# ALBANIA

## Highlights

- **The economy has started to recover in 2021.** After a 3.3 per cent contraction in 2020, gross domestic product (GDP) rose by 17.9 per cent year-on-year in the second quarter of 2021, driven by a recovery in domestic and external demand.
- **A new law on climate change has been adopted.** The law is an important step towards a comprehensive legal and inter-institutional framework for climate action at the national level.
- **A large-scale overhaul of the railway network has started.** In early 2021 the contract to upgrade the railway linking the capital, Tirana, with the country's largest port, Durres, was signed.

## Key priorities for 2022

- **Fiscal reforms need to be strengthened to ensure sustainability of long-term public debt.** The authorities should maintain targeted support for those affected by the Covid-19 pandemic but also adopt an appropriate medium-term revenue strategy, improve public investment management and enhance the management of fiscal risks stemming from public-private partnerships, state-owned enterprises and government guarantees.
- **The business environment needs to be improved so that more private-sector companies can reach their potential.** Simplifying the tax system and procedures, strengthening the public administration capacity and fighting corruption would help reduce informality and level the playing field for businesses.
- **Financial stability should be monitored carefully.** The financial sector has remained liquid and stable throughout the Covid-19 pandemic but attention needs to be paid to the progress of restructured loans to detect any potential vulnerabilities early.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 3.8 | 4.0 | 2.1 | -3.3 | 8.0 |
| Inflation (average) | 2.0 | 2.0 | 1.4 | 1.6 | 1.9 |
| Government balance/GDP | -1.4 | -1.3 | -2.0 | -6.9 | -6.7 |
| Current account balance/GDP | -7.5 | -6.7 | -7.9 | -8.9 | -8.6 |
| Net FDI/GDP [neg. sign = inflows] | -8.6 | -8.0 | -7.5 | -6.9 | -6.7 |
| External debt/GDP | 68.8 | 65.1 | 60.0 | 66.0 | n.a. |
| Gross reserves/GDP | 25.9 | 26.5 | 24.4 | 30.3 | n.a. |
| Credit to private sector/GDP | 34.8 | 33.0 | 34.4 | 38.9 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy has started to recover.** GDP contracted by 3.3 per cent in 2020, mostly on the back of lower exports – especially of services, which make up nearly 75 per cent of all exports and primarily consist of tourism receipts – and a drop in household consumption. The GDP contraction was smaller than expected, mainly because of accommodative fiscal policies and an uptick in construction and real estate sector activities (especially in the second half of 2020), linked to rebuilding activities following the November 2019 earthquake. GDP rose by 5.5 per cent year-on-year in the first quarter of 2021 and by 17.9 per cent in the second quarter, driven by strong investment growth, higher consumption and a healthy export recovery in the second quarter. Exports of goods increased by more than 30 per cent year-on-year in nominal terms in the first nine months of 2021, largely on the back of construction materials, metals, mineral products and textiles and footwear. The tourism sector also seems to be recovering. After the government lifted all Covid-19 pandemic restrictions for foreigners entering the country, the number of tourists in June, July and August 2021 almost reached levels seen in the same months in 2019. This recovery was largely due to more tourists from neighbouring Kosovo and North Macedonia.

**Public debt remains high.** General government debt increased sharply in 2020 by around 10 percentage points, reaching 77.6 per cent of GDP at the end of the year. A further increase is likely, as in June 2021 the government announced plans to place another Eurobond by the end of the year.

**GDP should exceed its 2019 level by the end of 2021.** A rebound is under way in 2021, with GDP expected to grow by 8.0 per cent, as household consumption demand and the tourism sector are recovering well. The planned large public investment programme, including continued reconstruction activities after the 2019 earthquake, should also boost domestic demand. Goods exports are also picking up strongly. The economy is expected to grow further at 3.7 per cent in 2022. These forecasts assume that there will be no resurgence of the Covid-19 pandemic; downside risks include the possibility of further tourism disruptions during the post-pandemic phase.

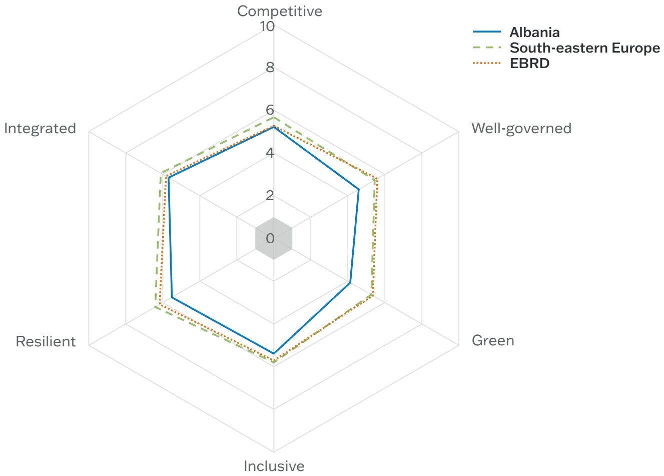
## Policy response to Covid-19

**A new guarantee fund is to be established.** After two sovereign guarantee funds in 2020, in June 2021 the government announced plans to launch a third one. The €100 million fund is to issue loan guarantees to companies whose operations were negatively affected by the containment measures, primarily companies in tourism and manufacturing. The guarantees should be equally divided between the two sectors.

**The total budget for Covid-19-related expenditures in 2021 is 1.0 per cent of GDP.** The budget targets extra spending on healthcare, including higher wages for healthcare workers, along with increased social assistance and unemployment benefits. In January 2021 the Bank of Albania (BoA) extended the suspension of dividend distribution by banks until the end of 2021. In February 2021 the BoA and the European Central Bank (ECB) agreed to prolong the duration of the repurchase agreement (repo) line set in mid-2020 until March 2022. The BoA can borrow up to €400 million from the ECB in exchange for adequate euro-denominated collateral.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**No decision has been made on the opening of European Union (EU) accession negotiations.** Despite the green light in March 2020 and the fact that Albania subsequently met the conditions set by the European Council for organising the first intergovernmental conference (IGC), no consensus on the IGC (the formal start of negotiations) has been possible in 2021. In June 2021 the Council concluded that this issue ought to be addressed during Slovenia's presidency of the EU in the second half of 2021.

**The government is developing a strategy to promote business and investment.** In July 2021 a new Business and Investment Development Strategy 2021-27 and the associated action plan were adopted following public consultations held in June. The strategy aims to improve access to finance for businesses, introduce a financial scheme for human capital development and attract foreign investors while retaining existing ones. Also, new tax legislation entered into force in 2021. Taxpayers with an annual income of less than ALL 14 million (€115,000) now pay zero corporate income tax (versus 5 per cent previously). The same applies for local taxes for taxpayers with an annual turnover of less than ALL 8 million (€65,000), while the threshold for the application of value added tax (VAT) has been increased fivefold, to ALL 10 million (€80,000). In addition, a new fiscal reform was introduced to mandate online reporting of all issued invoices and receipts for all businesses, thus aiming to reduce informality and increase fiscal revenues.

**The country has adopted the Law on Climate Change.** The law, approved in December 2020, envisions, among other measures, submitting the country's Nationally Determined Contribution on reducing greenhouse gas emissions to the United Nations Framework Convention on Climate Change, and creating a comprehensive legal and inter-institutional framework for climate action at national level. In addition, it provides the legal basis for the country to adopt the National Energy and Climate Plan for the period 2021-30.

**The construction of the third-largest solar park in the country is advancing.** In March 2021 French company Voltalia won the tender to build and operate the 100 MW Spitalle solar park in Durres.

CONTINUES

**The authorities are set to increase the number of international airports in the country to support tourism development.** In April 2021 Albania opened its second international airport in Kukes in the north east of the country. The airport was built in 2006 but was not made operational until now. Progress has also been made in the past year towards building further airports. In November 2020 the government reopened a tender for the construction of a new airport in Vlora, in the south of the country. Four months later, a 35-year concession for operating Vlora Airport was approved. And in August 2021 a €37 million tender was announced for the construction of a fourth airport, in the southern city of Saranda.

**A large-scale overhaul of the railway network in Albania has started.** In February 2021 the first contract for upgrading works was signed, supported by the European Bank for Reconstruction and Development (EBRD) and the EU. Under the contract, more than 34 km of the existing railway between Tirana and the country's largest port (Durres) will be upgraded. In addition, a new 5 km rail track connecting Tirana city with Tirana International Airport will be constructed.

**The banking sector remains well capitalised and liquid but non-performing loans (NPLs) are still relatively high.** At the end of March 2021 the capital adequacy ratio stood at 18.1 per cent and one-third of banks' assets were liquid. The NPL ratio has slightly declined over the past year but, at 7.8 per cent at the end of May 2021, it remains the highest in the Western Balkans and could start rising again if the economy fails to recover as predicted.

# ARMENIA

## Highlights

- **The twin shocks of the Covid-19 pandemic and the conflict in Nagorno-Karabakh caused a strong fall in economic activity in 2020.** Gross domestic product (GDP) declined by 7.4 per cent in 2020 before recovering by 4.4 per cent from January to September 2021.
- **Access to external financing helped fund the Covid-19 policy response.** The Economic Response Programme, aimed at supporting economic recovery, is benefiting from funds received under the International Monetary Fund (IMF) programme and the issue of a US$ 750 million Eurobond in early 2021.
- **Anti-corruption reforms are continuing.** Parliament approved the formation of an Anti-Corruption Committee and an Anti-Corruption Court in 2021.

## Key priorities for 2022

- **Structural reforms to support economic recovery and strengthen Armenia's resilience are needed.** They should focus on: strengthening governance and institutions; enabling the independence and competence of the judiciary; improving the insolvency resolution framework; improving corporate governance standards; and making continued progress on improving the competition framework.
- **Further efforts should be made to use the natural potential for renewables to tilt the economic recovery to green.** Favourable natural conditions for renewables, paired with a conducive regulatory environment, could attract foreign direct investment (FDI) in this area. This is even more important, bearing in mind the country's high import dependence on fossil fuels and its need to maintain competitiveness.
- **The right balance is needed between the increased public debt level and large infrastructure investment needs.** The authorities should prioritise and implement efficiency-enhancing infrastructure investment, while ensuring fiscal discipline and keeping public debt within manageable levels.

**Main macroeconomic indicators %**

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 7.5 | 5.2 | 7.6 | -7.4 | 5.0 |
| Inflation (average) | 1.0 | 2.5 | 1.4 | 1.2 | 6.9 |
| Government balance/GDP | -4.8 | -1.8 | -1.0 | -5.4 | -4.0 |
| Current account balance/GDP | -1.5 | -7.0 | -7.4 | -3.8 | -2.9 |
| Net FDI/GDP [neg. sign = inflows] | -1.9 | -2.1 | -1.7 | -0.6 | -1.6 |
| External debt/GDP | 91.3 | 87.7 | 90.9 | 102.1 | n.a. |
| Gross reserves/GDP | 20.1 | 18.1 | 20.9 | 20.7 | n.a. |
| Credit to private sector/GDP | 53.0 | 57.1 | 62.6 | 73.3 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The Armenian economy was hit by twin shocks in 2020.** Economic activity contracted by 7.4 per cent in 2020 as the flare-up of the conflict in Nagorno-Karabakh in the second half of the year hit an economy already affected by the Covid-19 pandemic. The decline was broad-based as household consumption, investments and exports plummeted. Nevertheless, macroeconomic stability was preserved throughout 2020, as a strong import contraction outweighed the decline in export revenues, which helped to contain currency pressures and supported exchange rate stability throughout most of the year. Depreciation reappeared from November 2020 on the back of rising uncertainties but the exchange rate stabilised at the beginning of 2021. Inflation rose from 1.2 per cent in 2020 to 8.9 per cent year-on-year in September 2021 as a result of higher international food prices and a pass-through of Armenian dram depreciation. This prompted the Central Bank of Armenia to raise the re-financing rate five consecutive times, by 3 percentage points in total, to 7.25 per cent in September 2021.

**The external sector remained stable.** The authorities concluded the third review under the IMF programme in December 2020 and tapped external markets by issuing a US$ 750 million Eurobond in early 2021 to help finance the projected fiscal deficit. Armenia's public debt increased from 50.1 per cent of GDP in 2019 to 63.5 per cent in 2020 on the back of spending pressures to support the economy. The current account deficit narrowed from 7.4 per cent of GDP in 2019 to 3.8 per cent in 2020 mainly on the back of import contraction. Money transfers increased by 32.5 per cent year-on-year in the first half of 2021, versus a 17.4 per cent contraction in 2020, largely driven by a strong growth of transfers from the United States of America. This trend mostly reflects the increased share of remittances sent through formal channels, as long-distance travel remains constrained. International reserves remain at prudent levels, close to US$ 3.2 billion in September 2021 and cover approximately eight months of imports.

**The economic recovery is accelerating.** After a decrease of 3.3 per cent (year-on-year) in the first quarter of 2021, the economy achieved a growth of 5.0 per cent overall in the first six months as nearly all sectors of the economy posted strong growth in the second quarter. We expect GDP growth of 5.0 per cent in 2021, rising to 5.3 per cent in 2022. However, the economic recovery is faced with downside risks from the slow speed of vaccinations, especially in light of new and potentially more infectious virus strains. Risks also stem from geopolitical instability.

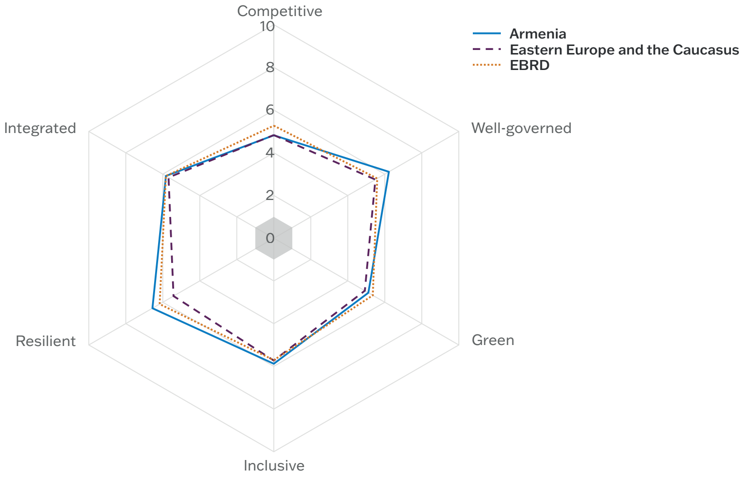
## Policy response to Covid-19

**The aim of immediate relief measures in 2020 was to support those most affected by the Covid-19 pandemic.** The authorities, together with banks' support, allocated US$ 367 million (2.9 per cent of GDP) to support the economy in 2020. Measures included subsidised loans to the most affected sectors and businesses, in particular tourism and agriculture, grants to the private sector, direct wage subsidies to micro, small and medium-sized enterprises (MSMEs), and a strengthened social assistance programme with additional lump sum transfers. The main aim was to preserve jobs and thus protect the most vulnerable. Banks were advised to undertake voluntary loan restructuring and offer limited payment holidays to ease the liquidity pressures facing borrowers.

**The government approved the Economic Response Programme and relevant action plan in February 2021 to support the economic recovery in 2021.** Through 12 targeted actions and 14 assistance programmes, the government aims to restore economic activity, maintain viable and reliable business and consumer environments, and develop a medium-term economic policy agenda.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**A centralised register of bank accounts of individuals was introduced in the regulatory framework.** In June 2021 parliament approved an initiative of the Central Bank of Armenia to create a centralised register of bank accounts of individuals. By doing this, the legislature is aligned to global standards for combating money laundering and the financing of terrorism, and meets one of the obligations within the European Union (EU)-Armenia Partnership Agreement (CEPA). In future, this will be the foundation for innovative ideas related to the automation of bank accounts of citizens and it forms the appropriate infrastructure for advancing the online services sector. At the moment, the main purpose is to reduce operating costs when authorised bodies from law enforcement agencies apply for data.

**Armenia is advancing its digitalisation efforts.** A new digitalisation strategy, approved in February 2021, aims to advance the digital transformation of state institutions, individual economic sectors and society, through innovative technologies, cyber security and a data processing policy within the public administration. The goal of the strategy is to ensure system interoperability, introduce common standards, and implement educational programmes and various digital tools. This is expected to improve the quality of public services, increase public governance efficiency, promote institutional digitisation and infrastructure development, encourage data-driven decision-making and help develop a highly skilled workforce.

**Anti-corruption reforms continued.** In March 2021 parliament voted in favour of replacing the Special Investigative Service with an Anti-Corruption Committee with enhanced detection and investigative powers to examine corruption cases. A law on the creation of the Anti-Corruption Court, which will specialise in corruption crimes and anti-corruption civil cases and will have the right to examine the lawsuits for confiscation of property of illegal origin, was adopted in April 2021. Both laws are part of the government's anti-corruption strategy adopted in 2019, aiming to curb corruption and strengthen the rule of law in Armenia.

CONTINUES

**Armenia is increasing its efforts to tackle climate change.** In April 2021 the government approved Armenia's updated nationally determined contributions (NDCs) under the Paris Agreement for 2021 to 2030. The new NDCs are more ambitious and now include the goal to reduce greenhouse gas emissions by 40 per cent by 2030 from 1990 levels. Furthermore, Armenia has the ambition to double the share of renewable energy in its energy production by 2030, as well as to increase the forest cover by 12.9 per cent of the territory of Armenia in the same period.

**Amended legislation on the rights of people with disabilities will help to reduce discrimination.** In May 2021 the government amended the law on the rights of people with disabilities. The aim of the new law is to end discriminatory practices and to improve the disability assessment so that it is based on the extent of limited functionality and personal needs rather than on the degree of disability only. Thus, the new law creates opportunities for a more inclusive society.

# AZERBAIJAN

## Highlights

- **Economic recovery is under way.** The main driver of the recovery is the non-hydrocarbon sector but the oil and gas sectors are starting to contribute strongly too, with the rising demand for, and price of, oil, supported by an expected gradual increase in oil quotas.
- **A new reform vision has been developed.** The "Azerbaijan 2030" strategy outlines the main directions and priorities of sustainable socio-economic development. A draft strategy of socio-economic development in 2021-25 accompanies the vision.
- **A new regulatory framework to support renewable energy is in place.** It outlines the framework for foreign investment and specifies incentives for private investors.

## Key priorities for 2022

- **Diversifying the economy would enhance its resilience to shocks.** This includes continuously improving the business environment to support private-sector development, as well as pursuing commercialisation and governance reforms in the state sector to increase efficiency. Considering the current regional disparities in the country, a balanced territorial approach is essential.
- **Implementing the "Azerbaijan 2030" vision and the accompanying strategies needs to go hand in hand with enhancing public administration capacity.** Public agencies and ministries need to be properly staffed, their expertise enhanced and the operational framework strengthened to effectively transform the long-term vision into socio-economic development of the country.
- **The authorities should continue to develop a sustainable and competitive energy market with a sound regulatory framework and institutions.** The new regulatory framework for renewables, which sets the groundwork for increased participation of the private sector, should be used as a stepping stone for greening the energy sector.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 0.2 | 1.4 | 2.5 | -4.3 | 4.0 |
| Inflation (average) | 12.9 | 2.3 | 2.6 | 2.8 | 4.4 |
| Government balance[1]/GDP | -1.3 | 5.5 | 9.1 | -6.5 | -1.8 |
| Current account balance/GDP | 4.1 | 12.8 | 9.1 | -0.5 | 7.8 |
| Net FDI/GDP [neg. sign = inflows] | -0.7 | 1.7 | 2.9 | 1.8 | -0.8 |
| External debt[2]/GDP | 22.8 | 19.0 | 18.9 | 20.7 | n.a. |
| Gross reserves[3]/GDP | 13.1 | 11.9 | 13.0 | 14.9 | n.a. |
| Credit to private sector/GDP | 16.7 | 16.3 | 18.7 | 20.1 | n.a. |

[1] Includes central government and main extrabudgetary funds, including operations of the oil fund and the social protection fund.
[2] Public and publicly guaranteed external debt outstanding.
[3] Excluding assets of the State Oil Fund (SOFAZ).

CONTINUES

## Covid-19: macroeconomic implications

**The economic recovery in 2021 is being driven by the non-oil and gas sectors.** After being hit by a triple shock – the Covid-19 pandemic, a slump in oil prices and the flare-up of the conflict over Nagorno-Karabakh – Azerbaijan's gross domestic product (GDP) declined by 4.3 per cent in 2020. A strong contraction in the oil and gas sector of 7.2 per cent was balanced by a softer decline in the rest of the economy, which was helped by the government's extensive support package. Non-hydrocarbon sectors started to recover in 2021, posting 6.2 per cent year-on-year growth from January to September 2021. However, overall GDP growth, estimated at 4.8 per cent year-on-year in the same period, continues to be weighed down by lower oil and gas production on the back of the Organization of the Petroleum Exporting Countries (OPEC) oil production cut. Exports, which are dominated by hydrocarbons, remained at the 2020 level in real terms from January to August 2021 (year-on-year). Monetary policy was loosened in 2020 as demand remained tightly constrained and inflation low. However, in spite of currency stability, increasing global price pressures are pushing inflation from an average of 2.8 per cent in 2020 up to 8.5 per cent in September 2021.

**Large assets of the State Oil Fund of Azerbaijan (SOFAZ) helped to weather the crisis.** Lower oil revenues on the back of the price slump and the production decline turned external and fiscal surpluses to deficits in 2020. The current account balance turned from a surplus of 9.1 per cent of GDP in 2019 to a small deficit of 0.5 per cent in 2020, while the fiscal balance went from a surplus of 9.1 per cent in 2019 to a deficit of 6.5 per cent in 2020. However, Azerbaijan's public debt remained low at 23.4 per cent of GDP in 2020 despite the ensuing gaps, as funding needs were met domestically by drawing on the large assets of SOFAZ. International reserves remained relatively stable, at US$ 7.0 billion in September 2021, covering almost eight months of imports.

**Recovery is expected to continue but risks remain significant.** Rising demand for, and higher prices of, oil, supported by an expected gradual increase of oil quotas in the coming months, will strengthen the overall economic performance in the second half of 2021. The non-oil and gas economy is expected to stay on the recovery path. On this basis, the economy is forecast to grow by 4.0 per cent in 2021 and 3.2 per cent in 2022. Numerous risks remain, related to structural weaknesses of the economy, geopolitical developments, the speed of vaccinations and possible volatility in commodity prices.

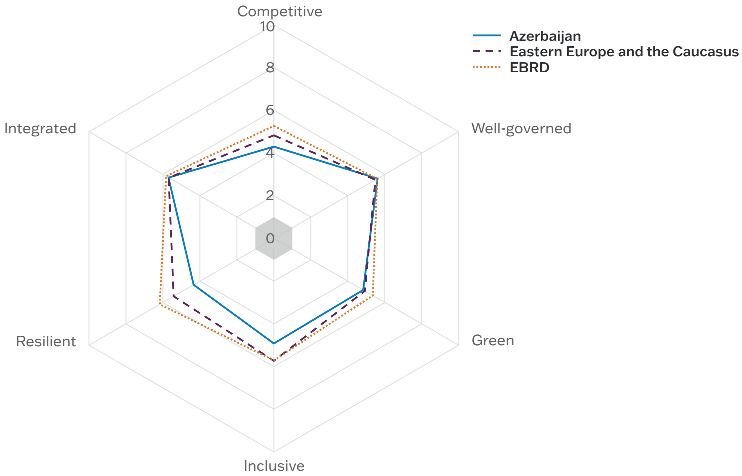
## Policy response to Covid-19

**The authorities implemented a crisis response package of economic and social support in 2020.** The package was worth in excess of 4.6 per cent of GDP. It included wage subsidies, support for micro entrepreneurs, extended payment deadlines for various taxes, loans to businesses on preferential terms, state guarantees and subsidised interest rates on the existing loan portfolios of small and medium-sized enterprises (SMEs). The Central Bank of Azerbaijan relaxed capital requirements and risk weights on mortgage loans, introduced a moratorium on late fees and interest rate penalties and suspended inspections of credit institutions. The full deposit insurance scheme was once again extended in December 2020, until April 2021. The upper limit of the insured amount was increased and, to support SMEs, deposits of individual entrepreneurs to a certain threshold have been included in the scheme. Comprehensive social assistance measures bolstered the overall economic support programme.

**Efforts to support the economy continue in 2021.** The 2021 budget allocated another AZN 261 million (0.3 per cent of GDP) to fight the Covid-19 pandemic. Benefits to businesses have been expanded and additional social assistance has been provided. At the beginning of the year, the Central Bank of Azerbaijan lifted some measures introduced in 2020, including resuming inspections of credit institutions and reinstating additional capital requirements for consumer loans.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The government has outlined its main directions and priorities of sustainable socio-economic development until 2030.** In February 2021 the president signed a decree on "Azerbaijan 2030: National Priorities for Socio-Economic Development", outlining a long-term framework of policies and reforms. The framework includes strengthening the connections between society, businesses and the state. It outlines the following key factors for economic recovery: effective and efficient management of the state's role in the economy via market-oriented reforms, bolstering private institutions, government-friendly business management and further liberalisation of trade practices. The Cabinet of Ministers is expected to prepare a draft strategy of socio-economic development in 2021-25 within nine months of the approval of "Azerbaijan 2030".

**The authorities are stepping up efforts to promote renewable energy.** A new law on the use of renewable energy sources in the production of electricity, approved in May 2021, was signed by the president in July, together with a presidential decree on implementing the renewable energy law. The law outlines the regulatory framework for foreign investment and specifies incentives for investors in renewable energy source projects in Azerbaijan, including guaranteed off-take and connection, priority in transmission and distribution, and long-term land leases. Additional efforts in the past year to green the economy include publishing an in-depth review of the energy efficiency policy, which will be followed by a national action plan to enhance energy efficiency.

**There is more awareness of the need to enhance digitalisation of government services.** In February 2021 a mobile application of the government portal "myGov" was launched to make public services more accessible. The Central Bank of Azerbaijan also continued its efforts to expand digital payments in the country. Strategic cooperation agreements and a memorandum of understanding were signed with Visa and MasterCard. These include initiatives to support key drivers accelerating the development of the payment market, introducing innovative payment solutions, increasing mobile payments, as well as expanding financial literacy and inclusion.

# BELARUS

## Highlights

- **The impact of Covid-19 on economic growth in 2020 was limited.** The authorities did not impose a full lockdown but they increased support to the real sector and halted the gradual phasing-out of directed bank lending to the state sector. The contraction of the services sector and domestic consumption was moderate, while manufacturing remained flat.
- **Economic recovery in the short term is facing significant uncertainty due to sanctions.** Export industries could have serious challenges in reaching developed Western economies while many domestic industries could face supply disruptions.
- **The general environment in the country and the business climate have been worsening.** Developments after the presidential elections and sanctions imposed by many developed economies made investors more reluctant than before to engage in the country.

## Key priorities for 2022

- **The authorities should resume the gradual phase-out of directed lending.** During the Covid-19 pandemic, the support of state-owned banks to state-owned enterprises (SOEs) helped weather the negative impact of the Covid-19 crisis. However, this also significantly increases vulnerabilities in the medium term.
- **A regulatory level playing field is needed to unleash the full potential of private companies.** Private companies still face regulatory discrimination in many sectors of the economy. Liberalising economic governance and introducing appropriate market regulation are critical for restarting the stalled economy.
- **Improving corporate governance and commercialising the state-owned sector are utmost priorities.** Inefficiencies and a lack of corporate governance in SOEs are seriously undermining the growth potential of the economy. Further delays to corporate governance reforms will have long-term negative consequences on SOE valuations and growth prospects.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 2.5 | 3.1 | 1.4 | -0.9 | 2.0 |
| Inflation (average) | 6.0 | 4.9 | 5.6 | 5.5 | 9.2 |
| Government balance[1]/GDP | -0.3 | 1.8 | 0.9 | -2.9 | -3.9 |
| Current account balance/GDP | -1.7 | 0.0 | -1.9 | -0.4 | 0.4 |
| Net FDI/GDP [neg. sign = inflows] | -2.2 | -2.3 | -2.0 | -2.2 | -1.8 |
| External debt/GDP | 72.8 | 65.5 | 63.1 | 70.0 | n.a. |
| Gross reserves/GDP | 13.4 | 11.9 | 14.6 | 12.4 | n.a. |
| Credit to private sector/GDP | 20.9 | 21.3 | 21.9 | 23.7 | n.a. |

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

CONTINUES

## Covid-19: macroeconomic implications

**In the absence of a full lockdown, the impact of Covid-19 on the economy in 2020 was limited.** Gross domestic product (GDP) contracted by 0.9 per cent in 2020 due to a decline in final consumption and investment by 1.4 and 8.3 per cent respectively, while net exports increased by 2.7 per cent. The services sectors fell by only 2.1 per cent. However, subsidised lending to SOEs and sustained real wage growth alleviated the impact of reduced global demand and supported domestic demand. Manufacturing remained flat, while ICT services and agriculture even enjoyed 7.0 and 5.3 per cent growth, respectively. Following the disruptions after the presidential election in August 2020, household deposits in banks and the currency came under pressure. In total, the Belarusian ruble depreciated by 18.2 per cent against the US dollar in 2020. In 2021 the currency stabilised to a large extent, as did the level of deposits withdrawal. However, the lagged pass-through from currency depreciation and rise of global food and energy prices pushed inflation to 10.2 per cent year-on-year in September 2021, well above the target rate of 5 per cent. This caused the National Bank of the Republic of Belarus to raise the refinancing rate twice, once in April and again in July 2021, from 7.75 per cent initially to 9.25 per cent in July. Consumption and investment remained weak, while net exports and manufacturing have been the main drivers of growth, which stood at 2.7 per cent year-on-year from January to September 2021.

**Fiscal and financing constraints gave little room for manoeuvre.** The fiscal position turned from a surplus of 0.9 per cent of GDP in 2019 to a deficit of 2.9 per cent in 2020. At the same time, foreign reserves declined from a historical high of US$ 9.4 billion at the end of 2019 to US$ 7.4 billion in July 2021, covering only 2.4 months of imports. This combination of a lack of available foreign financing, a low level of foreign reserves and substantial debt obligations have left the authorities little room to tackle the impact of economic sanctions. Access to external financing remains difficult and dependent on support from Russia. US$ 500 million was provided through the Eurasian Fund for Stabilization and Development (EFSD) in October 2020. In December 2020 Russia approved a US$ 1 billion loan to Belarus, paid in two tranches in 2020 and 2021. A new International Monetary Fund Special Drawing Rights allocation brought a windfall of almost US$ 1 billion in August 2021, lifting foreign reserves to US$ 8.5 billion and temporarily easing external financing pressures.

**Short-term prospects for recovery are uncertain amid economic sanctions and the ongoing political crisis.** Amid a deteriorating environment, the economy is predicted to grow by 2.0 per cent in 2021 and 0.2 per cent in 2022. Economic sanctions and targeting of the export-focused potash and petroleum industries are expected to hit the economy, although with some time lag due to the exemption of contracts concluded before the sanction date. In addition, sanctions-related supply shortages of products originating from developed economies could cause disruption of the production process in many companies. While direct lending of state-owned banks to SOEs helped to sustain the economy through the Covid-19 pandemic, vulnerabilities will likely increase in the medium term.

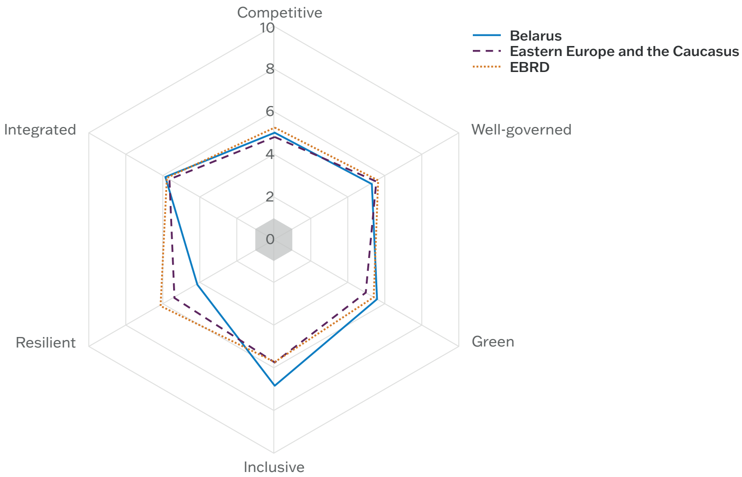
## Policy response to Covid-19

**The country's crisis-response measures in 2020 were limited amid the resumption of directed lending.** Measures included capping price increases on socially important goods, delinking wages from productivity growth in the state sector, production subsidies for public-sector organisations and a significant increase in new directed loans to SOEs. The National Bank of the Republic of Belarus eased prudential requirements, issued guidance to banks recommending loan holidays for targeted customers, released some of its capital buffers and extended the maturity of its refinancing loans.

CONTINUES

**The government extended its 2020 package of fiscal measures to the end of 2021.** Measures include additional resources for the healthcare sector (such as salary allowances for essential personnel) and tax relief and deferrals to support affected businesses. Employers at risk of having to reduce employment or close down were able to apply for wage subsidies for their employees up to the legal minimum for the period 1 May through to 31 July. Monthly allowances for eligible citizens were extended until August. Most measures were implemented at the local government level. The national vaccination plan for 2021-22 was approved in February 2021. Belarus started producing the Sputnik vaccine and mass vaccination is currently ongoing.

Assessment of transition qualities (1-10)




## Structural reform developments

**The general business climate worsened after the presidential elections in August 2020.** Among other developments, in May and June 2021 the president signed new laws that significantly limit news media activities and increase the penalties for attending unauthorised demonstrations. The new laws allow the Ministry of Information to shut down media outlets without a court hearing. The penalty for attending protests has been increased from fines or a short jail sentence of up to two weeks, to potentially up to three years. The deterioration of the human rights situation after the presidential elections and resulting sanctions imposed by many developed economies  have made potential investors more reluctant than before to engage in the country. International financial institutions have reduced their engagement with Belarus. The reform agenda was, to a large extent, crowded out from the authorities' priorities in the last 12 months.

**Previously started activities for integration into the global financial system and digital advances were completed**. In early 2021 the Ministry of Finance joined the International Organization of Securities Commissions (IOSCO) as an associate member. This would have supported the integration of the securities market into the global financial system if financial sanctions had not been introduced. Furthermore, the expansion of remote customer service systems in the non-banking segment of the financial market is ongoing, thus advancing the digital preparedness of the country. In December 2020 amendments to the tax code created the preconditions for the practical functioning of investment funds, aiming to stimulate the creation of new funds through a preferential taxation regime. The first special depository of investment funds was created in 2020.

CONTINUES

**Currency control regulations were further liberalised.** In April 2021 legislation was passed that formalises existing government decrees abolishing restrictions on foreign exchange operations. Individuals and legal entities can open bank accounts at foreign banks without restrictions. The National Bank of Belarus and the government can jointly introduce temporary currency restrictions for a period not exceeding one year in cases of threats to the economic security and stability of the financial system.

# BOSNIA AND HERZEGOVINA

## Highlights

- **Economic recovery has started in 2021.** After a gross domestic product (GDP) contraction of 3.2 per cent in 2020, the first half of 2021 was marked by positive signs for the economy, including strong growth in manufacturing output, exports and tourist overnight stays.
- **Work on transitioning away from coal has started but concerns remain about environmental sustainability.** One of the three state-owned power utilities in the country has agreed with the miners' union on a restructuring plan, but the country is in breach of environmental standards of the Large Combustion Plant Directive (LCPD).
- **Loan repayment moratoria and other Covid-19 response measures were extended.** Due to the worsening epidemiological situation in early 2021, the loan repayment moratoria were prolonged until June 2021 and other special measures for banking sector clients up to the end of December 2021.

## Key priorities for 2022

- **To support post-Covid-19 recovery, public capital expenditure should be boosted and strategic planning for large capital investments introduced.** The authorities currently lack a comprehensive investment strategy, and implementation of public investment projects is often slowed by weak internal capacity, lack of financing and political disagreements.
- **Reforms of state-owned enterprises (SOEs) should be stepped up.** The country still has a large and inefficient SOE sector. Establishing a clear ownership rationale, key performance indicators and an effective governance system should improve the performance of the sector, with positive spill-over effects to the private sector and whole economy.
- **Financial stability should be closely monitored and supervisory activities properly coordinated.** Although banking supervision agencies have worked together during the Covid-19 pandemic, there is no centralised macro-prudential framework in the country. In addition, some obstacles to an effective non-performing loan (NPL) resolution (for example, facilitation of out-of-court restructurings or tax treatment of NPL sales to specialised companies) remain.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 3.2 | 3.7 | 2.8 | -3.2 | 4.5 |
| Inflation (average) | 1.2 | 1.4 | 0.6 | -1.6 | 1.8 |
| Government balance/GDP | 1.8 | 1.7 | 1.4 | -4.1 | -3.3 |
| Current account balance/GDP | -4.8 | -3.3 | -2.8 | -3.8 | -3.9 |
| Net FDI/GDP [neg. sign = inflows] | -2.3 | -2.9 | -1.5 | -1.7 | -2.2 |
| External debt/GDP | 72.0 | 64.4 | 64.3 | 69.5 | n.a. |
| Gross reserves/GDP | 33.6 | 34.8 | 35.7 | 40.5 | n.a. |
| Credit to private sector/GDP | 58.3 | 57.5 | 58.0 | 58.9 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**After a recession in 2020, economic activity has been recovering in 2021.** The economy contracted by 3.2 per cent in 2020 on the back of falling exports, consumption and investment. The tourism sector was severely affected; foreign tourist arrivals decreased by 84 per cent in 2020. Trade, transport and accommodation and food services recorded a combined decline of more than 10 per cent. The crisis also hit the manufacturing sector, where production of base metals, motor vehicles and other transport equipment fell by around 25 per cent and the production of furniture, clothes and beverages by around 15 per cent. Because of the Covid-19 pandemic, remittances from the country's large diaspora also shrank by 16 per cent, negatively affecting consumption. The recovery started in the first quarter of 2021, with GDP growing by 1.5 per cent year-on-year on the back of growth in private consumption and exports. Growth accelerated in the second quarter as the economy expanded by 11.6 per cent year-on-year, with strong expansion across all expenditure categories. Manufacturing output started expanding from March, averaging nearly 9 per cent year-on-year until September, and goods exports increased sharply in the first nine months (33.1 per cent year-on-year in nominal terms). The tourism sector is also doing significantly better, with a 112 per cent increase in overnight stays of foreign tourists in the first eight months of 2021 versus a year earlier. Still, the number of overnight stays is around 55 per cent of that in the same period in 2019.

**Bosnia and Herzegovina did not secure a programme with the International Monetary Fund (IMF).** The talks between the country's authorities and the IMF on a three-year Extended Fund Facility worth €750 million ended in failure in December 2020, due to disagreement over which reforms should be included in the programme. Discussions about a new programme may restart later in 2021.

**Public debt has increased moderately.** As a result of the entity governments requiring more financing to respond to the Covid-19 crisis, public debt rose by around 4 percentage points over the past year, to 36.7 per cent of GDP at the end of 2020. In April 2021 Republika Srpska placed a five-year Eurobond worth €300 million on international financial markets (London Stock Exchange). The Republika Srpska government planned to use the proceeds to finance the budget and repay debts. Disbursement of the European Commission (EC)'s macro-financial assistance, approved in May 2020, has progressed very slowly. The disbursement of the first instalment (€125 million) is awaiting the country's ratification of the memorandum of understanding, which was signed in January 2021. IMF special drawing rights of approximately €300 million were allocated at the end of August 2021.

**Moderate growth is expected in the short term.** GDP is forecast to grow by 4.5 per cent in 2021 on the back of the ongoing recovery in exports and resumption of consumption, followed by 3.0 per cent growth in 2022. Downside risks include a potentially slower recovery in the main eurozone export markets, a possible prolonged impact of the Covid-19 pandemic on tourism and the persistent unwillingness of the authorities to undertake structural reforms and increase investor confidence.

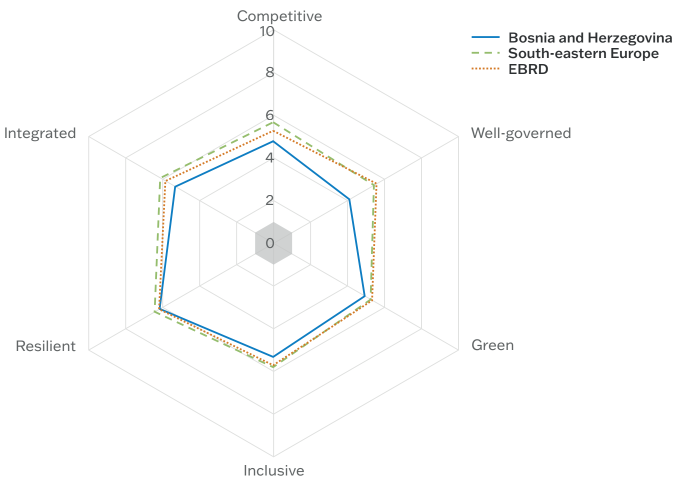
## Policy response to Covid-19

**The accommodating fiscal policy is continuing in 2021.** Fiscal measures related to the Covid-19 response in 2020 amounted to 2.5 per cent of GDP in 2020 and are projected at around 1.8 per cent of GDP in 2021. These primarily include support for firms but also households, as well as extra spending on the health sector. In 2020 the entity governments established guarantee funds to support on-lending by commercial banks. The Federation of Bosnia and Herzegovina fund (backed by government funding of around €50 million) has no expiration date. The Republika Srpska fund (backed by government funding of around €25 million) is set to expire by the end of December 2021, but may be extended.

CONTINUES

**Loan repayment moratoria and other measures adopted at the onset of the Covid-19 pandemic have been extended.** In March 2021 the application of the loan repayment moratoria, initially set to expire at the end of 2020, was extended by six months by the banking agencies of Republika Srpska and the Federation of Bosnia and Herzegovina, to June 2021. Other special measures, such as a grace period for repaying loan principal and a longer maturity for annuity loan repayments, were extended until the end of December 2021.

Assessment of transition qualities (1-10)




## Structural reform developments

**There has been limited progress in the European Union (EU) approximation process over the past year.** The country submitted an EU membership application in February 2016. In May 2019 the European Commission issued its Opinion on the application, which was subsequently endorsed by the Council. The Opinion identified 14 key priorities for the country to fulfil in order to be recommended for the status of EU candidate country. In its most recent report of October 2020, the European Commission recognised that some steps have been taken to address the key priorities from the Opinion amid the Covid-19 pandemic. However, the report also states that the country is at an early stage in its level of preparedness and ability to take on the obligations of EU membership and needs to significantly step up the process to align with the EU *acquis* and implement and enforce related legislation.

