

# REGIONAL ECONOMIC PROSPECTS



European Bank  
for Reconstruction and Development

SEPTEMBER  
2022

## A COLD WINTER AHEAD? Confronting the energy crunch



---

# Regional Economic Prospects in the EBRD Regions



## A cold winter ahead?

### Confronting the energy crunch

September 2022

*Output in the EBRD regions increased by 6.8 per cent in 2021 after contracting by 2.4 per cent in 2020. The war on Ukraine has, however, been having a profound impact on the economies in the EBRD regions.*

*Output in the EBRD regions is expected to grow by 2.3 per cent in 2022 and 3 per cent in 2023. The upward revision of 1.2 percentage points in 2022 compared with the forecast made in May 2022 is driven by better-than-expected outturns in the first half of the year, with a year-on-year growth of 3.9 per cent recorded in January-June. In emerging Europe, in particular, private savings accumulated during the Covid-19 lockdowns have been actively spent. This temporarily boosted consumption despite falling real wages and resulted in a sharp widening of current account deficits in central Europe.*

*A downward revision to growth forecasts of 2023, of 1.7 percentage points, reflects reduced supply of gas from Russia, including its impact through spillovers from slower growth in advanced Europe, as well as mounting inflationary pressures in the global economy and the EBRD regions. Taking into account an upward revision to growth in 2022 and a downward revision in 2023, output in 2023 is expected to be 0.5 per cent lower than forecast in May.*

*Projections are subject to major downside risks should hostilities escalate or should exports of gas from Russia be further restricted. For instance, in a scenario where gas supplies from Russia to Europe are cut off completely, GDP growth in the EBRD regions could be 1.3 percentage points lower in 2023 than in the baseline scenario.*

*The price of gas has increased sharply as supplies of gas from Russia to Europe have been curtailed on account of closure of Nord Stream 1 and disruptions to transshipment through Belarus and Ukraine. Since late February 2022, gas prices in Europe have averaged around 2.5 times their 2021 level (in inflation-adjusted terms). For many countries in the EBRD regions higher gas prices imply increases in gas import bills equivalent to up to 4-5 per cent of GDP, as economies are highly dependent on gas in their energy mix.*

*Gas accounts for the bulk of derived heat production in the EBRD regions. In some economies, gas is also an important source of electricity production. Even where electricity is not directly derived from gas, electricity and gas prices tend to co-move. In some economies, in particular in Central Asia and the Western Balkans, GDP remains highly energy-intensive by international standards. Spiralling costs in gas-intensive sectors, such as aluminium, iron and steel, chemicals and parts of the automotive sector, as well as spillovers through supply chain linkages with Germany will weigh on growth in central and south-eastern Europe.*

Average inflation in the EBRD regions reached 16.5 per cent in July 2022, a level last seen in 1998, at the end of the transition recession. While wheat prices have largely returned to their pre-war levels, oil prices remain high by historical standards. Energy and food account for a higher share of consumption of poorer households, who are experiencing even higher effective rates of inflation. Real wage growth has turned negative on average, with greater falls in real incomes in south-eastern Europe.

Policymakers have turned to a wide range of measures to mitigate the effects of higher energy and food prices. Over two-thirds of economies in the EBRD regions implemented fuel subsidies per unit of consumption, also widely used in advanced economies. While popular and easy to implement, these have significant fiscal costs. Price controls, state aid, preferential loans and export restrictions have been more widely used in the EBRD regions than in comparators. Targeted support, less costly but requiring higher levels of administrative capacity, was used somewhat less frequently.

Fiscal and external vulnerabilities have increased. The median bond yield in the EBRD regions increased by 2.5 percentage points since early February.

Output in **central Europe and the Baltic states** is expected to increase by 3.7 per cent in 2022. Upward revisions relative to May reflect strong outturns in the first half of the year. Growth is expected to slow sharply to 1.3 per cent in 2023 on gas supply disruptions and spillovers from slower growth in advanced Europe, in particular Germany and Austria.

GDP in the three **south-eastern European Union** countries is expected to grow by 5 per cent in 2022, with growth slowing to 2 per cent in 2023. As in central Europe and the Baltic states, this reflects better-than-expected outturns in the first half of 2022, but downward revisions in 2023 on reduced gas supply and spillovers from the slowdown in advanced European economies.

