

REGIONAL ECONOMIC PROSPECTS



European Bank
for Reconstruction and Development

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Regional Economic Prospects in the EBRD Regions



European Bank
for Reconstruction and Development

Taming inflation

May 2024

Growth in the EBRD regions slowed from 3.3 per cent in 2022 to 2.5 per cent in 2023, below the global average of 2.7 per cent, as the war on Ukraine took its toll, energy prices in Europe remained relatively high and the post-Covid recovery in the services sector ran out of steam.

Growth in the EBRD regions is expected to pick up to 3 per cent in 2024. A 0.2 percentage point downward revision relative to the September 2023 forecast in part reflects slower-than-expected growth in early 2024 in central Europe and the Baltic states, in line with weak growth in Germany. Economic activity in the southern and eastern Mediterranean is expected to be weaker than previously projected because of spillovers from the war in Gaza and structural challenges and slow reform progress in Egypt while intermediated trade in Central Asia appears to have levelled off and is expected to make a more modest contribution to growth than in the past two years.

As increases in the prices of energy, and to a lesser extent food, moderated, inflation in the EBRD regions came down, averaging 6.3 per cent in March 2024 versus the peak of 17.5 per cent in October 2022. While disinflation has so far been somewhat quicker than expected a year ago, inflation remains two percentage points above the pre-pandemic average. This pattern is broadly similar to the one observed in advanced economies where inflation declined considerably over the past year but remained above central banks' targets.

In some economies, however, cumulative price increases since February 2022 exceeded 30 per cent. Peak inflation tended to be higher, and disinflation slower, in economies with more expansionary fiscal policy (higher budget deficits) as well as in economies with weaker macroeconomic policy frameworks and sizable currency depreciations. Tight labour markets were not necessarily associated with greater inflationary pressures in the EBRD regions.

In the EBRD regions as a whole, the median yield on 5-year government bonds increased by three percentage points between early February 2022 and early April 2024. Most of this increase reflects monetary tightening in advanced economies against the backdrop of persistent inflation. In the US and Germany interest rates increased by an average of 2.6 percentage points over this period. The remaining 0.4 percentage points are due to a widening of the spread between the typical economy in the EBRD regions and Germany/US, which, in turn, reflects a reassessment of economic and geopolitical risks faced by individual borrowers. This average masks a variety of experiences within the EBRD regions. In a typical non-EU economy in the EBRD regions the spread vs Germany has been narrowing gradually since peaking in August 2022, while in EU-EBRD economies the spread that opened sharply in March 2022 has been maintained. Sovereign bond yields are elevated in Lebanon, Tunisia and Ukraine with these economies effectively losing market access.

1 May 2024 marks the twentieth anniversary of the EU accession of eight economies in the EBRD regions—Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia (they were followed by Bulgaria and Romania in 2007 and Croatia in 2013). Their experience was characterised by fast growth of per capita incomes. The average EU-8 economy's GDP per capita (at market exchange rates) increased from 14 per cent of Germany's in 1995 to 26 per cent in 2003 and 50 per cent by 2023. Of the 24 percentage points of average convergence observed between the EU- 8 and Germany, 10 percentage points are shared with other emerging markets with similar characteristics, while the remaining 14 percentage points can be thought of as an “EU accession bonus”, facilitated by rapid growth of exports relative to GDP as these economies became deeply integrated into European and global supply chains.

Geopolitical tensions are having a profound impact on the EBRD regions and beyond leading to rapid fragmentation of trade and investment and a notable rise in defence spending. As the ‘peace dividend’ has been eroded, since February 2022, arms trade as a share of imports and exports of the EU economies in the EBRD regions increased from 0.1 per cent (stable for years) to 0.3 to 0.5 per cent. In recent months, exports have become increasingly concentrated when measured across product*country pairs (more so than across countries). In other words, specific goods (for instance, critical raw materials or defence goods) are increasingly traded with a narrower set of countries. As trade tensions escalated, foreign direct investment (FDI) has been increasingly targeting “bridging” economies that maintain close trade ties with other blocs. Inward FDI from China to the EBRD regions picked up sharply in 2023. Foreign direct investment from Russia to Central Asia also increased, driven by logistics services.

In **central Europe and the Baltic states** growth is expected to accelerate from 0.1 per cent in 2023 to 2.2 per cent in 2024 and 3.1 per cent in 2025, though growth in a number of economies has been revised down since September 2023 on weak economic activity indicators in recent months. Growth in the **south-eastern EU** is projected to pick up from 2 per cent in 2023 to 2.8 per cent in 2024 and 3.1 per cent in 2025, supported by accommodative fiscal stances and robust real wage growth. Likewise, growth in the **Western Balkans** is expected to pick up from 2.5 per cent in 2023, to 3.3 per cent in 2024 and 3.7 per cent in 2025.

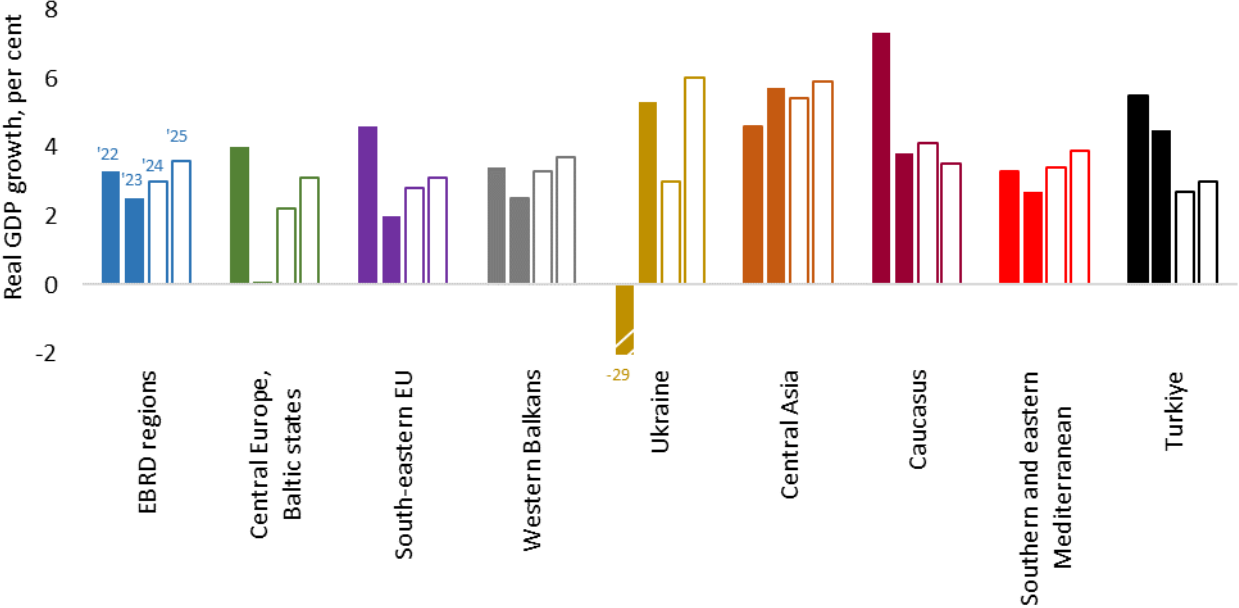
Growth in **Central Asia** is forecast to moderate from 5.7 per cent in 2023 to 5.4 per cent in 2024 as intermediated trade with Russia appears to have reached a plateau while spring floods weigh on Kazakhstan's growth prospects. Growth is expected to pick up to 5.9 per cent in 2025.

In the **Caucasus**, growth is expected to pick up from 3.8 per cent in 2023 to 4.1 per cent growth in 2024 before moderating closer to 3.5 per cent in 2025, a level in line with estimates of medium-term potential growth. A record harvest supported growth in **Ukraine** in 2023, but significant recent damage to electricity infrastructure is expected to hold back growth in 2024.

Growth in **Turkiye** is expected to slow from 4.5 per cent in 2023 to 2.7 per cent in 2024 before picking up to 3 per cent in 2025 on expectations of a more restrictive monetary and fiscal policy stance in the face of persistently high inflation.

Growth in the **southern and eastern Mediterranean** is expected to accelerate from 2.7 per cent in 2023 to 3.4 per cent in 2024 and 3.9 per cent in 2025. This represents a downward revision on the previous forecast for 2024 owing to slower-than-expected implementation of large public investment projects in Egypt and spillovers from the war in Gaza. While the impact of the war on government yields in Egypt and Jordan proved short-lived, the negative effect on tourist arrivals in Jordan and Lebanon may prove more lasting.

Chart 0. Growth in the EBRD regions is expected to pick up from 2.5 per cent in 2023 to 3 per cent in 2024 and 3.6 per cent in 2025



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

Table 1. GDP growth in real terms

	Actual			Forecast (May'24)		Rev. since Sep'23
	2021	2022	2023	2024	2025	2024
EBRD regions	7.3	3.3	2.5	3.0	3.6	-0.2
Central Asia	5.2	4.6	5.7	5.4	5.9	-0.5
Kazakhstan	4.1	3.2	5.1	4.5	5.5	-0.5
Kyrgyz Republic	5.5	9.0	6.2	8.5	7.0	1.5
Mongolia	1.6	5.0	7.0	5.0	8.0	-2.5
Tajikistan	9.4	8.0	8.3	7.5	7.0	0.0
Turkmenistan	6.2	6.2	6.3	6.3	6.3	-0.7
Uzbekistan	7.4	5.7	6.0	6.5	6.0	0.0
Central Europe and the Baltic states	6.5	4.0	0.1	2.2	3.1	-0.3
Croatia	13.8	6.3	2.8	2.9	2.8	0.6
Czechia	3.6	2.4	-0.3	0.9	2.5	-1.6
Estonia	7.2	-0.5	-3.0	0.8	3.5	-1.2
Hungary	7.1	4.6	-0.9	2.2	3.5	-0.6
Latvia	6.7	3.0	-0.3	1.8	2.6	-0.2
Lithuania	6.3	2.4	-0.3	1.5	2.3	0.0
Poland	6.9	5.3	0.2	2.9	3.5	0.2
Slovak Republic	4.8	1.9	1.6	1.8	2.7	-0.4
Slovenia	8.2	2.5	1.6	2.3	2.6	0.0
Eastern Europe and the Caucasus	5.3	-13.0	4.4	3.5	4.9	0.4
Armenia	5.8	12.6	8.7	6.2	4.8	1.7
Azerbaijan	5.6	4.6	1.1	3.1	2.7	0.6
Georgia	10.6	11.0	7.5	5.2	4.6	0.7
Moldova	13.9	-4.6	0.7	3.5	3.7	0.0
Ukraine	3.4	-29.1	5.3	3.0	6.0	0.0
South-eastern EU	7.0	4.6	2.0	2.8	3.1	0.0
Bulgaria	7.7	3.9	1.8	2.6	3.0	0.0
Greece	8.4	5.6	2.0	2.3	2.6	0.0
Romania	5.7	4.1	2.1	3.2	3.4	0.0
Southern and eastern Mediterranean	6.4	3.3	2.7	3.4	3.9	-0.5
Egypt	7.2	4.2	2.9	3.9	4.4	-0.6
Jordan	3.7	2.4	2.6	2.4	2.6	-0.1
Lebanon	-10.0	0.0	-0.2	0.2	3.0	-2.8
Morocco	8.0	1.3	3.2	3.0	3.6	0.0
Tunisia	4.6	2.6	0.4	1.9	2.0	-0.6
Turkiye	11.4	5.5	4.5	2.7	3.0	-0.3
Western Balkans	7.9	3.4	2.5	3.3	3.7	-0.1
Albania	9.0	5.0	3.4	3.3	3.5	0.0
Bosnia and Herzegovina	7.4	4.1	1.7	2.8	3.0	-0.2
Kosovo	10.7	4.3	3.3	4.0	4.0	0.0
Montenegro	13.0	6.4	6.0	3.5	2.9	-0.2
North Macedonia	4.5	2.2	1.0	2.5	3.5	-0.5
Serbia	7.7	2.5	2.5	3.5	4.0	0.0
Memo: Egypt (fiscal year to June)	3.3	6.7	3.8	3.0	4.0	-1.8
Caucasus	6.7	7.3	3.8	4.1	3.5	0.8
Belarus	2.4	-4.7	3.9	2.8	2.2	1.5
Russia	4.7	-1.2	3.6	2.5	1.5	1.5

Source: National authorities and EBRD. Notes: Weights are based on the values of gross domestic product in 2022 at market exchange rates.

Growth in the EBRD regions slowed from 3.3 per cent in 2022 to 2.5 per cent in 2023

Growth in the EBRD regions slowed from 3.3 per cent in 2022 to 2.5 per cent in 2023 as the war on Ukraine took its toll, energy prices in Europe remained relatively high and the post-Covid recovery in the services sector ran out of steam (see Table 1). As a result, average growth fell short of the global average of 2.7 per cent (calculated at market exchange rates).

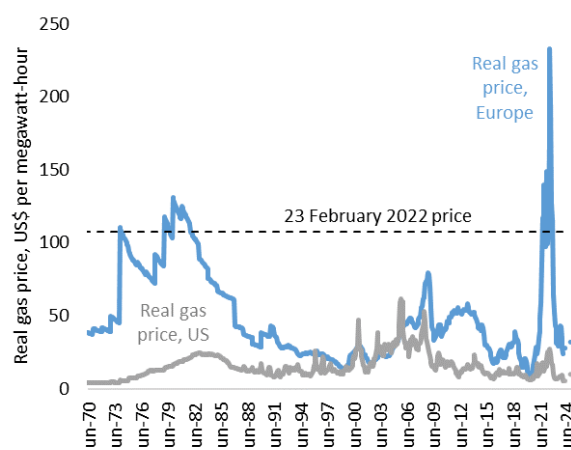
In much of Emerging Europe, slow growth in advanced European economies weighed on growth in 2023. At the same time, better-than-expected tourism seasons provided a boost to growth in most tourism-dependent economies.

In stark contrast, growth in Central Asia and parts of the Caucasus remained strong throughout 2022 and 2023, reflecting gains from growing trade with Russia and high levels of migration and remittances from Russia. Growth also remained strong in Turkiye where private consumption was supported by the fiscal stimulus implemented in the first half of 2023 and rising wages.

Oil and gas prices fell back to below pre-war levels

The price of gas in Europe increased sharply in late 2022. It has eased since, and as of mid-April 2024 was back to below its pre-war level (see Chart 1). At the same time, gas in Europe remains relatively expensive, trading at almost five times the US price.

Chart 1. Gas prices in Europe are back to below their pre-war levels, but almost five times the US price



Source: Bloomberg, CEIC, IMF and authors' calculations.

Note: Prices adjusted for US inflation.

Oil prices also moderated on subdued economic activity (see Chart 2). Increases in the supply of crude oil have mostly kept up with increasing demand since early 2021. The reaction of oil prices to the escalation of conflict in the Middle East was muted as of mid-April and markets expected oil to trade around its 2017-2021 average level (adjusted for US inflation).

Chart 2. Oil prices moderated as increased supply kept up with increasing demand

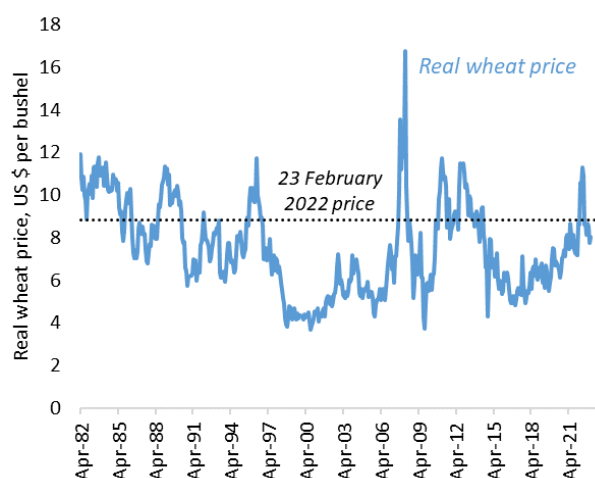


Source: Bloomberg, Refinitiv and authors' calculations.

Note: Prices adjusted for US inflation.

