Albania

Highlights

- **Economic growth is moderating.** Following a sharp rise in 2022, fuelled by a record tourist season, growth slowed in the first half of 2023 as domestic demand eased as a result of elevated inflation.
- **The legal environment has become more conducive to the development of renewables.** A new law, in force since April 2023, which aligns legislation with that of the European Union (EU), sets out rules on financial support for renewable energy producers and the use of renewable energy in heating, cooling and transport. It also gives market access to "prosumers" (entities producing electricity mainly for self-consumption).
- **Public-sector wages are being reformed.** New laws have given the government more power to determine salaries in the public sector, authorised salary increases for judges and prosecutors, and introduced a new salary-increase scheme for the public administration.

Key priorities for 2024

- **Meaningful revenue-enhancing measures would help medium-term fiscal consolidation following public-sector wage increases.** The government should further decrease arrears, increase the tax-revenue ratio and improve compliance, including with the recently approved income-tax law.
- **Financial and exchange-rate risk should be carefully monitored.** The financial sector is liquid and stable, but vigilance should be maintained in light of the economic slowdown and tighter monetary policy. Ongoing efforts to build higher capital buffers are welcome.
- **Better-targeted fiscal support would help fiscal balances and benefit vulnerable groups.** Despite robust economic growth, the poverty rate remains stubbornly high, highlighting the need to increase the efficiency and scope of social assistance, including through a system of annual indexation of economic and disability benefits.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.1	-3.3	8.9	4.8	2.5
Inflation (average)	1.4	1.6	2.0	6.7	4.8
Government balance/GDP	-1.9	-6.7	-4.6	-3.7	-2.5
Current account balance/GDP	-7.9	-8.7	-7.7	-6.0	-6.0
Net FDI/GDP [neg. sign = inflows]	-7.5	-6.7	-6.5	-6.6	-6.8
External debt/GDP	60.0	64.2	64.2	53.9	n.a.
Gross reserves/GDP	24.4	29.6	32.7	27.3	n.a.
Credit to private sector/GDP	34.1	37.9	36.6	34.0	n.a.

Macroeconomic developments and policy response

Economic growth continues in 2023, but at a more moderate pace. Following a rise in gross domestic product (GDP) of 4.8 per cent in 2022, supported by a record tourist season, growth moderated to 2.8 per cent year on year in the first quarter of 2023 before accelerating to 3.2 per cent in the second quarter of the year. The slowdown was mainly driven by weaker domestic demand resulting from elevated inflation. Goods exports contracted on an annual basis in the first half of the year amid sluggish growth in Albania's key trading partners and sharp currency appreciation. The lek strengthened due to record levels of tourist arrivals alongside robust inflows of remittances and foreign direct investment. In line with lower domestic and external demand, agriculture and industry posted muted growth rates, while service sectors such as real estate, construction, information and communications technology (ICT) and retail trade were the fastest-growing sectors of the economy. Service exports were robust in 2022, as Albania's booming tourism sector recorded its best performance ever in terms of tourist arrivals and overnight stays. The sector is in for another strong performance this year, with the first eight months of the year showing a 27 per cent annual increase in tourist arrivals.

The government has been gradually withdrawing measures that supported the economy during and after the Covid-19 pandemic. In response to elevated inflation, the central bank raised the policy rate several times, from 0.5 per cent in March 2022 to 3.25 per cent in November 2023. Due to higher borrowing costs, credit growth has slowed markedly, but remained positive at 2 per cent year on year in August 2023. Following the implementation of two comprehensive Social Resistance Packages in 2022, aimed at shielding households and businesses from rising prices, the authorities began to reform and increase public-sector wages, and raised the minimum wage by 18 per cent in 2023. The Fuel Transparency Board, which had been setting fuel prices since March 2022, was abolished in June 2023 following a decision by the Constitutional Court. In light of significant local-currency appreciation, the authorities put in place measures to support exporters' liquidity, such as a temporary freeze on profit tax prepayments, an acceleration of value-added tax (VAT) refunds and a full refund of excise taxes on petroleum gas and certain types of oil. The government has committed to maintaining a budget surplus in 2023, one year ahead of the deadline set by the Organic Budget Law. To support the state budget and help repay an existing Eurobond that matures in 2025, Albania tapped into external markets by way of an oversubscribed five-year €600 million Eurobond in June 2023.

Growth is expected to moderate in the near term because of the unfavourable external environment. Economic growth is expected to slow to 2.5 per cent in 2023 as the growth prospects of Albania's key trading partners remain muted, persistently high inflation constrains disposable income at home and abroad, and tight global and domestic monetary policies restrict credit growth. Nonetheless, the continued strong performance of the hospitality sector tilts the risks to the upside. Growth is set to pick up in 2024 – we forecast to 3.3 per cent – in line with an expected improvement in the global outlook, bringing it closer to the economy's medium-term potential.

Assessment of transition qualities (1-10)

Structural reform developments

The Albanian Power Exchange (ALPEX) became operational with the launch of the day-ahead market. With the regulatory framework for the joint power exchange in Albania and Kosovo having been completed in 2022, the day-ahead market was launched in April 2023. The ALPEX exchange was awarded the status of a nominated electricity market operator in both countries in July, paving the way for market coupling. Starting in June 2023, responsible bodies in Albania can issue guarantees of origin for electricity, enabling trading in line with EU rules.

The authorities are tackling money laundering and terrorist financing. Since June 2022, the Albanian authorities have been addressing notable shortcomings with regard to trustees being subject to anti-money laundering/combating the financing of terrorism (AML/CFT) requirements, and have streamlined access to beneficial ownership information for competent authorities. Improved measures for regulating and supervising notaries and real-estate agents are now in place, with the licensing authority for notaries now empowered to revoke licences in case of infringement of AML/CFT legislation. Risk-based supervision of real-estate agents has also been introduced. Albania is acknowledged to have made significant progress on addressing strategic deficiencies and was removed from the so-called grey list of jurisdictions, subject to increased monitoring by the Financial Action Task Force (FATF) in October 2023.

Parliament has passed a law establishing a court of arbitration. The law, adopted in July 2023, aims to settle in-country any commercial disputes between the Albanian state and private businesses, rather than use the internationally acknowledged International Centre for Settlement of Investment Disputes (ICSID) procedures often favoured by foreign investors.

The legal framework for renewable energy has progressed. The Law on Promotion of the Use of Energy from Renewable Sources, adopted in April 2023, lays down rules on financial support for renewable energy producers and the use of renewable energy in heating, cooling and transport. It also gives market access to “prosumers”. The law further introduces a renewable energy operator, a public joint stock company that will serve as a contracting party for producers eligible for support under the law.

Public-sector wage reform has begun. The package of three laws adopted in May 2023 gives the government greater power to determine salaries in the public sector, authorises salary increases for judges and prosecutors, and introduces a new salary-increase scheme for the public administration. The laws were accompanied by an 18 per cent increase in the minimum wage and should, according to the authorities, spark a follow-on increase in wages in the private sector, with the ultimate goal of the average monthly wage reaching €900 by 2024.

Armenia

Highlights

- **Armenia's robust economic performance continues amid geopolitical and economic uncertainty.** The strong performance of the services industry, in particular, remains largely driven by the inflow of money transfers, but the first signs of a slowdown are already visible.
- **Connections with neighbours are improving slowly.** The past year has seen enhanced energy interconnections with Iran, which may yield economic benefits for Armenia.
- **Anti-corruption efforts will benefit from new measures to detect and prevent corruption**. The recent launch of the Electronic Platform for Declarations of Assets, Incomes, Expenditures and Interests, as well as the use of artificial intelligence, will make it easier for the Corruption Prevention Commission (CPC) to detect and prevent corruption.

Key priorities for 2024

- **Continued progress on implementing the digital agenda is necessary to maintain growth momentum.** The focus should be on advancing the digital transformation of the economy by improving the delivery of digital public services and supporting the development of digital skills.
- **Initial steps to facilitate green investments should continue.** An efficient and transparent regulatory environment and favourable natural conditions for renewable energy could help attract foreign direct investment in initiatives to green the economy and open up new growth potential.
- **Addressing the basic housing and social needs of displaced Karabakh Armenians is an utmost priority.** Their efficient inclusion in the labour market, health system, social security network and education would have a positive impact on their integration and on long-term economic growth.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	7.6	-7.2	5.8	12.6	6.5
Inflation (average)	1.4	1.2	7.2	8.6	3.5
Government balance/GDP	-1.0	-5.4	-4.6	-2.1	-2.7
Current account balance/GDP	-7.1	-4.0	-3.5	0.8	-1.4
Net FDI/GDP [neg. sign = inflows]	-1.7	-0.7	-2.5	-4.9	-1.6
External debt/GDP	90.9	102.1	99.8	78.2	n.a.
Gross reserves/GDP	20.9	20.7	23.3	21.1	n.a.
Credit to private sector/GDP	57.1	68.6	58.2	50.1	n.a.

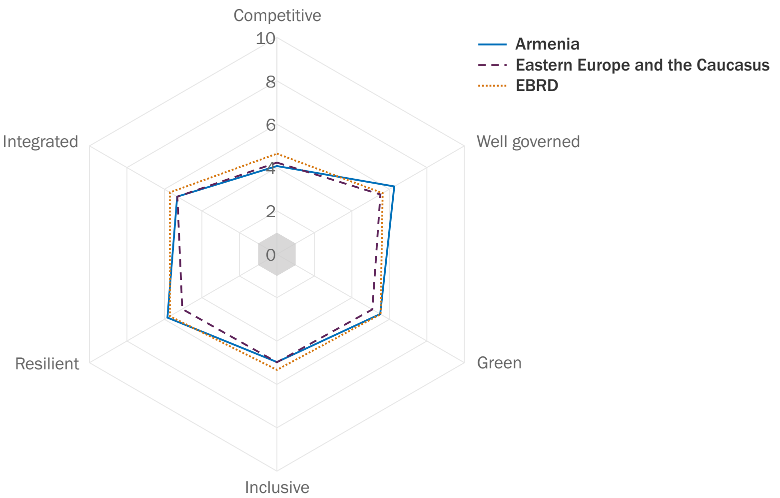
Macroeconomic developments and policy response

The economy continues to perform well in 2023. After exceptionally strong growth (12.6 per cent) in 2022, January to July 2023 saw further growth in gross domestic product (GDP) of 10.4 per cent year on year. Construction and services continue to drive GDP, posting double-digit rates of growth, although industrial production is almost flat. Money transfer inflows to individuals, which have been driving high demand for services, have remained robust, but there has been a noticeable rise in outflows in 2023 to date. While inflows from Russia have moderated slightly and outflows to Russia have edged up relative to the peak months of 2022, the main difference lies in the significant rebound in outflows to other countries. As a result, net money inflows in the first half of the year declined by 10 per cent from the same period in 2022 and by more than 40 per cent from their peak in the second half of 2022. At the same time, exports and imports increased by 72.8 and 73 per cent (year on year), respectively, in the first half of 2023, deepening the trade and current account deficits. Foreign reserves rose by almost one-third to US$ 4.1 billion (around €3.8 billion, covering 3.8 months of imports) in 2022 and have remained around this level in 2023. Armenia's fiscal position has continued to improve in 2023 on the back of its prolonged, robust economic growth and improved public-finance management. Public debt has stabilised at around 50 per cent of GDP, after a sharp decline in the two preceding years, helped by low fiscal deficits, high GDP growth rates and the appreciation of the currency.

Annual inflation eased in the first half of 2023. Inflation peaked at 10.3 per cent in June 2022, but several factors have contributed to a significant decline since then. Timely monetary policy tightening, with a total increase in the policy rate of 650 basis points between December 2020 and December 2022, as well as falling global energy and food prices and significant appreciation of the Armenian dram in 2022, drove inflation to 0.1 per cent in September 2023. The Central Bank of Armenia (CBA) cut the policy rate three times beginning in June 2023, to 9.75 per cent in September, the first such reductions in almost three years. Nevertheless, the CBA is being cautious about easing monetary policy, as consumer demand remains strong. Successful disinflation and a stable nominal exchange rate since the beginning of 2023 have contributed to the eventual reversal of a two-and-a-half-year period of real currency appreciation.

Short-term growth is likely to slow down. The temporary factors that drove the exceptional economic activity of 2022 have been subsiding gradually in 2023. We expect GDP growth of 6.5 per cent in 2023 and 4.5 per cent in 2024. The exodus of more than 100,000 Karabakh Armenians will likely divert budget expenditures to address the immediate social needs, with an uncertain impact on short-term growth. The isolation of the Russian economy from Western markets could have negative long-term consequences for the Armenian economy, as Russia remains a major trading partner. On the positive side, progress on opening the border with Türkiye could have a positive impact on the medium-term growth outlook.

Assessment of transition qualities (1-10)



Structural reform developments

The government has committed to preventing Armenian companies from circumventing Western sanctions on Russia. In 2023 the authorities have made numerous decisions to help Armenian businesses comply with the sanctions. Notably, in the context of a fivefold increase in exports to Russia from 2022, the government has issued a list of goods prohibited from re-export to Russia and applied strict controls on "dual-use" goods that could ultimately be used by the Russian arms industry. The country acknowledges, however, that it will not be possible to prevent all exports of potential dual-use goods, given legitimate consumer demand for such products from Russia.

Some steps have been taken to enhance electricity market integration. Armenia is building a third interconnecting electricity transmission line to Iran, with a capacity of 400 kV, to add to the two existing ones, which have a capacity of up to 220 kV each. The new interconnection is expected to be operational by the end of 2023. In addition, Iran and Armenia have signed an extension to 2030 of the bilateral agreement under which Armenia exports electricity to Iran in exchange for natural gas.

Digital innovation in public administration is helping to prevent corruption. In February 2023 the CPC launched its Electronic Platform for Declarations of Assets, Incomes, Expenditures and Interests. By incorporating artificial intelligence and machine learning into the new asset declaration system, the CPC hopes to enhance its ability to scrutinise asset declarations filed by public servants, making it easier to detect and prevent corruption. Corruption watchdogs can now easily cross-check asset declarations with data in systems maintained by other state agencies. In addition, the requirement to submit declarations has been expanded significantly, with up to 35,000 declarations expected to be filed over the next year.

The authorities are striving to adopt international best practice on green investments. In February 2023 the Ministry of Economy launched its "Developing Green Taxonomy in Armenia" project, a year-long initiative aimed at creating a policy and legal basis for green investments in the country. The development of a green taxonomy in Armenia is another step in laying the foundations for a sustainable green finance ecosystem, by attempting to provide clear definitions and criteria for identifying and promoting environmentally sustainable investments, attracting capital and fostering the growth of green projects.

Azerbaijan

Highlights

- **Economic growth has subsided in 2023 and non-oil sector growth has moderated.** Lower energy prices, declining oil production and slow growth in the non-oil sector led to gross domestic product (GDP) growth of less than 1 per cent on the year in the first seven months of 2023.
- **There is growing support for information technology (IT) sector development and the digitalisation of the economy.** New tax legislation provides incentives for employees and companies in the IT industry. At the same time, capital market development is benefiting from a new digital platform that enables online securities issuance by market participants.
- **Important steps are being taken to develop the Middle Corridor trade route and promote renewable energy.** Azerbaijan is engaging with Kazakhstan and Georgia to coordinate the development of the Middle Corridor for cross-border energy transmission and non-oil goods, and the authorities are promoting major initiatives on the production and transmission of renewable energy.

Key priorities for 2024

- **Further investment in the non-oil sector is crucial to the sustainable diversification of the economy.** The authorities should encourage the diversification of the country's economic structure by strengthening the regulatory framework on competition and reducing the state's footprint across the economy.
- **The legislative and regulatory frameworks for the renewable energy market need improvement**. Recent reforms to reduce monopolies in the electricity market are welcome, but legal tools to control monopolistic entities in this market should be strengthened further. The authorities should also devise legislation for all types of renewable energy and improve the regulatory framework to attract foreign investors.
- **Enhancing the capacity of the Middle Corridor could play a crucial role in economic diversification.** The authorities should enhance the institutional capacity of domestic state-owned infrastructure companies along the Middle Corridor and step up collaboration with other countries along the corridor to unify tariffs and simplify customs procedures.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.5	-4.2	5.6	4.6	1.5
Inflation (average)	2.6	2.8	6.7	13.9	10.3
Government balance/GDP	8.9	-6.4	4.1	6.0	1.0
Current account balance/GDP	9.1	-0.5	15.1	29.8	16.3
Net FDI/GDP [neg. sign = inflows]	2.9	1.8	3.8	6.0	4.8
External debt/GDP	47.2	55.7	43.6	31.5	n.a.
Gross reserves/GDP	13.0	14.9	12.9	11.4	n.a.
Credit to private sector/GDP	18.7	20.1	18.4	15.1	n.a.

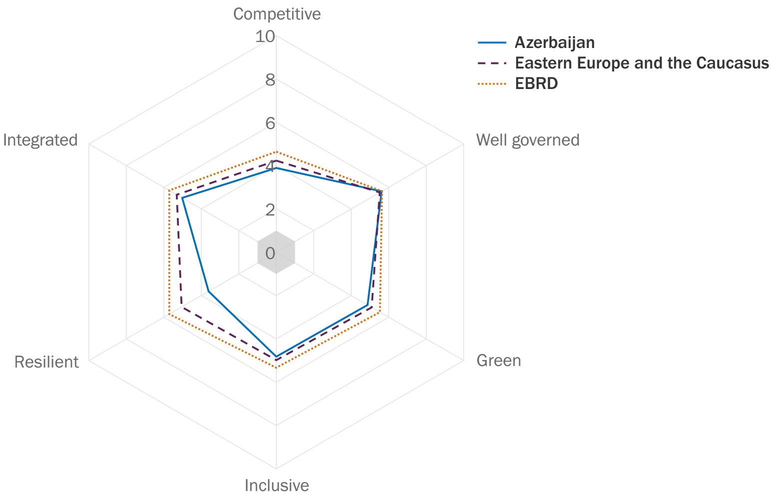
Macroeconomic developments and policy response

The strong economic growth of the past two years has started to slow. GDP grew 4.6 per cent in 2022, driven by strong growth in the non-oil and gas sector (9 per cent year on year), which benefited from large foreign-currency inflows as the high global prices of oil and gas boosted export revenues. However, the economy slowed in the second half of 2022 as global energy prices moderated and inflation reduced growth in real incomes. GDP growth decelerated sharply to 0.7 per cent year on year in January to July 2023. In a similar pattern to the previous year, output in the oil and gas sector fell 2.2 per cent, while non-oil sector output increased 3.4 per cent in the first seven months of the year, although the latter was well below the growth rate of 2022. Net money inflows increased almost sixfold in 2022, mostly from Russian citizens of Azerbaijani origin, but the pace of inflow growth has slowed markedly in 2023. Although oil and gas revenues declined 7.6 per cent in the first three months of 2023, the current-account balance maintained a large surplus on the back of rising gas exports and an oil price above pre-war levels.

Monetary policy tightening continues to curtail inflation, but domestic demand remains strong. Inflation has been easing in 2023, but was still relatively high, at 5.1 per cent year on year, in September 2023, after peaking at 15.6 per cent in October 2022. The authorities have reacted with significant monetary tightening. The Central Bank of Azerbaijan raised the policy rate to 9 per cent in May 2023, its tenth rate rise in the last two years. Robust nominal income growth of around 20 per cent in 2022 has added to the inflationary pressures, although this has slowed since the beginning of 2023. Lending to households has continued to rise, however, up 25.9 per cent year on year between January and July 2023, on top of a 30 per cent increase in 2022. Amid high domestic demand, in the middle of 2023 the government approved an increase in budgetary spending to boost public-sector wages, support the development of territories surrounding Karabakh, and strengthen the country's defence capabilities.

Energy exports will continue to drive short-term growth. The combination of stable energy prices and increasing demand for Azerbaijan's energy products is expected to support high levels of oil and gas revenues, despite declining oil output and rising gas production. This is likely to enable a continuation of current levels of public investment and government expenditure. However, persistent inflation is likely to dampen the real impact of fiscal stimulus and could lead to further appreciation of the real effective exchange rate. We therefore forecast GDP growth of 1.5 per cent in 2023, rising to 2.5 per cent in 2024. The forecast is highly sensitive to movements in global oil prices and to the effects of geopolitical developments on demand for Azerbaijan's gas exports.

Assessment of transition qualities (1-10)



Structural reform developments

The gradual transition to green energy continues. In December 2022 the government signed a memorandum of understanding (MoU) with Georgia, Romania and Hungary on the joint development and transmission of green energy through an electric cable under the Black Sea. The feasibility study on installing the electric cable should be finished by the end of 2023. The shift to green energy sources has been increasingly supported by the authorities through agreements and MoUs with international renewable investors. The Ministry of Energy has also signed an MoU with the European Bank for Reconstruction and Development to receive support for the development of a low-carbon and climate-resilient power sector in Azerbaijan, in line with the country's commitment to the Paris Agreement.

Reforms aimed at creating a competitive electricity market have accelerated. The adoption of a new law on electric power in May 2023 set in motion the gradual deregulation of the electricity sector and should enable the creation of a centralised electricity market. The law will enter into force at the beginning of 2024. The process of establishing an energy market regulator will begin by defining the role of the state and the regulator in 2024. Next steps include the legal separation of the generation, transmission and distribution of electricity, along with the creation of a market operator by July 2025. The final stage of the reform will be the establishment of retail and wholesale markets by the middle of 2028.

New tax legislation is facilitating the development of the IT sector. From January 2023 the new tax code widened the scope of tax exemptions to cover IT sector employees who reside outside the country's technology parks. The new law also exempts external activities conducted by enterprises located within the technology parks from corporate income tax, withholding tax on dividends and property tax.

The authorities have expanded cooperation with trading partners on developing the Middle Corridor. In June 2023 bilateral discussions with Kazakhstan resulted in the signing of an MoU that envisages investment of €5 billion over the next five years to develop infrastructure and enhance the efficiency of the Middle Corridor. At the same time, bilateral discussions with the Georgian authorities are focused on digitalisation as a way of overcoming customs and administrative bottlenecks along this part of the Middle Corridor.

Digitalisation is contributing to capital market development. In December 2022 the Central Bank of Azerbaijan launched an online securities issuance system. Under this system, issuers can avail of simpler online procedures for registering stocks and bonds, getting prospectus approval, safekeeping securities, and listing on the Baku Stock Exchange. Previously, issuers had to submit separate hard copies of the required documentation to the Central Bank of Azerbaijan, the National Depository Centre and the Baku Stock Exchange. This new digital platform is accessible to all market participants, enabling a simpler, faster securities issuance process.

Employment opportunities for women have been broadened. Until recently, women in Azerbaijan faced employment restrictions on around 700 jobs in various sectors, such as transport, energy and agriculture. However, the authorities repealed these restrictions in November 2022, as the jobs were no longer deemed hazardous to women's health. With the support of the World Bank, the authorities adopted a new rule for enhancing occupational safety and health across those jobs that were previously closed to women.

Belarus[1]

Highlights

- **The economy is struggling under heavy sanctions.** After a deep recession in 2022, gross domestic product (GDP) growth turned slightly positive in the first half of 2023, while inflation decelerated to a level not seen in many years, mainly due to base effects and a stable exchange rate.
- **Economic uncertainty remains extremely high.** The impact of heavy sanctions on trade and logistical disruptions to links with European Union (EU) economies is constraining the export-oriented and high-tech sectors and undermining any hope of an economic recovery.
- **The EU and other advanced economies have imposed new rounds of sanctions.** As of August 2023, restrictive measures apply to a total of 233 individuals and 37 entities.

Key priorities for 2024

- **Essential first steps towards recovery must be for the country to halt prosecution of civil society, to release political prisoners, and to distance itself from Russia's invasion of Ukraine.** No sustainable growth is feasible unless sanctions are eased and ultimately removed, allowing renewed access to the international financial system and to the EU market and logistics.
- **Urgent steps are needed to improve the business climate and the quality of governance.** Legislation must be clear and unambiguous, and allow for the equal treatment of private and state enterprises. Private entrepreneurs should be relieved from undue pressure from the authorities.
- **The authorities should overhaul and restructure state-owned enterprises (SOEs), which dominate the economy but are plagued by inefficiencies and weak governance.** Commercialisation and the introduction of corporate governance standards in the large state-owned sector could improve growth prospects and asset valuations.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	1.4	-0.7	2.4	-4.7	2.0
Inflation (average)	5.6	5.5	9.5	15.2	4.7
Government balance/GDP	0.9	-2.9	-1.7	-3.9	-0.7
Current account balance/GDP	-1.9	-0.3	3.2	3.7	2.7
Net FDI/GDP [neg. sign = inflows]	-2.0	-2.1	-1.9	-2.0	-0.9
External debt/GDP	63.1	70.0	61.5	54.6	n.a.
Gross reserves/GDP	14.2	12.0	12.4	10.7	n.a.
Credit to private sector/GDP	21.9	23.7	23.0	n.a.	n.a.

1. The EBRD announced on 4 April 2022 that, following the invasion of Ukraine, its Board of Governors had formally suspended Belarus's access to EBRD funding for projects or technical cooperation.

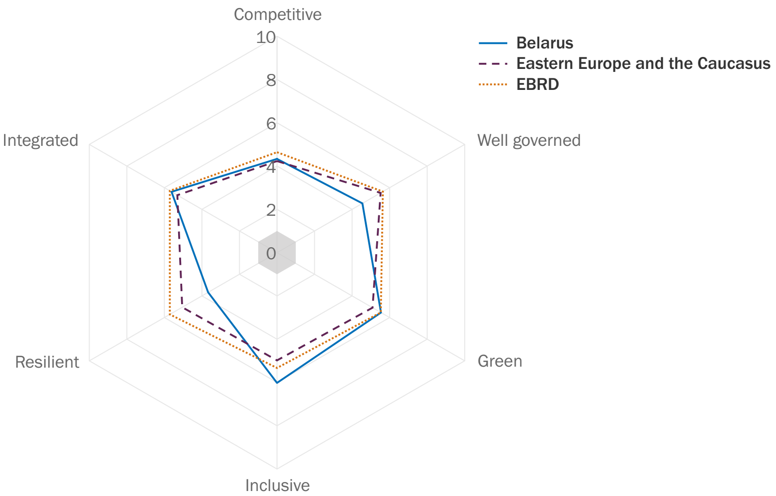
Macroeconomic developments and policy response

Some growth has returned in 2023 after a deep recession in 2022. After contracting 4.7 per cent in 2022, annual GDP increased 2 per cent year on year in the first half of 2023. The economy is nevertheless struggling to adapt to the heavy sanctions imposed by the EU and other trading partners as a result of the country's support for Russia's war on Ukraine. The moderate upturn so far in 2023 is being driven by a rebound in manufacturing, construction and retail trade, which increased 7.6 per cent, 6.1 per cent and 5.5 per cent on the year, respectively, in January to June. In contrast, the information and communications technology sector and the transport sector continued to decline in the first half of 2023, bringing output in both sectors to around 80 per cent of the level of 2021. Exports rose 12.4 per cent and imports 22.6 per cent year on year in January to June, with the direction of exports shifting significantly away from Western countries towards those in the Commonwealth of Independent States. During the first half of 2023 the authorities provided more than US$ 70 million (€64.7 million) of financial support to over 600 small and medium-sized enterprises (SMEs) in the form of subsidies, soft loans and liquidity. Almost two-thirds of the firms receiving this support were in the manufacturing sector, with the remainder mainly in the agriculture and transport sectors.

Inflation decelerated sharply and the exchange rate remained broadly stable. The inflation rate eased to 2.7 per cent in July 2023, its lowest level in the last 15 years. Base effects from high prices in 2022 were the main reason for the fall; other factors included tight monetary policy, a stable exchange rate and disinflation in Russia, the country's main trading partner. Foreign reserves stabilised at US$ 8 billion (€7.2 billion) in July 2023, covering 2.3 months of imports. Responding to the falling inflation rate, the National Bank of Belarus reduced its policy rate by a cumulative 250 basis points to 9.5 per cent between January and June 2023. Notwithstanding the positive trends, food inflation edged up slightly in July, the first increase since the middle of 2022.

The short-term outlook remains gloomy. Although the first half of 2023 saw some growth return, the uncertain geopolitical outlook and the possibility of a new wave of sanctions mean that the economy is unlikely to improve significantly in the short term. As a result, the economic growth attained in the first half of the year is likely to be short lived and to moderate to an overall rate of 2 per cent in 2023. We expect this to be followed by a growth rate of 1.3 per cent in 2024.

Assessment of transition qualities (1-10)



Structural reform developments

Structural reforms have stalled amid widespread and expanding sanctions. Although sanctions have been in place in some form since 2004, several rounds imposed by the EU and others since the contested presidential elections in August 2020 and, later, in response to Belarus's role in Russia's military invasion of Ukraine, have been far-reaching. Following the latest round of sanctions adopted by the EU in August 2023, restrictive measures now apply to a total of 233 individuals and 37 entities. Further measures, including the closure of remaining border crossings for vehicles and the suspension of cross-border railway transport links, cannot be ruled out.

Bosnia and Herzegovina

Highlights

- **Growth is moderating in 2023.** Following robust acceleration in 2022, output growth slowed significantly in the first half of 2023, due mainly to worsening net exports, as external demand has been continuously weakening.
- **Some missing parts of the legal framework for renewables have been completed.** The adoption of a set of energy laws in the Federation of Bosnia and Herzegovina (FBiH) streamlines administrative procedures for the construction and operation of renewable energy facilities and reforms the incentives system for renewable energy. Similar laws are already in place in the Republika Srpska (RS) entity.
- **The government has approved the draft National Energy and Climate Plan (NECP).** The draft NECP is aiming for a carbon emissions trading scheme by 2026, taking into account the European Union (EU)'s upcoming Carbon Border Adjustment Mechanism (CBAM), and sets the coal power plant shut-off date for 2030.

Key priorities for 2024

- **Long-term growth could be boosted by increasing public investment.** Given the availability of fiscal space and existing infrastructure gaps, the authorities should scale up investments that promote growth and the green economy, in addition to improving the capacity of the public administration to implement public investments.
- **More preparation is needed for the EU's CBAM.** Efforts should be intensified given the country's target to introduce a carbon emissions trading scheme by 2026, including aligning excise rates on fossil fuels with the EU acquis, redirecting fossil fuel subsidies to renewable energy sources, and continuing electricity tariff reforms.
- **Faster alignment of the country's legal framework with the EU acquis is necessary to advance the EU accession process.** Alignment of domestic legislation with the EU should follow the 14 priorities set out by the European Commission, leveraging the reform momentum brought on by the country's fresh candidacy status.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.8	-2.9	7.3	3.8	1.5
Inflation (average)	0.6	-1.1	2.0	14.0	5.5
Government balance/GDP	1.4	-4.6	0.6	0.9	-1.1
Current account balance/GDP	-2.5	-2.8	-1.7	-4.5	-4.3
Net FDI/GDP [neg. sign = inflows]	-2.0	-2.0	-2.6	-3.0	-2.4
External debt/GDP	62.1	66.9	55.5	52.1	n.a.
Gross reserves/GDP	34.5	39.0	40.8	35.3	n.a.
Credit to private sector/GDP	57.2	57.7	53.3	48.1	n.a.

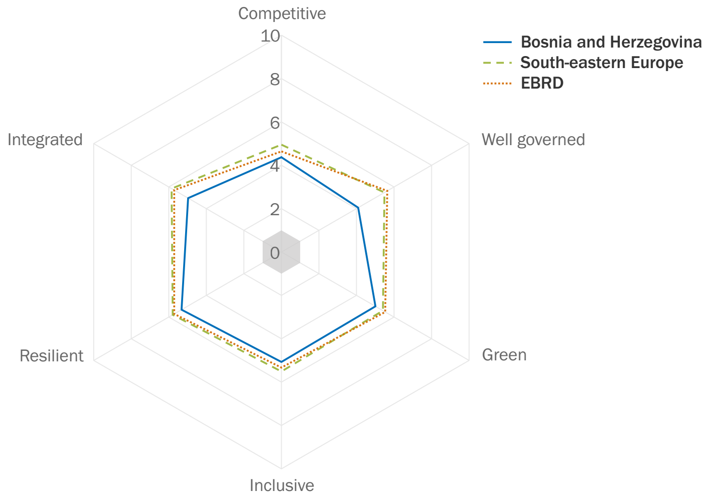
Macroeconomic developments and policy response

Economic growth is slowing. Following robust growth of 3.8 per cent in 2022, the economy expanded by just 1.4 per cent year on year in the first half of 2023, partly due to the slowdown in external demand. As the sizeable industrial sector contracted by 4 per cent in real terms and the net export position deteriorated in the first half of the year, growth was mainly supported by investment on the expenditure side and services (notably retail, tourism and information and communication) on the production side. Mildly negative import growth exceeded export growth (with exports contracting by 4 per cent year on year), and the current account deficit, which doubled in 2022, remained elevated in the first half of 2023. In the face of persistently high inflation, household consumption remained muted despite stable credit growth and consistently high remittance inflows of around 7 per cent of gross domestic product (GDP).

The authorities have used fiscal policy measures to mitigate the effects of inflation. Annual inflation peaked at 17.4 per cent in October 2022 but dropped to 4.1 per cent by September 2023, reflecting global disinflation trends and slowing domestic demand. The authorities continued to employ expansionary fiscal policy in 2023 to protect the population's disposable incomes, including minimum wage increases from the beginning of the year and pension adjustments in both entities, alongside one-off aid to veterans and a cut in wholesale gas prices in the FBiH. Most price control measures have expired, as did the export ban on firewood and pellets in January 2023 and that on logs in July 2023. The central bank increased remuneration rates on required reserves of banks from July 2023, in line with International Monetary Fund (IMF) recommendations and with the goal of narrowing the interest rate gap with the eurozone. A measure limiting retailers' profit margins on essential food and household items was put in place in the FBiH in August 2023, and in the RS in October 2023.

Economic growth is expected to be subdued in the short term, as risks tilt towards the downside. GDP growth is forecast at 1.5 per cent in 2023 and 3 per cent in 2024. The worsening outlook stems from the persistently high inflation rate eroding disposable incomes, the expected further deterioration of net exports due to the ongoing slowdown in the eurozone and other export markets, as well as tighter financing conditions. Domestic political issues are also a risk to the outlook, as witnessed by recent delays to foreign-funded infrastructure projects in the RS. On the positive side, the country's EU candidacy status and relatively quick state- and entity-level government formation may accelerate reforms.

Assessment of transition qualities (1-10)



Structural reform developments

A set of energy laws has been adopted. The FBiH adopted three new laws in July 2023 on: (i) electricity, (ii) energy and the regulation of energy activities, and (iii) the use of renewable energy sources and efficient cogeneration. The laws are set to streamline administrative procedures for the construction and operation of renewable energy facilities, and reform the incentives system for renewable energy so that feed-in tariffs for small plants and feed-in premiums for large plants are determined through auctions. The legislation introduces new categories of participants in the electricity market, such as the “energy community”, the “storage operator”, and the “prosumer” (an entity producing electricity mainly for self-consumption). A similar piece of legislation, the Law on Renewable Energy Sources, is already in place in the RS, but that law allows bidding procedures to determine incentives for larger renewable capacities only. From January 2023 electricity prices in the RS have been pegged to consumption through block tariffs. From June 2023 issuing bodies in the RS can also issue guarantees of origin for electricity, enabling trading in line with EU rules.

The draft NECP has been approved by the government and has undergone public consultation. The draft NECP takes into account the EU’s upcoming CBAM and plans for the introduction of a carbon emissions trading scheme by 2026, while setting the shut-off date for coal power plants at 2030. While the draft plan states there will be no new fossil fuel plants, Tuzla 4 and Kakanj 5, two highly polluting thermal power plants, are set to continue operating beyond their allowed lifetime under the opt-out regime of the EU’s Large Combustion Plant Directive, thus breaching the country’s obligations under the Energy Community Treaty. Nonetheless, the draft NECP sets an ambitious target for 70 per cent of gross final consumption of electricity to come from renewable sources in 2030 (compared with some 50 per cent in 2022). Public consultation for the document was open until the end of July 2023.

A set of laws related to EU accession has been adopted. The parliament of Bosnia and Herzegovina adopted in August 2023 the Law on the Ombudsman, the Law on Access to Information, the Law on Foreigners and the Law on Wines, while another important piece of legislation, the Law on High Judicial and Prosecutorial Council, was adopted in September. These laws are in line with some of the 14 priorities set out in 2019 by the European Commission in the Opinion on Bosnia and Herzegovina’s application for EU membership.

Public enterprise oversight units have been established in both entities. This is an important step for the broader reform of public enterprises, as it should help improve transparency regarding their operations. The RS unit has been up and running since March 2023 but the FBiH unit is yet to be staffed. A registry of public enterprises in the FBiH is available online, now with complete financial reporting, while the RS is working on a roadmap for a comprehensive fiscal risk assessment of public enterprises, according to the IMF.

Bulgaria

Highlights

- **Economic growth is slowing.** Gross domestic product (GDP) growth reached 3.9 per cent in 2022, but momentum waned in the first half of 2023 amid a slowdown in investment and weaker external demand.
- **The new coalition government has committed to far-reaching judicial reform.** It is expected that constitutional amendments will be adopted to reform the Supreme Judicial Council, Office of the Chief Prosecutor and anti-corruption entities.
- **Legislation has been adopted to promote the deployment of renewable energy sources.** A legislative framework for offshore wind energy entered into force in January 2023, and the minimum amount of installed capacity subject to licensing was increased. Other initiatives are also progressing, including to develop a renewable energy storage system.

Key priorities for 2024

- **Recovery and Resilience Plan (RRP) implementation should be accelerated.** Bulgaria received its first disbursement from the Recovery and Resilience Facility (RRF) at the end of 2022, and the government submitted a second payment request in October 2023. It is important to show tangible progress on the high number of deliverables to which the authorities have committed.
- **Prerequisites for euro adoption should be finalised.** Having made the decision to delay eurozone accession by another year, the authorities should ensure that all necessary reforms and legal requirements are completed by the middle of 2024.
- **Stronger commitment to decarbonising the energy sector is needed.** Although some of the green transition reforms and investments listed in the RRP are ongoing, the energy sector as a whole, particularly the part based on coal production, needs to be transformed more quickly if it is to align with European Union (EU) targets.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.0	-4.0	7.7	3.9	1.6
Inflation (average)	2.5	1.2	2.8	13.0	8.5
Government balance/GDP	2.1	-3.8	-4.0	-2.9	-2.8
Current account balance/GDP	1.9	0.0	-1.7	-1.4	0.0
Net FDI/GDP [neg. sign = inflows]	-2.0	-4.5	-1.8	-2.5	n.a.
External debt/GDP	61.3	63.3	58.1	52.3	n.a.
Gross reserves/GDP	40.4	50.1	48.7	45.4	n.a.
Credit to private sector/GDP	48.9	51.0	47.9	45.2	n.a.

Macroeconomic developments and policy response

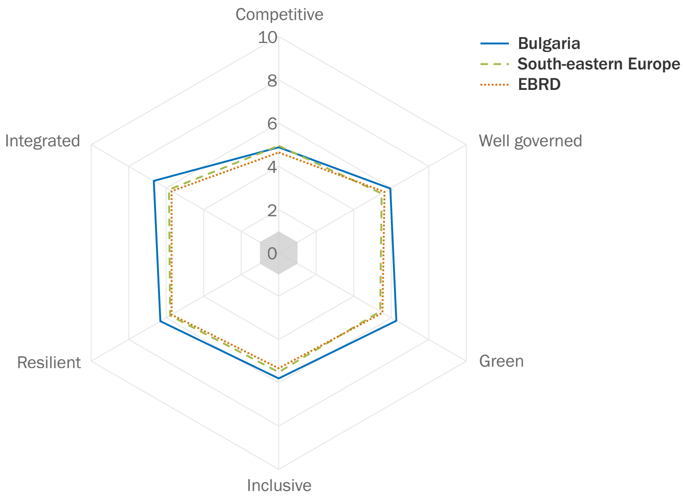
The economy is slowing considerably. After expanding by 3.9 per cent in 2022, the economy has been cooling in 2023 amid weaker external demand and a contraction of public spending and investments. In the first half of 2023 GDP grew 2 per cent year on year, thanks to the surprising resilience of private consumption, which increased by 7.2 per cent. Exports recorded a year-on-year decline of 1.3 per cent in the first six months of 2023. Imports, meanwhile, fell 7 per cent on the year in the first half of 2023, leading to a considerable drop in the trade deficit. Raw materials and energy exports slumped in the first few months of 2023 owing to a drop in coal and nuclear electricity production, and to a moderation in market prices, which rendered Bulgarian electricity less competitive. The fall in exports is also reflected in the year-on-year decline of manufacturing since March 2023. After a strong rebound in the second half of 2022, investments slumped again in the first half of 2023.

Inflation is moderating from a relatively high peak. Consumer price inflation peaked at 18.7 per cent in September 2022, largely driven by food prices. Inflation had dropped notably to 6.3 per cent by September 2023, with most components on a disinflationary trend, though energy tariffs were raised recently. Nominal wage growth has been strong in the past year and reached 17.3 per cent year on year in the first quarter of 2023, before moderating to 13.1 per cent in the following quarter. Since September 2022, real wage growth has turned positive, supporting household consumption.