Similarly, output in the **Western Balkans** is expected to grow by 3.2 per cent in 2022 and slow to 3 per cent in 2023 (revised down relative to May), with risks to the economic outlook increasing, in particular in light of the fiscal vulnerabilities and sensitivity to growth in European markets.

Output in **eastern Europe and the Caucasus** (excluding Ukraine) is expected to expand by 4.9 per cent in 2022 and 2.8 per cent in 2023 as temporary stays by Russians boost consumption in Armenia and Georgia. The forecast for growth in Ukraine in 2022 (-30 per cent) is unchanged relative to May given high levels on uncertainty, while the rebound in 2023 (8 per cent) is now forecast to be more muted.

Output in **Central Asia** is expected to grow by 4.3 per cent in 2022 and 4.8 per cent in 2023. Upward revisions to both years relative to May reflect a boost to consumption driven by public sector wage hikes, high remittance flows and a sharp increase in shadow trade with Russia, as well as gains in commodity exporters. Russia's economy is forecast to contract by 5 per cent in 2022 (less than previously expected) and by 3 per cent in 2023.

GDP growth in **Turkey** is expected at 4.5 per cent in 2022, supported by government spending ahead of the planned elections and better-than-expected net exports, reflecting in part increased exports to Russia. The forecast for 2023, at 3.5 per cent is unchanged relative to May.

Output in **the southern and eastern Mediterranean** is expected to grow by 2.9 per cent in 2022, though structural problems, external vulnerabilities and limited progress on reforms continue to weigh on growth. Growth is expected to increase to 4.7 per cent in 2023.