**Problems with energy efficiency and pollution have led to infringement procedures.** Bosnia and Herzegovina is in breach of environmental standards of the LCPD. As a signatory of the Energy Community Treaty, the country is subject to the LCPD, which sets emission limits for sulphur dioxide, nitrogen oxides and dust (particulate matter) for plants with a rated thermal input equal to or above 50 MW. However, with the energy sector heavily dependent on coal, the country keeps exceeding agreed limits. Consequently, the Energy Community Secretariat launched an infringement case in March 2021. This comes on top of an existing infringement process regarding the planned Tuzla 7 thermal power plant (450 MW), the construction of which remains uncertain.

CONTINUES

**A credible commitment to decarbonisation is still missing.** While work on a National Energy and Climate Plan (NECP) is ongoing, both entities currently lack a credible and firm commitment to decarbonisation, in particular to the transition away from coal-fired power. All three state-owned electricity generators have strengthened their plans for new renewable energy sources, envisaging large investments in wind, solar and new hydropower plants. Other investments in gas interconnections for heating purposes are planned. However, some of these planned projects are already marked by controversy and it remains to be seen whether the SOEs have the financial capacity to implement these significant investments. And with the authorities' lack of firm commitment to a credible NECP and regulatory framework to enable bankable private sector investments, these renewable energy investments are placed in doubt.

**Work on a transition away from coal has started in the FBiH entity.** EPBiH, one of the three state-owned power utilities in the country, has initiated a reorganisation of the coal mines to make them economically sustainable. In May 2021 the government of the Federation of Bosnia and Herzegovina, EPBiH and the miners' union agreed on restructuring, which will see the number of employees in the mines fall by 2,000 to 5,200 by 2023. This plan also envisages new investments and efforts to reskill employees. Discussions on a Just Transition Roadmap have started at the state and entity levels. Renewable energy capacity has also expanded, with the wind farm Podvelezje (48 MW of installed capacity) starting operations in March 2021. In addition, in July 2021 the EPBiH announced plans to build solar power plants on former open-pit coal mines. It also launched a public call for municipalities, individuals and legal entities to express interest in selling or leasing out land for constructing photovoltaic power plants.

**Banking sector NPLs are down but still relatively high**. The capital adequacy ratio of the banking sector stood at 18.9 per cent at the end of March 2021, well above the regulatory minimum of 12.0 per cent. At the same time, the NPL ratio of the banking sector was at 6.0 per cent, down from 6.6 per cent a year ago but with the potential to increase once loan repayment moratoria and special measures have been lifted. During the Covid-19 pandemic, the two entity banking supervisory agencies have worked closely together to implement support measures such as debt moratoria.

# BULGARIA

## Highlights

- **The economic recovery has been modest so far.** Gross domestic product (GDP) expanded by 3.4 per cent in the first half of 2021, while quarter-on-quarter growth remained negative.
- **The policy response to Covid-19 has been extended with more permanent measures in 2021.** While regional peers continued conditional support measures for employment and company liquidity, the authorities in Bulgaria have also focused on increased resources for pensions and public wages.
- **Reforms in the energy sector continue, with an enhanced focus on renewables.** Liberalisation of the electricity market will be accompanied by the introduction of market-based support for small renewable projects, while administrative barriers to renewables are being removed.

## Key priorities for 2022

- **Efficiently implementing incoming European Union (EU) funds will be critical.** As of mid-October 2021, Bulgaria has submitted its Recovery and Resilience Facility (RRF) plan and is now awaiting assessment by the European Commission. Bulgaria has requested a total of €6.6 billion in grants under the RRF. Political stability would help the country prepare for the next EU budget and adequately direct the allocation of EU funds towards key objectives.
- **Further efforts are needed to improve governance and the rule of law.** Areas that require attention include the anti-money laundering framework, the non-banking financial sector, state-owned enterprises and the insolvency framework, all of which would help the country achieve its target of adopting the euro in January 2024.
- **Moves towards decarbonisation should be stepped up.** Energy sector reforms have lagged those of Bulgaria's peers but the authorities have been considering coal phase-out dates. New opportunities for firms are opening up with the liberalisation of the market and high electricity and gas prices are creating incentives for decarbonisation.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 2.8 | 2.7 | 4.0 | -4.4 | 4.2 |
| Inflation (average) | 1.2 | 2.6 | 2.5 | 1.2 | 2.1 |
| Government balance/GDP | 0.8 | 0.1 | -1.0 | -2.9 | -3.7 |
| Current account balance/GDP | 3.3 | 0.9 | 1.9 | -0.3 | 0.5 |
| Net FDI/GDP [neg. sign = inflows] | -2.5 | -1.3 | -2.0 | -3.5 | -2.7 |
| External debt/GDP | 71.8 | 66.1 | 61.3 | 64.6 | n.a. |
| Gross reserves/GDP | 45.0 | 44.6 | 40.4 | 50.3 | n.a. |
| Credit to private sector/GDP | 49.5 | 49.8 | 48.9 | 51.3 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy remains below the pre-pandemic level.** After plunging in the second quarter of 2020 (and by 4.4 per cent in the full year 2020), GDP closed some of the gap in the third quarter of 2020. Net exports, private consumption and inventories were the main headwinds to growth in 2020, while investment and government spending held up relatively well. In 2021 the economy failed to expand, as in the first two quarters quarterly GDP growth declined by 0.1 and 0.3 per cent, respectively. Private consumption has been the main driver of growth in 2021, as investments had a sluggish performance, while export growth in the second quarter did not compensate the accelerated growth of imports supported by domestic demand.

**Pressure on government spending has increased.** At the end of July 2021 the budget recorded a 0.6 per cent of GDP surplus for the year to date, lower than the surplus recorded in 2020 and in previous years. Expenditures rose significantly in this period, by 21.4 per cent, on the back of increased social spending and personnel costs. The 2021 budget originally targeted a deficit of 3.9 per cent of GDP, but the current caretaker government has drafted a revision proposing a cash-based deficit of 3.6 per cent of GDP. The revision shifts resources to allow the government to deal with another Covid-19 infection wave in autumn 2021, cover the upcoming pension increase and continue supporting the private sector.

**Inflation has picked up in 2021.** After falling to a low of -0.6 per cent in January 2021, inflation increased to 3.7 per cent year-on-year by August 2021, largely due to higher fuel, gas and electricity prices. The wholesale electricity price on the local exchange reached record highs in August 2021, mainly due to the increase in demand and a more expensive carbon price, prompting some companies to stop production.

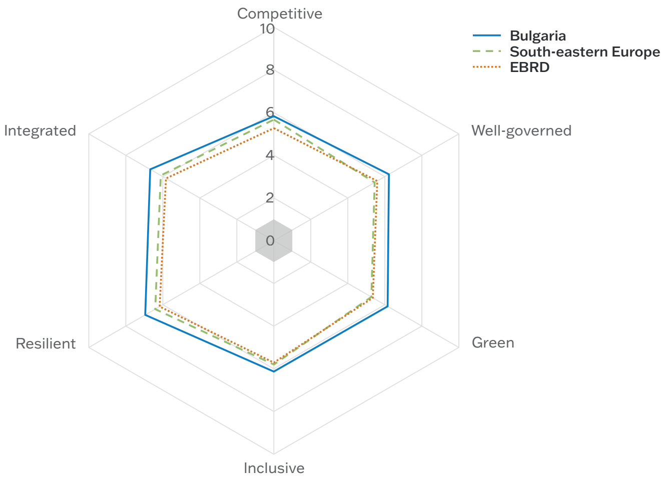
**The growth outlook remains favourable but downside risks are strong.** We forecast the economy to expand by 4.2 per cent in 2021 on the back of the expansionary fiscal policy, which is supporting consumption. The main downside risks are a prolonged political stalemate, which could affect the budget execution and EU funds absorption, and the low vaccination rate. The authorities are already preparing for another wave of infections, which could lead to new containment measures. In 2022 the economy should grow by 4.4 per cent, with EU funds expected to support investment.

## Policy response to Covid-19

**The policy response in 2021 was mostly concentrated on long-lasting policy changes.** In 2020 the authorities deployed a Covid-19 crisis-response package of about 3 per cent of GDP, centred on the 60/40 scheme covering wages, a decreased value added tax (VAT) rate in the hospitality sector until the end of 2021 and liquidity support through the Bulgarian Development Bank. In 2021 the government extended the 60/40 scheme to help preserve jobs. A pension bonus of about €25 was introduced in autumn 2020, with parliament voting for an increase to €60 from October 2021 until the end of the year. Resources were also shifted towards more permanent increases in spending, such as a 10 per cent increase in public wages and a hike of 12.5 per cent in pensions starting December 2021, on top of an indexation of 5 per cent approved in July 2021.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The competition law was updated as a step towards full alignment with EU regulations.** The amendments to the law came into force at the end of February 2021, transposing the EU directives on European Competition Network Plus (ECN+) and Unfair Trading Practices (UTP). Among the main changes are: introducing a significant impediment of effective competition test in antitrust proceedings; repealing the concept of stronger bargaining power (a rather unclear procedure introduced by Bulgaria in 2015 but not in other EU member states); and stricter deadlines for solving cases by the Commission for Protection of Competition. Other updates this year include measures to address bid rigging and the introduction of a pre-notification contact in merger proceedings.

**Digitalising the judiciary has accelerated.** Due to the outbreak of the Covid-19 pandemic and the need to respect containment measures, the judicial process has been allowed to operate digitally. In July 2020 parliament amended the Civil Procedure Code to introduce online court hearings, including administrative and criminal cases.

**The Energy Act was amended to include support for small renewables and remove indirect administrative barriers.** The premium model for renewable projects with a capacity between 0.5 MW and 1 MW was proposed in an amendment to the Energy Act in November 2020. The introduction of small renewable projects comes after premiums replaced the feed-in tariffs for projects over 1 MW in 2019 and over 4 MW in 2018. This will support further liberalisation of the energy market and provide stronger incentives to deploy renewable sources. In addition, new renewable projects will not be required to pay a contribution of 5 per cent of future income to the Security of Electricity Supply fund, set up to stabilise the electricity market.

**Competition watchdog CPC approved Eurohold's acquisition of the assets of Bulgarian power company CEZ.** After a years-long process and the initial CPC ruling against the acquisition in 2019, the process was finalised in early 2021. The European Bank for Reconstruction and Development (EBRD) agreed on a €60 million loan to Eurohold to support the €335 million acquisition and modernisation of the acquired assets, as well as digitalisation and improved governance.

CONTINUES

**A new gas interconnection project was launched to link Bulgaria with Serbia.** The project, which was announced in 2018 with construction expected to start by the end of 2021, is in line with the government's plans to ensure energy security and diversify sources. The €85 million connector will be operated by Bulgartransgaz, which, given its regional importance, has received financing from the EU and the European Investment Bank (EIB). This complements another interconnector between the two countries, which became operational in 2021 and is part of the TurkStream pipeline. A notable regulatory change is the introduction of licensing for wholesale natural gas traders.

**The Waste Management Act was updated to include more ambitious recycling targets.** The amendments, which will come into force at the start of 2022, cover increased recycling targets for packaging waste along with a phased schedule within which to reach them. The aim is to recycle 70 per cent of packaged waste by 2030. Moreover, all entities producing packaged waste are now obliged to adhere to the law, while commercial sites need to ensure they have adequate facilities to collect and separate this type of waste.

**Amendments to the law on protection from domestic violence are currently under way.** The changes aim to address the gaps and weaknesses of the current law, such as the lack of effective protection of victims, poor coordination between relevant institutions and insufficient data collection. Domestic violence remains a serious issue in Bulgarian society and the number of cases has increased since the outbreak of the Covid-19 pandemic.

# CROATIA

## Highlights

- **The economy is recovering well after a deep shock in 2020.** After recording an 8.1 per cent decline in gross domestic product (GDP) in 2020, the economy expanded by 7.8 per cent year-on-year in the first half of 2021, followed by a better-than-expected tourist season in July and August.
- **The Recovery and Resilience Facility (RRF) plan has been approved.** Croatia was among the front runners, as the European Commission approved the plan relatively early, with the first tranche of €818 million already disbursed in September 2021.
- **Renewables deployment has advanced.** Following the fully aligned premium model for renewables and new quotas, investor appetite for capitalising on Croatia's high potential in this area is rising.

## Key priorities for 2022

- **The reforms outlined in the RRF plan need to be implemented in a timely manner.** The RRF plan has multiple reform components tied to investments, ranging from business environment measures to education reforms, which will require additional efforts from the authorities. In light of the significant total allocation up to 2027 (38 per cent of 2020 GDP), European Union (EU) funds absorption capacity in general will need to improve.
- **Improvements to the corporate governance of state-owned enterprises (SOEs) should continue.** A recent Organisation for Economic Co-operation and Development (OECD) review of the existing corporate governance framework pointed to weaknesses in ownership policy, disclosure practices and board independence. Upcoming reforms to tackle these problems are part of the post-exchange rate mechanism (ERM) II accession commitments.
- **A more structured approach to reconstruction efforts in earthquake-affected areas should be developed.** Amending legal frameworks and improving institutional coordination will be major preconditions to removing the legal and financial barriers to the full implementation of post-earthquake reconstruction activities in Croatia.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 3.4 | 2.9 | 3.5 | -8.1 | 8.0 |
| Inflation (average) | 1.1 | 1.5 | 0.8 | 0.1 | 2.0 |
| Government balance/GDP | 0.8 | 0.2 | 0.3 | -7.4 | -4.1 |
| Current account balance/GDP | 3.4 | 1.8 | 2.7 | -0.8 | -0.1 |
| Net FDI/GDP [neg. sign = inflows] | -2.2 | -1.6 | -1.9 | -1.9 | -2.0 |
| External debt/GDP | 87.3 | 80.8 | 72.5 | 79.9 | n.a. |
| Gross reserves/GDP | 31.5 | 33.1 | 33.4 | 37.7 | n.a. |
| Credit to private sector/GDP | 54.4 | 53.0 | 52.2 | 58.8 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy is bouncing back strongly after a deep recession in 2020.** In 2020 GDP fell by 8.1 per cent, one of the biggest drops in output in the EU. The tourism sector was the main channel of disruption, as arrivals decreased by 64 per cent versus 2019. However, in the first half of 2021 growth was broad-based and reached 7.8 per cent year-on-year. The recovery is also reflected in the labour market, as the registered unemployment rate reached 7.3 per cent in August 2021, down from a peak of 9.8 per cent in January 2021 and already below the value recorded at the end of 2019.

**Tourism and goods exports have recorded significant growth rates.** Preliminary data are exceeding the authorities' initial expectations in 2021. By the end of August 2021 tourist overnight stays were 74 per cent of the record 2019 levels for the same period, with a longer season expected this year than in 2020. Moreover, in the first three weeks of August, overnight stays were around 90 per cent of the corresponding period in 2019, while total receipts from July to mid-August were 9 per cent higher than in 2019. Goods exports have also grown strongly in the first half of 2021, with volumes in this period being 21 per cent higher than in 2019. These two important components of the economy are supporting the accelerated recovery.

**Public finances also improved in 2021.** In the first half of 2021 the fiscal deficit inched down towards 2.6 per cent of GDP, with a target for the year as a whole of 4.5 per cent of GDP. The increase in revenues has been broad-based, while the spending increase has been milder. Public debt is projected to decrease to 83 per cent of GDP in 2021, after a significant increase from 73 per cent at the end of 2019 to 89 per cent at the end of 2020. The euro adoption plan could serve as an anchor to fiscal consolidation in the medium term, even if the final shape of the EU fiscal rules post-Covid-19 remains uncertain.

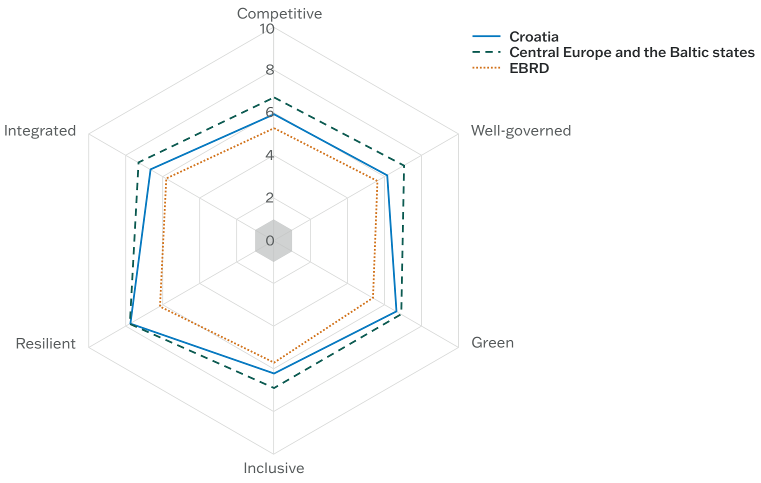
**The economic outlook continues to be positive but significant risks remain.** We forecast the economy to recover by 8.0 per cent in 2021, followed by a normalisation of growth towards 4.2 per cent in 2022. Considering the good performance of the tourism sector in the third quarter as well as the overall performance in the first half of the year, risks to the current forecast are oriented towards the upside. The main downside risk is the evolution of the Covid-19 pandemic, especially in light of the slow vaccination rate, although strict containment measures are unlikely to be reintroduced. In the medium term, EU fund absorption and associated reforms will define the extent to which growth increases above relatively low historical values.

## Policy response to Covid-19

**The authorities have continued the key job retention mechanism in 2021.** After devising a fiscal support package of about 3.8 per cent of GDP in 2020, the authorities have partially wound down assistance in 2021, estimated by the International Monetary Fund (IMF) at 2.5 per cent of GDP. The main scheme operational in both 2020 and 2021 is the job retention mechanism, which covered HRK 4,000 (€530) per retained worker in affected firms and sectors. In July 2021 the European Commission transferred €530 million from the Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU) package to support the scheme. Other support measures include grants to firms in affected sectors, including a dedicated scheme to support the tourism sector.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The RRF plan includes key structural reforms.** The €6.3 billion in grants will be targeted towards raising the productivity of the economy, primarily by enhancing the green and digital transition. On top of these two priorities, the plan outlines structural reforms in public administration, the judiciary, education, the labour market and social policy.

**The government adopted the National Development Strategy.** The strategic long-term development document was adopted in February 2021 and provides a framework for long-term budget planning, the use of EU funds and key reforms up to 2030. The development goal for 2030 is to increase GDP per capita in purchasing power standards (PPS) from the current 63 per cent to 75 per cent of the EU average, as well as to increase the share of exports of goods and services to 70 per cent of GDP.

**The government adopted a proposed anti-corruption strategy for the period 2021 to 2030.** The new strategy sets five priorities in the area of public policy, with most of the measures related to strengthening the institutional and normative framework, as well as the transparency and openness of public authorities' work. In the 2020 Eurobarometer survey on corruption, 97 per cent of respondents said they believed that corruption was widespread, compared with an EU average of 71 per cent.

**The European Competition Network Plus (ECN+) Directive regulating competition policy entered into force.** Parliament transposed the EU Directive in April 2021 and amended other parts of the Competition Act to fully align it with EU standards. ECN+ aims to ensure a common framework for all member states by establishing minimum common investigative powers and decision-making procedures. The transposition is expected to give more autonomy and instruments to the Competition Authority, thus enabling a fairer and more competitive business environment.

**Legislation to promote renewable energy has advanced.** All relevant legislation has been adopted so that the premium model for renewables can be put into practice. This model was formally adopted in 2016, replacing the feed-in tariff scheme. However, to date, the project pipeline has not been very strong due to administrative, financial and legislative barriers. By the end of 2020 all relevant acts were aligned with each other, with the main change being the definition of quotas for premiums in May 2020. The authorities expect a significant increase in renewable projects in the coming years. The planned capacity of renewable projects to be tendered amounts to 2.3 GW, a significant amount compared with the 4.8 GW of installed capacity at the end of 2019.

CONTINUES

**The New Foreigners Act includes a number of changes to employment regulation.** Under the Act, which came into effect in January 2021, the government will no longer determine the annual quota of employment permits for foreigners. Employers will have to request the relevant labour market standard from the Croatian Employment Service before applying for residency and a work permit for foreigners. This aims to ease labour shortages, which are expected to increase once the economy fully recovers from the Covid-19 crisis. Croatia also introduced a scheme to attract so-called "digital nomads".

**Further tax cuts have come into force in 2021.** Given the plan in place to ease the tax burden since 2016, which resulted in four rounds of tax adjustments, this year the income tax rate has been lowered from 24 per cent to 20 per cent and from 36 per cent to 30 per cent for the higher bracket. The tax rate for small and medium-sized enterprises has been lowered from 12 to 10 per cent. These tax cuts are expected to support the recovery of private consumption in the short term.

**Construction of the Krk LNG terminal is complete.** The floating terminal started operations in January 2021, with the entire capacity of 2.6 billion cubic meters fully booked for the next three years. The facility is poised to balance the energy needs of Croatia and its neighbours in light of the accelerated green transition, with gas being viewed as a transition fuel from coal.

# CZECH REPUBLIC

## Highlights

- **The economy has bounced back strongly after a significant decline in 2020.** Export-oriented industries and a rise in demand contributed to a robust recovery in the first half of 2021, while employment has remained stable.
- **The European Union (EU)'s Recovery and Resilience Facility (RRF) plan includes major infrastructure projects but also emphasises the need for reform.** Under the national plan, 42 per cent of the €7 billion plan will be invested into green transition and 22 per cent into digital transformation.
- **Progressive income taxation was reintroduced.** The government abandoned the concept of "super-gross salary" and a flat tax rate. It has shifted to a more employee-friendly system of taxing gross income with two tax rates of 15 and 23 per cent, while the annual personal tax deduction was increased.

## Key priorities for 2022

- **The green transition requires concrete steps in the direction of renewable energy.** Reducing the share of the coal industry presents a challenge for certain industrialised regions. Concrete actions are needed to further increase energy use from renewable sources, especially solar, by using Modernisation and Just Transition Funds.
- **Productivity and innovation capacities of the small and medium-sized enterprise (SME) sector should be addressed.** The government's post-crisis response should further focus on supporting productivity in the SME sector through upskilling and promoting digitalisation. A focus should be put on higher value-added research and development investment, which can broaden innovation capacities.
- **The government should emphasise investments in infrastructure and connectivity.** The Czech Republic, which will hold the EU presidency in the second half of 2022, should leverage the country's export-oriented industry, with an emphasis on promoting interconnection, modernising infrastructure and developing trans-European transport networks.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 5.2 | 3.2 | 3.0 | -5.8 | 3.4 |
| Inflation (average) | 2.5 | 2.1 | 2.8 | 3.3 | 2.7 |
| Government balance/GDP | 1.5 | 0.9 | 0.3 | -5.6 | -8.0 |
| Current account balance/GDP | 1.5 | 0.4 | 0.3 | 3.6 | 1.6 |
| Net FDI/GDP [neg. sign = inflows] | -0.9 | -0.9 | -2.4 | -1.3 | -1.2 |
| External debt/GDP | 88.0 | 81.3 | 76.5 | 76.1 | n.a. |
| Gross reserves/GDP | 63.4 | 59.0 | 59.1 | 62.9 | n.a. |
| Credit to private sector/GDP | 51.8 | 50.7 | 50.3 | 53.1 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**Export-oriented industries have triggered a swift recovery of gross domestic product (GDP) growth in 2021.** Despite a stable and competitive economy, the Covid-19 pandemic had a strong negative impact on GDP, which fell 5.8 per cent in 2020, representing the largest economic downturn in the country's history. Export-oriented industries, however, started driving growth in the third quarter of 2020, and GDP in the first half of 2021 increased by 3 per cent year-on-year. Prolonged containment measures at the beginning of 2021 slowed the improvement of household consumption, but investment growth has contributed significantly to the recovery. By the middle of 2021, industrial production had reached its pre-crisis level, although the automotive sector currently faces global shortages of parts and materials, which affect the continuation of production. The tourism sector has experienced a slow recovery, as expressed by the volume of tourist visits in the first half of 2021, which reached only a third of the level of the same period in 2019.

**The employment rate remained stable throughout the crisis, while wages are set to grow.** The unemployment rate reached 2.6 per cent in 2020 and increased to 3.2 per cent in the second quarter of 2021, due in part to intensified anti-pandemic measures. This remains one of the lowest unemployment rates in the EU. Nominal wage growth was 3.2 per cent year-on-year in the first quarter of 2021 and is set to grow further. In part, this can be attributed to a deficit in skilled workers. Among other factors, higher energy prices, wage pressures and pent-up demand influenced the rise in inflation, which exceeded 4 per cent year-on-year in September 2021. The Czech National Bank increased the main interest rate to 1.5 per cent in October 2021 in the biggest rate hike since 1997.

**Fiscal expenditures continue to grow.** To overcome the impact of the recession, the general government deficit in 2020 reached 5.6 per cent of GDP, staying slightly below the EU average. Public debt increased to 37.7 per cent of GDP, below most neighbouring peers. The fiscal deficit is likely to remain elevated in the short term. Public finances will be under additional pressure from the unreformed "pay-as-you-go" pension system.

**GDP is expected to continue to grow in the short term.** Assuming a further improvement in the pandemic situation, the economy should continue to recover. The main driver of growth will be increased consumer demand and higher investment, especially in the automotive sector, as well as the effective use of EU funds in the short and medium term. Consequently, the European Bank for Reconstruction and Development (EBRD) projects GDP growth of 3.4 per cent in 2021 and 4.6 per cent in 2022. The impact of global supply chain disruptions, the possibly incomplete implementation of the RRF and uncertainty surrounding potential new Covid-19-related measures constitute the main downside risks to the otherwise favourable outlook.

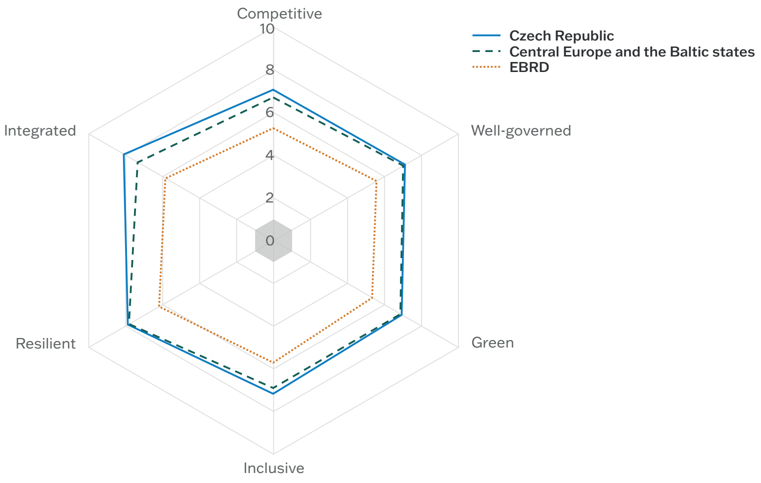
## Policy response to Covid-19

**The policy response in 2020 successfully supported employment retention.** The government's Covid-19 response in 2020 provided around 5.4 per cent of GDP to support employment, the self-employed and specific sectors through compensation, bonuses and financial support. The total amount of guarantees and loans reached approximately 15 per cent of GDP. A total of 1.2 per cent of GDP was spent on support to the health sector.

**The 2021 budget envisages an increased fiscal gap.** The budget continues to support sectors affected by the pandemic through wage compensation. Along with decreasing personal income tax rates and other tax changes (see below), the government wants to boost economic activity. The period for submitting tax refund applications has been extended and the employment support fund has been increased by more than 60 per cent. In addition to the budget measures in February 2021, bonuses were added for health and social care employees, and entrepreneurs were offered two additional support programmes. The impact of these measures could result in a fiscal gap in 2021 of 8.5 per cent of GDP, according to the Finance Ministry. In August 2021 the Czech National Bank increased the policy rate by 25 basis points to 0.75 per cent.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The government's RRF plan of €7 billion in grants involves a commitment to strengthen reform capacity.** The national plan is based on six pillars, with a focus on green transition and digitalisation. Investments in physical railway infrastructure, building renovation and a transition towards clean energy are followed by the digital transition, which envisages the development of a high-speed internet network and an increase in the public administration's digital capacity. Significant reforms will be dedicated to anti-corruption legislation, support of public investment and creating new financial opportunities for entrepreneurs through the national development bank. More efficient government services will be crucial to the timely selection and implementation of projects that are eligible for financing.

**"Kurzarbeit" was introduced to further support employment.** This short-time work scheme, introduced in July 2021 as an amendment to the Employment Act, provides state support for reduced-scale employment caused by unexpected events. Employers will be able to use the measure for a maximum of 12 months and 80 per cent of the employee's salary will be compensated.

**The government has reintroduced progressive income taxation.** According to the new income tax rules, from the beginning of 2021, two tax rates apply on all income types – 15 per cent on income up to CZK 1.7 million (€67,000) annually and 23 per cent for income above this amount. In addition, the basic annual personal tax deduction has been increased to the average wage for the prior calendar year and the real estate acquisition tax has been eliminated.

**An amendment to the Act on the Czech National Bank (CNB) increased the scope of its monetary policy.** With the accepted amendment from March 2021, the Senate allowed the CNB to temporarily execute open market operations with all participants in the financial market. With a wider range of financial instruments at the CNB's disposal, also with maturities of more than one year, these measures are likely to strengthen the country's financial markets.

CONTINUES

**Foreign direct investment (FDI) is subject to stronger supervision.** According to the newly introduced FDI control regime, from May 2021, potential risk capital flows will be monitored. More specifically, any foreign investor wanting to acquire at least a 10 per cent share in a company in the Czech Republic will be subject to further supervision by national regulators. Depending on the type of investment, supervision will be exercised by different national regulators.

**A new strategy for supporting SMEs has been approved.** The strategy, adopted in March 2021, aims to improve the business environment for SMEs for the period 2021-27. Along with facilitating access to finance and the market, aligning market needs with the education system and a broad digitalisation effort, the strategy includes 107 measures that will promote the efficient development of SMEs.

**A new reserve fund will be used to cover unforeseen costs in the South Moravian Region, which was affected by a tornado in June 2021.** With an amount of approximately €0.8 million, the government supported the initial costs associated with the natural disaster. The compensation for entrepreneurs includes an interest-free loan of up to approximately €1.7 million, as well as subsidies of up to approximately €40,000 for the reconstruction of fixed assets destroyed in the tornado. Subsidies for rebuilding homes amount to approximately €79,000 per household and loans with low interest rates are also planned.

# EGYPT

## Highlights

- **Macro and socio-economic conditions continued to improve.** The economy grew at 3.3 per cent in fiscal year 2020-21 (slightly below the previous year's growth rate), unemployment fell, inflation is low, a primary fiscal surplus was achieved and foreign exchange reserves are accumulating.
- **The government extended some Covid-19 response measures and provided support to certain sectors.** The initiative to support the tourism sector was extended for an additional year until the end of 2021 and the Central Bank of Egypt (CBE) directed commercial banks to increase their financing for micro, small and medium-sized enterprises (MSMEs) from 20 to 25 per cent of their credit facilities portfolio.
- **The government successfully completed the International Monetary Fund (IMF) programme and launched its National Structural Reform Programme.** The latest phase of reforms focuses on supporting private-sector-led growth and job creation and will capitalise on reforms implemented since late 2016 under successive IMF-supported programmes.

## Key priorities for 2022

- **Implementing the recently adopted medium-term revenue and debt strategies is essential to put debt on a sustainable, declining path.** This would lower the risks arising from high financing needs, notably the external part, and would create space for more productive spending on health and education.
- **Reforms to the role of the state in the economy would support competition and create a level playing field for private enterprises.** There is a need to develop a transparent state ownership policy and governance framework, and the state's role as regulator needs to be separated from that of operator to resolve potential conflicts of interest.
- **Integration into global value chains should be stepped up.** There is a need for a master plan for logistics, as well as for upgrading infrastructure and transport for better integration with other African economies. Reforms to customs and ports, including the use of automation, would facilitate and expedite exports.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|
| GDP growth | 4.1 | 5.3 | 5.6 | 3.6 | 3.3 |
| Inflation (average) | 23.5 | 20.9 | 13.9 | 5.7 | 4.5 |
| Government balance/GDP | -10.4 | -9.4 | -8.0 | -7.9 | -7.3 |
| Current account balance/GDP | -6.1 | -2.4 | -3.6 | -3.1 | -4.7 |
| Net FDI/GDP [neg. sign = inflows] | -3.3 | -3.0 | -2.6 | -2.0 | -1.4 |
| External debt/GDP | 33.4 | 37.0 | 36.0 | 34.0 | n.a. |
| Gross reserves/GDP | 13.0 | 17.4 | 14.5 | 10.2 | n.a. |
| Credit to private sector/GDP | 28.3 | 24.4 | 22.9 | 24.9 | n.a. |

Note: Fiscal year is July-June.

CONTINUES

## Covid-19: macroeconomic implications

**Economic growth slowed in fiscal year 2020-21.** Growth in fiscal year 2020-21 was 3.3 per cent, following 3.6 per cent in fiscal year 2019-20. There were improvements in the wholesale and retail trade, agriculture, telecommunications and construction, but sluggish manufacturing activity, coupled with weak tourism, slowed the recovery. Meanwhile, inflation slowed to 5.0 per cent year-on-year in the first nine months of 2021. This is at the lower end of the CBE's target of 7.0 per cent +/- 200 basis points, despite the cumulative 400 basis points cut in the CBE's policy rate to 8.75 per cent between March and November 2020. As a result, Egypt now has one of the world's highest real interest rates, which helped attract portfolio flows and stabilise foreign exchange reserves, as other traditional sources of foreign exchange (tourism and Suez Canal receipts) slowed because of the Covid-19 pandemic. At the same time, unemployment declined to 7.3 per cent in the second quarter of 2021 from a peak of 9.6 per cent in the second quarter of 2020, but the labour participation rate, at 41.9 per cent, remains below its pre-Covid-19 pandemic level of 42.7 per cent.

**The fiscal position improved, but the current account deficit widened**. Revenues rose, driven by an improvement in tax collection, partly thanks to new electronic systems being put in place, in addition to tax policy and revenue administration measures and the start of the recovery from the pandemic. Expenditures also increased, mainly investment and interest payments. As a result, the deficit narrowed to 7.3 per cent of gross domestic product (GDP) in fiscal year 2020-21 and the primary surplus remained at 1.3 per cent of GDP. Meanwhile, public debt increased to 91.4 per cent of GDP. On the external side, the current account balance widened sharply in fiscal year 2020-21, to 4.7 per cent of GDP from 3.1 per cent in fiscal 2019-20. Tourism revenues continued to underperform, imports increased and exports remained stagnant. Moreover, foreign direct investment (FDI) inflows declined to US$ 5.2 billion but portfolio flows recorded a strong US$ 18.7 billion inflow, against a US$ 7.3 billion outflow a year earlier, as foreign investors' confidence picked up, lured by the high real interest rates. International reserves increased to US$ 40.8 billion in September 2021 and continue to cover comfortably more than eight months of imports.

**The government is actively looking to diversify its funding sources and lower its interest payment bill.** In September 2020 the government issued its maiden green bond, raising US$ 750 million to fund climate-friendly projects. The government then sold US$ 3.75 billion in Eurobonds in February 2021 amid strong demand. Egypt's first issue of sukuks (Islamic financial certificates) is expected to take place in the first half of 2022, after the president ratified a law in August 2021 enabling the issue of sharia-compliant securities. Moreover, Egypt's public debt is expected to be Euroclearable in 2022, making the country more accessible to foreign investors.

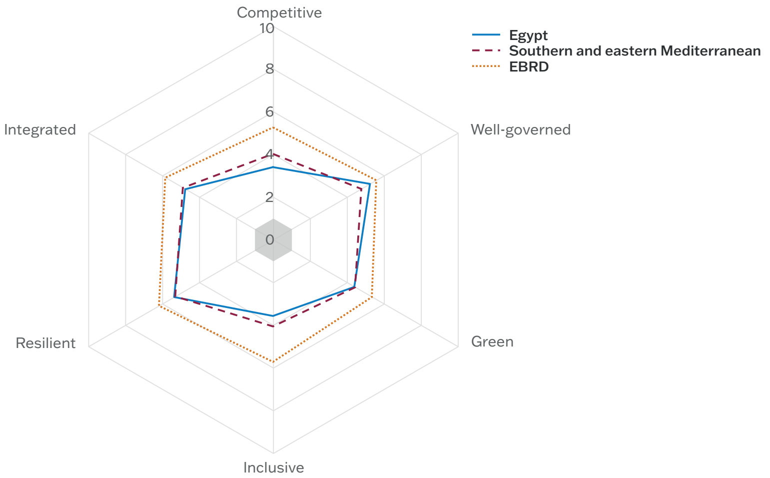
**The pace of GDP recovery is expected to pick up to 4.9 per cent in fiscal year 2021-22.** The boom in the telecommunications sector will continue to sustain growth, the falling unemployment rates will support consumption, and private investment and FDI flows will pick up. However, risks include slow uptake of vaccination, the weak outlook in the tourism sector in view of a probable global delay in the recovery of tourism, as well as the slowing momentum of major projects implemented in different parts of the country.

CONTINUES

## Policy response to Covid-19

**Support for businesses affected by the Covid-19 pandemic has been maintained.** The government decided to keep in place a package of financial support measures for businesses that were introduced in early 2020 in response to the Covid-19 pandemic. These include payments to cover the financing arrears of exporting companies, a scheme that is aimed at enabling such firms to continue meeting their current obligations. The government also extended its initiative to support the tourism sector for an additional year until the end of 2021. Banks are allowed to postpone dues and capitalise the interest rate on the principal without additional charges for a maximum period of three years. The government also extended the duration of the initiative for individuals working in the tourism sector, whereby banks can postpone their retail and mortgage loans due. Although the government's vaccination campaign was off to a slow start with only 3.7 per cent of the population fully vaccinated as of early September 2021, this had gone up to 10.5 per cent by early November 2021.

Assessment of transition qualities (1-10)




## Structural reform developments

**The government introduced a new phase of the National Structural Reform Programme.** The new phase, announced in April 2021, focuses on structural reforms to support private-sector-led economic growth and capitalises on recent economic reforms. The three-year programme targets 6 reform pillars, 31 policies and objectives, and 100 procedural and legislative structural reforms. The authorities will continue to reform subsidies and move towards better-targeted social spending, increase investment in human capital, and focus on boosting certain sectors, including agriculture, manufacturing and information and communication technology (ICT). Other envisaged reforms include efforts to liberalise trade, improve competition and upgrade transport and logistics infrastructure.

**Subsidy reforms have advanced.** In July 2021 the government performed another round of electricity subsidy reforms, by hiking prices to consumers by 8 to 26 per cent, depending on consumption. Moreover, in August 2021 the president announced that the price of subsidised bread, fixed at 5 piasters (US$ 0.003) per loaf since 1988, would be increased and the savings directed to targeted social benefits, such as school meals. More details about the bread subsidy reform have yet to be announced. Meanwhile, Egypt remains the world's largest importer of wheat. Lastly, the government continued to rely on its automatic fuel indexation mechanism and fuel prices have increased three times in 2021, in line with global oil prices.

CONTINUES

**The CBE has launched an EGP 100 billion (US$ 6.4 billion) mortgage finance initiative for low- and middle-income earners.** Under the initiative, introduced in July 2021, banks and mortgage finance companies will offer loans at a declining interest rate of 3.0 per cent over a repayment period of up to 30 years. The programme aims to offer subsidised mortgages on houses valued at up to EGP 1.4 million (US$ 89,000), provided homebuyers make a 20 per cent down payment. Pensioners will also be eligible to take part in the programme.

**Financing for small businesses is being expanded.** In February 2021 the CBE directed commercial banks to raise financing for MSMEs to 25 per cent of their credit facilities portfolio, from 20 per cent previously. In particular, the central bank circular asked banks to direct 10 per cent of their net loan book to small enterprises. The CBE also allowed banks to finance micro and small-sized enterprises, with annual sales of less than EGP 20 million (US$ 1.3 million), without the requirement to submit their financial statements. This comes at a time when the government is increasing its focus on smaller firms and on the private sector to drive growth, create jobs and promote financial inclusion.

**The government announced a minimum wage for workers in the private sector.** The National Council for Wages confirmed in June 2021 that the minimum wage for private-sector employees would be set at EGP 2,400 (US$ 153) per month from January 2022. This is in line with the increase of 20 per cent in public-sector employees' wages that took effect in July 2021. This comes against a backdrop of low formal labour force participation (41.9 per cent in June 2021) and a significant portion of the private-sector workforce consisting of self-employed farmers, thus excluded from minimum wage rules. While this measure could increase purchasing power and boost private consumption, it could also force some smaller companies to lay off staff, further strengthening the informal sector. It is estimated that more than 95 per cent of companies in Egypt are MSMEs.

**The Ministry of Finance continues to modernise and automate the tax management system.** An electronic billing system was launched in November 2020 and, in January 2021, the ministry launched the first phase of the unified automated tax payment system for large and medium-sized companies and high-income self-employed taxpayers. It inaugurated taxpayer service offices, which provide businesses with a single online system for filing and paying taxes. The unified automated tax payment system will be implemented in four phases and is projected to be completed by the end of 2022.

# ESTONIA

## Highlights

- **After the 2020 recession, gross domestic product (GDP) has rebounded strongly in 2021.** A significant relaxation of anti-Covid-19 pandemic measures in the middle of 2021 has accompanied strong economic growth during the year and a return to the pre-pandemic level of output.
- **The government is prioritising green transition and broad digitalisation.** In addition to investing in digital public services and strengthening research and development as part of the €1 billion plan financed by the European Union (EU)'s Recovery and Resilience Facility (RRF), the government is investing in a green fund for enterprises. The fund will provide additional support to companies that develop green technologies.
- **Guarantees to boost exports have been increased.** The volume of export guarantees offered by the state financial aid fund KredEx has been raised from the current €192 million to €400 million, giving Estonian companies additional support in reaching foreign markets.