The fiscal deficit is narrowing. The new parliament adopted a revised 2023 budget in late July that set a government deficit target for the year of just 3 per cent of GDP, well below that set by the provisional government. The administration plans to achieve the lower deficit through better tax collection, measures such as tighter customs and controls obliging firms with more than 100 employees to pay salaries solely through banks. The cash-based budget had recovered to a surplus of 0.3 per cent of GDP by July 2023. Subsidised electricity costs for firms, a key support measure during the energy crisis, have been extended to the end of 2023, but the budgetary cost is expected to be minimal amid lower electricity prices and a contribution from the windfall revenues of state-owned enterprises.

Lower public spending and weak foreign demand are the main drivers of slower growth. Considering how the economy performed in the first half of 2023, we forecast GDP growth for the year as a whole at 1.6 per cent. This downturn in growth relative to 2022 is driven by weaker investments and negative net exports, offset by still resilient private consumption. The planned fiscal consolidation will also lead to lower government spending. The economy should rebound by 2.6 per cent in 2024, by our forecasts, supported by lower inflation, the accelerated absorption of EU funds and revived foreign demand. Another energy price shock and the protracted weakness of key trading partners are the main downside risks.

Assessment of transition qualities (1-10)



Structural reform developments

The European Commission has closed the Cooperation and Verification Mechanism (CVM) for Bulgaria. In June 2023 the authorities reported that the last deliverable from the 2019 evaluation, related to the accountability and criminal liability of the chief prosecutor, had been fulfilled, prompting the closure of the CVM. Nevertheless, Bulgaria will still be monitored through the rule of law mechanism. In addition, the July 2023 report noted, among six recommendations issued, that there had been limited progress compared to last year on addressing high-level corruption and improving the functioning and independence of the Supreme Judicial Council.

Judicial reforms are advancing, including changes to the constitution. The new government has agreed to amend some of the constitution's key articles, including those relating to the term and powers of the chief prosecutor and the Supreme Judicial Council, and to introduce term limits for municipal mayors. The National Investigation Service was separated from the Office of the Chief Prosecutor in June 2023 to become an independent structure in the justice system. The Anti-Corruption Commission was split into two entities, an anti-corruption committee and a committee for seizing property, after the anti-corruption law was amended in September 2023. In July 2023 the European Commission's Rule of Law Report reiterated the need for progress on reforming the Supreme Judicial Council, tackling high-level corruption more effectively and applying integrity standards to people in high-level positions.

Parliament has updated the country's anti-money-laundering framework and public procurement law amid European Commission infringement procedures. In June and July 2023 the Commission announced that it had opened infringement cases against Bulgaria for the incomplete transposition of the EU Anti-Money-Laundering Directive (2018/843) and for outstanding shortfalls in public procurement legislation. In June 2023 parliament adopted amendments to the Prevention of Money Laundering Act to align the legislation with the latest recommendations of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL). In addition, the government proposed a series of changes to the Public Procurement Act to align it with RRP commitments and EU law, largely to streamline and safeguard the tendering process.

Amendments to the insurance bill were adopted as part of requirements for eurozone accession. In July 2023 and after significant delays, parliament adopted changes to national insurance legislation to align it with EU law. The updated law obliges insurers to compensate clients without delay and to refrain from disputing any claims for accidents abroad that are covered by the European Green Card system. Outstanding reforms needed for euro adoption include legislation on personal bankruptcy, amendments to commercial insolvency law and an update to the Law on the Bulgarian National Bank. The latter proposed law was well received by the European Commission and should be adopted by the parliament by the end of 2023.

Parliament adopted the act transposing the EU Whistleblowing Directive (2019/1937). In January 2023, after a delay of more than a year, parliament adopted a bill to transpose EU regulation on the protection of whistleblowers. The act entered into force in May 2023 and obliges firms with more than 50 employees to set up internal whistleblowing channels and procedures by December 2023.

Adjustments to the energy act were made to enable the deployment of renewable energy sources. In early 2023 parliament adopted several amendments to legislation regulating the energy sector to stimulate the development of renewable energy sources. The minimum amount of installed capacity subject to licensing was raised from 5 MW to 20 MW. The act also introduced a framework for energy storage, which is critical for balancing an electricity system based on renewable energy. Another important piece of legislation was an act regulating offshore wind development, which entered into force in January 2023 and sets out the deployment of 62 GW of capacity under the contracts-for-difference mechanism.

Bulgaria aims to double its gas storage capacity while infrastructure is being developed. Bulgartransgaz, the natural gas transmission and storage system operator in Bulgaria, announced in January 2023 that the capacity of the main gas storage facility in the village of Chiren would be expanded to 1 billion cubic metres. The project will also replace outdated Soviet equipment with American technology and will be completed within two years. In addition, the gas pipeline link to Serbia is now under construction and should be operational by the end of 2023.

Croatia

Highlights

- **Growth moderated in the first half of 2023 but was still above that of regional peers.** Gross domestic product (GDP) growth slowed towards the end of 2022 as headwinds strengthened, but remained resilient in the first half of 2023, helped by strong tourism figures.
- **Euro adoption and Schengen membership are boosting the country's integration with other European Union (EU) economies.** Export growth has been very strong since 2019, and euro adoption in January 2023 and the removal of border controls in the Schengen area have further cut trade and investment costs.
- **Measures are being taken to make the labour market more efficient and inclusive.** Croatia has introduced a voucher system to support green and digital skills development as one of its Recovery and Resilience Plan (RRP) milestones.

Key priorities for 2024

- **Challenging reforms are needed to implement the RRP.** The RRP schedule envisages a pipeline of more complex and politically difficult reforms, such as updating the public pay system and introducing a new law on state-owned enterprises (SOEs).
- **Inclusion issues and labour market outcomes need to improve.** The effectiveness of the Croatian social protection system and long-term care still lags behind that of its peers. Reforms need to go beyond narrow RRP commitments.
- **Efforts to attract foreign direct investment would boost long-term growth potential.** Historically, Croatia has not been a preferred destination for foreign direct investment, thanks to its higher labour costs and relatively unattractive business environment. Amid ongoing reforms and enhanced EU integration, the authorities and the private sector should grasp the opportunity to attract high-value-added investments.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.4	-8.6	13.8	6.3	2.5
Inflation (average)	0.8	0.0	2.7	10.7	8.6
Government balance/GDP	0.2	-7.3	-2.5	0.1	-0.8
Current account balance/GDP	2.9	-0.5	1.8	-1.9	-0.2
Net FDI/GDP [neg. sign = inflows]	-6.2	-1.4	-4.8	-5.7	n.a.
External debt/GDP	72.9	81.8	81.0	74.0	n.a.
Gross reserves/GDP	33.4	37.5	42.9	41.6	n.a.
Credit to private sector/GDP	52.1	58.5	51.9	49.8	n.a.

Macroeconomic developments and policy response

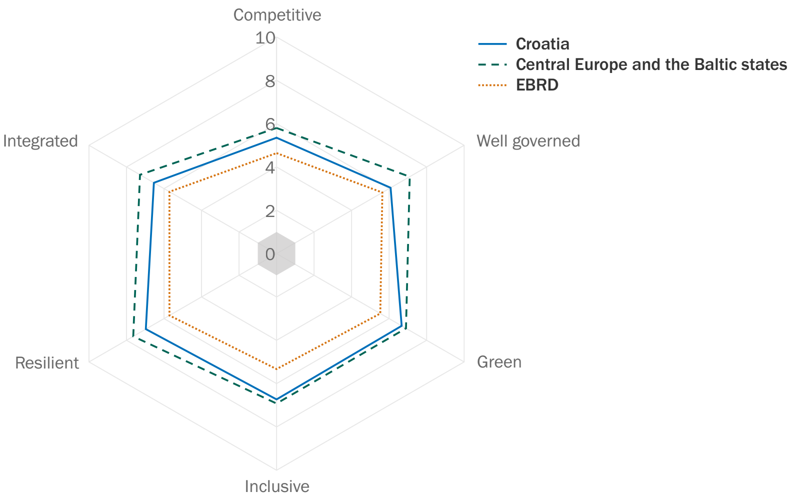
The economy is cooling after another year of strong growth. GDP growth was among the highest in the EU in 2022, at 6.3 per cent, driven by strong domestic demand, including an accumulation of inventories. In the first two quarters of 2023, GDP growth slowed to 1.6 per cent and 2.6 per cent year on year, respectively. However, quarter-on-quarter growth of more than 1 per cent in the second quarter, with private consumption accelerating amid declining inflation, suggests that the economy retains significant momentum. Still, exports recorded an annual decline in April and May 2023, largely owing to lower exports of fuels and crude materials. Industrial production also fell for six consecutive months up to May 2023, reflecting weak foreign demand and supply-side shocks. In the first half of 2023, tourist nights were 5 per cent higher than in the record year of 2019.

Inflation is declining while wage growth is picking up. Consumer price growth peaked at 13.5 per cent in November 2022, largely driven by food prices. Since then, inflation has been on a downward path, dipping to 6.7 per cent in September 2023. The adoption of the euro in January 2023 had only a marginal effect on inflation, according to estimates by the European Central Bank. Meanwhile, nominal wage growth has been brisk in 2023, averaging 12 per cent year on year. This has translated into relatively strong real wage growth (6.1 per cent year on year in July 2023), supporting household demand. The labour market remains tight, although the employment rate went down from a record high at the end of 2022, with unemployment rising to 7.3 per cent in the first quarter of 2023. Real-estate prices have risen significantly, posting a 17.3 per cent increase on the year in the fourth quarter of 2022.

The fiscal position is strong despite energy and cost-of-living support schemes. Strong economic growth, high inflation and an improving structural balance led to a fiscal surplus of 0.1 per cent of GDP in 2022. Government debt was down to 69 per cent of GDP at the end of 2022, below pre-pandemic levels. The 2023 budget is projected to post a small deficit of up to 0.3 per cent of GDP, according to the latest budget revision. The European Commission estimated the cost of energy support measures in 2023 at 1.5 per cent of GDP. In March 2023 the government introduced a lower value-added tax (VAT) rate on energy products, reduced excise duties on fuel, allocated additional social transfers and prolonged price caps on electricity and gas to October 2023 and March 2024, respectively. Hrvatska Elektroprivreda, the state-owned energy company, bore the financial impact of the price caps, for which the government approved a capital transfer of up to €900 million in March 2023.

Growth will moderate in the short term. We forecast GDP to grow by 2.5 per cent in 2023, as weak external demand and tighter financial conditions take a toll. Upside potential to the forecast comes from a strong tourism season, a recovery in domestic demand supported by a tight labour market, and an acceleration in investment driven by EU funds. GDP could expand by 2.3 per cent in 2024, as a moderation in domestic demand is offset by the recovery of key trading partners.

Assessment of transition qualities (1-10)



Structural reform developments

Croatia is benefiting from euro adoption and Schengen membership. Croatia joined the eurozone and the Schengen area in January 2023. As a result, the economy is benefiting from decreased trade and transaction costs, more foreign investment and greater inflows of tourists, some of whom are buying property. Consequently, there is a risk of faster real-estate price growth in the short to medium term.

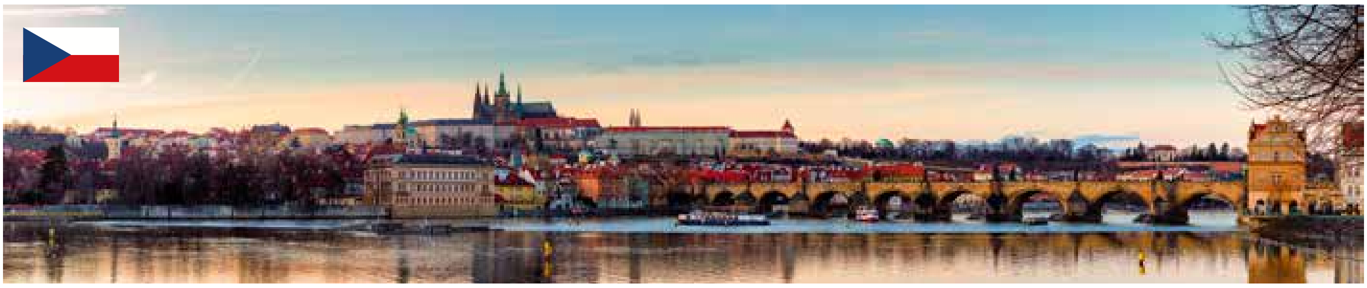
RRP implementation and associated reforms are advancing. With three payment requests already submitted, Croatia is progressing well on RRP implementation. Most of the reforms required in these initial stages pertain to updating and adopting national strategies and programmes around key transition topics, such as the green transition, good governance and competitiveness. Moreover, the authorities have also adopted a new hydrogen strategy and amended legislation on biofuels. The challenge now is to channel the available resources effectively into impactful projects and ensure that the legislative improvements translate into tangible outcomes. In addition, the upcoming payment requests will include more difficult reforms, such as updating the public pay system, launching a new procurement platform and adopting a new law on SOEs.

Additional efforts were made to strengthen competitiveness and improve the business environment. Under its second RRP payment request, Croatia committed to implementing an action plan set out in 2020 for reducing non-tax and para-fiscal charges, which the European Commission confirmed had been completed at the end of 2022. Moreover, the promised digital platform for firms to pay business fees online is now operational. Targeting specific sectors, the authorities updated the regulation to enable the digital single market to function, adopted a new law on agricultural land consolidation to increase productivity in the sector and launched a new sustainable tourism development strategy.

Several of the adopted measures target labour-market inefficiencies and skills development. A key objective of the Croatian RRP is to improve employment outcomes by increasing labour-market flexibility and addressing inequalities. Notable reforms so far include the adoption of the Labour Act, in force since January 2023, which clarifies fixed-term and remote work, and the Act on Elimination of Unregistered Work, which targets informal employment. An educational voucher system was introduced to promote digital and green skills. The government is also easing policy on seasonal workers in light of current labour shortages.

Gas infrastructure is being developed as Croatia becomes a regional hub. The energy crisis in 2022 accelerated plans for Croatia to develop its gas infrastructure. Key projects include the expansion of the Krk liquefied natural gas terminal, the Zlobin-Bosiljevo gas pipeline and the Southern Gas Interconnection with Bosnia and Herzegovina as part of the Ionian Adriatic Pipeline connecting Greece and Türkiye to central Europe. A potential gas interconnector between Croatia and Slovenia is also being discussed.

A corporate windfall tax was introduced in 2022. The one-off tax applied to companies with revenue of more than €40 million, to subsidise smaller firms and households struggling with the increased cost of living. The marginal 33 per cent rate was levied on any profits that were 20 per cent higher than a company's 2018-21 average. The additional tax brought in €230 million in 2022. The authorities are considering extending the levy to 2024.



Czech Republic

Highlights

- **The economy remains in stagnation.** Gross domestic product (GDP) growth declined 0.6 per cent annually in the first half of 2023 but the first signs of improvement have started to appear, pointing to marginally positive growth for the entire year.
- **A new law will allow for easier corporate restructuring.** Under the new law approved by parliament, the majority threshold needed to approve a restructuring has been lowered from 90 per cent to 75 per cent. The new law could effectively enable the government to increase its control of the CEZ energy group.
- **The use of European Union (EU) funds has stepped up.** The country had used 87.1 per cent of its 2014-20 EU Multiannual Financial Framework funds by August 2023, alleviating concerns that major funds would be lost due to insufficient absorption.

Key priorities for 2024

- **The authorities should discontinue energy compensation measures.** While these measures helped to support vulnerable groups through the energy crisis, stopping them now would aid fiscal tightening and allow price incentives to encourage energy savings.
- **Progress on implementing the Recovery and Resilience Plan (RRP) should be stepped up.** The authorities should focus on green transition, including large programmes to improve energy efficiency and heating systems.
- **Pension reform should be completed.** Outstanding steps include introducing a retirement age linked to life expectancy.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.0	-5.5	3.6	2.4	0.1
Inflation (average)	2.6	3.3	3.3	14.8	10.9
Government balance/GDP	0.3	-5.8	-5.1	-3.2	-4.1
Current account balance/GDP	0.3	2.0	-2.8	-6.1	0.5
Net FDI/GDP [neg. sign = inflows]	-2.4	-2.6	-0.5	-2.5	n.a.
External debt/GDP	75.7	75.7	74.0	65.6	n.a.
Gross reserves/GDP	58.5	62.2	62.4	46.7	n.a.
Credit to private sector/GDP	50.3	53.0	54.8	50.9	n.a.

Macroeconomic developments and policy response

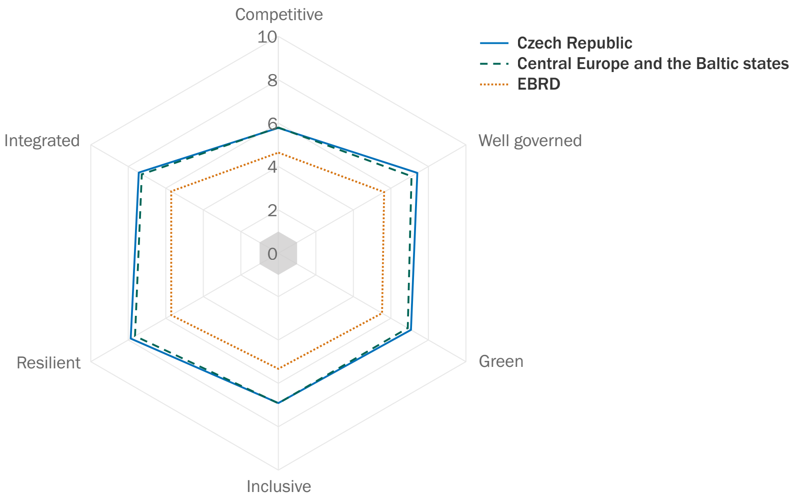
Economic growth has remained close to zero since the middle of 2022. The economy has been slow to recover from a collapse in consumption in the second half of 2022, resulting from a sharp drop in purchasing power. In addition, inventory adjustment is still taking its toll on the headline GDP numbers. On a positive note, consumption has started to show signs of improvement in 2023, as the structurally tight labour market prompts hoarding and wage growth. Amid rapidly declining inflation, sentiment and higher spending power have improved. The normalisation of energy prices has also provided a significant boost to Czech terms of trade, despite the uncertainty of the external demand outlook.

Inflation is moderating from a relatively high peak. The rate of consumer price growth reached 18 per cent in September 2022 but had returned to single digits by the summer of 2023, helped by a moderation in food and energy prices. Further declines are likely, as the strong base effects are still ahead. The Czech National Bank's (CNB) target inflation rate of 2 per cent could be achieved in early 2024.

Fiscal policy in early 2023 was accommodative, but tightening is on the horizon. In the first part of 2023, the authorities provided some counter-cyclical smoothing of demand, leading to a deficit of 6.1 per cent of GDP in the first quarter. In the second quarter, public finances improved and a fiscal surplus of 1.5 per cent of GDP was recorded. The government has committed to an austerity package, targeting a deficit of 2.1 per cent of GDP in 2024. The package includes eliminating tax exemptions, rebalancing local and central revenues, and increasing excise taxes on tobacco and alcohol.

Sticky inflation and weak foreign demand are the main drivers of downside growth. Considering how the economy performed in the first half of 2023, the remainder of the year should not bring major changes, putting GDP growth at around 0.1 per cent for the year as a whole. This will be driven by weaker consumption and exports, offset by a possible upturn in investor confidence arising from declining imports, rebounding investments, and enhanced political stability amid the formation of a new government. The economy should rebound by 2.5 per cent in 2024, supported by moderating inflation, accelerated absorption of EU funds, and revived foreign demand, although fiscal consolidation will damp growth in the short term. Another energy price shock and the protracted weakness of key trading partners are the main downside risks.

Assessment of transition qualities (1-10)



Structural reform developments

Financing conditions are easing. In June 2023 the CNB eased mortgage-lending limits and reduced the counter-cyclical capital buffer from 2.5 per cent to 2 per cent. This was in response to a major decline in loan volumes following an earlier tightening of monetary policy. In addition, from January 2024, businesses will be able to keep accounts in a foreign currency (euros, dollars or pounds) if they use that currency frequently.

Corporate restructuring is being made easier. In August 2023 parliament approved a law lowering the majority threshold needed for a decision to be made from 90 per cent to 75 per cent. The new bill, once signed into law, has potential consequences for the CEZ energy group, of which the state owns 70 per cent. Increased control over energy generation could allow the state to influence the energy market more directly, subject to EU notification procedures. Meanwhile, CEZ announced a potential bid for three small modular reactors, which could generate one gigawatt of power by 2040. The first reactor is planned to be completed in 2032 at the Temelín nuclear power station; the other two will eventually replace part of the capacity at the Dětmarovice and Tušimice coal-fired power plants. Contracting is still in the early phase, particularly for the latter two reactors.

Pension reform is advancing. Reforms in this area have been somewhat piecemeal, and some have faced significant opposition. The cabinet has announced reforms to the retirement age, but not yet signed them into law. So far, the legal changes to the system include smaller but more accurate indexation, conditions that limit early retirement through indexation cuts and adjustments to benefits for the self-employed.

Energy compensation measures are likely to be discontinued in 2024. This move would be in line with the European Commission's recommendations and falling energy prices. Current energy price ceilings apply to households and to small and large businesses, with additional limits and rules around profitability eligibility for the latter. They are theoretically financed by windfall taxes on the banking, energy and petrochemical sectors, which the government forecasts to reach CZK 46 billion (€1.9 billion) in 2023. Although the windfall taxes are due to be removed in 2025, the Ministry of Finance is considering removing them (and the energy price cap) sooner.

The use of EU funds has stepped up. The authorities had used 87.1 per cent of the country's 2014-20 EU Multiannual Financial Framework funds by August 2023, alleviating concerns that major funds would be lost due to insufficient absorption. Separately, the Czech Republic requested only CZK 19.4 billion (€800 million) in loans from the Recovery and Resilience Facility, effectively cancelling some planned investments as part of a fiscal tightening drive.

The economy is absorbing increasing numbers of Ukrainian refugees. As of the middle of 2023, 46 per cent of the approximately 220,000 Ukrainian refugees of working age in the Czech Republic were employed. According to rules announced in June 2023, the state will support refugee housing for five months, but will stop providing indefinite support to private families housing refugees.

Egypt

Highlights

- **Growth has slowed amid foreign-currency shortages and a decline in natural gas production.** The subdued performance of the construction, manufacturing and natural gas sectors weighed on growth in the first three quarters of the 2022-23 fiscal year. Inflation surged to a record high and the exchange rate depreciated significantly, raising fiscal and external financing pressures.
- **The country has embarked on a programme to reduce the state's footprint in the economy and boost private investment.** The authorities published a State Ownership Policy to privatise state assets, amended the Competition Law to promote a level playing field, and enacted several regulatory reforms to attract foreign direct investment.
- **Egypt has raised its green ambitions.** Aiming to increase the contribution of renewables in the energy mix to 42 per cent by 2030 (from 31 per cent in 2021), the government launched a programme to decommission fossil-fuel plants and scale up renewable energy generation, while ensuring a just transition.

Key priorities for 2024

- **Addressing fiscal and external vulnerabilities is a top priority.** Following approval of an International Monetary Fund (IMF)-supported programme, progress has stalled amid increased fiscal and foreign-exchange pressures. Key requirements for macroeconomic stability include maintaining a flexible exchange-rate regime and ensuring fiscal and debt sustainability.
- **Progress on privatisation and structural reforms is essential for growth and investment.** Efforts have been made to strengthen competition and improve the business climate, but progress has been slow. Key priorities in the short term are to advance the country's state asset sales agenda and continue reforms to level the playing field and strengthen competitive neutrality.
- **Accelerating the green agenda is necessary to achieve Egypt's goal of becoming an energy hub.** The authorities should continue promoting investments in solar and wind energy, as well as infrastructure, to support the growth of the green hydrogen sector. This is especially important to ensure energy security and achieve Egypt's potential in light of declining natural gas production.

Main macroeconomic indicators[1] (per cent)

	2019	2020	2021	2022	2023 est.
GDP growth	5.5	3.6	3.3	6.6	4.1
Inflation (average)	13.9	5.7	4.5	8.5	24.1
Government balance/GDP	-7.5	-7.4	-6.8	-6.1	-6.0
Current account balance/GDP	-3.4	-2.9	-4.4	-3.5	-1.2
Net FDI/GDP [neg. sign = inflows]	-2.6	-1.9	-1.2	-1.9	-2.5
External debt/GDP	34.2	32.4	32.5	37.3	n.a.
Gross reserves/GDP	14.0	10.0	9.6	7.0	8.7
Credit to private sector/GDP	21.7	23.6	26.3	27.8	26.6

1. Data refer to fiscal year ending in June.

Macroeconomic developments and policy response

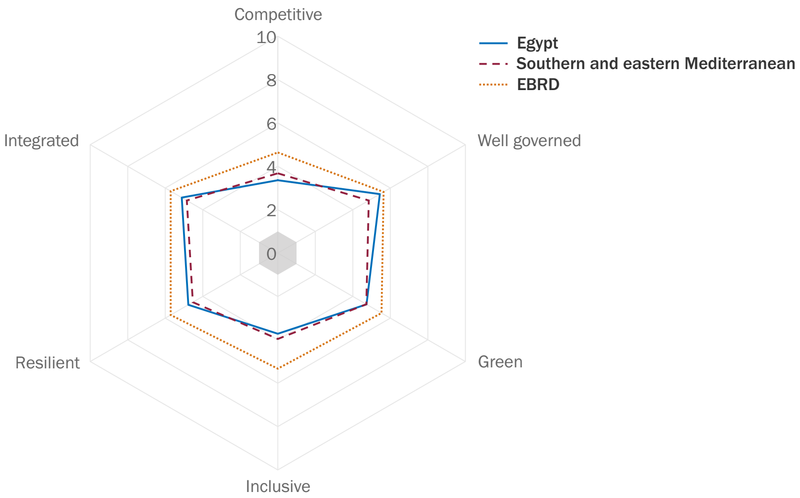
Growth slowed in the first three quarters of the 2022-23 fiscal year. Gross domestic product (GDP) grew by 4.1 per cent year on year in the first three quarters of the 2022-23 fiscal year (ending June 2023), down from 7.8 per cent in the same period of the 2021-22 fiscal year. Despite a recovery in revenues from the Suez Canal and from tourism, growth was weighed down by a deceleration in construction and manufacturing activity, as well as a contraction in gas production. Natural gas output is estimated to have declined by 10 per cent year on year in the first seven months of 2023, reaching a three-year low. Meanwhile, unemployment dropped slightly to 7.1 per cent in the first quarter of 2023, remaining at high levels among women (19.2 per cent) and in urban areas (10.3 per cent).

The authorities adopted several policies to control record-high inflation and mitigate its socioeconomic impacts. Egypt agreed to shift to a flexible exchange-rate regime as part of the IMF-supported programme, leading the central bank to devalue the pound multiple times since March 2022 (it has lost 50 per cent of its value against the US dollar since then). Inflation reached a record high of 38 per cent in September 2023. In response, the central bank has raised its key interest rates by a cumulative 1,100 basis points since April 2022. External financing risks and the uncertainty surrounding the exchange-rate regime have contributed to several international agencies downgrading Egypt's credit ratings since May 2022. Policies to mitigate the impact of inflation on citizens have included the launch of a new subsidised bread programme, as well as raising pensions, minimum wages for public and private employees, and the income-tax exemption threshold.

Fiscal pressures increased, driven by higher public spending, despite a narrower current account deficit and pick-up in foreign-exchange reserves. The fiscal deficit reached 6 per cent of GDP in the 2022-23 fiscal year. Higher spending on public investment, public wages, subsidies and social welfare, as well as inflation, higher interest rates and the currency's depreciation pushed up expenditures, although tax-collection revenues also rose. Gross public debt was an estimated 94.7 per cent of GDP in the 2022-23 fiscal year (up from 88.5 per cent in the 2021-22 fiscal year). Meanwhile, the current account deficit narrowed to an estimated 1.2 per cent of GDP by the end of the 2022-23 fiscal year, driven by higher tourism, Suez Canal revenues and a contraction in import demand due to foreign-currency shortages. Natural gas exports declined by 75.6 per cent year on year in April 2023, driven by the drop in global prices and decline in domestic production. Foreign-exchange reserves recovered slightly to reach US$ 35 billion (€33.2 billion) in September 2023, covering 5.5 months of imports.

Growth is expected to pick up over the medium term. GDP is expected to grow by 4.8 per cent in the 2023-24 fiscal year, as external and fiscal vulnerabilities ease and recent reforms to boost private-sector growth start to pay off. Headwinds that might hold back growth include higher inflationary and currency pressures, tighter monetary conditions and potentially slower progress on the structural reforms necessary to empower the private sector. The recent decline in natural gas production and exports could present additional risks to the outlook.

Assessment of transition qualities (1-10)



Structural reform developments

The IMF approved a programme to support Egypt's economic reforms. The 46-month US$ 3 billion (around €2.9 billion) Extended Fund Facility was approved in December 2022, supporting a shift to a flexible exchange-rate regime, fiscal consolidation, debt sustainability and the implementation of structural reforms to encourage private-sector-led growth. The first review was scheduled for March 2023, but was delayed amid slow progress on the exchange-rate reform and privatisation programme. It is now expected to take place alongside the second review in autumn 2023.

Egypt embarked on a privatisation plan to reduce the state's footprint. A new State Ownership Policy was published in January 2023, aiming to increase the role of the private sector to 65 per cent and attract US$ 40 billion (€38 billion) in private investment by 2026. In February 2023 the government announced a plan to sell stakes in 32 state-owned enterprises (SOEs), which it later expanded to 35 SOEs in August 2023, either to strategic investors or through initial public offerings. Despite the slow progress, momentum started to pick up in the second half of the fiscal year, with the government announcing the sale of US$ 1.9 billion (€1.8 billion) in SOE stakes by July 2023 (almost meeting the announced US$ 2 billion target).

The government passed key regulatory reforms to improve the business climate and promote a level playing field. In line with the new State Ownership Policy, the government and the Egyptian Competition Authority (ECA) instituted several measures in late 2022 to promote fair competition. These included: (i) amending the Competition Law to empower the ECA to regulate mergers and acquisitions and prevent anti-competitive economic behaviour; (ii) issuing a new Competitive Neutrality Strategy; and (iii) establishing the High Committee for Competition Policy and Competitive Neutrality. The authorities also introduced another round of amendments to the public-private partnership (PPP) law in September 2022 to facilitate the process and improve communication on potential projects. Lastly, the central bank announced in November 2022 the discontinuation of subsidised lending schemes to limit credit-market distortions, in addition to cancelling the letters-of-credit requirement in December. These measures had been designed to ease pressure on foreign reserves, but had suppressed imports and created shortages in some products.

Measures to support the green economy transition are advancing. The authorities plan to generate 42 per cent of Egypt's electricity needs from renewables by 2030. To support this goal, the government launched the Country Platform for the Nexus on Water, Food and Energy (NWFE) on the sidelines of the COP27 climate conference, which was hosted in Egypt in November 2022. Under the NWFE's energy pillar, there are plans to decommission 5 GW of fossil-fuel capacity (9 per cent of Egypt's installed capacity) and replace it with 10 GW of private solar and wind energy by 2028, while ensuring a just transition. Moreover, in November 2022 the government launched the Sovereign Sustainable Financing Framework, an update of the 2020 Green Financing Framework, to expand green and sustainable financing by exploring the issuance of green, blue, social, sustainable and gender bonds. In parallel, Egypt is advancing the green hydrogen agenda to leverage its renewable energy potential and become a regional energy hub.

The central bank continues to promote financial efficiency and inclusion, including through digitalisation. In July 2023 a new reform programme was announced to enhance the efficiency of the financial sector, supported by a US$ 615 million (€583 million) loan from the Arab Monetary Fund. The programme aims to: (i) enhance the soundness and efficiency of the payment systems infrastructure; (ii) strengthen the supervisory and regulatory framework; (iii) enhance financial technologies and strengthen security; and (iv) improve financial inclusion and sustainability. In May 2023 the central bank launched the country's first payment service mobile application (Instapay) to promote financial inclusion, allowing users to instantly transfer funds from their bank accounts to any local bank account or digital wallet without additional fees.

The government embarked on a natural gas exploration programme to boost exports and improve energy security. In July 2023, in parallel to its green energy drive, the government announced a programme to mobilise US$ 1.8 billion (€1.7 billion) worth of investments to dig 35 new gas wells in the Nile Delta and Mediterranean. The government aims to increase oil and gas exports by 12 per cent in 2023 and an additional 15 per cent the following year, to reach US$ 24 billion (€23 billion) by 2024.

Estonia

Highlights

- **The economy continues to contract.** Net exports have slumped, reflecting persistent inflationary pressures and subdued demand in the region, but domestic inflation is now on a downward trend, with real wage growth turning positive again.
- **Estonia aims to enhance energy independence and renewable energy with European Union (EU) REPowerEU funds.** Ninety million euros in funds from REPowerEU, approved in December 2022, are expected to help the country counteract future energy shocks and accelerate the move to renewable energy.
- **Healthcare reforms are under way, targeting the accessibility and affordability of long-term care.** The country implemented the first reform in July 2023, which focused on reducing the costs of general care services and prepared the way for further reforms to enhance the quality and affordability of healthcare services.

Key priorities for 2024

- **Further efforts are needed to achieve energy independence from Russia.** This will require, among other things, Estonia to disengage from the Belarus, Russia, Estonia, Latvia and Lithuania (BRELL) power system by early 2025 and take steps to ensure the country has stable liquefied natural gas (LNG) sources if there are supply disruptions.
- **Green transition should be advanced towards the 2030 energy and climate targets.** The focus in the short term should be on attracting enhanced investments in renewable energy sources and retrofitting the housing stock for energy efficiency.
- **The Recovery and Resilience Plan (RRP) should be implemented in a timely way.** The country is set to receive a total of €3.5 billion from the 2021-27 EU budget for the green transition and socioeconomic development. However, further efforts are needed as the country has been slow to fulfil its RRP milestones and targets.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.0	-1.0	7.2	-0.5	-1.8
Inflation (average)	2.3	-0.6	4.5	19.4	10.0
Government balance/GDP	0.1	-5.4	-2.5	-1.0	-3.5
Current account balance/GDP	2.5	-1.9	-2.6	-3.2	1.9
Net FDI/GDP [neg. sign = inflows]	-3.8	-10.7	-2.4	-0.3	-0.4
External debt/GDP	75.6	88.7	85.1	84.7	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	59.8	63.8	60.3	58.3	n.a.

Macroeconomic developments and policy response

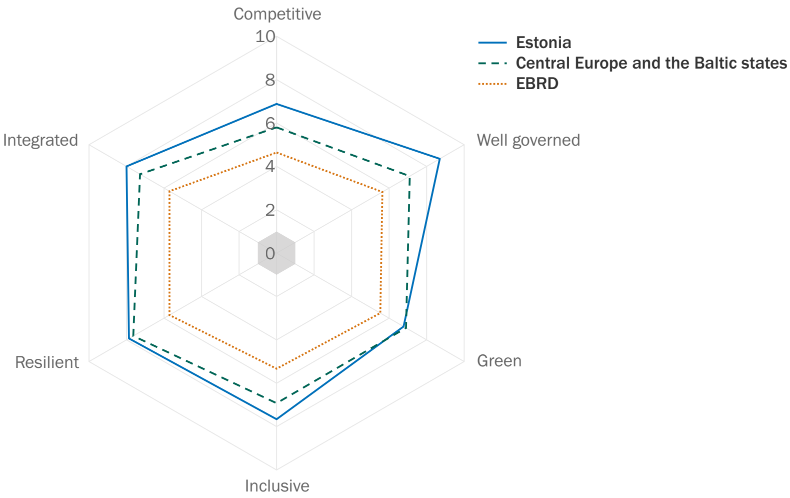
The economy remains in recession but is showing signs of a slow recovery. Gross domestic product (GDP) shrank by 3.3 per cent year on year in the first half of 2023 after contracting by 0.5 per cent in 2022, owing largely to the fallout from the war on Ukraine. Persistent inflation has taken a toll on real wages, and hence private consumption, while investment has continued to decline. Exports and imports are both falling due to weaknesses in the economies of key trading partners, resulting in worsening employment in sectors such as industry and trade.

Inflation is falling. The inflation rate peaked at 25.2 per cent in August 2022 but has been on a downward trend since then, reaching 6.4 per cent in July 2023, largely thanks to reductions in food, housing and transport prices. A further drop in inflation is likely as uncertainty concerning the war on Ukraine continues to translate into slower demand. Food and energy prices are easing, but retail sales (excluding vehicles) have fallen, reflecting the impact of past price increases on household consumption. The labour market remains tight, with an employment rate approaching historically high levels, but registered unemployment increased to 6.7 per cent in the second quarter of 2023. The country implemented several amendments to the Employment Contracts Act and Occupational Health and Safety Act, and the government raised the national monthly minimum wage from €654 to €725 in the winter of 2023.

Fiscal policy remains prudent. The government budget recorded a deficit of just 0.9 per cent of GDP in the first half of 2023. This result was better than expected and reflected higher tax revenues, partly owing to a strong rise in nominal wages. The deficit is forecast at 3.5 per cent of GDP for 2023 as a whole. To partially cover this deficit, in June 2023, the country increased the value of 10-year government bonds (worth €1 billion to date) by a further €500 million. General government debt in 2022 amounted to 18.4 per cent of GDP, still the lowest ratio in the EU.

An economic rebound is expected in 2024. Real GDP is forecast to shrink by 1.8 per cent in 2023, before recovering to 2 per cent growth in 2024. Private consumption is expected to pick up slowly in light of strong nominal wage growth in excess of inflation raising real disposable incomes. Exports are expected to remain subdued, given limited demand resulting from ongoing weaknesses in key trading partners. Key risks to the outlook are linked to the uncertainty caused by the war on Ukraine and concerns about energy security and energy price fluctuations.

Assessment of transition qualities (1-10)



Structural reform developments

Healthcare reforms have begun. The reforms adopted by the parliament in 2022 aim to improve the accessibility and affordability of long-term care and strengthen the quality of healthcare services. According to Eurostat data, self-reported, unmet healthcare needs amounted to 9.1 per cent in Estonia in 2022, versus an EU average of 2.2 per cent. The first reform, implemented in July 2023, aims to reduce out-of-pocket payments for general care services. The changes are part of Estonia's 16 key reforms under the RRP.

The pan-Baltic capital market is set to benefit from single index classification. The new single index, which was launched at the same time as the August 2023 Index Review, will allow the three markets to be integrated into the Morgan Stanley Capital International (MSCI) universe and will raise the region's profile among international investors who track MSCI indices. The approach is in line with efforts made by the ministries of finance in Estonia, Latvia and Lithuania, the European Bank for Reconstruction and Development, the European Commission and Nasdaq Baltic to create a single pan-Baltic capital market, as outlined by a memorandum of understanding signed in November 2017. The approach is also a building block of the EU's capital markets union initiative.

Efforts to become independent of Russian energy are intensifying. Estonia, along with Lithuania and Latvia, is continuing to move towards disengaging from the BRELL power system. In view of Russia's ongoing war on Ukraine, the three Baltic states have signed an agreement to accelerate this disengagement and focus instead on connecting to the European grid in early 2025. This means that the countries will officially inform all parties of their disconnection from the Russia-linked grid as early as August 2024. Estonia and Latvia signed a memorandum of understanding in May 2023 to jointly use the LNG terminal in the port of Paldiski in Estonia, via a floating storage re-gasification unit. The agreement aims to enable countries to purchase LNG if there are disruptions in natural gas supply.

The largest green energy tender has been held. This tender was launched in March 2023 and bids were submitted until September 2023. Power generation is expected to start no later than July 2027. The tender is expected to provide Estonia with 650 GWh of green energy, supplying around 215,000 households. This is the fifth national tender of this type in Estonia conducted by Elering, the national transmission system operator for electricity and natural gas. In February 2023 the country introduced subsidies for individuals and businesses to purchase zero-emission vehicles. The subsidies are worth €4,000 for individuals and €5,000 for companies per car, and €1,250 and €1,000, respectively, per bicycle.

There have been delays in the mobilisation of EU funds. The country is at risk of losing hundreds of millions of euros because of delays in meeting the necessary conditions. Of the €126 million of pre-financing the Ministry of Finance received in December 2021, €100 million remains unused. The EU recovery measures need to be aligned with a strict spending schedule, with operations of €1 billion to be completed by the first half of 2026. The country may otherwise lose funding intended to help mitigate the effects of the pandemic.

REPowerEU funds are targeting energy independence and renewable energy. The government approved €90 million of funding from the EU REPowerEU facility in December 2022 to counteract energy shocks and accelerate the development of renewable energy. The funding will help the country to achieve its target of full reliance on renewable energy sources by 2030, increase biogas production and deployment, strengthen grid integration capacity and allocate energy efficiency grants for small houses.

A major wind farm project is under way. The country's largest onshore wind farm, which should be completed in 2025, will increase national wind production by around 80 per cent. Enefit Green, an Estonian renewable energy company, secured €180 million to finance the project in September 2023. The wind farm is intended to cover 8.5 per cent of the country's electricity consumption and 40 per cent of households' energy needs.

A new car tax to reduce CO_2 emissions has been approved. The tax was adopted among several other amendments to tax legislation that parliament approved in July 2023. The tax includes a one-time registration fee and an annual fee based on CO_2 emissions and luxury car components.

