.** The delayed timetable for the National Projects partly reflects challenges in implementation. In this regard, key priorities include coordination among public institutions and inclusion of stakeholders in the planning and implementation phases of public investments.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	0.2	1.8	2.5	1.3	-4.5
Inflation (average)	7.1	3.7	2.9	4.5	3.2
Government balance/GDP	-3.7	-1.5	2.9	1.9	-3.5
Current account balance/GDP	1.9	2.0	6.9	3.8	1.2
Net FDI/GDP [neg. sign = inflows]	-0.8	0.5	1.4	-0.6	0.0
External debt/GDP	40.1	32.9	27.3	28.9	n.a.
Gross reserves/GDP	29.5	27.5	28.1	32.7	n.a.
Credit to private sector/GDP	53.1	52.1	50.9	52.4	n.a.

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Covid-19: macroeconomic implications

Before the Covid-19 pandemic, the Russian economy was in a relatively strong position. At the end of the first quarter of 2020 the trade, current and fiscal accounts were all in surplus, and inflation was at an historical (post-Soviet) low. This was largely thanks to several years of conservative macroeconomic policies, including an overhaul of the budget, which gave rise to a much lower breakeven oil price of US$ 42.45 per barrel, the introduction of a fiscal rule that helped lower the rouble's sensitivity to oil price fluctuations, and the adoption of a flexible exchange rate. In early 2020 the government announced a RUB 2.1 trillion (US$ 27 billion) social spending package to support real incomes. It also pledged to push the 12 National Projects, a US$ 400 billion investment aimed at modernising and revitalising Russian society, the implementation of which had been behind schedule.

The Covid-19 pandemic hit both the supply and demand side of the economy. The global nature of the crisis led to a plunge in the prices of oil and gas, key exports for Russia. The main effects of these shocks were a drop in consumption, driven by a two-month lockdown of the entire economy, a significant fall in external demand for commodity exports, and supply chain bottlenecks. The economy contracted by 8.0 per cent year-on-year in the second quarter of 2020, but activity started to pick up again in the third quarter, as did oil and gas prices.

Foreign reserves have increased despite the economic downturn. By September 2020 the level of reserves exceeded US$ 600 billion. This contrasts sharply with previous crises, and can largely be explained by the flexibility of the exchange rate. Although the cost of the recovery plan has turned the budget surplus into a deficit, this has been funded by profit received by the central bank of Russia (CBR) from the sale of Sberbank shares and the placement of domestic rouble debt. The government has not so far needed to tap the National Wealth Fund (NWF), which stood at US$ 176 billion as of September 2020.

A recovery is expected in 2021. Overall, the economy is expected to shrink by 4.5 per cent in 2020, followed by a rebound of 3.0 per cent in 2021. This forecast is subject to significant upside and downside risks, depending on the path of oil prices, the possibility of a second wave of the pandemic, and the outcome of several geopolitical issues.

Policy response to Covid-19

A comprehensive recovery plan is in place. The National Plan for Economic Recovery, adopted in June 2020, is the government's programme to help the economy recover after the Covid-19 shock subsides and oil prices increase. It runs for 18 months, costs RUB 6.4 trillion (US$ 83 billion) and consists of 500 programmes. Some of these programmes overlap with the National Projects. Combined with measures introduced to address the immediate impact of Covid-19, this makes a total of RUB 7.2 trillion (US$ 93 billion) of support, or 7 per cent of GDP. Of this, RUB 5 trillion (US$ 65 billion) is budgetary funds (spending and missing revenues) and RUB 2.2 trillion (US$ 28 billion) is reserved for infrastructure investment. The funds foresee social support, of which the prime goal is to stabilise income trends, increase employment and liberalise and deregulate labour relations. A special section targets SMEs via offers of tax relief, grants and subsidies. There is also a section covering investment, the digital economy and import substitution, largely repeating what was in the National Projects goals.

Large investment projects remain a key part of the recovery and development plan. Once the impact of Covid-19 subsides, the heart of the government's structural reform programme remains the US$ 400 billion National Projects scheme, comprising key development targets for the period 2019-24 in the social, economic and environmental sectors.

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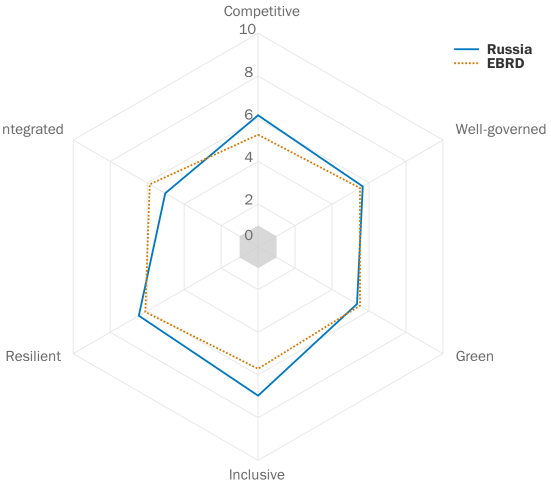
Assessment of transition qualities (1-10)



Structural reform developments

Following the constitutional amendments of July 2020, the President signed a decree that outlines a new set of national development goals for Russia. Instead of a National Projects-style roadmap of state-driven investment across 12 major areas, the new goals are less specific, and the timeline for completion has been extended from 2024 to 2030. Five development goals are outlined: maintain population, health and wellbeing; create possibilities for self-fulfilment and development of talents; a comfortable and safe living environment; effective labour and successful entrepreneurship; and digital transformation.

Local content provisions have expanded. One element of the government's import substitution strategy in recent years has involved the use of domestic content rules, notably in the electronics and information technology sectors, the segments of the economy in which Russia has one of the most broad-ranging and ambitious import substitution goals. In September 2020 the Russian Ministry of Industry and Trade proposed further changes to Decree 719 which regulates local content requirements for various industries and which applies to procurement by the public sector and state-owned enterprises.

Tax collection has improved drastically in recent years thanks to a digital overhaul of the Federal Tax Service. In recent months several further changes have been introduced which will help boost revenues. A progressive tax to apply above the 13 per cent flat tax has been proposed which will impact Russia's wealthier taxpayers. The mineral extraction tax has been increased, applicable to companies that mine metals, ores and rock used to make fertilisers, and all double taxation agreements are currently being reviewed, which would result in withholding tax being payable on dividend and interest payments by residents of the countries concerned.

SERBIA

Highlights

- **The effects of the Covid-19 pandemic are intensifying.** After a robust first quarter in 2020 (5.0 per cent growth year-on-year), GDP fell by 6.4 per cent year-on-year in the second quarter, as a consequence of the coronavirus-related lockdowns and disruptions in supply chains.
- **Work on a state-ownership policy (SOP) is advancing.** The SOP, which is designed to improve the governance of state-owned enterprises (SOEs), is expected to be adopted soon.
- **The government approved two economic support packages as a response to the pandemic.** Overall, the packages are worth around 12.5 per cent of GDP, with measures aimed primarily at preserving employment and increasing liquidity for businesses.

Key priorities for 2021

- **To ensure the sustainability of public finances, fiscal risks should be contained.** Public debt may exceed 60 per cent of GDP by the end of 2020. The government should decrease the budget deficit significantly in 2021, control wages and pensions and improve the structure of public expenditures towards more productive infrastructure investments and increase their value for money.
- **Public sector reforms need to progress.** In addition to adopting the SOP to improve the governance of SOEs and making necessary legal changes for its implementation, the government should proceed with the public administration reform, including the introduction of a new public sector pay grade system, and further professionalisation and de-politicisation of the administration.
- **Further improvements of the business environment are necessary in order to increase domestic private investments.** The focus should be on levelling the playing field for small and medium-sized enterprises (SMEs), strengthening the rule of law, implementing the legislation consistently and fighting corruption. In addition, the private sector should be properly involved in public consultations regarding new business legislation.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.3	2.1	4.5	4.2	-3.5
Inflation (average)	1.2	3.0	2.0	1.9	1.5
Government balance/GDP	-1.1	1.4	0.8	0.0	-8.0
Current account balance/GDP	-2.9	-5.2	-4.8	-6.9	-6.5
Net FDI/GDP [neg. sign = inflows]	-5.2	-5.9	-7.3	-7.8	-5.0
External debt/GDP	72.0	65.1	62.2	61.9	n.a.
Gross reserves/GDP	27.8	25.4	26.3	29.1	n.a.
Credit to private sector/GDP	41.0	40.3	41.4	42.1	n.a.

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Covid-19: macroeconomic implications

After solid growth in 2019, the economy is facing a recession in 2020. GDP expanded by 4.2 per cent in 2019, driven by domestic demand, primarily investments, among which the building of the TurkStream gas pipeline stood out. GDP also rose strongly in the first quarter of 2020, at 5.0 per cent year-on-year, driven by consumption, government expenditures (related to increased spending in the early stages of Covid-19 and a hike in wages) and investments. At the same time, exports growth slackened to 3.1 per cent year on year, which was the slowest quarterly rate since 2014. The second quarter of 2020 saw a fall in economic activity of 6.4 per cent year on year, as the impact of stringent lockdowns was felt by the economy.

Public debt has started to rise due to government measures to fight the effects of Covid-19. According to International Monetary Fund (IMF) estimates, the budget deficit in 2020 will reach 8.6 per cent of GDP. To finance it, Serbia raised €2 billion through a seven-year Eurobond issuance in May 2020 and stepped up domestic borrowing. In June 2020 the debt stood at 58.1 per cent of GDP, around five percentage points higher than at the end of 2019, and some further rise in the ratio is expected by the end of 2020.

Inflationary pressures have remained subdued. The average inflation rate in the first seven months of 2020 was 1.5 per cent year-on-year, which is exactly at the lower bounds of the central bank's target band (3 ± 1.5 per cent). After three cuts of 25 basis points each in 2019, the central bank lowered the key policy rate by another 100 basis points between March and June 2020, to an historical low of 1.25 per cent. The latest cuts are helping to mitigate the economic effects of the pandemic. The exchange rate against the euro has remained stable. The central bank has intervened in the foreign exchange market, mainly by selling euros (€1.4 billion net in the first seven months of 2020).

A recovery is expected in 2021. Overall, GDP is expected to decline by 3.5 per cent in 2020. Although the economy is being affected through several channels (lockdown measures, disruption in supply chains, lower inflow of foreign direct investment and remittances), the contraction in 2020 is smaller than in many neighbouring countries because the structure of the economy, with production of basic products accounting for an important share, is less vulnerable to the effects of the pandemic. In addition, the government has continued capital investments throughout the crisis period. Assuming a return to normal economic activity by mid-next year, GDP growth is forecast to resume at 3.0 per cent in 2021.

Policy response to Covid-19

The government is implementing a large aid package to mitigate the impact of Covid-19. The initial package, announced at the end of March 2020, amounts to €5.1 billion (or 11 per cent of GDP). Measures include: direct private sector support (payment of three minimum wages to entrepreneurs and micro, small and medium-sized enterprises and a subsidy at 50 per cent of the minimum net wage to large businesses that had to suspend activity); fiscal measures (postponed payment of social security contributions and payroll tax; delayed advance corporate income tax payments for the second quarter of 2020); and liquidity enhancement (primarily state guarantees for €2 billion new loans). Under the second package, adopted in July 2020, the state covered 60 per cent of minimum wages for August and September, deferred payment of social security contributions and payroll tax for one month, and continued to subsidise large companies. The condition for companies to obtain state aid was not to lay off more than 10 per cent of the workforce three months after receiving the last payment. In addition, the government set aside around €22 million for farmers and approved one-off aid to pensioners of RSD 4,000 (€35), one-off assistance to all adults (€100) and a 10 per cent wage hike of health workers. In August 2020, a programme of subsidies for city hotels in difficulties was adopted. The hotels would be entitled to one-off subsidies of €350 per single bed and €150 per room.