## Key priorities for 2022

- **The anti-money laundering/combating the financing of terrorism (AML/CFT) framework should be continuously strengthened.** Given the growing number of fintech companies and virtual currency providers registered in Estonia, supervisors in financial regulation should ensure the continued implementation and compliance with the AML/CFT agenda.
- **Reducing skills shortages and gender pay disparities remains a priority.** Active labour market policies such as re-training should raise the employability of workers with lower education. Further improvements in childcare services and removing "glass ceilings" should create a favourable economic environment for reducing the gender pay gap.
- **Exiting from oil shale electricity should be prioritised.** Concrete steps need to be taken to further diversify energy sources by increasing Estonia's links with the European electricity grid, strengthening renewables and encouraging the development of alternative economic sectors to oil shale-dependent areas.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 5.8 | 4.1 | 4.1 | -3.0 | 9.0 |
| Inflation (average) | 3.7 | 3.4 | 2.3 | -0.6 | 3.5 |
| Government balance/GDP | -0.5 | -0.6 | 0.1 | -5.6 | -2.9 |
| Current account balance/GDP | 2.3 | 0.8 | 2.5 | -0.3 | -1.8 |
| Net FDI/GDP [neg. sign = inflows] | -3.9 | -4.8 | -3.9 | -10.4 | -7.5 |
| External debt/GDP | 83.4 | 78.2 | 76.3 | 91.1 | n.a. |
| Gross reserves/GDP | n.a. | n.a. | n.a. | n.a. | n.a. |
| Credit to private sector/GDP | 64.4 | 62.6 | 60.2 | 65.2 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**After the downturn in 2020, the economy is recovering solidly in 2021.** GDP in 2020 contracted by 3.0 per cent, less sharply than the EU average. Due to the recovery of exports and investments and expanded government spending, GDP growth reached 8.5 per cent year-on-year in the first half of 2021. The increase in private consumption was also boosted by accumulated savings, while disposable income is expected to grow further due to the ongoing pension reform. Industrial production in the second quarter of 2021 increased by 3.2 per cent quarter-on-quarter and has already returned to 2019 levels. Significant growth in exports, primarily to Finland and Sweden, was noticeable in the first half of 2021 in the production of mineral oils, wood and electrical equipment. In contrast to most EU countries, Estonia recorded positive retail trade turnover year-on-year throughout 2020, which has continued in 2021.

**The labour market has still not fully recovered from the Covid-19 crisis but a rebound in labour demand is supporting wage growth.** The Covid-19 pandemic led to higher unemployment, which peaked at 7.7 per cent in the third quarter of 2020, falling to 6.9 per cent in the second quarter of 2021, still above the pre-crisis level. An increase in labour demand contributed to a 7.3 per cent year-on-year rise in the average wage in the second quarter of 2021. Together with the strengthening of economic activities, wage growth has contributed to inflationary pressures, with annual inflation reaching 6.4 per cent in September 2021.

**The fiscal deficit has widened due to Covid-19-related expenditures**. The general government deficit in 2020 reached 5.6 per cent of GDP and the gross debt level increased to 19 per cent of GDP, from 8.6 per cent in 2019. Contrary to expectations, the first half of 2021 was marked by a decrease in the total expenditure of state budget institutions, because fewer subsidies to the economy were needed and state payments to the second pension pillar are still suspended. Nevertheless, the deficit is still expected to exceed 6 per cent of GDP in 2021 before falling in 2022.

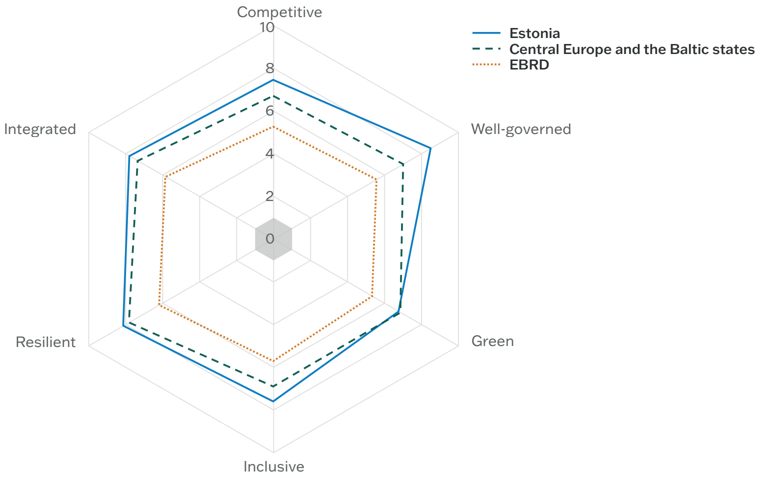
**GDP growth is expected to continue to rebound strongly in the short term.** Amid higher government expenditures, household consumption improved substantially and this trend is expected to gain in magnitude in the coming quarters. Household disposable income jumped by nearly €1 billion due to a withdrawal of the second pension pillar in September 2021. EU funds, including from the RRF, are expected to further boost investment, especially in infrastructure. Overall, GDP growth is forecast to reach 9.0 per cent this year, before slowing to 4.0 per cent in 2022.

## Policy response to Covid-19

**A supplement to the 2021 budget aims to mitigate some of the crisis effects.** In March 2021 parliament approved a bill for a €641 million supplementary budget, similar to a measure taken a year previously. According to the government's plan, additional costs in the health sector, such as the need for further medical facilities, Covid-19 testing and vaccinations, will be covered by an additional €150 million. To support employment and education and to reduce social exclusion, subsidies continue to be paid to partly cover labour costs if employees' working hours or wages have been reduced. As part of the additional budget from 2020 remained unspent, a decision was made that those subsidies could be used until the end of 2021.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The "Estonia 2035" action plan was approved.** With this action plan, which the government approved in October 2020, a long-term development strategy is now in place for the next 15 years. In addition to regaining competitiveness, the emphasis is placed on five areas: people (increasing labour market participation and lifelong learning); society (reducing relative poverty and promoting inclusion); economy (investing in research and development and a favourable business environment); living environment (promoting safe living and overall well-being); and governance (promoting efficiency of public services and participation in decision-making).

**Estonia will receive €1 billion from the RRF.** The requested allocation should enhance post-Covid-19 pandemic recovery by supporting green transition and digital capacities, primarily e-services, accompanied by investments in infrastructure, energy efficiency renovation and the decarbonisation of public transport. The goal of the envisaged reforms and investments is to achieve balanced regional development and make economic growth more resilient to future crises.

**Estonia and Finland signed a memorandum of understanding in the area of infrastructure.** The agreement, signed in April 2021, promotes the integration of the two Baltic countries through projects such as Rail Baltica, the Helsinki-Tallinn Tunnel, the Trans-European Transport Network and the North Sea-Baltic Corridor. A joint Helsinki-Tallinn Tunnel working group is being relaunched to make the proposed tunnel eligible for EU funding via the Trans-European Transport Network programme.

**A new state budget strategy for 2022-25 will lead to higher investment.** In April 2021 the government approved a new strategy to decrease the expenditure of ministries by 5 per cent, with savings used to support government sector investments of at least €2 billion a year, as well as to make the budget more transparent and easier to understand. Among other measures, the budget approval process will be shortened from two to one budgetary negotiation per year.

CONTINUES

**The government has announced an exit from oil shale electricity but implementation details remain unclear.** The government declared two phase-out dates: exiting oil shale electricity by 2035 and shale oil production by 2040 at the latest. However, details on the alternatives remain to be fully developed. An amount of €340 million from the EU's Just Transition Fund for the period 2021-27 will be mostly allocated to the north-eastern Ida-Viru region, which has relied strongly on the oil shale sector, in order to facilitate its economic diversification.

**The Estonian start-up economy recorded strong growth despite the Covid-19 pandemic.** According to data for the first quarter of 2021, the overall turnover of Estonian start-ups increased by 26 per cent year-on-year following a recovery of business activities shortly after the Covid-19 pandemic started. Start-ups are mainly concentrated in the IT software and services industry, product development and financial technology. They can profit from favourable loans and subsidies provided by the "Startup Estonia" state programme, which has been cooperating with the state financial aid fund KredEx since 2016.

# GEORGIA

## Highlights

- **Economic recovery is gaining momentum in the first half of 2021.** Renewed growth is benefiting from a supportive external environment but risks to the recovery remain, in particular the slow vaccination rate and potentially extended travel restrictions.
- **A new insolvency framework aims to address a long-standing business environment vulnerability.** It could also help resolve Covid-19 pandemic-related bankruptcies in a more efficient way.
- **The government has presented a 10-year country socio-economic development vision.** The vision is supported by ministry-specific strategies, which will set out development goals, financial needs and planned instruments.

## Key priorities for 2022

- **Strengthening governance standards needs to remain a top priority.** An impartial, independent, transparent, efficient and accountable formal and informal public institutional framework is key to maintain the trust of businesses and the general public.
- **The authorities should ensure that economic recovery is tilted to green, including by creating an enabling environment for non-hydro renewables.** Exploiting Georgia's great renewable energy potential would help ensure sustainable growth and increase the country's energy self-sufficiency and competitiveness.
- **Georgia should continue pursuing critical structural reforms such as education and state-owned enterprise (SOE) reform.** Pledges to reform the education sector and to bring corporate governance closer to best practices should be pushed forward to ensure the availability of skills and to increase competitiveness of the economy.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.8 | 4.8 | 5.0 | -6.2 | 7.5 |
| Inflation (average) | 6.0 | 2.6 | 4.9 | 5.2 | 9.3 |
| Government balance/GDP | -0.5 | -0.8 | -1.8 | -9.2 | -6.5 |
| Current account balance/GDP | -8.0 | -6.8 | -5.5 | -12.4 | -10.0 |
| Net FDI/GDP [neg. sign = inflows] | -10.5 | -5.6 | -6.0 | -3.5 | -3.9 |
| External debt/GDP | 106.6 | 101.3 | 106.7 | 129.7 | n.a. |
| Gross reserves/GDP | 18.7 | 18.7 | 20.1 | 24.6 | n.a. |
| Credit to private sector/GDP | 52.2 | 56.8 | 61.7 | 74.4 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy strongly contracted in 2020 as tourism and global demand plummeted.** Following an average growth of 4.9 per cent in 2017-19, gross domestic product (GDP) declined by 6.2 per cent in 2020 as the economy was hit by the Covid-19 pandemic shock. The hospitality sector and exports of goods suffered an immediate blow. In 2020 exports of services contracted by 65.6 per cent and exports of goods by 12.1 per cent, investment activity shrank by 4.8 per cent while repeated lockdowns weighed on consumption and many small service providers. Nonetheless, household consumption posted 5.4 per cent growth. Inbound money transfers grew by 8.8 per cent in the same period as strong growth in the second half of the year outpaced the initial fall in the second quarter. Many indicators point to a strong recovery from January to September 2021: money transfers grew by 27.8 per cent and nominal goods exports by 24.0 per cent, both year-on-year, the latter driven largely by increased trade with China and neighbouring economies. As a result, high-frequency economic data point towards a strong growth of 11.3 per cent year-on-year from January to September 2021. As Georgia lifted restrictions on international air travel in February 2021, tourism started to recover slowly but it remains far below the levels seen before the Covid-19 pandemic. In the first nine months of 2021, the number of international travellers was just 18.0 per cent of the figures for the same period in 2019.

**The downturn in 2020 led to higher public debt and inflation.** Increased spending on the Covid-19 crisis response, shrinking budget revenues and reduced economic activity deepened the budget deficit from an average of 1.0 per cent of GDP in 2017-19 to 9.2 per cent in 2020. On the back of the new borrowing needed to cover the fiscal gap, currency depreciation and economic contraction, this resulted in a steeply rising public debt, from 40.4 per cent of GDP in 2019 to 60.0 per cent in 2020. Upon repaying the 10-year Eurobond in April 2021, the authorities issued a five-year US$ 500 million Eurobond at a historically low coupon of 2.75 per cent, with demand exceeding supply by a factor of four. Together with official lending, this helped to maintain international reserves at high levels, amounting to US$ 4.1 billion in September 2021 and covering approximately 5.4 months of imports, despite the National Bank of Georgia's (NBG) occasional interventions on the foreign exchange market to smooth out currency volatility. Earlier depreciation and rising commodity prices raised inflation pressures in the first half of the year. Consumer price index growth stood at 12.3 per cent year-on-year in September 2021, compared with 2.4 per cent year-on-year in December 2020. To combat inflation, the NBG raised the refinancing rate three consecutive times, from 8 per cent in March 2021 to 10 per cent in August 2021.

**Recovery prospects are cautiously optimistic.** GDP growth is forecast to recover to 7.5 per cent in 2021 and accelerate to 5.5 per cent in 2022. The main driver for the overall economic recovery remains the return of tourism, which is a lifeline for many businesses in Georgia. Major risks stem from the slow vaccination rate and potentially extended travel restrictions because of more infectious variants of the Covid-19 virus spreading. Maintaining macro-economic policy discipline, in particular in relation to adherence to the fiscal rule, will be a challenging task.

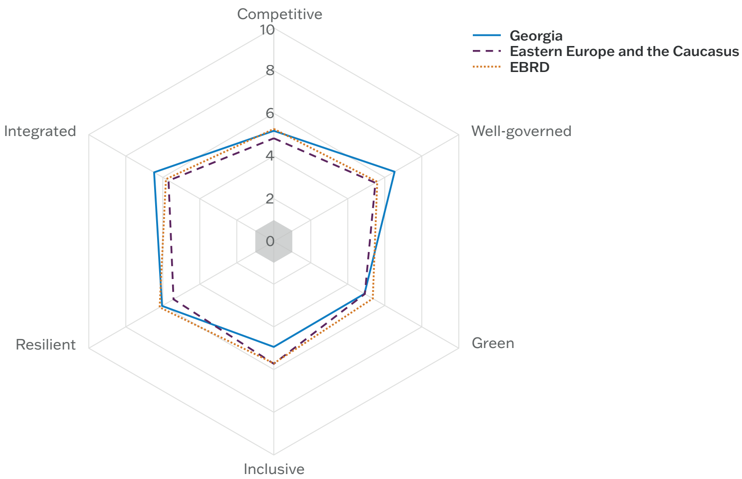
## Policy response to Covid-19

**The government implemented a comprehensive package of measures to support the economy in 2020.** The total fiscal support package amounted to 3.8 per cent of GDP (Lari 1.86 billion). Economic support measures included the postponement of tax payments, subsidised interest payments on loans and scaling up of the credit guarantee scheme. The central bank lowered capital and liquidity requirements and relaxed regulatory requirements to support loan restructuring.

CONTINUES

**The fiscal support package for 2021 is expected to reach 2.3 per cent of GDP (Lari 1.2 billion).** Previous measures were reintroduced during the second lockdown, including the coverage of utility fees for smaller household users and the exemption from income tax for those in low-paid jobs. In addition, employees in the hard-hit tourism sector are fully exempt from property tax in 2021. The Covid-19 policy response in 2021 is supported by external financing, including the International Monetary Fund programme finalised in April 2021 and Eurobond issue in early 2021.

Assessment of transition qualities (1-10)




## Structural reform developments

**Despite significant political volatility, the government presented a new 10-year development plan for Georgia.** Repeated disruptions to the economy and a difficult environment on the domestic political scene, on top of Covid-19 pandemic-related uncertainties, have reduced the space for reforms. Despite this, in July 2021 the government produced an overarching medium-term development vision to advance the socio-economic development of Georgia. The development plan is supported by ministry-specific strategies setting out development goals, financial needs and planned instruments for the next 10 years.

**A new insolvency framework is in place.** After adopting the Law on Rehabilitation and Collective Satisfaction of Creditors in parliament in September 2020, the new framework entered into force in April 2021. Before the reforms, the legislation was focused on swift liquidation of debtors in financial difficulties, thus essentially neglecting other restructuring possibilities and the interests of some stakeholders. The new law introduces a new profession of licensed insolvency practitioners and creates incentives to use other restructuring possibilities at an early stage, even before getting to the point of bankruptcy liquidation. It also introduces the possibility of reaching a regulated agreement outside of court. Thereby it is intended to offer adequate protection of creditor rights, ensure timely and efficient insolvency processes and provide an effective rehabilitation framework in line with best international standards. The new regulation is expected to strengthen Georgia's economic and financial system and help resolve Covid-19 pandemic-related bankruptcies more efficiently.

CONTINUES

**Labour reform law aims to unify interests of workers and employees and bring their rights into line with international standards.** A comprehensive labour law reform package was adopted in autumn 2020. It includes extending the scope of the labour supervisory body to the full range of labour rights, prohibiting discrimination and regulating internships and overtime. Labour inspectors will be able to achieve compliance through proactive steps and by giving them the necessary enforcement tools. The new laws bring Georgia's labour legislation into line with relevant international labour standards of the International Labour Organization and European Union Directives and aim to strike a better balance between the rights and interests of workers and employers.

**Significant improvements have been made in tax administration and reducing outstanding value added tax (VAT) refunds.** In October 2020 the government introduced fully automatic VAT refunds. This should help provide liquidity to the private sector and reduce the outstanding stock of VAT credits. The Georgia Revenue Service has been enhancing its risk-based approach to better identify non-compliant cases and inform individuals and legal entities at an early stage about inconsistencies. It is training its auditors to implement an audit case management system, which should improve productivity and timeliness of audits.

**The authorities have completed secondary legislation to support the banking resolution framework.** The new regulations, designed to enhance financial resilience, include legislation on resolution plans, a temporary administrator and special manager, recapitalisation tools, and temporary public support and emergency liquidity assistance backed by government guarantees.

**The digital agenda has advanced.** New electronic services (such as online applications for identity cards and passports, birth certificates, changes of name, new business and land title registrations) were integrated into the Unified Service Portal (www.my.gov.ge) throughout 2020 and 2021 to enable citizens to receive critical services without leaving their homes.

# GREECE

## Highlights

- **The economy is recovering strongly in 2021 after a deep contraction.** Gross domestic product (GDP) fell by 9 per cent in 2020, largely driven by a collapse in tourism and related services. A strong bounce back is evident in 2021, fuelled by rising investment, supportive fiscal policies and a partial recovery in tourist numbers.
- **Greece has entered the final year of the enhanced surveillance framework.** The latest European Commission report in September 2021 pointed to the good pace of reform implementation across a range of areas, although it also noted that progress was slower than expected in some areas.
- **A comprehensive reform plan, anchored within the European Union (EU)'s Recovery and Resilience Facility (RRF), has been developed.** A mixture of grants and loans, including close cooperation with the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB), will finance the new plan, "Greece 2.0". It will target in particular EU-wide green and digital targets as well as Greece-specific criteria to improve the export and supply chain performance, boost innovation and increase the size of Greek companies.

## Key priorities for 2022

- **Short-term support for the recovery remains crucial.** Although GDP is likely to reach its pre-Covid-19 pandemic level soon, many companies and households are still suffering financial distress from the crisis and will need further assistance, especially if there is a resurgence of infections.
- **Recovery and resilience funds should be exploited to capitalise on Greece's comparative advantage in renewables.** Reforms in the energy sector, including the closure of coal mines, should be pursued vigorously, taking into account the social implications of the resulting changes and ensuring a just transition for those most affected.
- **Enhancing public-sector governance remains a priority.** Governance remains a weak point for Greece compared with EU peers and further progress is needed in areas such as judicial reform, the fight against corruption and implementing the new law on public procurement.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 1.1 | 1.7 | 1.8 | -9.0 | 7.0 |
| Inflation (average) | 1.1 | 0.8 | 0.5 | -1.3 | -0.3 |
| Government balance/GDP | 0.6 | 0.9 | 1.1 | -9.7 | -7.5 |
| Current account balance/GDP | -2.5 | -3.5 | -2.2 | -7.4 | -6.6 |
| Net FDI/GDP [neg. sign = inflows] | 1.5 | -1.6 | -1.7 | -1.5 | -2.0 |
| External debt/GDP | 228.8 | 231.8 | 244.5 | 298.2 | n.a. |
| Gross reserves/GDP | n.a. | n.a. | n.a. | n.a. | n.a. |
| Credit to private sector/GDP | 100.7 | 91.7 | 80.9 | 82.1 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy is recovering strongly after a deep contraction in 2020.** GDP fell by 9.0 per cent in 2020, due mainly to a collapse of the all-important tourism sector, contributing to a decline in the export of services of 38.7 per cent. Private consumption also fell by 4.9 per cent. Signs of a strong recovery are apparent in 2021, with GDP in the first quarter rising by 4.5 per cent on a quarter-on-quarter basis and a further 3.4 per cent quarter-on-quarter in the second quarter. Investment has bounced back strongly in the first part of the year, especially inventory accumulation, and consumption is rising, boosted by improved consumer sentiment – the economic sentiment indicator reached an 18-month high in August 2021.

**Manufacturing is rising and tourism numbers are steadily moving back towards pre-Covid-19 pandemic levels.** The purchasing managers index (PMI), an important indicator of business confidence, reached 59.3 in August 2021, versus 57.4 in July, the highest level for more than 20 years and a clear signal of expansion in the sector. Unemployment has continued to decline, reaching 14.2 per cent in July 2021, the lowest rate since November 2010. Preliminary figures from the tourism sector indicate a better-than-expected performance so far this year, albeit still well below the record levels of 2019. Tourist arrivals in August 2021 were 35 per cent below the numbers achieved in the same month two years previously.

**Fiscal policy remains strongly oriented towards crisis-response measures.** In Greece and other eurozone countries, EU fiscal targets were suspended in 2020 and 2021 because of the Covid-19 pandemic and associated need for governments to step in and mitigate its impact on businesses and households. Accordingly, the general government deficit in Greece was nearly 10 per cent of GDP in 2020 and is expected to be more than 7 per cent of GDP in 2021, driven by extensive pandemic-related support packages. While Greece's sovereign debt remains among the highest in the EU relative to GDP, the exceptionally low cost of market funding has enabled the state to support the economy. As of early September 2021, Greece had issued €14 billion in total from five syndicated transactions during 2021. The government's cash reserves stood at €34 billion as of early July 2021.

**Robust growth is expected in the short term.** The EBRD currently projects GDP growth of 7.0 per cent in 2021, moderating to 3.9 per cent in 2022 as the recovery continues, important infrastructure projects advance and the roll-out of the RRF and European Structural and Investment (ESI) Funds picks up pace. However, the level of uncertainty around forecasts is particularly high at present and significant downside risks remain for the Greek economy, mostly associated with the future path of the Covid-19 pandemic and the possible impact of a new strain of the virus on tourism and other services.

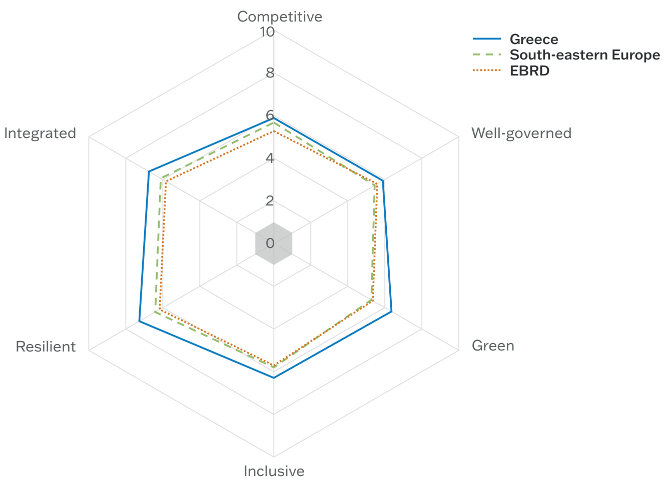
## Policy response to Covid-19

**The government is continuing to implement a wide range of measures in response to Covid-19.** Covid-19-related fiscal measures reached €17.4 billion (10.5 per cent of GDP) in 2020 and are projected at €15.6 billion (9.1 per cent of GDP) in 2021. Beyond support to the heath sector (including cash bonuses for health sector workers), social transfers to vulnerable individuals have been implemented, including cash stipends, full coverage of health and pension benefit payments for employees of the most affected sectors, and extended support for the unemployed. For hard-hit businesses, support has focused on liquidity support, including loan guarantees, subsidies and deferred payments of taxes and social contributions. The value added tax (VAT) rate has been reduced for critical products.

CONTINUES

**Substantial EU funds are also available to boost the post-Covid-19 recovery.** Greece is expected to receive more than €70 billion in EU funding over the next seven years, with €30.5 billion of that coming from the EU's €750 billion RRF Plan (€17.8 billion in grants and €12.7 billion in loans), and the rest from the EU budget, including €21 billion from ESI funds. Major focus areas will include the green and digitalisation agendas. In July 2021 the EU Council formally approved the Greek Recovery and Resilience Plan, and the Partnership Agreement for the ESI Funds was signed. In August 2021 Greece received the first tranche of €3.96 billion in pre-financing from the RRF funding envelope. The Greek government is finalising operational agreements to channel €5 billion of RRF loans via the EIB, €500 million via the EBRD and the remaining funds via the four systemic local commercial banks, asking them to provide equal amounts of their own resources to be deployed in the Greek economy over the next few years.

Assessment of transition qualities (1-10)




## Structural reform developments

**Green transition remains a top priority.** The government has reaffirmed its commitment to close all lignite plants by the end of 2025, with the vast majority shut down by the end of 2023. Approximately €11.7 billion (including one-third of the RRF grant allocation) of RRF funds is destined for projects that advance the green transition, with a further €10.4 billion to be mobilised from other investment resources. Of these, at least €1 billion RRF grants will be allocated to finance the deployment of first-generation renewable energy technologies as well as the piloting of second-generation technology, and €2.4 billion to finance energy efficiency in buildings, water and waste management products and other green priorities. The government is also proceeding with changes to the governance of loss-making public energy provider PPC, which continues to dominate the retail market, with plans to introduce further competition by allowing access to other providers. In September 2021 PPC launched a capital raising exercise of at least €750 million, which is expected to lead to the state's share in PPC (via two privatisation funds) falling from a majority 51 per cent to 34 per cent.

CONTINUES

**Significant advances are being made on the digital agenda.** A single digital portal has been available for more than 1,250 public services as of July 2021, following a new Digital Code. A new national digital strategy 2020-25, presented by the ministry in January 2021, set seven major objectives for digital transformation: safe, fast and reliable access to the internet for all; digitalising state services; developing digital skills; transforming digital enterprises; digital innovation support; using public administration data; and incorporating digital technologies into all economic sectors. This digital agenda is also one of the priorities for use of the RRF, with €6.8 billion out of the total RRF grants and loans envelope targeted at digital transformation projects.

**Several important privatisations have advanced.** The Covid-19 pandemic caused a number of projects to be delayed, and revenues from privatisation in 2020 were just €41 million. However, the pace has picked up again in 2021. In June 2021 the flagship Hellinikon (former Athens airport) project progressed, with the agreement signed for the transfer of shares from Hellenic Republic Asset Development Fund to Hellinikon Global. In August 2021 a preferred bidder was selected for the Egnatia motorway concession. In September 2021 Italgas from Italy was declared the preferred bidder for a 65 per cent stake in the Public Gas Corporation (DEPA) Infrastructure. Progress has also been made on tenders for stakes in several regional ports. However, other major privatisations, such as Athens International Airport and Hellenic Petroleum, are still on hold, pending a revival of potential investor interest.

**Non-performing loans have dropped sharply.** Data from the Bank of Greece released in September 2021 show a steep fall in the ratio of non-performing exposures (NPEs) to total exposures, from 32.9 per cent in March 2021 to 21.3 per cent in June. The asset-backed resolution scheme (known as Hercules) introduced in early 2020 is increasingly being used by the four systemic banks to reduce NPEs. Further efforts are under way to strengthen the insolvency framework following the new Insolvency Code's coming into force in June 2021.

**Public administration reforms are advancing.** Recent developments include finalising an action plan to improve the hiring process for civil servants and new measures to put a cap on the recruitment of temporary staff for public-sector jobs.

**Vocational education and training and lifelong learning are being boosted.** New legislation adopted in December 2020 aims to establish a national system of vocational education and training that should lead better training programmes and an upgrade of the necessary skills and infrastructure. The programme is timely, as the unemployment rate remains high, especially among young people (35.2 per cent as of July 2021).

# HUNGARY

## Highlights

- **Gross domestic product (GDP) is recovering steadily.** Following a decline in GDP of 4.7 per cent in 2020, the export-oriented sectors and a gradual easing of epidemiological measures have propelled a vibrant economic recovery in 2021.
- **The European Union (EU)'s Recovery and Resilience Facility (RRF) plan envisions investment to strengthen competitiveness and promote green transition.** The national plan is worth €7.2 billion in grants. Investment in its five strategic areas (green transition, healthcare, research, digital, and cohesion and public administration) will be important in supporting the country's economic recovery. The European Commission has still not approved Hungary's RRF plan, so the government is pre-financing its RRF programmes.
- **The issuance of forint-denominated green government bonds has been welcomed by the market.** The first issue of a 30-year forint-denominated green bond met strong investor demand.

## Key priorities for 2022

- **Fiscal policy needs to remain supportive and targeted.** Government support for the labour market and certain sectors should continue, to assist the recovery until all Covid-19 restrictions are lifted. Measures should then be oriented towards strengthening the innovation capacity of small and medium-sized enterprises (SMEs) and employability through upskilling.
- **For EU funds to be properly absorbed and the RRF to be implemented successfully, there needs to be enhanced reform capacity and political will, including with regard to the rule of law.** Hungary has been allocated €38 billion of cohesion, regional development and other EU funds, while the RRF national plan envisages €7.2 billion in grants – all EU funds to be used up until 2027.
- **Policies that address skills shortages and improve inclusivity would strengthen and make better use of labour supply.** Policies that embrace diversity and inclusion practices, including for the LGBT+ community, and better migrant job matching could attract and retain talent, such as in the tech and creative industries.

Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.3 | 5.4 | 4.6 | -4.7 | 7.7 |
| Inflation (average) | 2.4 | 2.9 | 3.4 | 3.4 | 5.0 |
| Government balance/GDP | -2.5 | -2.1 | -2.1 | -8.0 | -6.6 |
| Current account balance/GDP | 2.0 | 0.2 | -0.7 | -1.6 | 0.6 |
| Net FDI/GDP [neg. sign = inflows] | -1.6 | -1.9 | -0.5 | -1.6 | -0.8 |
| External debt/GDP | 83.3 | 79.8 | 73.6 | 83.6 | n.a. |
| Gross reserves/GDP | 19.5 | 19.6 | 19.5 | 25.6 | n.a. |
| Credit to private sector/GDP | 64.4 | 62.6 | 60.2 | 65.2 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**A substantial recovery in exports has boosted GDP growth.** Being an open and export-oriented economy, the Covid-19 pandemic hit the Hungarian economy hard, with a drop in GDP of 4.7 per cent in 2020. The recovery of industry and exports, especially in the automotive sector, in the first half of 2021 led to GDP growth of 7.6 per cent year-on-year, bringing the level of GDP above pre-crisis levels. The industrial sector began to recover at the end of 2020 and its production is also above pre-pandemic levels, with the highest growth rate in the manufacturing sector. However, the Hungarian automotive sector, which generates almost 15 per cent of Hungary's GDP (including suppliers), has been facing a global semiconductor shortage, which has hampered production. Despite that, economic confidence indicators have been recovering solidly since February 2021 and a large investment by Mercedes-Benz and BMW in electric-vehicle production continues.

**Unemployment remains below the regional average, while wage pressure is building.** With restrictive measures still partially in place, especially in the services sector, the unemployment rate did not change significantly during the Covid-19 pandemic, reaching 4.1 per cent in the second quarter of 2021, below the average for central Europe and the Baltic states (CEB). As the economy recovers, real wage growth is set to increase further, from 6.2 per cent in 2020, underpinned by a lack of skilled workers. Due to further pressure on wages, higher energy prices and demand recovery, inflation could exceed 5 per cent in 2021.

**The fiscal deficit rose sharply.** On account of the government's fiscal stimulus during the Covid-19 pandemic, the general government deficit totalled 8.0 per cent of GDP in 2020, exceeding that of all other CEB economies. Public debt increased to a relatively high 80.1 per cent of GDP. These ratios are likely to remain elevated in the short term.

**Strong growth will continue, but higher energy prices and global shortages of components and chips are risk factors.** GDP growth is expected to remain strong throughout 2021, at 7.7 per cent, before slowing to 4.8 in 2022. The post-crisis recovery is likely to be boosted by investment, co-financed by EU funds. While Hungary is still waiting for the European Commission to approve the RRF, the government has sold the equivalent of €4.5 billion in Eurobonds to pre-finance RRF projects. As higher energy prices and global shortages hamstring the manufacturing sector, however, especially automotive companies, this is likely to weigh on Hungary's exports in the short term.

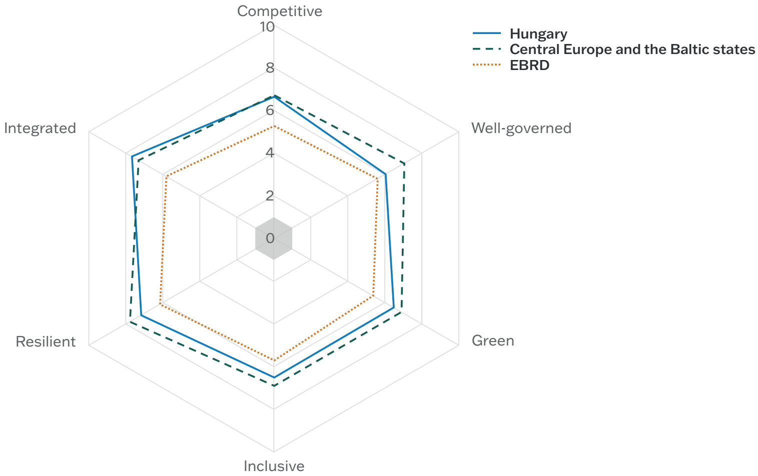
## Policy response to Covid-19

**The policy response in 2020 alleviated some of the Covid-19 pandemic's negative effects.** The government's overall response to the crisis was wide ranging. Through the newly established anti-epidemic fund, the increased needs of the health sector were addressed, while the Economic Protection Fund provided support for the labour market, businesses and households. The overall size of the fiscal response was around 12 per cent of GDP.

**The 2021 budget assumes continued support for the economy.** The budget envisions continued support for employment and subsidies for wages in vulnerable sectors. In December 2020, part of the central budget, amounting to 2 per cent of GDP, was transferred to public-sector institutions and the remaining funds can be used throughout 2021. A general reduction in social-security contributions has been ongoing and, as a part of the new family care plan, families with children can benefit from duty exemptions when purchasing residential properties, as well as from a one-off income tax rebate for 2021.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The government's plan for the use of RRF funds will support further economic transformation.** The national plan, worth €7.2 billion in grants, is based on five pillars: green transition, healthcare, research, digitalisation, and cohesion and public administration. The government decided not to use loan financing under the RRF, but to limit it to grants. To address the country-specific recommendations of the European Commission, the national plan foresees a digital upgrade to the prosecution service, fewer informal payments in the health sector and an improved legal framework for public procurement.

**The government has introduced new measures to support investment.** To facilitate larger investments, the government is adding more regions where investments of more than €5 million will receive state support. With regard to research and development, investments worth more than €1 million (up from €3 million previously) will be considered for additional support. From 2021, medium-sized enterprises with an investment value of at least HUF 300 million (equivalent to around €0.8 million) will be eligible for development tax incentives. Lastly, foreign-owned companies can now employ up to 20 per cent non-residents, rather than 10 per cent.

**The central bank embarked on a monetary tightening cycle to control inflation.** Rising inflation, brought about by the economic recovery and global market disruption, prompted the National Bank of Hungary (NBH) to raise the central bank base rate already five times since mid-2021, from 0.6 per cent to 1.8 per cent in October 2021. The monetary tightening cycle is likely to continue until the inflation rate stabilises within the NBH's target range of 2 per cent to 4 per cent.

**The authorities started to issue forint-denominated green bonds.** The first issue of a 30-year forint-denominated green bond took place in April 2021. Registering high demand and with an average yield of 3.69 per cent – a percentage point above its usual 10-year bonds – primary dealers' bids reached HUF 30 billion (€86.1 million equivalent). The second issue was in July 2021 and Hungary will continue to issue quarterly to fund green transition projects, such as a more energy-efficient railway. In addition, the central bank announced the launch of a green mortgage bond-buying programme and green loans from October 2021.

CONTINUES

**The state is bidding for majority ownership of the airport in Budapest.** Sixteen years after privatisation, the government submitted a bid in July 2021 to retake majority ownership of the airport. Currently, the biggest shareholder in Budapest Airport, with a 55 per cent stake, is AviAlliance. The offer was self-initiated and the government claims it is in the country's strategic interest.

**The government is advocating regional cooperation projects within the Visegrad Group (V4).** From the beginning of July 2021, Hungary chairs the V4. As a goal of its presidency, the country is emphasising regional cooperation in the field of financial regulation, with a focus on fintech and digitalisation. Regional integration will be further promoted through working group meetings on V4 high-speed rail links and negotiations to finance the project with EU funding.

# JORDAN

## Highlights

- **The economy is recovering slowly from the Covid-19 crisis.** The pandemic and related containment measures have led to rising public debt and record levels of unemployment, which are likely to present a difficult challenge for policymakers.
- **The authorities have extended a set of Covid-19 response measures in 2021 and developed plans to support economic recovery post-crisis.** Recovery plans are targeted at higher degrees of digitalisation and a greener and more sustainable recovery.
- **The authorities are committed to resuming reforms under the latest International Monetary Fund (IMF)-supported programme.** The 2021-24 Government Indicative Executive Programme (GIEP) is set to introduce public administration restructuring, energy and water sector reforms, policies to increase export competitiveness and more inclusive employment regulations.

## Key priorities for 2022

- **Swiftly implementing key reforms envisaged under the IMF-supported programme and the affiliated 2021-24 GIEP is crucial.** These include the implementation of the ambitious three-year electricity reform plan. Reforms should be supported by a continuation of the government’s anti-corruption campaign. A more agile, transparent and accountable public administration is essential to ensure credibility and trust in planned reforms.
- **A return to fiscal discipline 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 the tax and customs administrations should be complemented by spending containment and subsidy reforms, as well as improving social safety nets. Rolling out a pipeline of projects to be implemented under the country’s public-private partnership (PPP) scheme, in line with international best practices, is also essential.
- **There is a need to diversify sources of economic growth and tackle rising unemployment.** This would require measures to promote private-sector growth for job creation, labour market reforms to encourage female and youth employment, increased labour force participation and reduced informality in the private sector, as well as targeted employment and upskilling programmes.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 2.1 | 1.9 | 2.0 | -1.6 | 1.5 |
| Inflation (average) | 3.6 | 4.5 | 0.7 | 0.4 | 2.0 |
| Government balance/GDP | -3.6 | -4.7 | -6.0 | -8.9 | -7.7 |
| Current account balance/GDP | -10.6 | -6.9 | -2.1 | -8.0 | -8.9 |
| Net FDI/GDP [neg. sign = inflows] | -4.9 | -2.2 | -1.5 | -1.6 | -2.2 |
| External debt/GDP | 68.4 | 67.9 | 68.0 | 78.3 | n.a. |
| Gross reserves/GDP | 37.6 | 33.9 | 34.6 | 38.8 | n.a. |
| Credit to private sector/GDP | 72.4 | 76.5 | 78.1 | 82.9 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy is recovering slowly.** After a 1.6 per cent contraction in 2020, growth rebounded to 1.8 per cent year-on-year in the first half of 2021. Despite a strong recovery in financial services, manufacturing and mining, the decline continued in tourism and the rebound was slower in construction, transport and communications, as well as in a wide array of services, as health restrictions lingered and demand for exports and tourist services remained weak. Meanwhile, annual inflation gradually increased in the first eight months of 2021, at an average of 1.1 per cent year-on-year, due to strong base effects from the drop in oil prices in 2020. Moreover, the unemployment rate increased to 24.8 per cent in the second quarter of 2021, one of the highest levels in the past two decades. Unemployment is particularly high among graduates (31.1 per cent), women (33.1 per cent) and young people (48.5 per cent).

**Fiscal conditions recovered slightly, but the current account deficit widened**. The overall fiscal deficit (excluding foreign grants) narrowed to 4.4 per cent of GDP in the first quarter of 2021, from 7.2 per cent in the same period of 2020, as growth in revenues (except for shrinking external donor support) outpaced the increase in current expenditures. However, public debt remains elevated, at 100.1 per cent of GDP in 2020. In tandem, the current account deficit widened to 15.9 per cent of GDP in the first quarter of 2021, up from 2.3 per cent a year earlier. The increase was driven by rising demand for goods imports, which more than offset the improvements in exports, in addition to the drop in tourism income as travel restrictions persisted. Gross official reserves remained relatively stable following the issue of the US$ 1.75 billion Eurobond in mid-2020, amounting to US$ 19.6 billion in September 2021 and covering more than nine months of imports.

**A return to positive growth is expected in 2021, with an acceleration in 2022.** We currently project GDP to expand by 1.5 per cent in 2021, as restrictions on movement and activity are gradually lifted in the second half of the year. Growth is expected to pick up in 2022 to 2.2 per cent, sustained by stronger cross-border trade and a partial recovery of the tourism sector. The economy is expected to benefit from IMF-supported reforms in the long term, but will likely remain subdued as the necessary return to fiscal discipline caps government spending. Risks to the outlook include an erosion of real competitiveness stemming from an overvalued exchange rate, regional instability and slower-than-expected recovery in partner economies.

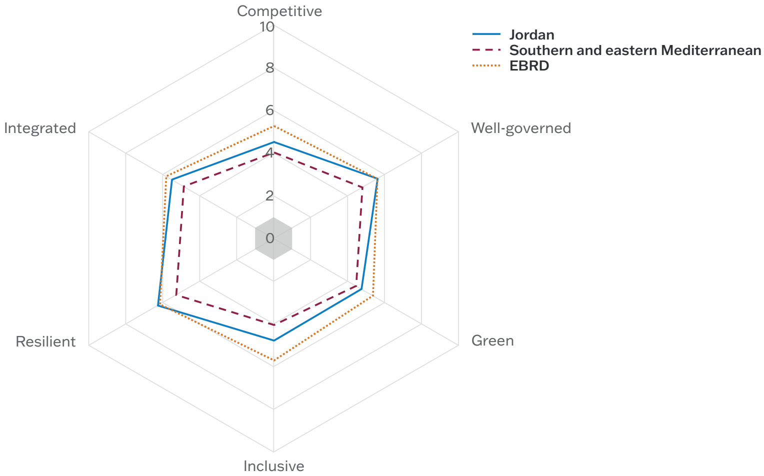
## Policy response to Covid-19

**The authorities extended some of the previously implemented fiscal, social and monetary measures into 2021.** In March 2021 the Central Bank of Jordan extended loan moratoria to affected sectors until the end of 2021 and expanded its subsidised small and medium-sized enterprise (SME) lending scheme by JOD 200 million (US$ 282 million). In the same month, the government announced a set of fiscal measures to the value of JOD 186 million (US$ 262 million), aimed at expanding social safety nets, supporting affected sectors and introducing employment programmes targeting young people and women.

**The uptake of the Covid-19 vaccine was initially slow, but has gathered pace in recent months.** More than 33 per cent of the population was fully vaccinated by early November 2021.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The government is continuing work under the IMF-supported programme.** 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. It aims to achieve stronger and more inclusive growth and create jobs, with implementation centred on growth-enhancing structural reforms and a gradual reduction of the budget deficit. The first and second reviews were completed successfully, the latter in July 2021, bringing total IMF disbursements to Jordan to around US$ 900 million since the start of 2020.