Prices in global food markets also normalized. Wheat prices have fallen back to below their 2017-21 average and futures markets expect them to remain around those levels (see Chart 3). While the war on Ukraine led to temporary price increases, large harvests in the northern hemisphere and increased exports from Russia eased supply concerns.

Chart 3. Wheat prices declined markedly on strong harvests



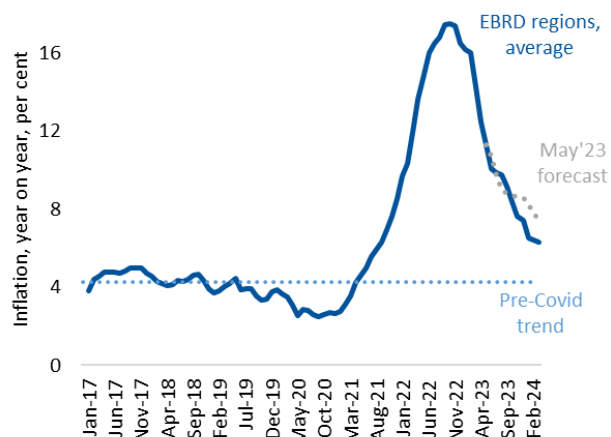
Source: Refinitiv and authors' calculations.
Note: Prices adjusted for US inflation.

Disinflation proceeded faster than expected

As gas oil and wheat prices moderated, disinflation proceeded more quickly than expected a year ago (see Chart 4).

Average inflation in the EBRD regions declined from 17.5 per cent at its peak in October 2022 to 6.3 per cent in March 2024 but remained 2 percentage points above the pre-pandemic average (see Chart 4). This pattern is broadly similar to the one observed in advanced economies, where inflation declined considerably but remained above central banks' targets (the March 2024 readings were 3.5 per cent in the United States, 2.4 per cent in the eurozone and 3.2 per cent in the United Kingdom).

Chart 4. Disinflation proceeded more quickly than expected a year ago

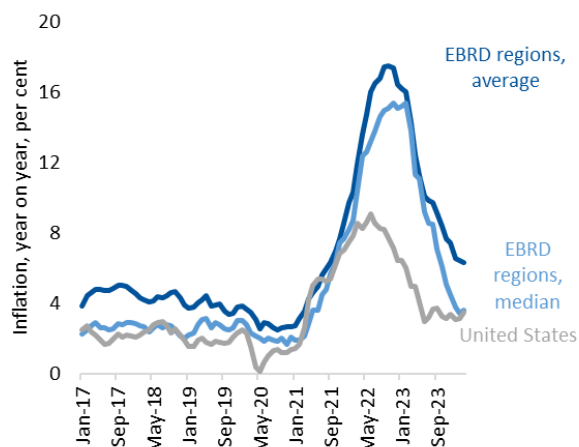


Source: May 2023 Regional Economic Prospects based on IMF, national authorities via CEIC, World Bank Global Inflation database and authors' calculations.

Note: Simple average across 33 economies. Dashed line denotes a month-to-month curve fitted based on end-of-year and annual average April 2023 IMF inflation forecasts.

As a result, in a typical (median) EBRD economy, inflation was at par with that in the United States by February 2024 (see Chart 5).

Chart 5. In a typical EBRD economy, inflation was at par with the United States by February 2024



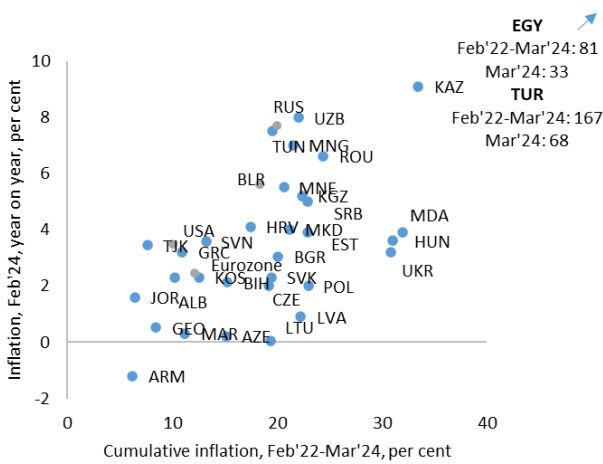
Source: National authorities via Refinitiv and authors' calculations.

Note: Simple average across 33 economies.

Disinflation experiences vary greatly across countries

As disinflation experiences varied considerably across economies, the gap between in median and average values of inflation in the EBRD regions increased (see Chart 5). Inflation in cumulative terms, between February 2022 and March 2024, exceeded 30 per cent in Egypt and Turkiye, where March 2024 inflation remained in double-digits, but also in Hungary, Kazakhstan, Moldova and Ukraine, where inflation has already come down to relatively lower levels (see Chart 6).

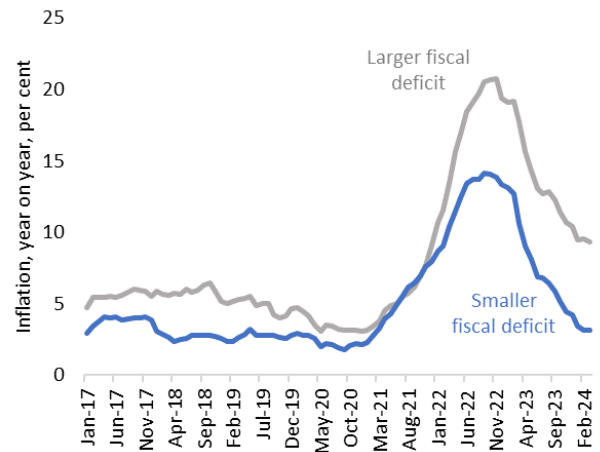
Chart 6. In some economies, cumulative price increases since February 2022 exceeded 30 per cent



Source: National authorities via Refinitiv and authors' calculations.

Peak inflation tended to be higher, and disinflation slower, in economies with more expansionary fiscal policy (higher budget deficits; see Chart 7). Disinflation has also been slower in economies with weaker macroeconomic policy, which experienced large depreciations.

Chart 7. In economies with expansionary fiscal policy, inflation peaked at higher levels and remained higher for longer, on average



Source: IMF April 2024 World Economic Outlook, national authorities via CEIC and authors' calculations. Note: Deficit above/below the median 2023 deficit in the EBRD regions. Simple averages.

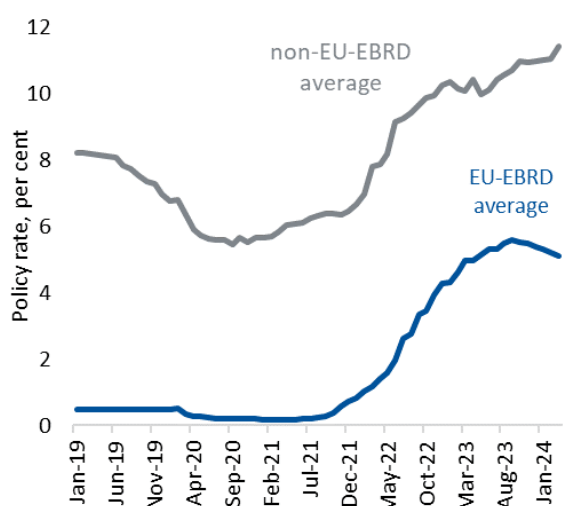
In contrast, disinflation paths were broadly similar in economies with higher and lower unemployment rates, perhaps because employers in countries with more labour market slack were unwilling or unable to draw on large pools of the unemployed, reflecting skill mismatches and high structural unemployment. If anything, disinflation has subsequently slowed in economies with higher unemployment rates, likely reflecting the effect of overall weaker macroeconomic policy frameworks in those economies.

Survey data suggest that individuals in the EBRD regions tend to base their inflation expectations largely on concurrent trends in food prices. While most people over-estimate future inflation, people with more trust in the central bank have significantly lower inflation expectations (see Box 1).

Monetary policy stance has remained largely unchanged since the start of 2023

The monetary policy stance in the median EBRD economy has, on average, remained largely unchanged since the start of 2023. However, while policy rates have increased further, on average, in non-EU-EBRD economies, there has been some monetary loosening in EU-EBRD economies in late 2023 and early 2024 as inflation pressures moderated (see Chart 9).

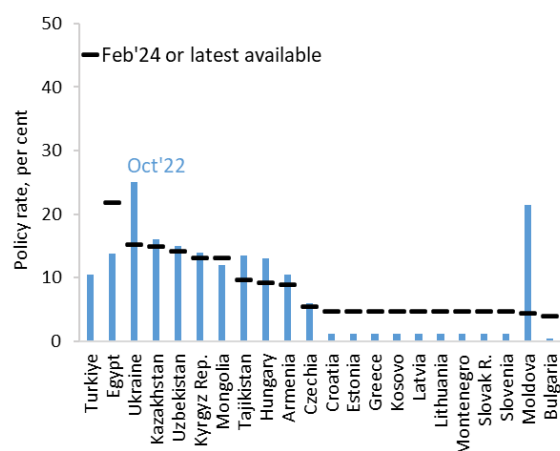
Chart 9. Policy interest rates started declining in EU economies in the EBRD regions



Source: Bloomberg, national authorities via CEIC and authors' calculations.

Monetary policy rates in the EBRD regions typically remain higher than they were when inflation peaked in October 2022. Notable exceptions include Moldova, Ukraine and some economies in Central Asia (see Chart 10).

Chart 10. Monetary policy rates typically remain higher than they were when inflation peaked



Source: Bloomberg, national authorities via CEIC and authors' calculations.

Note: Select economies shown.

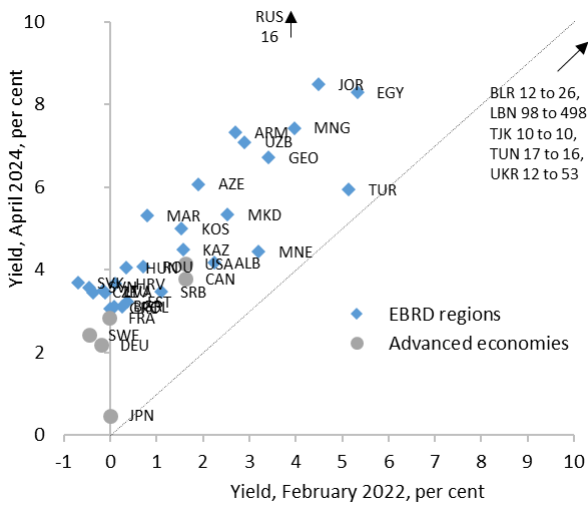
Borrowing costs — higher spread for EU-EBRD economies persists

In the EBRD regions as a whole, the median yield on 5-year government bonds increased by three percentage points between early February 2022 and mid-April 2024. Most of this increase reflects monetary tightening in advanced economies. In the US and Germany interest rates increased by an average of 2.6 percentage points over this period. The remaining 0.4 percentage points are due to a widening of the spread between the EBRD regions and Germany / the United States because of a reassessment of economic and geopolitical risks faced by individual borrowers. This average trend masks a variety of experiences within the EBRD regions.

Sovereign bond yields are elevated in Lebanon and Tunisia (as well as Belarus, Russia and Ukraine; see Chart 11) with these economies effectively losing market access. In March 2024, yields came down in Egypt on the news of financial commitments made by the United Arab Emirates, the International Monetary Fund, World Bank and other international partners equivalent to around 13 per cent of GDP (in some cases with significant frontloaded disbursements). The

official exchange rate was devalued, with the gap between the official and black-market rates closing. Remittances picked up and several rating agencies upgraded their outlooks.

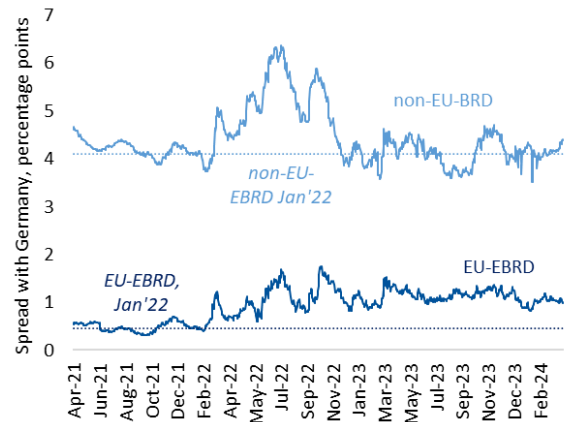
Chart 11. Yields on sovereign bonds remain, on average, 3 pp higher than in February 2022



Source: Bloomberg and authors' calculations.
 Note: Yields on 5-year government bonds in US dollars or closest benchmark available. As of 1 February 2022 (horizontal axis) and 16 April 2024 (vertical axis).

In a typical non-EU economy in the EBRD regions the spread relative to Germany has been narrowing gradually since peaking in August 2022 (see Chart 12). In contrast, in EU-EBRD economies the spread that had opened sharply in March 2022 has been maintained and remains around 1 percentage point.

Chart 12. In a typical EU-EBRD economy the spread that opened in March 2022 remains



Source: Bloomberg and authors' calculations.
 Note: Spread between the German 5-year bond and median government bond in EUR or USD of maturity between 4-7 years. EU-EBRD includes Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia.

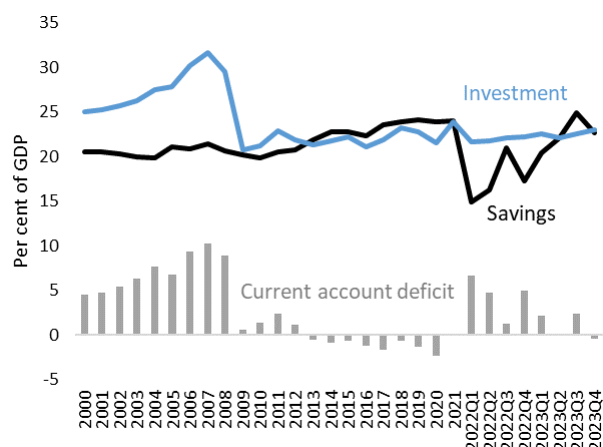
The US yield relative to Germany has also increased recently, towards one of the highest levels since the 1980s, on the back of sustained strong fiscal stimulus in the United States.

Covid-19 savings appear to have been run down

Savings levels in central Europe have normalised as the buffers of private savings accumulated during Covid-19 have been depleted. As a result, current account deficits have narrowed in 2023 (see Chart 13).

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

Chart 13. In Emerging Europe, savings levels have normalized



Source. Eurostat, IMF and authors' calculations.
 Note: Simple average of Croatia, Czechia, Estonia, Hungary, Latvia Lithuania, Poland, Slovak Republic and Slovenia.

20 years of EU accession

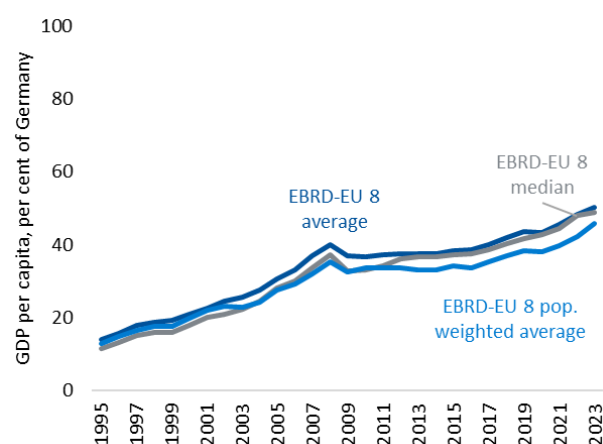
Eight economies in the EBRD regions, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia (EU-8), joined the European Union on 1 May 2004. Bulgaria and Romania joined in 2007, and Croatia in 2013. The following analysis examines the experience of these economies over the last 20 years.

'Accession bonus' boosted income convergence

The average GDP per capita of the EU-8 economies (simple average, measured at market exchange rates) increased from 14 per cent of Germany's in 1995 to 26 per cent in 2003 and 50 per cent by 2023 (see Chart 14). The experience of a typical (median) economy was similar (convergence was slightly slower if measured using a population-weighted average income per capita, reflecting slower progress in the larger economies). The starting share of 14 per cent of Germany's GDP per capita in the 1990s in fact coincides with the average ratio observed in the neighbourhood economies today (an average across the Caucasus, Moldova, the southern and eastern Mediterranean, Turkiye, Ukraine and the Western Balkans).