Financial measures have also been adopted as part of the crisis response. The measures ranged from loan repayment moratoria to possible inclusion of corporate bonds into monetary operations. In mid-March 2020, the National Bank of Serbia (NBS) introduced a 90-day loan

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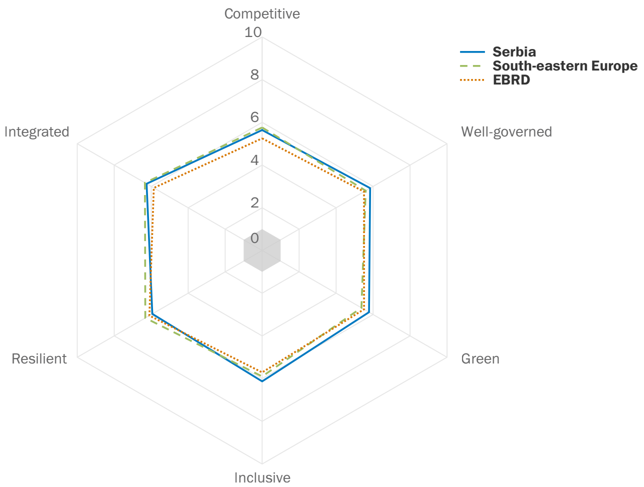
repayment moratorium for all debtors willing to use that option, which was later extended until the end of September. In addition, the central bank provided additional local currency and foreign exchange liquidity to banks through additional foreign exchange swaps and repurchase agreement (repo) auctions. To meet possible future euro liquidity needs, it also established a €1 billion repo line with the European Central Bank, which will remain in place until at least June 2021. In May 2020, the NBS announced inclusion of corporate bonds in conducting monetary operations. The NBS can buy dinar bonds from commercial banks, issued by the end of 2020 and with a maximum maturity of five years, provided the bonds have at least a B rating assigned by the national Business Registers Agency. In June 2020, the NBS passed a regulation lowering the downpayment for first home-buyers to 10 per cent of the sought loan amount, and in August it adopted measures in support of lending. However, the latter are rather narrow in scope (targeting mostly the construction sector and housing loans) and not mandatory for banks.

Assessment of transition qualities (1-10)



Structural reform developments

EU accession negotiations are advancing, albeit slowly. So far 18 chapters (out of 35) have been opened since the start of negotiations in January 2014, of which two are provisionally closed. According to the European Commission's country reports, the future speed of negotiations will depend on the pace of reforms regarding the rule of law as well as on progress in the normalisation of relations with Kosovo.

The government is taking steps to develop the capital market. In February 2020 the government announced drafting of the strategy for capital market development with the support of international institutions. At the same time, the law on capital markets was amended to allow greater availability of domestic securities for foreign investors. In May 2020 the Securities Commission enacted by-laws needed for the implementation of the law on alternative investment funds and law on open investment funds with public offerings, adopted in October 2019. The laws are intended to harmonise Serbian law with EU legislation, including on venture capital and private equity funds, and provide a more predictable environment for investors.

A new state ownership policy (SOP) is being developed. According to the IMF programme, the new policy, which should contribute to better corporate governance of SOEs, is to be adopted by the end of October 2020. The SOE sector in Serbia is relatively large and typically performs worse than it does in other countries or in the private

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sector. The government agreed to adopt a SOP as part of the IMF Policy Coordination Instrument programme, and to provide a strategic vision of state ownership, including ownership objectives, financial and public policy targets, reporting and monitoring guidelines and procedural guidelines for boards of directors.

Two important state-owned companies face severe difficulties. Air Serbia, the national air carrier, is facing a major financial crisis. In August 2020 the government announced it would provide financial assistance of €56.5 million to pay off the company's debt. Meanwhile, after a series of takeovers of domestic cable operators in 2018 and 2019, the debt of the telecommunications company Telekom Srbija rose from under €400 million at the end of 2017 to €1.2 billion at the end of 2019. There are claims that the takeovers were significantly overpriced. In September 2020 the company issued €200 million worth of five-year corporate bonds, stating the need to refinance its current liabilities and advance its operations. Previous attempts by the government to sell Telekom Srbija (the last time in 2015) were unsuccessful.

The third largest bank in the country has been privatised. Following the November 2019 purchase of the 34.6 per cent stake in Komercijalna Banka from international investors, the state sold its whole share in the bank (83.2 per cent) to Slovenian bank NLB in February 2020. The transaction is expected to be closed in the last quarter of 2020.

A special law to accelerate infrastructure development may jeopardise transparency and competitive tendering. In February 2020 the government adopted a law on special procedures for implementation of linear infrastructure projects (such as highways and the underground) deemed to be of special importance for the country. This *lex specialis* allows the government to exempt "strategic" projects from the application of public procurement rules and thus might not ensure value for money.

An important step has been made in tackling air pollution. At the end of January 2020 the government adopted the country's National Emissions Reduction Plan (NERP), shortly after the Energy Community Secretariat opened a dispute settlement procedure against the country for not adopting the Plan. (The draft NERP of Serbia was approved by the Secretariat in 2016.) The adoption of the NERP is an important step in reducing emissions from large combustion plants into the air.

SLOVAK REPUBLIC

Highlights

- **The Covid-19 pandemic has led to lower external demand and ruptured supply chains, causing a GDP contraction.** The situation is exacerbated by the homogeneity of the economy and heavy concentration on one industry – car manufacturing – which has been badly affected by the crisis.
- **Crisis response measures have supported employment and business liquidity.** The "First Aid" package, approved by the government in March 2020, amounted to about 1 per cent of annual GDP each month.
- **The bank levy has been removed.** The €1 billion already collected from past payments of the levy will be moved to the Slovak Development Fund to support development programmes, such as investments in healthcare and significant infrastructure projects.

Key priorities for 2021

- **Measures designed to restart the economy should also be targeted at long-term development.** Building an adequate skills base and a better innovation environment can ensure that the economy remains competitive and resilient through further productivity growth and relevance in global value chains, including beyond the automotive industry.
- **Further simplification and legislative amendments are needed to ensure that European Union (EU) funds are used in the most effective way.** This is particularly important as the unused money in the 2014-20 EU budget can still be spent in a more flexible way, especially on activities to fight the effects of Covid-19. Persistent trouble over the years with the investment co-financed with the EU funds have highlighted the need to improve the effectiveness and capacity of the administration at various levels of government.
- **Investments in energy efficiency and the green economy need to be substantially increased.** Greening of the economy should be a priority. So far the country has had limited success in delivering financial instruments to support the greening of small and medium-sized enterprises (SMEs), energy efficiency in the building sector (single-family homes and municipal buildings in particular), renewable energy capacities or waste management.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.1	3.0	3.9	2.4	-7.0
Inflation (average)	-0.5	1.4	2.5	2.8	1.5
Government balance/GDP	-2.5	-1.0	-1.0	-1.3	-8.8
Current account balance/GDP	-2.7	-1.9	-2.2	-2.7	-3.1
Net FDI/GDP [neg. sign = inflows]	-0.8	-2.8	-1.3	-2.2	0.8
External debt/GDP	92.5	108.3	114.6	112.0	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	57.3	60.4	62.5	63.4	n.a.

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Covid-19: macroeconomic implications

The coronavirus crisis prompted economic activity to plunge. GDP growth in 2019, at 2.4 per cent, was already on a downward path, and the lockdown imposed country-wide in March 2020 and the collapse of external demand pushed the Slovak economy into a deep recession in the first half of 2020. GDP dropped by 8.1 per cent year-on-year in this period, mostly weighed by a double-digit plunge in investment and private and government expenditures. The latter dropped more abruptly than the expenditures of households, reflecting major delays in the provision of support measures by the new government in the second quarter of 2020. The homogeneity of the economy has long been a risk factor, which is currently materialising. Car manufacturing, including smaller domestic suppliers, accounts for almost half of industrial production and 47 per cent of total exports. The country's four car makers stopped production completely in April 2020, but partially re-started a month later.

Car manufacturers' investments are on hold but remain in the pipeline. Despite the cyclical slowdown registered already in 2019, investment grew by 6.8 per cent, mainly because of major infrastructure construction projects and improved absorption of EU funds. The Covid-19 pandemic put the majority of investment projects on hold, as seen by the substantial drop of gross fixed capital expenditures of 10.1 per cent year-on-year in the first half of 2020. On the upside, several car manufacturers are considering new investments. Porsche is planning to build a new production plant for e-cars, worth €250 million, near Piestany in the west of the Slovak Republic. Volkswagen (VW), another German car maker, is planning to invest at least €500 million in the next five years, as a result creating an additional 2,000 jobs while not introducing any Covid-19-related redundancies by 2023. The government pledged to support the construction of residential housing near VW's plant in Bratislava.

The government deficit increased substantially. According to the International Monetary Fund's October 2020 estimates, the general government deficit is expected to rise to 8.8 per cent of GDP in 2020, before falling again in 2021 as the economy rebounds. As elsewhere, the deterioration of public finances is directly linked to the shortfall of tax revenues and government measures to mitigate the negative impact of the coronavirus outbreak on the economy. In June 2020 the government suspended the cap on state expenditures, approved in January 2020, due to the extraordinary circumstances linked to the pandemic. In March 2020 the European Commission invoked the General Escape Clause from the Stability and Growth Pact, so that market access and long-term fiscal sustainability became the only constraints on the size of public spending programmes.

Post-crisis recovery will largely depend on the condition of the automotive sector. GDP will fall sharply in 2020 by 7.0 per cent, according to our current forecasts. However, we anticipate some improvement in external demand next year, which together with improved absorption of EU funds, including the EU recovery package, and significant investments by the automotive industry, should bring a recovery of 5.0 per cent growth in 2021. The high reliance of the economy on the automotive industry remains a key risk factor. Any adverse shock to the industry, such as a drop in demand for cars or any break of supply chains, could delay the recovery.

Policy response to Covid-19

The Covid-19 pandemic-related restrictions triggered rapid crisis protective measures. As an accompaniment to the lockdown imposed in March 2020, the government launched various relief measures to preserve employment, support companies in a state of hibernation and support household incomes. The majority of restrictions were gradually lifted from May 2020, including international travel and a return of production in all car plants.