**The government launched its Executive Programme 2021-24, outlining its priorities and reform plans.** The programme, launched in February 2021, comprises seven pillars: structural and economic reforms; rule of law and anti-corruption reforms; green and digital transformation; promotion of investment and productive sectors; infrastructure services; social services; and employment and poverty reduction. Key plans under this programme include: fiscal reforms to widen the tax base; unifying custom administration; improving public administration efficiency; revising investment regulations and activating solvency law; digitalising streamlined business registration and licensing procedures; and simplifying procedures in economic courts.

**Some legal reforms are already under way.** In June 2021 the government introduced amendments to the General Sales Tax Law. The amendments address previous loopholes to minimise tax evasion as well as obstacles to disbursing tax refunds. The government also approved amendments to the Companies Law to allow companies to hold general assemblies and board of directors meetings by electronic means.

**An ambitious digitalisation plan has been approved.** In July 2021 the government approved the 2021-25 Digital Transformation Strategy, which aims to upgrade the country's digital infrastructure, introduce digital government services, electronic identification and e-signatures, and promote the use of digital payments. The strategy aims to increase the information and communication technology (ICT) sector's contribution to GDP from 3 per cent to 7 per cent in the next five years. It plans to introduce 5G technologies and connect all government entities, 80 per cent of businesses and 55 per cent of households to fibre optic cables.

**A new programme will promote the export of services by SMEs.** The programme, launched by the Jordan Enterprise Development Corporation in January 2021, aims to encourage the export of services and open new markets for small exporters.

# KAZAKHSTAN

## Highlights

- **The economy is recovering, albeit gradually.** Real gross domestic product (GDP) grew by 3.0 per cent year-on-year in the first three-quarters of 2021, driven by the recovery of domestic demand thanks to government stimulus policies and rising commodity prices. However, growth continues to be negatively affected by recurring domestic restrictions to contain the spread of Covid-19, and rising inflation and real estate prices are a growing concern.
- **The Comprehensive Plan for Economic Recovery has been extended until the end of 2021.** It includes more than 160 measures related to, among other things, investment promotion, support for small and medium-sized enterprises (SMEs), labour market, digitalisation, efficiency of fiscal revenues and the financial sector.
- **A National Development Plan through to 2025 has been adopted.** The plan rests on three main pillars: citizen welfare, quality of institutions and a strong economy. The government seeks, among other things, to strengthen the healthcare system, reduce the state's footprint in the economy, put in place an effective industrial policy framework, and promote digitalisation and the transition to a green economy.

## Key priorities for 2022

- **Fiscal support measures need to be better targeted.** State support was extensive even before the Covid-19 pandemic-related crisis. To better use scarce financial resources and encourage green investment and innovation, the government should design policies to deliver private-sector support in a targeted way using market-based incentives.
- **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 the supply of medical equipment. To bolster food security, it is desirable to improve the organisation of the agriculture sector and enhance its climate resilience – an urgent challenge illustrated by the severe drought plaguing Kazakhstan and the region in 2021.
- **Efforts are needed to improve inclusion across regions and for vulnerable population groups.** Reforms in education and vocational training 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 available for workers in need of upskilling and reskilling.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.1 | 4.1 | 4.5 | -2.6 | 3.6 |
| Inflation (average) | 7.4 | 6.0 | 5.2 | 6.8 | 7.7 |
| Government balance/GDP | -4.3 | 2.6 | -0.6 | -7.0 | -2.5 |
| Current account balance/GDP | -3.1 | -0.1 | -3.6 | -3.7 | -1.0 |
| Net FDI/GDP [neg. sign = inflows] | -2.8 | -0.1 | -2.0 | -2.3 | -2.5 |
| External debt/GDP | 100.7 | 90.0 | 87.5 | 96.7 | n.a. |
| Gross reserves/GDP | 19.3 | 18.1 | 16.1 | 21.0 | n.a. |
| Credit to private sector/GDP | 29.1 | 25.9 | 24.2 | 25.8 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**Real GDP grew by 3.0 per cent year-on-year in the first three-quarters of 2021.** The recovery was enabled by fiscal support measures and expansion in private consumption. Growth in real wages and consumer lending, together with stimulus measures, benefited household demand. Fixed investment remains sluggish due to the contraction in the mining sector but it has been growing outside of mining. Growth is held back by domestic restrictions to contain the spread of Covid-19 and a reduction in mining output to comply with Organization of the Petroleum Exporting Countries Plus (OPEC+) agreements.

**Inflation is inching up.** The inflation rate rose from 7.5 per cent year-on-year in December 2020 to 8.9 per cent year-on-year in September 2021, fed by rising international food and commodity prices, as well as pent-up demand fuelled by social transfers and other stimulus measures. Real estate prices surged, driven by increased mortgage lending and people spending their retirement savings (allowed from January 2020). Credit growth accelerated to 16.0 per cent year-on-year in August 2021 from 8.0 per cent a year ago. The central bank responded to inflationary pressures by hiking the policy rate stepwise from 9.0 to 9.25 per cent in July 2021, to 9.5 per cent in September 2021, and to 9.75 per cent in October 2021. The exchange rate bottomed out in early April 2021 after a short bout of depreciation triggered by new sanctions imposed on Russia, but is currently stable.

**The current account was in deficit in the first half of 2021**. Preliminary estimates show a deficit of US$ 1.7 billion in January to June 2021 compared with US$ 0.8 billion a year ago. This is due to a surge in net investment income payments made to foreign direct investors (up by 43 per cent year-on-year) and growing consumer goods imports (27 per cent year-on-year). The export of goods rose by a modest 3.4 per cent year-on-year, driven by non-oil exports.

**Economic growth is forecast to accelerate in the short term.** Real GDP is expected to grow by 3.6 per cent in 2021 and 3.8 per cent in 2022, supported by higher oil prices, fiscal stimulus and recovery of private consumption. Significant downside risks remain, however, including those related to the path of Covid-19 infections.

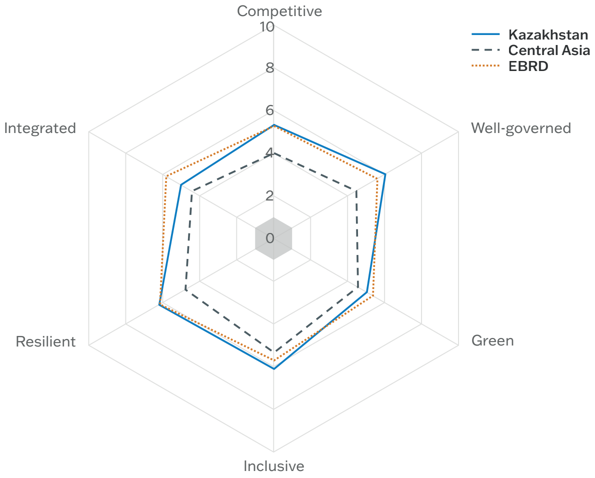
## Policy response to Covid-19

**Measures to support SMEs are continuing in 2021.** Credit support, tax and loan payment deferrals for SMEs have been extended. Concessional lending (at 6.0 per cent) is provided via state programmes such as the Employment Roadmap, the Business Roadmap and the Economy of Simple Things. There are also tax incentives in agriculture, tourism, transport and catering. A special retail tax regime was introduced in early 2020 for SMEs in sectors most affected by the Covid-19 pandemic, substituting a 3.0 per cent corporate income tax (on gross income) for social tax and value added tax (VAT) payments.

**The Comprehensive Plan for Economic Recovery has been extended until the end of 2021.** It includes more than 160 measures targeting, among other things, investment promotion, SME support, the labour market, digitalisation, the efficiency of fiscal revenues and the financial sector. Revisions to the 2021 budget include additional spending to support the fight against Covid-19 within a broader stimulus package. The overall fiscal stimulus package in 2021 amounts to about 1.6 per cent of GDP.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**Major development programmes are envisaged in the coming years.** The overall fiscal framework for 2022-24 and the proposed 2022 budget remain somewhat expansionary, to accommodate the ruling party's development programmes and social welfare commitments. The government plans major increases in healthcare, education and social spending, which are likely to add to inflationary pressures (although the government is projecting an actual slowdown in inflation from 6-7 per cent in 2021 to 4-5 per cent by 2024). These extra expenditures will be partially balanced by cuts in spending on municipal infrastructure and transport.

**A new National Development Plan through to 2025 is in place.** The plan, adopted in March 2021, is built on three main pillars: citizen welfare, quality of institutions and a strong economy. The government will seek, among other things, to strengthen the healthcare system, reduce the state's footprint in the economy, put in place a new industrial policy framework, and promote digitalisation, trade and financial integration, regional development and green economy transition. Key targets to be achieved are 5 per cent annual real GDP growth by 2025, a doubling of non-extractive exports and increasing the share of SMEs in GDP to 35 per cent.

**The government is committed to restarting privatisation through a programme for 2021-25.** Due to the Covid-19 pandemic and the associated deterioration in market sentiment, initial public offerings of KazMunaiGas (the national oil and gas company), Air Astana (the national airline), KazPost (the national postal operator) and Kazakhstan Temir Zholy (the national railways), initially planned for early 2020, were postponed until 2021-23. The new plan envisages privatising 736 state assets (including subsidiaries). Fifty per cent of enterprises will be privatised in 2021, 30 per cent in 2022 and the rest in 2023-24, according to the plan. The target is to reduce the share of state-owned enterprises (SOEs) in the economy to 14 per cent of GDP by 2025.

CONTINUES

**Kazakhstan is making progress on the green economy agenda.** In December 2020 the president announced the country's commitment to reaching carbon neutrality by 2060. As part of this journey, the country will accelerate transition to renewable energy sources and will plant two billion trees in the next five years to increase carbon absorption. In addition, the new environmental code, effective since July 2021, makes climate change adaptation a legal norm for sectoral and regional policy planning. The 50 largest companies, accounting for 80 per cent of emissions in Kazakhstan, are expected to upgrade to the best available technologies by 2025.

**Bitcoin mining has gained prominence due to favourable regulation and low electricity prices.** The growth in mining has also been given impetus by new restrictions imposed on cryptocurrency use in China since May 2021. Mining in Kazakhstan has reportedly made up about 8.2 per cent of the average monthly Bitcoin hash rate, ranking third behind China and the United States of America as of April 2021. The regulatory framework has been conducive to investment: the law on the regulation of digital technology has legalised the process of cryptocurrency mining and participation in the global cryptocurrency industry. Cheap electricity (KZT 8 per kilowatt hour (kWh)) is another major incentive for foreign investment in the area. The authorities signed a law on taxation of crypto miners in June 2021, according to which, starting in January 2022, registered miners will be charged an extra KZT 1 (US$ 0.0023) per kWh.

# KOSOVO

## Highlights

- **Growth has started to recover in 2021.** After the 5.3 per cent contraction in 2020, the economy expanded by 16.3 per cent year-on-year in the second quarter of 2021 on the back of growth in domestic demand and exports.
- **A new economic recovery package has been adopted.** The package, worth €420 million, includes support to employment, manufacturing, families and the public sector, as well as investment in infrastructure and the environment.
- **The much-needed green agenda is gradually advancing.** Since the end of 2020 Kosovo's transmission system operator (TSO) KOSTT has signed three important agreements on new renewable energy projects (wind and solar).

## Key priorities for 2022

- **Further improvements in the business environment and public governance are needed.** The private sector would benefit from the government cutting red tape, reforming business inspections and fighting corruption. Strengthening fiscal management and the governance of state-owned enterprises (SOEs) would also help to increase the economy's resilience to future shocks.
- **More progress towards a green transformation of the energy sector is critical.** Further efforts are needed in implementing the auctions systems in renewables, introducing a competitive market-based system to award new licences and exploring the potential of gas as a transition fuel instead of the old lignite power plants, which should be decommissioned.
- **Financial stability should be monitored carefully.** The financial sector withstood the recession well but non-performing loans (NPLs) could rise with the phasing out of regulatory measures and government support.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.8 | 3.4 | 4.8 | -5.3 | 7.7 |
| Inflation (average) | 1.5 | 1.1 | 2.7 | 0.2 | 3.1 |
| Government balance/GDP | -1.4 | -2.8 | -2.9 | -7.8 | -4.8 |
| Current account balance/GDP | -5.7 | -7.8 | -5.8 | -6.7 | -7.9 |
| Net FDI/GDP [neg. sign = inflows] | -3.3 | -3.4 | -2.7 | -4.2 | -1.2 |
| External debt/GDP | 32.9 | 30.5 | 31.2 | 37.2 | n.a. |
| Gross reserves/GDP | 10.8 | 11.5 | 12.2 | 13.3 | n.a. |
| Credit to private sector/GDP | 38.9 | 41.1 | 42.8 | 47.8 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**Gross domestic product (GDP) is recovering well in 2021.** The economy experienced a recession of 5.3 per cent in 2020. While exports of services fell fairly sharply (by 40 per cent), investments contracted by a milder 7.1 per cent and household consumption recorded growth of 2.5 per cent, supported by remittance inflows. Manufacturing also recorded growth, reflected in a surprising growth in exports of goods of 21.7 per cent, but output from the trade, transport and construction sectors fell strongly. In the first quarter of 2021 GDP grew by 5.6 per cent year-on-year and by 16.3 per cent year-on-year in the second quarter on the back of a strong rise in consumption, investment and exports. Both exports of goods and services recorded a robust nominal growth in the first half of the year (each by around 60 per cent year-on-year).

**Prices are trending up.** Following a mild deflation in the second half of 2020 and early 2021, the year-on-year inflation rate picked up relatively strongly thereafter, rising from 0.2 per cent in January 2021 to 4.9 per cent in September 2021. The uptick in prices came primarily on the back of growth in prices of transport (oil), telecommunication services, alcoholic beverages and tobacco.

**Economic activity could reach its 2019 level in 2021, subject to upside risks being realised.** According to our latest forecasts, GDP should expand by 7.7 per cent in 2021, mainly driven by the recovery in investment and travel and tourism activities related to the country's large diaspora. In 2022 GDP growth is expected to pick up further to 4.5 per cent. Risks to the projection seem to be more on the upside in 2021, given the positive developments in the first half of the year and reopening of the borders. Still, the pace at which diaspora visits and the economy as a whole recover will depend on how the Covid-19 pandemic develops, both locally and globally. Stronger economic growth would be helped by improving public investment management and accelerating the hitherto slow implementation of key infrastructure projects.

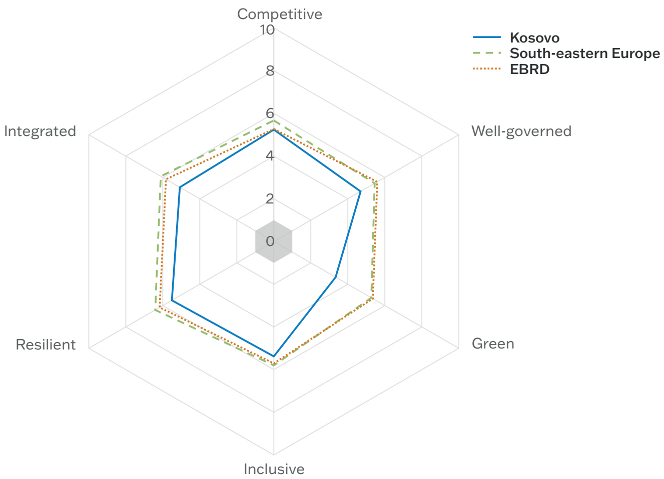
## Policy response to Covid-19

**The Law on Economic Recovery has been adopted.** The law, approved in December 2020, included an additional stimulus for businesses affected by the Covid-19 crisis, proposals to subsidise wages to employees who lost their jobs and the removal of value added tax (VAT) on all raw materials. Since the fiscal implications of the law were not fully covered by the 2021 budget, a revised budget was prepared in July 2021, following the adoption of the new government's programme 2021-25. The economic recovery package amounted to €420 million, with €190 million envisaged to come from the budget and the rest from borrowing.

**The country has issued treasury bonds for the diaspora.** In July 2021 the Ministry of Finance issued a public call to resident and non-resident physical persons to buy three-year and five-year diaspora bonds (carrying an annual interest rate of 1.2 per cent and 2.2 per cent, respectively), which are part of the economic recovery package. The first sale, in the amount of €10.4 million, was completed in August 2021.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**There has been little progress in the European Union (EU) approximation process over the past year.** Kosovo signed the Stabilisation and Association Agreement with the EU in October 2015, which formally entered into force in 2016. While the European Commission (EC) 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 EU member states do not recognise Kosovo bilaterally. Although the Commission confirmed that Kosovo fulfilled outstanding visa liberalisation benchmarks, the decision on visa liberalisation is pending in the European Parliament and the Council, and citizens of Kosovo remain unable to travel to the Schengen area without a visa.

**The TSO KOSTT has started operating as part of the energy bloc with Albania.** The connection agreement between KOSTT and TSOs from continental Europe entered into force in December 2020, marking the start of operations of KOSTT as a control area within the joint control block with OST, the Albanian TSO. A year earlier, KOSTT and OST signed an agreement to set up a common energy market consisting of Kosovo and Albania. In addition, the new 400 kV line between Kosovo and Albania has been put into operation, contributing to further cross-border exchanges.

**A draft law on the Commercial Court has been prepared.** The Commercial Court is being set up to increase the effectiveness of trade dispute resolution. Until now, many businesses have had to file claims in two departments of the Pristina Basic Court (the Economic Department and the Administrative Department). However, their unclear mandates and jurisdictions result in delays and sometimes inconsistent decisions by the two departments. The Commercial Court would be the sole body in charge of resolving trade disputes involving foreign businesses and other investors. The draft law was prepared in March 2021 and adopted by the Kosovo Assembly's legislation committee in July 2021.

**The central bank of Kosovo (CBK) has developed a national strategy for retail payments.** The National Retail Payments Strategy 2021-26 was prepared and published in July 2021. The strategy stipulates that the CBK should finalise transposing the relevant EU Directives, continuously review the legal and regulatory framework of the country's retail payments market and encourage the use of innovative payment services and instruments. To ensure progress of the strategy's implementation, increasing the adult account ownership ratio and the number of cashless payments per capita are set as objectives.

CONTINUES

**The financial system has remained stable throughout the Covid-19 pandemic.** Banks withstood the recession well, relying on previously high levels of liquidity and capital. In June 2021 the capital adequacy ratio in the banking sector averaged 17.3 per cent, while the liquidity ratio (showing the coverage of short-term liabilities by liquid assets) was 36.7 per cent. The quality of bank assets has also remained good, with the NPL ratio at 2.5 per cent in June 2021. However, asset quality requires continued vigilance as regulatory forbearance measures are being lifted.

# KYRGYZ REPUBLIC

## Highlights

- **The economy is recovering but gold production has dropped.** Real gross domestic product (GDP) expanded by 0.1 per cent year-on-year in the first three-quarters of 2021. However, gold production and exports declined significantly. Remittances are surging, supporting domestic demand. Services are recovering, while labour-intensive agriculture contracted in January-September 2021 due to drought.
- **A new tariff policy for heat and electricity has been proposed.** Once implemented, the policy would see a gradual increase in tariffs to achieve cost recovery by 2025. Substantial tariff reforms have been adopted in the past few years but have not been implemented consistently because of concerns about affordability and potential political repercussions.
- **Construction of the CASA-1000 electricity transmission line in the Batken region has started.** The project, with a total cost of US$ 1 billion, will help unlock the hydropower potential of Central Asia and significantly reduce carbon emissions in the region.

## Key priorities for 2022

- **The immediate priority is to continue supporting sectors affected by the Covid-19 pandemic and sustain private-sector employment.** Beyond this immediate need, the country should improve the conditions for investment in the labour-intensive sectors of the economy, such as hospitality, modern agriculture, and the garment and food processing industries. At present, the economy is dependent on aid and remittances (about 30 per cent of GDP), with Russia's economy serving as a safety valve for pressures building up in the Kyrgyz labour market.
- **Fiscal consolidation is urgently needed.** Public debt rose from 51.6 per cent to 68.0 per cent of GDP in 2020, of which external public debt (58.3 per cent of GDP) is on concessional terms. To reduce the debt burden to manageable levels, the government should downsize non-priority spending. The authorities should streamline the tax and customs administration, optimise the public sector wage bill (at 13 per cent of GDP, it is one of the highest in the region, about 30 per cent of government expenditure) and reduce energy subsidies (as part of the recently announced tariff reform).
- **Issues surrounding the Kumtor gold mine should be resolved.** It is critical that the government restores the country's access to global gold markets and addresses foreign investors' concerns resulting from the appointment of external management in the Kumtor Gold Company in May 2021.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.7 | 3.5 | 4.5 | -8.6 | 2.5 |
| Inflation (average) | 3.2 | 1.5 | 1.1 | 6.3 | 12.0 |
| Government balance/GDP | -3.7 | -0.6 | -0.1 | -3.3 | -4.0 |
| Current account balance/GDP | -6.2 | -12.1 | -5.6 | 4.5 | -6.0 |
| Net FDI/GDP [neg. sign = inflows] | 1.4 | -1.7 | -2.5 | 4.0 | 2.0 |
| External debt/GDP | 91.0 | 83.8 | 82.7 | 89.9 | n.a. |
| Gross reserves/GDP | 28.3 | 26.6 | 28.7 | 29.9 | n.a. |
| Credit to private sector/GDP | 21.4 | 23.4 | 24.6 | 28.5 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**Economic growth is being held back by a major drop in gold production and exports.** The economy is recovering from the lows of the 2020 recession and real GDP posted a small growth of 0.1 per cent year-on-year in the first three-quarters of 2021. Recovery is constrained by a major contraction of gold exports (down 2.9 times year-on-year in January-August 2021, and that is despite Jerooy, the country's second-largest gold mining project, moving to production in March 2021). On top of that, on 17 September 2021, the London Bullion Market Association (LBMA) temporarily suspended Kyrgyzaltyn, the country's state-owned gold producer, from its list of acceptable refiners. LBMA's decision may also restrict Kyrgyzaltyn's access to other gold hubs, including Switzerland and New York. On the positive side, GDP excluding Kumtor grew by 3.6 per cent year-on-year in the first three-quarters of 2021, driven by growth in retail trade, transport and communication. Agriculture was down by 5 per cent year-on-year in the same period, due to drought. Services expanded by 5.7 per cent year-on-year, enabled by the increased inflow of remittances (up 21 per cent year-on-year in US dollar terms in the first eight months of 2021) and the easing of lockdown measures.

**Inflation is rising.** Inflation has been consistently above the central bank's target corridor of 5-7 per cent so far in 2021, reaching 13.5 per cent in September 2021. This trend reflects rising global food prices along with the remittance-financed surge in consumer demand. To quell inflationary pressures, the central bank raised the policy rate stepwise from 5.5 to 6.5 per cent in April and to 7.5 per cent in July 2021.

**International trade has strongly rebounded.** Imports in the first eight months of 2021 increased by 41 per cent year-on-year, driven by major increases in clothing and accessories (up by a factor of 4.3 (x4.3)), knitted fabrics (x2.7), and threads and fibres (x1.8), reflecting positive dynamics in the country's textile production and re-exporting activity. Including gold, total exports in January-August 2021 were down 19.5 per cent year-on-year.

**The economy is expected to grow moderately in 2021.** A projected 2.5 per cent growth rate is fuelled by a strong recovery in remittances from Russia and growth in private consumption, which will positively affect the services industry. However, fixed investment is expected to remain subdued in 2021 due to political risks and investment climate concerns resulting from the government's decision to take temporary control of Kumtor in May 2021 and the ratcheting up of inspections and regulatory pressure on medium-sized businesses. Real GDP growth is projected to accelerate to 5.0 per cent in 2022. Significant downside risks are associated with the Covid-19 pandemic continuing to weigh on the hospitality sector in 2022 and the Kyrgyz Republic's future ability to access global gold markets.

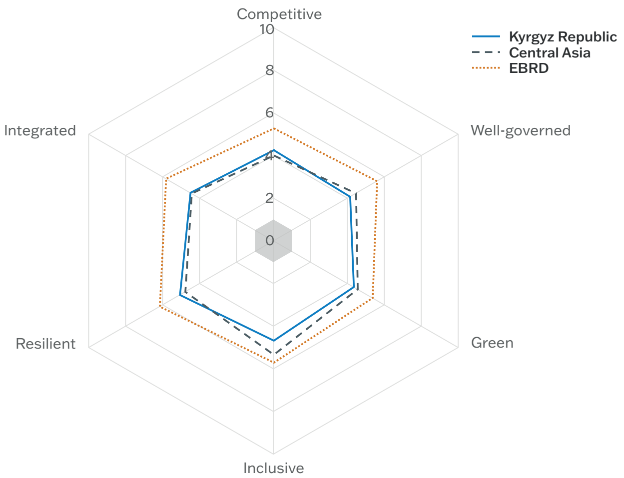
## Policy response to Covid-19

**Additional measures to support economic recovery were adopted in February 2021.** They are outlined in the Plan of Priority Measures to ensure social stability and economic sustainability. First, the plan seeks to improve the quality and increase the number of electronic government services available to the public. Second, to aid businesses, the government will simplify administrative procedures and invest in the automation of customs and tax processes. Third, to ensure the healthcare system is resilient to future waves of the Covid-19 pandemic, the government will intensify the vaccination campaign and introduce preventive measures in schools to curb the spread of coronavirus.

CONTINUES

**An export ban on some food, medical and pharmaceutical products was introduced in November 2020.** The ban on food exports was extended in June 2021 for another six months. The list of restricted items include wheat, wheat flour, sugar, rice, vegetable oil and chicken eggs. In addition, imports of granulated sugar and refined vegetable oil were exempt from value added tax (VAT) until the end of August 2021 for private-sector companies, and until the end of December 2021 for the State Material Reserves Fund. Enterprises processing certain domestic agricultural inputs (such as flour from cereals, vegetables and nuts) only need to pay 20 per cent VAT. Medicines and pharmaceutical products are also subject to a temporary export ban to ensure adequate domestic supply.

Assessment of transition qualities (1-10)




## Structural reform developments

**A new tariff policy for heat and electricity for 2021-25 was announced.** Stalled for at least a decade due to concerns about affordability and potential political repercussions, this reform, announced in June 2021, envisages a gradual increase in tariffs to achieve cost recovery by 2025. A new constitution and the shift to a presidential system could make it easier to implement necessary energy reforms. At the moment, the Kyrgyz Republic has one of the lowest electricity tariffs in the world, leading to inefficient use of energy, severe under-spending on maintenance and new investment, as well as poor supply reliability and quality. In 2021 the electricity deficit is forecast at around 3 billion kilowatt-hours (to be covered by electricity imports from Kazakhstan, Turkmenistan and Uzbekistan).

**Overzealous anti-corruption efforts are being reined in.** Implementation of the new Anti-Corruption Strategy for 2021-24 had led to a wave of tax audits targeting the country's medium-sized businesses, which many in the business community viewed as harassment. In June 2021 President Sadyr Japarov issued a decree shutting down the notorious Anti-Corruption Committee under the State Security Council, and announced the government's intention to streamline the tax, judicial and law enforcement systems with an eye to stopping business harassment and improving the country's investment climate. Corruption is seen as a major obstacle to private-sector development, as the Kyrgyz Republic ranks 124th out of 180 countries on Transparency International's Corruption Perceptions Index in 2020.

CONTINUES

**A new tax code is being developed to simplify tax administration and reduce informality.** The new tax code envisages simplifying VAT refunds and reimbursements and developing an alternative approach to resolving tax disputes. Tax administration procedures will be streamlined to reduce the scope for interpretation and eliminate inconsistencies in applying legal norms and requirements. This is an important reform for the country as the current tax administration is complicated and tax compliance costs are very high.

**Construction of the CASA-1000 project has begun.** This project, which started in the southern part of the country in February 2021, will facilitate the export of hydropower from the Kyrgyz Republic and Tajikistan to and through Afghanistan and to Pakistan. CASA-1000 could provide substantial revenues to the Kyrgyz Republic and Tajikistan with minimal impact on regional carbon emissions. However, recent instability in Afghanistan has placed a significant degree of uncertainty over its prospects.

**The banking sector remains resilient despite deteriorating asset quality.** Weakening asset quality is manifested in rising non-performing loan ratios (11.4 per cent in June 2021 versus 8.1 per cent in January 2020). Nevertheless, the banking sector remains resilient with the capital adequacy ratio at 22.9 per cent as of the end of March 2021 and the liquidity ratio at 65.5 per cent. Both indicators are well above the ratios set by the central bank.

# LATVIA

## Highlights

- **The economy is recovering after a moderate decline in 2020.** Following a gross domestic product (GDP) drop of 3.6 per cent in 2020, the economy has started a solid recovery in 2021 towards pre-Covid-19 crisis levels, mainly due to improvements in the manufacturing and services sectors.
- **The European Union (EU)'s Recovery and Resilience Facility (RRF) plan for Latvia reflects the government's reform priority areas.** The €1.8 billion plan foresees not only investments to improve energy efficiency and sustainable mobility, but also a broad digital transformation of business and administration, along with reduced regional socio-economic disparities.
- **The Economic Affairs Court has been established to help improve the business environment and reduce the shadow economy.** The newly constituted court, which began operating in March 2021, is the first specialised court in Latvia with jurisdiction including certain civil matters and economic, financial and corruption cases.

## Key priorities for 2022

- **A strategy to sustainably reduce the fiscal deficit is needed.** Following recovery from the Covid-19 crisis, the level of general government debt should not exceed 50 per cent of GDP. However, the medium-term strategy of a return to budgetary prudence should not be at the expense of important planned investments in key sectors.
- **Further strengthening of absorptive capacities is needed for successful RRF implementation.** Along with the structural reforms and proposed implementation plan, it is necessary to improve the public expenditure process and continue with advancing public procurement transparency to absorb the funds effectively.
- **The government should continue to promote innovation.** The innovation capacity of the private sector should be strengthened by targeted policy incentives, such as increasing digital capacities or facilitating access to capital markets.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 3.3 | 4.0 | 2.5 | -3.6 | 4.5 |
| Inflation (average) | 2.9 | 2.6 | 2.7 | 0.1 | 2.4 |
| Government balance/GDP | -0.8 | -0.8 | -0.6 | -4.5 | -8.6 |
| Current account balance/GDP | 0.7 | -0.3 | -0.6 | 2.9 | -1.0 |
| Net FDI/GDP [neg. sign = inflows] | -2.0 | -2.2 | -2.9 | -2.2 | -1.7 |
| External debt/GDP | 142.3 | 123.7 | 117.7 | 125.4 | n.a. |
| Gross reserves/GDP | n.a. | n.a. | n.a. | n.a. | n.a. |
| Credit to private sector/GDP | 43.5 | 38.0 | 36.6 | 35.6 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The first half of 2021 saw a recovery in economic activity.** Latvia recorded a milder GDP decline in 2020 than the EU average. The effects of the Covid-19 pandemic were mitigated by stable exports to Nordic trading partner countries and the country's relatively limited dependence on tourism. Intensified containment measures at the end of 2020 slowed the economy, but the recovery of the manufacturing and services sectors, as well as consumption, in the second quarter of 2021 contributed to GDP growth in the first half of the year of 5.2 per cent year-on-year. In the second quarter of 2021 industrial production increased by 2.4 per cent quarter-on-quarter, surpassing pre-Covid-19 crisis levels, while the manufacturing and energy sectors have been recovering from the beginning of the year. An additional positive signal comes from data on retail trade turnover, which from May 2021 exceeded comparable 2019 levels.

**The labour market still shows the impact of the Covid-19 pandemic, but wages are rising.** The unemployment rate peaked at 8.8 per cent in July 2020, falling marginally to 7.9 per cent by the second quarter of 2021. The real growth of the average wage in 2020 amounted to 9.0 per cent, and the increase in the minimum wage from the beginning of 2021 and the recovery of economic activities is contributing to further wage growth and inflationary pressures.

**To stimulate economic recovery, the fiscal deficit is likely to remain elevated this year.** Due to the temporary support measures introduced when the Covid-19 pandemic struck, the general government deficit in 2020 reached 4.5 per cent of GDP, interrupting a track record of budgetary prudence in recent years. The gross public debt level increased to 43.2 per cent of GDP, above the relatively stable pre-Covid-19 crisis level of 37.0 per cent of GDP. As the government still needs to allocate additional expenditures for economic recovery in 2021, the fiscal deficit is likely to be close to 9.0 per cent of GDP in 2021 before declining sharply in 2022.

**Short-term growth prospects are favourable, but vaccine hesitancy is a risk.** EU funds, especially through public sector investments, are likely to add to the GDP growth rate in 2021, which is expected to be 4.5 per cent. In 2022, GDP growth is likely to accelerate to 5.5 per cent. However, compared with the EU average, Latvia was relatively resistant to vaccination against Covid-19, but the vaccination rate improved by the end of October, with 62 per cent of people receiving at least one dose of the jab. A lack of herd immunity creates a risk of new lockdowns, as temporarily reintroduced in October 2021, aggravated by potential new variants of the virus.

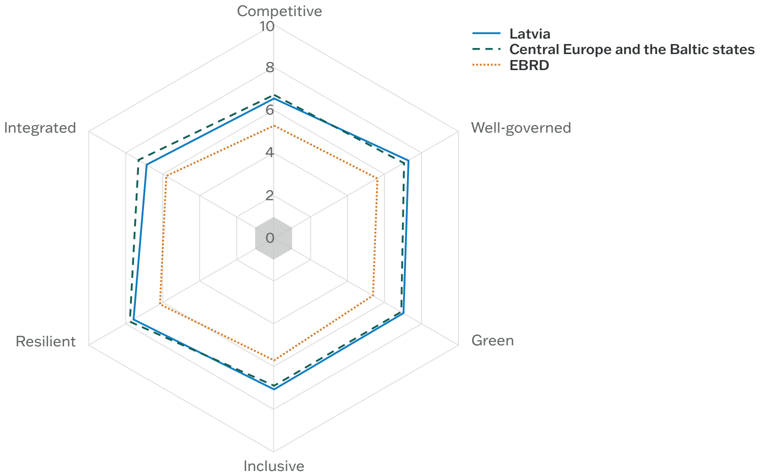
## Policy response to Covid-19

**The government's policy response to Covid-19 prevented major disruptions to the economy.** With stimulus packages implemented in 2020 that amounted to around 7 per cent of GDP, Latvia has managed to support its health system and compensate for losses in vulnerable sectors, for example, through coverage of 75 per cent of the cost of workers' downtime. Most support was directed towards loans and guarantees for businesses. Due to market shocks, the European Central Bank and Latvia's financial sector supervisor granted banks forbearance measures; using liquidity and capital buffers, banks could therefore support businesses and households through the Covid-19 pandemic. A loan payment moratorium up to 12 months for firms and individuals was valid until the end of 2020.

**The 2021 budget is providing further support for the post-Covid-19 recovery.** In December 2020 parliament adopted the 2021 budget, which assumed a €744 million increase in expenditures compared with 2019. The largest share of increased budgetary funding has been directed to healthcare, including increased wages for healthcare workers, a guaranteed minimum income and an increase in the minimum pension and state social insurance benefit. Following a budget revision in the middle of 2021, the Finance Ministry now expects the budget deficit to be smaller than expected.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The RRF is targeting the green and digital transitions.** More than half of the €1.8 billion allocation is dedicated to two priority areas: green transition (38 per cent of total funds), including the electrification of public transport and investments in energy efficiency and renewables, and digital transition (21 per cent), including the digitalisation of public administration and fostering a rising level of digital skills. Additional actions will address productivity and research and development investments, which are below the EU average. Further upskilling of the administration will be needed to maximise funds absorption.

**An 18-month programme to improve the insolvency framework was completed in March 2021.** Through improving the insolvency framework and debt restructuring, the Ministry of Justice, in cooperation with the European Commission and the European Bank for Reconstruction and Development (EBRD), has issued guidelines for identifying and managing the financial difficulties of corporates. Targeted at small and medium-sized enterprises, the aim is to increase their resilience and encourage timely reactions before insolvency.

**Latvia has confirmed its credibility in the financial markets despite the impact of the Covid-19 pandemic.** The relatively moderate GDP contraction in 2020 and the sustainable debt burden have given the country a stable credit rating and the prospect of favourable borrowing. In March 2021 the government issued a €1.25 billion 10-year Eurobond, with a zero coupon and yield of 0.105 per cent, the lowest coupon level of Latvian debt security issuance. In addition, in June 2021, the government issued a €500 million seven-year Eurobond, also with a zero coupon, and a yield of 0.003 per cent.

**The newly established Economic Affairs Court began operating in March 2021.** The new court has been set up to improve the quality of judicial institutions and address the shadow economy. Specifically, the court will expedite the resolution of commercial disputes, investigate financial fraud and resolve issues of company law, investor dispute and competition law. The establishment of the court is a continuation of work to prevent money laundering and financial crime. More concrete and closer cooperation with the United States of America in this area started after a bilateral cooperation agreement was signed in November 2020.

CONTINUES

**The parliament adopted a covered bond law in May 2021.** With covered bonds, Latvia will be able to get a source of long-term, secure and low-risk funding, as well as strengthen its competitiveness and regional integration. The legal part was financed through the EU Structural Reform Support Programme and supported by the EBRD.

**The tax changes package introduced in 2021 should mitigate the effects of the Covid-19 crisis.** To support business activities, a 30-day deadline for value added tax (VAT) overpayment refunds was introduced. Employers were given the opportunity to compensate employees for expenses related to remote working, and social insurance rates were reduced by 0.5 per cent for both employers and employees. Concerning personal income tax, the income threshold was increased from €1,200 to €1,800, up to which the non-taxable amount applies. After three years, the monthly minimum wage was raised from €430 to €500, still among the lowest in the EU (adjusted for purchasing power standards).

# LEBANON

## Highlights

- **Lebanon continues to sink into financial, economic and social crises.** Currency depreciation has deepened, the government has yet to rein in the parallel foreign exchange market, inflation continues to spiral and external imbalances point to further economic decline.
- **The pressure on financial resources is at a record high.** The government is unable to access international financial markets following the March 2020 Eurobond default, remittances and foreign direct investment are minimal and foreign currency reserves have shrunk to record low levels.
- **Progress on reforms in the past year has been negligible.** Several reforms were stalled or undermined by political paralysis, as well as the Covid-19 pandemic and the implications of the Beirut port blast.

## Key priorities for 2022

- **Agreement on an International Monetary Fund (IMF)-supported stabilisation and structural reform programme remain the most immediate priority.** An agreement would help rebuild credibility and improve access to much-needed external financing. Comprehensive banking sector restructuring needs to accompany fiscal and structural reforms.
- **Comprehensive social safety nets are a pressing necessity in tandem with the reform programme.** Economic hardship, record inflation and the Covid-19 crisis have led to alarming unemployment and poverty levels.
- **Strong commitment is needed to carry on and expedite the forensic audit of Banque du Liban (BdL), retrieve stolen assets and combat corruption.** Progress in these areas would help to restore credibility in Lebanese institutions and garner public support for any proposed reform agenda.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 0.8 | -1.7 | -7.3 | -25.0 | -10.0 |
| Inflation (average) | 4.5 | 4.6 | 2.9 | 84.9 | 150.0 |
| Government balance/GDP | -8.6 | -11.2 | -10.3 | -3.2 | n.a. |
| Current account balance/GDP | -26.3 | -28.4 | -27.6 | -15.6 | n.a. |
| Net FDI/GDP [neg. sign = inflows] | -2.3 | -3.7 | -3.3 | -15.8 | n.a. |
| External debt/GDP | 189.6 | 191.7 | 198.3 | 472.3 | n.a. |
| Gross reserves/GDP | 68.0 | 59.3 | 45.9 | 92.9 | n.a. |
| Credit to private sector/GDP | 111.6 | 106.6 | 92.4 | 56.5 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**Lebanon is sinking further into multi-dimensional crises.** The economy is estimated to have contracted by 25 per cent in 2020, reflecting dried-up fiscal resources following the Eurobond default in March 2020, almost no capital inflows, diminishing reserves and spiralling inflation on the back of a falling exchange rate that effectively wiped out purchasing power. Political inaction prolonged the economic crisis and exacerbated unemployment and poverty. The unemployment rate is estimated to be around 50 per cent, while more than 75 per cent of the population is estimated to have fallen below the poverty line in 2020. The situation is likely to be even worse in 2021, as the economic turmoil continues to worsen and households face greater challenges accessing food, electricity, water and medicine.

**The currency has continued to depreciate and the central bank is struggling to manage the parallel foreign exchange market.** The *de facto* official pegged exchange rate of 1,507.5 Lebanese pounds per US dollar has been abandoned *de jure*, with the BdL allowing banks to exchange at a rate of LBP 3,900 per US dollar in April 2021 through its Sayrafa platform. The BdL later introduced a different mechanism, whereby the rate for withdrawals of US dollar deposits (up to US$ 400) was raised to LBP 12,000 per US dollar. This remains well below the parallel market rate of LBP 21,000 per US dollar as of early November 2021, implying a 90 per cent depreciation. Meanwhile, inflation continued to spiral, reaching 157.9 per cent year-on-year in March 2021, before slowing slightly to 144.1 per cent in September, as the Lebanese pound continued to depreciate. Rebuilding efforts following the August 2020 explosion in Beirut have been derailed, as importing building materials is becoming increasingly difficult without fresh US dollars. Meanwhile, the foreign currency reserves of the BdL dropped by 38 per cent year-on-year to US$ 14.2 billion in August 2021, as they were used to subsidise a range of essential imports. The country's actual net foreign assets are negative.

**The ongoing political, economic and social crises, coupled with the external debt default, contributed to a narrowing of the fiscal deficit in 2020.** Revenues declined by 14 per cent, with both non-tax and tax revenues dropping significantly due to the worsening economic crisis. Expenditures also fell, by 27 per cent, mainly owing to a 93 per cent decline in foreign debt service costs, traditionally the main expenditure component, and to a decline in transfers to Electricité du Liban, which are usually around 4 per cent of gross domestic product (GDP). Overall, a primary deficit of 0.2 per cent of GDP was achieved and public debt increased. Meanwhile, Lebanon is struggling to access capital markets and is opting for domestic borrowing.

**External imbalances remain wide.** The current account deficit was 27.6 per cent of GDP in 2019, one of the highest in the world. In 2020, it remained large, at 15.6 per cent of GDP, as both exports and imports declined, by 15 and 42 per cent, respectively. Remittances and non-resident deposits continued to decline in 2021.