**Table 1. GDP growth in real terms**

	Actual			Forecast (Sep'22)		Revision since May'22		
	2020	2021	2022H1	2022	2023	2022	2023	2022-23
<b>EBRD Regions</b>	<b>-2.4</b>	<b>6.8</b>	<b>3.9</b>	<b>2.3</b>	<b>3.0</b>	<b>1.2</b>	<b>-1.7</b>	<b>-0.5</b>
<b>Central Asia</b>	<b>-0.6</b>	<b>5.0</b>	<b>4.3</b>	<b>4.3</b>	<b>4.8</b>	<b>1.2</b>	<b>1.1</b>	<b>2.3</b>
Kazakhstan	-2.6	4.0	3.4	3.0	3.5	1.0	1.0	2.0
Kyrgyz Republic	-8.6	3.6	6.3	7.0	7.0	6.0	3.0	9.0
Mongolia	-5.3	1.4	1.9	3.5	7.0	0.0	0.0	0.0
Tajikistan	4.5	9.2	7.4	7.0	8.0	4.0	3.0	6.9
Turkmenistan	5.9	6.2	6.0	7.0	6.0	1.0	0.5	1.4
Uzbekistan	1.6	7.4	5.2	5.5	6.5	1.5	1.5	2.9
<b>Central Europe and the Baltic states</b>	<b>-3.5</b>	<b>5.6</b>	<b>5.9</b>	<b>3.7</b>	<b>1.3</b>	<b>0.5</b>	<b>-2.1</b>	<b>-1.6</b>
Croatia	-8.1	10.2	7.4	6.5	2.0	3.5	-1.5	1.9
Czech Republic	-5.5	3.5	4.2	2.5	0.5	0.0	-3.0	-2.9
Estonia	-0.6	8.0	2.4	1.5	1.0	0.0	-1.5	-1.5
Hungary	-4.5	7.1	7.3	5.0	1.5	1.5	-2.0	-0.5
Latvia	-3.8	4.5	4.7	2.5	0.8	1.0	-1.2	-0.2
Lithuania	-0.1	5.0	3.2	2.0	1.5	0.0	-1.5	-1.5
Poland	-2.2	5.9	6.9	4.0	1.5	0.0	-2.0	-1.9
Slovak Republic	-4.4	3.0	2.4	2.0	1.0	0.0	-2.5	-2.4
Slovenia	-4.3	8.2	8.9	6.0	1.8	2.5	-1.2	1.2
<b>Eastern Europe and the Caucasus</b>	<b>-4.4</b>	<b>4.9</b>	<b>-15.7</b>	<b>-17.8</b>	<b>6.2</b>	<b>0.6</b>	<b>-11.3</b>	<b>-8.9</b>
Armenia	-7.2	5.7	11.8	8.0	4.0	6.5	0.0	6.4
Azerbaijan	-4.2	5.6	6.2	4.5	2.5	0.0	0.0	0.0
Georgia	-6.8	10.4	10.5	8.0	5.0	5.0	0.0	4.9
Moldova	-7.0	13.9	0.0	-1.0	0.0	-2.0	-3.5	-5.3
Ukraine	-3.8	3.4	-27.8	-30.0	8.0	0.0	-17.0	-13.6
<b>South Eastern EU</b>	<b>-5.8</b>	<b>6.6</b>	<b>6.6</b>	<b>5.0</b>	<b>2.0</b>	<b>2.4</b>	<b>-1.2</b>	<b>1.1</b>
Bulgaria	-4.4	4.2	4.5	3.0	1.5	0.5	-1.5	-1.0
Greece	-9.0	8.3	8.4	5.2	2.2	2.3	-1.3	1.0
Romania	-3.7	5.9	5.8	5.4	1.9	2.9	-1.1	1.7
<b>Southern and Eastern Mediterranean</b>	<b>-1.9</b>	<b>6.0</b>	<b>2.8</b>	<b>2.9</b>	<b>4.7</b>	<b>0.4</b>	<b>-0.1</b>	<b>0.2</b>
Egypt	1.5	7.2	3.6	3.9	5.6	0.8	-0.4	0.4
Jordan	-1.6	2.2	2.5	2.0	2.7	0.1	0.2	0.3
Lebanon	-25.9	-10.0	0.9	-2.0	4.0	-3.0	1.0	-2.0
Morocco	-6.3	7.4	0.6	1.1	3.3	-0.1	0.3	0.2
Tunisia	-8.6	3.5	2.6	1.7	2.9	-0.3	0.4	0.1
<b>Turkey</b>	<b>1.8</b>	<b>11.0</b>	<b>7.2</b>	<b>4.5</b>	<b>3.5</b>	<b>2.5</b>	<b>0.0</b>	<b>2.5</b>
<b>Western Balkans</b>	<b>-3.1</b>	<b>7.6</b>	<b>4.1</b>	<b>3.2</b>	<b>3.0</b>	<b>0.0</b>	<b>-0.6</b>	<b>-0.6</b>
Albania	-3.5	8.5	2.4	3.0	3.0	0.0	-0.3	-0.3
Bosnia and Herzegovina	-3.1	7.5	3.0	3.0	2.3	0.0	-0.7	-0.7
Kosovo	-5.3	10.5	8.6	4.0	3.7	0.0	-0.3	-0.3
Montenegro	-15.3	12.4	10.7	3.7	4.0	0.0	-0.5	-0.5
North Macedonia	-6.1	4.0	2.6	2.7	2.3	-0.3	-0.7	-1.0
Serbia	-0.9	7.4	4.1	3.3	3.3	0.0	-0.7	-0.7
Memo: Egypt (fiscal year to June)	3.6	3.3	8.9	6.6	4.7	0.9	-0.3	0.6
EEC excl. Ukraine	-5.6	7.7	7.0	4.9	2.8	1.6	-0.6	1.1
Belarus	-0.7	2.3	-4.2	-5.5	-1.0	-1.5	-1.0	-2.5
Russia	-3.0	4.7	-0.3	-5.0	-3.0	5.0	-3.0	2.4

Source: National authorities and EBRD. Notes: Weights are based on the values of gross domestic product in 2020 at market exchange rates. H1 estimates from national authorities and Refinitiv Eikon/Oxford Economics.

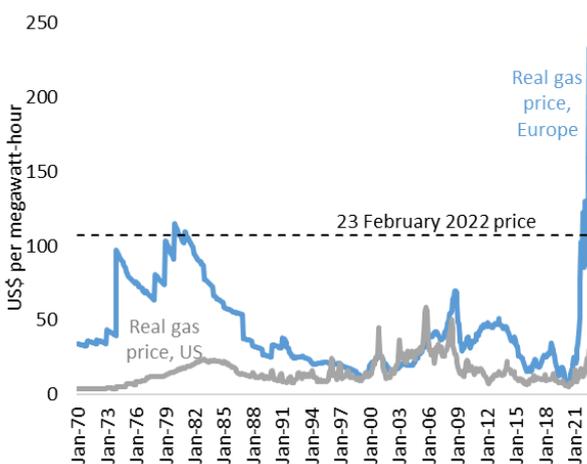
**Output in the EBRD regions increased by 3.9 per cent year-on-year in the first half of 2022**

Output in the EBRD regions increased by 6.8 per cent in 2021 after contracting by 2.4 per cent in 2020 (see Table 1). While growth slowed to 3.9 per cent year-on-year in the first half of 2022, as the war on Ukraine has been having a profound impact on the economies in the EBRD regions, the January-June outcomes were nonetheless better than previously expected, in particular in central Europe and the Baltic states and Central Asia.