As of 2023, GDP per capita levels vary significantly among the EU-8 economies, from 42 per cent of Germany's in Hungary and Poland to 57-61 per cent in Czechia, Estonia and Slovenia. Lower-income economies tended to enjoy faster income convergence over the period 2004-2023: Poland more than doubled its per capita income as a share of Germany's while Slovenia climbed up from 50 per cent of Germany's income per head in 2004 to 61 per cent by 2023.

Chart 14. The average EU- 8 economy's GDP per capita increased from 26 per cent of Germany's in 2003 to 50 per cent by 2023



Source: IMF April 2024 World Economic Outlook and authors' calculations.
 Note: Market exchange rates.

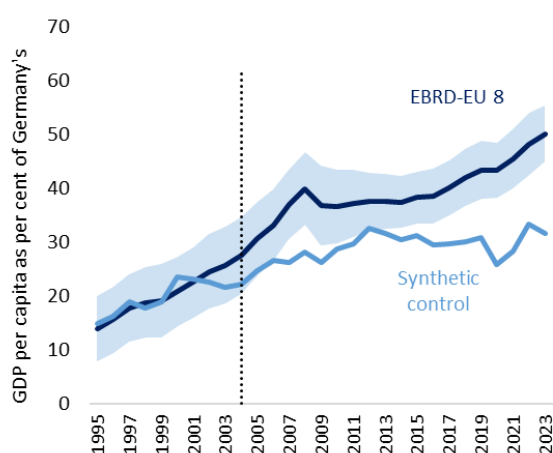
The economies that joined in 2007 and 2013 also experienced fast rates of income convergence. Bulgaria and Romania more than tripled their per capita incomes as a share of Germany's over the period 2004-23, from 10 to 30-35 per cent.

This performance stands out relative to the income convergence observed between other emerging markets at similar levels of development and advanced economies. The following analysis constructs 'synthetic controls' for each of the 8 economies – economies similar to them in terms of their GDP, GDP per capita in nominal US dollars, GDP per capita in PPP dollars and real GDP per capita growth over the period 1995-2003. The performance of the EU- 8 economies is then compared with the

performance of these ‘similar’ economies after 2004 to differentiate how much of the observed convergence holds in general, and how much of it may be attributed to EU accession (see, for instance Abadie and Gardeazabal, 2003, Abadie, Diamond and Hainmueller, 2010 and Chupilkin and Koczan, 2022, for a discussion of the synthetic control method). The synthetic counterpart of Poland, for instance, is an average of many economies with larger weights assigned to China, Equatorial Guinea, Kazakhstan, Russia, Saudi Arabia and Ukraine.

This analysis suggests that of the 24 percentage points of average convergence observed between the EU-8 and Germany, 10 percentage points are shared with comparators, while 14 percentage points can be thought of as an “EU accession bonus” (see Chart 15).

Chart 15. Of the 24 percentage points of average convergence, 14 percentage points can be thought of as an “EU accession bonus”



Source: IMF April 2024 World Economic Outlook and authors' calculations.

Note: 95 per cent confidence interval shown. Synthetic controls based on GDP and GDP per capita in nominal US dollars, GDP per capita in PPP US dollars, and real GDP per capita growth.

The accession bonus started materializing around 2001-02 as accession prospects firmed up and foreign direct investment (FDI) inflows to the EU-8 economies increased. On the other hand, convergence in many comparator emerging

markets slowed down markedly after the 1997-98 Asian financial crisis, resulting in a widening gap between incomes of the EU-8 and comparators.

While the 2008-09 crisis took a toll, with the “EU accession bonus” briefly becoming statistically insignificant in 2012, growth rates above those observed for synthetic comparators returned afterwards.

The pattern is very similar in terms of GDP per capita growth. Here too, the EU- 8 economies outperformed their synthetic comparators, the original positive effect was dampened by the global financial crisis but has since re-emerged strongly.

Life satisfaction and self-assessed health also increased sharply, based on analysis drawing on the first and fourth waves of the Life in Transition Survey, a large representative household survey conducted by the EBRD in collaboration with the World Bank. Between 2006 and 2022, the share of people reporting that they are satisfied with their life increased from 51 per cent to 58 per cent in the EU- 8 economies. Similarly, the share who assessed their own physical health as good or very good increased from 44 per cent to 62 per cent (see also EBRD, 2023a and EBRD, 2024).

The results of the synthetic control analysis are in line with those of earlier studies of EU enlargements. For instance, Campos, Coricelli and Moretti (2019) rely on a similar synthetic control method. Looking at all EU accessions between 1973 and 2004, they find that without EU accession, per capita incomes would have been, on average, approximately 10 per cent lower in the first ten years after joining the EU (see also Campos, Coricelli and Franceschi, 2022 on the productivity effects of the 1995 enlargement of the European Union).

Strong export performance

The 'EU accession bonus' has been underpinned by a strong growth of exports as a share of GDP. The average export-to-GDP ratio increased from 43 per cent in 1995 to 49 per cent in 2003 and 76 per cent in 2023 in the EU-8 economies as

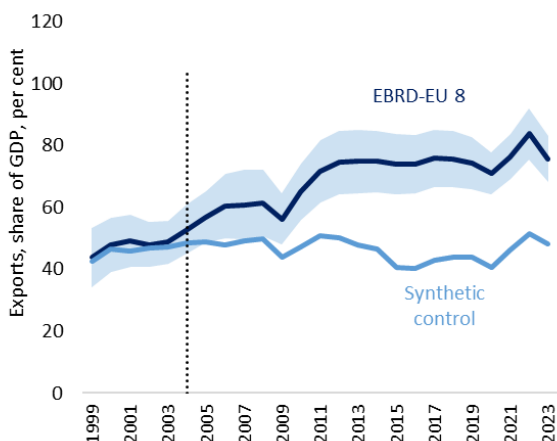
they became deeply integrated into European and global supply chains. Here, too, the pre-accession ratio of exports to GDP is similar to today's average ratio across neighbourhood economies, which stood at 44 per cent as of 2023.

Most EU-8 economies as well as Bulgaria, Croatia and Romania signed and ratified free trade agreements with the EU in the 1990s, with accession countries given more time to lower their tariffs than EU economies and accession economies able to reimpose tariffs if sudden imports harmed local industries.

The largest relative increase over the period 2004-2023 was observed in Poland (with exports-to-GDP rising from 34 to 57 per cent). In 2023, export-to-GDP ratios varied from 40 per cent in Romania to 92 per cent in the Slovak Republic.

In contrast, exports-to-GDP have been broadly flat among comparator economies during the last 20 years (see Chart 16).

Chart 16. Convergence was underpinned by strong export performance, unlike in comparators



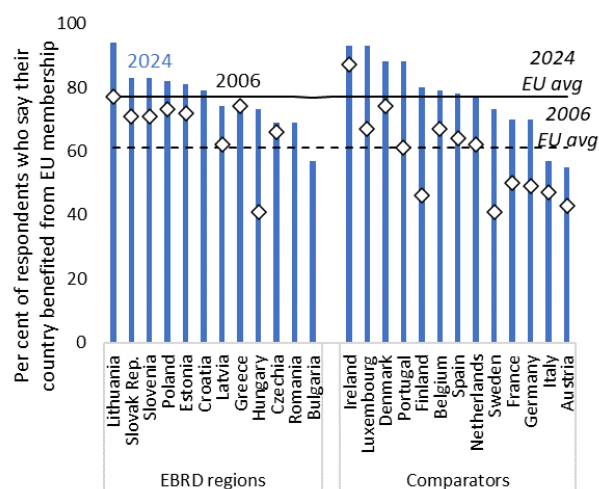
Source: IMF April 2024 World Economic Outlook and authors' calculations.

Note: 95 per cent confidence interval shown. Synthetic controls based on GDP and GDP per capita in nominal US dollars, GDP per capita in PPP US dollars, and real GDP per capita growth.

Most people feel their countries have benefited from EU membership

Attitudes towards EU membership have also improved over time. Both in the EU-8 economies and 'older' member states, most survey respondents feel they have benefited from EU membership and the shares of people expressing this view have increased in most economies since 2006 (with the notable exception of Greece). In the EU-8 countries this share edged up from 67 to 80 per cent between 2006 and 2024, while in the 'old' member states it increased from 59 to 77 per cent.

Chart 17. Most people feel their countries have benefited from EU membership



Source: Eurobarometer and authors' calculations.

Note: Per cent of respondents who agree with the statement 'Taking everything into account, would you say that [our country] has on balance benefited or not from being a member of the EU?'.

Geopolitical fragmentation of trade and investment flows

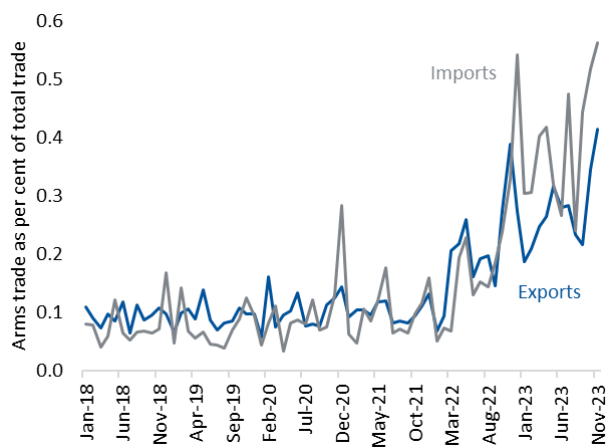
Geopolitical fragmentation is having a profound impact on trade, investment and defence spending in the EBRD regions and beyond.

Reduced 'peace dividend'

The so-called 'peace dividend' -- the economic benefit resulting from a reduction in defence expenditure and a subsequent reinvestment of funds in the civilian economy -- has been reduced

significantly. Before February 2022, the share of arms in exports and imports of EU-EBRD economies has been broadly stable at around 0.1 per cent of total cross-border trade. It has since risen sharply to 0.3 – 0.5 per cent, reflecting a broader increase in defence spending (see Chart 18). In terms of the average share of economies' GDP, this corresponds to an increase from around 0.1 per cent to 0.3 per cent.

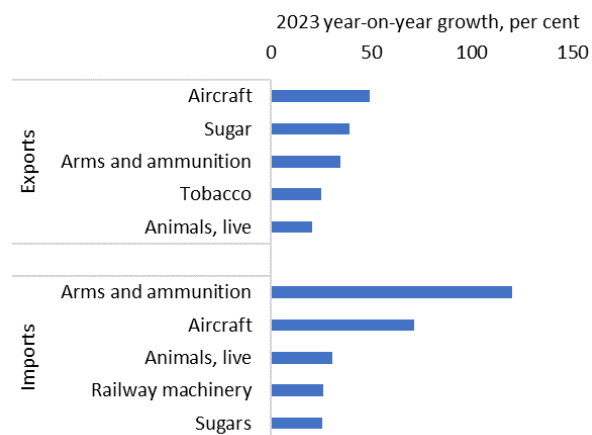
Chart 18. Arms trade has increased significantly in EU-EBRD economies



Source: UN Comtrade and authors' calculations.
Note: Sum across Czechia, Estonia, Latvia, Lithuania, Poland, Slovak Republic and Slovenia.

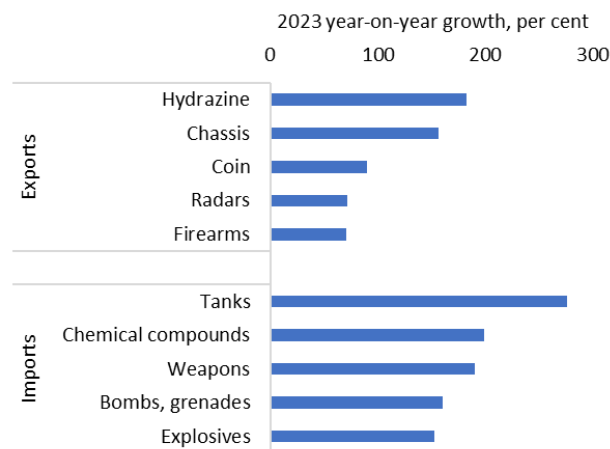
Defence goods also dominate the list of product groups with the fastest export and import growth in 2023 (see Charts 19 and 20 at the HS2 and HS4 levels of disaggregation, where HS4 level is more granular).

Chart 19. Defence goods were among the fastest growing exports and imports in EU-EBRD economies in 2023



Source: UN COMTRADE and authors' calculations.
Note: Product groups at the HS2 level of disaggregation. Sums across Bulgaria, Czechia, Estonia, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia. Based on goods with at least US\$ 100 million trade in 2023.

Chart 20. Defence goods were among the fastest growing exports and imports in EU-EBRD economies in 2023 also when using a higher level of product disaggregation



Source: UN Comtrade and authors' calculations. Note: Product groups at the HS4 level of disaggregation. Sums across Bulgaria, Czechia, Estonia, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia. Based on goods with at least US\$ 100 million trade in 2023.

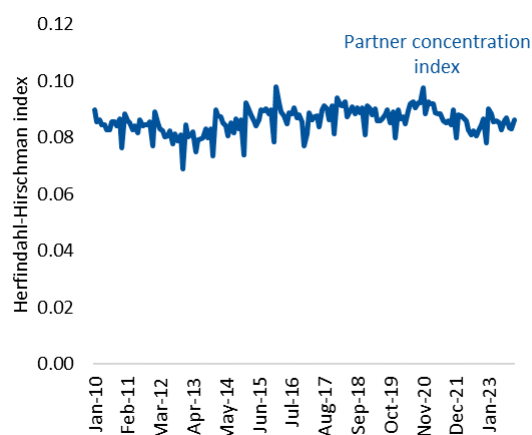
Rising concentration of cross-border trade across country-product combinations

Against the backdrop of rising geopolitical tensions, trade has become more fragmented. Restrictions have been increasingly levied on exports, in particular, exports of raw materials critical to the digital economy and the green transition (see EBRD, 2023a). Emerging market currencies became more commonly used in international trade transactions that have traditionally been dominated by the US dollar (see Chupilkin et al., 2023b). Gopinath et al. (2024) further show that since 2022 trade within blocs of geopolitically aligned countries has been growing significantly faster than trade across such blocs.

Moreover, data on bilateral trade of central European economies at the HS6 level of product disaggregation suggest that exports have become significantly more concentrated across product*country pairs and that concentration measured this way has risen considerably more strongly than when evaluated across products or across countries. This can be seen in Charts 21, 22 and 23.

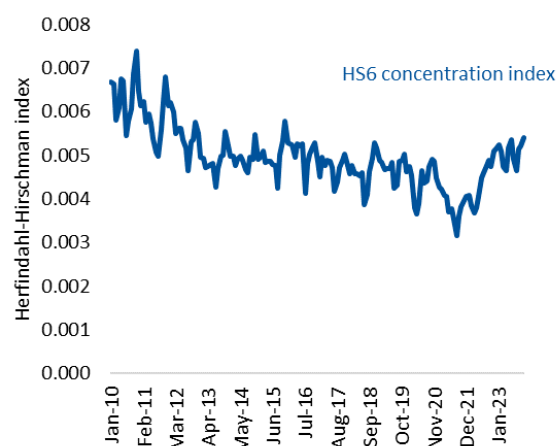
These patterns suggest that certain goods (for instance, critical raw materials or defence goods) are increasingly traded more with selected trading partners. Until recently, the long-term trend, if anything, had been towards greater diversification of relationships at the product-country level. The scale of the recent increase in export concentration is also large relative to historical fluctuations (see Chart 23).

Chart 21. The concentration of exports from central Europe in terms of partners did not change



Source: UN Comtrade and authors' calculations.
 Note: Trade weighted average across Czechia, Estonia, Latvia, Lithuania, Poland, Slovak Republic and Slovenia. Herfindahl-Hirschman Index (HHI) calculated by squaring the share of each country*product pair and then summing the resulting numbers. The value of one corresponds to concentrated exports and zero corresponds to fully diversified exports. Products are at the HS6 level of disaggregation.