Crisis response measures have been largely targeted at supporting employment and business liquidity. In March 2020 the outgoing government approved 31 measures to prevent the economy from collapsing. Key measures included the provision of liquidity to businesses through the Slovak Guarantee and Development Bank (SZRB) and the Eximbanka, tax and social security contribution deferrals, wage subsidies, extended sickness benefits, and negotiations with

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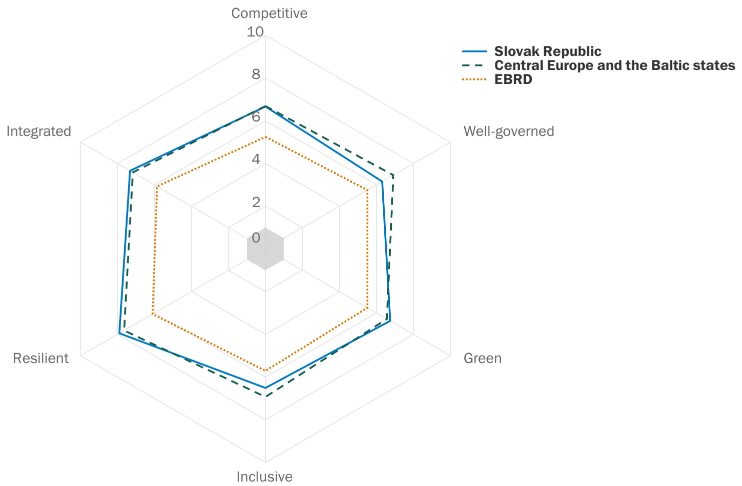
the banking sector on a moratorium on loan repayments. Later in March 2020 the government approved a "First Aid" package, worth about 1 per cent of annual GDP each month, to support businesses, the self-employed and employees. The package consisted of about €1 billion of direct aid and €500 million as bank guarantees. Further, in April 2020, the so-called "Kurzarbeit" – a reduction of working time and salaries as a means to avoid redundancies – and additional aid for entrepreneurs via preferred loans were introduced, followed by state assistance in rent payments to affected small businesses, such as shops or restaurants. In June 2020 the government approved an additional 114 measures, the so-called "Lex Corona", to improve the business environment and revive the economy. As a eurozone member, the Slovak Republic has been eligible for the European Central Bank's Pandemic Emergency Purchase Programme of €750 billion.

Assessment of transition qualities (1-10)



Structural reform developments

The government has set out plans for an employment preservation fund. In August 2020 the government proposed a scheme to preserve employment in future crises, such as the current coronavirus crisis, but also when other local problems emerge, such as floods. According to the proposal, employees who would otherwise be dismissed should receive 80 per cent of their net salary, of which 60 per cent is to be covered by the created employment preservation fund and the remaining 20 per cent by employers. The fund should also be available to the self-employed. According to the labour ministry, the current employment preservation scheme, as a part of the "First Aid" package, saved 500,000 jobs as of mid-August 2020.

The bank levy has been removed. In June 2020 the finance ministry and the Slovak Banking Association signed an agreement to remove the special bank tax on banks' assets, starting from July 2020. In return, banks agreed to boost their core capital, among other things, by not paying dividends. In addition, banks pledged to invest an additional €500 million in loans for households and businesses until 2023. The €1 billion collected from past payments of the levy will be moved to a new Slovak Development Fund, which will be established by the end of 2020 and which will focus on supporting and financing development programmes, such as investments in healthcare and significant infrastructure projects. The special bank levy was introduced in 2012 to create a buffer fund to help cope with potential crises.

Rules for use of EU funds have been simplified. In March 2020 the European Commission approved a request by the Slovak government to move uncontracted money between funds and to simplify the bureaucratic rules. Effectively, 100 per cent of the EU funds can now be used to mitigate

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the impact of the pandemic, without national co-financing. As a result, in April 2020 the government reallocated €1.25 billion of EU funds to five key areas: the healthcare system, jobs, SMEs, the emergency rescue system and education. As of the end of July 2020 the Slovak Republic had absorbed 32.5 per cent of EU funds under the 2014-20 EU budget. The upcoming 2021-27 EU funds will consist of two pillars: the regular multiannual financial framework (MFF) and an extraordinary Covid-19 recovery fund. The Slovak Republic is expected to receive €18.6 billion under the MFF 2021-27, and €7.5 billion in grants under the Covid-19 recovery fund, and it will be eligible to draw soft loans of up to €6.8 billion, repayable by 2058.

SLOVENIA

Highlights

- **The economy is undergoing a serious downturn.** The Covid-19 pandemic has put the economy into recession and is particularly affecting private consumption, investments, goods exports and tourism.
- **A sizeable crisis-response support programme has been adopted.** The government has adopted, in four stages, a significant fiscal package, helping to preserve jobs and firms' liquidity; the fifth package is awaiting parliamentary approval.
- **Structural reforms have slowed, due partly to political changes as well as the pandemic.** A new government was appointed amid the Covid-19 crisis and has focused on addressing the health and economic impacts of the pandemic.

Key priorities for 2021

- **More effective absorption of EU funds is important for a quicker recovery.** Slovenia will receive more than €10 billion during the next European Union (EU) programming period, and the commitment of the authorities to improve the use of funds is a welcome signal.
- **Progressing with important structural reforms is important for further convergence with the richer EU countries.** Key priorities include further enhancing corporate governance of state-owned enterprises (SOEs), developing capital markets and removing unnecessary barriers to doing business.
- **Further fiscal adjustments will be needed to maintain sustainable public debt.** In light of increasing public debt levels amid the significant fiscal stimulus, the authorities should define a plan to stabilise medium-term fiscal targets, while in the medium to long term an ageing population highlights the need to begin reforming the pension, health and long-term care systems.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.2	4.8	4.4	3.2	-7.5
Inflation (average)	-0.2	1.6	1.9	1.7	0.2
Government balance/GDP	-1.9	-0.1	0.7	0.5	-7.2
Current account balance/GDP	4.8	6.2	5.9	5.7	4.5
Net FDI/GDP [neg. sign = inflows]	-2.1	-1.2	-2.0	-1.6	-2.4
External debt/GDP	104.5	105.3	88.7	87.6	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	45.7	44.3	42.7	42.2	n.a.

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Covid-19: macroeconomic implications

Slovenia's economy has been hit hard by the coronavirus crisis. A slowdown in 2019 (to 2.4 per cent GDP growth) has been followed in 2020 by a severe recession, mainly due to the containment measures, which heavily affected private consumption, and the temporary collapse of international trade. In the first quarter of 2020 the economy was already contracting by 2.4 per cent year-on-year, one of the steepest falls in the region. In the second quarter, as the country felt the full effect of the crisis, the contraction reached almost 13 per cent year-on-year, as the lockdown measures, imposed in mid-March, resulted in a significant drop in domestic demand. The economy has also suffered disproportionately from the drop in international trade, due to its high integration in global value chains. Exports of goods, which account for more than 70 per cent of GDP, dropped by 12 per cent year-on-year in the first half of 2020. Another key channel for disruption was tourism, which normally accounts for about 7 per cent of GDP. The number of foreign tourists in the first half was down by about 80 per cent year-on-year, and the sector was relying more on local guests (whose spending was supported by government vouchers). This all resulted in a 7.7 per cent decline in economic activity in the first half of 2020. Unemployment, however, increased only marginally to 4.7 per cent in July 2020 (from 4.0 as of the end of 2019), mainly as a result of the government support schemes to preserve jobs.

The Covid-19 crisis has caused significant fiscal pressures. As a result of falling revenues and rising (crisis-response) spending, the fiscal deficit for 2020 is projected by the government at 9.3 per cent of GDP, with debt forecast to increase to 82 per cent of GDP by the end of the year, the same as at its peak level from 2015, following the banking sector bailouts. Nevertheless, access to funding remains satisfactory. By early September 2020, the government had raised €5.9 billion on the capital markets, covering almost 90 per cent of the estimated financing needs in 2020. Debt characteristics are favourable, as fixed interest debt, euro-denominated debt and long-term debt represents more than 95 per cent of government debt. In June 2020 credit ratings agency Standard & Poor's affirmed Slovenia's rating at AA- with a stable outlook, and in July 2020 Fitch kept Slovenia's rating at A, also with a stable outlook. These decisions reflect the economic resilience to the Covid-19 pandemic and the track record in recent years of fiscal prudence and reduced external and financial imbalances.

Growth is likely to return in 2021. In May, Slovenia was the first EU country to declare the end of the pandemic. While some precautions remained, the reopening of the economy paved the way for the recovery. Notwithstanding the severe immediate impact of the crisis, the recovery should limit the GDP reduction in 2020 to -7.5 per cent, and we expect GDP growth of 3.5 per cent in 2021, partly driven by a strong base effect. Nevertheless, the risks are on the downside. As a small, open economy, Slovenia is highly exposed to economic developments in its key trading partners, particularly the core eurozone economies. Support for the recovery is expected to come from public infrastructure projects, such as the second railway track to the port of Koper and the Karavanke tunnel.

Policy response to Covid-19

The government has supported the economy with several sizeable fiscal packages. A stimulus package of about 13 per cent of GDP is one of the most comprehensive responses in the EBRD regions. Preserving jobs, keeping businesses in operation and supporting those in vulnerable categories were at the core of the crisis response measures in Slovenia. The first economic package was adopted in early April 2020, worth €3 billion (6.7 per cent of GDP), and allowed payment of compensation and pension and healthcare contributions for businesspeople and farmers affected by the coronavirus, as well as to those who temporarily lost their jobs. The second economic package, worth €2 billion (4.5 per cent of GDP), was adopted in late April, and provided state guarantees to firms to take out bank loans to maintain their liquidity amid the crisis. In May 2020 the government adopted a third economic stimulus package, worth €1 billion (2.2 per cent of GDP), which featured subsidies for shortened working time, vouchers for citizens to spend in tourism facilities around the country, and favourable liquidity loans. Further precautionary measures were adopted in July and in September in preparation for a possible second wave of the pandemic. The latest measures include extension of the furlough scheme until year-end for all industries, reversing earlier plans to confine the measure to the

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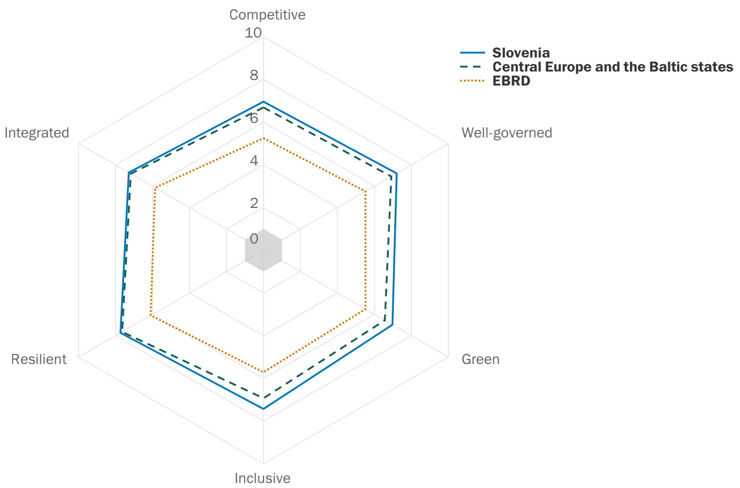
sectors worst hit, but with a stricter eligibility criterion, of at least a 30 per cent drop in turnover compared with last year. In addition, in April 2020 the Bank of Slovenia temporarily restricted banks regarding profits distribution, with the purpose of preserving capital so that the banking system could absorb potential losses and provide liquidity to the real economy. Likewise, the Slovenian Insurance Supervision Agency adopted the same measure.

Assessment of transition qualities (1-10)



Structural reform developments

The public procurement process has been strengthened. In November 2019 the new Act Amending the Legal Protection in Public Procurement Procedures was adopted. The amended act brought three major new features. First, a change in the organisation and formation of the National Review Commission (DKOM) to ensure greater independence and better operation of this authority, which has the status of a tribunal or an independent authority responsible for legal protection in public procurement procedures. Second, it allows administrative disputes against decisions of the DKOM. And third, it adopts measures to speed up legal protection procedures and enhance the effectiveness of legal protection in major projects.