**Runaway gas prices**

The price of gas has increased sharply as supplies of gas from Russia to Europe have been curtailed on account of the closure of Nord Stream 1 and disruptions to transshipment through Belarus and Ukraine. Gas prices in Europe, at around US\$ 205 per megawatt-hour as of early September were far above historic highs (see Chart 1). Since late February 2022, gas prices in Europe have averaged around 2.5 times their 2021 level (in inflation-adjusted terms) and more than seven times the level in the United States. While the war pushed up gas prices, other factors, including underinvestment in fossil fuels in the light of the green-energy transition led to sizable increases in the price of gas in Europe already before the war (see Chart 1).

**Chart 1. Gas prices in Europe are far above historic highs**

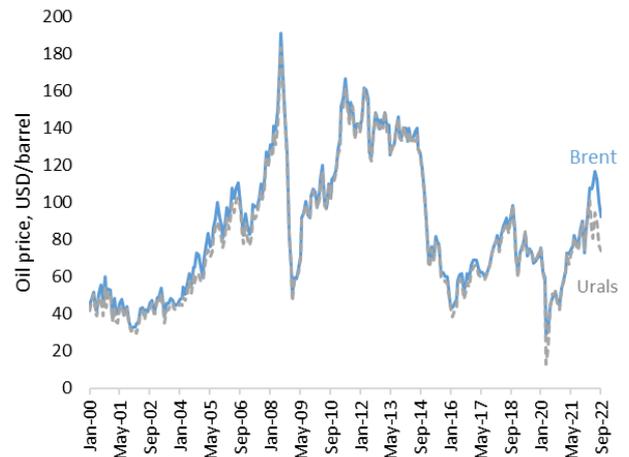


Sources: IMF, World Bank via CEIC and authors' calculations.

Notes: Prices adjusted for US inflation.

The price of oil also increased sharply in 2022, although, at around US\$ 90 per barrel as of early September, it remains below its historical peaks (see Chart 2). Urals oil continues to trade at a large discount relative to Brent as some buyers discontinued purchases of oil from Russia. Based on oil futures, markets expect prices to come down to around US\$ 84 per barrel by end-2023.

**Chart 2. Urals oil still trading at a large discount relative to Brent oil**

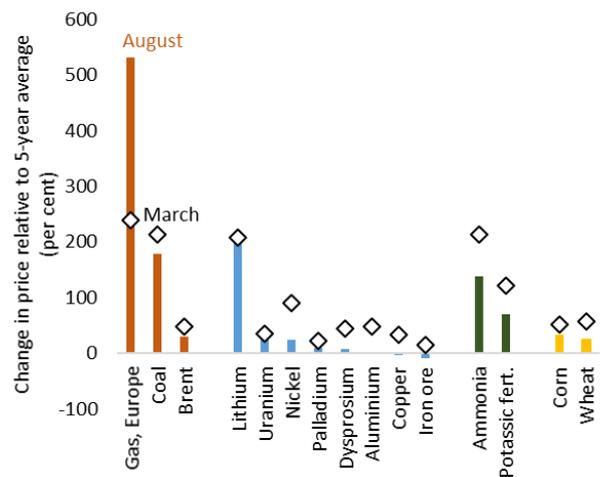


Sources: Refinitiv Eikon and authors' calculations.

Notes: Prices adjusted for US inflation.

The prices of metals have largely returned to their pre-war levels, in line with the weaker global economic outlook and reduced demand from China (see Chart 3).

**Chart 3. Prices of metals normalized**



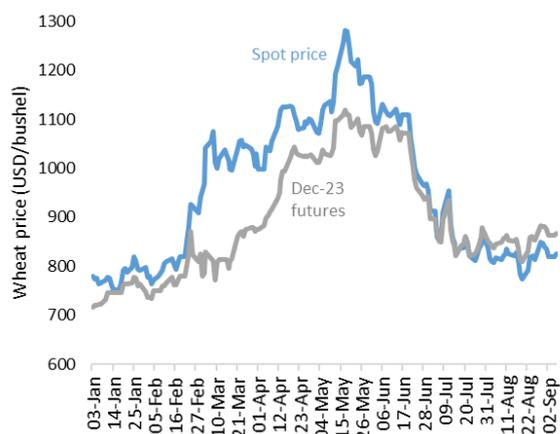
Sources: IMF, UN Comtrade, World Bank via CEIC and authors' calculations.