Georgia

Highlights

- **Growth remained robust, at 7.6 per cent year on year in the first half of 2023.** The extraordinary growth factors that have prevailed over the past year are gradually receding, and inflation has fallen below the central bank's target.
- **The European Commission (EC) has acknowledged progress on fulfilling the 12 requirements for European Union (EU) accession status.** In November 2023 the EC recommended to the European Council that Georgia be granted the status of candidate country once the 12 priorities are fully addressed.
- **There is increased focus on improving connectivity in the changing geopolitical environment.** Georgia is working with Azerbaijan, Hungary and Romania to connect the Caucasus to Europe through an electric cable under the Black Sea and to take action to increase the attractiveness of the Middle Corridor trade route between Asia and Europe.

Key priorities for 2024

- **The authorities should focus on implementing reforms that address the remaining priorities highlighted by the EC.** Progress on establishing independent anti-corruption institutions, an impartial judicial system and other priorities are crucial not only to progress on EU candidacy, but also to making another leap forward in improving the business environment.
- **Reform of state-owned enterprises (SOEs) should be speeded up.** It is necessary to have a clear governance framework in place for all SOEs and to adhere to best international corporate governance standards. SOEs should operate on commercial principles and be subject to the same regulatory requirements as private enterprises.
- **Reforms in the energy sector need to advance.** The authorities should avoid further delay in the development of competitive and organised domestic electricity and gas markets.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	5.0	-6.8	10.5	10.1	6.0
Inflation (average)	4.9	5.2	9.6	11.9	2.4
Government balance/GDP	-2.7	-9.3	-6.3	-2.5	-3.0
Current account balance/GDP	-5.9	-12.5	-10.4	-4.6	-6.1
Net FDI/GDP [neg. sign = inflows]	-6.1	-3.6	-5.0	-7.2	-4.6
External debt/GDP	107.9	131.7	118.4	95.5	n.a.
Gross reserves/GDP	20.1	24.7	22.9	19.9	n.a.
Credit to private sector/GDP	61.7	74.6	69.2	60.0	n.a.

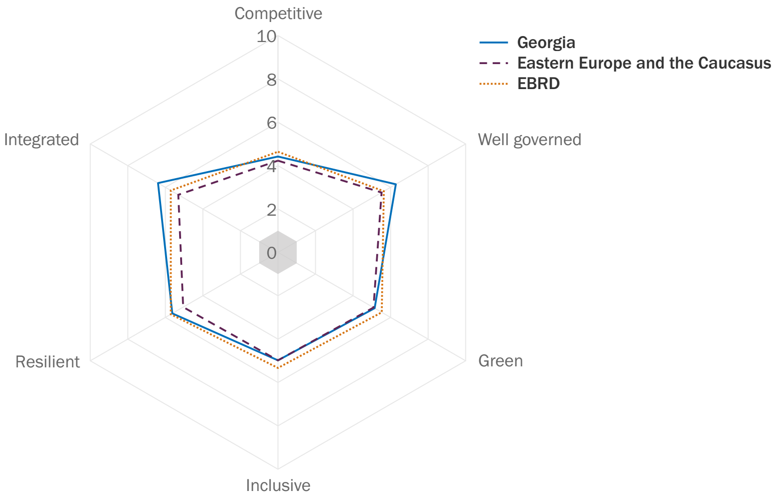
Macroeconomic developments and policy response

Economic growth has started to moderate from very high levels. After two years of double-digit growth, gross domestic product (GDP) grew by 7.6 per cent year on year in the first half of 2023, largely driven by the construction, trade, tourism and financial sectors. Transportation and energy supply, however, registered declines over the same period. Exports and imports of goods increased 19.4 and 24.3 per cent year on year, respectively, moderating after the extraordinary growth achieved last year. Income generated by foreign travellers continued to soar, up 57.9 per cent on the year in the first half of 2023, exceeding levels in the pre-pandemic period. The growth in tourism has included many visitors from the EU, Israel and neighbouring countries, suggesting the full recovery of this important industry. Growth in net money inflows continued, at 34.7 per cent year on year in the first half of 2023, helping to cover a significant part of the trade deficit and bring down the current-account gap. These trends lifted foreign reserves to US$ 5.4 billion (around €4.9 billion) in July 2023, covering 4.2 months of imports, and enabled the Georgian lari to remain broadly stable after strong appreciation in 2022.

Inflation has fallen below target. After two years of being well over the central bank's target of 3 per cent, annual inflation slowed to 0.7 per cent in September 2023 on the back of tight monetary policy, lower commodity prices and a stronger domestic currency. Fiscal policy also contributed, with a budget surplus in the first half of the year as a result of buoyant revenues. The National Bank of Georgia responded to the disinflation with a 50 basis-point cut in its policy rate in May 2023 and further 25 basis-point cuts in August and September to 10 per cent. The central bank remains cautious amid strong domestic demand and the persistently high level of cash inflows from migrants.

Robust growth is likely to continue in the short term. GDP growth is forecast to moderate to 6 per cent in 2023 and 4.5 per cent in 2024. Geopolitical uncertainty in the region remains the main downward risk to the forecast. The possibility of obtaining EU candidate status, in contrast, could give new impetus to growth-conducive reforms and promote economic stability.

Assessment of transition qualities (1-10)



Structural reform developments

Efforts have been made to implement the requirements for gaining EU candidate status. In the past year, the authorities achieved progress on the 12 priorities set out by the EC in 2022 as conditions for granting Georgia candidate status for EU membership. As a result, in November 2023 the EC recommended that the European Council grant Georgia the status of candidate country once these 12 priorities are fully addressed.

Parliament has rejected the draft law on de-oligarchisation, acknowledging the need for a systemic approach. Parliament halted the legislative process to regulate de-oligarchisation with a specific law, accepting the opinion requested from the Venice Commission, the Council of Europe's body of constitutional experts. Instead, Georgia's EU Integration Commission, led by the prime minister, adopted an action plan for eliminating the excessive influence of vested interests in economic, political and public life, which follows the Venice Commission's proposal for a holistic set of measures. The action plan includes amendments to the legislation in all areas identified by the Venice Commission. Although this is a move in the right direction, the action plan has not yet been implemented.

Measures promoting the fight against corruption progressed, but fell short of fully meeting the EC's recommendations. The Anti-Corruption Bureau of Georgia was established as a legal entity following a vote in parliament in November 2022. The entity has a mandate to promote the fight against corruption and develop relevant proposals for the prevention, detection and suppression of conflicts of interest in public institutions. However, the law does not grant the Anti-Corruption Bureau investigative powers. In an additional setback, the government recently decided to withdraw from the monitoring of the Organization for Economic Co-operation and Development Anti-Corruption Network for Eastern Europe and Central Asia (OECD/ACN), raising concerns about the country's commitment to anti-corruption reforms.

Energy links with neighbouring countries are being developed. In December 2022 the authorities signed a memorandum of understanding for new energy interconnections with European countries through an electric cable under the Black Sea, which will improve connectivity and energy security. The agreement on a feasibility study for a 500 kV Black Sea electric cable project connecting with Georgia and Azerbaijan with Romania and Hungary is an important step forward in transforming Georgia into an electricity hub and integrating the country into the EU's internal electricity market. A parallel digital data cable connecting Georgia with European countries is part of the same project.

Georgia has delayed the opening of its electricity market. In June 2023 the Georgian government decided to postpone the opening of the electricity market, originally scheduled for 1 July, by one year. The last-minute postponement raised uncertainty among market participants and investors. Establishing a fully functioning and liquid domestic electricity market remains a key prerequisite to Georgia's continuing integration with the European energy sector.

Some progress has been made in the field of environment and climate change regulation. The central bank has published a Sustainable Finance Taxonomy that establishes a system for classifying economic activities in accordance with their social, green and sustainable status. This forms the basis for banks' loan classification, and reporting and measuring their impact against climate and social goals. The government has also approved a new plan for ambient air quality management of central Georgia (which includes two of the country's regions) for 2023-25 that aims to reduce air pollution, assess the impact of air pollution on human health and raise public awareness of its importance. Georgian State Electrosystem has started to issue certificates of origin for electricity produced from renewable energy sources, allowing consumers to choose the origin of their energy.

Digital upskilling has advanced. In July 2023 Georgia's Innovation and Technology Agency, supported by the EU, launched an information technology (IT) ecosystem, which aims to provide training to more than 1,300 Georgian citizens in high-demand digital professions, with a special emphasis on women's participation in the IT industry.

The authorities are taking concrete steps to improve connectivity. In August 2023 the government approved the National Transport and Logistics Strategy 2023-30 and associated Action Plan for 2023-24. The main goal of the strategy is to establish the country as a transportation and logistics hub by implementing EU directives in this area, digitalising the transport and logistics sectors, and attracting investments in road infrastructure and high-speed railway connections with neighbouring countries.

Greece

Highlights

- **Growth continues in 2023, but at a slower pace.** Following two years of rapid growth in 2021 and 2022, gross domestic product (GDP) rose by 2.4 per cent year on year in the first half of 2023, driven by rising consumption and exports of goods and services, as well as a significant pick-up in investment and a strong start to the tourist season.
- **Greece has returned to investment grade.** High post-Covid economic growth rates and continued structural reforms have led to international ratings agencies successively raising the country's sovereign rating in recent years. In September 2023 DBRS Morningstar raised Greece's rating to an investment-grade BBB (low), while in October 2023, Standard & Poor's upgraded its rating to BBB-, with a stable outlook.
- **Implementation of the country's Recovery and Resilience Plan (RRP) is progressing well.** By August 2023 around €11 billion had been allocated in cash receipts, with a focus on the green transition and digitalisation of the economy.

Key priorities for 2024

- **Continued implementation of the revised RRP is essential to boost investment.** Greece should capitalise on the substantial European Union (EU) funds available in the coming years to make fundamental improvements to the whole economy.
- **Adhering to the green agenda at an accelerated pace is crucial.** Greece is already facing the consequences of climate change, highlighting the need to move away from fossil fuels and vigorously promote investments in renewable energy, along with vital improvements to the national electricity grid.
- **Judicial reform is urgently needed.** The legal system remains plagued by lengthy delays and inefficiencies, hampering the smooth functioning of businesses. Efforts should be stepped up to reduce the length of time cases take to be resolved.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	1.8	-9.0	8.4	5.9	2.4
Inflation (average)	0.5	-1.3	0.6	9.3	4.1
Government balance/GDP	0.0	-10.5	-7.7	-2.3	-1.6
Current account balance/GDP	-2.2	-7.3	-7.1	-10.1	-6.9
Net FDI/GDP [neg. sign = inflows]	-2.1	-1.4	-2.3	-2.2	-1.9
External debt/GDP	244.6	298.7	305.3	262.8	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	81.0	82.3	57.1	n.a.	n.a.

Macroeconomic developments and policy response

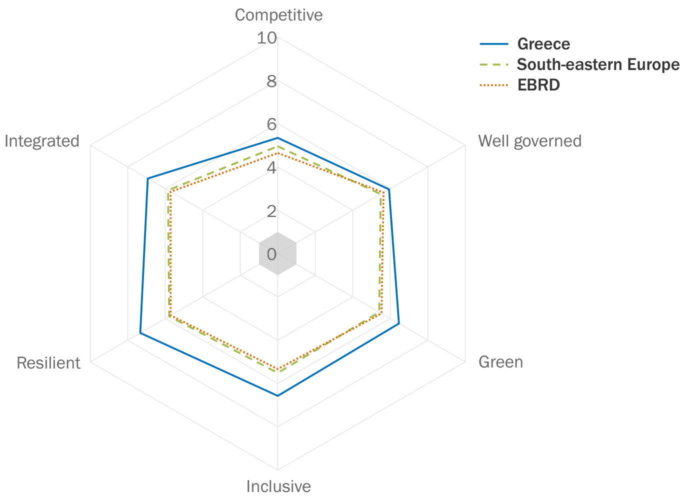
Growth is continuing in 2023, but at a reduced pace. After two years of very strong economic performance, the pace of growth has slowed, to 2.4 per cent year on year in the first half of 2023. Private consumption and gross fixed capital formation continue to drive growth, and most indicators are moving in the right direction. Economic confidence was steadily improving in the first eight months of 2023. The Purchasing Managers' Index had been on an upward trend since December 2022, reaching 52.9 in August 2023, and the Economic Sentiment Indicator hit a 17-month high (111.7 points) in August 2023. Both indicators have since fallen, however, to 50.8 and 106.4 respectively in October. Unemployment maintains a steady downward trend, coming in at 10 per cent (seasonally adjusted) in September 2023. Despite some concerns about the current account deficit (10.1 per cent of GDP in 2022), exports were up by 8.9 per cent year on year in the first quarter of 2023. And the ratio of gross fixed capital formation to GDP is rising steadily, albeit from a very low base – from below 11 per cent in 2019 to nearly 14 per cent in 2022.

Inflation has fallen markedly from its peak in 2022. The inflation rate rose sharply in 2022, mainly because of rising food and energy costs, peaking at 12 per cent in September 2022. Since then, it has been falling rapidly, to 1.6 per cent in September 2023 (CPI measure). A mild pick-up in the rate is possible later in the year and into 2024 due to the end of government support measures, but the prospect of a sharp rise in prices seems remote.

Fiscal performance has further improved. The government faced significant challenges in 2022 as a result of the energy crisis prompted by Russia's invasion of Ukraine. It responded with a series of mitigating measures, which came at a significant fiscal cost. Despite this, the government managed to achieve a small primary surplus (0.1 per cent of GDP) in 2022 and is on track for larger primary surpluses in 2023 and 2024, targeted at 1.1 per cent and 2.1 per cent of GDP, respectively. The country's public debt-to-GDP ratio remains the highest in Europe, but has fallen sharply in the past two years, from nearly 200 per cent at the end of 2020 to less than 170 per cent at the end of 2022, thanks to high nominal GDP growth and further debt-relief measures.

Moderate growth is likely to continue in the short run. We forecast GDP growth to continue at its current rate of 2.4 per cent in 2023, with a similar rate (2.3 per cent) in 2024. Significant risks to our forecast come from possible regional and global turbulence, while the wildfires and floods of summer 2023 are a reminder of how global warming could jeopardise the long-term health of the Greek economy. However, the good progress made in implementing projects funded by the Recovery and Resilience Facility (RRF), allied to improvements in the sovereign rating that will likely boost investor sentiment further, mitigate these downside risks.

Assessment of transition qualities (1-10)



Structural reform developments

Implementation of the RRP is advancing. Under the original plan approved by the European Commission, Greece was set to receive €17.8 billion in grants and €12.7 billion in loans overall from the RRF. In 2023, the authorities submitted a revised plan to the Commission, requesting a further €5 billion in loans and nearly €800 million in grants related to energy investments and reforms under the EU's REPowerEU scheme. By August 2023, cash receipts from the EU in grants and loans combined amounted to €11 billion, but the pace of disbursement to firms has been somewhat slow so far.

The development of renewable energy is proceeding rapidly. The law on licensing renewable energy projects was simplified in June 2022, and there have been a number of prominent investments since then. Renewable energy's share of the electricity production mix reached a record 54 per cent in May 2023, according to data from the independent power transmission operator. In May 2023, the government set out the timetable for a set of renewable energy auctions over the remainder of 2023 and 2024, along with maximum prices. Investment in renewable infrastructure is also progressing. Under the RRF's "electromobility" framework, the government is forging ahead with its plan for sustainable transport by replacing old buses and taxis with new electric ones and providing charging infrastructure.

Digitalisation is helping to tackle the shadow economy. Tax evasion and informal activities have long been features of the Greek economy. The size of the shadow economy could amount to around €40 billion (about one-fifth of GDP), according to 2023 research by Eurobank. The European Commission also estimates the size of the "VAT gap" (the difference between actual VAT receipts and what they should be according to consumption data) to be more than twice the EU-27 average. There have been efforts in recent years to tackle the problem through digitalisation. For instance, a budget of €258 million was allocated to the digital transformation of the tax and customs administration. By the end of March 2023, more than 447,500 businesses had connected their cash registers with myDATA to automatically track their retail transactions online.

Banking-system profitability remains strong and non-performing loans continue to decline. After a year of rising profits for the country's four systemic banks in 2022, helped by higher interest rates and a rapidly growing economy, banking-system profitability fell in the first half of 2023 on the back of rising operating expenses and lower income from trading and other activities. The ratio of non-performing to total loans has maintained a steady downward trend, from a peak of 49.2 per cent in mid-2017 to 8 per cent as of June 2023. The asset-backed Hercules resolution scheme, introduced in early 2020, may be extended with a focus this time on small banks. A key concern with regard to the banking system, however, remains the high share of deferred tax credits in banks' overall capital.

Privatisations are advancing, albeit slowly. Revenue from sales of state assets continued to underperform in 2022, at just €595.3 million versus a budgeted €2.2 billion. The Asset Development Plan of the Hellenic Republic Asset Development Fund (HRADF) was revised in November 2022 and includes 30 ongoing projects. Forecast revenues in 2023 are just under €2 billion, according to the state budget. In September 2023, GEK Terna, which had won the tender in 2021 for a 35-year concession for the Egnatia Odos highway, was declared the preferred bidder for a 25-year concession on the Attiki Odos highway, with a bid of €3.27 billion.

Labour-market reforms continue. Following the adoption of the framework-setting National Strategy for Active Labour Market Policies 2022-30, the Active Labour Market Policies (ALMP) reform aims to ensure the strategy is as effective as possible by redesigning, strengthening and reforming the ALMP toolbox. Recent reforms include a new framework for teleworking and various measures to make the labour market more flexible, including incentives for private-sector companies to convert part-time contracts to full-time ones.

Hungary

Highlights

- **The economy entered into recession in the first half of 2023.** Hungary currently has the highest inflation in the European Union (EU), damaging households' purchasing power since late 2022, and the slowdown in consumption has been accompanied by ongoing fiscal consolidation and subdued investment.
- **The government launched its economic protection plan.** It is designed to alleviate the negative impacts of the Russian war on Ukraine, including high energy and food inflation, energy insecurity, supply-chain disruptions and tight financing conditions for companies and households.
- **New energy supply routes and sources have been secured.** While the government signed agreements on gas supplies from new sources, it has not reduced its dependence on Russian energy, unlike Hungary's peers in central Europe and the Baltic states.

Key priorities for 2024

- **To unfreeze EU funds, including those from the Recovery and Resilience Facility (RRF), all super-milestones must be implemented.** Rule of law is one of the key concerns of the European Commission, and it will be important to follow the recommendations of the anti-corruption working group, established in 2022, which published its first report in March 2023.
- **Fiscal sustainability would benefit from more market-friendly support measures.** Ongoing fiscal consolidation will be critical once Hungary triggers the EU's excessive deficit procedure, and more targeted (rather than universal) fiscal support measures would put the economy on a more sustainable path.
- **Checks and balances need to be preserved amid increased state participation in the economy.** The government should take particular care to ensure high corporate governance standards in sectors where the state is expanding its ownership, following the recent acquisition of two major telecommunications companies and the announcement of plans to increase state ownership in other strategic sectors.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.9	-4.5	7.1	4.6	-0.2
Inflation (average)	3.4	3.4	5.2	15.3	18.0
Government balance/GDP	-2.0	-7.6	-7.2	-6.2	-5.5
Current account balance/GDP	-0.8	-1.1	-4.2	-7.2	-1.0
Net FDI/GDP [neg. sign = inflows]	-0.6	-1.6	-2.1	-2.8	-2.0
External debt/GDP	74.3	84.3	87.3	91.0	n.a.
Gross reserves/GDP	19.4	26.2	23.9	23.3	n.a.
Credit to private sector/GDP	31.8	34.9	34.7	32.6	n.a.

Macroeconomic developments and policy response

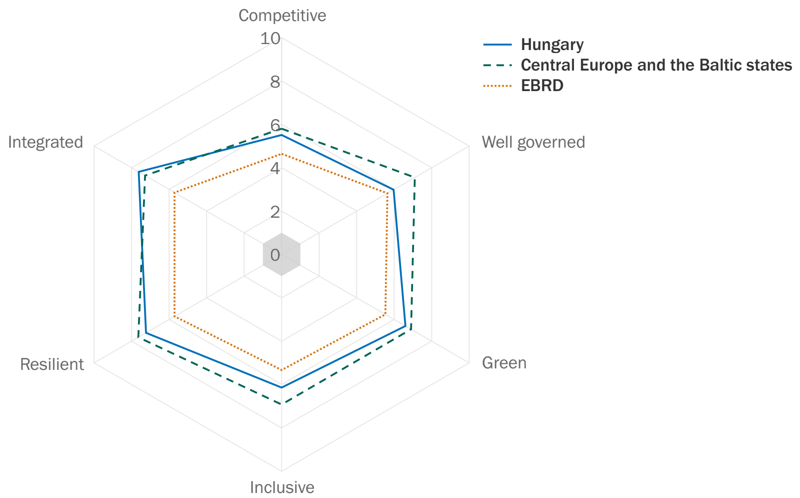
The economy entered a recession in the first half of 2023. Following robust growth in gross domestic product (GDP) of 4.6 per cent in 2022, economic activity shrank by 1.7 per cent year on year during the first half of 2023. The previous year's strong household consumption was largely fuelled by the government's pre-election fiscal expansion and anti-inflation shield programmes. But higher government spending led to elevated demand, and increased energy and food prices caused inflation to rise sharply, which has been damaging households' purchasing power since late 2022. Ongoing fiscal consolidation and decelerated investment have weighed on GDP performance since the fourth quarter of 2022. Fiscal consolidation in 2022 forced a freeze of several infrastructure investments, and total investment grew by just 0.1 per cent in 2022. It since plunged by 10.7 per cent in annual terms in the first half of 2023.

Inflation rates are the highest in the EU. The annual Harmonised Index of Consumer Prices (HICP) inflation rate peaked at 26.2 per cent in January 2023, and while it has been falling since then, it was still the highest among EU member states as at September 2023, at 12.2 per cent. As a result, real wages have been decreasing since the middle of 2022, dropping by 14 per cent year on year as at August 2023. The unemployment rate remains at a historical low, below 4 per cent since summer 2021, and the government relaunched its job-creation programme in January 2023 with the aim of keeping the economy at full employment during the current slowdown. Through subsidising employers' wage costs, the programme is expected to create more than 20,000 jobs, with a total cost of HUF 17.6 billion (€45.8 million).

Fiscal consolidation continues, but subsidised utility prices have been extended into 2024. The government has focused on fiscal consolidation, which led to a narrowing of the general government deficit to 6.2 per cent of GDP in 2022. Further savings are expected in 2023 and 2024, in line with plans to generate savings and enhance the efficiency of public spending. The government launched a public spending review to address the EU country-specific recommendations from May 2023. The general government deficit is expected to fall to 5.5 per cent of GDP this year before dipping below 3 per cent of GDP in 2024, as stated in the 2024 budget law, which parliament approved in July 2023. At the same time, the government earmarked HUF 1,340.7 billion (€3.5 billion, 2 per cent of GDP) in the 2024 budget to support regulated utility prices, to be largely financed out of windfall taxes on energy suppliers. These measures include subsidies to utilities to cover losses stemming from the fixed regulated utility prices, and support schemes for energy-intensive companies.

Economic growth stalled in 2023 but should pick up in 2024. Stagnant external demand and postponed investments, amid tight financing conditions and delayed inflows of EU funds, will likely result in a 0.2 per cent contraction of GDP in 2023. However, with inflation on a downward path from current highs, household purchasing power is expected to start improving in late 2023, as nominal wages continue to grow at double-digit rates. A recovery in economic activity, of 2.8 per cent, is forecast in 2024, when domestic demand strengthens and planned investments, some funded by the EU and others by foreign direct investors, materialise.

Assessment of transition qualities (1-10)



Structural reform developments

New energy supply routes and sources have been secured. The government wants to reduce its dependence on energy imports. Amid increasing solar electricity generation, more electricity should be produced in the new Russian-built Paks nuclear power plant. In August 2023 the expansion of the nuclear plant entered the construction phase and electricity production is expected by the beginning of the next decade. The government has secured new liquefied natural gas (LNG) deliveries from Azerbaijan and Croatia, and is working on new potential deliveries from Romania and Qatar, as well as from Algeria through a new gas pipeline with Slovenia. At the same time, in April 2023 Hungary signed a new agreement with Russia to buy additional quantities of gas on top of the 4.5 billion cubic metres per year under the ongoing long-term gas contract. There is also a continuous oil supply from Russia through the Druzhba pipeline through Ukraine. Meanwhile, in May 2023 the state-owned oil and gas group, MOL, signed a contract for oil deliveries via a Croatian pipeline, and in March 2023 it started supplying its refinery in Bratislava with its own crude oil extracted in Azerbaijan, where the company has a 9.57 per cent stake in an oil field.

Mandatory food price discounts and a price monitoring system have been introduced. Both initiatives were launched in June 2023 because the food price caps were set to terminate in August 2023. The mandatory price discount scheme is another anti-inflation tool that forces supermarkets to provide a 15 per cent discount, from the lowest price in the preceding 30 days, on one food product from each of 20 categories, to be applied on a weekly basis. At the same time, the competition authority launched a new price monitoring system that allows customers to browse through the offers of six retail chains.

Progress on the rule of law is uneven, delaying the disbursement of EU funds. Hungary will be able to tap into funding from the RRF only once it has fulfilled 27 super-milestones, mostly concerning the rule of law, requested by the European Commission in November 2022. In addition, in December 2022 the Commission approved Hungary's partnership agreement on 2021-27 cohesion funds worth €21.7 billion, to be allocated among 11 operational programmes supporting regional development, digitalisation, green investment and inclusion. In its July 2023 Rule of Law Report, the Commission noted some progress, but reiterated its concerns with respect to Hungary's judicial system, especially its lack of transparency around case allocations in lower courts and the lack of a robust track record of investigating corruption allegations concerning high-level officials. Pending the Commission's green light, further delays in the disbursement of EU funds are possible.

Subsidised loan programmes have been launched. In December 2022 state-owned development bank MFB launched its lending scheme for small and medium-sized enterprises (SMEs), worth HUF 313 billion (€820 million), to help reduce SMEs' operating costs through fixed, zero-interest-rate loans. In January 2023 state-owned Eximbank launched a corporate lending programme, extended to HUF 1,000 billion (€2.6 billion), to provide companies with forint loans capped at 6 per cent interest and euro-denominated loans fixed at 3.5 per cent interest. On top of the existing subsidised loan schemes, a three-pillar capital support programme worth HUF 600 billion (€1.6 billion) was launched in March 2023. Its first pillar, worth HUF 150 billion (€390 million), is designed to support the construction sector, including green construction, and investments on the Budapest stock exchange. The government aims to provide financial support to the economy worth HUF 3,600 billion (€9.4 billion or 5 per cent of GDP) in order to help companies secure cheaper financing and refinance their maturing loans from the Funding for Growth Scheme (FGS), the central bank's previous subsidised lending scheme. The schemes damp the negative economic impact of tight monetary policy, but also weaken the monetary transmission mechanism.

The government is encouraging savings in sovereign bonds. In June 2023 the government introduced a new 13 per cent social contribution tax on incomes generated from exchange-rate gains on bank deposits, investment funds and life insurance. In practice, it constitutes a form of capital control. The personal income tax rate of 15 per cent on capital gains is still in place on the remaining taxable income once payments to the new social contribution tax is deducted. In contrast, investments in government bonds are exempt from the new tax.

Jordan

Highlights

- **The economy posted steady growth in 2022 and the first half of 2023.** This was supported by a recovery in tourism and a broad-based improvement in non-service sectors. However, unemployment remains high, and rising food and energy prices are damping household demand.
- **Reforms under the government's 2033 Economic Modernisation Vision are advancing.** Recent progress includes regulatory reforms to promote investment and the adoption of measures to increase private-sector participation and foster competition, as well as to remove barriers to inclusive employment.
- **Jordan took steps to address barriers to youth and women's employment.** These include regulatory amendments to strengthen protection against workplace violence and harassment, as well as new incentives for employers to increase youth employment.

Key priorities for 2024

- **High unemployment and low female labour participation rates remain a constraint on inclusive growth.** Reforms to promote private investment, especially in labour-intensive sectors, will be key to creating jobs. Bold labour-sector reforms and addressing skills mismatches are vital to mitigating market rigidities and should be complemented by measures to promote entrepreneurship and innovation.
- **Solid progress on reforms is crucial to attract foreign investment and leverage private-sector participation**. Reforms are progressing under the Economic Modernisation Plan, but the authorities need to capitalise quickly on achievements, with effective implementation to attract foreign investment in and advance public-private partnerships (PPPs) on critical infrastructure projects.
- **Deeper structural reforms are needed to support debt sustainability.** In addition to revitalising growth and shoring up revenues, the authorities must address long-standing financial vulnerabilities in the water and energy sectors to safeguard fiscal reforms and improve private-sector access to services.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.0	-1.6	2.2	2.5	2.5
Inflation (average)	0.8	0.3	1.3	4.2	2.0
Government balance/GDP	-5.7	-8.6	-7.8	-7.3	-7.0
Current account balance/GDP	-1.7	-5.7	-8.2	-8.8	-7.6
Net FDI/GDP [neg. sign = inflows]	-2.8	-1.4	-1.6	-1.4	n.a.
External debt/GDP	82.6	79.5	82.6	86.9	n.a.
Gross reserves/GDP	32.6	54.8	57.8	52.7	n.a.
Credit to private sector/GDP	78.4	84.6	83.8	86.2	n.a.

Macroeconomic developments and policy response

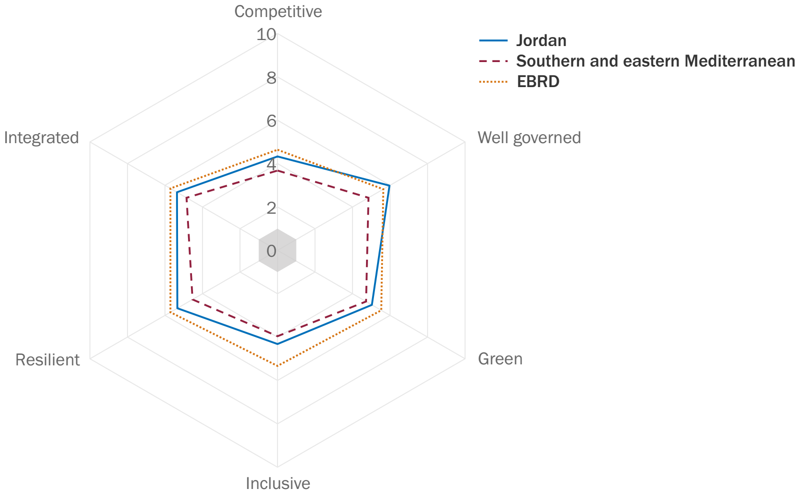
Economic growth was robust in 2022 and the recovery of underperforming sectors accelerated in the first half of 2023. Gross domestic product (GDP) grew 2.5 per cent in 2022, reflecting a broad-based recovery in most sectors. The pace of growth picked up to 2.7 per cent year on year in the first half of 2023 on the back of improved performance in the agricultural, construction and transport sectors. The rebound in tourism continued to gather pace, and tourism receipts in 2023 so far have surpassed pre-pandemic levels. Nonetheless, unemployment remained high in the second quarter of 2023, at 22.3 per cent, and even higher for women (26.7 per cent) and youth (43.7 per cent). Meanwhile, inflation eased to 1.2 per cent in September 2023 from a peak of 5.4 per cent in September 2022. However, the population continues to face elevated food and energy prices as a result of global inflation in 2023.

Fiscal discipline has been accompanied by rising domestic interest rates, but public debt remains high. In 2022 climbing energy prices were mitigated by reductions in fuel taxes. However, a lack of fiscal space meant that these broad-based subsidies were phased out and replaced with targeted support for the poorest households in 2023. Likewise, subsidies on food commodities remained limited to basic bread. In tandem, rising interest rates globally, particularly in the United States of America, have led to simultaneous rate hikes in Jordan to maintain the currency peg. The Central Bank of Jordan has raised its main rate four times in 2023 – to 7.5 per cent as at the end of September. Meanwhile, the general government fiscal deficit narrowed from 7.8 at the end of 2021 to 7.3 per cent of GDP at the end of 2022, despite sizeable energy subsidy spending, thanks to greater revenue mobilisation and expenditure efficiency. The move from universal to targeted subsidies is expected to help the government control public spending in 2023. General government debt, which stood at more than 114 per cent of GDP (including guarantees) at the end of 2022, is expected to decline slowly as the fiscal deficit continues to narrow. Rising financing costs on both external and domestic debt are expected to boost the debt-servicing burden in the medium term, but access to international debt markets remains comfortable, with Jordan successfully issuing US$ 1.25 billion (€1.19 billion) of Eurobonds in April 2023 at relatively low rates.

Rising commodity prices widened Jordan's current account deficit in 2022, but lucrative mineral exports are compensating in part. The current account deficit grew from 8.2 per cent to 8.8 per cent of GDP in 2022, as imports rose by almost a third due to lofty global oil and food prices. The effect on the overall trade balance was mitigated by a doubling in exports of goods and services, driven by rising phosphate and potash prices and a recovery in tourism. Lower commodity prices in the first half of 2023 have eased external pressures and the trade deficit narrowed, but medium-term trends remain uncertain, with risks of additional supply shocks looming and the pay-off from mineral exports sensitive to global conditions. Meanwhile, foreign-exchange reserves remained at comfortable levels and edged up to US$ 17.3 billion (€16.4 billion) in September 2023, covering around 7.6 months of imports.

Growth is expected to remain relatively stable in the short term, but significant uncertainty remains. GDP growth is projected at 2.5 per cent in 2023 and 2024, supported by a continued recovery in tourism and robust growth in non-service sectors. However, Jordan remains vulnerable to rising energy and food prices, as well as global supply-chain disruptions, thanks to its high import dependency. Tightening global and domestic monetary conditions also entail downward risks and could mute private-sector growth. In the long term, growth potential remains modest in the absence of strong drivers. Progress on transformative structural reforms is, therefore, all the more crucial.

Assessment of transition qualities (1-10)



Structural reform developments

Jordan continues to implement reforms under its International Monetary Fund (IMF)-supported programme. The four-year Extended Funds Facility, approved by the IMF Board in March 2020, remains on track, with the sixth review completed in June 2023. The authorities have met all programme targets so far, including closing tax loopholes, widening the tax base and maintaining stable foreign-currency reserves. These reforms have contributed greatly to macroeconomic stability, even during the challenging global circumstances of recent years, although Jordan has also benefited from programme flexibility and augmented financing to address rising prices. However, progress on deeper fiscal and structural reforms remains critical to preserving stability in the medium and long term, including on key emerging roadmaps for ensuring financial sustainability in the energy and water sectors.

The government launched its Economic Modernisation Vision, a comprehensive 10-year plan aimed at ensuring inclusive and sustainable growth. Work is ongoing under the Executive Programme for 2023-25, which lays the groundwork for envisaged reforms, including regulatory amendments and sectoral strategies. The Vision targets a doubling of GDP growth rates and stimulating job creation, driven mainly by private investment, especially foreign direct investment.

Parliament approved a new investment law, supported by the launch of an investment promotion strategy. Investment Environment Law 21 was passed in November 2022 and came into effect in January 2023. It provides for equal treatment between Jordanian and non-Jordanian investors and expands the number of sectors benefiting from incentives. The law also facilitates the employment of foreign labour on jobs requiring specialised skills up to 25 per cent of total employees, or up to 40 per cent if qualified Jordanian labour is not available. The new Investment Promotion Strategy 2023-26, approved by the cabinet in May 2023, identifies priority sectors, including information and communications technology (ICT), logistics, chemicals, mining, healthcare and real estate, and aims to streamline communication, registration and licensing processes for investors through a specialised electronic platform.

The Public-Private Partnerships Law has been amended. The amendment, adopted in July 2023, aims to streamline and expedite processes and establish a dedicated PPP unit under the Ministry of Investment. This should minimise overlap between various governmental bodies, enable efficient budget allocation, and optimise pipeline formulation and project implementation.

The government took steps to foster competition. Amendments to the Competition Law of 2004 were passed in March 2023 and are designed to combat monopolistic practices. They include articles to improve the definition of market concentration and increase violation penalties.

Legal reforms aim to boost youth employment and female labour-market participation. Changes to the law, adopted in March 2023, include greater protection against sexual harassment and violence in the workplace, as well as lifting restrictions on women's employment in certain sectors. The Social Security Law was also amended to lower employer contributions to social security for young hires, in order to encourage youth employment.

Work is ongoing under the Public Sector Modernisation Plan 2022-25 to support economic reforms. Key pillars include the digitalisation of government services and the introduction of a new human resource strategy for 2023-27. The modernisation plan aims to improve governance and transparency, centralise strategic planning and policymaking, and empower public-sector officials to take decisions in a manner that speeds up processes and improves the quality of services.

Kazakhstan

Highlights

- **Economic growth has accelerated significantly in 2023.** The economy grew 5.3 per cent year on year in the first half of 2023. Very strong investment in transport and warehousing (up 56.8 per cent year on year in the first half of the year) is a reflection of the country's ability to substitute for Russia as a production and distribution hub serving Central Asia.
- **The authorities are taking steps to level the playing field for entrepreneurs.** A new Comprehensive Plan of Measures to Counteract the Shadow Economy for 2023-25 aims to reduce shadow trade within the retail and wholesale sectors, improve the tax and customs administration, upgrade the competitive environment for businesses and rationalise fiscal policy.
- **Regional inclusion is being improved.** The Concept for Rural Area Development (2023-27) aims to improve living standards and socioeconomic conditions for rural inhabitants by upgrading and constructing infrastructure, providing financial assistance and reducing rural poverty and unemployment rates.

Key priorities for 2024

- **The authorities should accelerate infrastructure investment in conjunction with comprehensive tariff reform.** Key priorities are transport (East-West and North-South corridors) and energy (including transmission infrastructure to support the roll-out of renewables). Public-private partnerships (PPPs) should complement sovereign financing to mobilise private resources, boost employment and strengthen the country's competitiveness.
- **The authorities should ensure adequate access to drinking and irrigation water.** With transboundary water cooperation re-emerging as a key constraint on Central Asia's future development, Kazakhstan should lead on regional diplomacy efforts while rationalising its domestic water policies through cost-reflective tariffs and improved resource management.
- **Diversification efforts should be stepped up through a combination of privatisation and industrial policies targeting medium-sized companies in priority sectors.** The authorities should proceed with initial public offerings of large state-owned assets, such as Air Astana and Bereke Bank, as well as privatise all non-core assets. Multipronged industrial policies should be employed to nurture medium-sized enterprises in specific value chains, including loan guarantees to unlock commercial financing, and non-financial support measures to help businesses embrace new technologies and reach export markets.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.5	-2.6	4.1	3.3	5.0
Inflation (average)	5.2	6.8	8.0	15.0	15.0
Government balance/GDP	-0.6	-7.0	-5.0	0.1	-0.9
Current account balance/GDP	-3.9	-6.4	-1.3	3.5	-1.5
Net FDI/GDP [neg. sign = inflows]	2.1	4.2	2.3	2.2	n.a.
External debt/GDP	87.7	94.4	81.1	n.a.	n.a.
Gross reserves/GDP	15.9	20.8	17.4	15.9	n.a.
Credit to private sector/GDP	24.3	25.6	26.0	25.6	n.a.

Macroeconomic developments and policy response

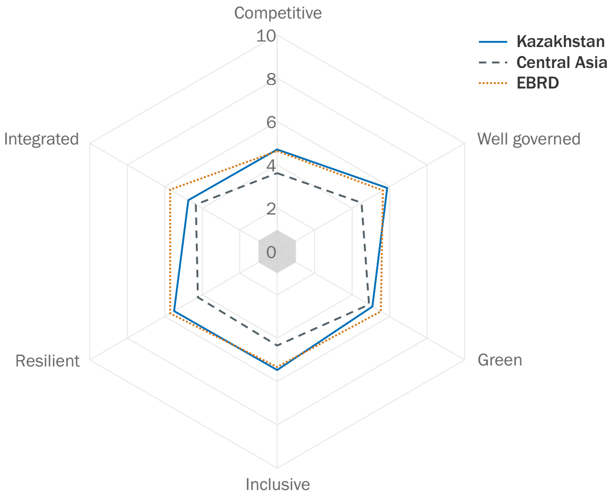
Economic growth has accelerated significantly in 2023. Gross domestic product (GDP) expanded 5.3 per cent year on year in the first half of 2023. The strongest gains were seen in construction (up 13.4 per cent on the year), driven by public infrastructure investment and generous (although declining) mortgage subsidies from the government. Retail trade turnover was up 8.8 per cent year on year, with the large size of the sector making it the highest contributor to GDP growth. Industry (up 3.8 per cent year on year) and agriculture (up 3.2 per cent year on year) posted smaller growth rates. On the expenditure side, fixed capital investment gained most (up 13.1 per cent year on year). Importantly, a very strong rise (of 56.8 per cent year on year) in investment in transport and warehousing reflects the country's ability to substitute for Russia as a production and distribution hub serving Central Asia. Preliminary estimates suggest that the current account recorded a deficit of US$ 3.6 billion (€3.4 billion, 1.5 per cent of 2022 GDP) in the first half of 2023, despite a positive trade balance.