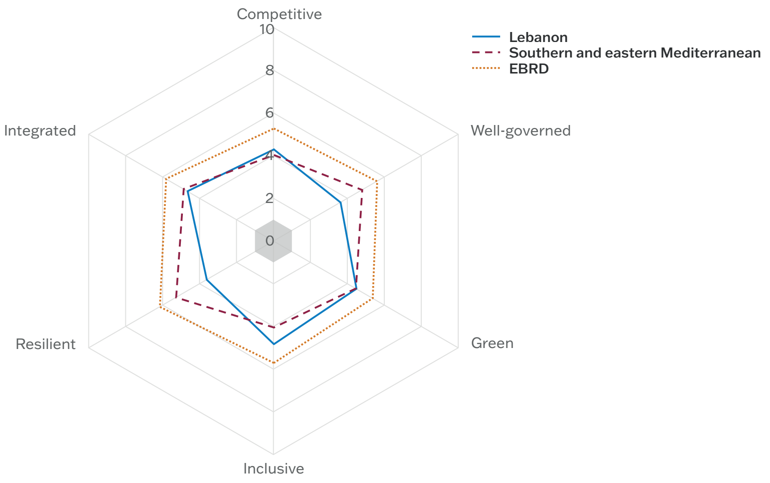
**The outlook remains highly uncertain and any recovery depends on the speed of reforms and the outcome of elections in March 2022.** A further contraction of 10.0 per cent is expected in 2021 as a result of the ongoing economic, political and social crises, the government's inability to borrow on international markets, delays in implementing critical reforms and the drying-up of financial resources. The economy is expected to record positive growth in 2022, at 3.0 per cent, conditional on an IMF-supported programme being successfully implemented by a reform-minded government, which would allow negotiations to resume with international partners.

## Policy response to Covid-19

**The vaccination campaign was rolled out in March 2021 and the uptake was initially slow.** However, it is picking up pace as the government attempts to minimise damages to public health in light of the worsening economic crisis. As of early November 2021, more than 22 per cent of the population was fully vaccinated.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**Efforts to reach agreement on an IMF-supported financing programme were derailed.** Discussions with the IMF began in April 2020, but were placed on hold in July 2020. Resuming talks is conditional on the government agreeing a common approach towards – and starting to implement – reforms in key sectors. The Eurobond default in March 2020 further underlined Lebanon's inability to access external financing without IMF support. Several conferences were held to attract support for crisis-stricken Lebanon and, while some participants offered immediate relief and aid to reconstruct the port of Beirut following the August 2020 explosion, these pledges were conditional on successful government formation, which only took place in September 2021, 13 months after the previous government had resigned following the explosion.

**Some reforms in early 2020 have been either halted or undermined.** As an example, the forensic audit that was agreed with management consultants Alvarez & Marsal in September 2020 faced several obstacles, mainly BdL management's refusal to share necessary documentation, citing bank secrecy laws. Parliament voted to lift bank secrecy for public officials in December 2020, but the BdL did not agree to hand over documents until April 2021.

**The draft capital control law proposed in mid-2020 was held back in parliament until June 2021.** The draft law, which is part of the overall reform package, prompted significant opposition and was deemed ineffective unless appropriate fiscal, monetary and exchange rate policies were put in place. Irrespective of the law, it is noteworthy that informal capital controls have been enforced by the banking system since late 2019.

**Lebanon's Public Procurement Law was approved by parliament and published in the Official Gazette in July 2021.** The law, which was formulated in line with international best practice and will enter into force in July 2022, will improve financial governance and market competition and promote transparency and accountability in the use of revenues, especially tax revenues. Completing the main reforms mandated by the law will be essential to ensuring its correct and efficient implementation.

CONTINUES

**Some subsidy reforms were implemented, in part to ease the unprecedented pressures on foreign currency reserves, but access to basic goods is becoming progressively difficult.** From June 2020 the government hiked the price of subsidised bread seven times; it raised fuel prices in June and August 2021. It is negotiating new import destinations, such as Egypt, Jordan and Syria, for fuel in a bid to lower the energy bill. The BdL also announced it would offer credit lines for fuel imports, starting in August 2021, based on the market price of the Lebanese pound, signalling an effective end to fuel subsidies. However, delays in implementing concrete measures in a timely manner led to a further depletion of reserves and prompted the population to hoard medical and food stocks in anticipation of the remaining subsidies being lifted. As a result, access to medicine, food, fuel and other basic necessities became increasingly difficult, leading to nationwide power outages in August 2021. Access to basic necessities for the Lebanese public is further undermined by eroded purchasing power and sizeable smuggling activities along the borders.

**Parliament approved a ration card programme for poor families in June 2021, which has been announced, but yet to be launched.** The programme, which will cost US$ 556 million a year and support 500,000 households, will replace the direct subsidy for essential goods, including medicine, fuel and wheat, which costs between US$ 5 billion and US$ 6 billion annually, thus moving to a better-targeted regime. The application process for the pre-paid cards started in September 2021, but the system will take time to implement and targeting is expected to be complicated by weak transparency and political concerns.

# LITHUANIA

## Highlights

- **The economy has returned to its pre-Covid-19 crisis level.** Stable goods exports and a fast recovery in consumption meant that gross domestic product (GDP) in 2020 was similar to 2019 levels. A swift improvement in industry contributed to a broad recovery in the first half of 2021.
- **Developing wind and solar energy plants and rising digitalisation stand out as main priorities in the government's recovery plan.** It is projected that 38 per cent of the €2.2 billion plan, financed through the European Union (EU)'s Recovery and Resilience Facility (RRF), will be invested in clean energy and an increasing share of energy efficient transport. A broader high-speed internet network will support an increase in digitalisation.
- **The government introduced new incentives for scaling up investments.** To strengthen competitiveness, special tax-exempt conditions, including a corporate tax exemption for a period of up to 20 years, will be offered to large-scale investors in strategic business areas, such as the manufacturing, information and communication technology (ICT) and science sectors.

## Key priorities for 2022

- **Social and labour disparities should be better addressed.** Priorities include further investment in education in rural regions, re-training and increasing digital services and teleworking.
- **Energy sustainability needs further strengthening.** Following the need to increase the domestic production of electricity, important aspects of the country's energy strategy include implementing the announced offshore wind farms in the Baltic Sea and promoting renewable energy sources.
- **The five-year development plan for the fintech sector should be implemented vigorously.** After a steadily growing number of licences for electronic money institutions, the Ministry of Finance has announced the creation of a development plan for the fintech sector. Successful implementation could attract new investment and strengthen competencies in supervisory institutions, with an emphasis on anti-money laundering and counter-terrorist financing by strengthening governance, internal controls and the compliance culture.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.3 | 4.0 | 4.6 | -0.1 | 4.5 |
| Inflation (average) | 3.7 | 2.5 | 2.2 | 1.1 | 3.0 |
| Government balance/GDP | 0.4 | 0.5 | 0.5 | -7.2 | -5.2 |
| Current account balance/GDP | 0.5 | 0.3 | 3.5 | 7.3 | 6.7 |
| Net FDI/GDP [neg. sign = inflows] | -2.0 | -0.5 | -2.3 | -1.1 | -1.3 |
| External debt/GDP | 82.6 | 78.3 | 70.1 | 75.7 | n.a. |
| Gross reserves/GDP | n.a. | n.a. | n.a. | n.a. | n.a. |
| Credit to private sector/GDP | 41.0 | 40.5 | 39.6 | 37.8 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**After one of the mildest GDP downturns in the EU in 2020, the economy is recovering strongly in 2021.** Due to Lithuania's stable export sector and targeted government measures, annual GDP was similar to 2019 levels, with a decline of just 0.1 per cent in 2020. A recovery in domestic demand, together with the strengthening of manufacturing and exports, drove strong GDP growth of 5.0 per cent year-on-year in the first half of 2021. Industrial production in the second quarter of 2021 was also above the level seen in 2019. Retail trade turnover, which fell during 2020, has bounced back strongly.

**A shortage of skilled labour contributed to higher wages and inflation.** Unemployment reached 9.9 per cent in September 2020, falling to 7.2 per cent by August 2021 but still above pre-Covid-19 crisis levels. Labour market mismatches have led to a lack of skilled labour, putting a strong pressure on wages and contributing to an elevated inflation rate. However, the current sharp increase in annual inflation, which stood at 6.4 per cent in September 2021, is mostly driven by external factors.

**After four consecutive years of surplus, the general government balance turned negative in 2020.** Increased government expenditure, especially on social protection, healthcare and subsidies, contributed to a general government deficit of 7.2 per cent of GDP in 2020. Public debt increased to 46.6 per cent of GDP as of the end of 2020, versus 35.9 per cent in 2019. As the economy and tax revenues are growing again, the government plans to increase its expenditure, with additional funds allocated to social protection and government sector wage increases. The government aims to return to a balanced budget in the medium term, projecting a 0.5 per cent of GDP deficit in 2024.

**Investment is likely to support the economic recovery.** GDP growth is likely to reach 4.5 per cent this year, boosted by accelerated public sector investment, and to slow somewhat to 4.0 per cent in 2022. However, exports, especially of services, are likely to be further negatively affected by the sanctions placed on Belarus by the Office of Foreign Assets Control (OFAC) of the US Department of the Treasury in August 2021. About one-third of all freight at Lithuanian ports is from Belarus, in particular, potassium chloride, which is used in fertiliser production; its loss is estimated to cost Lithuania approximately 0.4 per cent of GDP.

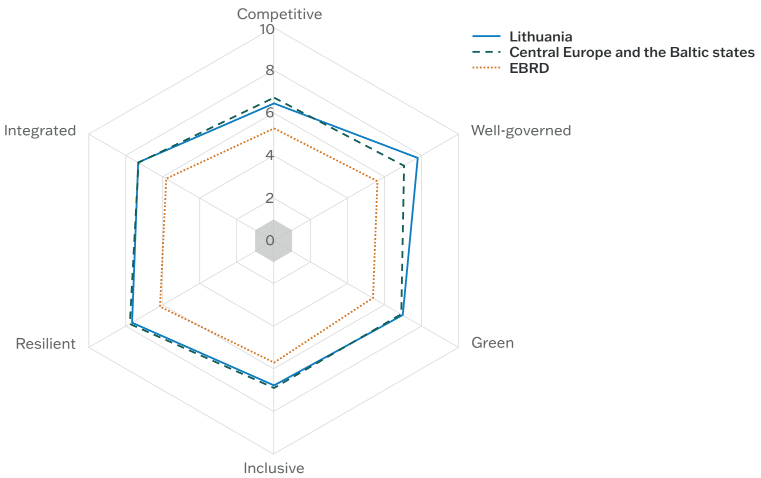
## Policy response to Covid-19

**The government's policy response to Covid-19 has been comprehensive.** With the fiscal support packages implemented in 2020, which accounted for around 6 per cent of GDP, Lithuania has managed to support the health system and compensate for most of the losses in affected sectors, such as the services sector. Employment was supported by job retention schemes, subsidised rates for enterprises and allowances for the self-employed. At the same time, vulnerable groups, such as pensioners, the unemployed and social benefit recipients, received a one-off payment of €200. A temporary deferral of credit obligations for private clients affected by the Covid-19 crisis remained in place until March 2021.

**The 2021 budget has earmarked around €1.7 billion to support the post-Covid-19 crisis recovery.** In December 2020 parliament adopted the 2021 budget, which included almost 6 per cent of GDP for the mitigation of Covid-19 pandemic effects and financial recovery support. The largest part of it was dedicated to subsidies during downtime and sickness for workers and the self-employed. Additional grants, soft loans and partial interest compensation were offered to crisis-affected companies, and funds for medical bonuses and the purchase of Covid-19 vaccines and tests and medical equipment were also provided. The national budget was revised in May 2021 and an additional €581 million was allocated to the healthcare sector and social security. In July 2021 the government issued a 30-year Eurobond worth €750 million, with the annual coupon set at 0.75 per cent.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**Lithuania's RRF plan aims to support long-term sustainable growth.** It is projected that 38 per cent of the €2.2 billion in grants will be invested in meeting climate targets through developing offshore and onshore wind and solar power and storage facilities (€242 million), increasing the share of clean public transport from 9 to 18 per cent, and bringing about a 15-fold growth of charging points for electrical cars. Digitalisation will be additionally addressed through an allocation of €70 million for broadening the high-speed network and 5G development. Long-term challenges related to learning outcomes, vocational education and upskilling will be addressed with projects worth a combined €312 million.

**The Centre of Excellence in Anti-Money Laundering has begun its work.** As a model of public- and private-sector collaboration in identifying and managing the risks of money laundering, the Centre of Excellence in Anti-Money Laundering started its activities in May 2021. It was collectively established by the Ministry of Finance, the Bank of Lithuania and other commercial banks, with the aim of collecting, analysing and sharing information on types of money laundering and terrorist financing (ML/TF) typologies through a special information platform at the national level. The centre will work, among other priorities, on guidelines and policy proposals to tackle ML/TF activities, as well as organise training programmes and strengthen the competencies of the public and private sectors in the ML/TF field.

**New measures to attract foreign direct investment (FDI) are in place.** In April 2021 the government approved a comprehensive mechanism that will ease administrative procedures for investors. Large investors in manufacturing, ICT or data processing that create at least 150 jobs and invest €20 million in fixed assets outside of the capital city, or create 200 jobs and put €30 million in fixed assets in Vilnius, can benefit from a corporate tax exemption for 20 years.

**Support to small and medium-sized enterprises (SMEs) has been stepped up.** The SME sector accounts for 99.6 per cent of all enterprises and more than 70 per cent of total employees. With a growing share of micro enterprises, companies operate mostly in the trade and transport sectors. SMEs in Lithuania tend to use traditional funding measures and, according to a Bank of Lithuania survey in 2019, more than 50 per cent of SMEs were not satisfied with credit conditions and access to capital. Following the signing of two guarantee agreements with the European Investment Fund for a maximum of €50 million in April 2021, the financial intermediary PayRay Bank will be able to offer SME financing for a period of three months to 10 years, with a loan amount per entity of up to €6 million.

CONTINUES

**The government adopted the Renovation Strategy 2050.** Together with the long-term strategy Lithuania 2050, the authorities are targeting climate-neutral building renovation, while preserving biodiversity. In line with the country's green transition goals, the Lithuanian Public Investment Development Agency (VIPA) signed a €67.5 million loan with the European Bank for Reconstruction and Development (EBRD) in August 2021. It is expected that the energy efficiency of old residential buildings in Lithuania will increase by at least 40 per cent.

**Energy security and sustainability stand high on the national and regional agenda.** Together with Estonia and Latvia, Lithuania continues to integrate its power system into Continental Europe's. After European Energy began building a wind farm of 49.5 MW capacity in August 2021, the government approved legislation which will enable the development of a 700 MW offshore wind farm in the Baltic Sea, with a possible first tender in 2023. By 2030 the government plans to produce 70 per cent of the country's electricity needs domestically.

# MOLDOVA

## Highlights

- **The economy is on the path to recovery in 2021.** On the back of growing global demand and private consumption, gross domestic product (GDP) grew by 11.7 per cent year-on-year in the first half of 2021.
- **Inflation accelerated sharply in the third quarter of 2021.** The acceleration took place after a lengthy period of relatively subdued inflation during most of 2020 and the first half of 2021, prompting an appropriate monetary policy response.
- **The financial sector continued to harmonise regulation with international standards.** The National Bank of Moldova (NBM) approved a new regulation that gradually introduces leverage indicators for banks, while the process of adopting the Solvency II Directive is advancing in parallel with an overhaul of the insurance sector.

## Key priorities for 2022

- **The authorities should advance the structural reform agenda, and improve governance and the business climate.** Key priorities in the short term include enabling an independent and professional judiciary, strengthening public institutions and continuing the fight against corruption.
- **Harmonisation of financial sector regulation with international standards needs to continue.** The NBM's independence should be strengthened by ensuring the legal irrevocability of its monetary and supervisory decisions.
- **Policies to support a resilient recovery from the Covid-19 pandemic should be prioritised.** Climate-awareness policies are needed to maintain competitiveness on an increasingly climate-aware European Union (EU) market. Policies regarding equality of opportunities and improving living standards are crucial to reduce emigration flows and foster growth prospects for the economy.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.7 | 4.3 | 3.7 | -7.0 | 7.0 |
| Inflation (average) | 6.6 | 3.1 | 4.8 | 3.8 | 3.0 |
| Government balance/GDP | -0.6 | -0.8 | -1.4 | -5.1 | -4.3 |
| Current account balance/GDP | -5.7 | -10.6 | -9.3 | -7.5 | -8.5 |
| Net FDI/GDP [neg. sign = inflows] | -1.4 | -2.3 | -3.9 | -1.3 | -1.9 |
| External debt/GDP | 70.6 | 64.1 | 62.2 | 70.8 | n.a. |
| Gross reserves/GDP | 29.0 | 26.1 | 25.6 | 31.8 | n.a. |
| Credit to private sector/GDP | 18.7 | 18.4 | 19.2 | 22.1 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy is recovering in 2021 on the back of gradually increasing investments and reviving household consumption.** The Covid-19 pandemic caused a deep GDP contraction of 7.0 per cent in 2020, with domestic consumption, investments and exports all registering substantial declines. In 2021 a recovery is under way, supported by growing global demand and private consumption. The automotive value chain led an export growth of 13.8 per cent year-on-year in nominal US dollar terms in the first half of 2021. In addition, money transfers have been exceptionally high in the first six months of 2021, increasing by more than 23.0 per cent year-on-year. This supported the recovery of economic activity, with 11.7 per cent growth year-on-year in the first half of 2021. Following higher food and oil prices and depreciation of the exchange rate, inflation accelerated from almost zero in January to 6.7 per cent in September 2021. The recent acceleration of inflation above the target rate of 5.0 per cent prompted the NBM to raise the base rate three times since July 2021, by a total of 2.85 percentage points, to 5.5 per cent in October 2021.

**The stable macroeconomic position allowed for important fiscal support during the Covid-19 crisis.** The current account deficit narrowed from 9.3 per cent of GDP in 2019 to 7.5 per cent in 2020, mainly financed by debt instruments, thus keeping international reserves at comfortable levels. International reserve assets amounted to US$ 4.0 billion in September 2021, covering more than seven months of imports. The relatively stable macroeconomic position before the Covid-19 crisis and access to US$ 235 million of the International Monetary Fund (IMF)'s rapid financing facility obtained at the onset of the Covid-19 pandemic helped the economy to cope with the pandemic shock. On the back of the economic contraction and fiscal costs of the policy support package aimed to reduce the impact of the pandemic, public debt increased from 28.3 per cent of GDP in 2019 to 34.8 per cent in 2020. The relatively low debt and availability of external financing allowed Moldova the fiscal space for a comprehensive support package.

**The economy is expected to rebound in the short term, despite uncertainties.** We expect GDP to grow by 7.0 per cent in 2021, helped by a recovery of global demand, followed by 4.0 per cent in 2022. The recovery of the economy depends on the roll-out of vaccines and a rebound of consumer and investor confidence. Since Moldova is integrated into the global supply chain of the automotive industry, the path of recovery is likely to be similar to the overall global recovery.

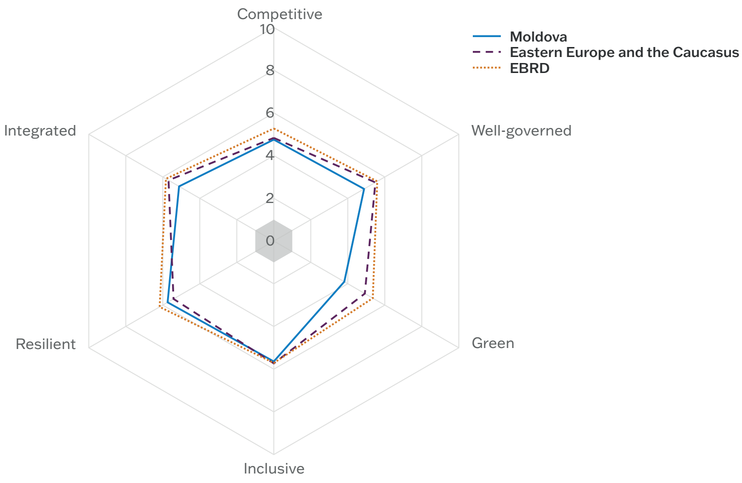
## Policy response to Covid-19

**The initial emergency policy response amounted to 2 per cent of GDP in 2020.** It was focused on tax deferrals, a temporary increase in social benefits, monetary policy easing and liquidity provision. Further measures included a reduced value added tax (VAT) rate for the hospitality sector, faster tax reimbursements, subsidised lending to small and medium-sized firms and payroll compensation for firms that ceased operation during the state of emergency. Social assistance for vulnerable groups included expanded unemployment benefits and targeted social help. The NBM allowed banks to defer loan payments and reduced the local currency reserve requirements to support liquidity in the banking sector. The NBM further recommended banks to refrain from paying dividends, thus strengthening their capital positions.

**Moldova's budget policy for 2021 prioritises support for the health sector and farmers.** Medical staff, most of whom are financed by the National Medical Insurance Fund, will receive a 30 per cent salary increase. Furthermore, salary-related tax subsidies will continue and people who lost their jobs during the Covid-19 pandemic will be able to access grants.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The retirement age has been lowered, threatening the sustainability of public finances.** In December 2020 the previous parliament adopted a number of laws which have been criticised by the international community, among which was a lowering of the retirement age. While most of the laws have been ruled as unconstitutional by the Constitutional Court or sent back to parliament by the president, the law on pension age will enter into force in 2022, with women retiring at age 57 and men at 62. It is not yet clear how the new parliamentary majority will deal with the law but international institutions, including the IMF, have flagged the potentially serious macroeconomic and fiscal implications. Meanwhile, the retirement age for women increased by six months to 59.5 years in July 2021, in line with the provisions of the previous law.

**The NBM continued to strengthen the prudence and soundness of the banking system.** In December 2020 the Executive Board approved a new regulation that introduces leverage indicators for banks. Banks will now report quarterly information on these leverage indicators to the NBM and, after analysing data over three years, the NBM will set a minimum level to limit the risk of over-indebtedness of the banking sector.

**The government adopted a comprehensive reform agenda for the insurance sector.** In October 2020 the government adopted the law elaborated by the National Commission for Financial Markets focusing on the partial transposing of the Solvency II Directive, which covers provisions on supervision, prudential measures, corporate governance and risk management. It also imposes minimum capital requirements and increased transparency for licensing insurance companies. The law comes at a time when a number of insurers have declared insolvency, while the state has recently regained majority control of one of the key players in the sector.

CONTINUES

**Digitalisation has been prioritised and advanced on a number of fronts.** The new government has a Vice Prime Minister for digitalisation, responsible mainly for the digitisation of public administration. The public procurement platform, MTender, has been updated in terms of access to information, in line with open government data principles, but more progress is expected to develop all functionalities in line with the previously adopted law. Also, the NBM has implemented an automated information technology tool to assist in anti-money laundering and terrorist financing, a first in the region. In general, the use of e-government platforms, including the online signature, has significantly increased since the outbreak of the Covid-19 pandemic.

**A limit on cash transactions has been imposed to curb informality.** Since the beginning of 2021 there is a ceiling of MDL 100,000 (€4,700) per month in cash transactions, or €470 per transaction between firms regardless of their ownership and legal form. The measure intends to stimulate transactions through banks and cards, thus limiting the potential for informal payments and employment. Exceptions include settlements with citizens and economic actors purchasing agricultural products, and individuals who are not engaged in entrepreneurial activities.

# MONGOLIA

## Highlights

- **The economy is firmly on the road to recovery following a major recession in 2020.** Driven by the mining sector, the economy grew by 6.3 per cent year-on-year in the first half of 2021 thanks to strong demand from China and elevated commodity prices.
- **A comprehensive stimulus plan to protect health and revive the economy was approved in February 2021.** Largely financed by the central bank, the package (around 27 per cent of gross domestic product (GDP)) will be implemented in 2021-23. It includes measures to improve access to credit, save jobs, provide housing and promote manufacturing, agriculture and non-mining exports.
- **The Bank of Mongolia has progressed on banking sector reforms.** Amendments to the banking law will require the five systemically important banks to conduct initial public offerings (IPOs) in the stock market and become public companies by June 2022, with a cap on bank shareholder rights at 20 per cent.

## Key priorities for 2022

- **The social and economic effects of the Covid-19 pandemic need to be mitigated while strengthening fiscal buffers and avoiding the risk of overheating.** The government should continue to protect those most affected by the Covid-19 crisis through job creation and expanded social protection. At the same time, government priorities should focus on gradually withdrawing excess liquidity and increasing savings held in sovereign wealth funds.
- **It is critical to reach an agreement with Rio Tinto on the Oyu Tolgoi (OT) copper and gold mine.** Resolving outstanding issues with OT will be vital to increasing the country's benefits from investment in the mining sector, attracting more foreign direct investment (FDI) to Mongolia and helping to sustain high growth rates.
- **Banking sector reforms should advance further but take into account the absorption capacity of domestic capital markets.** Ambitious IPO targets for the five systemic banks should be balanced against the currently small liquidity of the Mongolian Stock Exchange, which makes it challenging to absorb upcoming large equity offerings.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 5.3 | 7.2 | 5.1 | -6.5 | 6.1 |
| Inflation (average) | 4.3 | 6.8 | 7.3 | 3.7 | 6.5 |
| Government balance/GDP | -3.8 | 3.0 | 0.9 | -9.8 | -6.0 |
| Current account balance/GDP | -10.1 | -16.8 | -15.6 | -5.1 | -8.0 |
| Net FDI/GDP [neg. sign = inflows] | -13.1 | -14.9 | -17.6 | -13 | -14.0 |
| External debt/GDP | 245.4 | 235.3 | 221.0 | 246.0 | n.a. |
| Gross reserves/GDP | 26.4 | 27.1 | 31.4 | 35.0 | n.a. |
| Credit to private sector/GDP | 53.1 | 55.7 | 49.6 | 46.4 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**Mongolia recorded real GDP growth of 6.3 per cent year-on-year in the first half of 2021**. Growth was driven by the mining sector thanks to higher demand from China and elevated commodity prices. Exports rose by 25 per cent year-on-year in the first seven months of 2021 thanks to strong performances in iron ores and concentrates, copper concentrates and coal. Overall, mining output increased 34 per cent year-on-year in the first seven months of 2021. Services grew by a much more modest 3.0 per cent year-on-year. Agriculture was down by 4.6 per cent year-on-year due to large losses in livestock. Mongolia has one of the highest vaccination rates in the world: by late June 2021 more than 60 per cent of its population had been fully vaccinated.

**The Bank of Mongolia loosened monetary policy and banking regulations**. During 2020-21, the central bank reduced the reserve requirement by 2 percentage points, suspended the debt-service-to-income ceiling on consumer loans, provided longer-term financing to the banking sector and introduced temporary forbearance measures (softening asset classification requirements, extending maturities on consumer and mortgage loans, and restructuring business loans in the banking sector). The policy rate has been kept unchanged at 6.0 per cent since November 2020, supporting credit expansion (up 12 per cent year-on-year in July 2021). With the economy recovering, inflation accelerated to 9.0 per cent in August 2021 from a low of 2.3 per cent in December 2020. This is still within the central bank target corridor of between 4 and 8 per cent.

**Reserve coverage has improved significantly.** Since January 2020 the local currency (MNT) has lost 5 per cent against the US dollar, but it has been flat since September 2020. Gross international reserves are now at US$ 4.7 billion, having dipped as low as US$ 2.3 billion in spring 2020 due partly to a Eurobond repayment of US$ 500 million by a commercial bank. Reserves have since recovered, providing nine-month import cover, thanks to strong import compression, robust growth in gold exports, the recovery of coal and copper exports to China, as well as borrowing from international financial institutions and Eurobond issues. However, international reserves include a large borrowed component (swaps with domestic banks and China).

**GDP is expected to grow strongly in the short term.** Real GDP is forecast to expand by 6.1 per cent in 2021 and 6.5 per cent in 2022, supported by China's demand for Mongolia's key exports, higher private and public consumption and the recovery of FDI, which is contingent on the successful conclusion of negotiations over OT, Mongolia's largest FDI-financed project. Fiscal policy will support growth in 2021, with the budget deficit planned at 5.1 per cent of GDP.

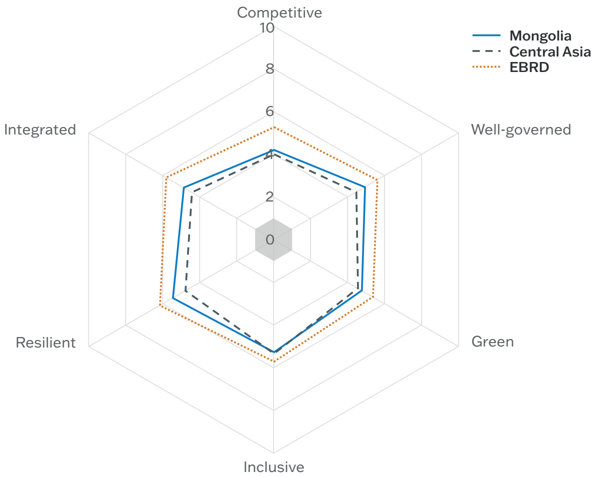
## Policy response to Covid-19

**A comprehensive stimulus plan to protect health and revive the economy was approved.** Largely financed by the central bank, the new package, approved in February 2021 and amounting to around 27 per cent of GDP, will be implemented in 2021-23. It includes measures to increase access to credit, promote manufacturers and business industries, save jobs, provide housing, support agricultural production and develop non-mining export products. The Bank of Mongolia will increase: repurchase agreement (repo) funding by MNT 2 trillion (US$ 700 million) per year; funding available to small and medium-sized enterprises (SMEs) by MNT 500 million (US$ 175,000); and funding for non-mining exporters by MNT 3 billion (US$ 1 million). In April 2021 the government launched a one-time cash handout equivalent to MNT 1 trillion (US$ 350 million or about 3 per cent of GDP) to support households.

CONTINUES

**A three-year joint project, Mongolia Covid-19 Crisis Response, was launched in October 2020.** The European Union is providing support of €1 million and the World Health Organization is providing €62,000 and technical guidance to Mongolia's health sector. The project will focus on strengthening the capacity of the national health system, as well as laboratory capacity at the national and sub-national levels. It will also ensure continuity and quality of essential healthcare services during widespread community transmission and lockdown. In addition, the Asian Development Bank approved a US$ 100 million loan in March 2021 to strengthen Mongolia's health sector and its response to the coronavirus pandemic.

Assessment of transition qualities (1-10)




## Structural reform developments

**Long-term reform planning has advanced.** With both the presidency and parliament controlled by the Mongolian People's Party since June 2021, the government has been able to push ahead with its long-term development programme, Vision 2050, launched in 2020. This aims to diversify the economy away from raw material exports, mainly through large state projects, but also by stimulating growth in new sectors and attracting foreign investment.

**The Bank of Mongolia has progressed on banking sector reforms.** In January 2021 parliament approved amendments to the banking law, which requires five systemically important banks to become public companies through IPOs by June 2022, with a cap on bank shareholder rights at 20 per cent. This is expected to reduce shareholder concentration in the banking sector and provide for timely and fully transparent disclosure of the banks' financials and operations.

**Progress has been made in resolving a dispute over Mongolia's largest copper and gold mine.** The cost of expanding the OT mine has surged to US$ 6.75 billion from its original budget of US$ 5.3 billion in 2016, which became a bone of contention between the operator, Rio Tinto, and the government. An independent review dismissed Rio Tinto's explanation for the delays as being caused by geological difficulties. Subsequently, Rio Tinto expressed its willingness to reduce the interest rate on the loans it provided to the government of Mongolia to finance its share of the construction costs. In exchange, a long-term power agreement is sought by Rio Tinto.

CONTINUES

**The country needs to step up efforts for green energy transition to be able to fulfil its nationally determined contribution (NDC) target within the agreed timeframe.** Mongolia has an NDC target of generation capacity from renewable energy sources of 20 per cent by 2023 and 30 per cent by 2030. The country's ability to deliver on its NDC commitment will be stretched by the government's July 2021 decision to construct a new coal-fired power plant. The Baganuur plant will operate under a 21-year power purchase agreement; its two 200 MW blocks are expected to be completed in July 2026 and October 2026. The plant will not be a combined heat and power plant, so will not help the country meet heat demand.

# MONTENEGRO

## Highlights

- **The economy is recovering from a deep recession in 2020.** Gross domestic product (GDP) fell by more than 15 per cent in 2020 but data from the second quarter of 2021 show a strong recovery in foreign tourist overnight stays, retail sales and manufacturing output.
- **Progress has been made on the country's digital agenda.** The electronic monitoring of fiscal cash registers has begun and a new electronic platform is enabling the rapid establishment of new companies.
- **The country has announced a date for phasing out coal.** Montenegro has joined the Powering Past Coal Alliance and has committed to ending power generation from coal by 2035.

## Key priorities for 2022

- **The government needs to step up fiscal consolidation once Covid-19 concerns recede.** To ensure fiscal sustainability, it is important not only to improve public investment management and tax collection, but also to adopt a comprehensive medium-term public debt management strategy and establish a fiscal council to strengthen the oversight of fiscal policy. Public investment projects should be assessed carefully and prioritised based on a cost-benefit analysis.
- **State-owned enterprise (SOE) governance should be enhanced.** Montenegro has a relatively large SOE sector and some important companies are run inefficiently. Adopting a government policy or law that defines the overall objectives of state ownership and its effective implementation would be desirable.
- **A "just transition" for the planned phase-out of coal should be ensured.** To mitigate the negative social and economic impacts of closing coal-fired power plants in the affected regions, it is important to work out in advance a strategy to address associated labour and regional development issues.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.7 | 5.1 | 4.1 | -15.3 | 12.3 |
| Inflation (average) | 2.4 | 2.6 | 0.4 | -0.3 | 2.0 |
| Government balance/GDP | -6.8 | -6.2 | -1.8 | -10.9 | -5.0 |
| Current account balance/GDP | -16.1 | -17.0 | -14.3 | -26.0 | -21.0 |
| Net FDI/GDP [neg. sign = inflows] | -11.3 | -6.9 | -6.2 | -11.2 | -9.1 |
| External debt/GDP | 161.0 | 163.7 | 169.0 | 224.1 | n.a. |
| Gross reserves/GDP | 19.7 | 22.3 | 27.6 | 41.5 | n.a. |
| Credit to private sector/GDP | 48.9 | 49.6 | 49.0 | 59.9 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**After a major recession in 2020, the economy started to recover in the first half of 2021.** In Montenegro, around one-fifth of GDP normally comes from tourism. Due to the Covid-19 pandemic and strict border policies, foreign tourist arrivals declined by 86 per cent in 2020. Consequently, GDP contracted sharply, by 15.3 per cent. The contraction came primarily on the back of falling services exports (mainly tourism-related) but investment and consumption also declined strongly. Although GDP fell again in the first quarter of 2021 on a year-on-year basis, it recovered strongly in the second quarter. In this quarter, retail sales picked up significantly (by almost 20 per cent year-on-year) and manufacturing output by 13 per cent year-on-year, while the number of foreign tourist overnight stays in July and August was around 85 per cent of the 2019 level.

**Prices are trending up.** The economy entered deflation in the second quarter of 2020, with the inflation rate averaging -0.2 per cent for the year as a whole. However, price growth became positive in the first nine months of 2021 (1.8 per cent year-on-year) on the back of higher transport (oil) and food and beverage prices.

**Public debt reached a record high in 2020.** The strong economic contraction and increased government expenditures to mitigate the negative effects of the Covid-19 pandemic resulted in public debt exceeding 100 per cent of GDP at the end of 2020. In light of the deteriorating fiscal and external positions, ratings agency Standard & Poor's downgraded Montenegro's sovereign ratings in March 2021 by one notch, to B. In July 2021 the government managed to hedge the Chinese Exim Bank loan for the Bar-Boljare highway through a swap deal which eliminated future exchange rate volatility risk and reduced the interest rate.

**The short-term rebound is expected to continue.** In 2021 GDP is forecast to increase by 12.3 per cent. A more relaxed border policy this year has boosted the tourism sector, while last year's positive base effect will contribute additionally to the relatively high growth rate. In 2022 a further recovery is expected, with the economy projected to expand by 5.7 per cent. Downside risks to the forecast are a possible weaker-than-expected recovery in tourism due to a prolonged impact of the Covid-19 pandemic, as well as limited fiscal space to accommodate further spending should such needs arise.

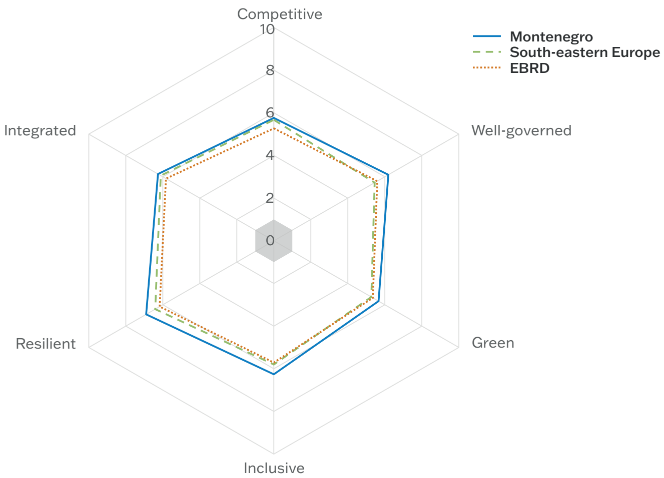
## Policy response to Covid-19

**The government has adopted two more aid packages in 2021.** The first package of measures, adopted in January 2021, included providing wage subsidies for businesses severely affected by the Covid-19 pandemic, as well as one-off assistance to the unemployed, pensioners and social welfare beneficiaries. Additional measures were also taken to support tourism and agriculture. The latest package, approved in April 2021, included credit support for the economy (aimed at providing the economy with at least €110 million of new loans in 2021) and support for tourism and the vulnerable.

**The moratorium on loan repayments has been extended.** In 2021 the Central Bank of Montenegro extended the right of loan beneficiaries to use the moratorium. Those who were given the right to a moratorium on loan repayment until 31 August 2021 included businesses performing activities threatened by the Covid-19 pandemic, providing accommodation and food services or preparing the tourist season, as well as those whose total revenue in 2020 was at least 50 per cent lower than in 2019. The moratorium was also extended until the end of 2021 for the repayment of loans granted to private persons who lost their job after 31 March 2020 or whose net salaries had not been paid to them for more than three months before submitting the application.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**There is a renewed focus on closing European Union (EU) accession negotiating chapters.** Having opened the last remaining chapter of the EU accession negotiating framework in 2020, the focus has now shifted to closing chapters. Only three chapters were provisionally closed since the opening of accession negotiations in June 2012 and there has been no progress on this over the past year. According to the European Council, further progress on negotiations will depend on meeting the interim benchmarks set out in the rule-of-law chapters (chapters 23 and 24) of the EU *acquis*.

**The country has a new state-owned national carrier, while the future of the former one is unclear.** In December 2020 the government announced the decision to shut down the troubled state-owned Montenegro Airlines and replace it with a new national carrier. Earlier, the company had received financial support from the government worth €43 million, which the Agency for Protection of Competition did not consider to be in line with state aid rules. In February 2021 a new state-owned national carrier, Air Montenegro, was established and it started operations in June. The future of the former national carrier, which is undergoing bankruptcy proceedings, remains unclear as it has restored some business operations and reopened sales offices in the country.

**A new state-owned company has been established to supervise the management of other SOEs.** In August 2021 the government decided to establish a company – Montenegro Works – whose task will be to oversee and analyse the financial performance of SOEs and to ensure that reforms to increase their efficiency are properly implemented. The company will provide strategic guidance to the government on establishing appropriate policies for managing SOEs. The effectiveness of the new company remains to be seen.

**An infringement procedure has been launched against Montenegro over the thermal power plant (TPP) Pljevlja.** In April 2021 the Secretariat of the Energy Community (the EU energy watchdog) initiated an infringement procedure against Montenegro for continuing to operate its only TPP after the opt-out period under the Large Combustion Plants Directives had expired. The authorities are planning an ecological reconstruction of TPP Pljevlja.

**The country has set the date for the coal phase-out.** In June 2021 Montenegro joined the Powering Past Coal Alliance, promoting the coal phase-out and the transition to clean energy. The country has announced it will end power generation from coal by 2035. Plans on how to meet this goal remain to be developed.

CONTINUES

**Feed-in tariffs have been abolished for renewables.** In July 2021 the government announced that it would no longer provide incentives for renewable energy as the country had met its target of a 33 per cent share of renewable energy in final energy consumption (in 2018 and 2019 the share was 39.8 and 38.7 per cent, respectively). In recent years Montenegro has made progress on creating a relevant legislative framework for developing renewable energy and decarbonisation, including legislation to limit greenhouse gas emissions, as well as introducing an emissions trading scheme for large industrial emitters.

**Electronic monitoring of fiscal cash registers (e-fiscalisation) has started.** Application of the Law on Fiscalisation in the Trade in Goods and Services, which entered into force in mid-2019, began on 1 January 2021, although full application was delayed until 1 June 2021. Together with more efficient inspections, e-fiscalisation should contribute to reducing the grey economy and increasing tax revenues.

**Electronic registration of new companies has been enabled.** In July 2021 the eFirma platform was launched, making it possible to establish a new company electronically. This has significantly shortened the time required for registration and reduced costs, as there are fewer required procedures and documents. The process to set up a company now takes just three days.

# MOROCCO

## Highlights

- **Several sectors of the economy are improving in 2021.** Exports rose, agricultural output increased – supported by favourable weather conditions – and the economy returned to growth in the first half of 2021. However, inflation is accelerating, tourism continues to decline and unemployment is on the rise.
- **The report on Morocco's new development model was completed.** The ambition of the new development model, which sets out goals up to 2035, is a thriving, prosperous, skilled, inclusive, sustainable and pioneering Morocco.
- **The National Business Environment Policy 2021-25 was adopted.** It aims to simplify administrative procedures and improve the legal and regulatory framework for businesses. The policy was set in partnership with the public and private sectors, under the National Business Environment Committee that was created in 2010 and chaired by the prime minister.