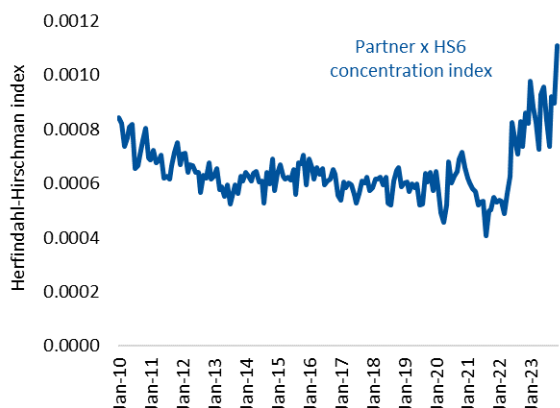
Chart 22. The concentration in terms of exported products is also around pre-war levels



Source: UN Comtrade and authors' calculations.
 Note: Trade weighted average across Czechia, Estonia, Latvia, Lithuania, Poland, Slovak Republic and Slovenia. Herfindahl-Hirschman Index (HHI) calculated by squaring the share of each country*product pair and then summing the resulting numbers. The value of one corresponds to concentrated exports and zero

corresponds to fully diversified exports. Products are at the HS6 level of disaggregation.

Chart 23. Exports from central Europe have become more concentrated across product*country-pairs



Source: UN Comtrade and authors' calculations. Note: Trade weighted average across Czechia, Estonia, Latvia, Lithuania, Poland, Slovak Republic and Slovenia. Herfindahl-Hirschman Index (HHI) calculated by squaring the share of each country*product pair and then summing the resulting numbers. The value of one corresponds to concentrated exports and zero corresponds to fully diversified exports. Products are at the HS6 level of disaggregation.

Changing bilateral trade relationships

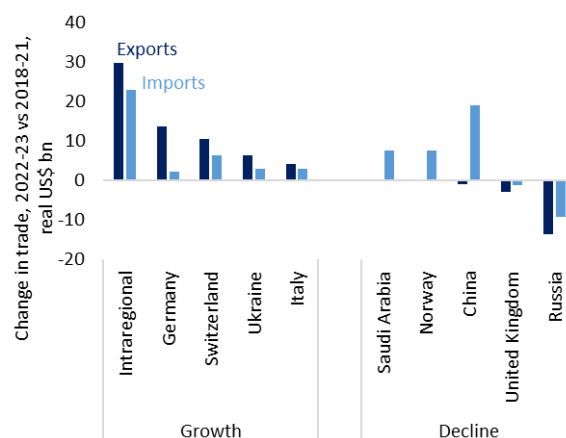
Shifts in trade patterns can also be seen in bilateral trade data. In absolute US dollar terms (adjusted for CPI inflation in the United States), trade between EU-EBRD economies and Russia and the United Kingdom declined substantially in 2022-23 relative to 2018-21 reflecting the impact of Brexit and economic sanctions imposed on Russia (see Chart 24).

In contrast, intra-regional trade (that is trade among EU-EBRD economies) increased significantly. The trade deficit with China increased as exports to China declined (in inflation-adjusted terms) while imports continued growing rapidly. In contrast, exports to Germany continued to increase, while imports from Germany increased less, reflecting the contraction of industrial production in Germany (relative to its pre-Covid level). Imports from Saudi Arabia and

Norway increased, driven by diversification of sources of oil away from reliance on Russia.

In relative terms, the sharpest growth in exports of EU-EBRD economies in 2023 was to the Kyrgyz Republic, Uzbekistan, Belarus, Morocco and Ukraine. Imports increased most from Norway and the United Arab Emirates, again largely reflecting substitution away from Russian oil.

Chart 24. Trade patterns of EU-EBRD economies shifted significantly



Source: UN Comtrade and authors' calculations. Note: Sums across Bulgaria, Czechia, Estonia, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia. Based on partners with at least US\$ 1 billion trade in 2023.

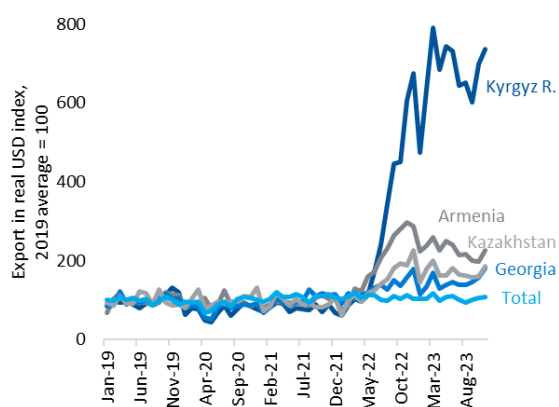
Following the imposition of trade sanctions on the Russian economy, EU exports to selected economies in Central Asia and the Caucasus increased sharply, as discussed in previous issues of the *Regional Economic Prospects* (see EBRD, 2023b and 2023c, as well as Chupilkin, Javorcik and Plekhanov, 2023, Chupilkin, Javorcik, Peeva and Plekhanov, 2024a and 2024b). This intermediated trade via the Caucasus and Central Asia continued growing, providing impetus to the intermediary economies. In recent months, such trade has stabilized at high levels (see Chart 25).

Despite having plateaued, it was still an important contributor to growth in 2023 as a whole. In January to December 2023, inflation-adjusted EU exports to the Kyrgyz Republic increased 172 per cent year on year, compared with a contraction of 3 per cent for total EU exports. Inflation-adjusted

EU exports to Armenia, Georgia and Kazakhstan registered growth of 23, 15 and 27 per cent respectively.

On current trends, intermediated trade is unlikely to contribute to growth mechanically in 2024, with a possible exception of the Kyrgyz Republic. At the same time, growth of manufacturing exports to Russia may continue, as exit of Western brands creates an opportunity for other manufacturers (see Box 2, which also discusses IT sector developments in the region).

Chart 25. Intermediated trade has stabilized



Source: UN Comtrade and authors' calculations.
Note: Trade in nominal US dollars as reported by EU exporters, adjusted for US CPI inflation.

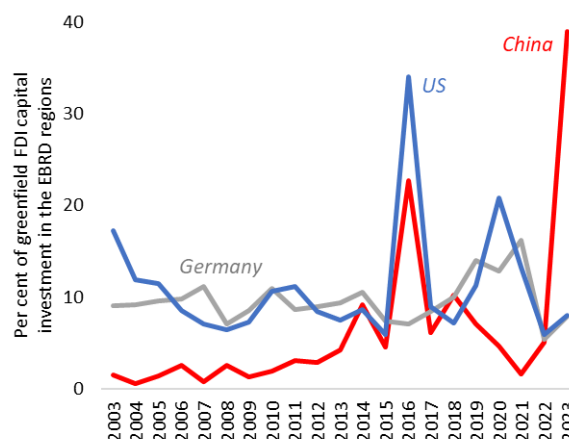
FDI response to geopolitical fragmentation

Geopolitical fragmentation of trade has also coincided with notable shifts in FDI patterns, with increasing investment in “bridging” economies that maintain close trade ties with rival blocs of economies.

Inward FDI from China to the EBRD regions picked up sharply in 2023, with particularly large announcements in Egypt, Morocco and Serbia, in sectors such as electronics, metals and renewables (see Chart 26). China’s interest in Morocco may partly reflect Morocco’s free trade agreement (FTA) with the United States, which affords favourable treatment under the Inflation Reduction Act (with Jordan’s FTA also potentially eligible). These patterns are consistent with the recent geopolitical complementarity between

flows of trade and FDI documented in Gopinath et al. (2024).

Chart 26. Inward FDI flows from China to the EBRD regions increased in 2023



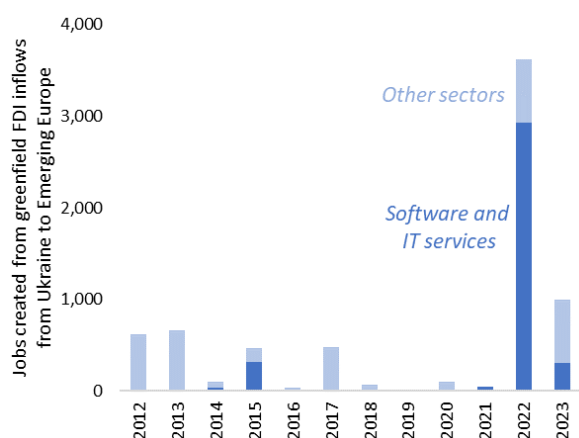
Source: FT fDi Markets database and authors' calculations.

Note: Breakdown by country of origin, based on the expected volume of capital expenditure for all projects including announcements where implementation may not have yet started. Until September 2023.

Foreign direct investment from Russia to Central Asia also increased sharply in 2023, driven by logistics services (which are complementary to increasing intermediated trade). Absolute amounts (in nominal US dollars) are highest in Kazakhstan, while in relative terms they are also high in Central Asia’s smaller economies.

FDI from Ukraine to Emerging Europe also increased sharply in 2022, from low levels and following Ukraine’s skilled labour, driven by software and IT services, mirroring the arrival of skilled workers from Ukraine to neighbouring economies (see Chart 27).

Chart 27. FDI inflows from Ukraine to Emerging Europe increased, driven by IT



Source: FT fDi Markets database and authors' calculations.

Note: Total greenfield FDI inflow related employment in Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia, until September 2023.

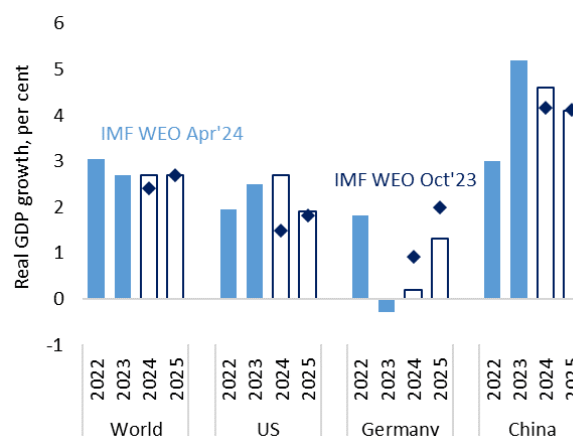
Slowing global growth

Amidst increasing geopolitical tensions and persistent inflationary pressures, global growth (measured at market exchange rates) slowed from 3 per cent in 2022 to 2.7 per cent in 2023. The International Monetary Fund (IMF) expected it to remain at this level in both 2024 and 2025 in its April 2024 *World Economic Outlook* (see Chart 28). Even though economic activity remained resilient in the face of global disinflation in 2022-23, the IMF's 5-year-out forecasts are the lowest in decades, largely on account of reduced economic dynamism and the lower extent of movement of labour and capital from less productive firms to more productive ones (IMF, 2024).

Growth has been revised up for the United States relative to the October 2023 forecasts, on better outturns at the end of 2023 and continued momentum in 2024. Growth prospects for Germany were, however, revised down sharply on weak consumer sentiment – more so than in the rest of the euro area. Growth in China is expected to slow in 2024 and 2025 relative to 2023 as the

post-pandemic boost wears off and weakness in the property sector continues.

Chart 28. Slower growth expected in Germany



Source: IMF October 2023 and April 2024 *World Economic Outlooks*.

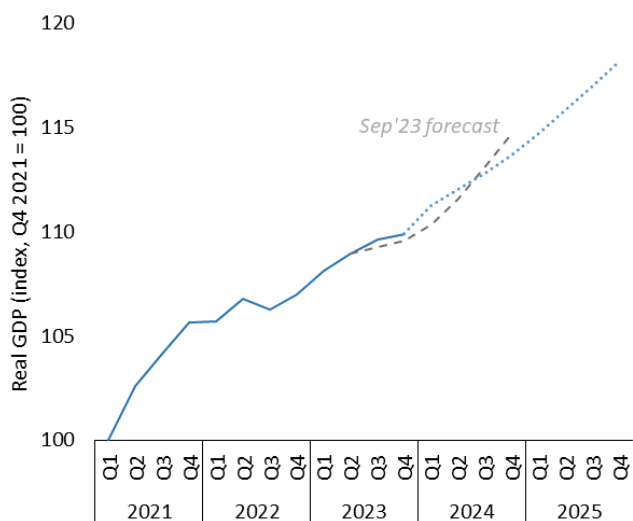
Output in the EBRD regions is expected to grow by 3 per cent in 2024 and 3.6 per cent in 2025

Against this backdrop, growth in the EBRD regions is expected to pick up to 3 per cent in 2024 from 2.5 per cent in 2023 (see Chart 29 and Table 1). This represents a 0.2 percentage point downward revision relative to the September 2023 forecast.

The downward revision in part reflects slower-than-expected growth in early 2024 in central Europe and the Baltic states, in line with weak growth in Germany. Economic activity in the southern and eastern Mediterranean is expected to be weaker than previously projected on spillovers from the war in Gaza and structural challenges and slow reform progress in Egypt while intermediated trade in Central Asia appears to have levelled off and is expected to make a more modest contribution to future growth.

Growth is expected to pick up further in 2025, to 3.6 per cent.

Chart 29. Output in the EBRD regions is expected to grow by 3 per cent in 2024 and 3.6 per cent in 2025



Source: National authorities via CEIC and EBRD forecasts.

Note: EBRD average based on the values of gross domestic product in 2022 in current US dollars from the IMF. Quarter 1 value in 2024 is based on the output of the nowcasting model taking into account various concurrent economic indicators.

The outlook is subject to significant risks, first and foremost related to further escalation of geopolitical tensions and the conflict in the Middle East. Although the rapidly shifting patterns of trade and investment relationships that accompany geopolitical fragmentation may create opportunities for individual economies, on a global scale such geopolitical fragmentation is a source of inefficiencies and increased volatility (see, for instance, the discussion in Javorcik et al., 2024).

In addition, hotter and more volatile weather may cause increasing damage to housing stocks and infrastructure as witnessed by the spring floods in Kazakhstan and Russia, the heaviest in the region in the last 80 years. Extreme weather may also affect harvests and push up global food prices—an important risk in particular for food importers in the southern and eastern Mediterranean.

Regional outlooks

In **central Europe and the Baltic states** growth is expected to accelerate from 0.1 per cent in 2023 to 2.2 per cent in 2024 and 3.1 per cent in 2025, though growth in a number of economies has been revised down since September 2023 on weak economic activity indicators in recent months. Growth in the **south-eastern EU** is projected to pick up from 2 per cent in 2023 to 2.8 per cent in 2024 and 3.1 per cent in 2025, supported by accommodative fiscal stances and robust real wage growth. Likewise, growth in the **Western Balkans** is expected to pick up from 2.5 per cent in 2023, to 3.3 per cent in 2024 and 3.7 per cent in 2025.

Growth in **Central Asia** is forecast to moderate from 5.7 per cent in 2023 to 5.4 per cent in 2024 as intermediated trade with Russia appears to have reached a plateau while spring floods weigh on Kazakhstan’s growth prospects. Growth is expected to pick up to 5.9 per cent in 2025.

In the **Caucasus**, growth is expected to pick up from 3.8 per cent in 2023 to 4.1 per cent growth in 2024 before moderating closer to 3.5 per cent in 2025, a level in line with estimates of medium-term potential growth. A record harvest supported growth in **Ukraine** in 2023, but significant recent damage to electricity infrastructure is expected to hold back growth in 2024.

While price pressures remain stubbornly high in **Turkiye** (inflation stood at 69 per cent in March 2024), much tighter credit conditions (with the policy rate raised to 50 per cent in March 2024), combined with a weaker lira, have caused the external balance to improve as domestic demand growth slowed in the second half of 2023. Growth is expected to slow from 4.5 per cent in 2023 to 2.7 per cent in 2024 before picking up to 3 per cent in 2025 on expectations of a more restrictive monetary and fiscal policy stance in the face of persistently high inflation.

Growth in the **southern and eastern Mediterranean** is expected to accelerate from 2.7 per cent in 2023 to 3.4 per cent in 2024 and 3.9 per cent in 2025. This represents a downward

revision on the previous forecast for 2024 owing to slower-than-expected implementation of large public investment projects in Egypt and spillovers from the war in Gaza. While the impact of the war on government yields in Egypt and Jordan proved short-lived, the negative effect on tourist arrivals in Jordan and Lebanon may prove more lasting.