### Food prices have normalized

Food prices increased sharply after the start of the war on Ukraine as markets expected a major drop in exports from Russia, Ukraine and Belarus, important food and fertiliser exporters. Wheat prices spiked, surpassing their 2008 peaks in inflation-adjusted terms, but have almost returned to their pre-war levels as exports from Ukraine and Russia picked up (see Chart 4).

These developments benefit importers in the Caucasus and southern and eastern Mediterranean. In particular, Egypt is one of the world's top wheat importers; its imports of Russian wheat increased 84 per cent March to May 2022 relative to a year earlier.

**Chart 4. Wheat prices normalized**



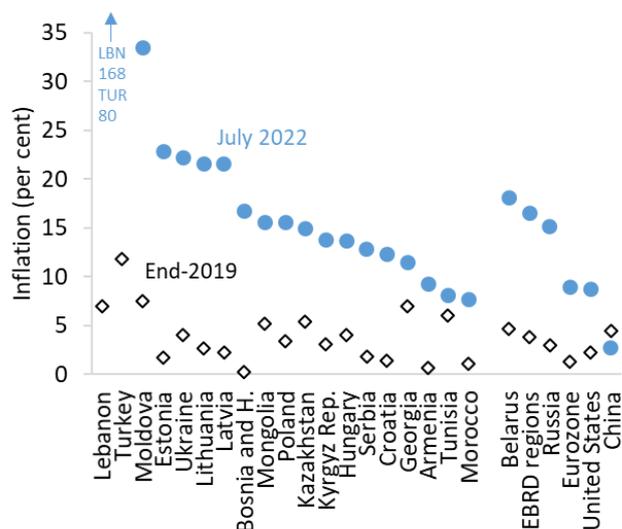
Sources: Bloomberg.

### Inflationary pressures increased further

High food and energy prices added to inflationary pressures, which were already high owing to the rebound in global demand as Covid-19 restrictions were phased out.

Average inflation in the EBRD regions reached 16.5 per cent in July 2022, a level last seen in 1998, at the end of the transition recession. Inflation was in double digits in over 80 per cent of economies in the EBRD regions, reaching almost 80 per cent in Turkey and exceeding 20 per cent in the Baltic states, Moldova and Ukraine (see Chart 5).

**Chart 5. Inflation in double digits in over 80 per cent of economies in the EBRD regions**



Sources: National authorities via CEIC and authors' calculations.

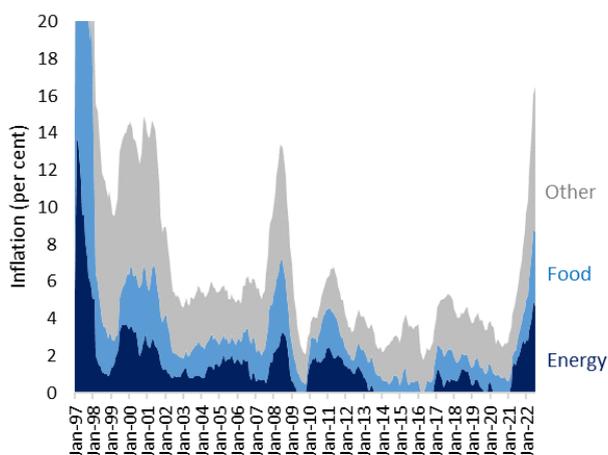
Notes: Year-on-year changes. EBRD regions refers to a simple average across 33 economies, excludes Lebanon.

Around 30 per cent of inflation is contributed directly by rising energy prices, and another 30 per cent by dearer food (see Chart 6). Food inflation exceeded 21 per cent in the EBRD regions in July 2022 (simple average across 30 economies). Estimates by the International Monetary Fund (IMF) suggest that the current surge in international fossil fuel prices will raise European households' cost of living in 2022 by close to 7 per cent of consumption on average. Furthermore, the impact of inflation tends to be regressive, with poorer households typically being hurt more than richer households.<sup>1</sup> The resulting adverse impact of inflation on inequality can be large and can persist over long periods of time.<sup>2</sup>

<sup>1</sup> See Ari et al. (2022).