Legislation was adopted to promote a more inclusive labour market. The new Labour Market Regulation Act was adopted in December 2019. The proposed amendments aim to provide better social security for the unemployed and increase the number of elderly persons in employment. They will also enable better integration of foreigners into the Slovenian labour market. Longer active participation in the labour market was also promoted through the pension and tax system reforms adopted in 2019.

Infrastructure development has continued, particularly in rail transport. Modernisation of the railway network includes: upgrading the lines between Zidani Most and Dobova (on the border with Croatia) and between Zidani Most and Celje; the planned upgrade of the line between Ljubljana and Divača (from where one route leads to Italy and the other to the port of Koper); and construction of a direct rail connection between the Primorska and Gorenjska lines (Tivoli curve); together with upgrading Ljubljana station.

Key infrastructure investments are being streamlined. According to new regulations which entered into force in May 2020, the projects benefiting from the new approach will be determined based on statutory criteria, which are that they: (i) implement objectives of national and strategic policies and EU cohesion policy; (ii) exceed €5 million investment; (iii) are ready to

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be implemented by the end of 2020; and (iv) have ensured financing by the end of 2020. They will receive priority treatment in administrative and court proceedings by being declared to be for public benefit. The benefits include obtaining construction permits quickly, allowing construction before a final building permit is issued, and overriding appeals related to environmental aspects. The participation of non-governmental organisations (NGOs) in the appeals process for these projects is being limited, prompting protests from environmental NGOs regarding the potentially harmful consequences of the regulation.

The share of renewables in energy production is increasing. In December 2019 Slovenia's state-owned power utility Dravske Elektrarne Maribor (DEM) began €65 million worth of investments in three wind farms – Ojstrica, Paski Kozjak and Rogatec – with a total installed capacity of 46 MW. Currently there are only two wind turbines in operation in the country, accounting for a negligible share of the country's energy mix, although Slovenia's wind potential is estimated at 415 MW. With this in mind, new wind park projects could help Slovenia meet renewable energy targets, which are set at a 27 per cent share of green energy in final energy consumption by 2030.

TAJIKISTAN

Highlights

- **The Tajik economy continues to grow despite the impact of the Covid-19 pandemic.** Real GDP rose by 3.5 per cent year-on-year in the first half of 2020 thanks to strong performances in industry (leading to a dramatic increase in gold exports) and agriculture.
- **The government has focused its limited crisis response resources on healthcare, food security, targeted support of vulnerable households, and tax benefits to small and medium-sized enterprises (SMEs).** Low-income households received cash transfers, and firms were granted tax holidays, free rent of state property, property tax exemptions and postponements of non-tax audits.
- **Tajikistan received a comprehensive foreign aid package.** This includes US$ 189.5 million in emergency financing from the International Monetary Fund (IMF), a US$ 52.5 million grant from the Asian Development Bank, a US$ 11.3 million grant from the World Bank, and debt relief of US$ 50 million under the G20 debt service suspension initiative.

Key priorities for 2021

- **The authorities should continue providing targeted support to vulnerable households and SMEs in the hardest-hit sectors.** There should also be a focus on preserving existing jobs, and creating new opportunities, for young workers and returning migrants, including through public work programmes.
- **Reforms need to continue to improve the business environment and attract foreign investment.** The focus should be on easing two key constraints for businesses: tax administration practices, and currency restrictions. The business environment is also hampered by governance deficiencies and a lack of a level playing field, which should be tackled to facilitate the flow of investment.
- **Fiscal and monetary discipline should be maintained.** The authorities should adhere to the targeted overall fiscal deficit of 4.4 per cent of GDP in 2021 and refrain from non-priority spending, while the central bank should continue exercising strong oversight of the banking sector to ensure confidence in the banking system.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	6.9	7.1	7.3	7.5	-1.0
Inflation (average)	5.9	7.3	3.8	7.8	8.0
Government balance/GDP	-9.0	-6.0	-2.8	-2.1	-6.0
Current account balance/GDP	-4.2	2.2	-5.0	-2.3	-7.5
Net FDI/GDP [neg. sign = inflows]	-3.5	-2.6	-2.9	-2.6	-0.1
External debt/GDP	68.9	77.2	79.4	80.3	n.a.
Gross reserves/GDP	9.4	18.0	17.1	18.1	n.a.
Credit to private sector/GDP	19.2	13.7	12.3	11.8	n.a.

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Covid-19: macroeconomic implications

Tajikistan's economy initially appeared to be relatively immune to the Covid-19 pandemic, but problems have arisen. With the first Covid-19 cases declared only at the end of April 2020, Tajikistan was able to introduce relatively mild containment measures, and did so later than most regional peers. Temporary restrictions included a ban on mass gatherings and closing of some local businesses, schools and kindergartens, but most SMEs were able to continue operating through much of the period. The economy was mainly affected by the disruption to transportation links with key trading partners and limited access to the Russian labour market. International arrivals halved in the first half of 2020 while remittances from Russia declined by around 15 per cent year-on-year in the same period, weighing on consumption, imports and the government's tax receipts.

Despite external pressures, Tajikistan's economy grew by 3.5 per cent year-on-year in the first half of 2020. Growth was driven by strong performances in industry (leading to a dramatic increase in gold exports) and agriculture. Freight transportation, hospitality, retail trade and services to households had a negative contribution to growth. The country's gold exports (to Switzerland) increased by 140 per cent year-on-year in US dollar terms. Excluding precious metals, exports took a major hit, declining by 22 per cent year-on-year. Tax revenues were 7 per cent lower than targeted in the first half of 2020, forcing the government to cut budget outlays to public management, industry and construction. The central bank reduced the policy rate stepwise from 12.25 per cent in December 2019 to 10.75 per cent in August 2020 in order to support domestic demand.

The exchange rate was mildly devalued. In response to deteriorating external accounts, the central bank devalued the exchange rate by 5 per cent in March 2020. Overall, the official exchange rate weakened by 6 per cent in the first three quarters of 2020. The gap between the official and parallel market exchange rate was 3.2 per cent at 30 June 2020. Inflation stood at 6.6 per cent year-on-year in September 2020 (slightly down from 8.1 per cent a year ago).

The economy is expected to go into a slight recession in the short term, with some recovery in 2021. The economy is forecast to contract by 1 per cent in 2020 but grow by 3 per cent in 2021, following expected economic recoveries in Russia and China. Risks are tilted to the downside, especially if a prolonged pandemic continues to affect key trading partners.

Policy response to Covid-19

The government's anti-crisis response focuses on food security, vulnerable groups, and tax benefits to SMEs. To prevent panic-buying and control prices, the government temporarily banned the export of wheat, rice, lentils, peas, mung beans, eggs, potatoes and meat. Price controls were introduced for key consumer goods and medical supplies, and essential imports were exempt from value-added tax. Vulnerable households received cash transfers equivalent to the minimum wage (around US$ 12 a week). Free medical care is provided to citizens diagnosed with Covid-19, along with sick leave and compensation benefits. Firms benefited from tax holidays, free rent of state property, property tax exemptions as well as postponements of non-tax audits. Public servant salaries, pensions and scholarships were increased by 10 to 15 per cent in September 2020. Health workers are to receive supplemental pay, while utilities tariff increases have been postponed until the end of 2020.

The central bank adopted an action plan to mitigate the impact of the Covid-19 pandemic. To free up liquidity for banks, in April 2020 the National Bank of Tajikistan (NBT) reduced reserve requirements for liabilities in local currency from 3 to 1 per cent and, in foreign currency, from 9 to 5 per cent. It exempted credit institutions from paying fees for using the settlement system. The NBT also recommended banks to waive penalties for affected businesses and individuals who struggle to repay their loans between May and October 2020. In addition, banks are also encouraged to prioritise lending to enterprises engaged in import-substituting activities.

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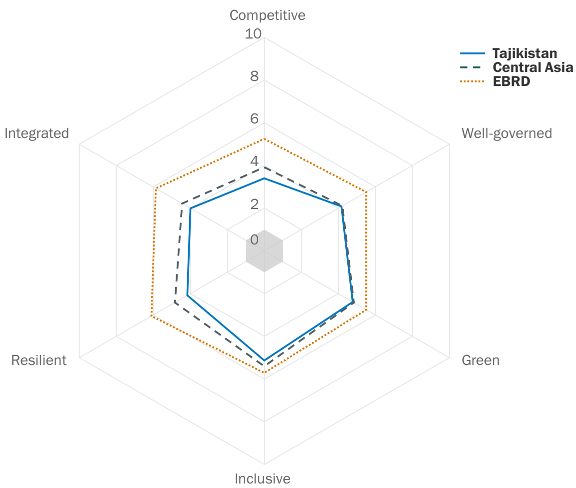
Policy response to Covid-19 is being supported by international financial assistance. Among others, Tajikistan received US$ 189.5 million in emergency financing from the IMF for budget support. The IMF estimates that a worsening in Tajikistan's external and fiscal positions will lead to a large fiscal and external financing gap in 2020 of around US$ 150 to US$ 400 million (2 to 5 per cent of GDP). The IMF assistance will provide a sizeable share of the financing needed to implement anti-crisis measures. The government also attracted a US$ 52.5 million grant from the Asian Development Bank, a US$ 11.3 million grant from the World Bank, and support from other development partners. The IMF and the authorities agreed on the implementation of fiscal consolidation measures of 2 per cent of GDP in 2021-22 to ensure debt sustainability. This will be achieved via a combination of revenue and expenditure measures to ensure that priority capital spending could be financed domestically to reduce reliance on external financing. In addition, Tajikistan received six-month debt relief from the IMF (amounting to US$ 10 million), with potential extensions of up to a maximum of two years from April 2020; debt relief around US$ 50 million was also provided under the G20 debt service suspension initiative.

Assessment of transition qualities (1-10)



Structural reform developments

A new Tax Code is being developed. This effort is being supported by international partners and is being designed in consultation with the private sector. Disruptive tax collection practices are a key challenge for Tajik businesses, and the private sector's engagement in the tax reform process is a positive development. The new Tax Code aims to simplify tax administration, reduce the tax burden, eliminate inconsistencies that allow for ambiguous interpretation and arbitrary application of many provisions, and incentivise businesses to move out of the informal sector. The draft Tax Code has been submitted to ministries and parliament for review and is expected to be finalised by January 2021.

Further steps have been taken to reform the energy sector. In 2019, the government adopted Resolution No. 389 of 2019, creating the Electricity Sector Regulation Department to serve as an independent sector regulator. The asset and inventory split between transmission and distribution, and functional unbundling of the national utility company Barki Tojik, were largely completed. Barki Tojik also proceeded with legal unbundling: in accordance with the government decree No. 330: OSHC "Barqi Tojik" was split into two companies: Shabakahoi Intiqoli Barq OJSC (transmitting electric networks) and Shabakahoi Taqsimoti Barq OJSC (electrical distribution network). As envisioned by the Ministry for Energy and Water Resources, the new companies are to become fully operational by the end of 2020, following the appointment of new management, and the establishment of separate balance sheets and income statements.