The war in Gaza has inflicted damages estimated in excess of US\$ 18 billion and left 70 per cent of houses destroyed. GDP for the West Bank and Gaza is estimated to have contracted by at least 5 per cent in 2023 and will likely drop further as the war continues.

Attacks on commercial shipping through the Suez canal by Houthi militants in Yemen created headwinds for global trade. Around 20 per cent of global container volume and 8 to 10 per cent of seaborne trade, LNG and tanker oil pass through the canal. As major shipment companies reroute traffic (adding a week to an average voyage), this also reduces Egypt's external revenues (canal fees totalled US\$ 9.4 billion in the last fiscal year, or 2 per cent of GDP).

In **Russia**, a 1.2 per cent contraction in output in 2022 was followed by a 3.6 per cent growth in 2023, as defence-related manufacturing boom underpinned a stronger-than-anticipated recovery. The recovery was facilitated by increasing trade with China and other neutral economies. Inflation has been running high reflecting labour shortages and the fiscal stimulus ahead of the March 2024 elections. As the economy is back to above pre-war levels, growth is expected to slow down in 2024.

Box 1. Inflation expectations in low- and high-inflation environments

This box examines inflation expectations in Emerging Europe in both low- and high-inflation environments. The results suggest that most people over-estimate inflation one year ahead, with expectations most closely correlated with food inflation at the time of the survey. Individual characteristics matter less for inflation expectations at times of high inflation, but trust in central banks is consistently associated with lower expected inflation.

Inflation expectations can feed into actual inflation as individuals, firms and investors adjust their behaviours according to their own beliefs. Inflation expectations can, in turn, be affected by the experiences of past and present inflation (in line with the literature on the scarring effect of economic shocks on expectations, see, for instance, Galati, Peolhekke and Zhou, 2018 and Koczan and Plekhanov, 2023). A better understanding of individual inflation expectations may thus help policy makers develop tools to limit inflation spirals and strengthen monetary policy frameworks.

This box studies inflation expectations in nine Emerging European economies using the OeNB Euro Survey, conducted by the Austrian National Bank (see also Allinger and Rumler, 2023). Inflation expectations are measured using the standard question "How much higher (lower) than now do you think prices in general will be in 12 months in [your country]?". The surveys examined here were administered in the third quarters of 2020 and 2022 to approximately 1,000 randomly selected individuals in each of the following 9 economies: Bosnia and Herzegovina, Bulgaria, Croatia, Czechia, Hungary, North Macedonia, Poland, Romania and Serbia.

While most earlier studies on inflation expectations focused on periods of low inflation, which may not be generalisable to more uncertain times, the following analysis looks at expectations in both 2020, when inflation in these economies

averaged 1.7 per cent, and 2022, when inflation rose to 13.5 per cent on average.

The results suggest that in both low- and high-inflation environments, average expectations in these economies considerably over-estimate future inflation.

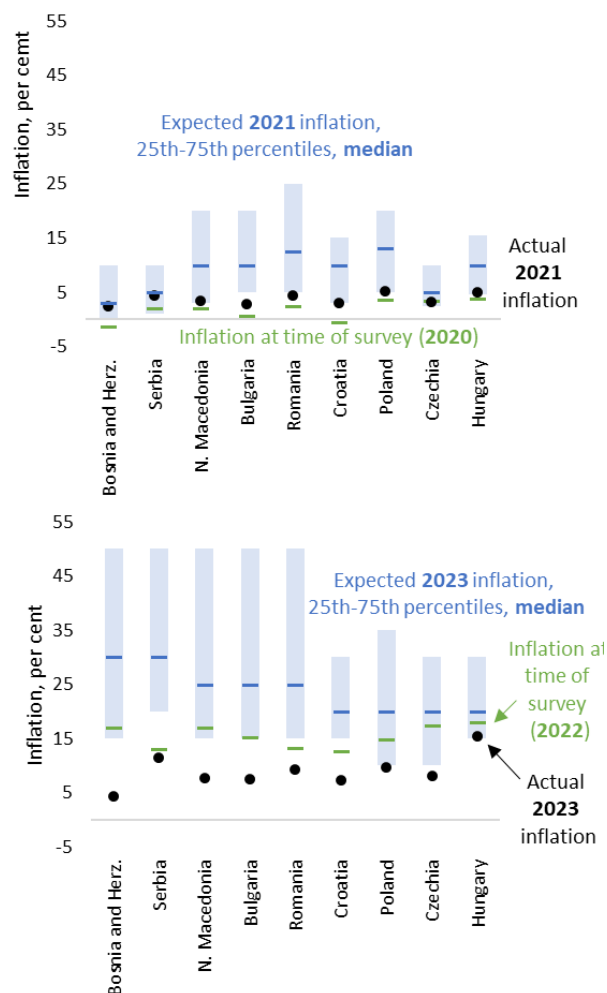
In 2020, median inflation expectations ranged from 3 to 13 per cent, the 25th percentile was around 0 to 5 per cent while realised inflation in 2021 was around -1 to 4 per cent. In 2022, median inflation expectations ranged from 20 to 30 per cent, the 25th percentile was around 10 to 20 per cent while realised inflation in 2023 was around 13 to 18 per cent.

In other words, realised inflation in 2023 was typically below the 25th percentile of the distribution of expectations as of the third quarter of 2022 (see Chart 1.1).

In both and low- and high-inflation environments, inflation expectations tracked food inflation at the time of the survey more closely than headline inflation at the time of the survey or realised (future) inflation (see Chart 1.2). This probably reflects the fact that witnessing food inflation is a daily or weekly experience for all, while other important components of the spending basket such as accommodation get repriced infrequently and for subsets of the population at a time.

Women, older respondents, those in lower income households and the unemployed had higher inflation expectations in 2020, likely reflecting both higher exposure to prices (as, for instance, women are more likely to be buying groceries) as well as higher vulnerability to increases in the cost of living. Education and financial literacy were not correlated with expectations in either year.

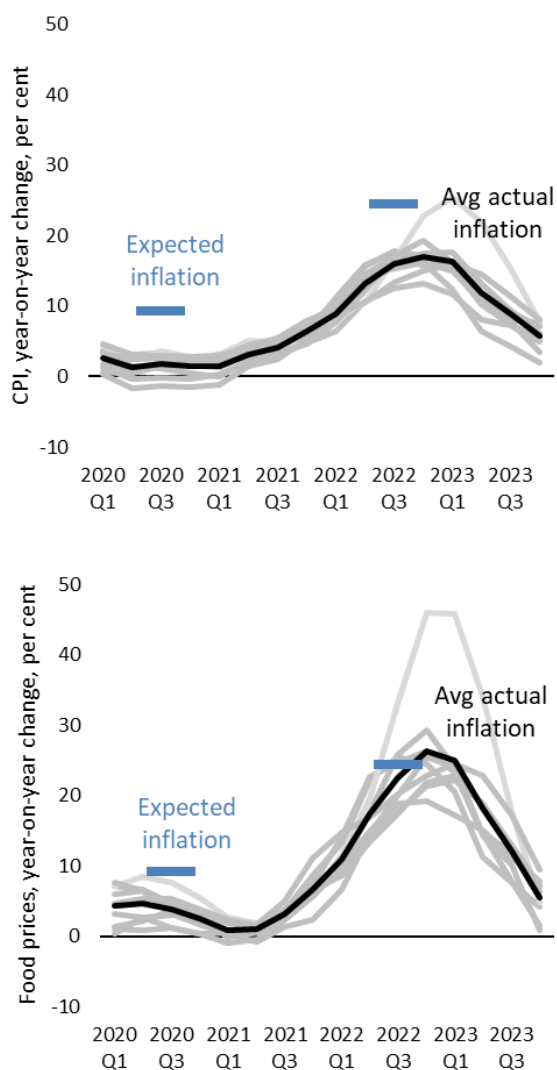
Chart 1.1 Most survey respondents in Emerging Europe over-estimate future inflation



Source: OeNB Euro Survey and authors' calculations.
Note: Year-on-year inflation.

In both low- and high-inflation environments, people with more trust in the central bank had lower inflation expectations. In 2020, the effect of higher trust in the central bank was as important for expectations as being unemployed. And while inflation expectations in 2022 were less correlated with individual characteristics than in 2020, the correlation with trust in the central bank was higher.

Chart 1.2 Inflation expectations match food inflation at the time of the survey more closely than overall inflation



Source: OeNB Euro Survey and authors' calculations.
 Note: Year-on-year inflation. Simple averages across 9 economies.

Box 2. Strong growth performance in the Caucasus and Central Asia

The Caucasus and Central Asia experienced rapid growth in 2022 and 2023. Drawing on Livny, Lim and Mamatova (2024), this box discusses how rapid IT sector development, the growth of export-oriented manufacturing and boom in the financial sector since the start of the war on Ukraine have contributed to the region's overall economic performance.

The Caucasus and Central Asia (CCA) experienced rapid growth in 2022 and 2023 despite limited, if any, support from rising commodity prices. As elsewhere, in part this reflected a post-pandemic rebound. Growing intermediated trade played an important role (as discussed in this *Regional Economic Prospects* and highlighted by Chupilkin, Javorcik and Plekhanov, 2023).

At the same time, strong economic performance was also supported by rapid IT sector development, the growth of export-oriented manufacturing and a boom in the financial sector.

Boost to services

The Caucasus and Central Asia received major inflows of money, businesses and people. More than 1 million individuals, including highly skilled professionals, are estimated to have left Russia in the past two years (estimates of emigration vary considerably). Many chose to relocate to the Caucasus and Central Asia, taking advantage of linguistic and cultural proximity and the relative ease of gaining residence and opening bank accounts. The smaller CCA countries, in particular, saw larger increases in the share of Russian migrants relative to their overall populations, with new arrivals in 2022 accounting, for instance, for 3 per cent of Georgia's population and 2.5 per cent of Armenia's.

Given the high purchasing power of Russian migrants ("relocant"), all CCA economies experienced strong demand-driven growth in service-oriented activities, such as real-estate, hospitality, logistics, financial and insurance services. For example, in Uzbekistan, the trade

and hospitality sectors grew by 10 and 12 per cent respectively in 2023 (year on year).

High growth in ICT sectors

Russian *relocants* include large numbers of entrepreneurs, as well as experienced IT and creative industry personnel. For instance, Georgia is estimated to have received more than 20,000 Russian tech professionals and more than 21,000 legal entities (firms) were established by Russian entrepreneurs between March 2022 and July 2023.

Kazakhstan has seen a doubling in the number of entities with Russian participation (19,000 firms as of October 2023 compared with around 8,000 in 2021), driven by a fivefold increase in ICT businesses. Armenia has seen a doubling in the number of ICT sector employees in 2022, with some multinational corporations, such as Nvidia, moving whole teams from Russia and opening research and development centres in Yerevan. Though some Russian entrepreneurs may have since left the region, the number of Russian businesses remains well above pre-war levels.

CCA economies introduced comprehensive “absorption” packages targeted at these professionals, including generous tax benefits, streamlined work permitting procedures and relocation support for companies and individuals registered with specially designated economic zones, such as the Astana Hub in Kazakhstan, Uzbekistan’s IT Park and the Kyrgyz Republic’s High Technology Park.

In many cases, these programmes built on existing ICT sector development policies. For example, Armenia’s IT companies have benefitted from simplified registration processes and significant tax breaks since 2015.

As a result, the ICT sectors have been developing rapidly. For instance, the Kyrgyz Republic’s High Technology Park’s revenues increased by 70 per cent between 2022 and 2023 (95 per cent of its revenue come from ICT exports). The number of (local and foreign) companies registered with the park increased from 228 in 2022 to 383 in 2023.

The High Technology Park receives no government support, provides a unique bottom-up governance structure for export-oriented ICT companies and is fully funded by contributions from registered companies (set at 1 per cent of export revenue). Inspired by this success, a sister programme, the Creative Industries Park was established in late 2023. The Kyrgyz Republic’s “digital nomad” initiative also enables ICT developers who are Eurasian Economic Union citizens to reside and work in the country without the need for additional permits.

IT exports by Uzbekistan’s IT Park increased 2.4-fold relative to 2022, while Astana Hub’s IT exports increased by 84 per cent year on year in 2023. With significant real estate at its disposal, Uzbekistan’s IT Park introduced a new “Zero Risk” programme granting participating companies free office space for 1 year, assistance with office equipment, and partial reimbursement of local personnel salary and training costs (effectively amounting to a negative income tax).

Growth of export-oriented manufacturing

As major international brands exited the Russian market, other exporters saw an opportunity to start or scale up exports to Russia. For instance, the Kyrgyz textile sector grew by 42 per cent year on year in 2022, with textile exports accounting for 45 per cent of the country’s total exports to Russia. The sector’s share in industrial production increased from 2 to 3.4 per cent between 2021 and 2023. Anecdotal evidence suggests that textile producers and wholesale traders at Dordoi (the largest wholesale and retail market in Central Asia) experienced a tripling of sales over previous years (which may also reflect growing intermediated trade).

Supported by rapidly growing demand, salaries in the textile sector have doubled, incentivising companies to expanding production in the country’s most remote and poorest regions.

The increase in sales was facilitated by integration with Russian online marketplaces. For example, Wildberries, Russia’s largest online marketplace,

recorded a 2.4-fold increase in the number of registered Kyrgyz sellers in 2022. Individual entrepreneurs and SMEs gained the most, as their share in Kyrgyz exports increased from 27 per cent in 2021 to 66 per cent in 2022 (and their contribution to GDP went up from 39 to 43 per cent, though this also reflects the decline in gold exports over this period).

The Kyrgyz Republic's output of food, tobacco and beverages also increased by 42 per cent year on year in 2022, and by another 16 per cent in 2023; the sector's share in industrial production increased from 12 to 15 per cent between 2021 and 2023. For instance, substituting for Italian produce, Kyrgyz exports of pasta to Russia increased by 95 per cent year on year in 2022 before falling by 13 per cent in 2023 (Italy's exports of pasta to Russia more than halved between 2021 and 2023 in nominal value terms according to UN Comtrade data).

Financial sector development

During the past two years, the CCA region has seen an unprecedented surge in money transfers from Russia. In part, these inflows represent remittances from CCA citizens in Russia, and in part money transfers by Russian citizens to their newly opened bank accounts in the CCA countries. The latter option has given Russian citizens access to international payment systems and a safe haven for their savings. Given the relative ease of opening bank accounts in the region, around 500,000 bank accounts have been opened by Russian visitors and migrants to Kazakhstan since the start of the war, while 100,000 have been opened in Georgia.

Money transfers have waned since the beginning of 2023, as Russian migrants have likely depleted their savings and commercial banks in the recipient countries have strengthened their compliance practices and increased the cost of banking services for non-residents. Some migrants have also returned to Russia or relocated to third countries.

In the Kyrgyz Republic, where money transfers from Russia accounted for almost 16 per cent of GDP in 2022, the value added embedded in financial services posted a staggering 15-fold increase, increasing their share of GDP from 0.9 per cent in 2021 to 6.2 per cent in 2022, primarily on account of a surge in transfer and currency conversion fees. Interest income also increased supported by the abundance of cheap funding and an increase in high-margin consumer lending.

On the back of money transfers from abroad, Armenia, Georgia and the Kyrgyz Republic, which received most immigrants relative to their populations, saw their banking-sector deposits grow by about 60-70 per cent relative to the 2021 average (compared with 5 per cent growth in Kazakhstan). However, with Russian migrants returning home or moving to third countries, deposits started to decline.

Supportive policies

Growth was also supported by a number of structural reforms in the area of tax and tariffs, scaled up efforts to clamp down on organized crime, corruption and informality, as well as targeted support to agriculture, digital and creative industries and manufacturing in rural areas. Countries in Central Asia have also achieved significant progress in delineating and demarcating long-disputed borders thus strengthening regional cooperation.

To leverage the growth momentum of the last two years further, CCA economies could consider easing immigration regimes further for highly skilled migrants. Liberalisation of migration and business relocation regimes could help with the retention of Russian talent while also facilitating the entry of businesses and arrival of professionals from countries further afield, including from the EU and other advanced economies.