<sup>2</sup> See Jaravel (2021).

**Chart 6. Inflation has increased to 16.5 per cent in the EBRD regions in July 2022**

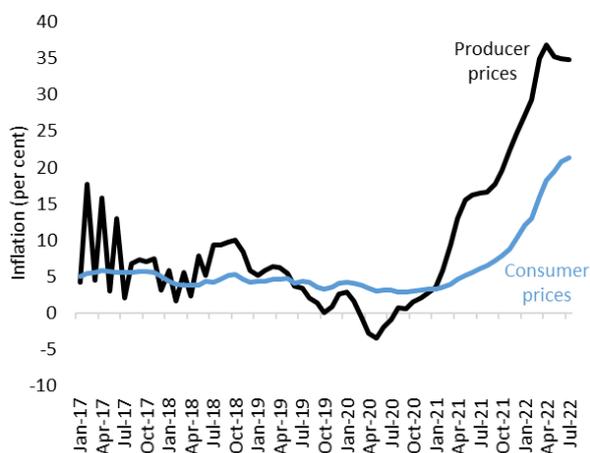


Sources: National authorities via CEIC and authors' calculations.

Notes: Year-on-year changes. Headline inflation is a simple average across 33 economies in the EBRD regions. The decomposition is based on an unbalanced panel ranging from 5 economies in 1997 to 11 economies from 2001. The decomposition is scaled to overall inflation in the EBRD regions.

Producer prices increased more than consumer prices, driven by the rising cost of energy and, to a lesser extent, by increases in the prices of intermediate goods (see Chart 7). This pattern holds in most economies in the EBRD regions (see Chart 8).

**Chart 7. Producer prices increased even more than consumer prices**

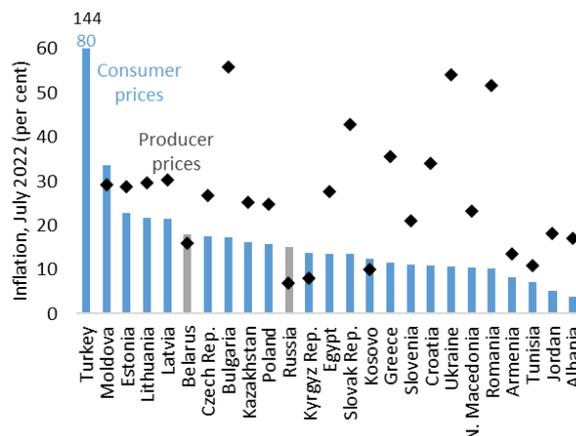


Sources: Refinitiv and authors' calculations.

Notes: Year-on-year changes. Simple average across 16 economies in the EBRD regions.

In most of the EBRD regions, inflationary pressures could thus be expected to increase further to the extent that higher producer costs are passed on to consumers.

**Chart 8. Producer prices rose more than consumer prices**

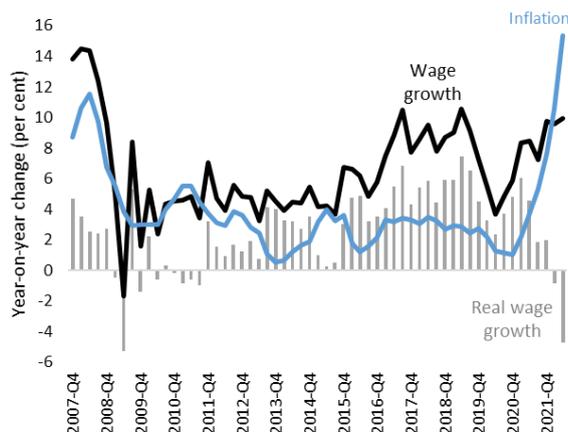


Sources: Refinitiv and authors' calculations.

Notes: Year-on-year changes. May 2022 for Croatia and Kosovo, April for North Macedonia, March for Romania and Tunisia, February for Ukraine.

As a result, wage growth in the EBRD regions now lags behind inflation, on average, for the first time since early 2011 (see Chart 9). The declines in the purchasing power of wage income are particularly pronounced in eastern and south-eastern Europe. For instance, real wages declined by 8-9 percentage points in Moldova and Serbia (see Chart 10).