Inflationary pressures started to recede in early spring 2023, in line with broader global trends. Annual inflation fell from a peak of 21.3 per cent in February 2023 to 14 per cent in July 2023, thanks to tight monetary policy and the appreciation of the tenge. The central bank increased its policy rate to 16.75 per cent in December 2022 and maintained it at that level until August 2023, when it undertook a 25 basis-point reduction. The tenge had been slowly gaining against major global currencies from July 2022 amid growing interest by non-residents in Kazakh government securities. In the seven months to July 2023, foreign investment in government and central bank paper increased 46.7 per cent, prompting policymakers to reduce the requirement of mandatory selling of hard currency export revenues from 75 to 30 per cent and then suspend it completely until 2025. Because of this measure, and possibly the Russian rouble's sharp devaluation against the US dollar, by the end of August 2023 the tenge had dropped to its January 2023 rate against the US dollar.

Strong international reserves support Kazakhstan's fiscal stance, despite increased public debt. In the first six months of 2023, the country's public debt increased by US$ 8.1 billion (€7.67 billion) to US$ 62.8 billion (€59.4 billion, around 27 per cent of 2022 GDP). Meanwhile, external government debt accounted for just 7.3 per cent of 2022 GDP. Taken together, the central bank's official reserves (US$ 34.18 billion [€32.35 billion]) and the National Oil Fund's assets (US$ 60.2 billion [€56.98 billion]) amounted to around 42.7 per cent of 2022 GDP, providing a comfortable cushion against external vulnerabilities.

Strong growth is likely to continue in the short term. We forecast the economy to grow by 5 per cent in both 2023 and 2024. Key downside risks stem from the potential for Russia's war on Ukraine to escalate to the point of disrupting east-west transport routes, including the Caspian Pipeline Consortium (CPC) pipeline, and negatively affecting global growth. Concurrently, water and energy issues have been constraining growth, due to insufficient public investment in infrastructure on the one hand, and low tariffs failing to induce private-sector investment and the rational use of resources, on the other. On the upside, growth could be boosted by National Oil Fund-financed fiscal stimulus spending and investment in transport and other public infrastructure.

Assessment of transition qualities (1-10)



Structural reform developments

The authorities are tackling the informal economy. In July 2023 the government approved a Comprehensive Plan of Measures to Counteract the Shadow Economy for 2023 to 2025. The plan sets ambitious objectives, with a focus on reducing the share of shadow trade within the retail and wholesale sectors from an estimated 6.7 per cent in 2022 to 5 per cent by 2025. The government is further committed to confronting informal employment and raising the contribution of small and medium-sized enterprises to the country's GDP from 36 per cent in 2022 to 37.5 per cent by 2025. The plan includes many initiatives to enhance tax and customs administration, promote healthy competition and ensure prudent budget allocation.

PPP legislation was revised in January 2023. The amended law seeks to tackle the issue of excessive profit margins and advance a more equitable risk-sharing framework between the government and private sector companies involved in PPP projects. In addition, the Ministry of National Economy is developing a PPP portal designed to enhance transparency and mitigate corruption risks in procurement of PPP projects.

Kazakhstan has adopted a decarbonisation strategy until 2060. The strategy, adopted in February 2023, encompasses climate mitigation and adaptation actions, incorporating environmental and social governance (ESG) principles, gradually enacting cost-reflective tariffs (with targeted assistance to vulnerable groups as part of a just transition) and digital monitoring of carbon emissions. A special carbon fund will be set up to accumulate funds from carbon credit sales and carbon taxes to finance investment in low-carbon technologies.

Kazakhstan is advancing in financial sector reforms. The European Bank for Reconstruction and Development (EBRD)-supported derivatives legal framework became effective in September 2022. This marks the completion of a complex reform effort that will help businesses and investors manage a wide variety of risks, starting with currency- and interest-rate-related risks. In turn, this will increase Kazakhstan's appeal to foreign investors, while promoting financial stability. The EBRD also helped develop a framework for the resolution and sale of non-performing loans (NPLs) to private investors, which will enhance banks' NPL management and increase the availability of credit to the economy.

The electricity sector is undergoing reform. In March 2023 the government adopted the Concept on the Development of the Electric Energy Industry for 2023-2029. As part of the initiative, it introduced the Tariff in Return for Investment strategy, seeking to stimulate private-sector investment in ageing heat and power infrastructure. Furthermore, on 1 July 2023 the government inaugurated a real-time balancing market for electricity, with the Financial Settlement Centre of Renewable Energy acting as a single-buyer responsible for the centralised procurement of electricity. These measures are designed to curtail regional disparities in electricity pricing and facilitate more effective planning of electricity consumption and generation, ultimately enhancing grid stability.

A strategic partnership with the European Union (EU) sets the stage for an accelerated transition to green energy. In November 2022 the EU and Kazakhstan signed a memorandum of understanding (MoU) to ensure a sustainable supply of critical raw materials, batteries and green hydrogen. Central to this partnership are the establishment of resilient green supply chains, capacity-building and innovation associated with the decarbonisation of value chains in critical raw materials, and joint sustainability initiatives. Building on the MoU, Kazakhstan and the EU-based Svevind Group finalised a US$ 50 billion (€47.32 billion) agreement in late November 2022 for the production of green hydrogen in Kazakhstan. The project is expected to yield up to 2 million tonnes of green hydrogen annually when completed in 2032. Kazakhstan is expanding its green energy generation capacity, with the share of renewable energy sources in the overall electricity mix rising to 5.8 per cent in the first half of 2023 from 4.5 per cent in 2022.

Oil export routes are being diversified. The authorities have developed alternative oil export routes as a hedge against potential disruptions to the CPC Black Sea terminal in Novorossiysk, on which the country remains highly reliant. In 2023 Kazakhstan increased its oil shipments through the Druzhba and Baku-Tbilisi-Ceyhan pipelines. The recent escalation of security risks in the Black Sea region presents a serious threat to operations of the CPC terminal in Novorossiysk, potentially affecting maritime insurance costs and clouding Kazakhstan's oil export and growth outlook.

Measures to promote rural development are under way. In April 2023 the government introduced the Concept for Rural Area Development (2023-27) to enhance the living standards and socioeconomic conditions of rural inhabitants. This strategic plan seeks to modernise 3,500 high-potential villages to house 90 per cent of the country's rural population. The initiative includes substantial investments in water, transport, social infrastructure and internet access, as well as financial assistance through favourable lending schemes and capital expenditure support for rural households. These measures are intended to improve the wellbeing of rural communities to discourage the migration of rural residents to urban areas.

Digital inclusion is advancing. In February 2023 the Ministry of Digital Development, Innovation and Aerospace Industry published Accessible Internet, a national pilot project to be implemented from 2023 to 2027. The pilot entails the extensive enhancement of communication infrastructure in rural regions, broader and better access to high-speed internet, and the establishment of data centres throughout the country. Aligned with this project, the government has set a goal to elevate the proportion of internet users in rural areas from 91.7 per cent in 2022 to 97 per cent by 2027.

Kosovo

Highlights

- **Economic growth continues at a robust rate.** Output growth in the first half of 2023 was led by a strong performance of service exports, driven by the tourism and information and communications technology (ICT) sectors.
- **The authorities have renewed engagement with the International Monetary Fund (IMF) under two disbursing programmes.** A two-year precautionary Stand-by Arrangement (SBA) is expected to provide liquidity in case downside risks materialise, while the Resilience and Sustainability Facility (RSF) will provide affordable financing to support Kosovo's climate change mitigation and adaptation efforts.
- **Kosovo has adopted an energy strategy and launched renewable energy auctions.** The energy strategy affirms that coal plants will be phased out by 2050 and includes plans to scale up renewable energy capacity significantly. Kosovo's first renewable energy auction for solar electricity generation was launched as one of the first steps.

Key priorities for 2024

- **Public investment should be accelerated.** As the authorities take steps to address bottlenecks in public investment management, including through structural benchmarks of the SBA with the IMF, there is space to step up investment, thereby boosting both short- and medium-term growth prospects.
- **Energy sector reforms and targeted support for vulnerable groups are needed to support the country's green transition.** Higher electricity tariffs and the elimination of blanket subsidies should be accompanied by a new definition of vulnerable energy consumers, enabling those most in need to receive support.
- **The recent increase in public sector wages should be accompanied by efficiency gains.** The authorities should improve the financial oversight and accountability of oversized and loss-making public enterprises, a key source of inefficiency.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.8	-5.3	10.7	5.2	3.5
Inflation (average)	2.7	0.2	3.3	11.7	4.7
Government balance/GDP	-2.9	-7.8	-1.2	-0.7	-2.3
Current account balance/GDP	-5.7	-7.0	-8.7	-10.5	-8.1
Net FDI/GDP [neg. sign = inflows]	-2.7	-4.2	-4.0	-6.2	-4.5
External debt/GDP	31.0	37.0	37.1	38.5	n.a.
Gross reserves/GDP	12.2	13.3	13.8	13.2	n.a.
Credit to private sector/GDP	42.0	45.5	43.5	40.4	n.a.

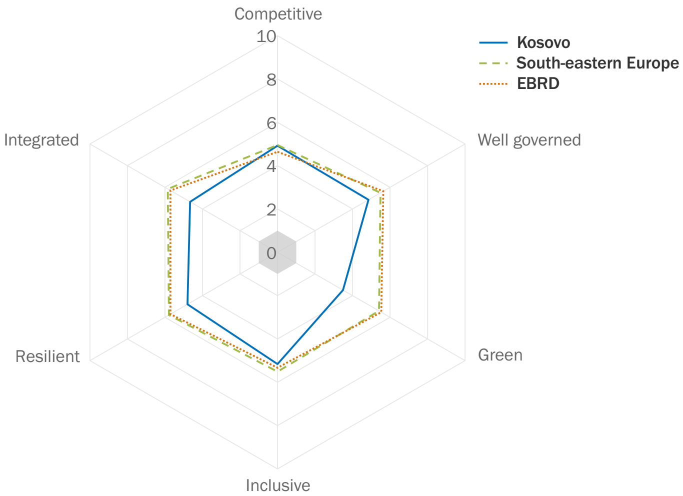
Macroeconomic developments and policy response

The economy has continued to grow in 2023, despite headwinds. Following an expansion of 5.2 per cent in 2022, supported by heightened external demand, gross domestic product (GDP) growth moderated to a robust 2.9 per cent year on year in the first half of 2023, reflecting continued favourable movements in the net export position. Diaspora-related (financial) inflows supported a 6 per cent increase in the retail and tourism sector and boosted service exports which grew by 19 per cent year on year in the first half of 2023, offsetting the contraction of goods exports. With moderate import growth, the net export position moved in a positive direction in the first half of the year. The current account deficit also narrowed by 23 per cent year on year in the first seven months of 2023 but remains elevated compared with the 2019-21 average. Household consumption growth remained positive (growing by 2 per cent year on year) despite persistently high inflation, helped by robust remittances (14 per cent of GDP in the first half of the year), double-digit credit growth to households and a long-awaited hike in public sector wages. Investments remained sluggish, however, reflecting a low level of public investment.

Fiscal measures to support the economy are becoming more targeted. Annual inflation reached 14.2 per cent in July 2022, driven by higher food and oil prices, gradually decelerating to 2.4 per cent in July 2023 before picking up again to 4.2 per cent in September. The energy regulator ended the freeze on electricity tariffs introduced in 2022 by approving an almost 15 per cent tariff increase, effective from April 2023. Meanwhile, the government scaled up subsidies for households that reduce their electricity consumption and for purchases of energy efficiency equipment. The coefficient for public sector wages was raised in February 2023, with the average salary in the public sector increasing by 15 per cent on the year the same month, while in July 2023 the parliament approved a minimum wage increase of 103 per cent for employees under 35 years of age, and an increase of 55 per cent for workers over 35. Public debt remains low, at an estimated 20 per cent of GDP at the end of 2022, allowing space for increased public investment, as envisaged under the SBA with the IMF.

Growth will continue in the short term, but downside risks are significant. GDP growth is forecast to reach 3.5 per cent in 2023, rising to 4 per cent in 2024. Downside risks to the outlook include stickier-than-expected inflation, lower-than-planned public investments and rising geopolitical uncertainty which may negatively affect domestic demand, trade flows, the availability of international funding and investor confidence.

Assessment of transition qualities (1-10)



Structural reform developments

Reform efforts have been somewhat stalled by rising political tensions related to the situation in northern Kosovo and the European Union (EU)-facilitated dialogue with Serbia. In response to the authorities' failure to take measures requested by the EU for a de-escalation in the north of Kosovo, the European Commission decided to take a number of "temporary and reversible" measures, including putting on hold the work of the Stabilisation and Association Agreement bodies and the programming of funds for the Instrument of Pre-accession Assistance (IPA) exercise in 2024 under the Western Balkans Investment Framework (WBIF). The Commission's measures also put on hold the signing of new contracts and suspended high-level meetings (other than those focused on addressing the crisis). In September 2023 the EU indicated that it could impose further measures on both parties if no progress was made in the de-escalation and implementation of the commitments under the Agreement on the path to normalisation between Kosovo and Serbia.

Public sector wage reforms are advancing. The main aims of the reforms are to create a uniform and transparent system of salaries and compensate for real wage losses. The law governing public sector wages was approved in parliament at the end of 2022, following a months-long strike by public sector employees. The legislation entered into force in February 2023, following a significant decrease in real wages in the public sector in the preceding two years.

Renewed engagement with the IMF is alleviating liquidity risks and supporting the greening of the economy. A €100 million two-year precautionary SBA, approved by the IMF Board in May 2023, is expected to provide liquidity in case downside risks materialise, including from Russia's war on Ukraine. The €78 million RSF, approved alongside the SBA, will in turn provide affordable financing for Kosovo's climate change mitigation and adaptation efforts, including through greener electricity production and more efficient energy use. It is also expected to act as a catalyst for other climate financing. Kosovo is the first European country to access the RSF.

A new energy strategy sets ambitious targets for renewable energy generation. The strategy for the 2022-31 period, adopted in March 2023, affirms that coal plants will be phased out by 2050 but envisages modernisation works on three coal-powered thermal power plant units, given that at present some 90 per cent of the country's electricity is produced from lignite. The country is planning to reach a total of 1.6 GW in renewable capacities (up from around 300 MW of existing capacity) by 2031, while a carbon pricing system is to be introduced by 2025. As one of the initial steps, Kosovo's first renewable energy auction for solar electricity generation was launched in May 2023 for 100 MW under a 15-year power purchase agreement with the national market operator, with an extended deadline for bids of the end of January 2024. Market integration with Albania is expected by the end of 2023, as the Albanian Power Exchange (ALPEX), which is now operational, was awarded nominal electricity market operator status in both countries in July 2023, paving the way for market coupling.

Kosovo is revising its policies on attracting foreign direct investment (FDI). The new Law on Sustainable Investment, which aims to accelerate investment into the country while ensuring an equal environment for foreign and domestic investors, passed the first reading in parliament in May 2023. The law foresees the establishment of a new agency within the prime minister's office, which will replace the Kosovo Investment Enterprise and Support Agency (KIESA) in functions related to FDI facilitation and export promotion, with a platform for public-private dialogue to be established within the agency.

A new sovereign fund will manage key public enterprises. A draft law establishing the sovereign fund passed first reading in parliament in July 2023. The five largest public enterprises (out of 18 in total), including the national telecommunications, railway, mining and postal companies, will be transferred to the fund, which will operate as an autonomous public institution under the Assembly. In an additional step to strengthen the management of public enterprises, the authorities have committed to publishing timely quarterly and annual financial reports on those enterprises under the ongoing SBA with the IMF.

Kyrgyz Republic

Highlights

- **Gross domestic product (GDP) growth has slowed in 2023, mainly due to a decline in gold output.** Overall growth was less than 3 per cent year on year from January to July 2023, but other (non-gold) manufacturing activities and services expanded at double-digit rates, and the short-term prospects for growth remain favourable.
- **The government is undertaking reforms to the business and investment environment.** Recent measures include an adjustment to the timetable for introducing mandatory cash registers, electronic invoices and shipping bills, easing access to visas for foreign investors and reducing the regulatory burden on businesses.
- **The authorities are taking measures to strengthen water and energy security.** A new National Water Strategy to 2040 should strengthen water-sector governance and foster improved water conservation practices, while staggered increases in electricity tariffs, introduced over the course of 2023, will induce energy saving behaviour and encourage private-sector investment in renewable energy, including solar and wind.

Key priorities for 2024

- **The government should step up efforts to capitalise on the country's competitive advantages.** In light of new opportunities arising from geopolitical developments, the authorities should upgrade the country's logistics capacity and facilitate the emergence of export-oriented "clusters" in agriculture and light industry. Building on recent improvements in digitalisation and human capital development, the High Technology Park and the Park of Creative Industries should be leveraged to attract international companies, start-ups and entrepreneurs willing to invest in the Kyrgyz Republic.
- **The government should ensure greater compliance with international sanctions by Kyrgyz companies and banks.** Several Kyrgyz companies have recently been sanctioned by the US Treasury for helping Russia circumvent sanctions, potentially hurting the country's appeal as a partner for Western investors and its access to international banking and financial services.
- **Active promotion of regional dialogue to address border management issues would further improve transport connectivity, energy and water cooperation.** The momentum created by a recent border agreement between the Kyrgyz Republic and Uzbekistan should be used to reach closure with other Central Asian neighbours on water sharing, border demarcation and the cross-border movement of persons and goods.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.6	-7.1	5.5	7.0	4.6
Inflation (average)	1.1	6.3	11.9	13.9	11.7
Government balance/GDP	-0.1	-3.1	-0.7	-0.3	-1.8
Current account balance/GDP	-11.5	4.5	-8.0	-46.5	-20.0
Net FDI/GDP [neg. sign = inflows]	4.6	-5.2	2.6	2.7	n.a.
External debt/GDP	95.3	111.5	103.7	n.a.	n.a.
Gross reserves/GDP	27.4	36.1	34.1	25.6	n.a.
Credit to private sector/GDP	24.6	28.3	25.6	23.1	n.a.

Macroeconomic developments and policy response

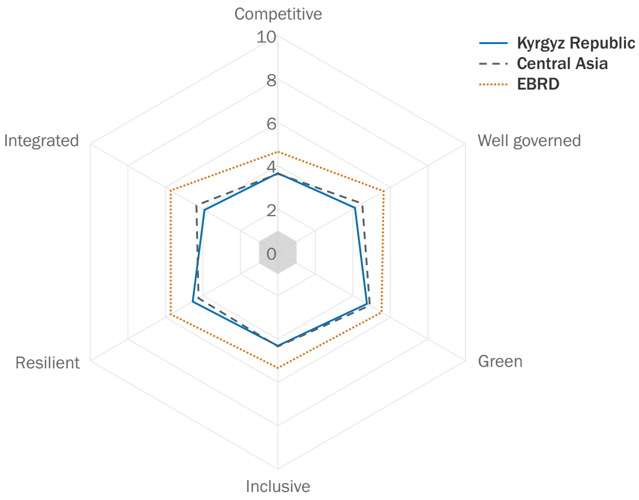
The economy slowed significantly in the first half of 2023 on reduced gold output. GDP added just 2.9 per cent year on year in the first seven months of the year, far below the 2022 growth rate (7 per cent). However, this slowdown was almost entirely due to a contraction (-11.7 per cent) in a single sector – gold and base metals – which accounts for more than 58 per cent of the country's manufacturing output. Other manufacturing activities expanded at impressive rates, led by the fast-growing, labour-intensive textile sector (up 40.2 per cent year on year). The revival of tourism provided a boost to hospitality (up 25.9 per cent) and other services, such as wholesale and retail trade (up 12 per cent), despite a plunge in net remittances (-28.5 per cent) due to high base effects. Of special note was the strong expansion of international trade: in the first half of 2023, imports and exports grew 30.3 and 34.6 per cent year on year, respectively, on the back of a resumption in gold exports and a boom in intermediated trade activities. Imports of goods from China neared US$ 10 billion (€9.46 billion) in January-July 2023 (up 27 per cent year on year), according to official Chinese data.

Inflationary pressures have receded while the banking sector saw record profits. Annual consumer price inflation peaked at 16.2 per cent in February 2023, but slowed thereafter to 10.3 per cent in July 2023. Having ratcheted up the policy rate to 14 per cent in March 2022, the National Bank of the Kyrgyz Republic reduced it by 100 basis points to 13 per cent in November 2022, but has left it unchanged ever since as of the end of August 2023. The Kyrgyz som has been relatively stable against the US dollar since early 2023. Meanwhile, banking sector profits soared in 2022 (up 539 per cent year on year) on the back of high interest rates and elevated transaction fees. Moreover, the growth in bank foreign currency-denominated deposits has significantly outpaced the expansion in lending, leading to a massive accumulation of liquidity.

Tax reforms and a dramatic increase in trade activity have boosted fiscal performance. In the first half of 2023, budget revenues increased 31.6 per cent year on year. Sales tax receipts grew nearly threefold, driven mainly by improvements in tax administration, while significant gains were recorded in receipts from all tax and non-tax revenue sources. Expenditures soared as well (up 31.2 per cent), but the budget recorded a small surplus of about 1.2 per cent of GDP. Carefully staggered increases in electricity tariffs will reduce government spending on energy subsidies and help alleviate budgetary pressures. Government revenues in 2023 are also being boosted by a new law that requires the central bank to transfer the bulk of its profits to the state coffers. That said, the International Monetary Fund (IMF) continues to project an increase in the fiscal deficit as a result of recent hikes in public wages and pensions and very ambitious public investment plans. On the downside, the country's gross international reserves shrank by 9.8 per cent from January to July 2023 (to US$ 2.45 billion [€2.32 billion], covering just three months of 2022 imports) after interventions by the central bank.

Robust growth is expected in the short term. We forecast the economy to grow by 4.6 per cent in 2023 and 7 per cent in 2024, supported by political stability, windfall gains from intermediated trade, the relocation of Russian companies and individuals, strong domestic demand resulting from growing wages and remittances, and a boom in the export-oriented textile and tourism sectors. However, vulnerabilities remain, particularly in relation to potential water shortages and external factors, such as possible secondary sanctions on Kyrgyz companies, uncertain Russian demand for Kyrgyz goods and workers, and further fluctuations in the rouble's value and its impact on remittances from Russia.

Assessment of transition qualities (1-10)



Structural reform developments

Steps are being taken to improve the business environment. To reduce the pressure on small and medium-sized enterprises, the government adjusted the timetable for introducing mandatory cash registers, electronic invoices and shipping bills, allowing businesses to adapt to the new requirements. In January 2023 the Kyrgyz legislature approved a bill granting 5- and 10-year investor visas to foreigners meeting certain investment thresholds. In April 2023 the government introduced the Programme on the Development of Businesses to 2026, crafted in collaboration with business community representatives. The proposed measures aim to alleviate the fiscal and regulatory burden on local businesses while enhancing their resilience to external shocks.

Efforts to digitalise the banking sector are ongoing. In 2022 the National Bank of the Kyrgyz Republic approved the Concept of the Digital Som. If implemented, the innovation could significantly enhance financial inclusion and promote the formalisation of commercial activities. The government has also taken further steps to digitalise the banking sector, including standardised QR codes and the acceptance of cashless payments for all state-provided services.

The government adopted a National Water Strategy to 2040. In response to persistent water shortages, the government started to develop the National Water Strategy in 2021. After several revisions, the president approved it in February 2023. The document sets out measures to optimise water use across sectors, enhance inter-agency coordination and water-sector governance, introduce a single information system on water resources, and promote improved water conservation practices in the long term.

Cross-border collaboration on the construction of the Kambar-Ata 1 hydropower plant may enhance regional water and energy security. In January 2023 Kazakhstan, the Kyrgyz Republic and Uzbekistan endorsed a roadmap for implementing the Kambar-Ata 1 hydropower plant project, expected to be the Kyrgyz Republic's largest power facility, with a generation capacity of 1,860 MW and an annual output of 5.6 billion kWh. The Kyrgyz Republic is promoting the project with the World Bank, as well as with investors from China, Russia and the United Arab Emirates. If implemented, the project will enhance energy security upstream in the Kyrgyz Republic and stabilise water supply downstream in Uzbekistan and Kazakhstan.

Latvia

Highlights

- **The economy continues to stagnate in 2023, but inflation is falling.** Inflationary pressures in the past year have contributed to reduced private consumption, low investment growth and disruptions in industrial production.
- **European Union (EU) funds are being targeted at energy efficiency and the electricity transmission system.** In October 2022 the country received the first disbursement of €201 million as a part of the EU's Recovery and Resilience Facility (RRF) and is now planning to invest in the electricity transmission system with the support of EU funds amounting to €135 million between 2024 and 2033.
- **The government launched programmes to enhance leadership skills and innovation in higher education institutions.** The programmes are expected to be supported by the European Regional Development Fund (ERDF).

Key priorities for 2024

- **Further efforts are needed to achieve energy independence from Russia.** The authorities should push ahead with plans to disconnect from the Belarus, Russia, Estonia, Latvia and Lithuania (BRELL) power system and connect instead to the European grid. Progress should also be made towards investing in reconstructing the energy system's substations, lines and distribution points.
- **The Green Economy Transition (GET) approach should be pursued vigorously.** The authorities should continue to focus on reducing greenhouse gas emissions and increasing the use of renewable energy based on improved energy and resource efficiency, including by using RRF funds to implement a programme on the energy efficiency of apartment buildings.
- **Further reforms of the higher education system are needed.** Following the programmes aimed at facilitating innovation and expanding leadership capabilities in 2023, the authorities should focus on increasing competitiveness by creating new opportunities to improve the development and governance of higher education institutions.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	0.6	-3.5	6.7	3.4	0.3
Inflation (average)	2.7	0.1	3.2	17.2	9.0
Government balance/GDP	-0.5	-4.5	-7.2	-4.6	-3.7
Current account balance/GDP	-0.6	2.9	-3.9	-4.7	-3.0
Net FDI/GDP [neg. sign = inflows]	-2.9	-2.2	-2.5	-3.2	-2.6
External debt/GDP	116.7	121.5	109.6	100.5	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	36.7	34.9	32.4	29.4	n.a.

Macroeconomic developments and policy response

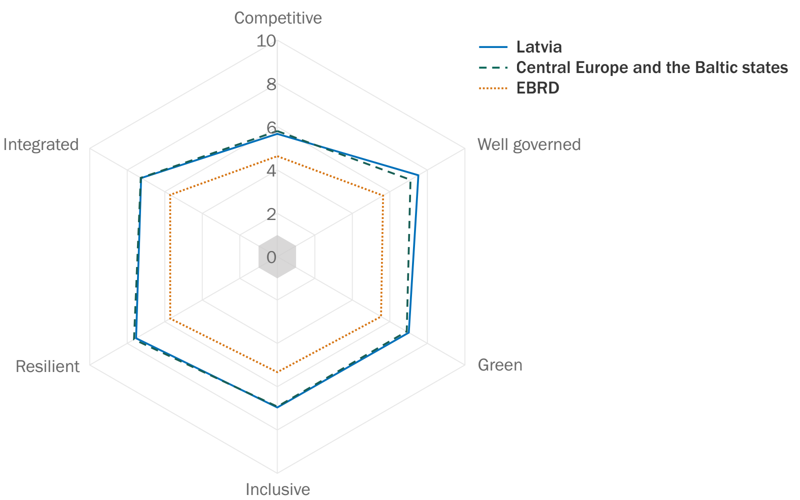
Economic growth remains subdued. The economy grew by 3.4 per cent in 2022, but high inflation and soaring energy prices have affected private consumption and investment. As a result, the gross domestic product (GDP) growth in the first half of 2023 was around zero year on year. Real wages have been falling because of the elevated inflation rate, while the ongoing war on Ukraine is taking a toll on Latvian exports. Industrial production has struggled, given energy supply difficulties and supply chain disruptions, which have led to a fall in manufacturing output.

Inflation is falling gradually from double-digit levels. The annual inflation rate peaked at 22 per cent in September 2022, but has fallen to single-digit levels since June 2023, with a further decline expected in the second half of the year, partly as a result of stabilising energy prices. Despite economic difficulties, the registered unemployment rate remains historically low, at 6.5 per cent in the middle of 2023, contributing to rising nominal wages and some persistence in inflationary pressures. Labour shortages are the main driver of wage growth, especially in the agriculture, mining and utilities sectors.

The general government budget deficit is declining. The government's fiscal deficit amounted to €137.7 million (around 0.4 per cent of GDP in 2022) in the first half of 2023, nearly 40 per cent lower than in the same period in 2022. Key spending priorities include pursuing the country's energy transition and maintaining national security as the war on Ukraine persists. The government is continuing to compensate for high energy prices with a spending package amounting to €417 million (0.96 per cent of GDP) in the first half of 2023 and a €34 million support package for Ukrainian refugees. These measures are planned to be phased out gradually.

Low economic growth is set to continue. The economy is projected to return to modest growth in the second half of 2023, following the contraction in the second quarter. We forecast 0.3 per cent GDP growth in 2023, increasing to 2 per cent in 2024. The outcome will be largely influenced by falling, but still significant, price growth and persistently weak consumer sentiment reflecting inadequate private consumption. Low investment is expected to continue, but a slight boost is likely given structural EU funds are available. Downside risks to the forecast remain, associated with high core inflation supported by wage increases.

Assessment of transition qualities (1-10)



Structural reform developments

Support programmes to be phased out. Crisis-support programmes covering energy price subsidies and support for Ukrainian refugees are planned to be progressively withdrawn in favour of one-off safety measures and possible compensation for future energy surges. The energy support included a fixed tariff of up to 100 kWh for households, compensation for central heating costs, transfers to households in difficult situations, and a suspension of the electricity services tariff for legal entities.

The pan-Baltic capital market is set to benefit from single index classification. The new single index, which was launched at the same time as the August 2023 Index Review, will allow the three markets to be integrated into the Morgan Stanley Capital International (MSCI) universe and will raise the region's profile among international investors who track MSCI indices. The approach is in line with efforts made by the ministries of finance in Estonia, Latvia and Lithuania, the European Bank for Reconstruction and Development, the European Commission and Nasdaq Baltic to create a single pan-Baltic capital market, as outlined by a memorandum of understanding signed in November 2017. The approach is also a building block of the EU's capital markets union initiative.

Higher education reforms are under way. The government launched new programmes funded by the ERDF in January 2023, following the legislative changes adopted in 2022. The programmes cover modules to enhance leadership and support innovative projects in higher education institutions. Latvia ranked third lowest among all EU member states on the European Innovation Scoreboard in 2023, lagging behind in financing research and development in particular. In addition, Latvia is expected to receive a total of €82.5 million in RRF grants to improve the capacity of educational institutions.

Latvia is moving towards energy independence from Russia. Along with its neighbours Lithuania and Estonia, the country is focused on disconnecting from the BRELL power system. The three Baltic countries have signed an agreement to accelerate this disconnection and focus on connecting to the European grid in early 2025. This means that the countries will officially inform all parties of their disconnection from the Russia-linked grid as early as August 2024. Latvia and Estonia signed a memorandum of understanding in May 2023 to jointly use the liquefied natural gas (LNG) terminal in the port of Paldiski in Estonia, via a floating storage regasification unit. The agreement aims to enable countries to purchase LNG if there are disruptions in natural gas supply.

EU funds are supporting investment in the electricity transmission system. A total of €509.8 million will be allocated to investments connecting Latvia to the EU energy system. Of this total, approximately €135.8 million will come from EU funds. The measures are aimed at reducing dependence on Russian electricity while synchronising with the European grid. The allocation plan will run until 2033 and includes €188.8 million for the network and between €21 million and €30 million to be invested annually in reconstructing substations, lines or distribution points.

A new energy efficiency programme is in place. The energy efficiency of apartment buildings 2022-26 programme financed by the RRF was launched in December 2022. The programme includes €57.3 million of financial assistance in the form of subsidies, loans and guarantees to improve efficiency and energy management, and the use of renewable energy sources. When completed, the programme is expected to deliver at least 30 per cent energy savings in multi-family buildings.

A large solar park is being built. European Energy, a privately owned Danish renewable energy developer, will build a solar park in the south-western part of the country. The project entered the final development stages in August 2023, and the park is expected to be connected to the Latvian grid by 2025. When completed, the installed capacity of the park is set to be 115 MW, projected to generate enough energy for around 57,000 Latvian households per year.

Lebanon

Highlights

- **Lebanon's recovery is being held back by political inaction and an impasse on key reforms.** The currency has continued to depreciate, with multiple exchange rates still in place, while inflation is soaring, pushing the poverty rate above 80 per cent of the population.
- **Rising global prices have put added pressure on the external accounts, while Lebanon remains locked out of international markets.** The current account deficit remains large, despite some relief from rising tourism revenues and remittances, and the government is still unable to access international financial markets.
- **Parliament has failed to elect a new president, paralysing other branches of government and holding back progress on reforms.** As a result, there has been no progress on key preconditions to an International Monetary Fund (IMF) programme, including restructuring of banking-sector debt and electricity-sector reforms.

Key priorities for 2024

- **Meeting the reforms required for an IMF-supported stabilisation and structural reform programme remains the most immediate priority.** An agreement with the IMF would help rebuild credibility as to reform commitment and provide access to necessary external financing. Urgent progress is, therefore, necessary on electing a president and forming a government, in addition to comprehensive bank restructuring and regulatory reform.
- **Establishing comprehensive social safety nets has become even more pressing as the population suffers from rising prices for essential products and services.** Wider coverage and improving the transparency of targeted subsidies are critical to addressing the deepening rate of poverty. Given its severe financing constraints, the government will need to attract donor assistance and gradually build robust support networks.
- **Progress on energy-sector reforms, including on the legislative side, is necessary to unlock the financing needed to develop sectoral capacity.** Stronger commitment to greener energy production and improved efficiency will greatly help to address severe shortages and limit import dependence.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	-6.9	-25.9	-10.0	0.0	0.0
Inflation (average)	2.9	84.3	150.6	183.8	229.0
Government balance/GDP	-10.6	-4.1	1.2	-5.2	-6.9
Current account balance/GDP	-27.9	-15.7	-17.3	-29.0	-12.5
Net FDI/GDP [neg. sign = inflows]	-3.4	-5.3	-2.1	n.a.	n.a.
External debt/GDP	201.0	135.0	392.0	391.0	n.a.
Gross reserves/GDP	48.1	72.2	48.6	58.6	n.a.
Credit to private sector/GDP	88.3	54.3	n.a.	n.a.	n.a.

Macroeconomic developments and policy response

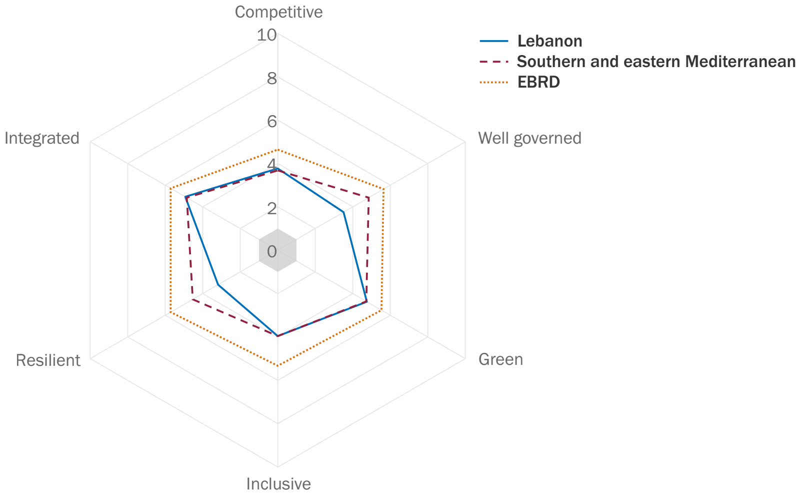
Political deadlock is still holding back economic recovery, and the population's living conditions are dire. The economy is estimated to have recorded zero growth in 2022 after two years of deep recession (a 10 per cent contraction in gross domestic product [GDP] in 2021, on top of a decline of 25.9 per cent in 2020). The resulting surge in the cash economy and informal sector has further deprived the state of highly needed fiscal revenues, underpinning the overall deterioration of macroeconomic fundamentals. Throughout most of 2023, Lebanon has seen little progress on reforms, as the lack of a functioning government has stalled progress and left the country unable to access international donor support. The black-market exchange rate deteriorated further in the first half of 2023 to a peak of LBP 134,800 per US dollar, despite improvements in the inflow of fresh dollars, before stabilising at around LBP 89,700 per dollar at the end of October (compared with an official rate of LBP 15,000 per dollar). This fuelled even higher inflation, which reached 208 per cent in September 2023. The prolonged crisis continues to threaten the livelihoods of most households; the International Labour Organization estimated the unemployment rate at 29.6 per cent in January 2022, with more than 80 per cent of the population estimated to be living in poverty at the end of 2021. Elevated prices for food and energy have placed more pressure on vulnerable households, with only limited targeted support available to those most in need.

Multiple exchange rates persist, amid a dire fiscal and public debt situation. Banque du Liban (BDL) announced a new official exchange rate of LBP 15,000 per US dollar in February 2023. The gap to the black-market rate remains significant, however; the BDL's most widely used Sayrafa platform rate stood at LBP 85,500 per dollar at the end of August 2023. Steps have been taken to end Sayrafa, unify the exchange rate and move to an electronic FX trading platform, as announced by the new BDL leadership team in August. Meanwhile, the fiscal deficit is estimated to have widened due to severe revenue shortfalls, reflecting distorted exchange-rate pricing for taxes and customs, as well as eroded collection capacity. The diminishing real salaries of public-sector employees have resulted in high numbers of resignations and increased absenteeism, further undermining the country's already weakened public administration capacity. Public debt stood at 282 per cent of GDP at the end of 2022 and is forecast to be around 250 per cent by end of 2023.

The current account deficit peaked in 2022 and the population's access to basic goods remains precarious. The deficit is estimated to have exceeded 29 per cent of GDP in 2022, but is expected to ease in 2023, helped by increasing tourism receipts and rising remittances from Lebanese nationals abroad. Access to wheat imports have remained largely secure in 2023, owing to a US$ 150 million (around €142 million) World Bank loan to help stabilise bread prices. However, fuel prices continue to change based on availability, exchange-rate fluctuations and global prices, while access to electricity in some areas is limited to two hours a day, increasing the population's dependence on private generators. Regional agreements to supply Lebanon with energy remain on hold pending progress on electricity reforms, including the gas import agreement signed by Egypt, Syria and Lebanon in July 2022 and the agreement signed with Jordan to import electricity in January 2022. The fuel supply deal with Iraq was extended for another year in the middle of 2023.

The outlook remains highly uncertain, and any recovery depends on the speed of government formation and agreement on an IMF deal. The economy is expected to see zero growth again in 2023, amid political inaction and stalled reforms. A return to growth is possible in 2024 – provisionally forecast at 3 per cent – conditional on an IMF-supported programme being successfully implemented by a reform-minded government, which would also allow negotiations to resume with international partners.

Assessment of transition qualities (1-10)



Structural reform developments

Lebanon has made little progress on the prerequisites to the IMF staff-level agreement reached in April 2022. The proposed IMF programme would be a 46-month US$ 3 billion (around €2.8 billion) Extended Fund Arrangement. Discussions with the IMF have been on hold, with no progress on forming a new government since May 2022 or electing a new president since October 2022. In its June 2023 Article IV consultation, the IMF identified gaps in the draft banking secrecy and capital controls laws (both are programme prerequisites), which are still being discussed in parliament. Political support for the draft banking resolution law, necessary for financial-sector restructuring, has also been limited. Delays in adopting the 2022 draft budget law, and now the 2023 budget law, also point to political and capacity constraints that are hindering the implementation of crucial fiscal reforms.

Consensus on the proposed economic recovery plan and subsequent bank restructuring is still out of reach. The plan, approved by the cabinet in May 2022, introduces sweeping banking-sector restructuring, including for the BDL. Banking-sector losses are estimated at roughly US$ 70 billion (€66 billion), and reforms are likely to result in large haircuts on deposits over US$ 100,000 (around €94,000). The plan initially received pushback from the Association of Banks in Lebanon (ABL) regarding the distribution of losses and continues to face political opposition.

The much-awaited central bank forensic audit findings have finally come to light. The audit was concluded in August 2023 after numerous delays. The findings provide evidence of misconduct and financial mismanagement, including the disguising of substantial losses incurred by the BDL. They also highlight gaps in governance, risk management, transparency and accountability. An interim management team for the BDL was appointed in August 2023. The interim management team announced its intention to gradually stop financing the state budget, phase out the Sayrafa platform and liberalise the exchange rate, all of which signal a new approach to monetary policy and central bank independence, though it remains to be seen whether it will get the necessary political support.

Electricity reform remains stuck. More than a year after cabinet approval, the government's electricity reform plan remains stuck in parliament, blocking international support and energy imports from neighbouring countries. The plan should involve the creation and operationalisation of an electricity regulatory authority, for which management hiring is facing delays. Other elements include a comprehensive audit of the state power company, Electricité du Liban (EDL), and tariff adjustment. EDL increased its electricity prices in November 2022 for the first time since the 1990s, but further revisions to the tariff structure are likely to be needed.

International donor support has been much more limited recently, with the exception of crisis-response financing from the World Bank. The World Bank approved financing worth a total of US$ 500 million (around €470 million) so far in 2023 for agricultural sector support and social safety nets, building on previous emergency and Covid-19 response funding.