## Key priorities for 2022

- **Measures to stimulate competition and level the playing field for new entrants would support the private sector.** As highlighted by the report of the Special Commission on the Development Model, several factors restrict competition and innovation, including regulations, the system of economic incentives and the ineffective implementation of competition policy. Strengthening the Competition Council should be prioritised.
- **To improve access to finance and promote financial inclusion, there is a need to expand the range of digital financial services and enhance financial literacy.** The outbreak of the Covid-19 pandemic exacerbated the urgent need to address financial inclusion gaps. Digitalisation would increase access to financial services for customers, as well as enhance the internal processes of banks and other financial institutions, thus helping to channel funds to the economy more effectively.
- **Social safety nets need to be strengthened.** As the government moves ahead with subsidy reforms, an inclusive and consolidated system is needed for targeted transfers. The decision to harmonise all current social assistance programmes into a single family allowance scheme, starting from 2023, is a step in the right direction.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.2 | 3.1 | 2.6 | -6.3 | 5.0 |
| Inflation (average) | 0.7 | 1.6 | 0.2 | 0.6 | 1.1 |
| Government balance/GDP | -3.5 | -3.7 | -3.8 | -7.6 | -6.5 |
| Current account balance/GDP | -3.4 | -5.3 | -3.7 | -1.5 | -3.1 |
| Net FDI/GDP [neg. sign = inflows] | -1.5 | -2.4 | -0.7 | -1.1 | -1.4 |
| External debt/GDP | 34.8 | 31.8 | 33.1 | 43.7 | n.a. |
| Gross reserves/GDP | 23.9 | 20.7 | 22.0 | 30.8 | n.a. |
| Credit to private sector/GDP | 63.0 | 62.4 | 63.4 | 70.0 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy contracted by 6.3 per cent in 2020 but rebounded in the first half of 2021.** In 2020 the drought-burdened agricultural sector declined by 8.6 per cent, while non-agricultural activities, mainly tourism, transport, retail and manufacturing, dropped by 6.0 per cent. In the first half of 2021 the economy returned to growth, at 7.6 per cent year-on-year, driven by the agricultural sector, which benefited from above average rainfall. Non-agricultural economic activity expanded, despite the continued contraction in tourism and slow growth in transport. Inflation accelerated to a three-year high of 2.2 per cent year-on-year in July 2021, largely on the back of volatile food prices, although averaging 1.0 per cent in the first nine months of the year, in line with Bank Al-Maghrib's projections. Meanwhile, the unemployment rate rose to 12.8 per cent in the second quarter of 2021, with higher-than-average rates for women (15.9 per cent), in urban areas (18.2 per cent), graduates (20.4 per cent) and young people (30.8 per cent).

**The fiscal deficit widened significantly in 2020.** The deficit reached 7.6 per cent of gross domestic product (GDP), compared with 3.1 per cent on average in 2015-19. Both tax and non-tax revenues declined due to the drop in economic activity, the absence of privatisations and the decline in payments from state-owned enterprises, while spending on transfers to workers in the informal sector, support to companies and health rose to contain the socio-economic impact of the crisis. As a result, total debt increased to 77.7 per cent of GDP in 2020, from 64.8 per cent on average in 2015-19.

**The current account deficit narrowed in 2020 as exports, tourism and imports fell, and remittances increased.** For 2020 as a whole, the current account deficit was 1.5 per cent of GDP. In the first half of 2021 both exports and imports increased, reflecting not just the low base effect but also the recovery in external demand and in trading partners, as well as the rebound in the key export sectors of automotive, phosphates and textiles. Nevertheless, tourism revenues declined by 58.1 per cent year-on-year, reflecting the continued impact of the Covid-19 pandemic. Reserves reached US$ 34.8 billion in August 2021, comfortably covering more than seven months of imports.

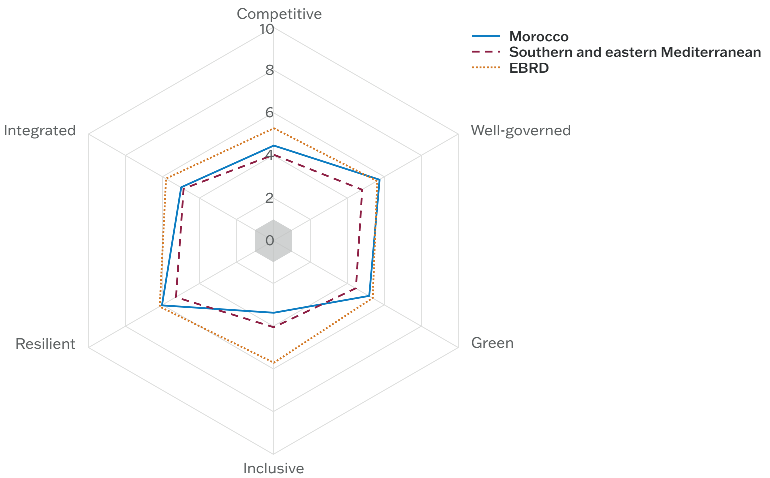
**A solid recovery is expected in 2021.** We forecast GDP growth of 5.0 per cent in 2021, as Morocco benefits from the relative success of its vaccination campaign (61.5 per cent of the population was fully vaccinated as of early November) and therefore a relatively faster reopening of the economy, despite a cautious resumption of tourism globally. The economy will also benefit from a good rainy season and the expected recovery in Europe, Morocco's main trading partner, as well as the strengthening in exports from the phosphate and automotive sectors. In 2022 a slower expansion is projected (at 3.2 per cent), as base effects subside and the pace of growth returns to pre-Covid-19 pandemic levels. The outcome depends partly on political developments as well as uncertainty over the future of the pandemic.

## Policy response to Covid-19

**The government extended some fiscal and monetary response measures to support the economy.** First, it extended social transfers to employees temporarily unemployed until the end of March 2021 (MAD 2,000 per month; US$ 225) and further deferred social contribution payments for businesses in some sectors – including tourism – with fewer than 500 employees made temporarily idle and experiencing a reduction in turnover of more than 50 per cent. In February 2021 Bank Al-Maghrib extended the reduction in the capital conservation buffer, initially announced in March 2020, by 50 basis points until June 2022. In March 2021 the government extended the Damane Relance facility until June 2021. Originally, Damane Relance was set up in May 2020 as a post-crisis facility to support businesses. It provides financing to cover working capital needs at subsidised interest rates, a sovereign guarantee, and offers a seven-year tenor and two-year grace period.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The report for Morocco's new development model was completed and presented to the King in May 2021, after some delay.** In November 2019 the King established the Special Commission on the Development Model comprising a broad range of prominent stakeholders from the government, the private sector, academia and civil society. It was mandated to review the achievements and identify any inadequacies of Morocco's current development trajectory and suggest a new development model. In May 2021 the commission published a general report outlining key findings, including diagnoses, forecasts and projections up to 2035. The new development model envisages a prosperous, skilled, inclusive, sustainable and pioneering Morocco. The four priority areas highlighted are: a productive and diversified economy that creates value-added and quality jobs; enhanced human capital that is better prepared for the future; opportunities for inclusion for all and a stronger social bond; and resilient territories.

**A bill was approved to integrate the micro credit sector further into the financial system and improve its governance.** The new bill, approved by parliament in June 2021, aims to broaden the scope of activity of microfinance institutions, including granting micro credit, collecting deposits and conducting micro-insurance operations. Under this bill, the micro credit ceiling will be set by decree, depending on the category, objectives and financial resources of each company. It also aims to adapt to the provisions of the banking law and to ensure a single representation for micro credit establishments regardless of their legal form, while also offering the possibility of creating micro credit institutions either as an association or a joint stock company assimilated to a credit institution. Lastly, the new regulatory framework raises the loan limit to MAD 150,000 (US$ 16,800), from MAD 50,000 (US$ 5,600).

**The Maroc Mines 2021-30 plan was launched.** The new plan, launched in June 2021, updates the development strategy put in place for the period 2013-25. It aims to revitalise the national mining sector, enhance its performance and economic and social impact, and transform it into a driving force for responsible and sustainable development at the local, regional and national levels. It also aims to strengthen the sector's ability to respond to the intrinsic challenges it faces, including the need to discover new fields and maximise the value added of the mineral substances exploited. The plan is based on four strategic pillars: developing a network of competitive players; overhauling the institutional organisation of the sector; strengthening the social impact and the responsible nature of the sector; and adapting the legislative framework of financial and fiscal resources to the new ambitions of the sector.

CONTINUES

**The government has announced plans to cut subsidies on butane gas, sugar, wheat and flour from 2022.** This move, in July 2021, follows several rounds of subsidy reforms conducted successfully by the authorities in recent years. They aim to replace subsidies on key products, which tend to disproportionally benefit consumers with higher levels of consumption, with targeted social protection mechanisms to support low-income families, thus making government spending more efficient and improving Morocco's fiscal position. Eliminating subsidies on commodities will be gradual, with wheat and flour subsidies to be reduced in 2022 and removed by 2023, subsidies on sugar to be eliminated in 2022, and butane gas subsidies to be reduced by at least 50 per cent in 2023 before being fully eliminated in 2024.

**The National Business Environment Committee – the public-private dialogue platform created in 2010 – adopted the National Business Environment Policy 2021-25.** The new policy, adopted in May 2021, includes 33 reform projects relating to the simplification of administrative procedures and the improvement of the legal and regulatory framework for businesses, payment deadlines and access to financing, infrastructure and public procurement. The policy also aims to improve the quality of human capital, strengthen support mechanisms for businesses and integrate the informal sector into the formal economy. It aims to develop an integrated strategic vision to create favourable conditions for investors. The policy is based on three pillars: improving the structural conditions of the business environment; simplifying companies' access to the necessary resources; and reinforcing transparency, inclusion and cooperation between the public and private sectors.

# NORTH MACEDONIA

## Highlights

- **Economic growth is picking up.** As a result of the Covid-19 pandemic, gross domestic product (GDP) fell by 4.5 per cent in 2020, with industry, trade, transport and tourism being particularly affected. Manufacturing, exports and retail trade picked up relatively strongly in the first six months of 2021.
- **Plans have advanced for the closure of coal-fired power plants.** The country is preparing to shut down all coal-fired thermal power plants by the end of 2027, as set out in the National Energy and Climate Plan (NECP), currently under public consultation.
- **Support for economic inclusion of the Roma population has been increased.** A new €2 million fund has been set up to support Roma businesses and address unemployment in this community.

## Key priorities for 2022

- **To maintain fiscal sustainability, the fiscal governance framework needs to be improved.** While fiscal policy should remain supportive to growth, it would be important to develop a credible medium-term fiscal strategy. The focus needs to be on enhancing the efficiency of tax collection and improving public investment management.
- **A "just transition" for the planned phase-out of coal should be ensured.** To mitigate the negative social and economic impacts of the closure of coal-fired power plants and related coal mines in the affected regions, it is important to work out in advance a plan to address associated labour and regional development issues.
- **Educational reform should be accelerated to address the persistently high level of youth unemployment.** Ongoing reforms focusing on addressing skills mismatches in the labour market through revamping the vocational education system could help address this problem.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 1.1 | 2.9 | 3.2 | -4.5 | 4.0 |
| Inflation (average) | 1.4 | 1.5 | 0.8 | 1.2 | 3.1 |
| Government balance/GDP | -2.7 | -1.8 | -2.0 | -8.1 | -5.9 |
| Current account balance/GDP | -1.0 | -0.1 | -3.3 | -3.4 | -2.1 |
| Net FDI/GDP [neg. sign = inflows] | -1.8 | -5.6 | -3.2 | -1.4 | -3.0 |
| External debt/GDP | 73.3 | 73.0 | 72.7 | 79.1 | n.a. |
| Gross reserves/GDP | 23.2 | 26.7 | 29.1 | 31.1 | n.a. |
| Credit to private sector/GDP | 49.9 | 50.2 | 51.5 | 56.2 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**After a recession in 2020, GDP has started to recover in 2021.** In 2020 GDP declined by 4.5 per cent year-on-year, on the back of a double-digit fall in investment and exports and a 5.6 per cent decline in private consumption. These falls were somewhat counter-balanced by a significant (10.1 per cent) increase in government consumption. Industrial output contracted by 10 per cent in 2020, and the trade, transport and accommodation sectors only slightly less. After a negative first quarter, economic developments became more favourable in the second quarter of 2021 with GDP growing by 13.1 per cent year-on-year; domestic trade picked up by a strong 46 per cent year-on-year on the back of pent-up demand, and manufacturing recovered by nearly 20 per cent year-on-year, which was also reflected in strongly growing exports (by 45 per cent year-on-year). Investments rebounded by nearly 40 per cent year-on-year in the same quarter.

**The fiscal stance remains expansionary.** The general government deficit jumped from 2.0 per cent of GDP in 2019 to 8.1 per cent in 2020. As a consequence, general government and government-guaranteed debt rose to 60 per cent of GDP at the end of 2020, more than 10 percentage points higher than at the end of 2019. The expansionary fiscal stance is continuing in 2021, involving further Covid-19-related support measures such as wage subsidies, investment incentives and liquidity support to firms. In March 2021 the government issued a €700 million seven-year Eurobond. Some of the proceeds (€500 million) were used to repay a Eurobond issued in 2014 and the rest of the proceeds will be used to finance the state budget for 2021.

**GDP should exceed its 2019 level in 2022.** A partial recovery is expected in 2021, with real GDP growth of 4.0 per cent on the back of the recovery of exports and private consumption, as well as sustained government consumption. The growth momentum is expected to continue in 2022, also at 4.0 per cent, on the back of resuming private investments. However, the projection is subject to significant uncertainty. Both upside and downside risks are present and primarily relate to the speed of recovery of external demand and the government's ability to realise its ambitious infrastructure agenda, given the narrowed fiscal space.

## Policy response to Covid-19

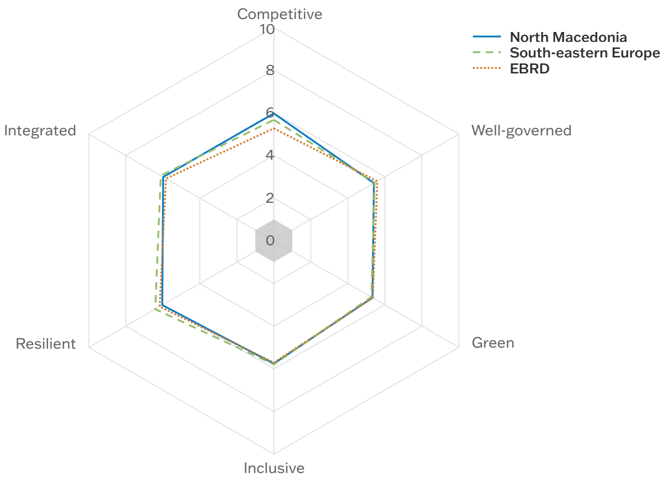
**The fifth and sixth packages of support measures were approved in April 2021.** The fifth package was worth €160 million and consisted of four pillars: (i) direct financial support for companies in the troubled sectors (tourism, transport, hospitality and the events industry) to help preserve jobs; (ii) interest-free loans to the private sector with a grant component to support the liquidity of companies; (iii) a reduction of para-fiscal duties, tax relief measures and tax deferrals to improve the business environment; and (iv) direct financial assistance to citizens. The sixth package of economic support measures was worth €17.8 million and it aimed to financially support around 10,000 companies employing around 60,000 workers in total.

**New interest-free loans have been extended to micro, small and medium-sized enterprises (MSMEs) and a guarantee scheme is to be established.** In December 2020 the Development Bank of North Macedonia issued a public call for small and medium-sized enterprises (SMEs), sole proprietors and artisans to apply for interest-free loans under a €31 million credit line. In July 2021 the government announced the launch of a guarantee fund that would provide loan guarantees worth up to €500,000 to MSMEs, but also to large companies with export revenues accounting for at least 30 per cent of total revenues.

**The central bank temporarily blocked dividend distribution**. In February 2021 the central bank prohibited commercial banks from distributing dividend payments to shareholders until the end of 2021. The decision was rescinded in August 2021. In March 2021 the key policy rate was cut by 25 basis points, to 1.25 per cent.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**No decision was made about opening European Union (EU) accession negotiations.** Despite the green light in March 2020 and the subsequent positive report by the European Commission on the country's progress towards the start of the EU accession negotiations, no decision has been made by the Council in 2021 on the formal start of negotiations because of a dispute with one member country. In June 2021 the European Council concluded that this issue ought to be addressed during Slovenia's presidency of the EU in the second half of 2021.

**A review of 377 para-fiscal charges is under way to improve the business environment.** Para-fiscal charges create considerable barriers to businesses and could push them to operate in the informal sector. It is planned that these charges will be either eliminated or streamlined, optimised and digitalised to reduce the burden on companies, especially SMEs.

**The authorities have developed a plan to close coal-fired power plants, accompanied by large-scale investment in renewables and gas-fired power capacity as a transitional fuel.** North Macedonia has become the first country in the Western Balkans to set a concrete plan for the closure of coal-fired power plants, through the country's Energy Development Strategy until 2040 and draft NECP, which was the first in the region to be submitted and reviewed by the Energy Community Secretariat. The NECP, currently under public consultation and expected to be approved by the government in the first half of 2022, sets a date of the end of 2027 for coal-fired power plants to close. At present, coal-based thermal power plants account for around 50 per cent of total electricity production and about a third of total consumption. To replace these, renewables will play a primary role in the transition, with planned investment of about 1,600 MW of solar power plants, 600 MW of wind farms and about 333 MW of hydropower plants. According to the government's Intervention Investment Plan 2021-27, presented in May 2021, the country will invest a total of €3.1 billion in the energy sector, mostly in renewables. In recent years, both the private and state sectors have been investing in large-scale wind, solar and hydropower projects.

**Value added tax (VAT) on electricity has been temporarily cut.** In July 2021 the VAT Law was amended to lower electricity prices and reduce expenses for households. The VAT rate on electricity was cut to 5 per cent from 18 per cent. The reduced rate will apply for one year, until 30 June 2022. Afterwards, it will be increased to 10 per cent until the end of June 2023 and then, in July 2023, it should return to 18 per cent.

CONTINUES

**The government has signed an agreement with Greece for the construction of a gas interconnector.** The 123 km-long pipeline will cost €110 million and will have the capacity to transport around 1.5 billion cubic metres of natural gas every year. The final investment decision by the government is expected by the end of 2021.

**The government is promoting the economic inclusion of the Roma population.** A €2 million development fund was launched in July 2021 to support Roma businesses and address the issue of unemployment in the community. The aim of the initiative is to create more favourable business conditions for Roma entrepreneurs in several ways, by facilitating access to loans, offering coaching, business development services and creating new jobs, formalising Roma employment and harnessing the Roma's demographic dividend.

# POLAND

## Highlights

- **There has been a steady increase in economic activity in the first half of 2021.** The 2.5 per cent drop in gross domestic product (GDP) in 2020 was significantly lower than the European Union (EU) average and, since the beginning of 2021, investment growth and rising consumption have been driving a robust recovery.
- **Potentially one of the EU's largest Recovery and Resilience Facility (RRF) packages envisages major investment in energy transition and broad-based digitalisation.** The national plan is based on €23.9 billion in grants and €12.1 billion in loans and, in addition to the green and digital transition, it foresees strengthening health sector capacity and supporting businesses in their post-Covid-19 pandemic recovery. A legal dispute on rule-of-law reforms could postpone the roll-out of the RRF, however.
- **The energy policy strategy up to 2040 has been approved.** With an emphasis on renewable energy, it is projected that by 2040, coal's share of energy generation will be between 11 and 28 per cent, while larger cities should introduce zero-emission public transport by 2030.

## Key priorities for 2022

- **High energy prices should be addressed in a market-friendly way.** While rising energy prices could provide greater incentives for energy efficiency investments, they directly affect households, especially those at risk of energy poverty. Instead of subsidising energy prices, cash transfers should be provided to the most vulnerable households.
- **The transparency of public finances needs to be improved.** While the Covid-19 pandemic triggered higher and more targeted government expenditure, including through off-balance-sheet special-purpose funds, such as those of Polish development bank BGK, budgetary transparency deteriorated sharply. Greater harmonisation of definitions with Eurostat, the EU's statistical office, would be a step forward.
- **Policies that address skills shortages and improve inclusivity would strengthen and make better use of the labour supply.** In regions dependent on the coal industry, increasing skills and targeted training would enable job transitions to the renewable energy projects announced in the national RRF plan. Policies that embrace diversity and inclusion practices, including for the LGBT+ community, and better migrant job matching could attract and retain talent, such as in the tech and creative industries.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.8 | 5.4 | 4.7 | -2.5 | 4.9 |
| Inflation (average) | 1.6 | 1.2 | 2.1 | 3.7 | 4.7 |
| Government balance/GDP | -1.5 | -0.2 | -0.7 | -7.1 | -4.2 |
| Current account balance/GDP | -0.4 | -1.3 | 0.5 | 2.9 | 2.3 |
| Net FDI/GDP [neg. sign = inflows] | -1.4 | -2.6 | -2.0 | -2.2 | -1.1 |
| External debt/GDP | 67.0 | 64.2 | 58.8 | 60.6 | n.a. |
| Gross reserves/GDP | 21.4 | 19.9 | 21.5 | 25.8 | n.a. |
| Credit to private sector/GDP | 52.0 | 50.9 | 50.2 | 48.0 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy is growing robustly after the downturn in 2020.** The Covid-19 pandemic had a relatively mild impact on the Polish economy, causing GDP to decline 2.5 per cent in 2020. Some recovery had already begun in the third quarter of 2020, but a moderate tightening of restrictive measures at the end of the year constrained GDP growth in the first quarter of 2021. After a pick-up in the second quarter, economic output increased by 4.6 per cent year-on-year in the first half of 2021, largely due to greater activity in the manufacturing sector. Restrictive measures did not significantly affect household consumption, which, along with imports of goods and services, registered a positive trend in the first half of 2021. Economic sentiment started to recover from February 2021. Industrial production so far in 2021 has exceeded pre-pandemic levels, with particularly strong activity in the automotive industry.

**The labour market fallout from the pandemic was limited and wage pressures persist.** The unemployment rate increased only slightly, to just 3.7 per cent, in the second quarter of 2021, with job losses limited by anti-pandemic measures. Wages are growing at a brisker clip once again, with nominal wage growth of 9.6 per cent year-on-year in the second quarter of 2021. The rise of economic activity and substantially higher energy and other utility prices has resulted in a rise in HICP inflation, to 5.6 per cent year-on-year in September 2021. In October 2021, to limit the risk of inflation staying above the central bank's target of 2.5 per cent (plus/minus 1 percentage point band) in the medium term, the Narodowy Bank Polski (NBP), the Polish central bank, increased interest rates and withdrew the bill discount credit.

**Fiscal expenditure is increasing to support the economy.** As a consequence of the government's comprehensive stimulus package, the general government deficit in 2020 reached 7.1 per cent of GDP, slightly above the EU average. Public debt increased to 57.4 per cent of GDP as of the end of 2020. A gradual decline in these numbers is projected in the coming years, supported by high nominal GDP growth.

**Real interest rates remain negative amid persistently low financing costs and improving business sentiment, which should lead to further investment and GDP growth.** Overall, GDP growth is forecast at 4.9 per cent and 4.8 per cent in 2021 and 2022, respectively. However, the delayed disbursement of the EU's RRF funds constitutes a negative risk to that scenario, especially for public-sector investment. According to the Finance Ministry, the RRF funds could add 0.4 percentage point to annual GDP growth. Another downside risk to the generally positive outlook is the population's relative reluctance to vaccinate against Covid-19, with only 53 per cent of people vaccinated as of mid-October 2021. This could lead to sporadic lockdowns this winter, aggravated by potential new variants of the virus.

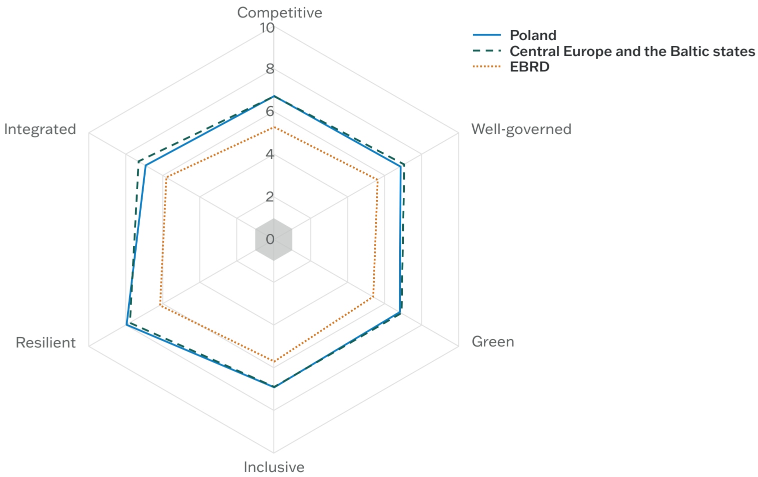
## Policy response to Covid-19

**Crisis-response measures in 2020 alleviated the effects of the Covid-19 pandemic.** The government responded to Covid-19 with fiscal measures to support the economy through the BGK and with discretionary measures. These included a job protection scheme, with co-financing of wages in the affected sectors and compensation to entrepreneurs, moratoria on loans and solidarity allowances. Total government support through various programmes is estimated at 15 per cent of GDP. Monetary policy followed economic developments, with the NBP reducing the policy interest rate three times in 2020, from 1.5 per cent to 0.1 per cent in May 2021. Some of the Polish central bank's other supportive measures have included purchasing government and government-guaranteed securities on the secondary market and offering bill discount credits with a view to refinancing bank loans to companies.

CONTINUES

**The 2021 budget envisages selective but continuous support to the economy.** As the impact of the crisis is still visible in some sectors in 2021, most of the job support measures have been extended. Small and medium-sized enterprises (SMEs) in sectors heavily affected by the restrictions, such as the services sector, can receive financial support of up to 70 per cent of fixed costs. Liquidity guarantees for large companies and exemptions from social security contributions for specific industries are in place. Within the increase in expenditure, the 2021 budget envisages an increase in healthcare spending, bringing it to 5.3 per cent of GDP.

Assessment of transition qualities (1-10)




## Structural reform developments

**Large RRF funds, if cleared by the European Commission and Council, could further target key sectors, including the green and digital transitions.** The Polish national plan is based on €23.9 billion in grants and €12.1 billion in loans. It consists of five pillars: economic resilience, green energy, digital transformation, sustainable transport and the health system. Investment in renewable energy sources such as wind farms, however, has received little emphasis to date and it remains to be seen how hydrogen and natural gas will be used in line with the EU's energy strategy. With the European Commission not having endorsed the plan as of late October 2021, Poland has expressed concerns about the timeliness of its response. The European Commission, meanwhile, has requested that the European Court of Justice (ECJ) impose financial penalties on Poland to ensure its compliance with the Court's interim measures order on the functioning of the Disciplinary Chamber of the Polish Supreme Court.

**Disagreements between Poland and the EU institutions over judicial reform have escalated to new levels.** In October 2021, the Polish Constitutional Tribunal ruled that some articles of the EU treaties were incompatible with the national constitution. Earlier – and further to requesting the financial penalties in relation to the functioning of the Disciplinary Chamber – the European Commission had sent a letter of formal notice to Poland for not taking the necessary measures to comply fully with the judgement of the ECJ (of 15 July 2021), which found Polish disciplinary legislation against judges incompatible with EU law.

CONTINUES

**The government approved a new energy policy strategy to 2040.** Adopted in February 2021, the strategy presents a vision for transforming the economy into a low-carbon one. Although it shows a slower energy transition plan than EU climate targets, coal's share of energy generation is projected to drop from about 70 per cent in 2020 to between 11 and 28 per cent by 2040, depending on emission prices. The strategy emphasises the need to further expand the capacity of wind farms and solar power plants. It also says that greenhouse gas emissions should fall by 30 per cent by 2030 and larger cities should introduce zero-emission public transport by 2030.

**The government has presented a tax reform and economic support package.** The new package, presented in May 2021, includes an increase in the tax-free income allowance and other measures leading to more progressive income tax. The health-insurance contributions of the self-employed will increase in proportion to their income, in line with the rules that apply to employees. The government also plans to introduce relief for taxpayers settling in Poland, as well as state guarantees for mortgage loans on social housing or for families with four children or more. These changes in taxation are expected to come into force from January 2022.

**Uncertainty remains high with regard to the possible outcome of legal disputes over foreign-currency mortgages.** In September 2021 the Supreme Court again postponed a decision on how to deal with cases involving foreign-currency loans – specifically, a large number of mortgages in Swiss francs, which may result in high costs for banks due to exchange-rate changes since the loan origination dates. The court has decided to seek the opinion of the ECJ on the composition of judicial benches. At the same time, several commercial banks have taken measures to facilitate the conclusion of voluntary settlements with their customers.

**The roll-out of a high-speed internet network is focused on lower-population-density areas.** Following the introduction of the National Broadband Plan to connect all households to high-speed internet by 2025, a project to develop fibre-to-the-home infrastructure in five less-populated regions was contracted in August 2021. The value of the project is approximately €227 million. It is planned that, by 2023, more than 500,000 households and 1,400 schools will get a high-speed internet connection.

# ROMANIA

## Highlights

- **The economy is recovering quickly after the Covid-19 shock.** Gross domestic product (GDP) has been expanding robustly since the last quarter of 2020 and was already above pre-Covid-19 pandemic levels in the first quarter of 2021. Most of the growth was accounted for by rising private consumption, as the authorities eased containment measures.
- **The National Recovery and Resilience Plan (NRRP) includes key structural reforms.** The approved €29 billion plan combines investments with reforms in sustainable infrastructure, education, health and local development. Public administration, pension and fiscal reforms are also envisaged.
- **Covid-19 and political tensions have held back structural reforms.** The centre-right coalition has focused on addressing the Covid-19 pandemic and preparing the NRRP.

## Key priorities for 2022

- **Judicial reform remains a key priority.** Although some amendments have taken place, further efforts are needed to reform justice laws and step up the fight against corruption, as specified by the latest assessments of the European Union (EU)'s Cooperation and Verification Mechanism, the European Court of Justice of the EU and the Group of States against Corruption (GRECO).
- **Improving administrative capacity to absorb EU funds will be critical.** Almost €100 billion will be available to the country until at least 2027, combining new allocations with leftover funds from the previous EU budget. The key challenge remains the administrative capacity to absorb these funds, considering the modest performance previously in this regard.
- **Fiscal consolidation should advance next year, in line with the commitments under the Excessive Deficit Procedure.** With inflation already running significantly above target and external accounts in deficit, there is a risk that financing conditions will tighten in the short term. The authorities should therefore commit to a more ambitious consolidation plan from 2022.

Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 7.3 | 4.5 | 4.1 | -3.9 | 7.2 |
| Inflation (average) | 1.3 | 4.6 | 3.8 | 2.6 | 4.3 |
| Government balance/GDP | -2.6 | -2.9 | -4.4 | -9.4 | -6.7 |
| Current account balance/GDP | -3.1 | -4.6 | -4.9 | -5.2 | -5.7 |
| Net FDI/GDP [neg. sign = inflows] | -2.6 | -2.4 | -2.2 | -0.9 | -1.6 |
| External debt/GDP | 52.0 | 48.8 | 49.2 | 58.2 | n.a. |
| Gross reserves/GDP | 19.5 | 16.8 | 18.0 | 19.8 | n.a. |
| Credit to private sector/GDP | 26.3 | 25.6 | 24.6 | 25.9 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy is growing rapidly in 2021 after a better-than-expected performance in 2020.** GDP declined by 3.9 per cent in 2020, with private consumption and exports being the main headwinds to growth. Strong public investment was a counter-cyclical factor in 2020 and again in 2021, together with recovering private investment. In line with the relaxation of containment measures, private consumption has driven most of the recovery in 2021, mainly on the back of strong demand for durable goods. Export performance was mixed, with some sectors held back by supply constraints in the automotive industry and fluctuating demand in the eurozone, while imports recovered faster. The current account balance reflects this trend, as the trade deficit in goods continued to widen in 2021. The unemployment rate declined from a high of 5.9 per cent in February 2021 to 5.2 per cent in August 2021, but remains above the pre-Covid-19 pandemic level.

**The public sector deficit is high but fiscal consolidation is under way.** The high structural deficit and Covid-19-related support measures aggravated the government balance significantly to a deficit of 9.8 per cent of GDP in 2020. A budget revision in August 2021 raised expenditure plans, mainly for health and regional transfers, in line with the higher GDP growth and revenue targets, but the deficit target for 2021 is still 7.1 per cent of GDP in cash-based terms. The medium-term fiscal framework envisages a deficit below 3 per cent of GDP by 2024 and public debt is expected to hover below 60 per cent of GDP in the medium term. In April 2021 ratings agency Standard & Poor's upgraded its outlook for Romania from negative to stable, given the lower fiscal risks.

**Accommodative monetary policy supported economic recovery and credit growth, while inflation increased.** The National Bank of Romania (NBR) reduced the policy rate to a record low of 1.25 per cent in January 2021 to support economic recovery. Inflationary pressures increased in 2021 due to the liberalisation of the electricity market and recovering global energy prices. The inflation rate reached 6.3 per cent in September 2021. The NBR started to wind down liquidity from the market through its deposits facility before hiking the policy rate to 1.5 per cent in October 2021 to counter rising inflation. Nevertheless, credit growth continued accelerating in the first half of 2021, driven by a strong demand from corporates supported by the state credit guarantee schemes.

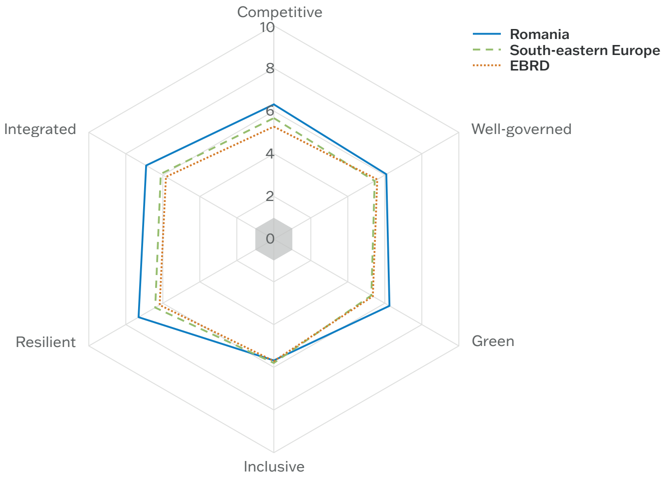
**The economy has strong growth momentum in the medium term.** Overall, the economy's current momentum is expected to lead to 7.2 per cent GDP growth in 2021. In 2022 the NRRP should start boosting investments, in particular, which, together with private consumption growth and gradually improving net exports, will translate into projected 4.4 per cent growth. The downside risks to the forecast are related to the evolution of the Covid-19 pandemic amid the slow progress of vaccination, while the twin (fiscal and current account) deficits and high inflation indicate a deepening of macroeconomic imbalances.

## Policy response to Covid-19

**Policy support in the first half of 2021 amounted to 0.7 per cent of GDP.** Support measures worth about 4.5 per cent of GDP in 2020 included tax deferrals, preserving employment through subsidies and facilitating access to finance. In 2021 spending on Covid-19-related support significantly decreased, in line with the drop in requests for employment support. However, demand for state credit guarantees has been robust and the impact on credit growth has been visible, which has led to an extension of the small and medium-sized enterprise (SME) investment programme until the end of 2021. As of the end of May 2021 state credit guarantees totalled €2.6 billion, mostly in investment loans, out of a total of €6.9 billion allocated in 2020 and 2021. The authorities also devised three grant schemes for working capital and investments and a dedicated scheme for the hospitality sector financed by EU funds. By August 2021 about €600 million had been disbursed through the working capital scheme, while the other two schemes encountered problems with budgeting. The hospitality scheme was open to applications until the end of July 2021 and will disburse grants of €500 million to June 2022, covering 20 per cent of the difference between revenue recorded in 2020 and the level of revenue in 2019.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**Infrastructure works have accelerated in the past year.** A number of large highway projects have advanced rapidly, with the Ministry of Transport fast-tracking the award of contracts on key highway projects that had stalled in the past. The RRF will finance some sections of highway, most notably the A7 highway linking Bucharest with the Moldova region, which is expected to be finalised in 2024.

**A new renewables support scheme is in preparation.** The scheme, announced in spring 2019, with a memorandum signed in mid-2020, is based on a contracts-for-difference mechanism (CfD) and is being designed as the new procedure for supporting low-carbon electricity generation. It is expected to enter into force by the end of 2022. Moreover, in an amendment to the Energy Law in May 2020, the ban on over-the-counter power purchase agreements (PPAs) was lifted.

**A law subsidising the development of offshore wind farms was adopted.** The law, adopted by the Senate in November 2020, regulates the subsidies that investors receive when producing electricity, which will differ based on the mechanism for awarding the contract (auction or direct licensing). However, Romania has yet to prepare a maritime spatial plan and a framework law that would enable offshore wind investments, while subsidies following auctions will need to be aligned with the CfD mechanism, which (as noted above) is not yet finalised.

**A new law on agricultural land may hold back the development of renewables.** The law regulating the sale of agricultural land, adopted in August 2020, heavily constrains the sale of arable land to buyers without pre-emptive rights, especially foreign investors, while imposing an 80 per cent tax on the difference between the sale price and purchase price if the land is sold earlier than eight years after purchase. While the law does not explicitly change the procedure to change the use of the land, the business community has voiced concerns over the impact of the law on developing both onshore renewables and gas infrastructure. Nevertheless, it remains to be seen if the law will have a visible impact on potential investment.

CONTINUES

**The government announced plans to list 15 per cent of Hidroelectrica's shares next year.** The Ministry of Energy announced that it intends to list a minority package of the most profitable state-owned enterprise (SOE), Hidroelectrica, in the second half of 2022. The process recently started with the company launching a tender for auditing the SOE, a first step in the initial public offering process. For now, a listing is not possible due to the law suspending any privatisation for two years, adopted last year. Hidroelectrica supplies about 30 per cent of electricity in Romania and is seen as a central actor in future investment in offshore wind and solar infrastructure.

**Tax incentives have been introduced to firms that improve their equity positions.** The low equity of most Romanian firms limits their access to finance. To counter that, a reduction of 2 per cent of the tax due will be granted to companies and to the permanent establishments of non-residents if their equity is positive, while certain increases in equity capital compared with previous years will be rewarded as well. The scheme will be active from 2021 until 2025.

**A law regulating 5G networks has been adopted.** In June 2021, after several delays, parliament gave the green light to 5G auctions being held in 2021. However, the auctions will depend on (among other things) implementation of the European Electronic Communications Code, which has yet to be adopted by the government. Previously, both public- and private-sector actors had criticised the draft law for its lack of alignment with EU regulations.

# RUSSIA

## Highlights

- **The economy is recovering from a moderate contraction in 2020.** Russia's economy proved resilient to the shock of the Covid-19 pandemic, thanks to strong fiscal and external buffers. Higher commodity prices and the lifting of Covid-19-related restrictions are supporting growth in 2021, despite the uneven pace of vaccination and resurgence of infections.
- **Monetary policy has turned from accommodative to tight amid a sustained rise in inflation.** The Central Bank of Russia (CBR) reversed its loose policy and undertook a series of policy rate hikes in response to inflation rising to a five-year high, driven by an improving labour market, a depreciating Russian rouble and higher global food prices.
- **The government is taking steps to reduce red tape.** The authorities are implementing a "regulatory guillotine", a universal review of business regulations aimed at cancelling or replacing superfluous ones. Meanwhile, progress on the infrastructure-oriented "national projects" scheme remains slow.

## Key priorities for 2022

- **Steps are needed to increase the role and competitiveness of the private sector.** Russia's economy is being held back by a dependence on commodity exports, a dominant public sector and a challenging business environment. Reducing the role of the state in the economy through privatisations, addressing anti-competitive regulations, improving the business environment by reducing regulatory burdens and pursuing infrastructure development would help boost growth, entrepreneurship and competitiveness in the private sector.
- **Efforts to promote innovation, digitalisation and technology development need to be intensified.** Promoting the development of new technologies and digitalisation through incentives and investment would improve the productivity of the private sector and foster the growth of the manufacturing and services sectors. Hastening the digitalisation of public services would also have the benefit of cutting red tape and improving the business environment.
- **Transparency and impartiality in public governance need to be improved.** Steps need to be taken to address corruption in the public administration, while the impartiality of the judiciary needs to be ensured to provide a level playing field and predictable business environment for all businesses.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 1.8 | 2.8 | 2.0 | -3.0 | 4.3 |
| Inflation (average) | 3.7 | 2.9 | 4.5 | 3.4 | 6.4 |
| Government balance/GDP | -1.5 | 2.9 | 1.9 | -4.0 | -0.6 |
| Current account balance/GDP | 2.0 | 7.0 | 3.9 | 2.4 | 5.7 |
| Net FDI/GDP [neg. sign = inflows] | 0.5 | 1.4 | -0.5 | -0.2 | 0.5 |
| External debt/GDP | 32.9 | 27.5 | 29.1 | 31.8 | n.a. |
| Gross reserves/GDP | 27.5 | 28.2 | 32.9 | 40.2 | n.a. |
| Credit to private sector/GDP | 52.1 | 51.2 | 52.7 | 60.0 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy has been resilient and weathered the Covid-19 pandemic relatively well.** As a result of years of prudent macroeconomic policies, the economy entered the Covid-19 pandemic with strong fiscal and external buffers. This provided enough room for an increase in government consumption, which, together with rising non-oil net exports (helped by a weaker Russian rouble), offset part of the contraction in household consumption. A rebound in oil prices since the end of 2020 and improving labour market conditions are supporting a return to growth in 2021; gross domestic product (GDP) grew by more than 10 per cent year-on-year in the second quarter of 2021.

**A surge in inflation has led the CBR to adopt tighter monetary policy.** Inflation has more than doubled since the start of the Covid-19 pandemic, reaching 7.4 per cent in September 2021, driven by rising global food prices, supply chain problems, a strengthening labour market and the depreciation of the rouble. In response, the CBR has undertaken six consecutive rate hikes, of a cumulative 325 basis points, since the start of 2021.

**Despite uneven progress in vaccination and a resurgence of the Covid-19 pandemic, growth is expected to be relatively high in 2021.** The authorities have avoided nationwide lockdowns despite a sharp rise in infections during the summer of 2021. Meanwhile, the rate of vaccination has picked up after a slow start early in 2021. As a result, private consumption and investment are expected to continue driving the recovery, despite the tightening monetary policy. At the same time, rising commodity prices and the relaxation of the Organization of the Petroleum Exporting Countries plus (OPEC+) production quotas will continue supporting net exports. As a result, the economy is forecast to grow by 4.3 per cent in 2021, followed by 3.0 per cent in 2022. The forecast is subject to upside and downside risks, depending on progress with the Covid-19 pandemic, the path of oil prices and the outcome of several geopolitical issues.