Horizontal measures addressing bottlenecks in access to finance, inefficiencies in tax administration and the regulatory environment

could further help retain and attract foreign capital and entrepreneurial talent. Given the large share of ICT-reliant businesses and digital nomads among relocating companies, special attention should be paid to improving access to reliable broadband internet, particularly outside capital cities.

IT and creative industry parks could be extended further. Most CCA countries, including Armenia, Georgia, Kazakhstan, the Kyrgyz Republic and Uzbekistan, already provide incoming IT personnel and entrepreneurs with targeted benefits, including relocation support, a special tax regime, access to office space and infrastructure.

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Regional updates

Central Asia

Central Asian economies continued on a path of robust post-Covid recovery, aided by a wave of money, businesses and high-quality human capital from Russia and strong demand for key export commodities. Importantly, the opportunistic spike in Central Asia's intermediated trade has been accompanied by sizeable publicly and privately financed investment in transport, logistics and export-oriented manufacturing capacities (see Box 2). Robust growth in wages and real incomes, coupled with a surge in international arrivals and tourism, created a consumption boom, further supported by technological advances in consumer lending (despite elevated interest rates). An increasing tax intake coupled with efforts to clamp down on high-level corruption and improve tax and customs administration provided governments with the wherewithal to finance social programmes and infrastructure spending. Lastly, intra-regional trade, investment and tourism continued to rise, fuelled by deepening regional cooperation, reflected in the demarcation of certain long-disputed borders. Despite mounting demand-side pressures, inflation receded to single-digit levels in all countries in line with broader global trends, allowing central banks in most Central Asian countries to start softening their monetary policy stances. While extreme weather events in Kazakhstan and Mongolia that occurred in early 2024 may adversely affect growth performance of these countries in the short term, the region's outlook for both 2024 and 2025 is positive. Improving infrastructure, public management practices and human capital as well as politically sensitive tariff reforms, and efforts to reach a broad regional agreement on the use of shared resources, such as transport, water and energy, are likely to dominate the region's public policy agendas in 2024-2025.

Kazakhstan

Real GDP added 5.1 per cent in 2023 on the strength of robust domestic demand, despite a 7 per cent decline in exports. Throughout 2023, the labour market was unprecedentedly strong with unemployment falling to historic lows (4.7 per cent) and wages increasing by 5.3 per cent year on year in real terms in the last quarter of 2023 (on top of significant increases achieved in previous years). Retail and wholesale trade were the main growth drivers, supported by strong growth in wages and consumer lending (the latter up 34.2 per cent in 2023). The trade sector as a whole grew by 11.3 per cent, contributing 1.9 percentage points to GDP growth. Government expenditure in 2023 rose by 24.3 per cent, mainly financed by a substantial increase in non-oil revenues (personal income and social taxes, VAT and SOE dividends). While oil export revenues declined on lower prices, exports to Eurasian Economic Union countries provided a boost for non-oil activities. The economy slowed down slightly in the first quarter of 2024, growing by 4.7 per cent year on year, supported by expansion in construction (up 15.9 per cent year on year), communication (up 9.3 per cent) and transport and warehousing (up 9.5 per cent). With inflationary pressures receding, the National Bank of Kazakhstan started to gradually reduce the policy rate from the peak of 16.75 to the current 14.75 per cent. However, at 9.1 per cent in March 2024, the annual consumer price index still exceeded the central bank's target rate. The Tenge gained 1.6 per cent against the US dollar in 2023, and continued appreciating in 2024 (+1.3 per cent, as of mid-April 2024), supported by foreign exchange sales from the National Fund. Real GDP is forecast to grow by 4.5 per cent in 2024. Downside risks to the outlook relate to severe floods hitting Kazakhstan's regions in late-March-April 2024. While elevated government spending will soften their negative impact on aggregate demand, the floods' full impact is yet to be felt. In 2025, economic growth will likely accelerate on account of higher oil production and potential privatisations.

Kyrgyz Republic

The Kyrgyz Republic has been the main beneficiary of the surge in intermediated trade as well as money transfers, relocation of businesses and highly skilled individuals from Russia. In 2023, exports rose by 46.7 per cent, excluding very sizeable re-exports of motor vehicles, which grew at an astonishing rate judging by imports data (up 4.5 times in volume and 5.1 times in value). The government's efforts to reduce the informal economy enabled a significant increase in budget revenues, boosting infrastructure and social spending. On top of that, in 2023, in response to growing external and domestic demand, manufacturing output in sectors other than metal products increased by almost 22 per cent, with textile and food processing being key drivers. Overall, real GDP grew by 6.2 per cent in 2023, despite a decline in production at the Kumtor gold mine. Growth has accelerated in the first months of 2024; the economy expanded by 8.8 per cent year on year in the first quarter of 2024, led by construction activities (up 53.8 per cent year on year, contributing 2.4 percentage points to overall growth). Remittances (up 40 per cent in January-February 2024) and credit growth (outstanding consumer loans were 68.6 per cent higher year on year in February 2024) supported domestic demand, boosting wholesale and retail trade (up 19.1 per cent in the first quarter of 2024). At 5.3 per cent in March 2024, inflation returned to the central bank's target range. The central bank nevertheless continues to maintain a cautious stance with the policy rate remaining at 13 per cent since November 2022. The economy is expected to grow by 8.5 per cent in 2024 and 7 per cent in 2025, driven by the resumption of gold exports, elevated remittances, a continued construction boom, and strong domestic demand. There are significant upside risks to the outlook related to progress with long-overdue institutional reforms, significant fixed capital investment (up 66.6 per cent year on year in the first quarter of 2024) coming to fruition and a further expansion in tourism. On the downside, the threat of secondary sanctions and Russia's recent

measures to reduce the number of intermediaries engaged in its imports may dampen growth rates.

Mongolia

In 2023, the economy grew by 7.0 per cent, supported by expansion in mining and quarrying and a revival of tourism. Agricultural output was flat, however, due to a period of extreme cold (dzud). Exports added 21.1 per cent (on vastly increased coal exports), while imports grew by just 6.3 per cent, helping Mongolia's balance of payment and international reserves (up almost 45 per cent year on year). The number of international visitors finally exceeded pre-pandemic levels, growing 2.6 times year on year, and driving demand in tourism-related goods and services, including cashmere products. The outlook for 2024, judging by first quarter data, appears to be mixed. On the positive side, industrial production added 13.6 per cent year on year, driven by a 14.6 per cent increase in mining and 9.9 per cent increase in manufacturing. An impressive uptick in tax revenues (up 52.3 per cent) enabled elevated government spending (up 37.6 per cent year on year), supporting domestic demand. On the negative side, an extremely severe dzud led to massive losses of adult livestock (up 6.6 times compared with the first quarter of 2023) and lower survival rates for young animals. As of February 2024, annual consumer price inflation was brought within the central bank's target range (4-8 per cent), standing at 7 per cent. The Bank of Mongolia decreased its policy rate from 13 to 12 per cent in March 2024, showing caution in light of potential inflationary pressures related to upcoming parliamentary elections. Economic growth is set to slow down in the short term due to a decline in agriculture. GDP is forecast to rise by 5 per cent in 2024, with growth accelerating to 8 per cent in 2025 on the back of favourable external demand conditions, increased output in agriculture and scaling up of manufacturing and mining activities. Oyu Tolgoi mine is expected to reach full potential and improvements in transportation are expected to support coal exports to China. The main downside risks relate to energy supply not

catching up with growing demand amid potential interruptions in fuel imports from Russia.

Tajikistan

Real GDP grew by 8.3 per cent in 2023, with particularly strong gains in mining (up 11.7 per cent), manufacturing (up 12.3 per cent), and agriculture (up 9 per cent). Exports added 14.6 per cent, driven by a 2.2-time increase in exports of gold and other precious metals and stones, while imports rose by 13.8 per cent. Domestic demand swelled on increased remittances, wages, international arrivals and credit (outstanding loans rose by 31 per cent in 2023, and 26 per cent year on year in January-February 2024). As a result, retail trade and hospitality activities grew by 15.4 and 17.2 per cent, respectively. Supported by an 18 per cent increase in tax revenues, vigorous public spending (up almost 13 per cent) contributed to a construction boom and fixed capital investment (up 22.5 per cent). The economy continued growing in January-February 2024, as industrial production added 9.6 per cent year on year, led by significant gains in mining (up 31.2 per cent year on year). Fixed capital investment expanded by a further 43.2 per cent year on year with more than half of this investment allocated to electricity production and transmission related to the ongoing construction of Roghun power plant. Tajikistan maintains the lowest inflation in the region owing to tight monetary policy and food price controls. Annual consumer price inflation stood at 3.8 per cent in December 2023, further declining to 3.6 per cent in March 2024, prompting a reduction in the National Bank of Tajikistan's policy rate to 9.5 per cent in February 2024. Public debt declined from 30.8 per cent of GDP in 2022 to 26.9 per cent of GDP in 2023 thanks to strong output growth. Tajikistan's fiscal stance improved on the back of strong tax receipts (up 22.6 per cent year on year in January 2024) and international reserves reached the equivalent of seven months of imports in the first quarter of 2024. GDP is forecast to grow by 7.5 per cent in 2024 and 7 per cent in 2025 on the strength of public infrastructure investment,

policies stimulating private sector investment in import-substituting manufacturing and agriculture, and remittances growth. With agriculture accounting for 25 per cent of GDP and 60 per cent of employment, downside risks mainly relate to climate change and adverse weather conditions affecting agricultural productivity, as well as fluctuations in Russia's demand for Tajik labour. On the upside, ongoing efforts to consolidate agricultural holdings and develop value chains may help attract FDI, facilitating transition away from low-productivity smallholder agriculture.

Turkmenistan

In 2023, Turkmenistan's economy grew by 6.3 per cent year on year, despite a slight reduction in gas production and exports. Non-hydrocarbon output was supported by vigorous public spending on signature infrastructure projects, and policies stimulating private sector investment in agriculture and manufacturing. With domestic demand supported by a 10 per cent increase in public sector salaries, pensions, and social benefits (effective as of January 1, 2024), GDP rose by 6.3 per cent year on year in the first quarter of 2024 with the largest gains achieved in trade, services and transport sectors. Fixed capital investment continued to increase on major infrastructure projects, such as the 600 km Ashgabat-Turkmenabat motorway and Arkadag City. As global food and transportation prices normalized, inflation declined to low single-digit levels while a steady supply of foreign currency helped maintain the Manat's unofficial exchange rate at 19 - 19.5 Manat per US dollar. Turkmenistan maintained a strong fiscal stance: with, according to Fitch, sovereign net foreign assets (SNFA) reaching 51.5 per cent of GDP in 2023, well above the levels observed for peer economies. In the first quarter of 2024, government revenues exceeded planned amounts by 2.9 per cent. The economy is forecast to grow by 6.3 per cent in both 2024 and 2025, supported by elevated public and private investment, and partial diversification of gas exports, as reflected in recently discussed gas

supply contracts with Central Asian neighbours, Turkiye and Iran. On the upside, Turkmenistan's apparent interest in joining international trade corridors running through its territory could trigger investment in rail, road and sea transport infrastructure. In the same vein, Turkmenistan's recent decision to sign the Global Methane Pledge may enhance the country's appeal for international investors in renewables. On the downside, water scarcity aggravated by outdated infrastructure, inefficient management practices and climate change is a key risk for the country's agriculture and food security.

Uzbekistan

Real GDP increased by 6 per cent in 2023 as consumer spending soared due to growth in nominal wages (up 17.2 per cent), rapid credit expansion (outstanding loans went up almost 50 per cent in 2023, driven by digital advances in consumer lending), and rising remittances and international arrivals. Export revenues rose by 23.5 per cent thanks to high gold exports, strong tourism receipts and growing shipments of foodstuffs and manufactured products. Growth was balanced, with services, construction and industry adding 6.8, 6.4 and 6.0 per cent, respectively. The economy expanded by 6.2 per cent year on year in the first quarter of 2024. Fixed capital investment grew by 74.5 per cent year on year, part of it financed by Uzbekistan's Fund for Reconstruction and Development (UFRD). Subsidised loans accounted for 29.1 per cent of newly disbursed loans of UFRD in 2023. Due to government efforts to stimulate the economy, the budget deficit was 5.5 per cent of GDP in 2023 (above the planned deficit of 4 per cent). Given this deficit-financed fiscal stimulus, CPI inflation turned out to be stickier compared with regional peers, despite a hawkish monetary policy stance by the central bank. With the policy rate standing at 14 per cent, inflation has been hovering around 9 per cent since June 2023. The fiscal deficit may shrink in 2024 as tariff reforms are expected to cut energy subsidies, reducing public expenditures by an estimated 1.5 percentage points of GDP. The economy is

forecast to expand by 6.5 per cent in 2024 and 6 per cent in 2025, with strong contributions from fixed capital investment and net exports.

Privatisation and market-oriented reforms may strengthen the outlook by attracting foreign direct investment. On the downside, growth is likely to be constrained by chronic energy and water deficits.

Central Europe and the Baltic states

Central Europe and the Baltic states (CEB) was the weakest performing EBRD region in 2023, as economic growth averaged just 0.1 per cent. High inflation, tighter monetary policy, weak demand from western Europe and uncertainties related to the war on Ukraine all weighed on the growth of the economies in the region. De-stocking contributed to the drop in imports, which, along with lower energy prices, led to a lowering of trade deficits across the region, except in the Baltic states where the drop in exports was sharp. Tight labour markets, coupled with generous increases of minimum wages and disinflation, are expected to lead to a strong rebound in real wage growth, supporting consumption in 2024. Fiscal policy is forecast to be largely aligned with the EU fiscal rules, except for Hungary, Poland and the Slovak Republic, which could run significant deficits in the medium term. Growth will accelerate in 2024 and 2025 on the back of recovering consumption, EU-backed investments and slowly improving foreign demand.

Croatia

The economy continued to grow in 2023, with GDP expanding by 2.8 per cent, above most peers. Robust investments compensated for the deceleration in consumption caused by the spike in inflation. Inflation dropped swiftly and stabilised at 4.1 per cent throughout the first quarter of 2024. Real wage growth peaked in November 2023 and remained at around 9 per cent in the following two months, while the minimum wage was hiked by 20 per cent in 2024. Reflecting this, retail sales expanded strongly at the end of 2023, putting consumption on a recovery path in 2024.

Despite an uptick in the last quarter, unemployment reached record-low levels in 2023 amid worsening labour shortages. Industry had a bumpier 2023, reflected in the annual decline of goods exports after two years of stellar growth. The tourism sector performed well in 2023 as tourist arrivals increased by 10 per cent, but price increases in recent years translated into a 40 per cent revenue increase relative to pre-Covid levels. Croatia remains one of top performers in the implementation of the Recovery and Resilience Plan, while public accounts have been largely in balance in the past two years. GDP growth is expected to reach 2.9 per cent in 2024 and 2.8 per cent in 2025, driven by EU-funded investments and Croatia's further integration with EU markets.

Czechia

Czechia was among the most affected economies by the cost-of-living crisis, as GDP contracted by 0.3 per cent in 2023. Private consumption declined in annual terms for seven quarters in a row, although partial recovery occurred in the second half of 2023. This decline was mainly caused by the deep fall in real wages, the second largest reduction in the EU, as inflation averaged 12 per cent in 2023. The export deceleration relative to the robust outturn in 2022 was offset by lower imports, tied to significant destocking and lower energy prices. On a positive note, investment growth accelerated compared with 2023, and the trend is expected to continue in 2024. Moreover, with inflation declining to 2 per cent by early 2024, monetary easing has already started and is expected to continue gradually, improving financing conditions and supporting aggregate demand. The economy is expected to grow by 0.9 per cent in 2024 on the back of a modest rebound in both consumption and investment, but stagnating foreign demand remains a major source of risk to the outlook. In 2025, more favourable financing conditions are expected to boost growth towards 2.5 per cent.