Lithuania

Highlights

- **Gross domestic product (GDP) fell in the first half of 2023.** The drop is largely the result of reduced industrial activity that reflects weak external demand, subdued consumption amid high inflation, and persistent uncertainty, which is affecting confidence.
- **The European Union's (EU) Recovery and Resilience Facility (RRF) funds have helped the country to boost investment.** The country received the first payment of €542 million under the RRF in May 2023, having fulfilled 31 out of 33 milestones required for the disbursement. In October 2023 Lithuania's Recovery and Resilience Plan (RRP) was being amended to include a new REPowerEU chapter and will be submitted to the European Commission by the end of 2023. In addition, Lithuania has requested that the RRP be supplemented with an additional €1.6 billion in loans to promote business investments in green, innovative and digital technologies, and in producing and exporting high value-added products.
- **In 2022 Lithuania stopped importing energy from Russia, marking an important step towards energy independence.** Lithuania continues to work towards an ambitious goal of meeting all of its domestic electricity needs with renewables by 2030.

Key priorities for 2024

- **Further measures to become fully independent from the Russian power system are being implemented.** A key step will be to disconnect from the Belarus, Russia, Estonia, Latvia and Lithuania (BRELL) power system and to synchronise the Baltic states' electricity systems with the synchronous area of continental Europe, planned to take place in February 2025.
- **Investments in offshore wind farms will help the country to become an energy exporter by 2030.** Successful completion of a tender in October 2023 for a €1.83 billion investment for the construction of an offshore wind farm would help reach the target of making it operational by 2030, with a capacity of 700 MW. Another tender for a wind farm, also with a capacity of 700 MW, is planned to be announced in January 2024, and it is expected that two offshore wind power plants will become operational by 2030.
- **Full use of all EU funds under the RRF is needed.** The concentration of domestic reforms and investments should be aimed at stimulating the economy and gradually eliminating structural weaknesses, along with a green and digital transition. The consolidation of four Lithuanian development agencies into one is well under way and could boost further mobilisation of the RRF funds.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.7	0.0	6.3	2.4	-0.5
Inflation (average)	2.2	1.1	4.6	18.9	9.0
Government balance/GDP	0.5	-6.5	-1.1	-0.7	-1.8
Current account balance/GDP	3.5	7.3	1.1	-5.5	0.5
Net FDI/GDP [neg. sign = inflows]	-2.3	-1.1	-2.2	-2.5	-2.0
External debt/GDP	70.0	80.7	78.9	67.6	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	39.6	37.5	37.4	35.9	n.a.

Macroeconomic developments and policy response

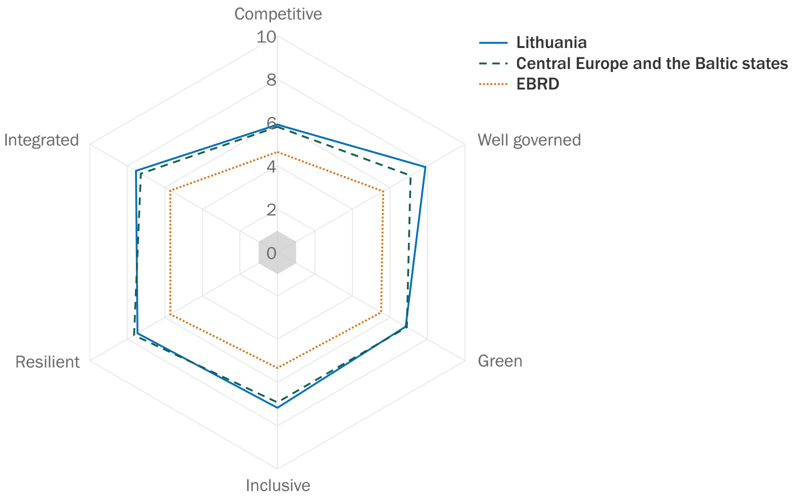
The economy is set to contract mildly in 2023, although a strong rebound of 2.4 per cent in the second quarter suggests there may be a recovery. Following a slowdown in GDP growth to 2.4 per cent in 2022, the economy shrank by 0.8 per cent on a year-on-year basis in the first half of 2023. Weak economic performance was largely driven by uncertainty related to Russia's war on Ukraine, inflationary pressures, tightening credit conditions and sluggish external demand, which affected industrial activity. Unemployment remains close to historically low levels, reaching 6.3 per cent in the second quarter of 2023. Despite elevated energy prices and weakness in the industrial sector, the labour market remains resilient.

Inflation has declined from high levels. After peaking at 24.1 per cent in September 2022, the inflation rate has been decreasing steadily, reaching 4.1 per cent in September thanks to lower food, transport and housing utility prices. Inflation should be on a further downward trend in 2024. Average wages continue to rise strongly, to double digits, surpassing the rate of inflation and supporting the recovery of households' purchasing power. The 15 per cent rise in the minimum wage in January 2023, along with the government's temporary subsidy programmes during the energy-price-shock period, provided substantial support for individuals at the lower end of the income distribution. The demand for household loans is on a downward trend, reflecting elevated uncertainty and high interest rates.

The government introduced subsidies for energy and gas prices. To mitigate the economic and social impacts of high energy prices, the government adopted a new support package worth €557 million at the start of 2023, introducing subsidies on energy and gas for households and businesses. As the energy market stabilises, the energy support measures have been gradually withdrawn: the partial subsidy on electricity prices for businesses was terminated in the first quarter of 2023; the electricity support scheme for households was discontinued in the second half of 2023; and gas subsidies for households and business will not continue beyond the end of 2023. The drop in wholesale gas and energy prices has resulted in the government spending significantly less than planned on these schemes, and the budget deficit is now expected at 1.9 per cent of GDP in 2023. No support measures are planned for 2024.

Negative growth in 2023 should be followed by a modest recovery in 2024. GDP is projected to grow by 1.5 per cent in 2024, driven by recovering household consumption, as wage growth will substantially outpace inflation. This growth will also be driven by better external demand for Lithuanian exports. EU funds directed towards public investment will also contribute to increased economic activity. However, downside risks remain, associated mostly with geopolitical developments and main trading partners' economic conditions.

Assessment of transition qualities (1-10)



Structural reform developments

The government presented and submitted a tax reform to parliament for discussion. The tax reform aims to provide a tax system that is more balanced, supports growth and improves social fairness. The package responds to some of the key recommendations made over the years by international organisations and financial institutions, such as broadening the tax base and addressing the complexity of the various forms of economic activity. Among the measures in the package aimed at stimulating growth are the immediate depreciation deduction for fixed assets to encourage productive investments, and the increase in the annual income threshold for businesses to register as value-added tax (VAT) payers. The reform also proposed expanding the scope of real-estate tax, introducing more consistent progressivity on high-income earners and bringing the taxation of self-employed workers' incomes closer to that of workers in standard employment, thus broadening the coverage of social security guarantees.

The pan-Baltic capital market is set to benefit from single index classification. The new single index, which was launched at the same time as the August 2023 Index Review, will allow the three markets to be integrated into the Morgan Stanley Capital International (MSCI) universe and will raise the region's profile among international investors who track MSCI indices. The approach is in line with the efforts made by the ministries of finance in Estonia, Latvia and Lithuania, the European Bank for Reconstruction and Development, the European Commission and Nasdaq Baltic to create a single pan-Baltic capital market, as outlined by a memorandum of understanding signed in November 2017. The approach is also a building block of the EU's capital markets union initiative.

Lithuania successfully cut off fossil-fuel imports from Russia. Following the opening of the Poland-Lithuania gas interconnection in May 2022, Lithuania strengthened its links with Latvia by completing a gas interconnection in December 2022. Moreover, Lithuania, together with Estonia and Latvia, took measures to synchronise with the western European power system and disconnect from the BRELL power system. The country has installed four large-scale electricity storage facilities in Vilnius, Siauliai, Alytus and Utena with a total capacity of 200 MW to provide a reserve of energy. According to the Ministry of Energy, the country is on track to notify BRELL counterparts in August 2024 of its disconnection, and to cut off the eastern power system by early 2025.

New EU funds are being added to foster green transition and digitalisation. In June 2023 the authorities requested a REPowerEU chapter to be added to Lithuania's RRP. In addition, the government plans to expand the RRP with an additional €1.6 billion in loans to promote business investments in green, innovative and digital technologies, and in producing and exporting high value-added products. Lithuania expects amendments to be adopted by the end of this year.

In May 2023 the country received the first payment of €542 million under the RRF. Once all conditions are met, a further payment of €260 million is expected before the end of 2023. The funds are directed at supporting climate objectives and fostering the digital transition. According to the European Commission, the country satisfactorily fulfilled 31 out of 33 milestones before receiving the payment.

Excise tax reform is contributing to the green transition. In May 2023 the parliament approved a package of fuel excises discouraging the use of the environmentally harmful fuels. The package includes withdrawing (narrowing) subsidies for fossil fuels, and introducing CO_2 components to the excise duty structure, which will support the country's green transition.

Renewable energy is being developed. In March 2023 the Lithuanian National Energy Regulatory Council (VERT) opened the tender process for the construction of an offshore wind farm. The investment will amount to €1.83 billion, with an estimated capacity to provide up to a quarter (700 MW) of the country's total electricity needs. The wind farm is expected to be operational by 2030. In 2022 wind power production in Lithuania accounted for 13.5 per cent of total consumed energy. In the longer term, Lithuania has set an ambitious target for renewables (mainly offshore wind and solar) to cover all domestic electricity demand by 2030.

Moldova

Highlights

- **The economy continues to struggle.** Output fell further in the first half of 2023 after a steep decline in 2022, and inflation decelerated to 8.6 per cent in September 2023.
- **Digital transformation is advancing.** A new government digital strategy aims to develop the information technology (IT) sector, improve the efficiency of government services, enable remote identification and simplify online business registration for foreign investors.
- **Structural reforms have accelerated.** Having been granted European Union (EU) candidate country status in June 2022, the authorities have made important progress in addressing the nine priorities identified in the European Commission's opinion on the application for membership. As a result, in November 2023 the European Commission recommended that the European Council open accession negotiations with Moldova once all priorities have been fully addressed.

Key priorities for 2024

- **Administrative and institutional capacities need strengthening in advance of EU accession negotiations.** The authorities should ramp up ongoing public administration and judicial-system reform efforts to further reduce corruption and eliminate the influence of oligarchs in the political system.
- **The authorities should continue to undertake legislative reform to support the digitalisation of public services.** Building on the success of new platforms to promote e-government, the necessary legislative and regulatory framework should be put in place to enable systemic digitalisation across all layers of government.
- **Energy-sector reform should continue, to further integrate the domestic energy market into the EU single market.** Enhancing energy security remains a priority given the country's location. The authorities should advance policy action with the EU to enable competitive energy trading with European partners and reduce the country's dependency on a single source of energy supply.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.6	-8.3	13.9	-5.0	0.0
Inflation (average)	4.8	3.8	5.1	28.7	13.3
Government balance/GDP	-1.5	-5.3	-2.6	-3.2	-6.0
Current account balance/GDP	-9.4	-7.7	-12.4	-17.1	-12.1
Net FDI/GDP [neg. sign = inflows]	-4.1	-1.3	-2.7	-3.7	-1.5
External debt/GDP	61.2	70.1	63.8	65.9	n.a.
Gross reserves/GDP	26.1	32.8	28.5	30.8	n.a.
Credit to private sector/GDP	19.6	22.9	23.3	22.5	n.a.

Macroeconomic developments and policy response

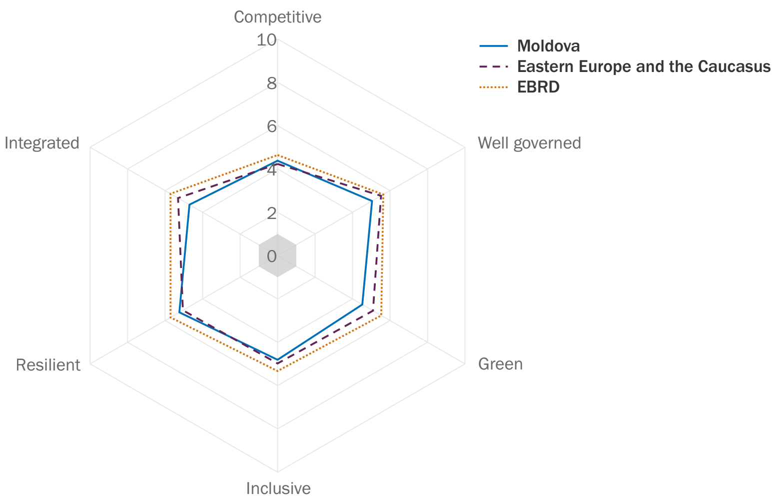
The economy is struggling to exit from a negative spiral. Moldova is one of the economies hardest hit by the war on Ukraine, with gross domestic product (GDP) falling by 5 per cent in 2022. Soaring inflation (peaking at 34.6 per cent in October 2022) and tight monetary policy stifled domestic demand, while a severe drought led to a steep decline in agricultural production. These negative trends continued in the first half of 2023, when GDP contracted by 2.3 per cent year on year, mainly due to a further 5.6 per cent fall in private consumption. Industrial output dropped 7.6 per cent year on year during the same period and exports of goods declined 10.9 per cent. With imports remaining flat, the current account deficit-to-GDP ratio remained at double-digit levels. On a more positive note, the combination of more stable energy prices and tight monetary policy contributed to a sharp deceleration in the annual inflation rate, to 8.6 per cent in September 2023, allowing the National Bank of Moldova to cut the policy rate to 6 per cent.

Fiscal pressures have increased as a result of the Ukraine war. In December 2022 parliament approved a 12.5 per cent increase in government expenditure in 2023, targeting higher public-sector wages and pensions and expanding standard-of-living support for the most vulnerable. In the past year, the Moldovan authorities have provided social assistance, public education, emergency healthcare services and temporary accommodation to 117,000 Ukrainian refugees. They have also introduced energy subsidies for vulnerable Moldovan households through the Energy Vulnerability Reduction Fund. Financial support for agricultural producers in rural areas increased 17 per cent year on year between January and July 2023. Since November 2022 micro, small and medium-sized agricultural producers can apply for a 100 per cent subsidy for diesel used, while large agricultural enterprises can receive a 30 per cent subsidy for energy used. All of these measures led to a fiscal deficit of 3.2 per cent of GDP in 2022 and 2.8 per cent of GDP in the first half of 2023.

Official creditors' external financing is helping to cover the twin deficits. In April 2023 the International Monetary Fund (IMF) approved the disbursement of US$ 96 million (€87.5 million) for immediate budgetary support out of a total US$ 795 million (€750 million) from the Extended Credit Facility (ECF)/Extended Fund Facility (EFF). In addition, the EU increased its macro-financial assistance (MFA) by €145 million in January 2023, while the World Bank paid out additional grant funding of US$ 43 million (€40.6 million) in May 2023 through its emergency response. On the back of significant capital inflows, the domestic currency appreciated 8 per cent from the beginning of 2023 and foreign reserves reached US$ 5 billion (€4.5 billion) at the end of July 2023, covering six months of imports. Public debt is moderate, at 33.7 per cent of GDP at the end of 2022, though is likely to have edged up by a few percentage points as a result of the new loans.

Geopolitical uncertainties are weighing on the short-term economic outlook. The government's expansionary fiscal policy in 2023 and the drop in inflation have not yet resulted in clear signs of an economic rebound. Nevertheless, the progress achieved on energy resilience and the expected rise in real incomes are likely to improve growth prospects in 2024. We, therefore, forecast GDP growth of 0 per cent in 2023, followed by growth of 3.5 per cent in 2024. The prospects for EU accession and associated reforms could drive a stronger recovery in the medium and long term.

Assessment of transition qualities (1-10)



Structural reform developments

The authorities are focusing reform efforts on nine priorities identified by the European Commission when granting Moldova EU candidate country status. In November 2023 the European Commission noted that Moldova has made important progress on the nine priorities and has taken additional measures to complement and sustain these achievements. Therefore, the Commission recommended that the European Council open accession negotiations with Moldova once it complies in all nine areas.

Progress is under way on reducing the influence of oligarchs. The authorities have accepted the advice of the Venice Commission on implementing a systemic approach to removing the political influence of oligarchs. This approach covers the adoption, strengthening and integration of legal tools across different fields of law to prevent the influence and growth of oligarchs in the long term. The authorities have also submitted an action plan to the Venice Commission, outlining institutional and legal progress, as well as a plan to revise it every six months. The Venice Commission made recommendations on the implementation of the action plan, including measures on the consistent reform of the judicial system, conducting impact assessments and introducing additional or complementary legislation.

Anti-corruption measures have progressed, but there is parliamentary opposition to their scope. A new legislative process began in March 2023, setting out a clear division between the National Anti-corruption Centre and the Anti-corruption Prosecutor's Office to optimise coordination between the two main anti-corruption agencies. To simplify corruption case proceedings, the authorities partially amended the Criminal Procedure Code at the end of December 2022. However, in July 2023 parliament proposed amendments to limit the role of the Anti-corruption Prosecutor's Office to taking on only large-scale corruption cases (over €15,000 for bribery and €150,000 for damages).

Reforms to the judicial system continued, but judicial independence remains vulnerable. In August 2023 parliament passed a law on the Supreme Court of Justice under which it will become a court of cassation rather than an appeals court. Recent amendments to the judiciary's roles and responsibilities include changes to the status of judges, the code of criminal procedure and the code of civil procedure. However, vested interests and slow progress on passing these legal and regulatory amendments are hindering transparent judicial staff appointments and the budgetary independence of the anti-corruption agencies.

A new strategy for digital transformation is boosting digital technology applications in the public sector. In January 2023 the authorities launched the 2023-27 Strategy for Digital Transformation of the Republic of Moldova. Its main goals are to enhance IT sector competitiveness, expand access to digital services for the wider population and improve e-government services. In March 2023 parliament voted to discard legal constraints on foreign investors who want to open an online business in Moldova without a physical presence. Legislative amendments were made to allow remote identification of clients in the financial sector from July 2023. The authorities are also developing a digital platform to enable remote identification for e-government services.

Moldova's domestic energy sector is being integrated into the European market. Reducing dependence on energy imports from Russia has been a key target of energy-sector reform since the start of the war on Ukraine. Electricity trade capacity from continental Europe to Moldova increased to 1,050 MW in May 2023 through a new agreement with the European Network of Transmission System Operators for Electricity (ENTSO-E). The Moldovan authorities and the EU agreed in May 2023 that energy infrastructure projects in Moldova would be eligible to apply for EU grants under the bloc's energy infrastructure rules. Financial support from the European Bank for Reconstruction and Development (EBRD) also enabled the authorities to accumulate gas reserves for the coming winter.

Governance reforms of state-owned enterprises (SOEs) have advanced. In December 2022 the authorities adopted an ownership strategy identifying all SOEs at central government level that should be subject to reorganisation, privatisation or liquidation. It also published a plan to strengthen corporate governance. Later, amendments to the law were passed, enabling the Public Property Agency to monitor implementation by SOEs of corporate governance regulations, evaluate the performance of SOE board members and monitor the potential fiscal risks of SOEs. The authorities are also finalising an SOE privatisation plan.

Mongolia

Highlights

- **The Mongolian economy is booming on China's reopening.** Real gross domestic product (GDP) grew 6.4 per cent year on year in the first half of 2023. This was driven by a surge in commodity exports and a tourism boom following the reopening of the Chinese economy after the removal of Covid-related restrictions.
- **The financial system is undergoing a major transformation.** With XacBank conducting a successful initial public offering in May 2023, all five of Mongolia's systemically important banks have been transformed into publicly traded companies. As a result, Mongolian stock-market capitalisation exceeds US$ 3 billion (€2.84 billion) and trading volumes in the first half of 2023 nearly doubled year on year.
- **The investment environment is improving.** A revised investment law, offering major improvements for foreign investors, entered the public discussion phase, and the government established the Private Partnership Centre and the Investment and Trade Agency. The latter is tasked with safeguarding investor interests and serving as a streamlined one-stop shop for foreign investors.

Key priorities for 2024

- **The government should use windfall revenues from commodity exports to inject capital into the newly created sovereign wealth fund, while ensuring its independence.** The government's decision to transform the state-owned mining company, Erdenes Mongol, into a sovereign wealth fund is conceived as a countercyclical move, but it is important to ring-fence the fund from political interference through proper corporate governance arrangements.
- **Measures to improve soft connectivity infrastructure would help diversify the economy.** Newly built railways are enabling Mongolia to significantly increase mineral exports by cutting transport and logistics costs. To boost non-commodity exports, Mongolia should digitalise border crossings and customs protocols, as well as address well-known e-trade challenges, such as legal and regulatory bottlenecks for cross-border payments.
- **Resolving legacy issues in the energy sector will help unlock investment in renewables.** Challenges related to the curtailment of electricity supply from existing variable renewable energy generators, issues of non-payment, and non-cost-reflective tariffs discourage new private-sector investment in renewables. Addressing these challenges is paramount given Mongolia's extreme reliance on coal and recently unveiled plans to construct new coal-fired power plants.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	5.6	-4.6	1.6	5.0	7.2
Inflation (average)	7.3	3.7	7.4	15.2	12.3
Government balance/GDP	1.0	-9.2	-3.0	0.7	-0.7
Current account balance/GDP	-15.2	-5.1	-13.8	-13.4	-10.9
Net FDI/GDP [neg. sign = inflows]	17.2	12.9	14.2	14.9	n.a.
External debt/GDP	222.7	243.1	222.0	n.a.	n.a.
Gross reserves/GDP	30.7	34.1	28.7	20.2	n.a.
Credit to private sector/GDP	48.9	45.8	47.5	n.a.	n.a.

Macroeconomic developments and policy response

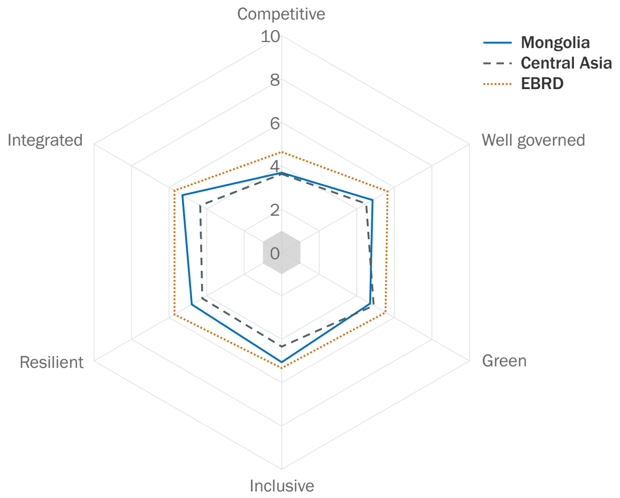
The economy is booming. China's removal of Covid-related restrictions in December 2022 enabled a rapid expansion of Mongolian mining and quarrying activities, as well as the full recovery of tourism. In the first half of 2023, the economy grew 6.4 per cent year on year. Foreign trade turnover increased dramatically in January-July 2023. Exports rose 34.5 per cent year on year, driven by a more than 60 per cent increase in coal exports, supported, in turn, by the launch of two new rail lines connecting Mongolia's main coal deposits in Tavan Tolgoi to China. Imports grew by 5.5 per cent year on year on very strong demand for machinery, equipment and electrical appliances (up 26.9 per cent year on year), reflecting foreign direct investment-related capital investment. With pandemic-related travel restrictions finally rescinded, the number of incoming travellers in the first half of 2023 saw a threefold increase from the previous year, boosting revenues in the hotels, restaurants and catering sector, as well as the cashmere trade (Mongolia's largest producer, Gobi, saw its domestic sales increase 89 per cent on the year).

Inflation is on a downward trajectory. Following a broader global trend, consumer price inflation decreased to 9.2 per cent in July 2023, having peaked at 16.9 per cent in June 2022. Even so, the Bank of Mongolia has maintained its policy rate at 13 per cent since December 2022. Since March 2023, the tugrik has appreciated by 1.5 per cent (as at 28 August) against the US dollar, reflecting a massive increase in exports and foreign-currency earnings. However, the currency remains below its value before the war on Ukraine, having lost about 20.8 per cent against the dollar in 2022.

The fiscal stance is improving. The government budget posted a surplus of 0.7 per cent of GDP in 2022, compared with a deficit of 3 per cent the previous year. This positive trend continued in the first seven months of 2023, with the budget seeing a surplus of MNT 1.36 trillion (€370.5 million, or 2.3 per cent of 2022 GDP), driven by a 41.4 per cent year-on-year increase in tax revenue, against a government spending increase of just 16.7 per cent. Public debt decreased as a share of GDP, to 82.4 per cent in 2022 from a peak of 97.4 per cent in 2020 (according to the International Monetary Fund), but remains elevated by regional standards. On the positive side, the country was able to partly refinance US$ 1.1 billion (€1.04 billion) in debt maturing in 2023 and 2024 by issuing a new US$ 650 million (€615.2 million) bond with a lower coupon rate. This reflects investors' confidence in Mongolia's continued growth and improved fiscal discipline, as manifested in the recently adopted budget law, which enhances fiscal transparency and accountability.

Strong growth is likely to continue in the short term. We forecast real GDP to grow by 7.2 per cent in 2023 and 7.5 per cent in 2024. There is significant upside potential to the 2023 growth outlook from the boom in tourism continuing in the second half of 2023 (and beyond), as well as from mining activities and commodity exports gathering further steam. Downside risks relate to unfavourable external developments, such as the war on Ukraine further disrupting transportation and transit through Russia, a continued tightening of global credit conditions and China's potential slowdown affecting commodity prices and demand for Mongolia's exports.

Assessment of transition qualities (1-10)



Structural reform developments

A comprehensive national anti-corruption strategy is being considered. In April 2023 the State Grand Khural, Mongolia's parliament, received a draft strategy from the Ministry for Justice and Home Affairs for consideration. The proposed strategy envisions enhancements to the governance of state-controlled assets, augmented protection for whistleblowers, anti-corruption education, the standardisation of operations for state-owned enterprises and heightened transparency in public appointments and procurement. The prime minister has emphasised the need to fortify anti-corruption measures in the extractive industries – a noteworthy development given massive protests in December 2022 due to corruption allegations in the coal mining sector. Mongolia launched the Opening Extractives programme in June 2022 following the implementation of a law mandating public disclosure of beneficial ownership in major companies, including those in the extractive sector. With 2023 declared the Year of Fighting Against Corruption, these efforts underscore the country's commitment to combating corruption and upholding the principles of good governance. The measures taken so far have received a positive response from international partners, but they need to be implemented consistently.

Government proposals to enhance the investment climate have entered a critical public debate stage. The proposed amendments to the existing Investment Law seek to make Mongolia more attractive to foreign investors. The main improvements include: cancelling the mandatory requirements to obtain a special residency permit, to meet a minimum investment threshold (of US$ 100,000 [€94,648]) and to have at least one-third of company shares owned by a Mongolian national; limiting the number of inspections of foreign-owned firms; equalising permit fees for local and foreign enterprises; reducing the withholding tax on repatriating profits; and granting foreign investors limited land tenure rights. Following public criticism of the land tenure-related provisions, in August 2023 the Ministry of National Economic Development put forward a revised proposal for public discussion. In parallel, the government announced the establishment of two entities, the Private Partnership Centre and the Investment and Trade Agency. The latter is tasked with safeguarding investor interests and serving as a one-stop shop for foreign investors.

Mongolia's rapid digital transformation is gaining momentum. Consistent with its Vision 2050 strategy, the Mongolian government has progressed significantly in the digital realm by broadening internet access, introducing e-government services and investing in information and communications technology (ICT) infrastructure. Supported by the European Bank for Reconstruction and Development (EBRD) and the Republic of Korea, the United Nations Conference on Trade and Development conducted an eTrade Readiness Assessment, helping to formulate a roadmap for Mongolia's e-commerce progression. Key challenges identified by the assessment include logistics bottlenecks, limited cross-border payment options, an inadequate legal framework and an extensive digital divide between urban and rural areas. The government intends to tackle the latter issue by granting two licences to SpaceX to provide low-orbit satellite internet via Starlink to augment connectivity in remote regions.

Green finance initiatives are receiving international support. In March 2023 the International Finance Corporation (IFC) invested in Khan Bank's inaugural green bond issuance. As Mongolia's largest bank, Khan Bank's green bond aligns with the country's ambition to increase green lending from 1.4 per cent in 2023 to an impressive 10 per cent of total lending by 2030. The IFC contributed US$ 15 million (€14.2 million), while an additional US$ 45 million (€42.59 million) was attracted from other international investors, including the Dutch entrepreneurial development bank (FMO) and MicroVest Capital Management. With this investment, Khan Bank expects to expand its climate portfolio by funding projects in climate mitigation and adaptation. Further advancing Mongolia's green agenda, in July 2023, the EBRD and the Green Climate Fund jointly launched a Green Economy Financing Facility (GEFF), valued at US$ 137 million (€129.67 million), to support Mongolia's green transition. Borrowers can access these funds through Khan Bank and XacBank, the EBRD's partner financial institutions. Lastly, Mongolia has cooperated with international organisations on the establishment of a Conservation Trust Fund. Launched in July 2023, the fund will finance environmental conservation projects, further underscoring Mongolia's commitment to addressing climate change-related challenges.

Montenegro

Highlights

- **Economic growth has remained strong in 2023.** The economy continued its robust expansion in the first half of 2023 and the tourism sector is on course to exceed pre-pandemic levels in 2023.
- **Tax changes aimed at boosting revenues have been adopted.** The amendments introduce progressive taxation of real-estate sales, higher corporate income taxes for offshore companies and an increase in excise duties on sweets, single-use plastic, tobacco and online gaming.
- **The state-owned electricity company, Elektroprivreda Crne Gore (EPCG), is undertaking its first utility-scale renewable energy investment.** A new 55 MW onshore wind farm near the village of Gvozd in the Nikšić municipality will help the company to accelerate its decarbonisation plan and the country with its broader energy transition.

Key priorities for 2024

- **Systemic measures are needed to support medium-term fiscal sustainability.** Adopting a medium-term fiscal framework and establishing the fiscal council would help govern a much-needed return to fiscal consolidation in an environment of elevated borrowing costs.
- **Enhancing the business environment would encourage investment.** A more efficient public administration system (to streamline, in particular, the burden stemming from local administration and para-fiscal charges), and more transparent and cohesive economic policymaking are needed to improve investor confidence in uncertain times.
- **The country would benefit from accelerating the pace of green transition.** The National Energy and Climate Plan (NECP), set to govern Montenegro's energy transition, and the country's first law on renewable energy, have not yet been adopted.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.1	-15.3	13.0	6.4	3.5
Inflation (average)	0.4	-0.3	2.4	13.1	8.3
Government balance/GDP	-1.8	-10.9	-1.7	-4.2	-1.7
Current account balance/GDP	-14.3	-26.0	-9.2	-13.2	-10.7
Net FDI/GDP [neg. sign = inflows]	-6.2	-11.2	-11.7	-13.2	-8.0
External debt/GDP	167.4	221.6	191.7	157.9	n.a.
Gross reserves/GDP	27.6	41.5	35.3	32.3	n.a.
Credit to private sector/GDP	51.3	55.7	56.2	55.7	n.a.

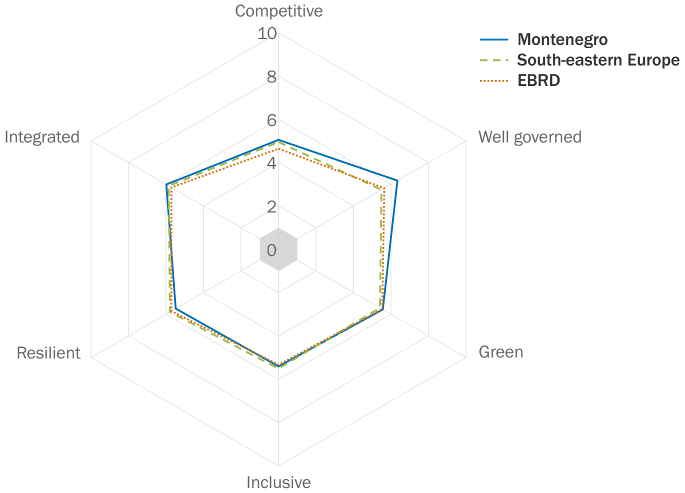
Macroeconomic developments and policy response

Strong economic growth has continued in 2023. The economy grew by 6.4 per cent in 2022, boosted by robust household consumption and a strong performance by the hospitality sector. Gross domestic product (GDP) growth accelerated to 6.6 per cent year on year in the first half of 2023 as household consumption expanded by 10 per cent year on year, driven by the large increase in arrivals from abroad, partly reflecting the substantial inflows of Russian and Ukrainian immigrants. A record year for the tourism sector is anticipated for 2023 as a whole, with foreign tourist arrivals up by 25 per cent year on year and by 13 per cent in the first eight months of 2023 compared with record 2019 levels. Tourism revenues have nearly doubled on an annual basis, while retail trade expanded by 16 per cent in the first half of the year. Economic growth was supported by investment on the expenditure side and a 4 per cent annual increase in industrial output on the production side, driven by an increase in electricity production resulting from favourable rainfall patterns for hydropower generation. The current account deficit in the first half of 2023 remained unchanged from the same period of 2022, as strong service exports offset higher goods imports.

Limited targeted fiscal measures have been introduced. Annual inflation peaked at 17.5 per cent in November 2022, decelerated to 6.9 per cent in July 2023 before picking up again to 7.9 per cent year on year in September. Net nominal wages maintained strong annual growth of 11 per cent in August 2023, given the 80 per cent minimum wage hike and the abolition of healthcare contributions that took place in 2022, and spurred on by an increase in most public sector wages from the beginning of 2023. A set of tax changes was introduced in July 2023 with the aim of boosting budget revenues, and the government brought in lower excise duties on fuel for farmers, fishermen and some transport companies. An extraordinary adjustment in the minimum pension, set to benefit a third of Montenegrin pensioners, was enacted from October 2023. Following several years of elevated fiscal spending (with the government budget deficit for 2022 coming in at 4.2 per cent of GDP), the budget deficit target for 2023 was revised to 2.9 per cent of GDP in May 2023 (down from 5.9 per cent), on account of higher revenues from the EU Energy Support Package and elevated inflation, which boosts government revenues. General government debt has decreased from its peak at 107 per cent of GDP in 2020 but remained elevated at 72 per cent of GDP at the end of 2022.

Growth is projected to slow down amid elevated uncertainty. GDP growth is forecast at 3.5 per cent in 2023 and 3.7 per cent in 2024, with the weak global growth outlook dampen short-term prospects. Nonetheless, strong private consumption and the robust performance of the hospitality sector tilt the risks to the outlook towards the upside. A potential resolution of the current political deadlock presents further upside potential, as this would allow the implementation of the economic reform agenda to resume and public investments to move forward.

Assessment of transition qualities (1-10)



Structural reform developments

Energy market reforms have advanced. A new day-ahead market, launched in April 2023 on the Montenegrin Power Exchange (MEPX), is expected to lead to a more liquid and transparent market. It will benefit both consumers and producers by ensuring fair prices and leading to better integration of energy systems in the Western Balkans and the broader region.

Parliament has enacted a set of amendments to tax laws. The main aims are to reduce tax fraud, bring about environmental and health benefits, and enhance revenues. The amendments, adopted in February 2023 and valid from 2024, introduce progressive taxation of real-estate sales and higher corporate income taxes for offshore companies, as well as higher excise duties on sweets, single-use plastic, tobacco and online gaming. As per amendments to the Budget Law, Montenegro will also establish a fiscal council, an independent body tasked with evaluating the country's fiscal policy and providing recommendations.

Reform and privatisation of state-owned enterprises (SOEs) have been slow. There has been no progress on the previously planned state ownership strategy, the establishment of a list of key companies remaining in state ownership, or plans to improve SOE management and financial performance. Due to a lack of political consensus, a holding company managing SOEs has also not been set up, and the unit in the Ministry of Finance monitoring SOE fiscal risks has been scaled down. Privatisation has also not progressed: the state has instead increased its share in certain SOEs (the Simo Milosevic health institute, Meljine hospital, Plantaze winery and the Bar sea port).

The legal framework for doing business is being enhanced. A public consultation was completed in September 2023 for two key laws on the business environment in Montenegro: the Law on Companies and the draft Law on the Registration of Business and Other Entities. The amendments to the Law on Companies aim to enhance the environment for doing business by harmonising regulations further with three European Union (EU) directives on the use of digital tools and processes, cross-border mergers and divisions, and shareholder engagement. The draft Law on the Registration of Business is a new, complementary piece of legislation governing how businesses are registered (which has so far been regulated through the Law on Companies), which aims to simplify the registration process while increasing the transparency of data and documentation, in line with the EU acquis.

The state-owned electricity company, EPCG, is undertaking its first utility-scale renewable energy investment. A new 55 MW onshore wind farm near the village of Gvozd in the Nikšić municipality will help the company accelerate its decarbonisation plan and the country with its broader energy transition. Once completed, the Gvozd wind farm is expected to generate enough renewable energy output to supply more than 25,000 households per year. It is a milestone project for EPCG, being its first major new-generation asset in more than 40 years, as well as its first wind farm.

An action plan has been adopted to operationalise the Strategy for the Development of Women's Entrepreneurship. An action plan for the 2023-24 period was adopted in July 2023 and focuses on three strategic priorities: enhancing the business environment for women in business, supporting the competitiveness of female-owned businesses, and improving the position of women in business.

Morocco

Highlights

- **Growth recovered in 2023, but will potentially be affected by the severe earthquake of September 2023.** Following the acute drought of 2022, better weather conditions and easing inflation led to faster growth in the first half of 2023 and to some reduction in unemployment rates. An earthquake (measuring 6.8 on the Richter scale) in September caused the loss of thousands of lives, as well as widespread destruction in and around Marrakech and the Atlas mountains.
- **Steps have been taken to mitigate the effects of inflation, but public finances remain sound.** The government raised the minimum wage and extended a range of subsidies and tax exemptions to stabilise prices, but the fiscal deficit narrowed and public debt remains contained.
- **Reforms have been adopted to address water scarcity, improve food security and support private investment.** The country's water and electricity company launched a new investment programme for water infrastructure, and the government enacted a new legal framework to enable independent power producers (IPPs) to sell and export renewable energy.

Key priorities for 2024

- **Diversifying the economy remains a top priority.** This includes promoting innovation, boosting private investment in export-oriented industrial sectors and exploring new export markets. In addition, continued efforts to improve the business environment and promote private investment are essential.
- **Investing in agricultural resilience is vital to mitigate climate risk.** Morocco needs to adopt a long-term plan to address climate challenges (notably the impacts of drought). This includes investing in water storage, wastewater treatment and alternative water sources, as well as strengthening value-chain resilience.
- **Continued investment in renewables and infrastructure is important for the country to become an energy hub.** Capitalising on renewable energy resources and leveraging the private sector could enhance energy security and reduce import dependence. Moreover, investing in infrastructure, including in electricity interconnections, green hydrogen and its derivatives, could boost exports and provide immense opportunities in the long run.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.9	-7.2	8.0	1.3	3.1
Inflation (average)	0.2	0.7	1.4	6.6	6.3
Government balance/GDP	-3.6	-7.1	-6.0	-5.2	-4.9
Current account balance/GDP	-3.4	-1.2	-2.3	-3.5	-3.1
Net FDI/GDP [neg. sign = inflows]	-0.6	-0.8	-1.2	-1.5	-1.4
External debt/GDP	42.5	50.8	47.4	50.9	n.a.
Gross reserves/GDP	20.5	29.7	25.1	24.7	n.a.
Credit to private sector/GDP	58.9	66.2	62.4	64.2	n.a.

Macroeconomic developments and policy response

Following a slowdown in 2022, growth picked up in 2023. Gross domestic product (GDP) growth decelerated to 1.3 per cent in 2022, driven by a drought-induced contraction in the agricultural sector (the wheat harvest fell by 69 per cent), a slowdown in non-agricultural activities and rising inflation, which damped household demand. In the first half of 2023, growth recovered to 3.4 per cent year on year, as inflation eased, domestic demand recovered, and the agricultural and non-agricultural sectors expanded. Unemployment decreased slightly to 12.4 per cent in the second quarter of 2023, but remains higher among women (17 per cent), youth (33.6 per cent) and in urban areas (16.3 per cent).

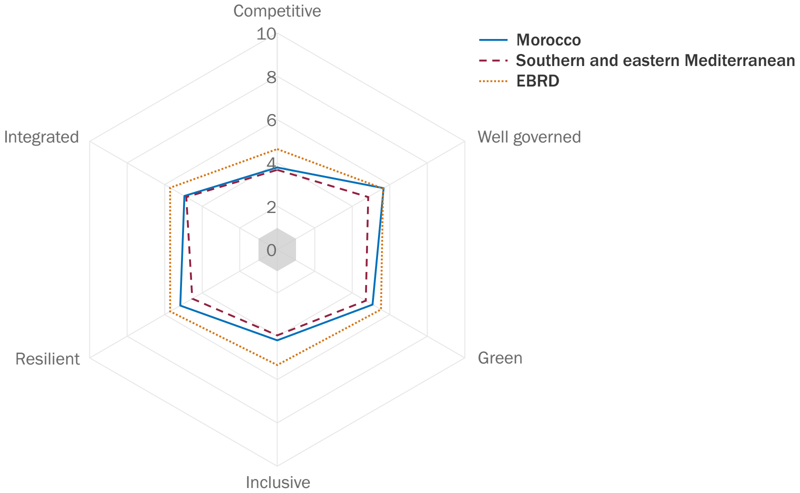
An earthquake in September 2023 caused the loss of more than 3,000 lives and widespread destruction. The devastation and the subsequent reconstruction spending will strongly affect the country's macroeconomic performance in the coming year. The epicentre of the earthquake was in the Atlas Mountains near Marrakech. It caused physical damage to both historical buildings and essential infrastructure, demolishing entire villages. Given the affected region's moderate contribution to GDP, the immediate impact on national output is likely to be modest. The government announced a reconstruction plan amounting to MAD 120 billion (around €11 billion, or 8 per cent of GDP) over five years, which is likely to boost GDP and could help mitigate regional disparities, as many of the affected villages are remote and disadvantaged. The plan would significantly increase financing needs, already estimated at 15 per cent of GDP for 2023.