TUNISIA

Highlights

- **The economy is contracting significantly in 2020.** The Covid-19 crisis and related containment measures are leading to higher unemployment and rising fiscal deficits, but inflation is lower, foreign exchange reserves are up and the exchange rate is stable.
- **The authorities have responded to the crisis with a wide range of measures.** The government executed an emergency plan, created a fund for health and social spending, and disbursed cash transfers for the most vulnerable segments of the population. The Central Bank of Tunisia (CBT) reduced the policy interest rate by 150 basis points.
- **There has been some progress in structural reforms.** The CBT raised the limits on overseas borrowing by local firms, the interbank guarantee fund for bank deposits started operating, and a new law regulating crowdfunding was approved.

Key priorities for 2021

- **Digitisation of government services should continue.** During the Covid-19 crisis, several digital applications were developed to meet the needs of the administration with a large number of ministries and several online services, such as tax regulation. Increased literacy of the population alongside upgraded digital infrastructure in southern and interior regions will allow digital technology and electronic payments to be applied more widely.
- **Tunisia could benefit from the relocation of European and Asian industry to the southern Mediterranean post-Covid-19.** Tunisia should develop its international positioning to benefit from a wide range of business opportunities. Essential reforms include improving the competitiveness of economic sectors such as health and education, agricultural and agro-food, automotive and textiles.
- **The authorities should commit to further reforms in the energy sector and public administration.** Key reforms on the agenda include a reduction in energy subsidies and streamlining of the civil service wage structure.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	1.2	1.9	2.7	1.0	-8.0
Inflation (average)	3.6	5.3	7.3	6.8	5.8
Government balance/GDP	-6.2	-5.9	-4.6	-3.9	-8.1
Current account balance/GDP	-9.3	-10.2	-11.2	-8.5	-8.3
Net FDI/GDP [neg. sign = inflows]	-1.7	-2.0	-2.5	-2.1	-0.6
External debt/GDP	66.9	82.0	86.1	99.4	n.a.
Gross reserves/GDP	14.2	14.1	13.1	19.1	n.a.
Credit to private sector/GDP	76.8	80.3	80.4	77.4	n.a.

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Covid-19: macroeconomic implications

The economy is undergoing a severe contraction. GDP fell by 11.4 per cent year-on-year during the first half of 2020 because of the Covid-19 crisis and related containment measures. The largest contractions were in the tourism, transport, public administration, manufacturing, construction, textiles and trade sectors. Meanwhile, the agricultural and agro-food sectors posted strong positive growth, thanks to a record-breaking olive oil harvest in 2019-20. Unemployment increased to 18 per cent in the second quarter of 2020, the highest rate reported since 2011. Inflation is also quite elevated by regional standards at 5.4 per cent in September 2020, although it is slowing down. The CBT implemented a rate cut of 100 basis points (to 6.75 per cent) in March 2020 in response to the Covid-19 crisis, and by another 50 basis points in October, reversing a trend of monetary tightening to contain inflation.

The fiscal deficit widened and debt increased. The original budget targeted a deficit of 3.0 per cent of GDP for 2020, but the complementary budget forecasts a much higher deficit because the implications of the Covid-19 crisis emerged. In the first eight months of 2020, revenues shrank while expenditures stagnated, as the drop in capital spending offset the increase in interest payments and administrative spending, mainly the public sector wage bill, although an increase in expenditures is projected for the end of the year. Meanwhile, the government's public debt stock increased to 71.4 per cent of GDP at the end of June 2020, and is likely to be higher by the end of the year, given the contraction in GDP and a larger fiscal deficit.

The external accounts have been supported by record olive oil exports and by a lower imports bill due to declining crude oil prices. The current account deficit narrowed to 4.0 per cent of GDP in the first half of 2020, reflecting a larger contraction in imports than in exports. Exports started to rebound in June and July, as did imports in July. Meanwhile, tourism declined by 61 per cent year-on-year in the first eight months of 2020 because of the Covid-19 crisis, and foreign direct investment flows dropped 14.2 per cent year-on-year during the first half of 2020. However, reserves actually increased to US$ 7.6 billion in October 2020, covering 4.7 months of imports.

Negative growth in 2020 should be followed by a recovery in 2021. We forecast GDP growth at -8.0 per cent in 2020 before picking up to 4.0 per cent in 2021. Lower global oil prices and reforms anchored within a new IMF-supported programme are expected to support the economy next year, but risks remain with slow policy reforms and a possible resurgence of the pandemic globally.

Policy response to Covid-19

The authorities responded to the Covid-19 crisis with a range of measures. The government implemented an emergency plan, to which it allocated TD 2.5 billion (US$ 0.9 billion), including value-added tax (VAT) exemptions, VAT refund procedures and reimbursement acceleration, the creation of a TD 100 million (US$ 36 million) fund for the acquisition of equipment for public hospitals, the purchase of emergency medical equipment and medicine, and increasing the strategic food reserve. On the social side, the government disbursed cash transfers for low income households, disabled and homeless people (TD 150 million, US$ 55 million) and support for those in temporary unemployment (TD 300 million, US$ 109 million). It also created investment funds (worth TD 600 million, US$ 219 million) and a state guarantee for new credits (TD 500 million, US$ 182 million). The CBT asked banks to suspend fees for electronic payments and withdrawals, and initiated a mechanism to cover the difference between the policy rate and the effective interest rate on investment loans within a 3 per cent cap.

The CBT is also supporting the recovery. In June 2020 the CBT raised the limits on overseas borrowing by local firms to help them tap other sources of finance and support the recovery from the Covid-19 crisis. This is a welcome step towards foreign exchange control relaxation. Allowing firms to borrow more money from abroad will widen the credit pool and reduce the demand for loans from local banks. The CBT's move will likely increase the flow of foreign credit to Tunisian businesses in the short to medium term, which could potentially allow local corporates to seize more cross-border merger and acquisition opportunities.

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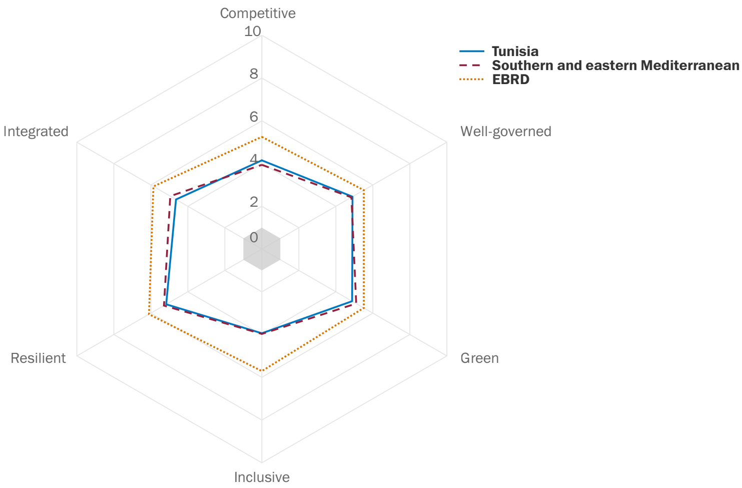
Assessment of transition qualities (1-10)



Structural reform developments

The interbank guarantee fund for bank deposits started operating. Almost all of the 29 banks operating in Tunisia are taking part in this new public body, which began operating in August 2020 and is managed by the state and the CBT. The fund was mandated by the Banking Law of 2016, which brought a number of sizeable amendments to existing rules and regulations and laid out new frameworks. The bank deposit guarantee fund serves to provide reimbursements in cases provided for by law and up to TD 60,000 (US$ 22,000) in case of default or forced administrative liquidation of a bank. The mission of the fund is to protect the savings of bank clients, reimburse them if their deposits become unavailable and contribute to the stability of the Tunisian financial system.

A new law regulating crowdfunding was passed in August 2020. It aims to organise a new means to provide financing – based on raising funds from the public via a dedicated online platform – for projects and companies to promote investment, entrepreneurship, creativity and innovation. The Financial Market Council, the CBT and the Microfinance Control Authority will regulate financing through crowdfunding. This law will help to address some of the economic problems that Tunisia is facing, by introducing new means of financing projects, as the private sector has identified lack of access to finance as one of the main obstacles to doing business.

The authorities implemented direct employment measures to target long-term unemployment, but the feasibility of such a strategy is doubtful. In August 2020 parliament approved a bill that allows the public sector to prioritise recruitment of those aged 35 and over who have been unemployed for more than a decade. Serious questions remain about the feasibility of implementing this law. Tunisia already has one of the highest wage bill to GDP ratios in the world, and several attempts to contain spending and freeze wage increases in previous years faced strong opposition from the powerful labour and trade unions.

Fuel subsidies have been reduced. In March 2020 the government introduced an automatic adjustment mechanism to align domestic prices with the global market price and reduce fuel subsidies. The technical price adjustment committee, set up by virtue of a decree by the energy and finance ministries in March 2020, sets fuel prices each month. The decree outlines that the maximum monthly adjustment step is no more than 1.5 per cent in either direction. As international fuel prices have been falling, the government was able to cut fuel prices for five consecutive months in 2020, with a 1.4 per cent cut on average in August 2020. The reduction in global oil prices is expected to have a favourable effect on Tunisia's energy imports and state budget via a reduction in planned fuel subsidy spending.

TURKEY

Highlights

- **Covid-19 has been a major shock to both the demand side (domestic and external) and supply side of the economy.** Before the pandemic, a fiscal and credit stimulus had helped the economy recover from the recession of 2018, and economic growth in 2020 was expected to be robust, but the economy contracted sharply in the second quarter.
- **The authorities have brought in a range of mitigating measures in response to Covid-19.** Several measures were introduced to support vulnerable households, workers and businesses and limit the economic impact of the pandemic, including social assistance programmes, short-time work allowance, a ban on layoffs, loan holidays and low-cost loans through state banks.
- **Expansionary monetary policy has put pressure on the exchange rate and foreign reserves.** A significant easing of monetary policy via policy rate cuts, quantitative easing and other measures to increase liquidity, and the extensive expansion of credit, have put pressure on the exchange rate, and attempts by the authorities to support the lira have resulted in a significant depletion of reserves.

Key priorities for 2021

- **Efforts to help the economic recovery need to be balanced carefully with measures to maintain macroeconomic stability.** The Turkish economy's longstanding reliance on external credit alongside the extensive use of credit stimulus to generate growth in recent years has made it vulnerable to sudden stops of capital inflows. A key priority is preserving the credibility of the central bank in order to increase the effectiveness of monetary policy.
- **There should be tighter rules for the recognition of non-performing loans (NPLs).** The use of asset ratios to encourage credit expansion risks is giving rise to further asset quality issues, at a time when the NPLs hanging over from the 2018 crisis have not been fully addressed.
- **Structural reforms need to be enacted to ensure a genuine rebalancing of the economy.** Reforms are needed to improve workforce skills, promote firm-level innovation and develop domestic capital markets. The recent trend towards shorter supply chains may provide significant opportunities for Turkish companies.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.2	7.5	2.8	0.9	-3.5
Inflation (average)	7.8	11.1	16.2	15.5	12.0
Government balance/GDP	-1.3	-1.6	-1.9	-2.9	-5.4
Current account balance/GDP	-3.1	-4.8	-2.7	1.1	-3.7
Net FDI/GDP [neg. sign = inflows]	-1.2	-1.0	-1.2	-0.8	-0.7
External debt/GDP	47.0	52.8	56.4	57.1	n.a.
Gross reserves/GDP	12.3	12.6	12.1	13.8	n.a.
Credit to private sector/GDP	69.8	70.8	68.0	66.0	n.a.