Estonia

The economy contracted by 3 per cent in 2023, with almost no signs of improvement until the end of the year, marking two years of uninterrupted recession. In 2023, the decline was broad-based: net exports remained the biggest contributor in the second half of the year, but private consumption failed to respond to falling inflation and rising real wages amidst poor consumer confidence. Even the corporate investment recovery, which looked promising in the third quarter, was masked by the strong base effect of the large transport equipment purchases of late 2022. Over one percentage point of the decline of GDP in 2023 came from energy production (inefficient and shale-oil-based), though the transport and manufacturing sectors also weighed on growth. Overall, a gradual recovery is expected, with GDP growth of 0.8 per cent in 2024 and 3.5 per cent in 2025.

Hungary

The economy is slowly recovering from the real-income shock caused by a combination of the spike in inflation, an inventory glut and recession in Germany. Investment saw a significant annual decline of 7.4 per cent in 2023, adding to economic pressures. GDP fell by 0.9 per cent in 2023. Inflation dropped to 3.6 per cent by March 2024 from 25.2 per cent a year earlier, supporting a partial recovery of consumer confidence and building the case for further monetary easing. The government fiscal deficit has exceeded plans to reach 6.7 per cent of GDP, one of the highest in the EU, and there is a risk of a further fiscal slippage in 2024. The unemployment rate ticked up from 3.7 per cent at end-2022 to 4.3 per cent at end-2023. Real wage growth, boosted by public spending, strong construction and a passing inventory overhang are expected to pave the way for growth of 2.2 per cent in 2024 and 3.5 per cent in 2025.

Latvia

The economy stagnated in 2023, held back by weak net exports and private consumption which counterbalanced substantial increases in public spending. The initial reading from the fourth quarter of 2023 was at last more optimistic, as investment accelerated, while private consumption started recovering thanks to positive real wage dynamics. As in most EU countries, unemployment increased but, at 6.8 per cent in the last quarter of 2023, it remains low compared with previous slowdown episodes. The impact of the marginally weaker labour market was counterbalanced by the massive, 24 per cent increase in minimum wage in 2023, followed by another 13 per cent increase in 2024. GDP growth of 1.8 per cent is expected in 2024, rising to 2.6 per cent in 2025, but recovery prospects hinge crucially on ambitious public investment plans, co-financed by EU funds.

Lithuania

The economy contracted by 0.3 per cent in 2023. A 12 per cent investment expansion, driven by infrastructure and energy outlays financed by the Recovery and Resilience Facility, offset steeper declines in consumption and net exports. Judging by the government's budgetary plans and the EU funds cycle, public investment is likely to remain strong in 2024. Total employment in the economy is close to an all-time high as substantial immigration in recent years increased the labour supply. Inflation, which had reached record levels, fell steadily during 2023, supporting real income growth by the end of the year. This translated into growing consumer confidence in 2024. Growth is expected to reach 1.5 per cent in 2024, picking up to 2.3 per cent in 2025.

Poland

The economy stagnated in 2023, on the back of a drop in private consumption and heavy de-stocking. On the upside, investment and net exports had positive contributions to growth, as imports dropped more than exports. Rapid

disinflation meant that the inflation rate fell below the central bank's target by March 2024, resulting in a recovery of real wages. Additionally, the minimum wage was hiked by 20.5 per cent in 2024, supporting a potential consumption-led recovery, early evidence of which is seen in the recovery of retail sales in early 2024. Relatively loose fiscal policy, combined with declining inflation, is expected to support further growth in domestic demand, resulting in an acceleration of GDP growth to 2.9 per cent in 2024. Additionally, the EU-funded investment cycle, strengthened by disbursements under the Recovery and Resilience Facility (RRF), is forecast to support public investment. Downside risks come from a possible resurgence in inflation and increasing dependence on external financing. In 2025, growth is expected to reach 3.5 per cent, moving closer to estimates of long-term potential growth.

Slovak Republic

GDP grew by 1.6 per cent in 2023 as inflation came down on declining commodity prices and tighter monetary policy. Wage growth is anticipated to surpass inflation, enhancing household purchasing power, and consumption is expected to strengthen in the latter half of 2024. However, foreign demand remains weak. GDP growth is expected to reach 1.8 per cent in 2024, picking up to 2.7 per cent in 2025. The labour market is predicted to stay robust, with employment declines from early retirements offset by new entrants into the labour market including foreign arrivals. Fiscal consolidation poses a risk to economic growth, while upside risks to inflation remain, particularly related to energy prices and an increase in excise duties.

Slovenia

GDP growth slowed further in 2023, to 1.6 per cent, owing to a deceleration in private consumption growth and weak foreign demand. Nevertheless, a sharper drop in imports resulted in a strong increase in the trade surplus, while investments expanded by almost 10 per cent year on year. Inflation dropped to 3.3 per cent by

January 2024 before inching up in March, as real wage growth amid labour shortages and strong demand for services pushed prices up. After eleven months of annual declines, industrial production growth turned positive in February 2024, suggesting improved momentum in manufacturing. Nonetheless, consumer spending is yet to return to its 2022 level. Post-flood reconstruction should boost investment this year after a slow start in 2023 resulted in a better-than-expected fiscal outturn. GDP growth is forecast to reach 2.3 per cent in 2024 and 2.6 per cent in 2025, supported by recovering foreign demand.

Eastern Europe and the Caucasus

Economic performance varied widely across the economies of eastern Europe and the Caucasus in 2023 amid a challenging environment, but solid growth is expected in 2024 in all five economies. While Armenia, Georgia and Ukraine will likely see moderation of GDP growth from the high levels achieved last year, growth rates in Azerbaijan and Moldova are expected to accelerate from a low base. Disinflation policies across the region have succeeded in bringing inflation below targeted levels. In 2025, the economies in the Caucasus are likely to experience further moderation with growth rates closer to the estimates of long-term potential levels, while further recovery is expected in Moldova and Ukraine. Risks related to the war on Ukraine remain high.

Armenia

The economy continued to perform well in 2023. GDP increased by 8.7 per cent on the back of buoyant export demand and double-digit growth of construction, hospitality, and information and communication services. Net capital inflows in 2023 declined by almost 40 per cent compared with 2022 but remained substantially higher than in 2021. As the surplus in exports of services offset the deepening deficit in the trade of goods, the current account returned to a deficit of 2.1 per cent of GDP. Public finances improved in 2023

due to prolonged, robust economic growth and improved management of public finances. This enabled a budget response to support refugees in the last quarter of 2023. Inflation mostly stayed close to zero during the year and enabled a cautious reduction in the policy rate by the central bank. A gradual slowdown of economic growth towards the estimated medium-term potential is under way, with GDP growth of 6.2 per cent expected in 2024, with a further moderation to 4.8 per cent in 2025. Elevated public expenditures aimed at easing the integration of refugees will support growth. Risks to economic outlook mostly arise from geopolitical uncertainty.

Azerbaijan

GDP growth slowed to 1.1 per cent in 2023. The oil and gas sector shrank by 1.7 per cent, whereas the non-oil sector grew by 3.7 per cent, significantly more slowly than in 2022. The moderation of energy prices has contributed to a decline in oil and gas export revenues of around 40 per cent in 2023. However, the current account surplus remained at a comfortable level. Annual inflation fell to 0.4 per cent in March 2024 and successful disinflation enabled the Central Bank of Azerbaijan to reduce the policy rate to 7.5 per cent in March 2024. Economic growth has been strengthening since mid-2023 through the first quarter of 2024. Energy exports will drive short-term growth despite dwindling oil output. Gas production has been rising steadily amidst growing European demand for Azerbaijan's oil and gas. Government spending and public investment for the development of regained territory is expected to increase. GDP growth in 2024 is forecast to rise to 3.1 per cent in 2024 before moderating to 2.7 per cent in 2025. Main risks arise from the vulnerability of the economy to fluctuations in oil prices and geopolitical fragility.

Georgia

Economic growth moderated to 7.5 per cent in 2023 after two years of double-digit expansion. It was largely driven by construction, trade, IT services, tourism and transportation. In 2023, growth of exports and imports moderated to 9.1

and 14.9 per cent, respectively, from the extraordinary levels of growth achieved in the previous year. The tourism sector has fully recovered, benefiting from rising arrivals from neighbouring countries, the EU and Gulf countries. Income generated by foreign travellers was up 17.3 per cent year on year in 2023, exceeding the pre-pandemic level by one quarter. Net capital inflows were short of the record levels of 2022 but remained comfortably above 2021 values, declining by only 6.4 per cent in 2023. Several years of robust economic growth have stabilised public finances and reduced the level of public debt to below 40 per cent of GDP. Inflation was brought down in the early months of 2023 and remained low thereafter. This allowed the National Bank of Georgia to start with a cautious loosening of monetary policy. GDP growth is forecast to moderate to 5.2 per cent in 2024 and 4.6 per cent in 2025. The main risks arise from geopolitical instability in the region and domestic political polarisation. Potential progress concerning the country's EU candidate status, in contrast, could create a more stable environment and stimulate growth-supporting reforms.

Moldova

Moldova continues to struggle with the fallout from the war on Ukraine. GDP recorded a growth of 0.7 per cent in 2023, following a decline of 4.6 per cent in 2022. Output in the agricultural sector rebounded by 32 per cent in 2023 after a similar decline a year earlier, whilst manufacturing, construction, transport and trade continued to struggle. Private consumption and investment contracted further, while net exports expanded by 5.8 per cent. Inflation, which peaked at 34.6 per cent in October 2022, gradually slowed to be within the targeted level of 3.5 to 6.5 per cent by the end of 2023. It stood at 4.3 per cent in February 2024. Successful disinflation allowed the National Bank of Moldova to reduce the policy rate from 21.5 per cent in August 2022 to 3.75 per cent in March 2024. Fiscal pressures intensified as the authorities reinforced social safety nets, including for a substantial number of Ukrainian refugees, and introduced energy

subsidies for low-income households and rural agricultural producers, resulting in an estimated fiscal deficit of 5.0 per cent of GDP in 2023. External financing from official creditors, amounting to around US\$ 900 million in 2023, helped alleviate the pressure from the rising fiscal and external deficits. The IMF approved the fourth review under the ECF/EFF programme, releasing a tranche of US\$ 95 million, and extended the programme until October 2025. GDP is expected to grow by 3.5 per cent in 2024 and 3.7 per cent in 2025. EU accession reforms could increase growth potential in the medium to long term, while geopolitical instability remains an important downside risk.

Ukraine

The economy grew by an estimated 5.3 per cent in 2023, from a low base. Increased defence spending supported domestic demand while net exports continued to decline. The authorities managed to restore electricity supply and businesses have shown remarkable resilience and adaptability. Timely external financing helped stabilise macroeconomic conditions and reduce inflation to the targeted level. In March 2023, the IMF approved a 48-month extended arrangement under the Extended Fund Facility (EFF) for an equivalent of US\$ 15.6 billion. Three reviews have been successfully completed, with the latest one approved by the IMF Board in March 2024. Ukraine received a total of US\$ 42.5 billion from donors and international organisations in 2023, of which US\$ 12 billion in grants. This lifted official foreign reserves to record levels as public debt surged to close to 90 per cent of GDP. The prospect of a prolonged war of attrition and renewed doubts about external financing raise new challenges. Limited domestic demand, labour shortages and insufficient investments will likely constrain growth prospects. On the positive side, the Black Sea export corridor along the coastline has been opened. After a slow start, its usage has been picking up, not only for grain but also for other bulk goods like metals and ores, boosting the metal industry and mining which were among the hardest hit industries over the last two years.

A recovery of exports and the expansion of domestic military production will likely generate economic growth of 3 per cent in 2024 accelerating to 6 per cent in 2025. Risks remain high, in particular related to the recent and ongoing destruction of port and electricity infrastructure.

South-eastern EU

Economies in the south-eastern EU have seen a significant deceleration of growth in 2023 but still grew at a higher rate than most EU peers, reflecting robust consumption. Moreover, investment trends remain positive and the availability of substantial EU funds in the coming years is expected to be an important driver of short- and medium-term growth, alongside strong wage growth.

Bulgaria

GDP growth slowed to 1.8 per cent in 2023 amid subdued foreign demand and lower contributions from industry and services while private consumption expanded by 5.4 per cent. Strong wage growth and declining inflation, which stood at 3.1 per cent as of March 2024, translated into relatively high real wage growth in 2023, while the minimum wage was hiked further, by almost 20 per cent in 2024. Investment growth accelerated in the second half of 2023, but the ongoing political crisis poses risks to the public investment outlook and EU funds absorption. Weaker EU demand led to a 1.9 per cent decline in exports in 2023 (in real terms), offset by a stronger fall of imports. In nominal terms, exports to European economies outside the EU, including Ukraine, declined by almost 20 per cent in 2023 reflecting lower export prices of fuel and electricity. GDP growth in 2024 is to reach 2.6 per cent in 2024 and 3 per cent in 2025, supported by moderating inflation and robust consumption, as well as slowly recovering foreign demand. Key downside risks to the forecast include further delays in EU funds absorption and reforms amid elevated political uncertainty.

Greece

Following a strong post-Covid recovery in 2021 and 2022, GDP grew by just 2 per cent in 2023, though still significantly outperforming the euro area average. Both private and public consumption grew by close to 2 per cent, gross fixed capital formation was up by 4 per cent, and exports of goods and services rose by 3.7 per cent, exceeding import growth (2.1 per cent). Tourist arrivals and receipts increased substantially in 2023, exceeding pre-Covid-19 levels. Confidence indicators also started moving in the right direction, while easing energy prices helped disinflation in 2023. Headline annual inflation was 3.5 per cent in the last quarter of 2023, having reached double-digit rates in 2022. In addition, Greece returned to investment grade credit rating during 2023 for three out of the four main ratings agencies. The budget recorded a primary surplus of 1.9 per cent of GDP in 2023 and the fiscal outlook is assessed to be in line with the provisions of the existing Stability and Growth Pact, reactivated as of 2024. Economic confidence is steadily improving, with the Purchasing Managers Index (PMI) on an upward trend in the first quarter of 2024 (56.9 in March 2024, the highest level since February 2022), and the Economic Sentiment Indicator (ESI) reaching a 7-month high (108.4 in March 2024). Both indicators remain at relatively high levels compared to the euro area. Good progress has been made in implementing projects funded by the Recovery and Resilience Facility (RRF), mitigating the downside risks coming from global and regional turbulence, as well as climate-related disasters. The overall short-term outlook therefore remains positive, with growth expected to pick up to 2.3 per cent in 2024 and 2.6 per cent in 2025. Key downside risks remain, associated with possible delays in deploying RRF funds and weaknesses in key export markets and tourism source countries.

Romania

Economic growth slowed down notably in 2023, to 2.1 per cent, although it was among the highest growth rates in the wider region. De-stocking contributed to the slowdown after years of inventory build-up. The easing of private consumption growth, caused by high inflation, was offset by stellar investment growth and government spending, bringing final domestic expenditure growth to the highest rate since 2018. Retail sales further accelerated at the start of 2024. Although inflation was the highest in the EU in March 2024 at 6.6 per cent, real wage growth remained elevated at around 7 per cent in early 2024. After a poor 2023, industrial production started recovering, with car production growing by 7 per cent year on year in the first quarter of this year. For the first time since 2016, net exports made a small positive contribution to growth. The main vulnerability remains the fiscal position, as the fiscal deficit worsened to 5.9 per cent of GDP in 2023 (cash basis). Public spending is expected to increase further on the back of public wage and pension hikes, supporting consumption but risking an even larger deficit in 2024. Considering stronger domestic demand and loose fiscal policy, translating into higher-for-longer inflation, monetary easing will likely be more modest than in regional peers in 2024. Growth in 2024 is expected to reach 3.2 per cent in 2024 and 3.4 per cent in 2025 as inflation moderates and financing conditions gradually ease. Painful fiscal consolidation from 2025 onwards and potential market pressures represent key downside risks to growth in the medium term.

Southern and eastern Mediterranean

The southern and eastern Mediterranean region has overall shown resilience in the face of the war in Gaza and rising regional political and security tensions over the past months, although Jordan has seen a drop in tourism and investment while Tunisia continued to struggle with financing constraints. The reduction in Suez Canal traffic revenues received by Egypt was more than

compensated by recent commitments from international partners, including an expanded IMF programme. More broadly, Morocco, Jordan and Egypt have all benefitted from support from the IMF and international donors, contributing to macroeconomic stabilisation. Inflation has moderated across the region (though in Egypt it remains above 30 per cent) and the region is broadly on track for fiscal consolidation in 2024, while aiming to maintain growth-enhancing investments and targeted social protection. The region's average growth rate is expected to pick up to 3.4 per cent in 2024 as economic stabilisation programmes and reforms start to pay off – although major downside risks remain related to potential escalation of tensions in the Middle East.