The government adopted several measures to mitigate the impact of inflation. Annual inflation eased to 4.9 per cent in September 2023 from a peak of 10.1 per cent in February 2023 after the central bank raised interest rates by a cumulative 150 basis points from October 2022. The government extended a range of subsidies to stabilise the prices of butane gas and other basic commodities and to help specific sectors facing higher fuel prices. In 2023 the government confirmed that it would maintain those subsidised electricity prices and announced the removal of value-added tax on agricultural inputs. Moreover, it recently announced a plan to amend the 2023 budget law, increasing spending by US$ 1 billion (€0.95 billion) to address drought and inflation challenges.

The fiscal position remains strong, although external imbalances increased in 2022. The budget deficit narrowed to 5.2 per cent of GDP in 2022 and is expected to shrink further to 4.9 per cent of GDP in 2023 on the back of improved tax collection and higher non-tax revenues. Public debt remained sustainable at 69 per cent of GDP. Still, the current account deficit widened to 3.5 per cent of GDP in 2022 on the back of a larger trade deficit, due to a doubling of energy imports and a rise in grain imports amid a poor harvest and higher prices. Meanwhile, exports of automotive, textile, agriculture and fertiliser products expanded, benefitting from higher global prices. The current account deficit is expected to narrow to 3.1 per cent of GDP in 2023 as energy prices ease, weather conditions improve, and tourism and remittances pick up. Foreign reserves declined to US$ 32.2 billion (€30.5 billion) at the end of 2022, but recovered slightly to US$ 35.5 billion (€33.7 billion) in August 2023, covering around 5.8 months of imports.

Growth is expected to continue to recover in the short term, with some downside risks. The economy is forecast to grow by 3.1 per cent in 2023 and remain stable at around 3 per cent growth in 2024. This will be driven by improved agricultural production as weather conditions improve, a continued recovery in tourism, easing inflation and a relative pick-up in domestic and external demand as European markets recover. These forecasts do not incorporate the effects of the earthquake, as the likely impact on overall economic activity remains difficult to gauge at this stage. In addition, Morocco's high dependence on energy imports and seasonal agricultural production make the country vulnerable to global instability and climate risks.

Assessment of transition qualities (1-10)



Structural reform developments

A new International Monetary Fund programme should mitigate potential financing risks and accelerate reform. The country's two-year US$ 5 billion (around €4.7 billion) Flexible Credit Line was approved in April 2023. It is designed to build up the country's external buffers and provide insurance against risks, enabling the authorities to create the necessary policy space for and accelerate the implementation of a comprehensive reform agenda. The programme is expected to catalyse the country's New Model of Development 2021-35, which aims to enhance governance, human capital, inclusion, sustainability and regional leadership.

Morocco continues to address the increasing challenges of water scarcity and food insecurity. Capitalising on the National Drinking Water Supply and Irrigation Programme (PNAEPI) 2020-27, in May 2023 the government increased the programme's budget allocation to US$ 14.3 billion (€13.6 billion) from an initial investment of US$ 11.5 billion (€10.9 billion). The PNAEPI aims to scale up investments in the water sector, strengthen the supply of drinking water and irrigation, and build resilience against climate risks. The additional investment would accelerate the construction of dams, connect various water basins (raising Morocco's freshwater storage capacity), increase the share of reused treated wastewater and speed up the transition to alternative water sources (the government has embarked on an ambitious desalinated seawater programme). Moreover, in June 2023 the government signed a framework agreement worth US$ 1 billion (€0.95 billion) with agricultural sector professionals to reduce the impact of drought on agriculture and strengthen resilience.

Multiple reforms are under way to support competition, investment and renewable energy. The new investment charter, passed in December 2022, aims to make the country a hub for investments from abroad. It offers investment support systems in the form of subsidies or grants for investment projects carried out in key regions and sectors, and boosts investment in small and medium-sized enterprises (SMEs). This was complemented in early 2023 by legislation amending existing laws on renewable energy and the regulation of the electricity sector, so that IPPs can: (1) produce energy for their own consumption, (2) sell surplus energy from renewable sources to other consumers by connecting to the national grid, and (3) export renewable electricity through national electricity grid interconnections. However, further clarification is required from the National Electricity Regulation Agency on tariffs and conditions for feeding electricity into the network while preserving grid stability. In addition, the Moroccan Competition Council, which oversees the country's antitrust regime, has become more active over the past year, especially in the field of merger control. Reforms to ensure the smooth handling of cases include a simplified filing form for no-issue transactions and the introduction of a filing fee, with an optional expedited process for an additional fee.

The government introduced a new programme to support industrial innovation. Launched in September 2022, the innovation programme plans to invest US$ 30 million (around €28.5 million) over 2023-25 to promote research and innovation by industrial SMEs. The programme aims to support at least 100 qualified projects by supporting: (1) the development of patents (by contributing 80 per cent of the patent process costs), (2) innovation, research and development of new products or processes in the design-to-prototype phase (by contributing 60 per cent of the costs of inputs and services), and (3) the industrialisation of products and processes in the pilot phase (by contributing 30 per cent of investment costs).

Efforts are being made to unify corporate tax rates and promote investment. The Finance Law 2023 introduced a four-year, phased reform aimed at promoting convergence to a unified corporate tax rate from the current multi-rate system (depending on profits, sector and location). By 2026 the regime will comprise a tax rate of 20 per cent for standard companies, 35 per cent for companies with profits of at least MAD 100 million (around €9 million) and 40 per cent for financial institutions. The reform would particularly benefit medium-sized firms (with profits between MAD 1 million [€90,000] and MAD 100 million [€9 million]) and industrial companies (with profits of less than MAD 100 million [€9 million]), which would benefit from a gradual reduction in their tax rate by 2026. This is expected to improve tax revenues, as lower rates should encourage formalisation and widen the tax base, while simplifying the system and improving incentives and resource allocation.

North Macedonia

Highlights

- **Economic growth has slowed in 2023.** The economy grew more slowly in the first half of 2023 than it did in 2022, as weakening domestic demand was only partially offset by lower imports and higher net exports.
- **A two-year Precautionary and Liquidity Line (PLL) arrangement with the International Monetary Fund (IMF) is ongoing.** The structural conditionalities under the arrangement focus on the energy sector and the fiscal impact of a large infrastructure project. The first review was planned for May 2023, but has been delayed.
- **Renewable energy sources are being commissioned at an enhanced rate.** In the first half of 2023 the Energy and Water Services Regulatory Commission issued licences for electricity production from renewable energy sources to 278 planned power plants, more than it issued in the whole of 2022.

Key priorities for 2024

- **Continued fiscal consolidation under the new fiscal rules is needed.** The authorities should follow up on commitments made under the PLL arrangement with the IMF to continue reducing the budget deficit in the medium term, returning the deficit to limits envisaged under the Organic Budget Law.
- **Public investments need enhanced evaluation, implementation and monitoring.** The first step set out in an action plan created in response to the IMF's Public Investment Management Assessment (PIMA) is to establish a PIMA unit within the Ministry of Finance.
- **Reform efforts and public investment in the transmission network should complement private-sector investment in renewable energy sources.** The draft National Energy and Climate Plan should be updated to reflect the aftermath of the energy crisis. Investments should be made in the transmission network and in making systems more flexible to ensure that renewable energy capacity can be integrated into the power grid. Electricity subsidies, which are still high, should be increasingly directed towards vulnerable groups.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.9	-4.7	3.9	2.1	2.0
Inflation (average)	0.8	1.2	3.2	14.2	10.0
Government balance/GDP	-2.0	-8.0	-5.4	-4.5	-4.7
Current account balance/GDP	-3.0	-2.9	-2.8	-6.0	-3.3
Net FDI/GDP [neg. sign = inflows]	-3.2	-1.4	-3.3	-5.1	-5.2
External debt/GDP	72.4	78.7	81.9	83.6	n.a.
Gross reserves/GDP	29.0	31.0	31.2	29.9	n.a.
Credit to private sector/GDP	46.7	51.6	50.8	52.4	n.a.

Macroeconomic developments and policy response

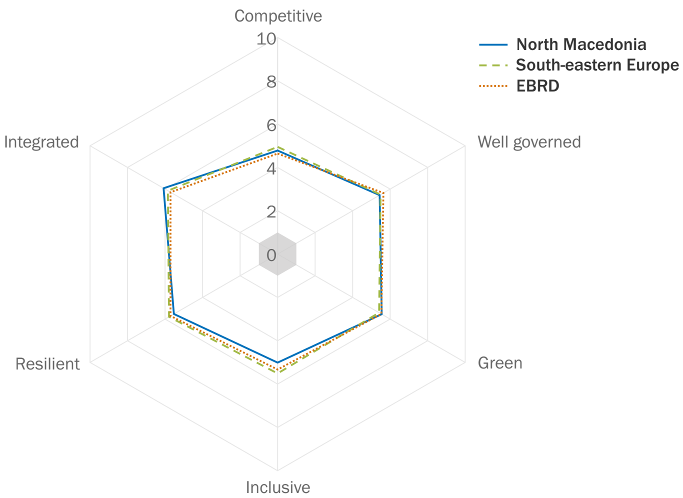
Economic growth continues at a moderate pace. Gross domestic product (GDP) growth slowed to 2.1 per cent in 2022 and moderated further to 1.6 per cent year on year in the first half of 2023 as household consumption growth slowed despite elevated inflation. Net exports turned more favourable in the first half of the year amid a contraction in imports. Exports maintained a positive growth rate in the first quarter of the year, boosted by strong electricity production, before contracting in the second quarter in line with subdued external demand. The current account narrowed to near zero in the first half of the year in line with favourable movements in the trade balance and a sharp increase in remittances. Retail trade performance remained strong, going beyond double-digit growth rates and driving growth on the production side. Meanwhile, the construction sector entered a deep contraction in the second quarter of the year, stifling growth.

Monetary and fiscal measures are supporting the economy amid inflationary shocks. Annual inflation peaked at 19.8 per cent in October 2022 and gradually decelerated to 6.6 per cent in September 2023. The National Bank of the Republic of North Macedonia tightened monetary policy in the past 18 months, raising the policy rate several times, from an all-time low of 1.25 per cent in April 2022 to 6.3 per cent in September 2023. As inflation was largely driven by food prices, the government imposed price caps on basic foodstuffs (including the most popular types of bread, dairy products, pasta, eggs, rice and some fruit and vegetables) in April 2023, before lifting the caps in June, citing favourable market conditions. The parliament approved a pension increase, valid from March 2023, and a hike in the minimum wage effective from April 2023.

The country has turned to external funding to satisfy elevated liquidity needs. In light of a Eurobond repayment coming due, the authorities returned to the external market in March 2023 via a four-year Eurobond of €500 million issued at a 6.96 per cent yield. The issuance came after a month-long delay owing to a government reshuffle and was oversubscribed, with order books exceeding €2 billion. Alongside the ongoing IMF programme, the European Union's (EU) €80 million budget support grant and €100 million in macro-financial assistance are helping to finance the budget deficit. The European Central Bank has extended the duration of a €400 million repo line to the National Bank of the Republic of North Macedonia by another year, until January 2024.

Slow growth is forecast in the short run. Despite the expansionary fiscal policy measures, household demand is set to remain moderate in the short term as inflation is still high. The slowdown in North Macedonia's main trading partners will continue to affect exports, alongside increased uncertainty and tighter financing conditions, which may weigh on investor confidence. GDP growth is therefore likely to remain modest, at around 2 per cent in 2023, before accelerating to 3 per cent in 2024 on the back of an expected global recovery.

Assessment of transition qualities (1-10)



Structural reform developments

A domestic day-ahead power trading platform has been launched. The platform, which was launched in May 2023, aims to encourage investment in renewable energy production and help to make energy systems more stable by providing clear and transparent pricing signals.

Renewable energy sources are being commissioned at an enhanced rate. In the first half of 2023 the Energy and Water Services Regulatory Commission issued licences for electricity production from renewable energy sources for 278 planned power plants, more than were issued in the whole of 2022. According to the regulatory authority, the total installed capacity of the planned power plants licensed in the 18 months from January 2022 to June 2023 amounted to 270 MW, enough to power 104,000 average households if the investments are fully realised.

A two-year PLL arrangement with the IMF is in place, but the first review has been delayed. The IMF Board approved the arrangement in November 2022, providing upfront access to €530 million. The structural conditionalities under the arrangement include gradually eliminating electricity subsidies, improving energy efficiency, and producing a comprehensive and independent study to monitor fiscal risks stemming from the Corridor VIII and Corridor X-d road project. The first review was planned for May 2023, but had not taken place by early September as the impact of the project on public finances was still being assessed. Satisfactory implementation of the arrangement is also a condition for the disbursement of €100 million in macro-financial assistance from the EU, approved in June 2023.

Additional measures and regulations have been introduced to preserve financial stability. The measures are in line with the provisions of the Law on Financial Stability, which was adopted in July 2022. The Financial Stability Committee was set up and held its first meeting in November 2022, and submitted its first annual financial stability report to parliament at the end of March 2023. A decision on the credit risk management methodology was adopted in February 2023 that aims to strengthen the management of non-performing and restructured loans and is due to enter into force in 2024. The National Bank of the Republic of North Macedonia also introduced borrower-focused macroprudential measures (caps on loan-to-value and debt service-to-income ratios) in the first half of 2023 to help contain risks, particularly in the real-estate sector. A new law on bank resolution, adopted in October 2023, introduces a comprehensive framework for addressing problems in troubled financial institutions, including through the establishment of a bank resolution fund.

Tax reform has begun. In line with amendments to the Law on Personal Income adopted at the end of 2022, progressive taxation, which had been set to enter into force from 2023, was abolished. Taxation of interest on savings was postponed until the country accedes to the EU. In turn, the amendments aim to broaden the tax base by targeting undue exemptions and reliefs in the existing system. The amendments are part of a broader effort to reform the taxation system and include amendments to the corporate income tax and value-added tax (VAT) regime adopted by the government in December 2022, but not yet by the parliament (as at September 2023).

Poland

Highlights

- **Economic activity has slowed sharply, as higher prices are affecting households' purchasing power.** Following strong gross domestic product (GDP) growth of 5.3 per cent in 2022, the economy shrank in annual terms during the first half of 2023 amid still high, though falling, inflation.
- **Child benefits and pensions have been increased.** The per-child allowance was raised from PLN 500 (€110) to PLN 800 (€180) per month from January 2024, while pensioners will now benefit from payments of 13th and 14th month pension bonuses, which are set to be paid on a permanent basis in the future.
- **A subsidised mortgage loan programme for first-time house buyers has been launched.** The subsidised loans have an interest rate of just 2 per cent, plus the bank's margin, for the first 10 years, with the state covering the difference between the average fixed market rate and 2 per cent.

Key priorities for 2024

- **Investments in renewable energy and energy storage should be scaled up.** More investment in grid infrastructure, including grid connections, grid strengthening and cross-border electricity interconnections, is required to align with the requirements of a modern energy system that can accommodate a high share of intermittent renewable energy sources, such as offshore and onshore wind or solar.
- **Transport and logistics infrastructure in eastern Poland needs to be developed.** Better intermodal transport infrastructure, including road, rail and shipping, would improve connectivity, increase capacity and ensure smoother border crossings. Together with increased warehouse space in eastern Poland, investment in infrastructure will be critical for Polish companies wishing to expand eastwards once Ukraine's post-war reconstruction is under way.
- **Social support should be targeted at the most vulnerable groups only.** The current fiscal position highlights the need to avoid making commitments to untargeted and costly social programmes.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.4	-2.0	6.9	5.3	0.6
Inflation (average)	2.1	3.6	5.2	13.2	12.0
Government balance/GDP	-0.7	-6.9	-1.8	-3.7	-5.3
Current account balance/GDP	-0.2	2.4	-1.3	-2.4	1.0
Net FDI/GDP [neg. sign = inflows]	-2.0	-2.4	-3.8	-3.7	-3.5
External debt/GDP	58.9	60.7	56.5	53.0	n.a.
Gross reserves/GDP	21.6	25.6	24.4	24.2	n.a.
Credit to private sector/GDP	50.3	47.7	45.2	39.2	n.a.

Macroeconomic developments and policy response

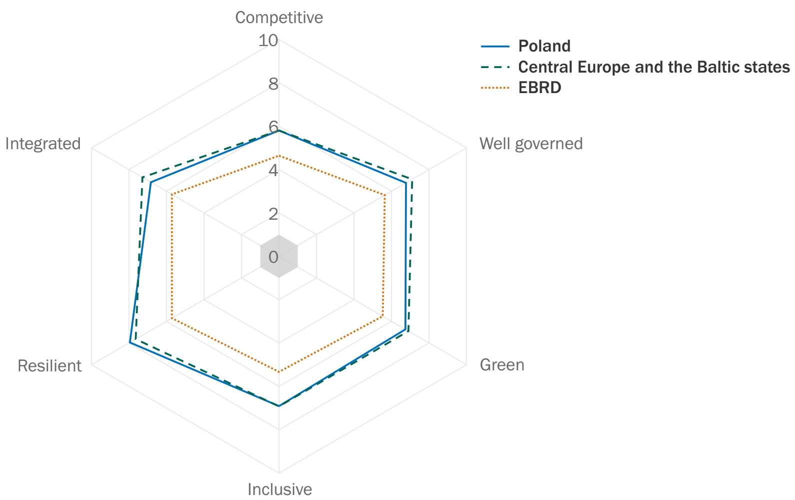
High inflation and tighter financing conditions are weighing on GDP growth. Economic activity remained robust in 2022, with GDP growing by 5.3 per cent, but it dropped sharply to -1 per cent year on year in the first half of 2023. The high growth in inventories has been the key economic driver for the last two years, amid uncertainty related to disrupted value chains and weakening household consumption. Subdued external demand has negatively affected exports, but recently stabilised energy prices have provided some relief to the economy, helping to turn the current account into a surplus in the first half of 2023. Investment remains robust, recovering to 8 per cent year on year in the first half of 2023, but the high financing costs weigh mostly on housing investments.

Inflation is coming down and real wage growth has turned positive again. The harmonised index of consumer prices (HICP) peaked in February 2023 at 17.2 per cent and has fallen since then, settling at 7.7 per cent in September 2023. As a result, the economy-wide real wage growth turned positive in June 2023 for the first time since the end of 2021. While the average household budget is expected to gain amid double-digit nominal wage growth and decelerating inflation, household purchasing power is expected to rise only slightly in 2023. Structurally, labour market pressures have been eased to some extent by the inflows of refugees and migrants, counterbalancing unfavourable demographic trends. However, this effect has not endured, as some Ukrainian refugees have been conscripted into Ukraine's army.

The general government deficit remains high. Substantial energy support measures, estimated at 2.4 per cent of GDP, remaining anti-Covid expenditures (0.7 per cent of GDP) and the costs of supporting Ukraine's refugees (0.5 per cent of GDP) all contributed to a general government deficit of 3.7 per cent of GDP in 2022. Further, increased defence spending, expected at 4.2 per cent of GDP in 2023, and possible enhanced energy support measures (depending on energy prices), are expected to substantially increase government spending this year and in 2024. As a result, the budget law was amended in July 2023 to include a "defence clause" to reflect the discrepancy between prepayments for the purchase of military equipment and actual deliveries of equipment. Poland is likely to find itself operating under the European Union's (EU) excessive deficit procedure in 2024, based on the deficit out-turn of 2023. The European Commission forecasts Poland's general government deficit at 5 per cent and 3.7 per cent of GDP in 2023 and 2024, respectively.

The current drop in GDP growth should ease in 2024. GDP is forecast grow by just 0.6 per cent in 2023. However, further positive real wage growth, low unemployment, an improvement in consumer sentiment and a slight easing in monetary policy are expected to fuel a recovery in GDP growth in 2024, forecast at 2.7 per cent. Further delays in Recovery and Resilience Facility (RRF) transfers and uncertainty about potential increases in energy prices constitute the main risks to that scenario.

Assessment of transition qualities (1-10)



Structural reform developments

The government is pre-financing some RRF-related programmes. In March 2023 the wind farm bill, which liberalises where onshore windfarms can be located, was passed into law. The bill was one of two milestones that Poland had to pass to unlock RRF transfers. The other milestone concerns judicial reform (see below), but an unresolved dispute means this has stalled. As a result, the Polish Development Fund (PFR) started to pre-finance RRF programmes using its own resources. Poland's Recovery and Resilience Plan (RRP) was approved by the European Commission in June 2022 and is based on €23.9 billion in grants and €33.5 billion in loans. The government boosted the latter amount in April 2023 to enable greater investments in the energy system, the green transition of cities, gas infrastructure and the healthcare sector.

EU concerns about the rule of law are not yet resolved. In February 2023 the parliament passed an amended law on the Supreme Court, which was meant to address a key European Commission milestone to unlock RRF funds. However, the bill was not signed by the president and it is currently with the Constitutional Tribunal for examination. Meanwhile, the Court of Justice of the European Union (CJEU) ruled in June 2023 that the Polish justice reform of December 2019 "infringes EU law".

Poland's first offshore wind farm is expected to support the country's renewable energy generation and help it reach its decarbonisation targets. In October 2023 Baltic Power, a special purpose vehicle jointly owned by ORLEN, the Polish multi-utility company, and Northland Power, a Canadian independent power producer, received a final investment decision to construct the wind project in the Baltic Sea. Once fully operational, the wind farm, which will have a capacity of up to 1.2 GW, is expected to generate electricity equivalent to 4,000 GWh or approximately 2-3 per cent of Poland's current electricity generation.

Coal mining companies need to pay a windfall tax. In July 2023 parliament approved a 33 per cent windfall tax on coal-mining companies, to be levied on profits exceeding 120 per cent of 2018-21 average profits. The expected revenues amount to PLN 2 billion (around €450 million) in 2023. At the same sitting, a bill was approved that raises the maximum amount of household energy consumption covered by capped prices (at 2022 levels) by 1,000 kWh annually. Price caps will likely remain as such until the end of 2023, when all electricity subsidy schemes are set to expire. The cost of these energy subsidy schemes, including those for gas bills, is expected to be partially covered by windfall tax revenues, as well as temporary levies imposed on firms engaged in production and distribution of electricity and gas, which were legislated on in October 2022.

Price-suppressing measures on food have been extended. In June 2023 the government extended a zero VAT rate on most food products until the end of the year. The measure is expected to cost PLN 11 billion (€2.5 billion) in 2023. According to government estimates, this measure should cut about 0.3-0.5 percentage points from headline inflation.

Child benefits and pensions have been increased. In August 2023 the government increased the current per-child monthly payment of PLN 500 (€112) to PLN 800 (€180) from January 2024. The programme is effectively an indexation of the Family 500+ scheme introduced in April 2016. The total cost of the programme is expected to be PLN 63.7 billion annually (€14.3 billion, 1.9 per cent of GDP), or about 1 per cent of GDP higher than the existing costs of the scheme. In addition, in May 2023 the government approved payment of a permanent 14th-month pension bonus (according to ESA 2010 not classified as pension expenditures), after approving a (13th-month) pension bonus in 2019. The total cost of the indexed pension expenditures, including the two pension bonus payments, is estimated at PLN 80 billion (€18 billion), which brings total spending on pensions to PLN 320 billion (€71.7 billion, 9.7 per cent of GDP) in 2023.

A subsidised mortgage loan programme has been launched. The "Safe Credit 2 per cent" subsidised mortgage loan scheme started in July 2023 and is expected to attract up to 50,000 first-time house buyers by the end of 2024, according to the government. The subsidised mortgage loan has a reduced interest rate of 2 per cent, plus the bank's margin and commission (if it is charged), for the first 10 years, with the state covering the difference between the average fixed market rate and the 2 per cent rate. The programme is limited to those aged 45 or younger with loans up to PLN 600,000 (€134,000), and can be used for a first-time purchase, with PLN 200,000 (€45,000) as the maximum down payment. According to the Polish Bank Association (ZBP), the number of total mortgage loans is estimated to drop by 30 per cent in 2023 amid increased interest rates. The subsidised mortgage loan programme offsets that decrease to a large extent.

The banking sector remains profitable but legal risks related to Swiss franc mortgages have risen. The CJEU ruled in June 2023 that banks could not seek remuneration for invalidated Swiss franc loans, although borrowers might be able to. As a result, banks with significant Swiss franc loan portfolios now need to increase provisions in case of legal action, which would reduce their ability to finance the economy. According to the central bank, additional provisions needed to cover the cost of legal risk materialisation of Swiss franc housing loans would be about PLN 40 billion to PLN 50 billion (€9 billion to €11 billion) in 2023-25, depending on the number of out-of-court settlements signed. In 2022 Poland's banks increased their net profits to PLN 10.7 billion (€2.4 billion), from PLN 6.1 billion (€1.4 billion) in the previous year, largely due to high interest rates and strong economic activity.

Romania

Highlights

- **The economy has slowed after resilient growth in 2022.** Despite numerous headwinds, gross domestic product (GDP) growth reached 4.7 per cent in 2022, but then slowed markedly in the first half of 2023 on the back of falling industrial production and moderating consumption.
- **Reform delays under the Recovery and Resilience Plan (RRP) are accumulating.** As of the end of September 2023, the government was behind on implementing the RRP, delaying future disbursements. For the third payment request, delays relate to investments and reforms in green transition and energy storage, and to corporate governance improvements at state-owned enterprises (SOEs).
- **Hidroelectrica's initial public offering (IPO) has boosted the local stock market.** The large listing brought new investors to the local stock market, boosting its liquidity and regional attractiveness, and acting as a model for the potential listing of other SOEs.

Key priorities for 2024

- **The administrative capacity to implement the RRP needs to be improved.** With increasing delays in reaching RRP milestones, the authorities need to allocate sufficient resources and organise those institutions responsible for delivering the requisite reforms and investments.
- **Fiscal consolidation should be achieved through systematic fiscal reform.** In line with recommendations from the European Union (EU) and other international organisations, the authorities should embark on creating a more efficient, inclusive and straightforward tax system that will yield higher fiscal revenues.
- **Continued reforms and investments aimed at greening the energy sector are needed.** Romania has great potential to develop its renewable energy market, supported by EU funds and associated recent reforms. More work is needed to integrate renewable energy into the grid and adopt a regulatory framework for offshore wind energy.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.8	-3.7	5.9	4.7	1.8
Inflation (average)	3.8	2.6	5.0	13.8	10.7
Government balance/GDP	-4.6	-9.6	-6.7	-5.8	-6.3
Current account balance/GDP	-4.9	-4.9	-7.2	-9.1	-7.3
Net FDI/GDP [neg. sign = inflows]	-2.2	-1.3	-3.7	-3.1	n.a.
External debt/GDP	49.0	57.5	56.7	50.3	n.a.
Gross reserves/GDP	16.7	19.3	19.0	18.3	n.a.
Credit to private sector/GDP	24.3	25.5	26.2	24.6	n.a.

Macroeconomic developments and policy response

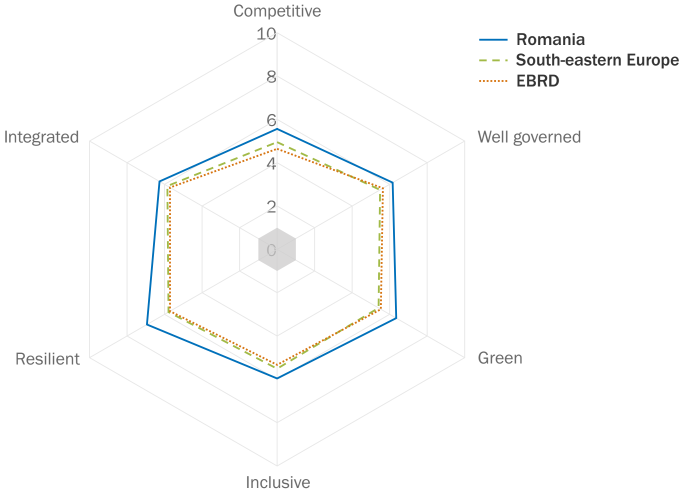
Despite a slowdown, the key economic drivers show resilience. The economy performed strongly in 2022, expanding by 4.7 per cent, despite significant external headwinds, and driven by robust domestic demand and accumulating inventories. In the first half of 2023, growth decelerated to 1.7 per cent year on year, with a notable slowdown in the second quarter. Domestic demand remained resilient amid higher government spending and investment, but falling inventories and an annual decline of goods exports dragged on growth. Industrial production has failed to return to growth so far, reflecting the considerable supply-side shocks in 2022 and weaker foreign demand.

Inflation is on a slow downward path despite stubborn food and core prices. After peaking at 16.8 per cent in November 2022, inflation fell to 8.8 per cent in September 2023. While this trajectory is aligned with the National Bank of Romania's forecast of 7.5 per cent at the end of 2023, risks of stickier inflation remain, especially following the recent increase in a range of taxes (see below). Services inflation is growing steadily, reaching 12.1 per cent in September 2023. The National Bank of Romania has kept the 7 per cent policy rate since January 2023 and signalled that rate cuts were unlikely this year. With stable policy and exchange rates, significant foreign capital inflows and lower credit activity, interbank liquidity reached record levels by the middle of 2023, driving down the three-month money market rate from a peak of 8.2 per cent in November 2022 to 6.4 per cent by September 2023. Still, credit growth in local currency has essentially turned negative in 2023 as companies switched to cheaper foreign-currency loans.

The fiscal position has worsened despite some consolidation efforts. In 2022 the government missed the opportunity to lower the planned deficit by using inflation-boosted revenues and extraordinary budget revenues, such as windfall taxes from energy SOEs. By the middle of 2023, the cash-based fiscal deficit was higher than the corresponding period in 2022, with projections showing a year-end deficit of above 6 per cent of GDP, instead of the targeted 4.4 per cent. Value-added tax (VAT) revenues increased by just 7 per cent in the first half of 2023, reflecting more subdued economic activity, while government spending increased by 16.5 per cent. The government has therefore introduced revenue and spending-side measures to reduce the budget imbalance. Among the key measures are VAT increases on specific products and services, a revenue tax, the elimination of tax benefits for employees in information technology (IT), construction and agribusiness sectors, and lowering administrative spending by cutting advisors and senior management posts. The 2024 deficit is targeted at 3 per cent of GDP, but the International Monetary Fund (IMF) expects a deficit slightly above 5 per cent of GDP, including the effects of the adopted fiscal package.

Moderate growth is likely in the short term. Considering the slowdown in the first half of 2023, we forecast GDP growth for the year as a whole at 1.8 per cent. More moderate private consumption, together with a potential tax reform, will likely define the growth path this year. Stronger agricultural production and exports, EU-funded investments and a tightening labour market provide upside potential, while weaknesses in sectors such as industry and construction will drag on growth. In 2024, amid a normalisation of inflation and easing financial conditions, growth should accelerate to a projected 3.2 per cent in the absence of major shocks.

Assessment of transition qualities (1-10)



Structural reform developments

The European Commission has closed the Cooperation and Verification Mechanism (CVM) for Romania. In November 2022 the Commission concluded that the progress the Romanian authorities had made with judicial reforms was sufficient for the mechanism to be closed, with remaining issues to be addressed through continuous dialogue and the rule-of-law mechanism. The last CVM report noted the progress Romania had made in strengthening the judiciary and combating corruption. The Commission formally started the process of repealing the CVM in June 2023.

The RRP is facing mounting delays. As the authorities had not satisfactorily completed two milestones (investments in new electrolysers for hydrogen production and projects on gas co-generation and district heating) from the second payment request from the Recovery and Resilience Facility (RRF) by December 2022, the Commission triggered a payment suspension procedure that envisages only partial disbursement if the items have not been completed by January 2024. Other milestones with a missed deadline in 2022, which will also affect the third payment request, include two investments in battery storage and supply chains, and improvement to the corporate governance of SOEs. The wider pension system reform, another key requirement of the RRP, was due in the first quarter of 2023. The third payment request, which was initially planned for March 2023, is likely to be submitted around November 2023, meaning Romania may miss out on the funds allocated for 2023.

A minority stake in Hidroelectrica was listed on the local stock exchange. After years of preparation and delays owing to Covid-19 and the war on Ukraine, investment fund Fondul Proprietatea listed almost 20 per cent of Romania's largest energy SOE on the Bucharest Stock Exchange. Local and foreign institutional investors have subscribed to around 80 per cent of the shares. The IPO was valued at €1.9 billion, the largest listing in the history of the local capital market. The deal contributes to the growth and liquidity of the local stock market, as it was reported that new foreign investors had subscribed for the first time in Romania.

The contract-for-difference mechanism was adopted to support renewable energy, and the Neptun Deep offshore gas project was given the green light. In August 2023 the government adopted a regulatory framework to implement the mechanism. The first contracts for 2,000 MW of onshore wind and solar capacity should be assigned towards the end of 2023. The mechanism should stimulate the renewable energy market and accelerate deployment. Another highlight is the Neptun Deep project being developed by the state-owned Romgaz and OMV Petrom, which was approved in June 2023. The project will cost €4 billion and, from 2027, will supply Romania with 10 years' worth of gas.

Three key judicial laws were modified as part of an RRP milestone. In November 2022 the government modified the laws regarding the status of magistrates, judicial organisations and the Superior Council of the Magistracy. The laws aim to improve the efficiency and staffing of the justice system and introduce some digitalisation measures. The government also initiated amendments to the penal code, which the parliament adopted, but which may be sent to the Constitutional Court for approval as some key changes were not aligned with the Court's past recommendations.

A long-term care strategy was adopted with support from the World Bank. The strategy, which was a milestone in the RRP, was adopted in December 2022 and defines the country's priorities until 2030. As the size of the elderly population is expected to increase significantly, the strategy prioritises prevention measures and person-centred care. The strategy also looks to streamline organisational processes for more effectiveness. EU funds and local budgets will finance investments in relevant infrastructure. While the number of private care centres for the elderly has more than doubled in recent years, some of these centres have been exposed as housing residents in dire conditions.

Russia[1]

Highlights

- **Cracks are beginning to show in the economy's resilience.** Falling energy prices have eroded the large current account surplus that helped the economy weather the storm of sanctions in 2022, and recent months have seen a significant weakening of the rouble, which has caused inflation to rise.
- **Growing economic imbalances are posing difficult policy choices.** The ongoing war on Ukraine implies significant expenditure, and cutting non-military spending is politically difficult. Government revenues are declining as oil prices fall. The central bank has, therefore, increased policy rates significantly to reduce domestic demand and discourage imports.
- **Structural reforms remain largely stalled.** Russia's increased isolation is already having a negative impact on productivity and growth. The authorities' focus on the ongoing war means that much-needed reforms continue to be postponed.

Key priorities for 2024

- **No meaningful reform progress is possible until Russia ends its invasion of Ukraine and seeks to re-establish itself as part of the global economy.** Such a step remains unlikely in the short term, as there is no sign of any move by the Russian authorities in this direction.
- **Beyond the conflict, a concerted effort to promote private-sector development is needed to boost growth, entrepreneurship and competitiveness.** From a structural perspective, the Russian economy continues to suffer from a lack of diversification. It is heavily dependent on commodity exports, with a dominant public sector and a challenging business environment – all trends that have been exacerbated by the war.
- **Efforts are needed to promote innovation, digitalisation and technological development.** The loss of vital technology imports as a result of sanctions has seriously damaged the manufacturing sector, and ongoing efforts to develop domestic alternatives are unlikely to compensate sufficiently.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.2	-2.7	5.6	-2.1	1.6
Inflation (average)	4.5	3.4	6.7	13.8	5.3
Government balance/GDP	1.9	-4.0	0.8	-1.4	-3.7
Current account balance/GDP	3.9	2.4	6.7	10.5	3.4
Net FDI/GDP [neg. sign = inflows]	-0.6	-0.2	1.4	1.2	1.4
External debt/GDP	29.0	31.3	26.3	17.0	n.a.
Gross reserves/GDP	32.7	40.0	34.3	25.9	n.a.
Credit to private sector/GDP	53.2	60.3	55.3	56.4	n.a.

[1] The EBRD announced on 4 April 2022 that, following the invasion of Ukraine, its Board of Governors had formally suspended Russia's access to EBRD funding for projects or technical cooperation.

Macroeconomic developments and policy response

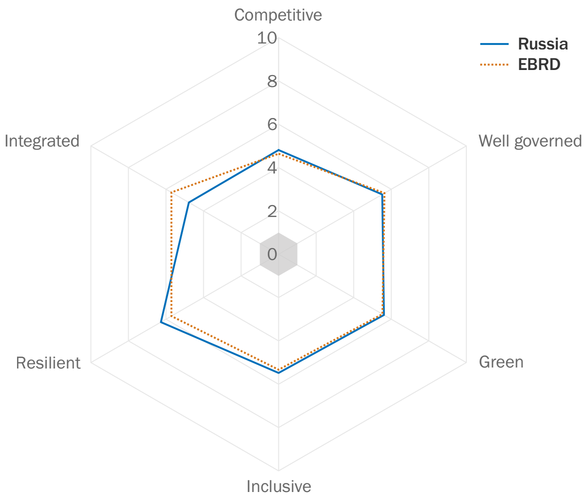
The Russian economy proved resilient to sanctions in 2022, but cracks are developing. The economy contracted by 2.1 per cent in 2022, much less than had been expected given the wide-ranging sanctions imposed. Stimulus in the first half of 2023 is likely to result in the economy returning to growth for the year as a whole. Its resilience in 2022 was largely due to significant growth in the current account surplus, which reached US$ 227 billion (€211.4 billion), or 10 per cent of gross domestic product (GDP). The surplus was driven by high energy prices, which boosted Russia's terms of trade and helped export revenues boom, particularly as Russia managed to diversify its export markets away from the West in response to the sanctions. These trends strengthened the rouble and helped lower inflation, from almost 18 per cent in March 2022 to around 2 per cent in April 2023.

Loose fiscal policy has resulted in overheating in 2023. The economy has seen a growing output gap in the context of a tight labour market due to military mobilisation and high rates of capacity utilisation. Faced with expenditure demands arising from the ongoing invasion of Ukraine, the authorities are finding it challenging to tighten fiscal policy, especially as cutting non-military spending would be politically unpalatable. For the time being, the National Welfare Fund and local bond issuance have enabled them to maintain expenditure levels.

A significant decline in the current account surplus in 2023 is a major cause for concern. Loose fiscal policy has drawn in imports, while falling energy prices and European Union-imposed price caps on Russian oil and oil-derived products have hit export revenues, shrinking the current-account surplus significantly. The surplus was US$ 25 billion (around €23.5 billion) in the first seven months of 2023, an 85 per cent decrease from the same period in 2022. As much of the central bank's foreign-exchange reserves are frozen and private capital inflows are minimal, a worsening balance-of-payments situation is a major concern. These challenges have weighed on the rouble, which weakened by more than 30 per cent against the US dollar between December 2022 and October 2023, further adding to inflationary pressures. In response, the central bank has been tightening monetary policy to try to stem domestic demand and thereby cut import demand. A 100 basis-point hike in the policy rate in July 2023 was followed by a 350 basis-point jump in August, another 100 basis-point increase in September and a 200-basis point increase in October, bringing the policy rate to 15 per cent.

The short-term outlook for growth is weak. Although policy tightening is causing the economy to slow significantly in the second half of 2023, the stimulus-driven growth of the first half of the year should result in a GDP growth rate of around 2 per cent for the year as a whole. The outlook for 2024 will depend very much on how the war on Ukraine and the related economic sanctions evolve; at this stage, economic growth is forecast at around 1 per cent. The outlook is likely to remain bleak in the absence of a peace agreement that results in a loosening of sanctions. Meanwhile, the economy's shift towards autarky and the loss of qualified workers to emigration mean that long-term growth potential will remain significantly eroded.

Assessment of transition qualities (1-10)



Structural reform developments

Structural reform has been extremely limited in 2023. Russia's war on Ukraine has left the country isolated and barred from accessing much western technology. This is hindering the country's ability to diversify away from oil.

Implementation of the National Projects scheme has slowed significantly. The ongoing conflict has resulted in a diversion of government expenditure, hampering progress on implementing the National Projects, a series of 13 large-scale infrastructure and social development projects set out by the president in 2019. There has been no progress of note over the past year.

The authorities are continuing their comprehensive review of business regulations, known as the "regulatory guillotine". This involves a review of more than 20,000 business regulations and requirements. Many regulations, some of which date back to the Soviet era, are being abolished or replaced based on cost-benefit analysis. The scheme is supposed to improve the business environment by cutting red tape and aligning regulations more closely with the needs of businesses.