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Covid-19: macroeconomic implications

The Covid-19 pandemic resulted in a shock to both the demand and supply side of the economy. Domestic demand was hit by containment measures, external demand contracted sharply, and the economy has suffered from the collapse in travel and tourism. The partial lockdown in the country had a major impact on domestic consumption, in particular the retail sector, which constitutes 26 per cent of GDP. Production facilities were also hit hard, with many companies shut down for a period due to the containment measures and resulting supply chain disruptions. The economy contracted by 9.9 per cent year-on-year in the second quarter of 2020.

The authorities have responded to the crisis with fiscal and monetary measures. Fiscal measures to address the crisis amounted to around 6.5 per cent of GDP (see below for details). Meanwhile the central bank's policy rate has been slashed from 24 per cent in July 2019 to 10.25 per cent as of September 2020, contributing to an annualised rate of credit growth in 2020 of 25 per cent, principally driven by state banks. The credit stimulus has led to rising inflation and a widening current account deficit (mainly from rising imports), despite the weakening of the exchange rate by around 20 per cent in relation to the US dollar since the start of 2020. This depreciation has arisen despite the authorities spending US$ 60 billion of reserves defending the currency so far in 2020, on top of the US$ 30 billion spent in 2019. In the face of declining reserves, the central bank has engaged in swap agreements, mainly with state banks, to tap the extensive foreign exchange deposits of Turkish residents.

Signs of economic recovery are emerging, but significant risks remain. GDP is projected to contract by 3.5 per cent for the year as a whole, with economic activity recovering in the second half of 2020. This recovery should support growth of around 5.0 per cent next year. If policy tightening addresses the depreciation of the lira, the contraction in domestic demand alongside lower oil prices should keep inflation and the current account deficit relatively contained. However, risks to our forecast are on the downside, especially if there is a second wave of the pandemic, which would likely lead to further containment measures. Other key risks are those associated with a possible further significant depreciation of the lira and withdrawal of foreign exchange deposits from the banking system.

Policy response to Covid-19

The government announced a relief package in mid-March 2020. The package, entitled the Economic Stability Shield, involved tax holidays and value-added tax cuts for hard-hit sectors, and funding for workers. It introduced a mix of financial support, credit support and employment-related measures to help citizens and businesses during the Covid-19 crisis. Measures taken to ease liquidity, particularly for small and medium-sized enterprises, include loan repayment deferrals, credit guarantees and low-cost financings, particularly through public banks. Low-interest loans have been provided for various sectors, from tourism to housing and automotive, in order to revive domestic demand. Social assistance programmes for low-income households and increases in pension payments have also been implemented.

The government unveiled measures to support labour markets. These measures include a temporary working allowance for workers who partially or fully suspend their activities. A temporary nationwide ban on layoffs was imposed to mitigate the impact of the pandemic, while employers were allowed to put employees on unpaid leave with the state providing a daily income subsidy corresponding to half the minimum wage during this period.

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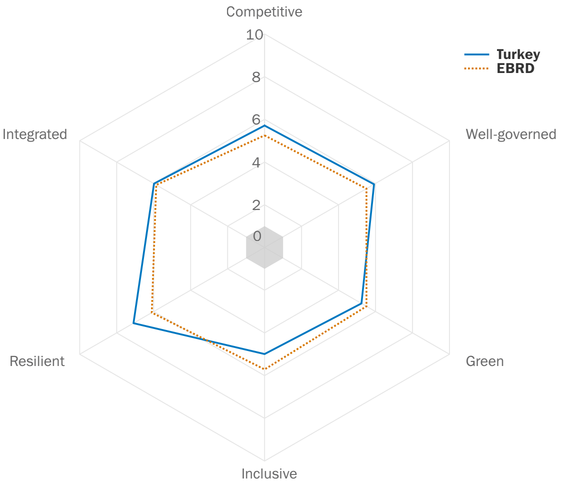
Assessment of transition qualities (1-10)



Structural reform developments

There has been backsliding over the past year in terms of governance and policymaking. Perennial concerns about the concentration of power within the Presidency and consequent lack of independence of key institutions such as the central bank continue. The central bank has cut rates heavily in the past year to the extent that real policy rates are negative, and it seems reluctant to use rate hikes to tighten policy, instead reverting to using the interest rate corridor. This results in less transparent policymaking.

Further capital market controls were introduced during the year, although some have recently been lifted as part of a wider normalisation exercise. Attempts to support the currency in the face of negative real policy rates have involved the introduction of a variety of measures that may be detrimental to investment. These include minor capital controls, including foreign exchange transaction taxes and settlement delays, and bans on shorting and lending certain Borsa Istanbul stocks. Other restrictions include those on offshore swap markets, which have made it difficult for foreign investors to hedge Turkish investments. These measures have resulted in the share of non-resident participation in the Turkish domestic bond market falling to historically low levels. Furthermore, import tariffs and other import restrictions have been introduced or increased on a wide variety of products in the past year. Some of these measures have recently been alleviated as part of a normalisation exercise.

Turkey has joined Euroclear bank. This move, which took place in June 2020, enables international investors to settle trades in Turkish government bonds. It should open up Turkish debt to more cautious investors such as sovereign wealth funds and pension funds, and is potentially important for the development of local debt markets.

The ongoing push to use credit stimulus to engineer a fast recovery has been relaxed in the face of recent lira weakness. Over the first half of 2020 several initiatives were introduced to support increased lending, including a significant increase in the size of the Credit Guarantee Facility to TRY 50 billion (US$ 7.7 billion), differential reserve requirements and remuneration to favour banks meeting certain lending targets, and asset ratios requiring banks to maintain certain levels of loan supply, government bond holdings or swaps with the central bank. Recently, in the face of ongoing weakness of the lira, these measures have been relaxed.

TURKMENISTAN

Highlights

- **Turkmenistan continues to report strong GDP growth despite a large drop in the country's export revenues.** Officially reported real GDP growth slowed to 5.8 per cent year-on-year in the first three quarters of 2020 from 6.3 per cent a year ago.
- **The Covid-19 pandemic has hit Turkmenistan's export revenues hard.** The outbreak of the crisis and the subsequent collapse of demand for gas has led China, Turkmenistan's main export market, to significantly reduce its pipeline gas imports from Turkmenistan.
- **The budget is being revised to cut down spending.** In April 2020 the president instructed the government to prepare proposals for revising the state budget and expenditure and to develop short- and medium-term measures to reduce the negative impact of the global economic contraction and the virus on business activities.

Key priorities for 2021

- **A key priority is to deal with the economic and healthcare implications of Covid-19.** The government should offer financial support to the affected sectors and households. Measures should focus on liquidity as well as solvency.
- **Currency convertibility issues need to be addressed and the exchange rate should be adjusted to reflect macroeconomic fundamentals.** Removing exchange rate distortions would improve the competitiveness of the country's exports and correct external imbalances while stimulating growth of the private sector.
- **The authorities should take measures to increase data transparency.** Collection of economic and social data and its availability must be improved to facilitate sound decision-making by all stakeholders and the public at large. Greater transparency would help private sector actors in planning investment, production and financial management decisions, while also helping the government take timely policy actions grounded in rigorous statistical evidence.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	6.2	6.5	6.2	6.3	-1.0
Inflation (average)	3.6	8.0	13.3	5.1	8.0
Government balance/GDP	-2.4	-2.8	-0.2	-0.3	-1.4
Current account balance/GDP	-20.2	-10.4	5.5	5.1	1.0
Net FDI/GDP [neg. sign = inflows]	-6.2	-5.5	-4.9	-4.8	-2.5
External debt/GDP	23.1	26.9	27.7	29.2	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	n.a.	n.a.	n.a.	n.a.	n.a.

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Covid-19: macroeconomic implications

Turkmenistan continues to report strong GDP growth despite the global economic contraction. Officially reported real GDP growth slowed to 5.8 per cent year-on-year in the first three quarters of 2020 from 6.3 per cent a year ago. The government reported that retail trade turnover increased by 19.4 per cent year-on-year in the first three quarters of 2020. According to official data, Covid-19 has not been diagnosed in the country. However, the authorities took preventive steps to restrict cross-border and internal movements and impose social distancing. Large shopping centres, markets, theatres, parks and sports facilities had to briefly suspend operations from 21 July to 1 August 2020. Nevertheless, domestic containment measures in Turkmenistan have thus far been milder than in other Central Asian countries, with services and small and medium-sized enterprise (SME) sectors affected to a much lesser extent than elsewhere.

Covid-19 has hit Turkmenistan's export revenues hard. In 2019, Turkmenistan was number one exporter of gas to China. Around 90 per cent of Turkmenistan's exports are supplied to China. The outbreak of the coronavirus crisis and the subsequent collapse of demand for gas has led China to reduce its pipeline gas imports. In March 2020, China issued a *force majeure* notice to its gas suppliers to suspend imports. In May 2020, the Chinese authorities indicated their intention to cut natural gas imports proportionally between Turkmenistan, Uzbekistan and Kazakhstan. According to the International Monetary Fund (IMF) and Trade Map data, exports declined by 44 per cent year-on-year in the first seven months of 2020, mostly consisting of gas supplies to China.

Reduced foreign exchange inflows have translated into tighter foreign exchange regulations. These added restrictions are interfering with private sector activities. While the official exchange rate peg is maintained at 3.5 manats per US dollar, the parallel market exchange rate has depreciated from 18 to 19 manats per US dollar in January 2020 to 23 to 24 manats in September 2020. In May the government established the Reserve Currency Fund which will accumulate the foreign currency earnings of all state enterprises.

The economy is likely to contract in the short term, given the large drop in gas exports. We forecast GDP to contract by 1.0 per cent in 2020 and return to growth of 1.0 per cent in 2021, supported by a recovery in China's demand for gas. Major uncertainty remains around these forecasts given the paucity of reliable economic data in Turkmenistan.

Policy response to Covid-19

A plan is in place to combat Covid-19 infections. In March 2020, the president approved the Preparedness and Response Plan, which is designed to prevent the emergence of Covid-19 in Turkmenistan. The plan was developed in collaboration with the United Nations and its agencies (United Nations Development Programme, World Health Organization [WHO] and the United Nations Children's Fund). Measures in the plan have been reported to fully comply with WHO recommendations. Those undertaken so far include closures of borders, restrictions on internal movement, cancellations of public sport activities, closures of gyms, theatres and other public places, and extensions of school holidays. Passenger railway transportation has been suspended since mid-July 2020 and citizens are required to wear masks in all public places.

The budget is being revised to cut down spending. In April 2020 the president instructed the government to prepare proposals for revising the state budget and expenditure and to develop short- and medium-term measures to reduce the negative impact of the global economic contraction and the virus on business activities. Suggestions focused on expanding lending to SMEs, tax and loan deferrals, supporting the transportation sector and creating jobs in the private sector. At the same time, all social payments and healthcare expenditure will be safeguarded, while construction spending will be downsized to preserve only socially important facilities.