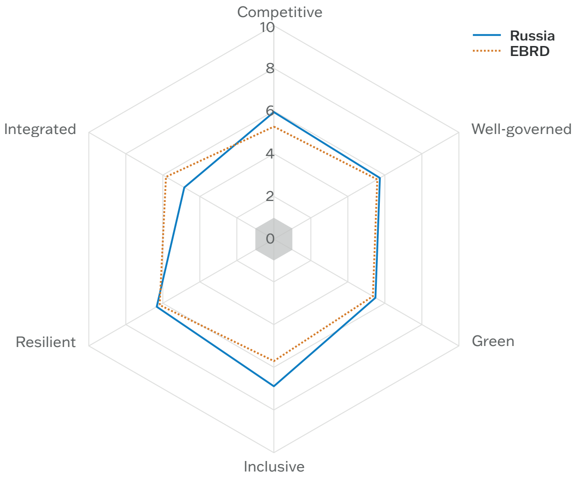
## Policy response to Covid-19

**Policy response has shifted towards measures to support households.** In April 2021 the president announced a series of social spending measures, including one-off payments of up to RUB 10,000 (US$ 130) per child to families, which is estimated to cost around 0.3 per cent of GDP. While most regulatory measures to promote lending and the restructuring of loans to small and medium-sized enterprises (SMEs) were phased out early in 2021, hiring incentives offered to Covid-19 pandemic-affected businesses have been extended until the end of the year.

**Efforts to increase the resilience of the economy are limiting the size of potential stimulus measures.** Despite the fiscal room offered by a budget returning to surplus, the authorities' emphasis on reducing the sensitivity of the economy to sanctions means that future measures are unlikely to entail substantial spending.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The authorities are undertaking a comprehensive review of business regulations.** As part of the "regulatory guillotine" scheme, public agencies are reviewing more than 20,000 business regulations and requirements in consultation with the private sector. A large number of regulations, some of which date back to the Soviet era, are being cancelled or replaced based on cost-benefit analyses. The scheme is expected to improve the business environment by cutting red tape and aligning regulations more closely with the needs of businesses.

**The government and businesses are preparing a new high-tech economy plan.** Among other things, this involves the digitalisation of government services and SMEs.

**Implementation of the "national projects" scheme remains behind schedule.** Government expenditures were diverted from investment to consumption and social transfers during the early stages of the Covid-19 pandemic, slowing progress in implementing the national projects, a series of 13 large-scale infrastructure and social development projects set out by the president in 2019. Nevertheless, the authorities have stated that the government will tap into the US$ 186 billion National Welfare Fund to help finance planned investments in the future.

**Legislation aimed at reducing greenhouse gas emissions was signed into law.** While short of setting a deadline for net zero emissions, the new law, which entered into force in July 2021, aims to cut emissions to 70 per cent of 1990 levels by 2030. The law introduces reporting requirements and emission limits for large greenhouse gas emitters and creates a carbon credit system for companies to offset their emissions with climate-friendly investments and initiatives such as reforestation. Also, the issuance of green bonds continues to develop.

**The authorities are revising tax treaties with major foreign direct investment (FDI) source countries.** The government has adopted a more restrictive stance on double taxation, seeking to limit exemptions to withholding taxes on interest and dividends earned by foreign entities in Russia. Tax treaties with Cyprus, Luxembourg and Malta were updated over the past year following renegotiation, while the authorities have terminated the double taxation treaty with the Netherlands, which accounts for 9 per cent of the FDI stock in Russia.

# SERBIA

## Highlights

- **The economy is growing strongly after a mild reduction in 2020.** Gross domestic product (GDP) fell by just 0.9 per cent in 2020, as the economy was propped up by a large fiscal package, and strong growth occurred in the first half of 2021.
- **Serbia has agreed a new non-financial and advisory deal with the International Monetary Fund (IMF).** The 30-month Policy Coordination Instrument (PCI) aims to support structural reforms and economic recovery, while maintaining macroeconomic and financial stability.
- **Progress on the green transition has been made in the past year.** New laws should help to enable large investments in renewable energy sources, as well as promote energy-saving and climate change mitigation measures.

## Key priorities for 2022

- **The green transition agenda should be accelerated.** Among other measures, the authorities should step up renewable energy auctions, energy efficiency improvements and environmental infrastructure investment.
- **The governance of state-owned enterprises (SOEs) needs to be strengthened.** SOE governance should be improved in line with the recently approved action plan for state-ownership policy.
- **Fiscal and financial sector risks should be contained after support measures expire.** To preserve fiscal sustainability, it would be prudent to adopt a new fiscal rule, prioritise productive capital investments and moderate the growth of pensions and public wages.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 2.1 | 4.5 | 4.3 | -0.9 | 6.5 |
| Inflation (average) | 3.0 | 2.0 | 1.7 | 1.6 | 3.0 |
| Government balance/GDP | 1.4 | 0.8 | 0.0 | -7.3 | -6.5 |
| Current account balance/GDP | -5.2 | -4.8 | -6.9 | -4.1 | -4.1 |
| Net FDI/GDP [neg. sign = inflows] | -6.2 | -7.4 | -7.7 | -6.3 | -6.0 |
| External debt/GDP | 65.1 | 62.2 | 61.4 | 65.8 | n.a. |
| Gross reserves/GDP | 25.4 | 26.3 | 29.1 | 28.8 | n.a. |
| Credit to private sector/GDP | 40.3 | 41.4 | 42.0 | 45.8 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy is recovering in 2021 after a modest drop in output in 2020.** The effects of the Covid-19 pandemic on the economy were moderate in 2020. The structure of the economy – a limited reliance on tourism and a relatively high share of basic goods, such as food and some chemicals in manufacturing – combined with large government aid packages and less restrictive lockdown measures for most of the year, contributed to a GDP contraction of just 0.9 per cent. In the first quarter of 2021 GDP grew by 1.8 per cent year-on-year, underpinned by a strong recovery in the construction sector, the growth of industrial output and an increase in trade, transport and tourism activities. The second quarter saw strong growth of 13.7 per cent year-on-year, reflecting the low base of last year due to Covid-19 pandemic-related restrictions.

**Inflationary pressures have increased.** The year-on-year inflation rate rose from 1.1 per cent in January 2021 to 5.7 per cent in September 2021, which is above the central bank target range (3.0 ± 1.5 per cent). The increase is primarily the result of temporary factors such as rising utilities, oil and primary commodity prices. The exchange rate against the euro has remained stable. The central bank has intervened in the foreign exchange market on both sides, but in the first seven months of 2021 it was a net buyer of euros (€700 million in total).

**Public debt has increased due to aid packages for the economy.** In July 2021 public debt stood at 55.2 per cent of GDP, around 2 percentage points below the 2020 level, but more than 3 percentage points higher than in 2019. The country placed a 12-year €1 billion Eurobond in February, while in September it issued its first ever 7-year €1 billion green bond at a record low coupon rate of 1.0 per cent, together with a 15-year €750 million Eurobond, the longest maturity Serbia has issued so far. Receipts from the green bond will be used to finance the construction of water and wastewater treatment plants, subway and modern railways, flood protection, biodiversity conservation, pollution control and prevention, waste collection, processing and recycling infrastructure, energy efficiency and renewable energy sources, and other projects from the green agenda.

**GDP will exceed its 2019 level in 2021.** Continuing expansionary fiscal policy in 2021, together with a planned significant increase in public investment and recovery in domestic and external demand, will result in GDP expanding by a projected 6.5 per cent in 2021. In 2022 a growth rate of 4.3 per cent is forecast, as the economy is expected to return to pre-pandemic growth rates amid a likely fiscal adjustment. Risks to the forecast are balanced. They relate primarily to the pace of recovery of external demand and speed of public infrastructure projects and structural reforms.

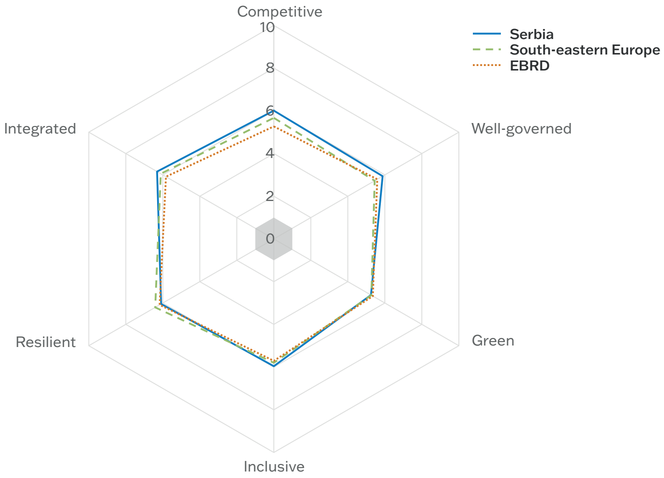
## Policy response to Covid-19

**A third package of Covid-19-response measures was approved in 2021.** The package, worth €2.2 billion (4.3 per cent of GDP), was adopted in February 2021. It included direct support to the private sector, extending the previous guarantee scheme and introducing a new one, and one-off financial assistance for adults and pensioners (€60 and €110, respectively). Direct support to the private sector comprised payments of 50 per cent of the minimum wage to all entrepreneurs and companies for three months and an additional minimum wage for employees in sectors that had been hit the hardest (catering, travel agencies, tourist guides, hotels, rental car agencies and so on). In addition, in June 2021 the state paid one-off "vaccine bonuses" of around €25 to those who had received at least one vaccine dose by the end of May.

CONTINUES

**The central bank has introduced new measures.** To support dinar liquidity, the National Bank of Serbia (NBS) introduced in November 2020 additional foreign exchange purchase swap auctions and securities purchase repo auctions, both on a weekly basis and with a three-month maturity. In December 2020 the key policy rate was lowered by 25 basis points to another historical low of 1.0 per cent. In February 2021 the NBS and the European Central Bank (ECB) agreed to prolong the duration of the precautionary repo line set in mid-2020 until March 2022. The line enables the NBS to borrow up to €1 billion from the ECB.

Assessment of transition qualities (1-10)




## Structural reform developments

**European Union (EU) accession negotiations are advancing, albeit slowly**. Since the start of negotiations in January 2014, 18 chapters (out of 35) of the EU *acquis* have been opened, of which two are provisionally closed. No new chapters have been opened in the past year. According to the European Commission, the future speed of negotiations will depend on, among other things, the pace of reforms regarding the rule of law as well as progress on normalising relations with Kosovo. In 2021 it was agreed to apply to Serbia the revised enhanced methodology for EU accession negotiations that was previously approved by the Council for candidate countries. This means greater leverage in preventing and addressing possible reversals in the reforms but it also presents an opportunity to accelerate the opening of new negotiation “clusters” containing several chapters.

**The IMF has approved the new 30-month PCI with Serbia.** Soon after the previous PCI had expired, the authorities launched talks with the IMF on a new one, which was approved in June 2021. The new PCI aims to support structural reforms and economic recovery, while maintaining macroeconomic and financial stability. The main pillars of the programme, which will run until the end of 2023, are: anchoring the fiscal policy framework; strengthening SOE governance; developing capital markets and further increasing dinarisation; improving the provision of social assistance; and transitioning to a green economy.

CONTINUES

**The country has made legislative changes that pave the way for the greening of the economy.** In March 2021 parliament adopted the Law on Climate Change, which should help establish a system for limiting greenhouse gas emissions. In April 2021 the country adopted four bills in the area of energy and mining (the Law on Energy Efficiency and Rational Energy Use, the Law on Renewable Energy Sources, and amendments to the Law on Mining and Geological Exploration and to the Law on Energy). These legal changes should enable large investments in renewable energy sources such as wind and solar, help achieve energy savings and security of energy supply, and reduce the impact of the energy sector on the environment and climate change. In addition, amendments to the Law on Energy create a legal basis for the adoption of the National Energy and Climate Plan (NECP) for 2021-30. The NECPs are the framework for EU member states to outline their climate and energy goals, policies and measures.

**Separation of electricity generation from electricity distribution has taken place.** In December 2020 the power utility Elektroprivreda Srbije (EPS) transferred its ownership of distribution system operator EPS Distribucija to the government of Serbia. The transfer of ownership is the final step in unbundling the distribution system from EPS, which began five years ago.

**The country has adopted a new state-ownership policy for 2021-27.** The policy, adopted in April 2021, should help better monitor and tackle fiscal risks and enhance the efficiency of SOEs. It identifies the rationale and objectives of state ownership and reviews the legal and regulatory framework for corporate governance of SOEs. In June 2021 the government adopted an action plan to implement the strategy for 2021-23.

**Ownership changes and acquisitions have been taking place in the banking sector.** The banking sector has remained stable, liquid and well-capitalised through the Covid-19 pandemic, with the non-performing loan ratio at 3.7 per cent in May 2021. In late 2020 Slovenia's state-owned commercial bank NLB completed the acquisition of the state-owned Komercijalna Banka, while a US investor sold its majority stake in Opportunity Bank Serbia to a group of investors. In June 2021 state-owned bank Postanska stedionica acquired MTS Banka, one of the smallest banks in the country, previously 100 per cent owned by the state-owned telecommunications company. As of early August 2021 there were 24 banks in the country and additional consolidation is under way.

# SLOVAK REPUBLIC

## Highlights

- **The economy is recovering in 2021, but some supply chain problems are emerging.** Following a gross domestic product (GDP) decline of 4.4 per cent in 2020, the Slovak economy has started to recover, reaching almost 5 per cent year-on-year growth in the first half of 2021. Rising car production is driving growth but supply chains have been disrupted recently by shortages in key inputs.
- **The government's plan for implementing European Union (EU) funds emphasises the green transition.** It is projected that the largest share of the €6.6 billion plan, financed through the Recovery and Resilience Facility (RRF), will be put into raising energy efficiency, encouraging decarbonisation and increasing the share of renewable energy sources.
- **"Kurzarbeit" was approved as a permanent work scheme from 2022.** As a new instrument in labour market policy, it will be available in extraordinary situations, whereby employers will be granted up to 60 per cent of the employee's average earnings. Alongside the continuation of hybrid work schemes due to the Covid-19 pandemic, remote working was further regulated.

## Key priorities for 2022

- **The announced tax changes should aim to encourage employment and investment.** The tax changes expected in 2022 should reduce the tax burden on labour to boost employment and increase disposable income. At the same time, tax incentives should be targeted at attracting new investment.
- **Implementation of green transition reforms requires enhanced public administration and greater local capacities.** Steps need to be taken to significantly strengthen administrative capacities and digital skills, also at the local and regional levels, as they can enable the timely implementation of energy-related projects, which will facilitate the country's access to the grid of clean energy sources.
- **Active labour market policies should promote labour market inclusion.** The government should make efforts to address the low participation of women in the labour market through regular upskilling, expanding the childcare system and granting tax allowances and compensation for fathers taking a share of parental leave.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 3.0 | 3.8 | 2.6 | -4.4 | 4.0 |
| Inflation (average) | 1.4 | 2.5 | 2.8 | 2.0 | 2.4 |
| Government balance/GDP | -1.0 | -1.0 | -1.3 | -5.5 | -7.5 |
| Current account balance/GDP | -1.9 | -2.2 | -3.4 | 0.1 | -0.9 |
| Net FDI/GDP [neg. sign = inflows] | -2.8 | -1.3 | -2.3 | 2.1 | -1.3 |
| External debt/GDP | 108.4 | 114.9 | 112.4 | 121.2 | n.a. |
| Gross reserves/GDP | n.a. | n.a. | n.a. | n.a. | n.a. |
| Credit to private sector/GDP | 60.4 | 62.7 | 63.5 | 68.1 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economic downturn in 2020 was less severe than the EU average.** The annual fall in GDP of 4.4 per cent in 2020 was the first decline since 2009. More resilient external demand and the recovery of car production ensured a return to positive growth in late 2020. After intensified containment measures from the end of 2020 and a gradual increase in activities in 2021, in the first half of 2021, GDP grew 4.9 per cent year-on-year. While economic sentiment and retail turnover started to recover from March 2021, the automotive industry and foreign trade have already surpassed figures from the pre-Covid-19 period. However, despite the growth in orders, the latest global chip shortage has resulted in a pause in production at some facilities, such as Jaguar.

**Containment measures limited the decline in unemployment, while wages are rising moderately.** After the unemployment rate reached 6.7 per cent in 2020, it increased further to 7.0 per cent in the second quarter of 2021, mainly due to the retention of certain restrictions in the services sector. Real wage growth in 2020 amounted to 1.7 per cent, with a rising trend in the industry sector. It also contributed to inflation pressure throughout 2021, with the level of inflation reaching 4 per cent year-on-year in September 2021.

**Government spending will continue to support economic recovery.** Due to the sizeable fiscal stimulus, worth 5.1 per cent of GDP, the general government deficit in 2020 reached 5.5 per cent of GDP. It interrupted a track record of low deficits. Public debt increased to 59.7 per cent of GDP in 2020, significantly higher than the pre-Covid-19 crisis level of 48.1 per cent in 2019. As the government will continue to use expenditure measures to combat the impact of the Covid-19 pandemic, the fiscal deficit is likely to exceed 6 per cent of GDP in 2021 before declining in 2022. According to the independent Council for Budget Responsibility, the long-term sustainability indicator of public finances continues to stay in the "high-risk zone", which suggests that general government gross debt should be reduced, accompanied by measures to achieve a structural budgetary surplus.

**Short-term growth will continue, but the homogenous nature of the Slovak economy is a risk.** On the upside, EU funds, including the RRF, of which the first tranche was already distributed in mid-October 2021, are expected to fuel investment, especially in the public sector. GDP growth will, therefore, likely reach 4.0 per cent this year and accelerate further to 5.0 per cent in 2022. However, the dominant automotive sector relies heavily on imports of components and chips, of which shortages are being experienced globally. As a result, disruptions in the supply of subcomponents have already hurt production, which could well lead to renewed job shedding and harm the recovery in household consumption. In addition, only 45 per cent of the population is at least partially vaccinated, creating a risk of sporadic new lockdowns.

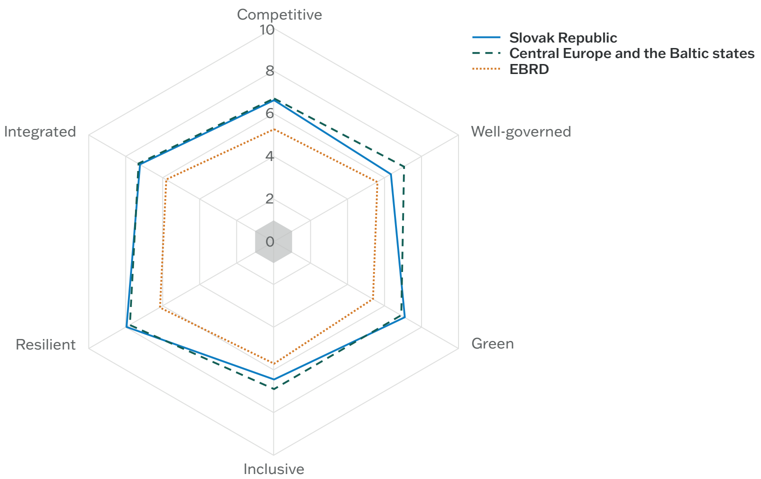
## Policy response to Covid-19

**A broad stimulus package prevented a stronger economic downturn in 2020.** With a stimulus package implemented in 2020 that amounted to 5.1 per cent of GDP, the government supported employers and the self-employed through the partial compensation of wages in sectors affected by the Covid-19 pandemic (such as the services sector), allowances and exemptions from social and health payments and extra spending on the social and health sectors. As a eurozone member, the Slovak Republic also took advantage of the quantitative easing policies of the European Central Bank.

CONTINUES

**The 2021 budget is marked by increased expenditure for the recovery.** Approved in December 2020, the budget provides for increases in expenditure on health, pensions, compensation and family support. Fiscal packages include extended wage compensation and unemployment benefits, along with a prolonged deferral of payroll and corporate tax payments for employers. In addition, the budget assumed a 1.1 per cent of GDP reserve for unforeseen developments related to the Covid-19 pandemic, which was increased with extra budgetary funds in May 2021, raising the target fiscal gap. The most significant change from June 2021 relates to financial aid linked to the so-called "Covid Automat". Under this system, regions are divided into green, orange, red, dark red and black districts, depending on their epidemiological situation. The support system includes four phases. Phase 0 means that at least 40 districts are in the green tier and no financial assistance is paid. In phase three (when most districts are in the dark red or black tiers), employers are able to ask for support amounting to 100 per cent of total labour costs and the self-employed can get up to €870 of assistance.

Assessment of transition qualities (1-10)




## Structural reform developments

**The implementation of the RRF plan will increase the use of renewable energy sources.** The national plan, worth €6.3 billion in grants (6.9 per cent of 2020 GDP) is based on five key components: green economy, education, health, public administration/digitalisation, and research, development and innovation. A significant amount of planned investments is dedicated to the green transition and will include decarbonisation and new investments in renewable and clean energy. The planned investments in the digital area will include strengthening the digital capacities of government services but also improving general digital skills – an area where the Slovak Republic lags the central European and Baltic state average.

**Parliament approved the permanent short-time work scheme from 2022.** As a new permanent instrument for supporting labour markets, "Kurzarbeit" will be provided to employers and the self-employed in extraordinary circumstances that they cannot prevent, such as a state of emergency or *force majeure* event. The maximum support will be 60 per cent of the employee's average hourly earnings in the calendar month for which the support is provided. The support will be valid for a maximum of six months, to be taken within 24 consecutive months.

CONTINUES

**Digitalisation was set as a priority of the government.** At the beginning of 2021 the authorities announced that digital reforms worth €1.2 billion would be based on: interconnectedness, cyber security, the digital economy, digital skills, innovations and access to state-related administration via mobile phones. Besides achieving a more effective public administration, a concrete goal is that, by 2025, all schools and, by 2030, all households should be able to access high-speed internet.

**A new act on the protection of competition came into force.** In May 2021 the Slovak parliament adopted a new competition act, following an EU request to empower the competition authorities. With the new act, the Antimonopoly Office of the Slovak Republic (AMO) will have more control over existing cartels and is likely to discourage the creation of new ones. The AMO will also be authorised to apply measures, fines and penalties in cases of suspected cartels or abuse of a dominant position.

**Flagship projects were selected for funding through the Just Transition Fund**. In the project implementation period, from 2022 to 2030, the Slovak Republic will have €459 million at its disposal. The highest amount is destined for the coal-dependent Upper Nitra region. Some of the selected projects include the construction or renovation of hospitals, renovation of public buildings and energy-efficient transport to improve living standards and promote the diversification of economic activities.

**New investments in the automotive industry are likely to boost economic growth**. As a major sector, the automotive industry has maintained its investment plans, despite the Covid-19 crisis. Jaguar Land Rover has announced the employment of 600 workers in the Nitra plant and an additional 300 jobs in the sub-supplier firm. Volkswagen Slovakia is expanding its production by €1 billion and, by 2023, will move production of the Superb model from the Czech Republic and the Passat model from Germany to Bratislava.

# SLOVENIA

## Highlights

- **The economy is recovering strongly in 2021.** After a 4.2 per cent fall in 2020, gross domestic product (GDP) recovered by 8.8 per cent year-on-year in the first half of 2021, supported by domestic demand.
- **Digitalisation has accelerated since the start of the Covid-19 pandemic.** The authorities have prioritised enhancing online public services in light of containment measures, while new structures in the government were created to coordinate and enhance the delivery of the digital transformation.
- **The National Recovery and Resilience Plan (NRRP) has been approved.** Following the plan's approval in July 2021, Slovenia received the first tranche of €231 million from the European Union (EU) in September, part of its total allocation of €2.5 billion.

## Key priorities for 2022

- **EU funds should be targeted towards productivity growth.** The authorities will need to prepare operational programmes for absorbing the funds from the next EU budget, which should complement the areas covered by the NRRP, namely, green, digital and smart growth.
- **A renewed commitment to fiscal consolidation is needed.** In line with the conclusions of the Fiscal Council and international partners, fiscal consolidation will need to accelerate after a year of Covid-19-induced delay.
- **Governance-related structural reforms should continue.** Further improvements are needed to the governance of state-owned enterprises and in the overall business environment, such as strengthening the public procurement system and further reducing administrative barriers.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.8 | 4.4 | 3.3 | -4.2 | 6.0 |
| Inflation (average) | 1.4 | 1.7 | 1.6 | 0.0 | 1.4 |
| Government balance/GDP | -0.1 | 0.7 | 0.4 | -7.7 | -7.0 |
| Current account balance/GDP | 6.2 | 6.0 | 6.0 | 7.4 | 6.4 |
| Net FDI/GDP [neg. sign = inflows] | -1.2 | -2.0 | -1.6 | 0.6 | 0.9 |
| External debt/GDP | 101.9 | 91.8 | 90.5 | 101.9 | n.a. |
| Gross reserves/GDP | n.a. | n.a. | n.a. | n.a. | n.a. |
| Credit to private sector/GDP | 44.4 | 43.0 | 42.3 | 43.5 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**Growth has exceeded expectations in the first half of 2021.** Following the -4.2 per cent recession in 2020, the economy expanded by 8.8 per cent year-on-year in the first half of 2021, almost reaching pre-Covid-19 pandemic levels. Domestic demand was behind the strong rebound, with private consumption growing by 8.9 per cent year-on-year and investment recovering by 13.4 per cent year-on-year in the first half of 2021 after a steep fall in 2020. Consumption has been supported by employment preservation schemes, with the unemployment rate falling to 4.3 per cent in the second quarter of 2021, a level comparable with the pre-pandemic situation. Exports have also reached 2019 volumes, but higher import growth, accelerated by domestic demand, resulted in a slightly negative contribution of net exports to growth.

**Fiscal expansion is aiding the recovery but also increasing fiscal risks.** The government deployed a comprehensive support package of 6.5 per cent of GDP in 2020, which, in combination with decreasing revenues, led to a fiscal deficit of 8.3 per cent of GDP. In 2021 the authorities initially projected a deficit of 5.7 per cent of GDP, but another wave of Covid-19 infections in the spring forced the government to adopt additional support measures. The resulting budget revision from September targets a deficit of 7.9 per cent of GDP. The deficit is then expected to fall to 5.4 per cent of GDP in 2022 and 3.3 per cent in 2023. As a result, public debt will remain at current elevated levels in the short term and will gradually fall to a projected 70 per cent of GDP at the end of 2024.

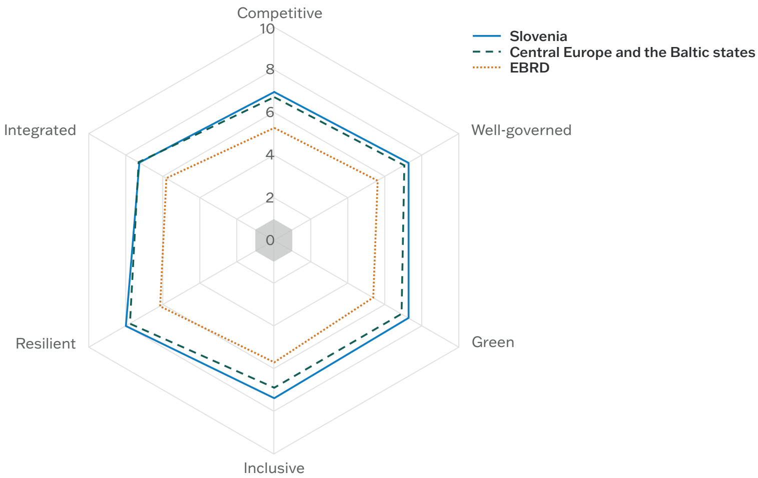
**The short-term outlook is positive.** We forecast GDP to grow by 6.0 per cent in 2021, moderating slightly to 4.5 per cent in 2022. Domestic demand will remain the key growth driver in the short and medium term. Risks to the current forecast are on the upside if consumption and investment continue the robust expansion seen in the first half of 2021. EU funds will also make a notable contribution to investment from 2022. The key downside risk remains the Covid-19 pandemic and the possibility of further containment measures amid new infection waves.

## Policy response to Covid-19

**The authorities have continued fiscal support for businesses and workers in 2021.** In 2020 the key support measures were the furlough and short-time work schemes, a credit guarantee scheme, help to cover fixed expenses for affected firms, and financial support to the self-employed and part-time workers. Most of these measures were extended until at least mid-2021. Nevertheless, only half of the initially announced support has been used since the start of the Covid-19 pandemic; credit guarantees have not been used much by firms due to the relatively stable level of liquidity. In May 2021 the authorities approved an eighth support package, worth €320 million, which extended the furlough scheme and provided subsidies to firms to compensate for the higher minimum wage, which entered into force in 2021.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The NRRP prioritises the green and digital transitions.** The approved plan allocates 42 per cent of the budget to green measures, such as addressing flood risk, mobility and improving the power network and energy efficiency of buildings. The digitalisation component of the NRRP focuses on modernising existing e-governance systems, digital education, enhancing civil servants' skills and boosting cybersecurity. The plan also includes reforms to improve long-term care, the pension system and social housing, and to modernise the healthcare system.

**An omnibus bill targeting the reduction of red tape has been passed.** The bill, passed by the government in March 2021, covers multiple areas, including: increased use of digitalisation in administrative services, changes to official registries and payment rules, increased powers to state secretaries and a cap on social security contributions of €6,000 per month. The latter measure sparked controversy, as it is not directly related to red tape and reduces fiscal space.

**The digitalisation of public services has advanced.** The Electronic Identification and Trust Services Act, adopted in April 2021, will enable the use of new biometric identity cards as electronic identification. In July 2021 the government created the Government Office for Digital Transformation and appointed a new minister for digital transformation to coordinate all digitalisation initiatives in the government.

**A framework bill on long-term care is in place.** The new bill, passed in June 2021, connects long-term care to the health, social care and pension systems under a more comprehensive system. Both institutional and community-based facilities will be developed to allow everyone to receive the required services, regardless of income or social status. The new system will be financed through a special mandatory contribution for long-term care, which will be implemented by mid-2024. Until the new financing mechanism is in place, existing resources and the national budget will cover the costs of developing relevant services.

**OTP Group has agreed to acquire Nova KBM to become the largest bank in Slovenia.** Nova KBM, the second-largest bank in Slovenia, has agreed to an acquisition by Hungarian OTP Bank, resulting in a market share for OTP Bank of about 30 per cent. The deal follows the completed merger between Nova KBM and state-owned Abanka in September 2020. The deal is still pending regulatory approval and is expected to be finalised in the second quarter of 2022, marking an end to the restructuring of the banking sector following the crisis in 2013.

CONTINUES

**Planned tax cuts will put additional pressure on fiscal neutrality in the medium term.** The key measures include an increase in personal income tax breaks, a reduction in capital gains tax from 27.5 per cent to 25 per cent, a rental income tax cut from 27.5 per cent to 15 per cent, and a reduction in the rate of personal income tax in the top bracket from 50 per cent to 45 per cent. Most of these tax breaks have not been included in the 2021-24 fiscal framework and will require an update of the current fiscal plan. A modelling exercise conducted by the Fiscal Council shows mixed effects on GDP, while the impact on public finances is likely to be negative, with a total estimated cost of 5.3 to 6.3 per cent of 2019 GDP between 2022 and 2025.

**The government has committed to phase out coal in the coming decade.** In line with EU targets, coal-powered plants will be closed by 2033. To support a "just transition", €235 million will be allocated to the Savinjsko-Šaleška region, where the only coal-fired plant is still operating, to support the creation of 5,000 jobs. However, some local stakeholders have put the cost of the plan at significantly higher levels, while increasing carbon costs could force an earlier shutdown and bring forward most expenses to earlier than currently planned.

# TAJIKISTAN

## Highlights

- **The economy is growing strongly again.** Real gross domestic product (GDP) expanded by 8.7 per cent year-on-year in the first half of 2021. Domestic demand started recovering with retail trade turnover growing and fixed investment increasing, while exports surged, driven by precious metals.
- **Two troubled banks, Agroinvestbank and Tojiksodirotbank, were finally liquidated.** Despite earlier efforts focused on restructuring and recapitalisation, the banks were wound down because their financial situation was not improving.
- **A single window for the registration of export, import and transit procedures has been launched.** The system is designed to speed up and simplify the exchange of information between stakeholders engaged in export-import and transit transactions. This is a significant contribution to the ease of cross-border trading.

## Key priorities for 2022

- **The government should step up efforts to create new opportunities for young workers and returning migrants.** The government needs to improve tax administration practices within the currently developed tax code to reduce the burden of tax compliance on businesses, which will create more opportunities for formal employment. Any spending measures should be balanced against the need to pursue fiscal consolidation.
- **Further efforts are needed to advance the digitalisation agenda.** The regulatory framework should be updated in line with international practices and broadband access should be expanded, which will improve businesses' access to information and finance, while enabling more Tajik workers to learn and work remotely.
- **Fiscal discipline should be maintained.** Since Tajikistan has a high risk of debt distress, the government should adhere to its commitment to consolidate the budget and manage any new borrowing in accordance with the updated Debt Management Strategy for 2021-23.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 7.1 | 7.3 | 7.5 | 4.5 | 6.5 |
| Inflation (average) | 7.3 | 3.8 | 7.8 | 8.6 | 8.5 |
| Government balance/GDP | -6.0 | -2.8 | -2.1 | -4.4 | -3.0 |
| Current account balance/GDP | 2.2 | -5.0 | -2.3 | 4.2 | 2.0 |
| Net FDI/GDP [neg. sign = inflows] | -2.6 | -2.9 | -2.6 | -1.3 | -3.0 |
| External debt/GDP | 77.2 | 79.4 | 80.3 | 80.6 | n.a. |
| Gross reserves/GDP | 18.0 | 17.1 | 18.1 | 26.8 | n.a. |
| Credit to private sector/GDP | 13.0 | 11.9 | 11.6 | 12.9 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy is recovering strongly.** Real GDP expanded by 8.7 per cent year-on-year in the first half of 2021. Domestic demand started recovering, with retail trade turnover growing 17.1 per cent year-on-year and fixed investment increasing 22.1 per cent year-on-year in the first half of 2021. Industrial output grew at a very high rate (23.4 per cent year-on-year in the first six months of 2021) with strong gains in mining (150 per cent year-on-year) and manufacturing (20.3 per cent year-on-year). Agriculture expanded by 8.1 per cent over the same period. The trade deficit narrowed in the first half of 2021 to US$ 619 million, from US$ 850 million in the first half of 2020. Exports nearly doubled in this period, driven by precious metals, while imports rose by 23 per cent year-on-year as domestic demand has expanded. However, data from the Russian central bank show that remittances from Russia to Tajikistan declined by 37 per cent year-on-year in US dollar terms in the first quarter of 2021.

**Inflation has been above target since September 2020.** Annual inflation was 9.0 per cent in June 2021, outside the central bank target corridor of between 4 and 8 per cent. The policy rate was raised from 10.75 per cent in January 2021 to 11.0 per cent in February, and was further increased by 1 percentage point in April and another 1 point in August. Loan growth accelerated to 14 per cent year-on-year in June 2021 from 10 per cent a year ago. The non-performing loan (NPL) ratio declined to 15.3 per cent in June 2021 from 30.4 per cent in June 2020, reflecting the liquidation in May 2021 of two troubled banks with a high concentration of NPLs (see below).

**Fiscal accounts have improved.** From January to May 2021 the state budget surplus was TJS 133 million (0.2 per cent of GDP) compared with a deficit of TJS 364 million (0.4 per cent of GDP) a year before. Revenues increased by 31 per cent in this period year-on-year thanks to a strong growth in tax receipts, while expenditures increased by 24.3 per cent year-on-year primarily in the energy sector, transport and communications as well as healthcare and social protection. The country's public debt reached almost 48 per cent of GDP in 2020, up from 43 per cent in 2019, as the government relied on external financing to mitigate the impact of the Covid-19 pandemic. The current public debt portfolio is mostly concessional, with the share of commercial loans at around 15 per cent of the total public debt stock, following the US$ 500 million Eurobond issued in 2017. Tajikistan's foreign exchange reserves were assessed at close to US$ 2 billion in August 2021, providing for eight months of import coverage, a significant improvement over the pre-pandemic situation. In addition, Tajikistan received a windfall of US$ 236 million worth of Special Drawing Rights allocated by the International Monetary Fund (IMF) in August 2021, which it can use to mitigate the economic impact of the Covid-19 pandemic.

**The economy is expected to grow by 6.5 per cent in 2021.** Remittances will support private consumption, and further expenditure on the Roghun project will drive public investment. In 2022 real GDP is forecast to grow by 6.2 per cent. Downside risks relate to the Covid-19 pandemic continuing to disrupt trade and mobility. The main upside risk is associated with a rapid intensification of trade, transport and investment linkages with Uzbekistan. In the longer term, re-establishing trade and transport connections with Afghanistan will be important for the Tajik economy, particularly given Tajikistan's plans to increase electricity exports following the completion of the Roghun hydropower plant and the CASA-1000 electricity transmission lines.

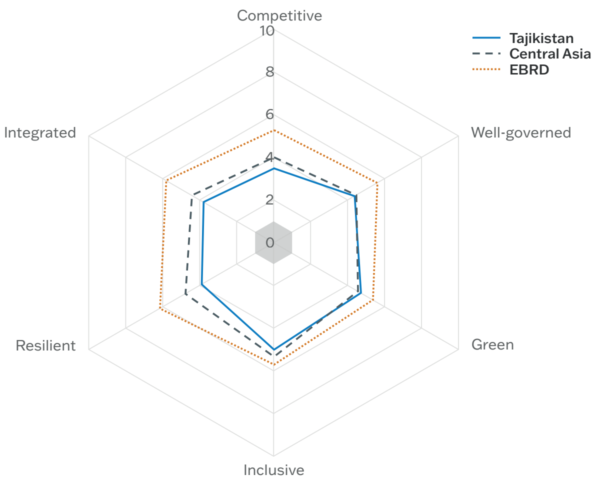
## Policy response to Covid-19

**Measures are still in place to mitigate the impact of the Covid-19 pandemic.** A government decree, "Preventing the effect of the Covid-19 pandemic on social and economic sectors of Tajikistan", approved in June 2020, remains the main anchor of the country's policy response to Covid-19. It includes measures such as price controls for key consumer goods and medical supplies, provision of free medical care to citizens diagnosed with Covid-19, tax holidays and free rent of state property. In addition, in August 2021 the government announced that 165,000 vulnerable families will receive TJS 500 (US$ 44) in emergency cash assistance.

CONTINUES

**Tajikistan received further financial assistance in 2021.** The World Bank provided US$ 8.63 million to finance the purchase of vaccines and US$ 12.57 million in grant financing in February 2021 as part of the Tajikistan Emergency Covid-19 Project, to further strengthen Tajikistan's healthcare capacity and protect vulnerable population groups. In addition, the Asian Development Bank approved a US$ 25 million grant in June 2021 to help the country procure vaccines and improve the country's capacity to implement its vaccination programme.

Assessment of transition qualities (1-10)




## Structural reform developments

**A single window for the registration of export, import and transit procedures has been launched.** The system, which began operating in September 2020, is designed to speed up and simplify information exchange between stakeholders engaged in export-import and transit transactions. This mechanism allows exporters and importers to provide standard documentation required by government agencies in a single form and to one agency. This is a significant contribution to the ease of cross-border trading.

**Agricultural sector reform seeks to increase productivity and improve access to export markets.** In October 2020 the government adopted a new concept for creating and developing agro-industrial clusters up to 2040. The main aim is to diversify agricultural production and facilitate the deeper processing of food products through increased cooperation among farms, aggregators, processing enterprises, research institutions and other upstream and downstream actors. In addition, the government approved a programme to promote the introduction of international food security standards (International Standard Global GAP) to improve agricultural producers' access to export markets.

**Two major banks have closed.** The two troubled banks, Agroinvestbank and Tojiksodirotbank, were finally liquidated in May 2021, in line with a long-standing IMF recommendation. Earlier efforts to improve the situation with these banks were focused on restructuring and recapitalisation; back in December 2016 the government announced a US$ 422 million (6.1 per cent of GDP) bail-out programme for the two banks, funded through the issue of special government debt securities guaranteed by the National Bank of Tajikistan. The banks were then wound down in May 2021 because their financial situation was not improving. This is a major step towards strengthening the banking sector and lowering the NPL ratio significantly.

CONTINUES

**Energy sector reform is advancing.** In accordance with government decree number 330 issued in June 2019, Barqi Tojik remains responsible for the generation of power while electricity transmission and distribution assets were transferred to the newly created Shabakahoi Intiqoli Barq and Shabakahoi Taqsimoti Barq, respectively. These new companies are now fully operational. The government is working to further amend the legal and regulatory framework to reflect the new business structure of the power sector.

# TUNISIA

## Highlights

- **Tunisia's recovery from its deepest recession since 1956 is slow.** The economy continued to contract in the first quarter of 2021, inflation is accelerating, reserves are declining and unemployment is high, notably among the youth.
- **The fiscal situation has deteriorated.** The fiscal deficit widened and debt is climbing, particularly the domestic currency-denominated part, but foreign currency-denominated debt still accounts for two-thirds of total debt. The public sector wage bill is now among the highest of all emerging markets, relative to gross domestic product (GDP).
- **Reform progress and an International Monetary Fund (IMF)-supported programme have been delayed by the ongoing political crisis.** Technical discussions with the IMF on the authorities' draft reform programme started in May 2021, but were put on hold due to political instability and a lack of societal consensus on reforms among various stakeholders.

## Key priorities for 2022

- **An agreed economic reform programme and recovery plan is necessary to help the economy rebound more quickly from the impact of the Covid-19 crisis.** To advance reform progress, institutions need to be stabilised and confidence among international donors and institutions restored. Innovative financing mechanisms are essential if companies affected by the pandemic are to be restructured.
- **Fiscal consolidation should be prioritised.** The government needs to cut its public-sector wage bill, reduce transfers to state-owned enterprises (SOEs) and enhance their governance, and replace subsidies with direct support for the needy, to ensure adequate and targeted social protection. Public debt needs to be put on a sustainable, declining path.
- **A deal with the IMF is needed to stabilise the economy and unlock other sources of external financing for Tunisia's needs.** In addition to fiscal consolidation, the government will need to implement labour-market reforms to create high-value skilled jobs, to modernise and liberalise the banking sector, and to advance reforms to the business environment to promote competition and facilitate access to markets.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 2.2 | 2.5 | 1.5 | -9.3 | 2.5 |
| Inflation (average) | 5.3 | 7.3 | 6.7 | 5.6 | 5.3 |
| Government balance/GDP | -6.0 | -4.5 | -3.9 | -9.8 | -8.3 |
| Current account balance/GDP | -10.3 | -11.1 | -8.4 | -6.8 | -7.3 |
| Net FDI/GDP [neg. sign = inflows] | -2.0 | -2.5 | -2.1 | -1.5 | -1.4 |
| External debt/GDP | 82.4 | 86.1 | 97.3 | 100.3 | n.a. |
| Gross reserves/GDP | 14.1 | 12.9 | 19.0 | 23.2 | n.a. |
| Credit to private sector/GDP | 80.5 | 78.9 | 74.8 | 82.1 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**Economic recovery started in the second quarter of 2021.** Real GDP increased 15.4 per cent year-on-year in the second quarter, reflecting base effects, after a drop of 2.1 per cent year-on-year in the first quarter, the fifth consecutive quarter of contraction. The tourism and transport sectors continued to be affected by Covid-19 restrictions, and agriculture contracted after a record year in 2020. However, the export-driven manufacturing sector recovered. Inflation remained quite elevated by regional standards, at 5.5 per cent year-on-year in the first nine months of 2021 and a 21-month high of 6.4 per cent in July 2021, driven by a reduction in subsidies and base effects. Meanwhile, the unemployment rate rose to 17.9 per cent in the second quarter of 2021 and was higher than average for women (23.6 per cent) and youth (41.7 per cent).