Serbia

Highlights

- **Growth has moderated in the past year.** Lower external demand, which has affected manufacturing output, and persistent inflationary pressures, which have restrained household consumption, have weighed on economic performance.
- **A two-year disbursing programme with the International Monetary Fund (IMF) centred on energy reform is under way.** Measures already taken include increasing electricity and natural gas tariffs, changing the legal status of the largest state-owned electricity company to a joint-stock company, adopting a new law on the management of state-owned enterprises (SOEs) and introducing a new energy investment plan that will be published as part of the forthcoming Energy Sector Development Strategy.
- **Serbia has successfully concluded its first renewable energy auctions.** With the regulatory framework for renewable energy complete, the auctions were launched with support from the European Bank for Reconstruction and Development (EBRD) in June 2023 for 400 MW of wind power and 50 MW of solar photovoltaics. The auctions were successfully concluded in August, with the capacities awarded doubling current wind generation and prices realised for most capacities a little more than half current market prices.

Key priorities for 2024

- **Prudent policies need to support medium-term fiscal sustainability.** In view of unfavourable global financing conditions, the authorities should save inflation-driven fiscal over-performance or direct it towards investments that promote growth. They should also budget measures to support the economy in line with the fiscal rule and with a view to medium-term sustainability.
- **SOE governance needs further improvement.** The new law on SOEs provides a good starting point for completing the legal framework on SOE governance, and for advancing broader SOE reforms on improving their performance and oversight beyond the energy sector.
- **Further improvements to the investment climate would enhance medium-term growth prospects.** Reforms to support human capital development and better access to finance, strengthen the rule of law and reduce administrative complexities would help to sustain the strong inflow of foreign direct investment (FDI) and encourage much-needed domestic private investment.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.3	-0.9	7.7	2.5	1.8
Inflation (average)	1.7	1.6	4.1	12.0	12.4
Government balance/GDP	0.0	-7.2	-3.3	-0.1	-1.8
Current account balance/GDP	-6.9	-4.1	-4.2	-6.9	-2.3
Net FDI/GDP [neg. sign = inflows]	-7.7	-6.3	-6.9	-7.2	-6.1
External debt/GDP	61.4	65.8	68.4	69.3	n.a.
Gross reserves/GDP	29.1	28.8	30.8	32.1	n.a.
Credit to private sector/GDP	49.0	60.0	52.3	48.4	n.a.

Macroeconomic developments and policy response

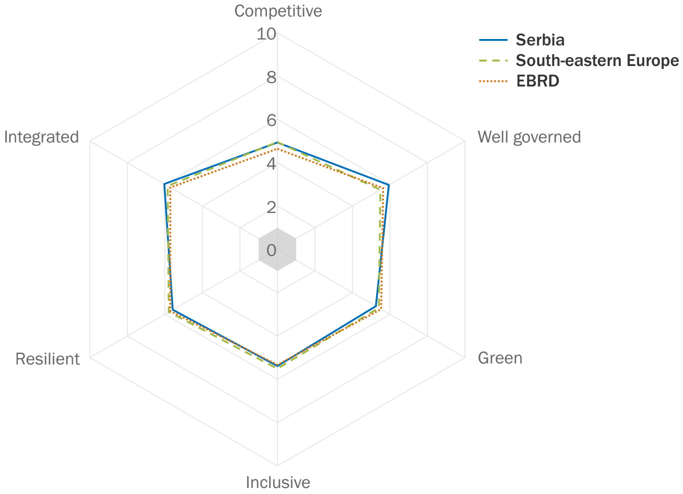
Economic activity is moderating. In line with the adverse global macroeconomic environment, gross domestic product (GDP) growth slowed to 2.5 per cent in 2022 and continued at a muted pace of 0.9 per cent year on year in the first quarter of 2023, before rising to 1.7 per cent year on year in the second quarter of the year. Household consumption growth slowed, ultimately contracting by the first quarter of 2023 as inflation remained firmly at double-digit levels. Construction activity declined in line with muted investment growth, but rebounded in the second quarter of 2023 as the authorities began implementing several sizeable public infrastructure projects. Despite heavy rainfall and occasional flooding, agricultural output grew compared with the previous year, which had been marked by drought. Industry maintained a mildly positive contribution to growth as the recovery of electricity production offset the impact of contracting mining and manufacturing activity. The current account deficit shrank to a fifth of its size year on year in the first half of 2023, driven by cheaper energy imports and strong electricity exports. Despite the shock brought about by the energy crisis, the current account deficit was entirely covered by record FDI inflows in 2022. FDI momentum was maintained in the first half of 2023, up 33 per cent year on year.

Monetary and fiscal measures were employed to support the economy. Increasingly broad-based inflation reached a decade-high level of 16.2 per cent in March 2023, before moderating to 12.5 per cent by July 2023. Inflation peaked later in Serbia than in other Western Balkans countries and the eurozone and is declining at a slower pace, partly owing to ongoing increases in regulated energy prices. The National Bank of Serbia gradually tightened monetary conditions in response, increasing the policy rate several times from 1 per cent in March 2021 to 6.5 per cent in July 2023. The authorities employed fiscal measures to support disposable income, including a pension hike and an increase in public healthcare and education wages, valid from September 2023; a price cap on 20 essential food and household products; one-off assistance for children; tourist vouchers; and state aid for repairing damages caused by storms. An increase in excise duties on fuel, tobacco, alcohol and coffee from October 2023 should contribute to a lower-than-originally-planned government deficit, as outlined in the budget rebalance adopted in September 2023.

The authorities repeatedly accessed external funding. In January 2023 Serbia returned to the external market via two issuances: a five-year Eurobond of US$ 750 million (€690 million) at a 6.3 per cent yield and a 10-year Eurobond of US$ 1 billion (€920 million) at a 6.8 per cent yield, and hedged the issuances against the euro. International reserves reached a record high of €23.6 billion (around six months of import coverage) at the end of August 2023 on account of enhanced access to external funding, including disbursement of the second tranche of the ongoing Stand-By Arrangement (SBA) with the IMF, strong remittances and exports, and central bank interventions in the foreign-exchange market aimed at quelling appreciation pressures.

Growth is set to remain subdued in the near term. Economic growth is expected to slow further to 1.8 per cent in 2023 before returning to nearer its medium-term potential at 3.5 per cent in 2024, in line with expected global recovery. The slowdown in eurozone export markets will weigh on external demand, persistently high inflation will continue to erode disposable incomes, and tight financial conditions on local and external markets, reflected in a slowdown of credit growth, will further damp domestic demand. Early elections could slow the implementation of public investments and economic reforms further, posing a downside risk to the medium-term outlook.

Assessment of transition qualities (1-10)



Structural reform developments

The new IMF programme focuses on energy and public-sector reform. The IMF Board approved a €2.4 billion SBA in December 2022, and the Serbian authorities successfully completed the first review in July 2023. The measures taken so far include increasing electricity and natural gas tariffs, transforming the largest energy SOE into a joint-stock company, and adopting a new energy investment plan that will be published as part of the forthcoming Energy Sector Development Strategy. The new law on SOE management, a key structural benchmark, was adopted in September 2023, following a second round of public consultations. According to the new law, which is aligned with the EBRD-supported State Ownership Policy, more than 20 public enterprises are now obliged to change their legal status from public enterprise to either limited liability or joint-stock company no later than one year from the law's entry into force, alongside other corporate governance improvements. The phased implementation of a centralised public wage and employment registry (ISKRA) is on track, with the registry set to cover most of the 450,000 public-sector employees by the end of 2023.

Serbia completed its regulatory framework for renewable energy and launched renewable energy auctions. Amendments to the Law on the Use of Renewable Energy Sources adopted in March 2023 and accompanying secondary legislation, such as the balancing decree and the feed-in premium decree, enable faster integration of new renewable capacities in the power system and market, while preserving the reliability and stability of the system's operations. Renewable energy producers will now take on a proportion of the balancing costs that the guaranteed supplier (the state-owned electricity company, EPS) used to bear entirely through the feed-in tariff, therefore mitigating the public costs resulting from volatile renewable energy generation. The amendments also grant the Ministry of Mining and Energy the authority to determine maximum offered prices at auctions, unlocking the auctions process. In June 2023 Serbia, with EBRD support, launched renewable energy auctions for 400 MW of wind power and 50 MW of solar photovoltaics, marking the first auction in a three-year plan for market-premium support for 1,300 MW of renewable energy. The auction was successfully concluded in August, with the wind segment quota oversubscribed and the solar segment quota undersubscribed. The capacities awarded will double the current wind generation and prices realised for most of the capacities will be just over half current market prices.

A set of judicial laws related to constitutional changes has been adopted. Parliament needed to approve a set of laws in February 2023 to implement the preceding year's changes to the constitution. As part of these changes, parliament will no longer elect judges and prosecutors; the High Judicial Council and the High Prosecutorial Council will elect them instead.

The Serbian electricity exchange SEEPEX has launched an intra-day market. The new market segment, launched in July 2023, operates on a continuous trading mechanism, enabling market participants to adjust their position almost instantaneously. This is crucial for reducing risks associated with volatile renewable energy sources.

The government approved the 2023-25 Programme for Suppressing the Grey Economy. The Programme, which was adopted in March 2023, sets out 23 measures aimed at strengthening the capacity of inspections and misdemeanour courts, and improving tax supervision and reporting procedures, as well as easing the fiscal and administrative burden on businesses.

Businesses are now solely registered online. A recent amendment to the Law on Registration Procedure requires companies to register electronically with the Serbian Business Registers Agency from May 2023, streamlining the process and aligning it with international best practices.

Slovak Republic

Highlights

- **Gross domestic product (GDP) growth has slowed further in 2023.** Household disposable income has fallen, investment remains subdued amid high financing costs, and the use of European Union (EU) funds has been sluggish.
- **The country's Recovery and Resilience Plan (RRP) has been revised.** In July 2023 the EU Economic and Financial Affairs Council (ECOFIN) approved an amended RRP for the Slovak Republic, worth €6.4 billion in grants. The revised plan includes reforms and investments linked to REPowerEU, aimed at reducing the country's energy dependence on Russia and supporting the transition to a green economy.
- **Energy security has increased.** The third unit of the Mochovce nuclear power plant is expected to be running at 100 per cent by autumn 2023 and will cover nearly 13 per cent of the country's total electricity needs.

Key priorities for 2024

- **Energy price subsidies should be provided to vulnerable groups only.** Any extension of existing support schemes, which have kept energy price increases low, should be targeted at those most in need, in order to protect public finances and encourage the switch to more efficient and green energy production.
- **Reforms to support economic convergence with the EU need to be relaunched.** According to the latest central bank report, in addition to improving the business environment, reducing red tape and speeding up the digitalisation of the economy, the management of EU funds needs to be improved, as it has constituted a major constraint on economic development.
- **Investments in e-mobility need to be accelerated.** Amid growing technological competition from China, rapidly stepping up concentration on electric vehicle and battery production will help the Slovak Republic to maintain international competitiveness and employment in the automotive industry.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.5	-3.3	4.8	1.8	1.0
Inflation (average)	2.8	2.0	2.8	12.1	11.0
Government balance/GDP	-1.2	-5.4	-5.2	-2.0	-5.0
Current account balance/GDP	-3.3	0.6	-4.0	-7.3	-2.7
Net FDI/GDP [neg. sign = inflows]	-2.3	2.6	-1.3	-2.1	-1.0
External debt/GDP	112.3	119.6	134.1	103.1	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	63.2	67.1	67.0	67.9	n.a.

Macroeconomic developments and policy response

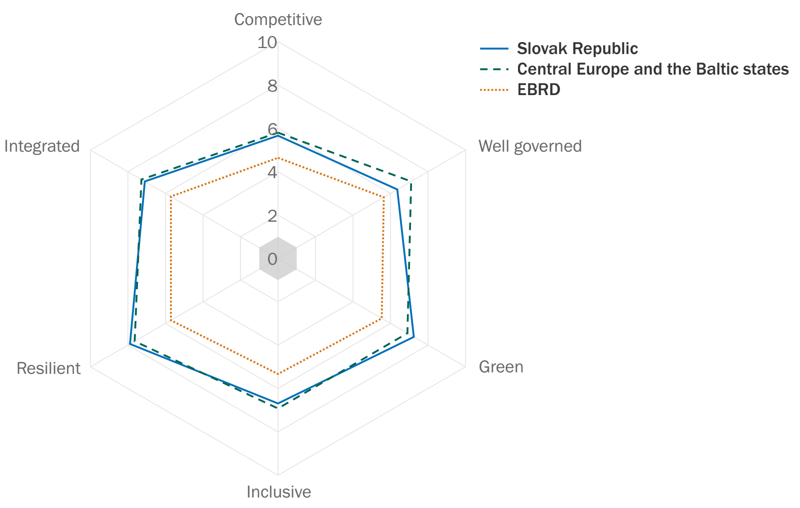
GDP growth has decelerated. After an impressive recovery in GDP growth to 4.8 per cent in 2021, economic growth slowed to 1.8 per cent in 2022 and 1 per cent year on year in the first half of 2023. High inflation rates have weighed on household disposable income, while elevated prices for imported energy have negatively affected the terms of trade. Increased financing costs, triggered by higher policy rates and an increased risk premium amid regional uncertainty related to the war on Ukraine, together with the slow use of EU funds, have held back domestic investment, although new investments in e-mobility are under way.

High inflation and rising indebtedness have triggered a surge in personal bankruptcies. In 2022 the number of personal bankruptcies increased almost 12 per cent from 2021 to 9,674 individuals, according to the Slovak Credit Bureau. At the same time, about 63 per cent of Slovaks are having difficulty making ends meet, with only 35 per cent living comfortably compared with the EU average of 54 per cent, according to the latest Eurobarometer survey. Inflation peaked at 15.4 per cent in February 2023 and has fallen since then, coming in at 9 per cent in September 2023.

Fiscal consolidation is needed amid widening budget deficits. Following a low budget deficit of 2 per cent of GDP in 2022, the European Commission expects the general government deficit to widen to more than 6 per cent of GDP in 2023, partly because of new measures to mitigate the effects of high energy bills. It forecasts public debt to increase to 58.3 per cent of GDP by the end of 2023. Fiscal consolidation will be a task for the new government to be formed after the September 2023 elections.

Economic activity is likely to pick up from current low levels in 2024. We forecast GDP growth of just 1 per cent in 2023, rising to 2.2 per cent in 2024, when households' purchasing power starts to improve (as inflation continues to fall) and external demand picks up. Key risks to the outlook include the persistently slow use of EU funds and potential political instability, which would hold back public investment. The labour market is expected to remain tight, with unemployment rates at historically low levels, but skills mismatches, a deteriorating demographic profile and high structural unemployment rates will all weigh on the country's medium- and long-term growth potential.

Assessment of transition qualities (1-10)



Structural reform developments

The country's RRP has been revised. In July 2023 ECOFIN approved an amended RRP for the Slovak Republic, worth €6.4 billion in grants. The revised plan includes reforms and investments linked to REPowerEU, aimed at reducing the country's energy dependence on Russia and supporting the green economy transition. In March 2023 the Slovak Republic received the second tranche of its Recovery and Resilience Facility (RRF) grants, amounting to one-third of the total package that needs to be used by the end of 2026. Moreover, as of the end of July 2023 the Slovak Republic had only absorbed about 75 per cent of the €14.5 billion in EU funds allocated to it in the 2014-20 programming period, which concludes at the end of 2023. In January 2023 the government started to draw down funds from its new EU allocation for the 2021-27 programming period, which totals close to €13 billion, following the European Commission's approval of the country's Operational Programme in November 2022. The new programme focuses on enhancing energy security, digitalisation, green investment and improving the quality of people's lives.

Government measures have kept household energy prices in check. According to Ministry of Finance estimates, consumers in the Slovak Republic experienced one of the smallest increases in electricity and gas prices in the EU in the second half of 2022. Prices have been held down by a combination of price caps, financial compensation schemes for the business sector and exceptional agreements with utility companies. In March 2023 the government approved electricity prices for 2024. These are expected to remain the same as in 2023, thanks to a memorandum of understanding with power utility Slovenske Elektrarne. In line with European Commission recommendations, however, the government is working on an energy support scheme that targets vulnerable groups only, rather than applying across-the-board assistance. Vulnerable households will be eligible for a subsidy covering the difference between market prices and a limit set by government.

The Ministry of Agriculture proposed seven measures for reducing food inflation, excluding any potential value-added tax (VAT) cuts or price caps. In June 2023, in response to a request from parliament, the Ministry of Agriculture announced one-off financial transfers to the most vulnerable households, as well as measures to increase food-chain efficiency, improve food-industry competition and trade, and improve the transparency of companies' economic results. At the same time, parliament approved a waiver of social contributions for employees of food producers and farmers for a six-month period to end 2023. Labour costs per employee are expected to be reduced by 24 per cent and capped at the level of the minimum wage of €700. The gap in social contributions should be covered by the state budget.

New energy windfall taxes were introduced. In April 2023 the president signed into law an increase in the windfall tax on refineries from 55 to 70 per cent until the end of 2023, with coal mining remaining exempt. In addition, in January 2023 the government approved a 90 per cent windfall tax on power producers' excess revenues, effective December 2022 for a period of two years. According to some market estimates, the two windfall taxes are likely to generate additional budget revenues of €435 million in 2023.

Energy security has increased. In February 2023 the third unit of the Mochovce nuclear power plant came into operation. It is expected to be running at 100 per cent by autumn 2023, covering about 13 per cent of the country's total electricity consumption, and has an expected service life of 60 years. The Slovak Republic is now electricity self-sufficient. In addition, by the middle of 2023 state-owned gas company SPP had secured more than 70 per cent of its gas supply needs from sources other than Russia. This includes access to LNG terminals and regasification facilities by signing memoranda of understanding with key partners, such as Italy's Edison in June 2023, and other countries earlier this year. In the middle of 2023 gas reservoirs had already been 76 per cent filled, thus exceeding the EU average of 73 per cent.

A proposed EU ban on combustion engines is meeting resistance. In May 2023 parliament approved a resolution on the EU's proposed ban on the production of new combustion engines after 2035. The resolution urges the government to oppose any EU-wide regulation that would disadvantage, overprice or ban internal combustion engines. Rather, the government should actively support the principle of "technological neutrality". At the same time, electric vehicle production is on the rise in the Slovak Republic. German company VW is planning to increase its share of electric and hybrid car production in the country to 17 per cent from 2025, while Swedish company Volvo is expected to launch the production of electric vehicles only near Košice from 2027. The country's car sector accounts for more than 50 per cent of domestic industrial production and 42 per cent of total exports.

The government is encouraging the development of rental apartments. In December 2022 the government approved pilot contracts with several large investors to build 9,000 rental flats worth some €1.5 billion. These apartments are intended for lifelong living and will be partially subsidised by the state to the tune of 30-40 per cent of market prices. The availability of rental and social housing remains a key challenge in addressing social exclusion.

Slovenia

Highlights

- **Economic growth has slowed considerably.** Gross domestic product (GDP) growth in the first half of 2023 was only 1.1 per cent year on year following growth of 2.5 per cent in 2022, with private consumption weakening amid falling real wages.
- **Slovenia was hit by flash floods in August 2023, causing significant damage.** On 4-5 August 2023 Slovenia experienced its most catastrophic natural disaster since independence, with reconstruction costs estimated at €6.7 billion (11 per cent of GDP). The government has already revised the 2023 budget to include some relief measures and will access €265 million of additional European Union (EU) funds.
- **The government formally requested a revision of the Recovery and Resilience Plan (RRP).** In July 2023 Slovenia submitted a revision of its national RRP to include two reforms and four investments under the REPowerEU initiative and to reschedule some milestones. A loan top-up of up to €750 million was requested, following the floods, to foster climate resilience and green infrastructure.

Key priorities for 2024

- **RRP implementation needs to be re-energised.** The government formally requested the second payment from the Recovery and Resilience Facility (RRF) in September 2023, initially scheduled for December 2022, while the revised plan was approved by the European Commission in October 2023.
- **Long-term care and healthcare system reforms need to be finalised.** The government's priority to ensure a sustainable long-term care system for Slovenia's ageing population has yet to translate into the adoption and implementation of all necessary legislative changes.
- **A more balanced budget will be needed to allocate flood relief funds while ensuring some consolidation.** As the fiscal deficit will reach a projected 4.9 per cent of GDP in 2023, some consolidation will be needed next year. With most flood relief costs pushed into 2024, it will be a challenge to achieve both aims.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.5	-4.2	8.2	2.5	1.5
Inflation (average)	1.6	-0.1	1.9	8.8	7.4
Government balance/GDP	0.7	-7.6	-4.6	-3.1	-4.9
Current account balance/GDP	5.9	7.2	3.3	-1.0	4.4
Net FDI/GDP [neg. sign = inflows]	-1.6	0.6	-0.8	-2.3	n.a.
External debt/GDP	90.1	101.6	97.2	90.9	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	42.2	43.4	41.4	40.2	n.a.

Macroeconomic developments and policy response

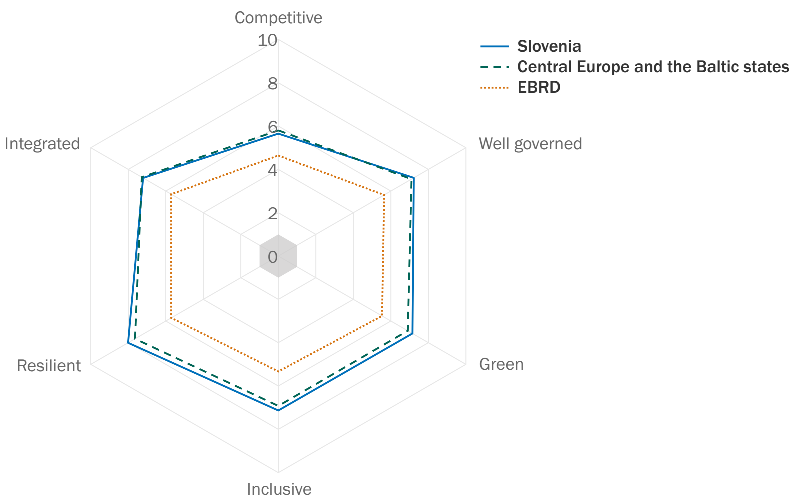
GDP growth decelerated in the first half of 2023. After expanding 2.5 per cent in 2022, the economy entered a phase of milder growth, with GDP growing only 1.1 per cent year on year in the first half of 2023. Behind the slowdown were a fall in private consumption, weaker exports and a continued decline in industrial output (since September 2022). Nevertheless, a sharp fall in imports resulted in a strong increase in the trade surplus in 2023. Investment was also robust, expanding almost 10 per cent year on year in the first two quarters of 2023.

Inflation will be stickier following the reversal of cost-of-living crisis measures from last year. Inflation inched up to 7.4 per cent in September 2023, higher than the 6.1 per cent recorded in July, mainly due to the expiry of energy price caps. Despite relatively strong nominal wage growth of 10.4 per cent in the first quarter of 2023, private consumption remains depressed, with retail sales recording annual declines since March 2023. The labour market remains very tight, with employment at record levels in 2022. This could contribute to some recovery in consumption, but carries risks of stickier inflation.

The fiscal position has worsened in 2023. Flash floods in early August 2023 forced the government to revise its 2023 budget to a projected deficit of 4.9 per cent of GDP, even though most relief costs will be budgeted in 2024. In the first three quarters of 2023, the central government deficit more than doubled compared with the same period in 2022. The government also approved certain financial support measures for affected municipalities. Flood-affected businesses will be provided with subsidies, loan deferrals and tax waivers, and hiring foreign workers will be made easier. To finance the reconstruction, at an estimated cost of €6.7 billion, the government introduced a 0.3 per cent tax for citizens, a 0.8 per cent levy for firms and a 0.2 per cent tax on banks' total assets. The levies will apply for the next five years. The budget deficit for 2024 is targeted at 3.8 per cent of GDP.

Short-term growth will remain subdued. We forecast GDP growth of 1.5 per cent in 2023, with significant downside risks stemming from weaker growth in the first half of the year, the decline in trade and depressed private consumption. On the upside, investment could accelerate as flood reconstruction starts and EU funds are disbursed. In 2024 we expect growth of 2.3 per cent, closer to the economy's potential, as falling inflation improves confidence.

Assessment of transition qualities (1-10)



Structural reform developments

The European Commission disbursed the first RRF payment in April 2023 amid mounting delays. The implementation of the RRP is ongoing, albeit behind schedule, with the second request planned for autumn 2023, later than the originally envisaged December 2022. Among the reforms that delayed the first payment request are legislation on promoting renewables, the reform of long-term care and the operationalisation of cloud infrastructure. The government is proposing to reschedule the latter two reforms in the amended RRP. In the second payment request (for the third instalment, as the first request covers two tranches), the main unfulfilled reforms as of June 2023 included operationalising a public transport company for passenger traffic and selecting a contractor for the construction of an infection clinic in Maribor.

The authorities submitted the REPowerEU chapter and requested amendments to the RRP. The chapter covers two reforms – shorter permitting procedures for renewables and promoting sustainable mobility – and four associated investments. Slovenia is entitled to €116 million from this initiative. When the government submitted its official request in July 2023, it also requested a decrease in loans due to the removal of some flood protection measures. After the floods in August, the authorities requested additional loans for a total of €1.3 billion from the RRF to address three main areas: (1) reducing the risk of floods and other climate-related disasters; (2) the sustainable renovation of buildings; and (3) increasing the capacity of railways. The European Commission's final decision on the top-up should be made by the end of 2023.

Measures are being taken to ensure energy security and accelerate the green transition. Following the energy crisis of 2022, the authorities are prioritising gas interconnectors with Croatia and Hungary to improve regional connectivity and supply routes. In January 2023 a comprehensive new law on the promotion of renewables entered into force, essentially transposing EU Directive 2018/2001 on promoting the use of renewable energy and Directive 2012/27/EC on energy efficiency improvements. Among the greatest challenges for the green transition is the need for major investments in grid capacity to absorb renewables.

Investments in railway infrastructure continue. In recent years the government has prioritised investments in railway infrastructure as a more sustainable form of transport. These investments include buying 20 rolling stock and modernising part of the Ljubljana-Divača railway line, for which a contract worth €204 million was signed in September 2023 and which should be completed by 2025. Total rail investments in 2023 may amount to €470 million. Improved connections with Croatia and Serbia are also being considered. The key reform in the sector to date has been legislation to establish an operator of integrated public passenger transport to cover rail, bus and other transportation modes.

Healthcare reform suffers a setback. Wider reform of the healthcare system was put on hold due to a bill focusing on health-system digitalisation and data consolidation. After government approval in June 2023, the bill was rejected by parliament on data protection grounds. The authorities then withdrew the bill in order to address its shortcomings and should propose an amended law some time in autumn 2023.

Nova Ljublianska Banka (NLB) issues a large green bond. The largest bank in the country, NLB, issued a four-year inaugural green bond worth €500 million to finance sustainable projects in Slovenia and the Western Balkans. The issuance was deemed a success as oversubscription translated into a rather low 7.1 per cent coupon with an option for early redemption.

Tajikistan

Highlights

- **Rapid economic growth continues, combined with low inflation.** Having expanded by 8 per cent in 2022, the economy grew by a further 8.3 per cent year on year in the first half of 2023, thanks to China's reopening and Russia's sustained demand for workers from Tajikistan. The country also stands out for its low inflation rate (2.3 per cent), which is well below that of regional peers.
- **The authorities have adopted a new civil code.** The new code is intended to enhance the protection of property and land tenure rights by streamlining registration processes, but the recent dispute related to Aga Khan Foundation assets in Khorog appears to contradict the spirit of the new code, potentially damaging investment confidence.
- **Tajikistan's ambition to serve regional energy needs is growing.** Fixed capital investment in electricity production, distribution and transmission infrastructure is increasing rapidly, and the recent re-engagement of major international financial institutions with the Roghun hydropower plant (HPP) project is likely to help in raising funds for its successful completion.

Key priorities for 2024

- **The authorities should strengthen their efforts to maintain investor confidence.** The recently introduced Business Support Programme for 2023-27, as well as reforms to the tax administration and construction licensing, are steps in the right direction. However, recent cases of alleged property rights violations and less-than-fully-transparent business closures might be concerning for potential investors.
- **Greater regional cooperation is required to de-risk major infrastructure investment projects and ensure energy and water security for all.** Border demarcation, as well as energy and water cooperation, should be front and centre of Tajikistan's engagement with neighbouring countries. In particular, investment in the Roghun HPP will require Tajikistan to secure downstream offtake agreements with Kazakhstan and Uzbekistan.
- **The water and irrigation sector is in need of major reform and investment.** Tariffs should be gradually brought to levels that reflect local costs to stimulate a transition to water-saving technologies and crops. Coupled with investment in billing and metering devices, this will help raise additional revenues to address investment needs in the sector.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	7.4	4.4	9.4	8.0	7.5
Inflation (average)	7.8	8.6	9.0	6.6	4.6
Government balance/GDP	-2.1	-4.3	-0.7	-0.2	-2.5
Current account balance/GDP	-2.2	4.1	8.2	15.6	-3.7
Net FDI/GDP [neg. sign = inflows]	2.6	1.3	0.9	1.7	n.a.
External debt/GDP	80.0	85.5	78.8	n.a.	n.a.
Gross reserves/GDP	17.7	27.5	28.0	36.7	n.a.
Credit to private sector/GDP	11.6	13.0	10.3	10.6	n.a.

Macroeconomic developments and policy response

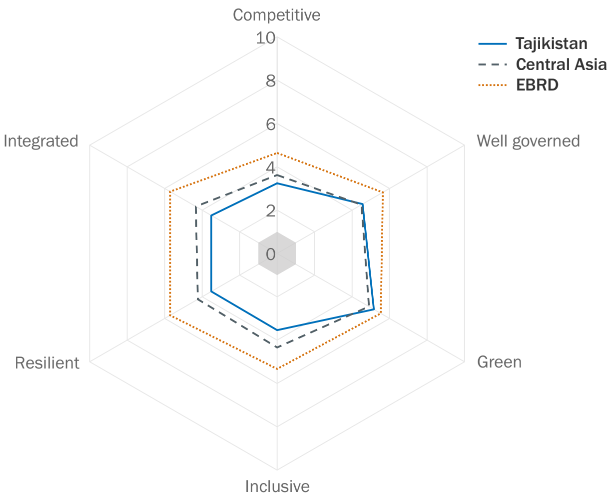
Strong growth continued in the first half of 2023. The economy grew by 8.3 per cent year on year in the first half of 2023, helped by China's reopening, Russia's sustained demand for workers from Tajikistan and vigorous public spending. Fixed capital investment increased 27.1 per cent year on year in the first six months of the year, the bulk of it allocated to the transport and energy sectors. Growth was broadly based, with most sectors expanding in remarkable fashion: industrial production, including export-oriented mining activities, up 10.3 per cent year on year; manufacturing up 14.2 per cent; agriculture up 7.9 per cent; and trucking up 12.3 per cent. Strong growth in hospitality (up 14.4 per cent) and retail trade turnover (up 10.4 per cent) are indicative of the continued strength of consumer demand on the back of steady remittances and growing real wages (the latter were up 14.2 per cent year on year as at May 2023).

Inflation is at a notably low level. With consumer price inflation of just 2.3 per cent (as at July 2023), Tajikistan is currently the only Central Asian economy to keep inflation below its central bank's target corridor (4-8 per cent). As inflationary pressures eased, the National Bank of Tajikistan gradually brought down its policy rate from 13 per cent in November 2022 to 10 per cent in May 2023. Since the beginning of 2023, the somoni has lost 7.4 per cent against the US dollar, but remains well above its value before the war on Ukraine. For now, the currency appears to be resilient to the rouble's sharp depreciation in August 2023, but is very likely to be negatively affected later in the year via the remittances channel.

Public debt is falling thanks to strong gross domestic product (GDP) growth and good fiscal performance. In 2022 public debt declined to 34.6 per cent of GDP on the back of very strong growth in output and improved tax collection. The International Monetary Fund (IMF) considers the level of Tajikistan's public debt to be sustainable in the medium term, as long as the government keeps the budget deficit below 2.5 per cent of GDP (the deficit stood at 0.2 per cent of GDP in 2022). In January to May 2023 the budget posted a surplus of TJS 1.046 billion (€90.86 million), an improvement on the same period in 2022. Budget revenues rose 18.1 per cent year on year thanks to rapid growth in tax receipts (up 19.4 per cent), while expenditures increased 18.8 per cent. The risk of debt distress remains high due to forthcoming (2025-27) principal repayments on a Eurobond and repayments of the IMF's Rapid Credit Facility. Uncertainty over future revenue flows and spending pressures associated with planned infrastructure investment and contingent liabilities generated by state-owned utility companies are major concerns.

Strong growth is set to continue. We forecast GDP growth of 7.5 per cent in 2023 and 2024 thanks to Russia's continued demand for labour from Tajikistan, enhanced cooperation with China, and investment in the Roghun HPP, transport and other types of infrastructure. Business and tax administration reforms may bring additional private-sector investment and facilitate further growth. Major downside risks relate to a possible worsening of external demand conditions (for example, China's potential slowdown, the performance of Russia's war economy, political destabilisation in Afghanistan), weaker investment confidence and potential conflicts over transboundary water resources, as illustrated by occasional flare-ups at the border with the Kyrgyz Republic.

Assessment of transition qualities (1-10)



Structural reform developments

Digitalisation in the public sector is advancing. The decree "on measures to expand non-cash payments", which came into effect on 1 August 2023, mandates that payments of taxes, state, communal and medical fees, as well as other budgetary payments, be made electronically. The decree prohibits state institutions from accepting cash payments and envisions the creation of a unified electronic portal for public services. This reform reduces the risk of public-sector corruption and increases budgetary transparency. In August 2023 Tajikistan signed a memorandum of understanding (MoU) with Kazakhstan to cooperate in digitalisation. The MoU envisages experience-sharing, training opportunities, assistance in designing e-government infrastructure, as well as a pilot project to connect 10 Tajik villages to the internet via the KazSat-3 satellite.

A new civil code is in place. In effect since 1 July 2023, the new code enhances the protection of property and land tenure rights. The document regulates property and personal non-property relations, intellectual rights, and corporate and labour relations, among other things. It aspires to improve land governance by streamlining land registration processes and delineating the responsibilities and rights of local dekhkan farms. However, the recent dispute over Aga Khan Foundation assets in Khorog appears to contradict the spirit of the new code, potentially damaging investment confidence.

The country is pushing for accession to the European Union (EU) Generalized System of Preferences+ (GSP+). In late 2022 and early 2023 the government of Tajikistan held several meetings with EU officials to discuss the country's potential accession to GSP+, which would enable its entrepreneurs to export, duty free, more than 6,000 denominations of goods to the EU market. Prospective GSP+ membership could boost Tajikistan's competitiveness in the EU market, provided it can produce goods that meet the EU's stringent price and quality requirements. However, the country's accession remains contingent on it ratifying multiple conventions on human rights and the environment.

Additional funding from international financial institutions is being sought to complete the Roghun HPP. The hydro plant, construction of which began in 2016, is expected to become Central Asia's largest power plant, with a total capacity of 3.6 GW. Once completed, it will address the country's domestic electricity shortages and generate extra revenue by exporting surplus electricity. While two out of six turbines are already operational, Tajikistan will need to secure additional funds to complete the project. In January 2023 the World Bank approved a US$ 15 million (€14.2 million) grant to improve the financial and commercial frameworks of the HPP. In addition, in May 2023 the Tajik authorities announced that the Asian Infrastructure Investment Bank (AIIB) had committed to a soft loan of US$ 500 million (€473.2 million) for the project. Securing offtake agreements with downstream countries, such as Kazakhstan and Uzbekistan, will be required for financial closure.

Tajikistan postpones connection to Central Asia's unified power system to 2024. In early 2023 the Deputy Minister of Energy and Water Resources announced Tajikistan's intention to reconnect to the unified Central Asian power system by April 2023. This system has two connection points in Tajikistan. The first point, in central Tajikistan, has recently been linked and currently operates in a technical test mode. However, due to additional preparatory work required to link the country's northern region, the completion date was moved to April 2024. Despite this delay, Tajikistan's commitment to rejoining the regional grid is a positive step, strengthening Central Asian cooperation and enhancing energy security for countries across the region.

Tunisia

Highlights

- **The economic situation has deteriorated and agreement on an International Monetary Fund (IMF) programme has been delayed again.** Growth slowed in 2022 and into the first half of 2023, as fiscal pressures and external vulnerabilities remained high and sovereign ratings continued to worsen.
- **Tunisia entered a long-term partnership with the World Bank to support growth and create jobs.** The new agreement will capitalise on the country's National Development Plan, offering annual financing of US$ 400-500 million (around €380-470 million) over a period of five years.
- **Steps have been taken to improve food security, enhance financial inclusion and liberalise the foreign-exchange rate.** These include an emergency programme to enhance self-sufficiency in the cereal sector, expanded access to electronic payments, the removal of some foreign-currency restrictions and the announcement of plans to replace some subsidies with targeted cash benefits.

Key priorities for 2024

- **Fiscal consolidation is essential to alleviate the pressure on the country's strained public finances.** This will require continued efforts to enhance revenue collection, but also to reduce the large public-sector wage bill, lower subsidies on various products (including fuel) and move towards more targeted support systems.
- **Accelerating the green transition and improving agricultural output are top priorities.** Scaling up renewables, including by promoting private investment and strengthening the regulatory framework, could improve energy resilience. Moreover, enhancing productivity and stability in the grain value chains and addressing climate risks are necessary to mitigate food shortages.
- **Improving the business environment and reforming state-owned enterprises (SOEs) are necessary to promote growth and job creation.** Reducing the state's footprint in the economy and reforming SOEs, including by advancing the new SOE law, strengthening operational efficiency and eliminating foreign-exchange restrictions are essential to boosting overall competitiveness.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	1.6	-8.8	4.3	2.4	1.9
Inflation (average)	6.7	5.6	5.7	8.3	9.4
Government balance/GDP	-3.4	-9.4	-7.7	-7.6	-7.7
Current account balance/GDP	-7.8	-5.9	-6.0	-8.6	-5.8
Net FDI/GDP [neg. sign = inflows]	-1.9	-1.4	-1.1	-1.4	-1.4
External debt/GDP	90.9	94.9	90.6	91.3	n.a.
Gross reserves/GDP	17.8	21.4	18.6	17.0	n.a.
Credit to private sector/GDP	68.6	72.9	69.8	n.a.	n.a.

Macroeconomic developments and policy response

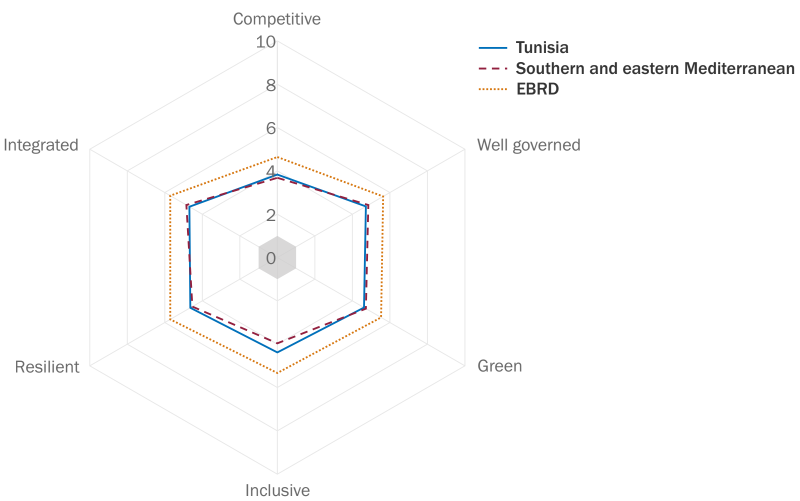
Growth slowed in 2022 and continued to do so into 2023, although the economy showed some resilience to extremely challenging conditions. Gross domestic product (GDP) grew 2.4 per cent in 2022 and just 1.2 per cent year on the year in the first half of 2023. The restrictive business environment, high inflation and social unrest all continued to weigh on economic activity. While the tourism, financial services and industrial sectors expanded, the slowdown in growth was driven by contractions in agriculture (drought impacted agricultural output) and mining (phosphate production dropped). Unemployment declined slightly to 15.6 per cent in the second quarter of 2023, remaining higher among women (21.1 per cent), youth (38.1 per cent) and graduates (23.7 per cent).

Fiscal measures to mitigate the impacts of soaring inflation strained public finances to the limit. Rising commodity prices have severely affected the Tunisian economy, which relies heavily on food and energy imports. Inflation reached 9 per cent year on year in September 2023, slightly below the 30-year high of 10.4 per cent recorded in February. In response to inflationary pressures in 2022 and 2023, the central bank has raised interest rates by a cumulative 175 basis points since May 2022. The government almost doubled subsidies on electricity and basic commodities in 2022, although fuel prices were increased five times in 2022. Minimum wages rose, but the government and unions reached agreement on a longer-term plan to contain the public-sector wage bill (which accounts for over 40 per cent of expenditures). Although tax revenues increased on the back of better tax enforcement, the budget deficit and public debt remained high in 2022, at 7.6 per cent and 80 per cent of GDP, respectively. The fiscal deficit is projected to increase to 7.7 per cent of GDP in 2023 (from an initial budget target of 5.2 per cent), mostly driven by elevated subsidies (due to delayed fiscal reforms and adjustments to the fuel, electricity and gas tariffs) and lower expected tax revenues (on the back of slower economic activity).