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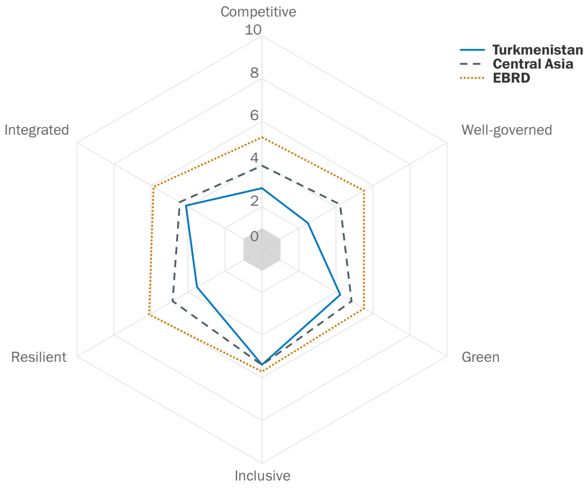
Assessment of transition qualities (1-10)



Structural reform developments

There has been steady progress with advancing the digitalisation agenda. Digitalisation has been identified as the core pillar of the Program of the President of Turkmenistan for the socio-economic development of the country for 2020-25. An important milestone in this regard was the adoption of the Law of Turkmenistan "on electronic documents, electronic document management and digital services" in March 2020. In July 2020 the Ministry of Finance and Economy implemented electronic document management for its units, with the president emphasising the need to transition to e-government. In August 2020 online registration of businesses was introduced, allowing entrepreneurs to accelerate the process of registration and liquidation. In addition, the "Electronic Tax" system is being introduced to optimise tax returns and simplify tax reporting.

Turkmenistan was granted observer status in the WTO in July 2020. The authorities had previously submitted a request for observer status in May 2020, intending to start negotiations for WTO accession within five years. This is a positive step towards further integration into global trade and may provide an impetus towards diversifying the economy from hydrocarbon exports. In addition, there are associated benefits of increased transparency for investors and trading partners.

Construction of the Turkmenistan–Afghanistan–Pakistan–India (TAPI) gas pipeline is being delayed. Turkmenistan failed to reach financial close for the project, which is worth US$ 8 to 10 billion, in early 2020 and will aim to do so in 2021. This pushes the deadline for the project to become operational from 2021 to 2023. So far the Turkmen side has built 200 kilometres of the pipeline from the Galkynysh gasfield to its border with Afghanistan. The pipeline's design capacity is planned to be 33 billion cubic metres of gas annually, helping reduce dependence on China as the country's main export market.

UKRAINE

Highlights

- **Structural weaknesses weighed on economic growth even before Covid-19.** GDP declined by 1.3 per cent year-on-year in the first quarter of 2020 before plunging by 11.4 per cent year-on-year in the second quarter, as the pandemic took its toll on the economy.
- **A new International Monetary Fund (IMF) programme has been approved.** Approval of the 18-month, US$ 5.0 billion Stand-By Arrangement in June 2020 helped ease immediate funding pressures, and the implementation of certain prior conditions unleashed the necessary external financing.
- **Progress in energy sector reform has been mixed.** The long-awaited Naftogaz unbundling will improve Ukraine's energy resilience, but a forced retroactive reduction in feed-in tariffs for renewables could damage investor confidence.

Key priorities for 2021

- **Preserving the independence of the National Bank of Ukraine (NBU) is vital for macroeconomic stability and maintaining access to external funding.** Strategic and operational decisions undertaken by the NBU, as regulator of the financial system, need to be governed exclusively by sound principles of macroeconomic policymaking and supervisory prudence.
- **Progress is needed in key areas of governance.** While the authorities have successfully implemented legal changes in many areas over the past years, they should push forward with privatisation, judicial reform, public administration reform and digitalisation of public sector services.
- **The lack of meaningful progress in the fight against corruption needs to be addressed.** More than five years after the Revolution of Dignity, widespread corruption continues to be among the main impediments to doing business in Ukraine.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.4	2.5	3.4	3.2	-5.5
Inflation (average)	13.9	14.4	10.9	7.9	3.2
Government balance/GDP	-2.2	-2.2	-2.2	-2.0	-7.8
Current account balance/GDP	-2.0	-3.1	-4.9	-2.7	4.3
Net FDI/GDP [neg. sign = inflows]	-4.1	-3.3	-3.4	-3.4	1.2
External debt/GDP	120.5	102.9	87.6	79.2	n.a.
Gross reserves/GDP	16.6	16.8	15.9	16.5	n.a.
Credit to private sector/GDP	41.9	34.1	30.1	24.5	n.a.

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Covid-19: macroeconomic implications

The economy was already slowing before Covid-19 induced a recession. In 2019 GDP growth moderated to 3.2 per cent, due mainly to a disappointing fourth quarter as consumption and construction-led investments, the main drivers of the economy, slowed down. Since March 2020 the pandemic has been taking its full toll on the economy through a combination of reduced foreign demand and a drop in domestic demand because of the lockdown. These developments have further damaged the already-declining manufacturing sector and reversed the fortunes of most services sectors. GDP declined by 1.3 per cent year-on-year in the first quarter of 2020 and plummeted by 11.4 per cent year-on-year in the second. The decline in the second quarter was broad-based across all sectors of the economy, especially affecting hotels and restaurants (value added was down almost 60 per cent year-on-year), while in a number of services value added fell by more than 20 per cent. Investments also declined by more than 20 per cent year-on-year in the second quarter. Despite the challenging environment, a credible monetary policy has preserved macroeconomic stability. In June 2020 the central bank reduced the policy rate to a historical low at 6 per cent amid subdued inflationary pressures. The current account deficit turned into a huge surplus in the period January to September 2020, supported by a huge fall in the trade deficit and an increase in the primary income surplus.

A new IMF Stand-By Arrangement is helping to close the financing gap. Following the December 2019 staff-level agreement on a US$ 5.5 billion, three-year IMF Extended Fund Facility (EFF) programme, the Ukrainian parliament was dragging its feet in terms of fulfilling the main conditions for IMF Board approval, namely, the adoption of a new land law and a set of laws that would prevent the return of closed and nationalised banks to their previous owners. In the meantime, the Covid-19 crisis shifted the priorities and focus of the authorities towards mitigation measures for the economy. In this new environment, the government and the IMF agreed on an 18-month US$ 5.0 billion Stand-By Arrangement (SBA) as a better fit for the country's immediate needs. The IMF Board approved the SBA in June 2020 following adoption of the prior actions agreed during the negotiations on the previous arrangement. A tranche of US$ 2.1 billion was immediately disbursed, unlocking additional support from the World Bank and European Union, and enabling a successful Eurobond issuance. Total financing attracted in June to July 2020 amounted to nearly US$ 6.0 billion.

A moderate recovery in 2021 is likely but uncertainty remains high. We forecast that the economy would contract by 5.5 per cent in 2020, followed by a partial recovery of 3.0 per cent in 2021. Risks to the downside remain considerable, not only because of a possible resurgence of the pandemic but also because of uncertainty about policy and structural reform commitments. Achieving a stronger recovery and sustainable medium-term growth would require a reinvigorated reform agenda, particularly in the judiciary, implementation of the anti-corruption programme, fair competition and improvements in governance.

Policy response to Covid-19

The authorities have put in place a range of crisis-response measures. The size of the authorities' initial crisis package, introduced in April 2020, is estimated at 3.1 per cent of GDP. Fiscal and regulatory support to businesses is focused on temporary tax breaks, tax audit holidays, abolishment of penalties for certain tax wrongdoings, extension of deadlines and an increased threshold for the simplified taxation regime. The subsidised loan programme, credit guarantee scheme and social support programmes were expanded to make them more generous and accessible. The authorities boosted pensions for certain categories, and introduced a moratorium on penalties and disconnection of households who are behind in their utility payments. Temporary price controls and export bans on particular food products, medicine and other medical equipment were introduced at the onset of the pandemic. Additional support for households and businesses has been offered to counteract the direct consequences of the lockdown, such as forgiveness of penalties related to delays in loan repayments. To support banks and ensure liquidity in the system, the NBU introduced a long-term refinancing facility, relaxed liquidity and reserves requirements and expanded the list of collateral for emergency lending.

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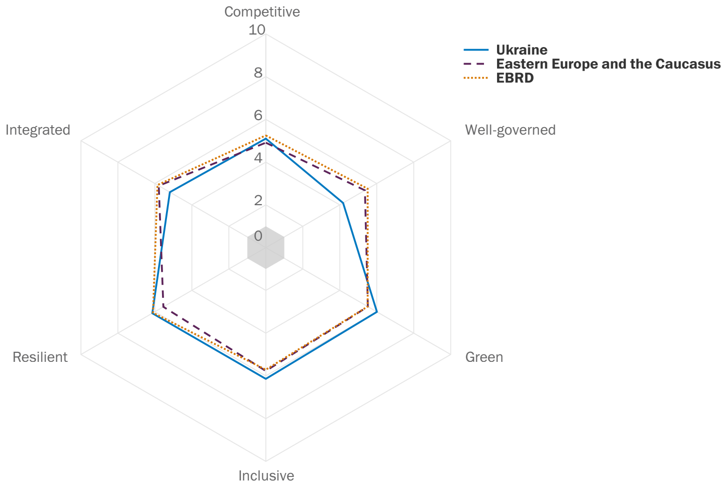
Assessment of transition qualities (1-10)



Structural reform developments

The bank resolution mechanism was significantly strengthened. A number of legal amendments, adopted by parliament in May 2020, aim to address regulatory gaps found during the banking sector clean-up in recent years and to ring-fence the decisions taken by the regulator. The law guarantees irreversibility of bank resolution as decided by the NBU by preventing the court from challenging the liquidation procedure, sale of assets and settlements with the bank's creditors. Further, it changes the procedure for courts to contest decisions by the regulators, namely the NBU, the cabinet of ministers and the Deposit Guarantee Fund, as it restricts the possibility of questioning their technical expertise and judgements. In cases where compensation to the previous owners is warranted, the law stipulates the exact conditions, processes and type of compensation, with the key role given to internationally acknowledged audit firms as unbiased experts. The reform also strengthens the early intervention framework and entry into resolution, and sets clear guidelines for potential nationalisation.

Reforms in the gas sector have advanced, but there were reform reversals in the renewables sector. At the end of 2019 gas production operations of the national oil and gas company, Naftogaz, were separated from gas transmission. The latter was moved to a new state-owned independent pipeline operator. The creation of an independent gas transmission system operator enabled the signing of a new five-year transit contract with Gazprom Russia at the end of 2019. The legislation pertaining to Naftogaz's unbundling was reviewed by the Energy Community and is deemed in line with Ukraine's obligations under the European Third Energy Package. After household gas prices were liberalised in January 2019 and the Public Service Obligation Order for the supply of gas to households was terminated in July 2020, household gas prices are now fully market-determined. However, long negotiations between the government, private sector and international development partners on restructuring the feed-in tariff mechanism for renewables in Ukraine did not lead to a consensus. In July 2020 parliament approved the reduction in the feed-in tariffs, thus changing the framework conditions for investing in renewables. While the main motivation was to decrease the burden on the state's finances, the forced retroactive changes will impair the investors' legitimate interests and may lead to litigation, with potentially serious future fiscal implications.