Egypt

Economic growth is expected to slow down from 3.8 per cent in fiscal year 2023 (ending June) to 3.0 per cent in fiscal year 2024 as foreign exchange shortages and reform uncertainty weigh on the economic outlook. Economic activity has been propped up by public spending as well as the tourism, construction and services sectors. Thanks to significant donor support and macroeconomic stabilisation under a revised IMF programme approved in March 2024, the outlook for the next fiscal year (2025) is more favourable, with growth expected to pick up to 4.0 per cent. The recent devaluation of the pound could reinvigorate foreign and domestic investment, especially if accompanied by structural reforms. Downside risks include high interest rates and persistently high inflation (expected to remain at 34 per cent in 2024) and further escalation of tensions in the Middle East endangering investor confidence, tourism and trade flows. On a calendar-year basis, growth is forecast at 3.9 per cent in 2024 and 4.4 per cent in 2025.

Jordan

Economic growth accelerated from 2.4 per cent in 2022 to 2.6 per cent in 2023 despite headwinds from the war in Gaza. Growth was led by strong performance of manufacturing, agriculture,

financial services and transport and a solid recovery in the tourism sector. Nonetheless, unemployment remained high at 21.4 per cent in the last quarter of 2023, it was higher among women (29.8 per cent) and youth (42.4 per cent). Meanwhile, inflation picked up slightly towards the end of the year, reflecting a rise in the prices of certain food staples and a planned increase in water tariffs, before easing to 1.6 per cent in March 2024. The Central Bank of Jordan continued to mirror the decisions of the US Federal Reserve, holding policy interest rate stable since July 2023 after a series of hikes (interest rates have increased by a cumulative 500 basis points since February 2022). Despite robust growth, spillovers from a prolonged war in Gaza are expected to lead to a deceleration in growth, to 2.4 per cent in 2024, reflecting lower tourist arrivals and suppressed investment inflows and consumers postponing large expenditures in times of increased uncertainty. A slight uptick in growth to 2.6 per cent is forecast in 2025, provided geopolitical conditions improve. Leveraging the country's medium-term growth potential will depend on the successful implementation of structural reforms under the government's Economic Modernisation Plan. Downside risks to the outlook include prospects of a wider regional escalation of conflict and delayed implementation of structural reforms.

Lebanon

The Lebanese economy was still unable to grow during 2023 on political deadlock, little progress on critical reforms and tensions in the south. GDP is estimated to have contracted by 0.2 per cent in 2023, adding to a cumulative loss in GDP of more than 40 per cent since 2018. In the meantime, the country remains locked out of international bond markets, and prospects of an IMF programme remain uncertain. Foreign exchange reserves, while still at a record low, edged up in 2023 on the back of increased remittances and tourist arrivals. In an attempt to unify the multiple exchange rates, Lebanon's Central Bank introduced several measures including phasing out the Sayrafa platform while the 2024 budget

law set the exchange rate closer to the black-market rate. Against this backdrop, the market rate has stabilised at around 89,700 pounds per US dollar since the end of August, and inflation dropped to 123 per cent in February 2024 from a peak of 352 per cent in March 2023, helped by easing energy and food price increases. Meanwhile, dire economic conditions and years of hyperinflation drove over 80 per cent of the population into poverty, with over a third of the labour force unemployed. GDP is expected to grow by 0.2 per cent in 2024, held back by geopolitical risks, political inaction and stalled reforms. Growth could accelerate to 3.0 per cent in 2025, provided regional tensions subside, an IMF programme is in place and implementation of reforms progresses.

Morocco

Following a slowdown in 2022, GDP growth picked up to 3.2 per cent in 2023, driven by the recovering agricultural sector (following a severe drought the previous year) and robust tourist receipts and growth in the transportation sector. The economy proved resilient in the face of the 6.8-magnitude earthquake, which caused widespread destruction around the High Atlas Mountains near Marrakech in September 2023. Despite additional expenditure related to the post-earthquake reconstruction and expanding targeted social protection spending, the government is pursuing a path of gradual fiscal consolidation, while leveraging domestic resource mobilisation. Unemployment edged up to 13.0 per cent by end 2023, while inflation eased to 0.3 per cent by February 2024. Growth is projected to reach 3.0 per cent in 2024, rising to 3.6 per cent in 2025, supported by a recovery in external demand and government investment. However, Morocco's high dependence on energy imports and seasonal agricultural production makes the economy vulnerable to climate risks.

Tunisia

Economic growth in Tunisia slowed down from 2.6 per cent in 2022 to 0.4 per cent in 2023, as a contraction in agriculture due to a drought and a

drop in phosphate sales were only partially offset by expanding tourism, financial services and industrial sectors. Against this backdrop, unemployment rose to 16.4 per cent in the last quarter of 2023 and inflation stood at 7.5 per cent in February 2024. Government finances remain constrained, the country was downgraded by several rating agencies, and access to external financing remained limited. Nonetheless, Tunisia repaid all outstanding external debt on time and continues to progress – albeit slowly – on key reforms, including gradual fiscal consolidation by containing the public sector wage bill and reforming certain subsidies. Thanks to reform efforts and continued fiscal consolidation growth is expected to pick up to around 1.9 per cent in 2024 and 2 per cent in 2025. Significant downside risks relate to limited fiscal space, a high external debt burden and the economy’s vulnerability to external shocks.

Turkiye

While Turkiye’s GDP growth slowed from 5.5 per cent in 2022 to 4.5 per cent in 2023, the economy performed better than was expected in September 2023. Growth last year was driven by the services sector (trade, logistics, tourism, financial services and government services) and reconstruction following the devastating earthquakes of February 2023. Private consumption remained strong, supported by the fiscal stimulus implemented in the first half of the year and rising wages. Ahead of the twin presidential and parliamentary elections in May 2023, the authorities hiked wages and pensions, cut taxes, increased subsidies, and introduced an early retirement scheme and government-backed guarantees and lending targets for banks, which spurred a credit boom. After the elections, economic policies were gradually tightened, with increases in taxes and tighter macroprudential policies. Starting in June 2023, the Central Bank of the Republic of Turkiye hiked the policy rate nine times, bringing it from 8.5 to 50 per cent. Nevertheless, inflationary pressures remain strong, with the year-on-year inflation rate averaging 53.9 per cent in 2023 and 66.8 per

cent in the first three months of 2024, well above the end-2024 inflation target of 36 per cent. The return to more orthodox economic policies helped improve confidence among domestic and international investors, as witnessed by the significant decline in Turkiye’s CDS premium since its peak in May 2023. Turkiye received its first sovereign rating upgrade from a major rating agency in over a decade. Going forward, the authorities will continue to face the difficult task of balancing growth and macroeconomic stability. Economic growth is expected to slow further in 2024, to 2.7 per cent before picking up to 3 per cent in 2025, as the tighter fiscal and monetary stance cools down the economy and private consumption growth weakens. Key downside risks to the outlook include high inflation, slower growth in Europe, the rise of geopolitical tensions in the region and tighter global financing conditions in the light of high short-term external financing needs. On the upside, faster implementation of much-needed structural reforms and commitment to orthodox monetary and fiscal policies could provide a boost to growth over the medium term.

Western Balkans

Growth in the Western Balkans slowed to 2.5 per cent in 2023 from 3.4 per cent in 2022 on still-high inflation holding back domestic demand and subdued external demand from the EU. In several economies, household consumption was supported by fiscal stimulus measures and rises in minimum wages. Growth is expected to pick up to 3.3 per cent in 2024 and 3.7 per cent in 2025, as inflation moderates and construction activity picks up throughout the region. IMF programmes helped to cover external financing needs and supported implementation of capital expenditure projects in Kosovo, North Macedonia and Serbia.

Albania

GDP growth was solid in 2023 at 3.4 per cent and is forecast to remain at a similar level (3.3 per cent) in 2024. Buoyant growth in tourism in the first two months of 2024 (41 per cent year on year) bodes well for another record season, boosting private consumption. Inflation continued to ease in the past year, reaching a two-year low

of 2.3 per cent in March 2024, and the authorities expect it to stay around the target band in 2024 and beyond. Monetary policy remained tight in the first quarter of 2024 and the Albanian lek stabilised in the first three months of 2024, after a year of appreciation against the euro. This may support exports of goods, which declined by almost 10 per cent in 2023. On the other hand, risks to growth arise from a possible drought negatively affecting agricultural output and electricity supply, with a significant downside risk to GDP given the relatively large contribution of agriculture (still close to 20 per cent) and the high share of hydropower in electricity generation (99 per cent of net domestic production). A further increase in growth is forecast in 2025, to 3.5 per cent, in line with the expected global recovery.

Bosnia and Herzegovina

The economy grew at 1.7 per cent in 2023 amid global and domestic political uncertainty. The weak growth impetus has continued into 2024, with industrial production declining in the first two months. On the other hand, tourism and retail trade are growing, boosted by lower inflation. Goods imports increased in the first two months of 2024, as a result of elevated domestic demand, while exports declined. This year's GDP growth, forecast at 2.8 per cent, will continue to rely on household consumption, foreign investment, and, from the production side, services. The contribution of infrastructure projects and construction more broadly to economic growth may be limited given the tight labour market and the potential need to import workers, as well as the lack of consensus for the prioritisation and approval of projects. Risks from adverse weather conditions may affect Bosnia and Herzegovina similarly to the rest of the region. Growth is forecast to rise to 3 per cent in 2025 on improving external demand and the implementation of major investment projects.

Kosovo

Growth in 2023, at 3.3 per cent, was broadly in line with expectations. The main driver on the supply side was the services sector, particularly

tourism and trade, while industry and construction made smaller contributions. On the demand side, private consumption continued to drive growth, despite double-digit inflation at the beginning of 2023. Public consumption and capital investments also boosted overall economic activity, while net exports weighed on growth given high import growth. Credit continued to expand at double-digit rates throughout 2023 and the first months of 2024, supporting household consumption and mirrored in the growth of household deposits. GDP growth is expected to accelerate to 4.0 per cent in 2024 and 2025, supported by robust private consumption as well as an increase in public infrastructure investments. The Stand-by and Resilience and Sustainability Facility arrangements with the IMF are undergoing the second review which, once completed, would unlock another €25 million for precautionary purposes and climate change adjustment projects.

Montenegro

After higher-than-expected growth in 2023 at 6 per cent, economic expansion is forecast to moderate to 3.5 per cent in 2024, reflecting a higher base and the negative impact of dry weather on hydropower generation. Growth is expected to be driven by private consumption and investments from the expenditure side as well as services and construction from the production side. Retail trade recorded double-digit growth (year on year) in the first two months of 2024, driven by fiscal expansion and strong wage growth, while industrial production declined, particularly in electricity production. Inflation was on a decreasing trend up to February 2024 but ticked up again to 5.5 per cent year on year in March, mainly due to the expiration of the effects of earlier anti-inflationary measures, which had involved the reduction of prices of around 150 products. In order to fund payments due on public debt maturing this year, a new 7-year international bond of US\$ 750 million was issued in March 2024, at an effective rate of 7.25 per cent. In March 2024, S&P upgraded the outlook from stable to positive, while maintaining rating B,

reflecting the country's improved fiscal and balance of payment performance over the past year. In 2025, growth is expected to slow down further to 2.9 per cent, given that the Pljevlja thermal power plant, currently supplying around 40 per cent of the country's electricity, will undergo a long rehabilitation, leading to a decline in electricity production and an increase in energy imports.

North Macedonia

GDP growth in 2023 of 1 per cent was lower than expected, mainly because of weak demand from the main export markets in the eurozone. Service sectors contributed to growth, but industrial production and construction recorded declines. Private consumption started to pick up towards the end of the year alongside a fall in inflation, and the contribution from net exports was positive, reflecting lower imports and robust growth in the export of services. From the beginning of 2024, the government had several new debt issuances in the domestic market, with yields declining from 4.1 to 3.8 per cent. In addition, the successful completion of the first review under the Precautionary and Liquidity Line arrangement with the IMF allows the government to access around €200 million for fiscal sustainability reforms, with a reduction of energy subsidies already in place and implementation of infrastructure investments ongoing. Growth is forecast to pick up to 2.5 per cent in 2024 and 3.5 per cent in 2025, as high remittance inflows and declining inflation continue to boost private consumption and external demand gradually recovers. Growth is somewhat constrained by limited fiscal space owing to the high fiscal deficit and public debt.

Serbia

After growing at 2.5 per cent in 2022 and 2023, economic activity appears to be accelerating in the first few months of 2024 as short-term indicators for the first two months of 2024 for industrial production, real retail trade and tourism, indicate strong growth. Inflation is expected to return within the central bank's target

band by the end of the year amid tight monetary policy. The current account deficit continued to narrow in the first two months of 2024 with an increase in the exports of goods and services and a decrease in the imports of goods. The third and final review under the IMF Stand-by arrangement is pending Board approval, which would allow the government to access around €400 million, but the authorities treat the programme as precautionary, given the strong accumulation of reserves and fiscal buffers, as well as the reduction in macroeconomic imbalances. On the basis of these developments, the economy is forecast to grow by 3.5 per cent in 2024 and 4 per cent in 2025, as inflation subsides further and preparations for the EXPO 2027 accelerate. Downside risks arise from the continued weakness of the eurozone economies, tight labour markets, geopolitical instability affecting supply chains and adverse weather conditions that may have a negative effect on agricultural production. Upside risks to growth arise from the successful implementation of reforms in the area of governance of state-owned enterprises.

Belarus

GDP rebounded by 3.9 per cent in 2023 after a contraction in the preceding year. Manufacturing and construction saw strong recoveries on the back of government-supported import substitution policies and expanding exports to Russia. Exports to other markets remained depressed because of sanctions and sanctions-related logistical disruptions affecting efforts to reorient exports to non-Western markets. Inflation declined to 2.0 per cent at the end of the third quarter of 2023 before rising again to 5.6 per cent by March 2024. As extensive sanctions are likely to impede economic development in the short and medium term, growth is expected to slow to 2.8 per cent in 2024 and 2.2 per cent in 2025, with high downside risks to the outlook.

Russia

In Russia, a 1.2 per cent contraction in output in 2022 was followed by 3.6 per cent growth in 2023, as a defence-related manufacturing boom

underpinned a stronger-than-anticipated recovery. Growth in 2023 was facilitated by increasing trade with China and other neutral economies. A considerable increase in inventories further contributed to GDP growth, reflecting increased military production coupled with lower external demand (due to sanctions) and domestic demand (due to monetary policy tightening). Starting in July 2023, the Central Bank of Russia (CBR) tightened policy interest rates five times, by a cumulative 850 basis points, to 16 per cent, after having kept the rates low at 7.5 per cent during the first half of 2023 to encourage credit growth and support economic expansion. Inflation has been running high, reflecting labour shortages and the fiscal stimulus deployed ahead of the March 2024 elections. It stood at 7.7 per cent in February 2024. As the economy is now back above pre-war levels, GDP growth is expected to slow down to 2.5 per cent in 2024 and 1.5 per cent in 2025. Downside risks stem from strong inflationary pressures, tighter monetary conditions and capital controls, rising dependence on China, India, and Turkiye and disruptions to international payments. Moreover, the impact of economic sanctions on productivity could increase in the medium and long term, as ability to replace advanced equipment may be more limited and large-scale FDI projects may become scarce.

About this report

The Regional Economic Prospects report is published twice a year. The report is prepared by the Office of the Chief Economist and the Department for Policy Strategy and Delivery and contains a summary of regional economic developments and outlook, alongside the EBRD's growth forecasts for the economies where it invests. The estimates and projections are based on statistical information available through April 25, 2024.

For more comprehensive coverage of economic policies and structural changes, see the EBRD's country strategies and updates, as well as the Transition Report 2023-24, which are all available on the Bank's website at www.ebrd.com.

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