External vulnerabilities increased in 2022 and the country was subject to downgrades by ratings agencies, but the situation has stabilised in 2023. The current account deficit increased to 8.6 per cent of GDP in 2022, mostly driven by a widening trade deficit, despite the recovery in tourism and remittances. The current account gap is projected to narrow to 5.8 per cent of GDP in 2023, supported by improvements in tourism, remittances and the trade balance (the latter narrowed by 28 per cent in the first three quarters of 2023). Since March 2022, Moody's Investors Service and the Fitch Ratings agency have downgraded Tunisia's sovereign ratings twice, as the country has experienced pressure in servicing its sizeable external debt. Foreign reserves recovered slightly to US$ 8.4 billion (€8 billion) in October 2023, but cover just 3.8 months of imports.

Domestic and foreign vulnerabilities will continue to weigh on the short-term economic outlook. Growth is forecast at 1.9 per cent in 2023, held back by limited fiscal space, a lack of access to external financing, the restrictive business environment and delays in implementing the structural reforms necessary to empower the private sector. Economic growth should pick up slightly to 2.5 per cent in 2024 if an IMF-supported programme is agreed and reform momentum picks up. Nonetheless, the country's high dependence on tourism, climate risks, reliance on imports and domestic opposition to the necessary reforms will continue to pose major risks to the outlook.

Assessment of transition qualities (1-10)



Structural reform developments

Progress stalled on the IMF-supported programme, blocking other donor support and exacerbating financing constraints. A staff-level agreement (SLA) for a US$ 1.9 billion (around €1.8 billion) IMF Extended Fund Facility was reached in October 2022, but has not yet been signed. The programme would aim to restore external and fiscal stability, lower the public-sector wage bill, review fuel subsidies and tackle inefficiencies in SOEs. The SLA came after the authorities and labour unions reached a milestone agreement on the cornerstones of key reform measures (SOEs and public-sector wage bill). However, amid concerns about the impact on living standards, the government is currently working on a revised reform plan to resubmit to the IMF.

Support from the World Bank and European Union (EU) has been secured. In June 2023 the World Bank announced a new Country Partnership Framework (CPF) 2023-27 to support Tunisia's development plan, by creating quality jobs in the private sector, strengthening human capital, reducing carbon emissions and building resilience to climate change. The programme builds on Tunisia's National Development Plan 2023-25, which aims to boost employment and achieve sustainable and inclusive growth. The government is also planning to strengthen infrastructure for targeted cash transfers (including a digital platform), in line with moving from blanket subsidies to more targeted support schemes. The EU will provide up to €900 million to support the struggling Tunisian economy and an extra €150 million to support the budget, once the IMF programme has been approved. In parallel, the EU will provide support for border management to help the country curb migration.

Progress advanced on the Tunisia-Italy interconnector (ELMED) project. Momentum picked up on implementing the high-voltage direct current interconnector project, with the feasibility study phase completed in 2022 and the procurement phase started in May 2023. The project secured €307 million from the EU in 2022 and US$ 268 million (€254 million) from the World Bank in June 2023 (under the new CPF) to build the necessary infrastructure. Launched in 2019 by the two countries' electricity grid operators, Société Tunisienne de l'Electricité et du Gaz (STEG) and Terna, ELMED aims to link their electricity systems using submarine cables to expand opportunities for the exchange of renewable energy between North Africa and Europe.

Tunisia embarked on a new a programme to improve food security. The Emergency Food Security Support Project in Tunisia (PAUSAT) 2022-26 is designed to enhance food security and self-sufficiency by strengthening resilience to climate and external shocks. The programme is a coordinated effort between development partners, with total financing of US$ 530 million (around €500 million) from the European Bank for Reconstruction and Development, the World Bank, the African Development Bank, the European Investment Bank and the EU. Its key objectives include: (1) increasing cereal production by providing agricultural inputs, (2) providing emergency cereal supplies to avoid shortages and support food security and (3) supporting digitalisation, capacity building and value-chain reforms.

The government is reviewing a new law to gradually liberalise the exchange rate. New regulations are under review to modernise the exchange-rate system and facilitate access to foreign currency. Under the new law, investors and Tunisian firms would be able to open foreign-currency accounts, enabling them to invest, purchase assets and pay any necessary expenses abroad. Moreover, the new law would allow foreign investors to maintain permanent non-resident status, regardless of their duration of stay, enabling them to avoid restrictions applicable to residents. While this is only a first step, the government has reiterated the ultimate objective of gradually reaching full liberalisation of the exchange rate.

The central bank continues to promote financial inclusion by digitising utility payments. With the aim of improving financial inclusion and transparency, the central bank launched a new digital platform in November 2022, allowing citizens to pay their bills online or through mobile applications for no additional fee. The central bank has an overarching objective of promoting financial inclusion by increasing the digitalisation and de-cashing of the economy. The total value of electronic transactions in Tunisia grew by 25 per cent on the year in 2022.

Türkiye

Highlights

- **Economic policies have taken a more orthodox turn.** A new economic management team appointed in the wake of the presidential and parliamentary elections of May 2023 has started to unwind the highly unorthodox monetary and financial policies adopted over the past two years.
- **Fiscal and external pressures are declining from peak levels.** Expansionary policies and major earthquakes in the first half of 2023 have resulted in twin deficits, which the authorities are seeking to address through a combination of fiscal and monetary tightening.
- **There has been limited progress on reforms in the past year, but long-term plans are being developed.** While the national elections took priority over structural reforms, the authorities have advanced efforts to lay out long-term strategies and action plans for climate change, energy transition and electric mobility.

Key priorities for 2024

- **The shift towards orthodox economic policy needs to be sustained.** Strengthening the monetary transmission mechanism and improving the regulatory environment of the banking sector remain key priorities for achieving macroeconomic stability and sustainable growth.
- **The authorities need to reinvigorate the structural reform agenda, which has been overshadowed by election campaigning.** This means addressing systemic issues affecting Türkiye's long-term growth potential, including low levels of innovation, the weak corporate governance of small and medium-sized enterprises (SMEs), and low levels of global value-chain participation.
- **Social protection policies need to be enhanced to address the negative impacts of recent developments on vulnerable groups.** Although the national minimum wage has increased substantially over the past year, high and sticky inflation means hunger and poverty thresholds exceed the monthly minimum wage. Among other things, this highlights the need to address high rates of informality, skills mismatches in the labour market and low rates of employment among women.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	0.8	1.9	11.4	5.5	3.5
Inflation (average)	15.2	12.3	19.6	72.3	53.0
Government balance/GDP	-4.8	-5.1	-4.0	-1.7	-5.4
Current account balance/GDP	1.4	-4.4	-0.9	-5.3	-4.1
Net FDI/GDP [neg. sign = inflows]	-0.9	-0.6	-0.8	-0.9	-0.7
External debt/GDP	54.7	60.1	54.4	52.0	n.a.
Gross reserves/GDP	13.9	13.0	13.6	14.2	n.a.
Credit to private sector/GDP	61.9	70.9	66.1	48.4	n.a.

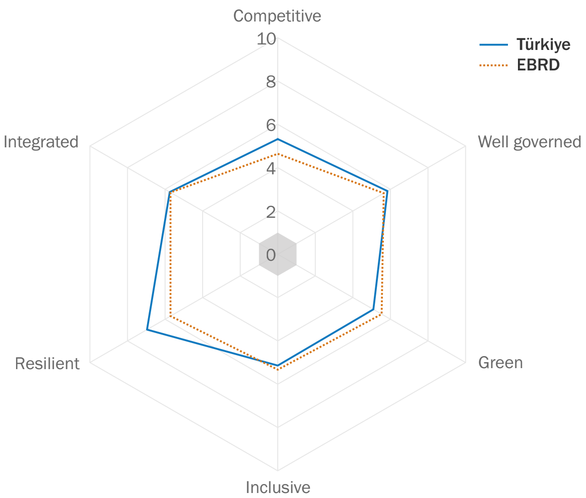
Macroeconomic developments and policy response

The economy grew rapidly in the first half of 2023, but so did the fiscal and current account deficits. Following a gross domestic product (GDP) growth rate of 5.5 per cent in 2022, the authorities enacted a series of stimulus measures in the first half of 2023, including hikes in wages and pensions, the introduction of an early retirement scheme, and government-backed guarantees and lending targets for banks, which spurred a credit boom. These policies contributed to a growth rate of 3.9 per cent year on year in the first half of 2023, although this came at a significant cost. Short-term external debt liabilities now exceed US$ 200 billion (€186.3 billion), while the cumulative 12-month current account deficit peaked at US$ 60 billion (€55.9 billion or 6.5 per cent of GDP) in May 2023, implying external financing needs in excess of 25 per cent of GDP. The authorities sought to prevent the strong depreciation of the currency by tapping into foreign-exchange reserves, with net reserves at one point down more than US$ 35 billion (€32.6 billion) since the start of 2023. Meanwhile, the government posted record fiscal deficits due to increases in personnel and social spending, as well as temporary expenditures related to the earthquakes of February 2023.

Policies have tightened markedly following the appointment of a new economic management team in the wake of May's elections. Starting in June 2023, the central bank has undertaken a series of policy rate hikes, which, although insufficient to achieve positive real interest rates, have helped improve investor confidence, as witnessed by the significant decline in Türkiye's credit default swap (CDS) premium since its peak in May 2023. Fiscal policies have also been tightened, with the government increasing the value-added tax (VAT) rate from 18 per cent to 20 per cent, hiking taxes on fuels and enacting cost-cutting measures in the public sector. The central bank has also cut back on interventions to defend the lira, which has lost over 30 per cent of its value since the start of 2023, driving another surge in inflation to 61.5 per cent year on year in September. While these measures have led to a lower current account deficit and improvements in reserves and the fiscal balance, leading indicators suggest that consumers and businesses are becoming more pessimistic and spending less, meaning that enhanced stability is coming at the expense of growth.

Short-term growth prospects are relatively subdued. In light of recent macroeconomic developments and policy changes, a growth rate of 3.5 per cent is expected in 2023, followed by 3 per cent growth in 2024. In the short term, the authorities will continue to face the difficult task of balancing growth and macroeconomic stability in the run-up to local elections in March 2024. Consequently, a key risk is the possibility of a sudden reversal of the current turn towards orthodox economic policy, which would damage investor confidence.

Assessment of transition qualities (1-10)



Structural reform developments

Restrictive regulations affecting the financial sector are being relaxed. The new economic management team has loosened a series of restrictive financial regulations adopted prior to the 2023 elections, including punitive security maintenance requirements for banks not meeting certain lending and de-dollarisation targets. While the process has been gradual and many rules adopted prior to the elections remain in place, the authorities have committed to pursuing normalisation steps in a holistic and data-driven manner in order to maintain financial stability.

The government is working to develop strategies and action plans to achieve long-term climate targets. In November 2022 the government updated Türkiye's Nationally Determined Contribution (NDC), increasing its emission reduction target from 21 per cent to 41 per cent by 2030. The authorities have also published the National Energy Plan (2020-35), which is aligned with the country's 2053 net-zero emission target, setting out actions for increasing the share of renewables, upgrading the electricity grid and reducing fossil-fuel consumption. Meanwhile, legislators are working on a new climate law, which is expected to incorporate the announced climate targets and policies and establish a national emissions trading scheme, with a pilot phase scheduled to start in 2024.

Efforts to promote electric mobility have been stepped up. In November 2022 the government reduced taxes on the purchase of electric cars, while at the same time raising import duties on electric cars built in China. Meanwhile, in July 2022 the Energy Market Regulatory Authority issued licences for 124 companies with plans to build over 1,000 new fast charging stations, in a move that is expected to help double the number of public charging stations by the end of 2023.

Social protection policies seek to contain the negative inclusion impacts of recent developments, but fall short of addressing fundamental shortcomings. The national minimum wage increased by a further 34 per cent in June 2023, after doubling over the course of last year. The hunger and poverty thresholds, however, continue to exceed the monthly minimum wage in light of persistent inflation. Economic hardship also risks increasing violence against women, with the government adopting new Provincial Action Plans to address the issue and facilitate access to justice across its 81 provinces. Whether such efforts can effectively mitigate the fallout from Türkiye's 2021 withdrawal from the Istanbul Convention on human rights remains to be seen.

The new Law on Retirement Age Victims (EYT, Law No: 7438) has the potential to reduce available human capital significantly. The 2023 law removed the age requirement for individuals who started working prior to September 1999 and have contributed a minimum 20 or 25 years to social security, enabling them to retire with immediate effect. Data suggest that in the areas affected by February's earthquakes, current and future beneficiaries of EYT make up around 7 per cent of the workforce, putting additional pressure on the already-stretched labour market. Meanwhile, efforts to improve the school-to-work transition for young people are ongoing, but have suffered from shifting priorities and frequent changes at national and regional level. So far, no announcements on a new stage of Türkiye's Education Vision 2023 or its National Youth Employment Strategy and Action Plan (2021-23) have been made.

Turkmenistan

Highlights

- **The economy continues to grow strongly.** According to official data, gross domestic product (GDP) growth exceeded 6 per cent year on year in the first half of 2023, primarily driven by elevated gas exports and manufacturing output, as well as increased capital investment.
- **The country's engagement with neighbouring countries is gaining steam.** Bilateral and multilateral discussions on energy, transportation and water management are being held, potentially leading to improved regional cooperation.
- **Efforts to lower methane emissions have accelerated.** The authorities approved the 2023-24 Methane Roadmap and created the Intersectoral Commission for the Reduction of Methane Emissions, which bodes well for Turkmenistan's commitment to join the Global Methane Pledge.

Key priorities for 2024

- **The authorities should strengthen compliance standards in the banking system.** Strong compliance with the international sanctions regime is a key requirement of Western financial institutions when deciding on the provision of correspondent banking services, which are key to entrepreneurs' ability to send or receive foreign-exchange transfers from abroad.
- **Soft connectivity bottlenecks should be resolved.** Given its location at a strategic transportation crossroads, Turkmenistan is in a position to serve larger volumes of cargo moving along the East-West and North-South transport corridors. For this opportunity to materialise, the authorities need to harmonise Turkmenistan's border management policies on the movement of people and goods with those of its immediate neighbours.
- **Steps are needed to address water scarcity.** Facing the highest risk of water stress in Central Asia, Turkmenistan should embrace a holistic approach to food and water security, including measures to encourage the transition to water-saving agricultural crops and technologies, water re-use and recycling. In particular, robust diplomatic efforts are required to agree water intake and river management rules with Turkmenistan's neighbours, including Afghanistan.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	-3.4	-2.9	6.2	6.2	6.5
Inflation (average)	5.1	6.1	19.5	11.2	5.9
Government balance/GDP	-0.3	-0.1	0.4	2.4	0.9
Current account balance/GDP	2.8	2.6	6.5	7.1	3.4
Net FDI/GDP [neg. sign = inflows]	4.2	3.2	n.a.	n.a.	n.a.
External debt/GDP	14.7	12.4	n.a.	n.a.	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.

Macroeconomic developments and policy response

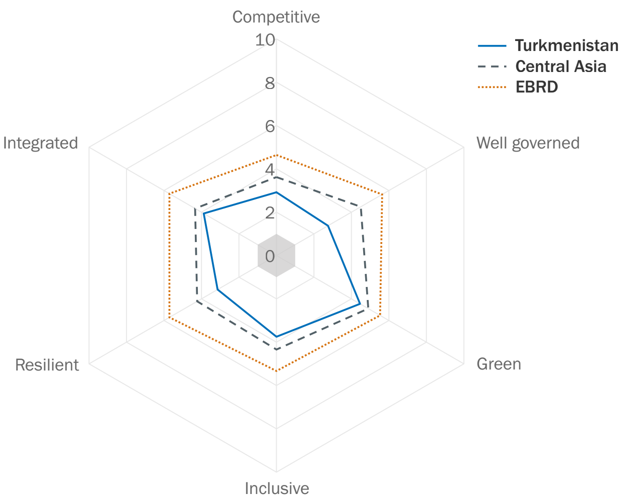
Strong economic growth continues in 2023. The official figure for GDP growth in the first half of 2023 was 6.2 per cent year on year. The country was able to exceed its plans for natural and associated gas production (by 8.3 per cent) and exports (by 12.1 per cent) thanks to the new Galkanysh well coming into operation. Agriculture and food production expanded 10.3 per cent year on year and manufacturing grew 9.6 per cent year on year, supported by the government's unorthodox industrial policies, including preferential access to foreign exchange. Growth in retail trade turnover (up 9.3 per cent year on year) and consumer loans (up 18.5 per cent year on year) reflect strong domestic demand, supported by recent increases in public-sector wages, pensions, stipends and social security benefits.

Higher capital investment is providing a strong growth impetus. In the first half of 2023 investment in fixed capital grew by 24.6 per cent (reaching around 16 per cent of the country's GDP), with almost 50 per cent being allocated to manufacturing. On 29 June 2023 the authorities inaugurated the new Arkadag city. Designed to be smart and environmentally friendly, Arkadag may attract additional investment. Turkmenistan's participation in the development of international transport corridors (both North-South and East-West) may trigger significant further investment in infrastructure, as well as in related logistics activities.

Inflation is trending downwards and growing tax receipts are strengthening the fiscal stance. While the authorities do not publish data on inflation, unofficial estimates suggest that inflation has been on a downward trajectory since early 2023, in line with global trends in food and transportation prices. The official exchange rate remains pegged at TMM 3.5 per US dollar and the black-market exchange rate stabilised in 2022 at around TMM 19 per US dollar. In the first half of 2023 the government budget posted a surplus of 2.3 per cent of GDP. In August 2023 Fitch affirmed Turkmenistan's B+ rating with a "positive" outlook, citing a strong fiscal position in the presence of structural challenges. Public debt is very low (around 5 per cent of GDP), well below levels in peer economies.

Strong growth will continue in the short term. We expect the economy to expand by 6.5 per cent in 2023 and 7 per cent in 2024, benefiting from its strong fiscal stance. Market-oriented reforms, if implemented, would strengthen the outlook. However, the country's extremely high reliance on a single commodity (gas) and a single export market (China), along with water scarcity, are major vulnerabilities.

Assessment of transition qualities (1-10)



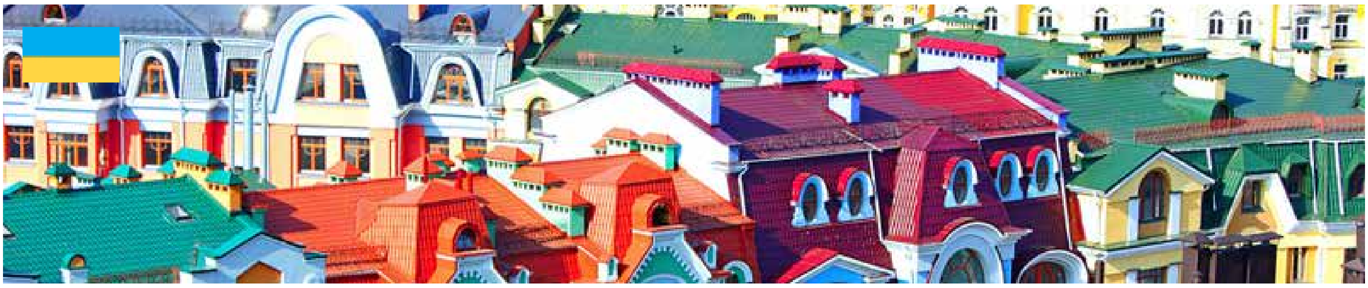
Structural reform developments

The country is actively engaging with neighbouring Central Asian countries on energy, transportation and water management. On 4 August 2023 Turkmenistan hosted a trilateral summit with the leaders of Uzbekistan and Tajikistan. The three presidents expressed a strong commitment to deepening trilateral cooperation, with a particular focus on energy, transportation and the management of shared water resources. In the energy sector, discussions are progressing on the construction of Line D of the Central Asia-China gas pipeline, traversing Uzbekistan, Tajikistan and the Kyrgyz Republic. This project has the potential to increase gas supplies from Turkmenistan to Xinjiang by an additional 30 billion cubic metres (bcm). In the realm of transportation, the three countries are emphasising the importance of developing multimodal routes, harmonising tariffs and enhancing logistical capabilities. In addition, Turkmenistan has recently been acting as a gas supplier of last resort for Uzbekistan, which experienced severe shortages in winter 2022-23, and reached a short-term agreement to export up to 2 bcm of gas in 2023-24. A long-term deal is being discussed, including plans for more extensive cooperation in the energy field, potentially including electricity deliveries and transit.

The country is taking steps towards joining the International North-South Transport Corridor (INSTC). In April 2023 Kazakhstan, Turkmenistan and Russia agreed to establish a joint venture between the railway companies of the three countries. Its primary goal is to create a unified logistics operator for the eastern route of the INSTC, a multimodal transport network connecting the Indian Ocean and the Persian Gulf to northern Europe. In July 2023 Russia consented to Turkmenistan's accession to the INSTC agreement. Prior to joining, Turkmenistan's authorities emphasised ongoing efforts to streamline tariffs and visa regulations. They also highlighted the potential of the Akayla (Turkmenistan)-Inche Burun (Iran) route to enhance transit volumes along the INSTC route.

Progress is being made on World Trade Organization (WTO) membership. In February 2022 the WTO established a "working party" to negotiate multilaterally Turkmenistan's terms of accession to the trade bloc. At a roundtable with the WTO Secretariat and the Asian Development Bank in May 2023, the Turkmen president announced the establishment of a special working commission to develop a Memorandum on the Foreign Trade Regime (MFTR), the first formal document required on the path to accession negotiations.

Efforts are under way to mitigate methane emissions. Turkmenistan has the highest rate of "super-emitter" events in the world. Its two fossil-fuel fields produced a combined 4.4 million tonnes of methane leaks in 2022 – greater than the equivalent CO_2 emissions of the United Kingdom in the same year. To curb methane emissions and mitigate their pernicious climate impact, the authorities approved the 2023-24 Methane Roadmap and formed an Intersectoral Commission for the Reduction of Methane Emissions. These initiatives lay the groundwork for Turkmenistan's joining the Global Methane Pledge and enacting relevant legislation to curtail methane emissions.



Ukraine

Highlights

- **The economy has stabilised in 2023, but economic conditions remain very difficult.** After an economic collapse in 2022, the situation has improved slightly in 2023 as businesses adapt to wartime conditions. Gross domestic product (GDP) growth is slightly positive once again, and inflation has declined to single-digit levels.
- **Timely external financing and the new International Monetary Fund (IMF) programme have helped to restore macroeconomic stability.** Foreign reserves have increased to a historical high, while surpluses on the foreign-exchange market have brought down the market exchange rate close to the official level and prompted a shift from a pegged to a managed flexible exchange rate.
- **The prospect of European Union (EU) accession and the IMF programme are powerful drivers of reform.** The authorities are coordinating a reform agenda with international partners and, despite the exceptionally difficult circumstances, are making steady progress, including on seven priority areas identified by the European Commission on Ukraine's application for membership. As a result, in November 2023 the Commission recommended that the European Council open accession negotiations with Ukraine once all priorities have been completed.

Key priorities for 2024

- **Reforms to strengthen governance and transparency and tackle corruption need to proceed without delay.** Progress in these areas is essential, not only to build a fair and prosperous society, but also to convince foreign investors that there is a level playing field in Ukraine and to assure donors that their resources will be well spent. These reforms are also critical to progress towards EU accession.
- **An asset quality review of systemically important banks is needed.** This exercise should reveal if banks' assets are valued appropriately and whether banks have adequate capital to absorb current and future losses on delinquent assets. Meanwhile, ongoing bank profits need to be fully added to capital reserves.
- **Fiscal policy should focus on systemic measures rather than short-term fixes.** Proposals for short-term tax breaks and, in the medium term, tax havens should be avoided. Budget needs will remain high long after the war ends, and long-term, quality investors will be attracted by a sound business environment rather than by tax incentives.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.2	-3.8	3.4	-29.1	1.0
Inflation (average)	7.9	2.7	9.4	20.2	17.7
Government balance/GDP	-2.2	-5.3	-3.4	-16.3	-19.1
Current account balance/GDP	-2.7	3.4	-1.6	5.0	-5.7
Net FDI/GDP [neg. sign = inflows]	-3.4	0.0	-3.8	-0.1	-0.4
External debt/GDP	79.1	80.3	64.9	81.6	n.a.
Gross reserves/GDP	16.4	18.6	15.5	17.8	n.a.
Credit to private sector/GDP	24.3	22.2	18.7	18.9	n.a.

Macroeconomic developments and policy response

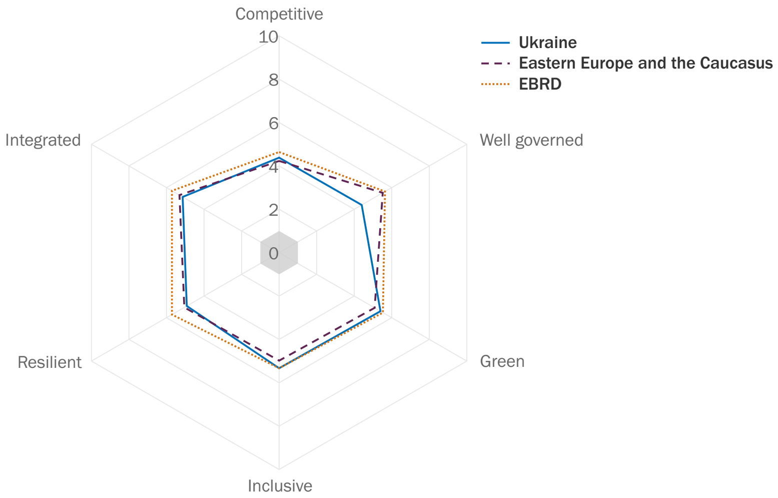
The economy has stabilised at around 70 per cent of pre-war real output levels. GDP collapsed by around 30 per cent in 2022 following Russia's invasion of the country. Signs of a modest recovery are now apparent, but domestic demand remains depressed due to the displacement of more than 8 million people abroad and the weak purchasing power of those remaining in Ukraine. According to a Transparency International survey, the war negatively affected the finances of 83 per cent of businesses, with 20 per cent suffering very significant losses. Encouragingly, businesses have adapted to the difficult conditions, and many have cited an optimistic outlook since the beginning of 2023. In the first half of the year, annual GDP increased by around 4.5 per cent, with the second quarter recording growth of 19.5 per cent compared to the second quarter of 2022, the first upturn since the start of the war. The grain and oilseed harvest in 2023 is forecast to be almost 10 per cent higher than last year, helped by favourable weather conditions. However, grain and oilseed exports are expected to fall to 49 million tonnes in the 2023-24 season (July to June) from 58 million tonnes in 2022-23.

External financing is supporting the recovery. In March 2023 the IMF approved a 48-month extended arrangement under the Extended Fund Facility (EFF) for an amount of SDR 11.6 billion (US$ 15.6 billion [€14.6 billion], and 577 per cent of the quota). The main goal of the programme is to sustain macroeconomic and financial stability under extreme uncertainty and promote reforms that support Ukraine's recovery on the post-war path to EU accession. The authorities met all applicable quantitative performance criteria and structural benchmarks in the first review in May 2023. Probably the most difficult measure was restoring pre-war tax rates on fuel and on the self-employed and small businesses, which were reduced or abolished in March 2022. This move will strengthen budget revenues in the second half of 2023. Meanwhile, external financing has become more timely, stable and predictable. As of 20 October 2023, Ukraine had received US$ 33.8 billion (€31.3 billion) from donors and international organisations out of the expected US$ 42.2 billion (€39 billion) for the whole year. This lifted official foreign reserves to US$ 39.7 billion (€37.3 billion) as at the end of September 2023, close to the highest level since Ukraine's independence. It also narrowed the exchange-rate spread between the cash market and the official exchange rate to less than 2 per cent (as of late August 2023) compared with 17 per cent in September 2022. These developments enabled a policy shift from a pegged to a managed flexible exchange rate at the beginning of October 2023.

Monetary policy is being eased amid falling inflation. The inflation rate peaked at 26.6 per cent in December 2022, but dropped thereafter to 7.1 per cent in September 2023. On the back of this positive development, the National Bank of Ukraine started easing monetary policy in July 2023 by reducing the policy rate from 25 per cent to 22 per cent, followed by a further cut to 20 per cent in September 2023. Increased foreign debt financing has lifted public debt by one-third since the start of the war, to US$ 133.9 billion (€122.7 billion) as of August 2023, or more than 80 per cent of GDP. Bilateral creditors from the G7+ group of countries have extended the grace period for debt repayments to March 2027. Meanwhile, the Ukrainian authorities are trying to reach an agreement with bond holders on a debt operation under comparable terms to bilateral creditors, with the aim of finalising it by the end of August 2024.

With the ongoing war, uncertainty remains high. Despite the optimism and mild recovery so far in 2023, the recent non-extension of the grain export corridor and the wave of destruction on grain port infrastructure add to the uncertainty surrounding the short-term outlook. On the assumption that the war continues at its current level of intensity, we forecast GDP growth of 1 per cent in 2023 and 3 per cent in 2024.

Assessment of transition qualities (1-10)



Structural reform developments

Reforms are moving ahead, despite the war, guided by the EU accession process and the IMF programme. The current environment is obviously not conducive to structural reforms, but the authorities are still taking important steps to implement reforms in line with the seven priority areas set out in the European Commission's opinion on Ukraine's membership application and with commitments under the IMF programme. In November 2023 the Commission noted Ukraine's progress on addressing the seven priorities and recommended that the European Council open negotiations on membership once all priorities have been completed.

Judicial reform has advanced. In December 2022 the parliament amended the procedure for selecting constitutional court judges in a competitive process. Under the new rules, an advisory group, comprising an equal number of Ukrainian and international experts, will check the integrity and professional competence of candidates. To address concerns about potential impasses in the decision-making process, the Venice Commission suggested adding one more international expert to the advisory group. The European Commission expects the Venice Commission's recommendations to be implemented in full in order to avoid political interference in the selection of Constitutional Court judges. In addition, the High Council of Justice resumed its work in early 2023 and in June 2023 appointed all 16 members of the High Qualification Commission of Judges, a judicial body that vets and nominates candidates for judicial jobs. This is a significant milestone in fundamental judicial reform. The two judicial governing bodies will have to appoint more than 2,000 judges and complete the process of building a professional and independent judicial system.

Anti-corruption reforms are continuing. The authorities have moved ahead with the appointment of heads of the High Anti-Corruption Court (HACC) and National Anti-Corruption Bureau (NABU). The new head of the HACC was named in February 2023 and in March the government appointed a new director of the NABU from the three candidates shortlisted by a selection commission consisting of three Ukrainians and three international experts. These steps complete the triad of a fully formed and functioning anti-corruption infrastructure. Progress on anti-corruption was acknowledged by the Council of Europe Group of States against Corruption (GRECO), which concluded in March 2023 that Ukraine had implemented or satisfactorily dealt with 15 out of 31 recommendations contained in the previous report, and partly implemented nine other recommendations. As a result, Ukraine is no longer deemed to be "globally unsatisfactory", and the special reporting procedure was discontinued.

Significant progress was achieved in regulating the media in accordance with EU standards. The new media law, adopted in December 2022, harmonises media-sector regulation with the EU audiovisual media services directive. It also gives the independent media regulator the power to ensure the smooth functioning of the media market. In May 2023 the parliament adopted the provisions of the EU acquis in the field of audiovisual advertising.

A law on de-oligarchisation was adopted, but further refinements may be necessary. The Venice Commission classifies the new law as a “personal approach”, which seeks to identify persons as oligarchs through specific criteria, such as wealth, ownership of a business monopoly, media ownership and political engagement, and subjects them to a series of limitations. Contrary to this, the common approach in most countries is to prevent undue influence through the concentration of economic and political power by pursuing a multi-sectoral and systemic approach.

Uzbekistan

Highlights

- **Economic growth has remained strong in 2023.** Key growth drivers include solid external demand for Uzbek goods and labour, and robust domestic consumption as a result of higher income from remittances and wages.
- **The authorities are seeking to improve conditions for foreign investors.** A new Centre for Investors, under the Agency for Attracting Foreign Investment, will facilitate visas for foreign investors and assign managers to guide them through the processes of permitting, land procurement and integration into relevant infrastructure networks.
- **The country has made further progress on fostering gender inclusion and curbing domestic violence.** In April 2023 Uzbekistan criminalised gender-based violence, increased the severity of administrative and criminal consequences for domestic violence, and banned the conditional release of individuals convicted of abusing minors.

Key priorities for 2024

- **Tariffs should be brought closer to cost-reflective levels.** Recent disruptions to heating and electricity supply, as well as water scarcity, highlight the urgency of addressing infrastructural deficiencies. Economically viable tariffs would stimulate investment in energy- and water-saving technologies, attract private and foreign capital, and encourage resource-saving behaviour.
- **Efforts to privatise and commercialise state-owned enterprises (SOEs) and banks should be sped up.** Partial initial public offerings for leading SOEs and banks would induce better corporate governance and management, ultimately leading to improved performance and contributing to the development of financial markets.
- **Support measures for small and medium-sized enterprises (SMEs) should be streamlined.** The authorities should encourage product innovation, including digital SME banking, by financial-sector actors and use loan guarantees to unlock SME financing by banks and non-bank financial institutions. Non-financial support mechanisms should also be employed to foster SME participation in the supply chains of larger companies.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	6.0	2.0	7.4	5.7	6.5
Inflation (average)	14.5	12.9	10.8	11.4	10.2
Government balance/GDP	-0.3	-3.3	-4.6	-4.2	-4.6
Current account balance/GDP	-5.6	-5.0	-7.0	-0.8	-4.3
Net FDI/GDP [neg. sign = inflows]	3.8	2.9	3.3	3.1	n.a.
External debt/GDP	37.2	53.7	56.0	n.a.	n.a.
Gross reserves/GDP	48.6	58.0	50.8	44.5	n.a.
Credit to private sector/GDP	28.9	35.5	35.6	36.7	n.a.

Macroeconomic developments and policy response

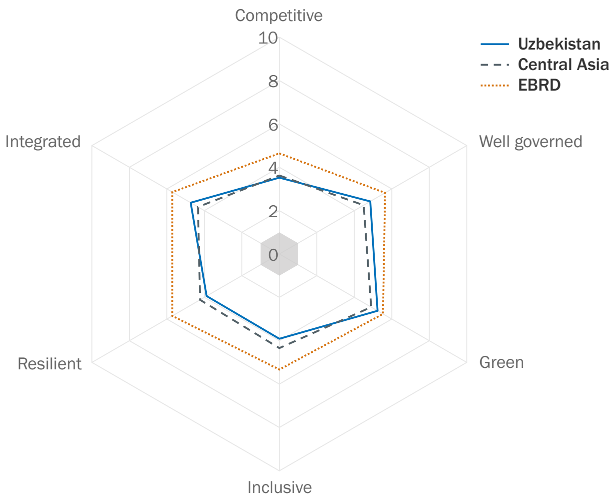
Robust growth continues and inflation is falling. Gross domestic product (GDP) grew 5.6 per cent year on year in the first half of 2023. The economy has been supported this year by strong external demand for Uzbek goods and labour. Exports rose 31 per cent year on year in January to July 2023. However, remittances were down by more than 20 per cent year on year in the first half of 2023 due to a high base effect. Nevertheless, domestic demand remains robust thanks to strong growth in wages and credit. All the main sectors of the economy have expanded this year, although agriculture is growing at a relatively slower pace. Meanwhile, inflation has been decreasing gradually, from a peak of 12.3 per cent in July 2022 to 9 per cent in June 2023, allowing the Central Bank of Uzbekistan to start softening its monetary policy stance. The Uzbek sum lost 4 per cent of its value against the US dollar in August 2023, seemingly driven by the sharp depreciation of the Russian rouble.

Banks are benefiting from a surge in money transfers. The banking sector remains strong and a recent surge in money transfers has added to banks' deposit base and profits. Notwithstanding the recent decline in remittances, bank deposits saw 9.6 per cent year-on-year growth in the first half of 2023. Furthermore, the ratio of non-performing loans to total loans dropped to 3.5 per cent at the end of June 2023 (from 5.3 per cent in June 2022). While banking-sector privatisation has been slowed by the Covid-19 pandemic and geopolitical realities, TBC Bank's successful expansion and the more recent privatisation of Ipoteka Bank by Hungary's OTP Bank suggest the market is ready for more.

Public debt remains low amid strong economic growth, but Uzbekistan's fiscal performance has worsened. The share of general government debt to GDP dropped from 37.1 per cent in 2020 to 34.3 per cent in 2022, mostly thanks to strong economic growth. In 2022 the government budget recorded a deficit of 4.2 per cent of GDP, a small improvement on the 4.6 per cent gap posted in 2021. However, in the first half of 2023 the situation deteriorated, as the deficit widened to 6.17 per cent of GDP. International reserves stood at US$ 33.7 billion (€31.9 billion) in July 2023, down 5.7 per cent from the beginning of the year, but still high enough to ensure adequate fiscal buffers and cover around 11 months of imports, according to Fitch Ratings.

Strong growth will continue in the short term. We forecast that the economy will grow by 6.5 per cent in 2023 and 2024. The continued relocation of foreign companies, well-managed privatisations and business-climate reforms are potential upsides. An escalation of Russia's war on Ukraine, however, could worsen the outlook by crippling Russian demand for Uzbek labour and goods. In the medium term, growth will be constrained by Uzbekistan's ageing energy and water infrastructure, as exposed by recent gas and electricity outages.

Assessment of transition qualities (1-10)



Structural reform developments

Measures are being taken to increase the country's attractiveness to foreign investors. A presidential decree on "measures for the effective organisation of state management in the sphere of investments, industry and trade within the framework of administrative reforms" was signed in July 2023. It mandates the Ministry of Investment, Industry and Trade to designate managers to guide prospective investors through the processes of permit acquisition, land procurement and integration into relevant infrastructure networks. The decree also establishes the Centre for Investors, under the Agency for Attracting Foreign Investment, to facilitate the granting of visas for foreign investors and otherwise ease their entry into the country.

Value-added tax (VAT) refund procedures are being streamlined. Responding to business community demands, from October 2023 the tax authorities will discontinue the practice of applying the "tax gap" coefficient for VAT refunds. This significantly reduces the room for corrupt practices in tax-refund calculations. The government is also set to implement a transparent entrepreneurial ranking system. Businesses that achieve higher rankings will be eligible for tax exemptions and expedited processing of their VAT refunds, with the turnaround time reduced to a single day.

Institutional support for small businesses is increasing. In August 2023 the president announced the transformation of Kishlok Kurilish Bank into Uzbekistan's Business Development Bank. Through its 14 regional centres, the bank will assist entrepreneurs by offering training and consultancy services in auditing, marketing, legal matters and accounting. Entrepreneurs participating in these programmes will gain access to affordable loans, but will have to cover 10 per cent of the training and consultancy service costs.

Progress is being made on establishing independent market regulators to more effectively regulate natural monopolies. A new presidential decree, signed in July 2023, stipulates that by 2025, independent market regulators will become responsible for regulating tariffs in their designated sectors. The reform will affect the civic aviation, natural gas, railway, telecommunications and power sectors. The Committee for the Development of Competition and Protection of Consumer Rights will prepare specific regulatory frameworks, together with relevant line ministries.

Climate change mitigation efforts are accelerating. In October 2022 Uzbekistan launched a digital platform enabling consumers to acquire locally produced solar panels and solar water heaters on favourable terms. "Green energy" certificates have been issued since July 2023 to further incentivise renewable energy generation. In August 2023 the authorities formulated a comprehensive set of measures to curb greenhouse gas emissions and fulfil their obligations under the Paris Agreement, as part of the World Bank-supported Innovative Carbon Resource Application for Energy Transition (iCRAFT) project.

New laws criminalise gender-based violence. In April 2023 the law on the protection of women and children from violence was amended, increasing the severity of administrative and criminal consequences for domestic violence and banning the conditional release of individuals convicted of abusing minors. These amendments also enhance legal support mechanisms for women and children, in line with Uzbekistan's commitment to foster inclusion and uphold human rights.

Uzbekistan is aligning its legislation with World Trade Organization (WTO) agreements to expedite its accession. In June 2023 the president signed a decree on "additional measures to expedite the republic of Uzbekistan's accession to the World Trade Organization". The decree prohibits any legislation that fails to adhere to WTO rules and regulations. It also establishes the role of Special Representative for WTO matters within the presidential administration. In August 2023 the president signed another decree to further harmonise Uzbekistan's legislation with WTO agreements.

A new development strategy sets ambitious goals, including on decarbonisation. In September 2023 the president of Uzbekistan signed a decree, approving the "Uzbekistan-2030" strategy, which encompasses 100 quantifiable objectives for the country over the next seven years. Specific targets include increasing GDP to US$ 160 billion (€151.4 billion) and per capita GDP to US$ 4,000 (€3,785.90); attracting US$ 110 billion (€104.11 billion) in foreign direct investment and US$ 30 billion (€28.39 billion) through public-private partnerships; increasing energy efficiency; boosting the country's transit potential; improving social welfare; fully digitising government services; preserving water resources; and fostering regional cooperation, particularly in the water sector. Crucially, the strategy emphasises the green economy transition, aiming to increase the share of renewable energy to 40 per cent of total consumption (up from the previous 25 per cent target).