The longstanding moratorium on the sale of agricultural land was lifted, albeit with limitations. In March 2020 parliament adopted a new law on the market circulation of agricultural land, which comes into effect in July 2021. A large number of limitations in the legislation put a tight cap on the productivity gains expected to be realised. In particular, the embargo on the participation of foreign persons and entities remains in place and can be lifted only on approval by a national

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referendum. The sale of state land also continues to be banned. Among other notable limitations, the law imposes an upper limit on the amount of agricultural land that can be owned by a citizen or legal entity, with the latter being able to make purchases from 2024.

Parliament re-criminalised illicit enrichment. The law on the prevention and punishment of revenues embezzled by public servants was originally approved in 2015 before it was overturned by a controversial Constitutional Court ruling in February 2019. Approved in November 2019, the current bill envisages filing criminal charges if public officials' assets, as stated in the asset declaration, exceed their official income by a certain amount. However, in October 2020 the Constitutional Court undermined the fundamentals of the anti-corruption reform by overturning the system of electronic declaration of assets and income of state officials and decriminalising the act of knowingly submitting fraudulent declarations.

A new law on concessions sets up a clear legal framework for this form of public-private partnership. Adopted and effective in the last quarter of 2019, the law replaces previous outdated regulations. A clear regulatory framework for concession activities is conducive to attracting investment and upgrading infrastructure. In June and August 2020, the new framework was successfully implemented in the selection and contraction of concessioners of two Black Sea ports.

New wage caps in state-owned institutions may hinder future governance improvements. In April 2020 the authorities introduced a cap on salaries of all public employees as well as top management and supervisory board members of state-owned enterprises (SOEs) and state-owned banks (SOBs) to match more closely average salaries in the country. The cap was introduced as a temporary emergency measure and it was removed for judges, prosecutors, members of parliament and members of the board of the National Bank of Ukraine in August 2020, and for the managers of state banks in September 2020. However, it stays in place for the board members of SOEs and SOBs, thus risking having a long-term detrimental effect on the ability to attract and retain leaders of appropriate quality and experience at institutions of systemic importance for the country.

UZBEKISTAN

Highlights

- **The economy is proving to be relatively resilient to the impact of Covid-19.** Growth slowed but remained positive at 0.4 per cent year-on year in the first three quarters of 2020, led by growth in agriculture and construction. Also, the economy is less dependent on external developments than some of its Central Asian peers.
- **The government's Anti-Crisis Fund is strengthening both the healthcare system and support for affected workers and businesses.** By investing in public infrastructure works and developing private land plots, the fund is also helping to create earning opportunities for low-income families.
- **Ambitious market reforms continue to advance despite the crisis.** Measures have been adopted in the past year to strengthen judicial independence and improve other aspects of the investment climate, privatise and develop the banking sector, promote export-oriented agribusiness clusters, and attract private investment in the electricity sector.

Key priorities for 2021

- **The immediate key priority is to continue providing support to sectors affected by Covid-19 and sustain private sector employment.** To help businesses stay afloat, support measures should seek to smoothen income shocks and boost consumption in the hardest-hit sectors, such as recreation and hospitality.
- **The authorities should step up efforts to promote digital transformation.** Investment in broadband infrastructure, and upgrading digital skills and the IT ecosystem are essential to enable remote working and learning for all groups of the population.
- **The government should adjust reform priorities in light of post-Covid-19 realities.** In the short term, priority should be given to macroeconomic stabilisation, continued improvement of the investment climate, and other measures to build investor confidence. Earlier plans for large-scale privatisation of state-owned banks and enterprises may have to be delayed in case of slower-than-expected economic recovery. Where feasible it would be important to proceed with divesting smaller-sized assets, while proceeding with improving corporate governance at state-owned enterprises and banks.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	6.1	4.5	5.4	5.6	-2.0
Inflation (average)	8.8	13.9	17.5	14.5	13.0
Government balance/GDP	0.8	1.3	1.7	-0.3	-4.5
Current account balance/GDP	0.4	2.5	-7.1	-5.6	-7.0
Net FDI/GDP [neg. sign = inflows]	-2.0	-3.0	-1.2	-4.0	-3.0
External debt/GDP	17.9	26.3	33.9	41.7	n.a.
Gross reserves/GDP	32.3	47.5	53.7	50.3	n.a.
Credit to private sector/GDP	12.4	16.6	23.8	30.0	n.a.

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Covid-19: macroeconomic implications

Uzbekistan's economy is proving relatively resilient to the impact of Covid-19. Compared with other countries in Central Asia, Uzbekistan's economy is more diversified: industrial output (mining, manufacturing and construction) accounted for 36 per cent of its GDP in 2019. Industry, and construction in particular (14 and 19 per cent growth in 2018 and 2019, respectively), also served as the main engines of growth in recent years. The country's export structure is quite diversified as well. Commodity exports constituted about 50 per cent of total exports in 2019, with gold accounting for more than half, providing a natural hedge in turbulent times.

Economic growth is slowing but remains positive. Real GDP increased by 0.4 per cent year-on-year in the first half of 2020, led by growth in agriculture and construction (3.4 and 8.6 per cent year-on-year, respectively). Industry output dropped by 2.7 per cent and gas production fell by 19.6 per cent year-on-year. Services, however, recovered in the third quarter of 2020 and recorded an increase of 1.8 per cent year-on-year in January to September 2020. The government imposed the first round of lockdown restrictions from mid-March until May 2020 and the second round from 10 July until 17 August 2020, gradually easing them since then. As a result, the unemployment rate surged to 13.2 per cent in January to July 2020 from 9.1 per cent a year ago. Real incomes started contracting in April 2020 and posted a decline of 1.7 per cent year-on-year in June 2020.

The country faces rising external pressures. While imports of goods decreased by 15 per cent year-on-year in the first eight months of 2020, growth of exports stalled in the same period, with the trade balance remaining negative. Energy exports declined by around 78 per cent year-on-year, owing to weak demand from China and Russia. Gold exports rose significantly by 47 per cent year-on-year in January to August 2020 thanks to the positive effect of record-high gold prices and higher gold shipments. Exports of services declined by 76 per cent year-on-year (mostly transport and tourism receipts). At the same time, closure of borders and limited economic activity in Russia and Kazakhstan led to a decline in remittances by 5.4 per cent year-on-year in US dollar terms in the first eight months of 2020.

The economy is forecast to contract in the short term but recover in 2021. Real GDP is forecast to drop by 2.0 per cent in 2020. A recovery of 4.5 per cent is expected in 2021, driven by an expected rebound in exports and domestic demand. Thus any failure of this rebound to materialise (because of a prolonged pandemic) is a key risk.

Policy response to Covid-19

An Anti-Crisis Fund has been established. This fund, of around 1.5 per cent of GDP, was established in April 2020 to strengthen the healthcare system and support vulnerable workers and affected businesses. Its revenues come from the state budget as well as loans from the International Monetary Fund, World Bank and Asian Development Bank (totalling more than US$ 1 billion). The fund finances spending on medicine, healthcare and medical workers' bonuses. It also allocates funding to support employment through public infrastructure works and development of private land plots of low-income families. Several sectors, such as aviation (Uzbekistan Airways) and transport (Tashkent Metro), received financial support during lockdown. In addition, the fund covers government expenditures on provision of liquidity, interest subsidies and guarantees to businesses.

The central bank eased monetary policy but maintained prudential requirements. As inflationary pressures eased, the central bank's policy rate was reduced from 16.0 per cent to 15.0 per cent in April 2020, and to 14.0 per cent in September 2020. In January 2020 the central bank introduced an interest rate corridor of plus/minus 1 per cent around the policy rate as part of its transition to an inflation-targeting regime, with the target rate declining from 10 per cent in 2021 to 5 per cent in 2023. In terms of prudential measures, the regulator recommended that banks deferred loan repayment by affected individuals and entrepreneurs until October 2020. Some banks were given access to targeted refinancing operations from the central bank.

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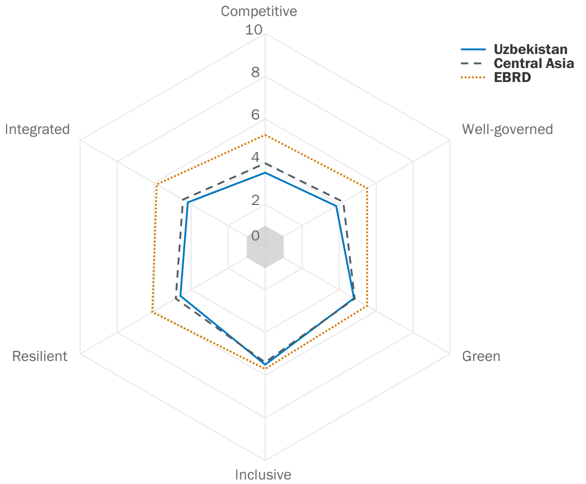
Assessment of transition qualities (1-10)



Structural reform developments

A new banking sector development strategy has been approved. The strategy, approved in May 2020, sets out an ambitious reform plan for the period 2020-25. It seeks to reduce state ownership in the banking sector and state-directed lending to the private sector. The government intends to keep shares in only three banks – the National Bank for Foreign Economic Activity, Agrobank and Microcreditbank. Other measures include improving the legal framework by introducing Basel standards and international financial reporting standards, facilitating digitalisation and improving customer services. Lastly, the reform calls for new preferential loans to be issued at interest rates not lower than the refinancing rate since 1 January 2020 and not lower than market rates as of 1 January 2021.

The authorities outlined post-Covid development plans for the transport sector. In the airline sector the aim is to attract new air carriers in order to increase competition and outsource the management of Uzbekistan Airways to an experienced foreign company. Airports will be modernised by attracting private investments through public-private partnerships. The plan for the railways sector is to restructure the non-core activities of the state-owned integrated monopoly, Uzbekistan Temir Yullari, and improve the tariff-setting mechanisms. The introduction of the "user pays" principle is envisaged for the road sector.

The government is planning to implement energy sector reforms to meet growing demand for electricity. Its efforts will be guided by the Concept for Provision of Electric Energy to Uzbekistan in 2020-30, which was approved in May 2020. The concept envisages transition to the wholesale electricity market by 2023, the establishment of an independent energy regulator in 2020-21, and the introduction of differentiated tariffs for electricity from 2022. In addition, there are plans to create an energy market operator – a state-owned company with online platforms for wholesale market customers to carry out purchases and sales of electricity and natural gas. The government also sets new targets for power generation, including solar, hydro, wind and nuclear power to meet growing demand (annual power consumption is expected to rise by 6-7 per cent a year until 2030).

Development of the agricultural sector is advancing under a new strategy. Approved in October 2019, Uzbekistan's Agriculture Development Strategy for 2020-30 aims to liberalise the sector, remove export barriers and eliminate mandatory production quotas for cotton and wheat. It provides a plan for diversifying agricultural production, phasing out state control of production, and the sale and processing of cotton and wheat. Agribusiness clusters will be created in the cotton,

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wheat, horticulture and livestock sectors in order to attract private capital, increase value added through deeper processing, and improve access to export markets. The sector's development will be accompanied by measures to ensure environmental protection and efficient use of resources.

Reforms have been introduced to the rule of law. Recent presidential decrees seek to advance the rule of law by introducing plea bargaining arrangements and ensuring greater independence of lower level courts. The plea bargaining mechanism will pave the way for faster trials and shorter prison terms for suspects who cooperate with investigators. In addition, a presidential decree from 24 July 2020 introduced additional measures to further improve judicial procedures. A panel of judges within the Supreme Court will consider investment disputes and competition involving large investors.