**The fiscal deficit widened and debt increased.** In 2020 the fiscal deficit widened to 9.8 per cent of GDP on the back of a decline in revenues, mainly tax and an increase in interest payments, as well as the public-sector wage bill, which, at 17.3 per cent of GDP, is among the highest in emerging markets. Meanwhile, public debt increased to 83.5 per cent of GDP in 2020, of which two-thirds is denominated in foreign currency.

**The current account deficit narrowed in 2020, but reserves are diminishing.** The change in the current account from 8.4 per cent of GDP in 2019 to 6.8 per cent in 2020 came thanks to the substantial narrowing of the foreign trade deficit, reflecting a sharper drop in imports, notably energy products, than in exports. Meanwhile, tourist arrivals declined by 19.4 per cent year-on-year in the first half of 2021. Moreover, reserves decreased to US$ 8 billion, covering just over four months of imports. Furthermore, in February and October Moody's downgraded Tunisia's credit rating to B3, then to Caa1, maintaining the negative outlook, while in July Fitch downgraded it to 'B-' with a negative outlook. Both agencies cited heightened fiscal and external liquidity risks.

**A weak recovery is expected in the short term.** GDP is projected to grow by just 2.5 per cent in 2021, before picking up to 3.3 per cent in 2022. The recovery will depend on the pace of vaccination allowing the reopening of the economy, including for the tourism sector, and on the pace of implementing reforms, currently held back by the lack of political consensus and limited ambition to overhaul public administration and SOEs. Fiscal tightening is expected to hold back a stronger recovery, as will lingering effects of the Covid-19 pandemic and the slow recovery in tourism worldwide.

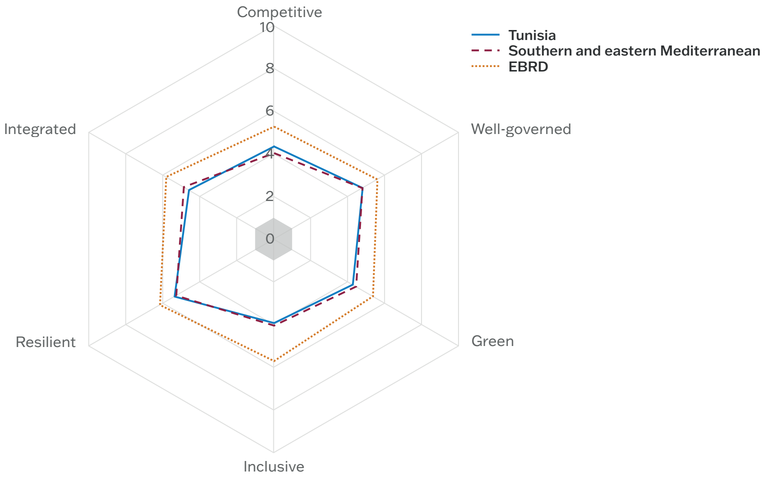
## Policy response to Covid-19

**The authorities extended some of the policy response measures announced in 2020 into 2021.** The 2021 budget law included additional measures to support the most affected enterprises and sectors, especially the tourism sector. These measures included an extension of the state guarantee scheme to the end of 2021, the exemption from corporate income tax payments during 2021 and support for the temporarily unemployed and most vulnerable. Moreover, in January 2021 the Banque Centrale de Tunisie (BCT) revised a methodology to calculate general provisions to address potential financial stability concerns that may arise from the debt repayment moratoria. It also extended the deferral of loan repayments for the tourism sector and for companies to September 2021.

**Tunisia's vaccination programme accelerated after a slow start.** Tunisia began its vaccination programme in March 2021 but progress in the first four months was slow owing to vaccine shortages, widespread vaccine hesitancy and administrative failings. However, thanks to a surge in international aid, the pace of vaccination accelerated from July and close to two-fifths of the population was fully vaccinated as of early November 2021.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**Talks with the IMF for a programme are on hold.** The president's decision in late July 2021 to suspend parliament and dismiss the prime minister added further delays to reaching an agreement with the IMF, as did the absence of societal consensus on reforms among various stakeholders. Prospects for reforms were already poor before the president's move. The fragile coalition in parliament, tensions between key political leaders and entrenched social opposition – including from the Tunisian General Labour Union (UGTT) – to budget cuts complicated efforts to advance fiscal consolidation and thus get IMF support. The fiscal situation would require the government to cut its public-sector wage bill, reduce transfers to SOEs and replace subsidies with direct support for the needy, while ensuring adequate and targeted social protection.

**The government and unions made some progress on tax and SOE reform**. In March 2021 the government and the UGTT signed an agreement to reform the subsidy system, the tax system and seven SOEs. However, the government committed not to privatise these SOEs, some of which are loss-making. Moreover, no agreement was reached on cutting the public-sector wage bill.

**Fuel prices increased under the automatic indexation mechanism.** Fuel prices, which are adjusted automatically in line with market prices, were raised in February, March and April 2021 after a series of cuts in 2020, when oil prices dropped substantially. The hike in April, by 5 per cent on average, signalled the lifting of the cap on monthly adjustments of 2 per cent. This would have positive effects on the government's fuel subsidy bill, which had already decreased by 70 per cent in the first four months of 2021.

CONTINUES

**The economic recovery and regularisation of the law relating to foreign exchange offences has been adopted.** The decision by parliament in July 2021 entails about 20 measures, including revaluing company fixed assets for tax purposes, deducting reinvested profits and income from the capital of fully exporting companies, a lower tax burden on housing built by property developers and regularising customs offences. It also allows people, for the first time, to open foreign currency accounts, permits companies and individuals to agree a financial settlement for foreign exchange violations, and enables firms to easily access loans and draw money from the black market. The law has yet to be promulgated by the president to enter into force. However, the BCT has advised the president against doing so, stating that it includes measures that are likely to hamper the sound conduct of monetary policy and affect Tunisia's international commitments and ability to continue to mobilise necessary external funds.

**The government's objective to increase the share of renewable energy in the electricity mix to 30 per cent by 2030 is advancing.** During 2021 the government launched tenders to develop and build 16 solar power plants with a total capacity of 70 MW. Selected projects will sell electricity to Tunisia's state-owned utility company STEG under a long-term power purchase agreement. Tunisia aims to install 3.8 GW of renewables before 2030. However, private-sector involvement in other sectors traditionally dominated by the public sector has been slow, with only limited progress on the public-private partnership (PPP) agenda.

# TURKEY

## Highlights

- **The economy made a robust recovery from the impact of the pandemic.** An unprecedented credit stimulus and monetary loosening helped Turkey avoid a GDP contraction in 2020, although at some cost to macroeconomic stability. Thanks to progress in vaccination and the lifting of lockdown measures since June 2021, economic activity has picked up despite a tight monetary policy and the phasing out of most stimulus measures.
- **Concerns about monetary policy effectiveness have continued as the president twice replaced the governor of the central bank.** Despite significant policy tightening and the simplification of the monetary policy framework, the removal of two governors has further undermined confidence in the central bank's ability to fight inflation, which has remained persistently in the high teens throughout 2021.
- **The authorities have renewed their commitment to certain reforms.** While managing the impact of the pandemic took precedence over reform implementation in the past year, in March 2021 the government published the Economic Reform Package, a high-level plan focusing on improvements in public finances, the financial sector, governance and employment.

## Key priorities for 2022

- **Containing inflation needs to remain a priority as economic activity revives.** Inflation is facing pressures from commodity prices, rising domestic demand following the lifting of lockdowns and pass-through from currency depreciation. The authorities need to maintain tight monetary policy and avoid premature loosening.
- **Implementation of the announced Economic Reform Package needs to be prioritised.** Some of the measures in the plan, including increasing public procurement transparency, securitisation of banks' problem assets and improving the legal framework for public-private partnerships, would address long-standing problems if implemented.
- **Efforts to build back better need to focus on addressing inclusion challenges exacerbated by the pandemic.** The authorities need to prioritise efforts to improve the employment and entrepreneurship prospects of women, youth and refugees, who have experienced significant economic challenges due to the pandemic.

Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 7.5 | 3.0 | 0.9 | 1.8 | 9.0 |
| Inflation (average) | 11.1 | 16.3 | 15.2 | 12.3 | 17.4 |
| Government balance/GDP | -1.6 | -1.9 | -3.0 | -3.5 | -4.9 |
| Current account balance/GDP | -4.8 | -2.8 | 0.9 | -5.2 | -2.4 |
| Net FDI/GDP [neg. sign = inflows] | -1.0 | -1.2 | -0.8 | -0.6 | -0.8 |
| External debt/GDP | 52.6 | 53.6 | 54.8 | 60.4 | n.a. |
| Gross reserves/GDP | 12.5 | 12.0 | 13.9 | 13.0 | n.a. |
| Credit to private sector/GDP | 70.3 | 67.4 | 65.4 | 75.1 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The Turkish economy was one of the few worldwide to grow in 2020, although this came at the expense of macroeconomic instability.** While the size of the on-budget fiscal stimulus was small, at 3.3 per cent of GDP, the authorities undertook significant off-budgetary measures, including monetary expansion and a major credit stimulus. Supporting a rebound in consumption and investment, the stimulus also led to an exacerbation of external imbalances and currency depreciation, giving rise to inflation, which reached 19.6 per cent in September 2021. Robust activity continued into 2021, with growth of over 14 per cent year-on-year recorded in the first half of the year.

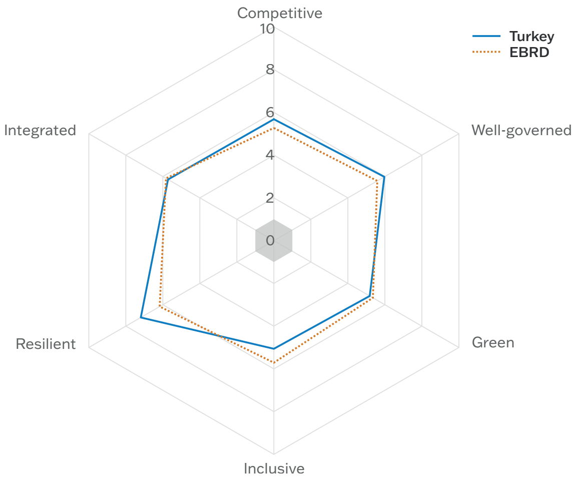
**The lifting of restrictions has supported economic activity in 2021, despite tight monetary policy.** Following the end of the credit stimulus in late 2020 and a cumulative policy rate hike of 10.75 basis points, pandemic support shifted to fiscal policy, including income support measures, such as the short-time work allowance. While some of these measures were phased out following the gradual reopening of the economy in June 2021, this has coincided with a rebound in tourism and services.

**External demand and base effects will drive growth in 2021.** Driven by the recovery in tourism, the declining real exchange rate and a favourable shift in global value chains, net exports will make a strong contribution to growth over the next year, enhanced further in growth terms by base effects. The persistent inflation needs to be contained in order for the central bank to rebuild its credibility, but there is a risk of the authorities relaxing policy prematurely due to the approaching electoral cycle in 2023. Subject to pandemic-related and policy risks, the economy is expected to grow 9.0 per cent in 2021, followed by 3.5 per cent in 2022. Downside risks include further waves of the pandemic and associated containment measures, and macroeconomic instabilities linked to external imbalances.

## Policy response to Covid-19

**The authorities' stimulus response to the pandemic has shifted from monetary policy and credit towards fiscal measures in 2021 and is being gradually withdrawn.** Tight monetary and macro-prudential policies adopted to contain inflation since late-2020 have left fiscal policy as the main tool to support the economy. However, most of these measures, which included income support to workers on unpaid leave due to a temporary layoff ban, short-time work allowances and grants to artisans and small businesses, are being phased out as the pandemic-related restrictions started being lifted in June 2021.

### Assessment of transition qualities (1-10)




CONTINUES

## Structural reform developments

**The government unveiled a high-level reform plan focusing on the public, employment and financial sectors.** The Economic Reform Package announced in March 2021 includes steps to improve fiscal and public sector governance, such as the reform of state-owned enterprises, a framework law for public-private partnerships and the simplification of public procurement processes. Regarding the financial sector, the package contains actions to improve the capacity of asset management companies, facilitate the securitisation and sale of problem loans and promote the issuance of green bonds. With the aim of promoting the development of domestic capital markets, the package also contains plans to lower the barriers for initial public offerings and to establish a bond guarantee fund for private sector debt securities.

**The government has released the National EU Green Deal Action Plan.** Published in July 2021, the plan contains 32 actions in nine areas, including carbon border adjustment and pricing, circular economy, green finance (including green bonds) and Islamic finance, clean energy, sustainable agriculture and transportation. The plan also contains a clause on reassessing Turkey's stance on the Paris Agreement; this was subsequently ratified in October 2021. The action plan is in line with the government's existing green strategy documents in areas such as energy efficiency, the circular economy and decarbonisation of industry, with its implementation monitored by an official working group. The authorities expect the implementation of the action plan to support Turkey's efforts to deepen the EU-Turkey Customs Union agreement, currently under discussion by both parties.

**The authorities took steps to promote energy efficiency and the circular economy.** A mandatory deposit scheme for drinks bottles is slated to be rolled out in 2022, while the Environment Agency was established in December 2020 to manage the scheme and promote the circular economy. A directive for energy performance contracting in public buildings was adopted, which will facilitate the financing of energy saving investments by funding them through the cost savings they generate.

**The Capital Markets Board has introduced new regulations enabling the financing of public sector projects through capital markets.** The regulations, which entered into force in July 2021, allow for the establishment of funds linked to one or more public projects in areas such as infrastructure, health and energy. These funds will be able to issue securities linked to the income and debt of these projects, which is expected to improve their financing prospects.

**The government is increasing financial support for apprenticeships for youth in vocational education.** The wages of students studying at vocational training centres will be covered by the government, meaning that the cost of labour will also be eliminated for employers.

**The scope of e-government has increased.** According to the Online Service Index computed by the United Nations Department of Economic and Social Affairs (UNDESA), a composite indicator on the use of information and communications technology (ICT) by governments and the quality of the online services provided, with values between 0 and 1, Turkey scores 0.86, significantly above the EBRD regional average of 0.68. In the past year, 600 new services have been added and use of these services has increased substantially.

# TURKMENISTAN

## Highlights

- **Turkmenistan's economy continues to grow rapidly in 2021.** Real gross domestic product (GDP) growth was reported at 6.2 per cent year-on-year in the first three-quarters of 2021 after decelerating to 5.9 per cent year-on-year in 2020. Exports (primarily gas exports to China) rose by 36 per cent year-on-year in the first half of 2021 but are still below 2020 levels.
- **The digitalisation agenda is promoted through a government programme.** Signed in August 2021, a new government programme seeks to promote the development of information technology products by the country's small and medium-sized enterprises (SMEs). The programme includes such instruments as subsidised loans to SMEs as well as measures to support the demand for domestically produced software products and equipment.
- **Talks are under way to advance the Turkmenistan-Afghanistan-Pakistan-India (TAPI) gas pipeline project.** Progress on this important project will depend on, among other things, discussions with the new regime in Afghanistan.

## Key priorities for 2022

- **The government needs to deal with the healthcare implications of Covid-19.** In previous years, Turkmenistan made heavy investment in upgrading equipment and hard infrastructure. The focus should shift to strengthening the qualifications and skills of medical staff.
- **Currency convertibility issues should be resolved and the exchange rate adjusted to reflect macroeconomic fundamentals.** Using access to foreign currency at an undervalued exchange rate as a support mechanism for selected entrepreneurs, as the government has been doing, is clearly inferior to market-based selection of the fittest firms. 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 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 to make investment, production and financial management decisions, while also helping the government take timely policy actions grounded in rigorous statistical evidence.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 6.5 | 6.2 | 6.3 | 5.9 | 6.3 |
| Inflation (average) | 8.0 | 13.3 | 5.1 | 7.6 | 12.5 |
| Government balance/GDP | -2.8 | -0.2 | -0.3 | -0.2 | -0.3 |
| Current account balance/GDP | -10.4 | 5.5 | 5.1 | -2.6 | 1.0 |
| Net FDI/GDP [neg. sign = inflows] | -5.5 | -4.9 | -4.8 | -2.5 | -3.5 |
| External debt/GDP | 26.9 | 27.7 | 29.2 | 28.5 | 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. |

CONTINUES

## Covid-19: macroeconomic implications

**According to official data, the economy continues to grow at pace in 2021.** Real GDP growth was reported at 6.2 per cent year-on-year in the first three-quarters of 2021. In 2020 the economy grew by 5.9 per cent. Such strong growth in 2020 is hard to reconcile with the wider economic context and global disruption to trade and mobility. The IMF estimates that real GDP in 2020 contracted by 3.4 per cent while average annual inflation accelerated from 5.1 per cent in 2019 to 7.6 per cent.

**External accounts came under pressure.** The current account balance turned from a surplus of 1.3 per cent of GDP in 2019 to a deficit of 0.5 per cent in 2020. Exports, a major source of growth, plummeted by 30.7 per cent in 2020, while imports rose by 1.6 per cent, according to IMF data. Exports rose by 18 per cent year-on-year in the first five months of 2021 but are still below 2019 levels. The official exchange rate peg is maintained at TMM 3.5 per US dollar. The parallel market exchange rate depreciated from TMM 18 per US dollar in December 2019 to TMM 40 in April 2021 but has recovered since then to TMM 20-25 per US dollar as of October 2021.

**State finances were balanced in 2020.** The government budget turned into a marginal surplus (0.1 per cent of GDP) in 2020 from a deficit of 0.4 per cent of GDP in 2019. However, the 2021 budget envisages total spending being 6 per cent below the 2020 budget, indicating strained public finances. More than 70 per cent of expenditures will be directed at social sectors, such as education and healthcare. Wages and pensions will increase by 10 per cent in 2021.

**The bulk of external debt was paid off.** The government reported that in June 2021 it paid off the debt it owed China for the construction of a gas pipeline and associated projects, and that henceforth all gas revenues would accrue to the state budget. In August 2021 Fitch assigned Turkmenistan a B+ rating with a stable outlook. The rating balances healthy fiscal and external positions with concerns over the difficult business environment, weak institutional capacity and state-centric economic policies.

**Economic growth is expected to moderate in the short term.** Real GDP growth is projected at 6.3 per cent in 2021 due to substantial export growth. The growth rate of the economy is forecast to slow to 5.5 per cent in 2022, reflecting structural challenges in many areas, including the poor quality of the business environment, limited financial sector depth and restrictions on private sector operations in the country. Major uncertainty remains around these forecasts given the absence of reliable economic data and the global situation with the Covid-19 pandemic.

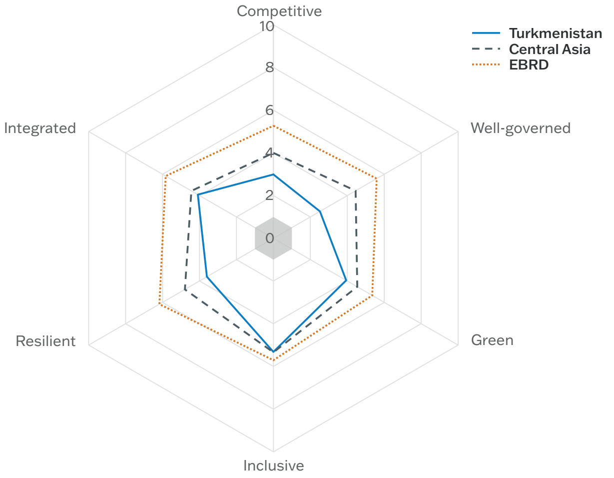
## Policy response to Covid-19

**There are no officially registered Covid-19 cases in the country as of August 2021 but several lockdown measures are in place.** Due to a spike in Covid-19 cases in neighbouring countries, the authorities in Turkmenistan enacted nationwide restrictions in June 2021. There are limitations on domestic travel (roads, railways, airports). Land borders with Afghanistan, Iran, Kazakhstan and Uzbekistan are closed, and international commercial flights are suspended. All major shopping centres, swimming pools and gymnasiums are closed in Ashgabat as of August 2021. Gatherings, including family celebrations, have been banned across the country. Social distancing of at least two metres is to be maintained and face masks are compulsory in public areas. Vaccination is also compulsory for the population above the age of 18.

CONTINUES

**The World Bank approved US$ 20 million for the Turkmenistan Covid-19 Response Project.** The loan, approved in July 2021, will support priority activities under the National Pandemic Preparedness and Response Plan. The country's Covid-19 pandemic preparedness activities cover a range of possible transmission scenarios. An Emergency Anti-Epidemic Commission Operational Headquarters has been established to coordinate the national Covid-19 pandemic preparedness and response effort.

Assessment of transition qualities (1-10)




## Structural reform developments

**Financial support will be provided to SMEs to help their digitalisation efforts.** The relevant resolution was signed by the president in August 2021 as part of the Concept for the Development of the Digital Economy in Turkmenistan for 2019-25. Loans will be issued to SMEs to help them develop hardware and software products. The loans will be for five years at a 2 per cent interest rate with a grace period of two years. In addition, financing will be provided for the purchase and commissioning of domestic software products and equipment for a period of three years at a 2 per cent interest rate with a grace period of six months.

**Talks are under way on advancing the TAPI gas pipeline project.** Turkmenistan failed to reach financial close for the project in 2020 but aims to do so in 2021. This pushes the deadline for the project to become operational from 2021 to 2023. The pipeline's design capacity is planned to be 33 billion cubic metres of gas annually, helping Turkmenistan to reduce dependence on China as the country's main export market. Further progress will depend on ongoing discussions with the new regime in Afghanistan, which is yet to form a unified position towards the project.

# UKRAINE

## Highlights

- **The economy started to recover in the second quarter of 2021.** The prolonged lockdown caused economic growth to decline by 2.2 per cent year-on-year in the first quarter of 2021 but the gradual lifting of containment measures and high commodity prices supported a growth of 5.7 per cent year-on-year in the second quarter.
- **The authorities renewed Covid-19 crisis response measures throughout the first half of 2021.** In December 2020 parliament adopted a new set of fiscal measures to support the economy during the prolonged Covid-19 pandemic. The central bank has extended some prudential measures in 2021 and kept crisis liquidity instruments until the middle of the year.
- **After a long delay, parliament approved a series of key reform bills.** These include reinstating criminal liability for inaccurate asset declarations of public officials, strengthening the independence and regulatory power of the central bank and taking steps to reform the judiciary.

## Key priorities for 2022

- **It is important to preserve reform achievements in the area of macro-financial stability and intensify reform efforts in the judiciary, anti-corruption and corporate governance.** An independent and professional central bank proved to be a great asset during the Covid-19 economic shock. Building an independent and professional judicial system, efficient anti-corruption bodies and good corporate governance in state-owned enterprises (SOEs) will lift the growth potential of the economy.
- **Post-Covid-19 recovery policies should focus on climate change and digitalisation.** A green-tilted recovery is necessary to reduce dependence on fossil fuels and to maintain the country's competitiveness on external markets, which increasingly take climate change into account. A systemic upgrade of digital infrastructure and skills, targeting all groups of society, could also boost competitiveness.
- **Preparations should be made to benefit from the expected reshuffle of global value chains.** As one of the largest economies in the European Union (EU) neighbourhood, Ukraine could play a significant role in the expected nearshoring efforts of companies in the EU.

Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 2.5 | 3.4 | 3.2 | -4.0 | 3.5 |
| Inflation (average) | 14.4 | 10.9 | 7.9 | 2.7 | 9.5 |
| Government balance/GDP | -2.2 | -2.1 | -2.2 | -5.8 | -4.5 |
| Current account balance/GDP | -3.1 | -4.9 | -2.7 | 3.4 | -0.7 |
| Net FDI/GDP [neg. sign = inflows] | -3.3 | -3.4 | -3.4 | 0.1 | -1.7 |
| External debt/GDP | 102.9 | 87.6 | 79.1 | 80.8 | n.a. |
| Gross reserves/GDP | 16.8 | 15.9 | 16.4 | 18.7 | n.a. |
| Credit to private sector/GDP | 34.1 | 30.1 | 24.4 | 22.6 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**After a contraction in 2020 and the first quarter of 2021, the economy has returned to growth in the second quarter of 2021.** In 2020 gross domestic product (GDP) declined by 4.0 per cent as a result of reduced foreign demand and Covid-19 pandemic containment measures. Private consumption remained slightly in positive growth territory, driven by a strong demand for goods, but investments in fixed assets fell by almost a quarter despite strong government stimulus in the roads sector. Exports and imports declined by 5.6 and 9.5 per cent respectively. A prolonged lockdown in early 2021 caused the economy to shrink by 2.2 per cent year-on-year in the first quarter of 2021, before returning to a growth of 5.7 per cent year-on-year in the second quarter of 2021, supported by higher commodity prices.

**The Covid-19 pandemic caused a reversal of previous trends in public finances and the external sector.** After several years of prudent fiscal policies, the government deficit deepened to 5.8 per cent of GDP in 2020 due to increased spending to finance the Covid-19 response. On top of that, the fall of output and currency depreciation led to an increase in public debt from 50.3 per cent in 2019 to 60.8 per cent in 2020. The current account deficit turned into a strong surplus of 3.4 per cent of GDP in 2020, supported by low prices of imported hydrocarbons, reduced spending on travel abroad and an increase in the primary income surplus. As a result, foreign reserves rose from US$ 25.3 billion in December 2019 to US$ 29.1 billion in December 2020, equal to 4.8 months of future import coverage. Reserves were boosted further in September 2021 by the new International Monetary Fund Special Drawing Rights allocation of US$ 2.7 billion, which fully compensated for the undisbursed remaining part of the Stand-By Arrangement (SBA) programme.

**Inflation is rising, prompting the central bank to raise the policy rate.** Driven by rising prices of utilities, food and transport, inflation accelerated in the first half of 2021 and reached 11.0 per cent in September 2021, prompting the National Bank of Ukraine (NBU) to raise the key policy rate four consecutive times since the beginning of the year to 8.5 per cent in September 2021.

**A moderate recovery in 2021 is likely amid rising global commodity prices and erratic reform progress.** The growth recovery which took hold in the second quarter of 2021 is expected to gain further traction in the second half of the year. We expect an economic growth of 3.5 per cent both in 2021 and 2022. Major downside risks remain, however, including the slow speed of vaccinations, the possibility of new variants emerging, and the slow progress of reforms.

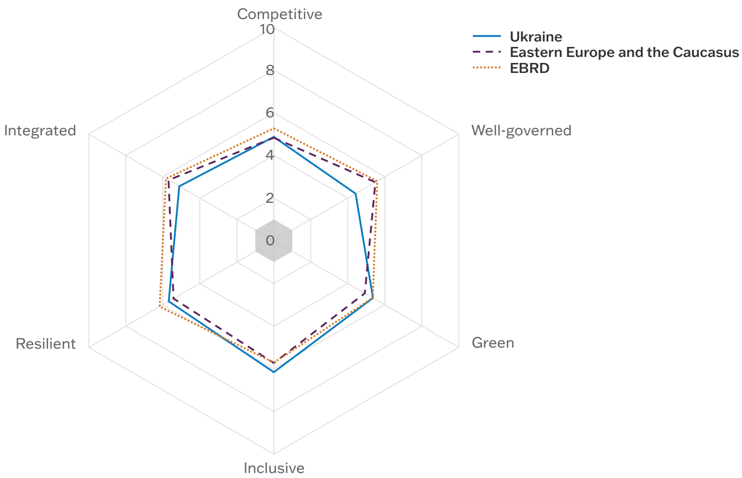
## Policy response to Covid-19

**In December 2020 parliament adopted a new set of fiscal measures to support the economy during the prolonged Covid-19 pandemic.** To help businesses during the strict lockdown in January 2021, a one-off payment of UAH 8,000 (US$ 280) was made to more than 400,000 employees and sole entrepreneurs who lost their income. Those entrepreneurs most affected by the Covid-19 pandemic were exempted from paying income tax and social security distribution tax in the period December 2020 to May 2021, and tax debts not exceeding UAH 3,060 (US$ 110) were written off. The subsidised loans programme, which was expanded at the beginning of the Covid-19 crisis, continued in 2021. In addition, parliament approved state guarantees amounting to US$ 180 million for business loans granted by banks.

**The central bank has extended some prudential measures in 2021 and kept crisis liquidity instruments until the middle of the year.** Banks were recommended to restructure loans of borrowers facing financial difficulties from the Covid-19 pandemic and refrain from credit risk revision until the end of April 2021. As the economy returned to a steady growth and financial markets stabilised, the NBU decided in June 2021 to gradually phase out anti-crisis monetary measures such as long-term refinancing and interest rate swaps.

CONTINUES

**Assessment of transition qualities (1-10)**




## Structural reform developments

**Insufficient progress on reforms led to a pause in further disbursements of the IMF programme.** To help sustain the external finances during the Covid-19 crisis, the authorities entered an 18-month IMF SBA of US$ 5.0 billion in June 2020. The lack of meaningful progress in the fight against corruption, in particular related to several rulings of the Constitutional Court undoing previous reform efforts, impeded the completion of several programme reviews. Additional concerns arose from the decision of the Cabinet of Ministers to temporarily reintroduce a regulated price for natural gas for households in January 2021 until the end of the heating season, which went against Ukraine's commitment to the IMF to apply a market-based pricing scheme.

**Concerns regarding corporate governance standards and their application resurfaced.** In April 2021 the Cabinet of Ministers dismissed the supervisory board of Naftogaz, the country's largest national oil and gas company, and subsequently dismissed the management board and appointed a new one. Immediately afterwards, the government reappointed the same supervisory board for another six months. This bypassing of the supervisory board to appoint a new Chief Executive Officer undermines the corporate governance principles of SOEs.

**After initial setbacks, reform momentum gathered pace at the end of June 2021.** A new bill, signed into law in July 2021, fully introduced criminal liability for civil servants for errors in asset declarations, significantly increasing the punishment for false or omitted reporting. The independence of the central bank and its regulatory powers regarding corporate governance and licensing in commercial banks were enhanced. Parliament approved in first reading the law to restructure the debt of the Deposit Guarantee Fund and for Oschadbank to join the Fund. The law also improves procedures for liquidating failed banks.

**Parliament approved key judiciary reform bills.** In July 2021 parliament approved a bill that relaunches an independent panel, the High Qualification Commission of Judges, to appoint judges and ensure they qualify for the job. The bill also includes a provision that gives international experts a decisive voice in selecting the nominees. Appointments of members of the High Council of Justice (HCJ), the key judicial governance body responsible for ensuring judicial independence and accountability of judges, are regulated by another regulation put in place in July 2021. The commission to select members of the HCJ, the Ethics Council, will include six members, of which Ukraine's Western partners will appoint three. The Ethics Council will also perform an integrity check of existing members of the HCJ.

CONTINUES

**Efforts to improve the investment climate are ongoing.** In March 2021 the president signed a law establishing the Bureau of Economic Security, which will take over the functions of investigating economic crimes from the Security Service of Ukraine, State Fiscal Service and State Bureau of Investigations. Efforts to make Ukraine more attractive for large investors have been increased in the past year. Investors can get state support of up to 30 per cent of their investment if it exceeds €20 million. State support can come in the form of tax benefits and special conditions for the rent of land or infrastructure construction around the project.

**The authorities made significant pledges to contribute to the global efforts to fight climate change.** Ukraine submitted its updated nationally determined contributions in July 2021. By 2030 greenhouse gas (GHG) emissions should not exceed 35 per cent of 1990 levels, which is a significant improvement on the 60 per cent target envisaged in 2016. In March 2021 the government approved the National Economic Strategy until 2030, through which climate neutrality is to be achieved no later than 2060. Ukraine also plans to set up a national GHG emissions trading system and to introduce carbon taxes in 2025. As a first step, in January 2021 the law implementing a system to monitor, report and verify GHG emissions came into force.

**Digital services are expanding.** The number of government services available via the "Diia" app is expanding. In March 2021 Ukraine gave e-passports the same legal status for domestic use as traditional paper documents.

# UZBEKISTAN

## Highlights

- **Uzbekistan's economy is recovering rapidly.** Real gross domestic product (GDP) increased by 6.9 per cent year-on-year in the first three-quarters of 2021, driven by services, manufacturing and mining. Investment activity has also started to recover, with fixed investment up by 5.0 per cent year-on-year in the first three-quarters of 2021.
- **State-owned enterprise (SOE) reform is advancing.** A new SOE strategy for 2021-25 seeks to reduce the state's footprint in the industrial, mining and manufacturing sectors, and ensure that SOEs are governed and managed in line with market principles.
- **Uzbekistan has committed to reaching carbon neutrality in power generation by 2050.** The authorities aim to develop power sources with low-carbon emissions, including solar, hydro, wind and nuclear, and modernise the electricity grid. Gas-fired power generation will be used in the transition to carbon neutrality and plans are under way for the construction of a comprehensive hydrogen energy infrastructure.

## Key priorities for 2022

- **The immediate priority is to continue supporting people's livelihoods.** Besides economic measures for the most vulnerable, relevant infrastructure should be put in place to ensure that the healthcare system has sufficient capacity for the sick during the Covid-19 pandemic.
- **The authorities should step up efforts to accelerate digital transformation.** Investment in broadband infrastructure, digital skills and the information technology ecosystem is essential to enable remote working and learning for all groups of the population.
- **The government should adjust reform priorities in light of the post-Covid-19 situation.** 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 to include restructurings in case of a slower-than-expected economic recovery or adverse market momentum.

### Main macroeconomic indicators %

| | 2017 | 2018 | 2019 | 2020 | 2021 proj. |
|---|---|---|---|---|---|
| GDP growth | 4.5 | 5.4 | 5.6 | 1.6 | 6.8 |
| Inflation (average) | 13.9 | 17.5 | 14.5 | 12.9 | 11.0 |
| Government balance/GDP | 1.3 | 1.7 | -0.3 | -3.1 | 3.0 |
| Current account balance/GDP | 2.5 | -7.1 | -5.6 | -5.0 | -6.5 |
| Net FDI/GDP [neg. sign = inflows] | -3.0 | -1.2 | -4.0 | -3.0 | -4.5 |
| External debt/GDP | 26.3 | 33.3 | 43.4 | 57.1 | n.a. |
| Gross reserves/GDP | 47.5 | 53.7 | 50.3 | 60.5 | n.a. |
| Credit to private sector/GDP | 16.6 | 23.8 | 30.0 | 37.0 | n.a. |

CONTINUES

## Covid-19: macroeconomic implications

**The economy is recovering rapidly.** Real GDP increased by 6.9 per cent year-on-year in the first three-quarters of 2021 (compared with 0.4 per cent growth a year ago). While growth was recorded across the board, the expansion in services, manufacturing and mining was particularly strong (7.6, 7.4 and 14.2 per cent year-on-year, respectively). On the demand side, a surge in remittances from Russia (up 35 per cent year-on-year in US dollar terms in the first eight months of 2021) stimulated private consumption and growth in retail trade (up 10.9 per cent year-on-year in the first three-quarters of 2021). Investment activity has also started recovering, with fixed investment up by 5.0 per cent year-on-year in January-September 2021. Exports declined by 20 per cent year-on-year in the first eight months of 2021, as gold exports were drastically reduced (down 24 per cent year-on-year). On the positive side, exports of gas, textiles and non-ferrous metals rose by 43, 60 and 72 per cent year-on-year, respectively.

**Inflationary pressures subsided.** Inflation has slowed (10.8 per cent in September 2021 versus 14.2 per cent a year earlier) thanks to currency stabilisation and conservative monetary policies implemented by the central bank. The policy rate was reduced from 16 per cent in early 2020 to 14 per cent in September 2020 and maintained at that level since then. After depreciating by 12 per cent on average in 2020, the exchange rate has been stable in 2021. Credit growth picked up to 22 per cent in June 2021 in real terms (both in corporate and retail segments) from 12 per cent a year ago, reflecting the reinvigoration of economic activity. At the same time, non-performing loans increased to 5.5 per cent in June 2021, versus 2.1 per cent at the end of 2020.

**Public debt has risen significantly, due to increased external borrowing.** The level of debt rose from 29.7 per cent of GDP in 2019 to 38.9 per cent of GDP in 2020. Significant external financing came from multilateral and bilateral creditors (around US$ 1.7 billion) and international sovereign bond placements of US$ 750 million in November 2020. As a result, external public debt surged from 15.7 per cent of GDP in 2019 to 21.1 per cent in 2020, prompting the government to set a cap on external public debt at 60 per cent of GDP. The overall fiscal deficit reached 4.3 per cent of GDP in 2020, up from 3.8 per cent in 2019. High gold prices had a positive impact on fiscal revenues and helped keep the rise of the deficit in check. Fiscal measures will continue to support the economy in 2021, with the consolidated fiscal deficit targeted at 5.5 per cent of GDP.

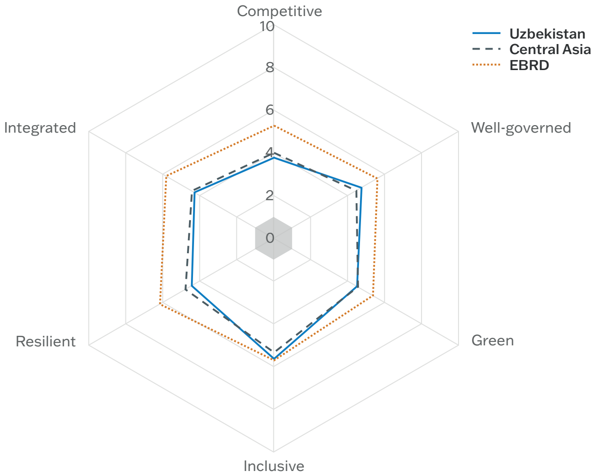
**The economy is projected to grow at a high rate in the short term.** GDP is forecast to expand by 6.8 per cent in 2021 and 6.0 per cent in 2022. A remittance-led surge in private consumption along with increased investment in infrastructure will be the key drivers of GDP growth. However, the forecast is subject to a high degree of uncertainty related to the path of the Covid-19 pandemic, potential resumption of international tourism, regional tensions and the situation in Afghanistan.

## Policy response to Covid-19

**Policies to facilitate post-Covid-19 recovery have been maintained through 2021.** The framework for the Covid-19 response is the government's resolution "On measures to restore economic growth in 2020-21 and continue systemic structural reforms", which was adopted in September 2020. One of the goals is to support key sectors of the economy and maintain annual economic growth at around 5.0-5.5 per cent from 2021. Key measures include reforming the banking system and the agricultural sector, facilitating investment, improving the competitive environment and putting in place effective industrial policies, as well as supporting exporting enterprises. The issue of rising debt is also addressed via measures to optimise public investment expenditures, ensure more efficient spending of externally borrowed funds and restrict the issue of new external debt. A sum of UZS 3 trillion (US$ 280 million) is earmarked in the 2021 state budget to mitigate the economic impacts of the Covid-19 pandemic. The government plans to support households and businesses via interest rate compensation, a revolving export credit facility, subsidies for the unemployed and a range of other measures.

CONTINUES

Assessment of transition qualities (1-10)




## Structural reform developments

**The digitalisation agenda has been laid out in the "Digital Uzbekistan-2030" strategy.** Approved by a presidential decree in October 2020, the plan is to connect every settlement to the internet by the end of 2022 and upgrade digital skills, among other goals. More than 280 projects will facilitate the digital transformation of regions and sectors, aiming to double the share of digital services in GDP in the next two years. As part of the strategy, three new data centres will be launched, in Tashkent, Bukhara and Kokand. About US$ 2.5 billion of investment will be attracted for the development of digital infrastructure in 2021-22. The strategy also envisages a gradual digitalisation of the banking sector, allowing for wider access to remote banking services by the population at large.

**SOE reform is advancing.** In March 2021 the government adopted the Strategy for the Management and Reform of Enterprises with State Participation for 2021-25. The strategy seeks to reduce the state's footprint in the industrial, mining and manufacturing sectors and ensure that SOEs are governed and managed in line with market principles. According to the strategy, new laws on privatisation and state property management will be adopted at the end of 2021. Key targets under the strategy are a 75 per cent reduction in the number of enterprises with state participation, initial public offerings (IPOs) and secondary placements of shares of at least 20 SOEs, and bringing the share of independent members on the supervisory boards of SOEs to 30 per cent by 2025.

**Uzbekistan has made a commitment to reach carbon neutrality in power generation by 2050.** The new commitment was announced in February 2021. The authorities aim to develop power sources with low-carbon emissions, including solar, hydro, wind and nuclear, as well as modernise the electricity grid. Gas-fired power generation will be used in the transition to carbon neutrality. As part of this commitment, a hydrogen energy strategy was adopted in April 2021, envisaging the construction of a comprehensive hydrogen energy infrastructure, driving the country's energy efficiency and security. To build the necessary professional expertise, a National Research Institute for Renewable Energy Sources has been established under the Ministry of Energy. The institute is to run a laboratory to test and certify renewable and hydrogen energy technologies.

CONTINUES

**Capital markets are being reformed.** To accelerate the government's goal to reform the capital market by 2023, a presidential decree "On measures for the further development of the capital market" was signed in April 2021. The decree abolishes the Capital Market Development Agency and transfers its functions to the Ministry of Finance. The government is planning to pass a new capital markets law by the end of 2021. This is expected to improve the efficiency of conducting IPOs and security payment orders, designate the functions of underwriters, enhance accounting and listing requirements, introduce sukuk (Islamic) bonds and other types of instruments (exchange-traded funds, futures and so on), and permit foreigners to invest in government bonds. Starting from 1 January 2023 Uzbek companies will need to place their shares first on the domestic stock exchange and only then on foreign stock markets.

**Uzbekistan has made major progress in eliminating child labour and forced labour in the cotton industry.** The International Labour Organization reported that in 2020 systematic child labour was no longer used during the cotton harvest in Uzbekistan. Reforms are being implemented step-by-step and continue to have a significant positive impact. However, there are still challenges with uneven implementation in certain provinces and districts. The nationwide share of forced pickers dropped by 33 per cent in 2020. The vast majority of pickers participated in the harvest voluntarily but about 4 per cent were subject to direct or perceived forms of coercion. Some provinces and districts had very few or no forced labour cases in 2020.