**Chart 9. On average, wages lag behind inflation in the EBRD regions**

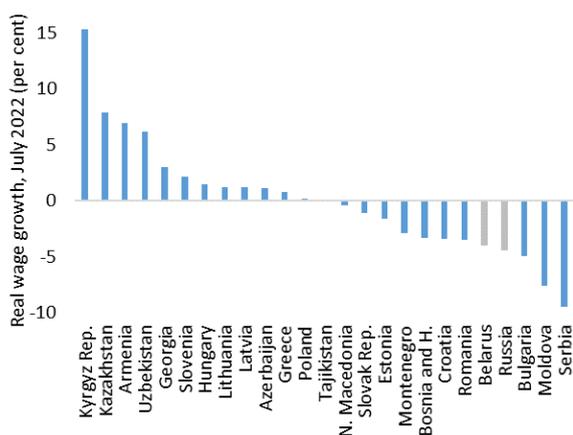


Sources: Bloomberg and authors' calculations.

Notes: Simple average across 15 economies in the EBRD regions.

A notable exception is Central Asia, where wage growth has been supported by significant wage hikes in the public sector and tighter labour markets as migration to and remittances from Russia picked up (see Chart 10). High wage growth may in turn further exacerbate inflationary pressures in these economies.

**Chart 10. Strong real wage growth in Central Asia**

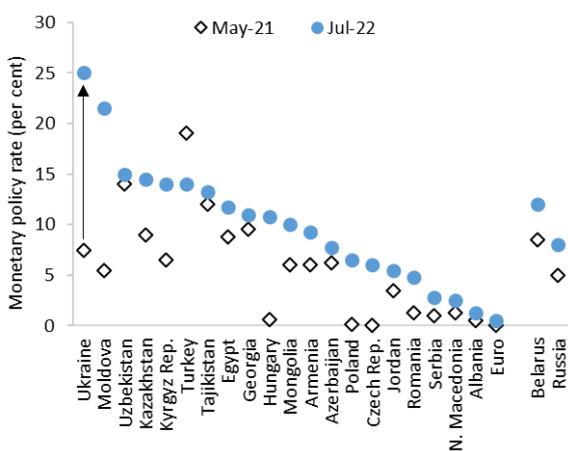


Sources: Bloomberg and authors' calculations.  
Notes: June 2022 for Azerbaijan, Montenegro and North Macedonia; April for Belarus and March for Cyprus, Estonia, Georgia, Greece, Latvia, Lithuania, Moldova, the Slovak Republic and Slovenia.

### Monetary policy tightened

In response to inflationary pressures, 88 per cent of central banks in the EBRD regions hiked policy interest rates between May 2021 and July 2022 (see Chart 11).

**Chart 11. 88 per cent of economies in the EBRD regions hiked policy since May 2021**



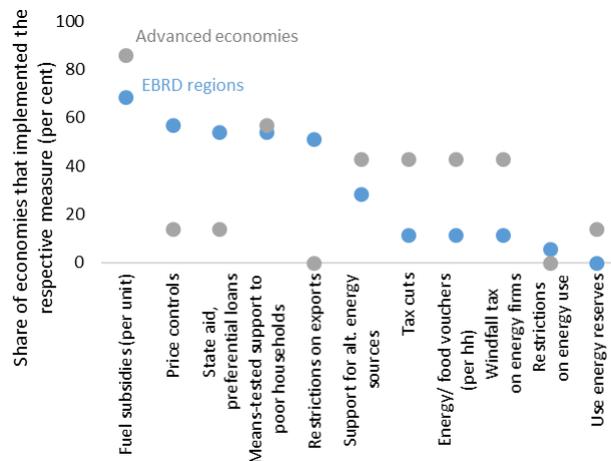
Sources: National authorities via CEIC and authors' calculations.

### Mitigating the effects of high energy and food prices

Policymakers across the EBRD regions have also turned to a wide range of measures to mitigate the effects of higher energy and food prices on households and firms.

Over two-thirds of economies in the EBRD regions implemented fuel subsidies per unit of consumption, also widely used in advanced economies (see Chart 12). For instance, Poland lowered the VAT on gasoline from 23 to 8 per cent and the VAT on heating from 23 to 5 per cent, and Montenegro halved excise duties on fuel. Such subsidies are relatively easy to implement and often enjoy popular support, but are not targeted and may encourage excessive energy use. New subsidies were somewhat less common in Central Asia and the southern and eastern Mediterranean, where economies were less affected by Russian gas cuts.

**Chart 12. Widespread use of fuel subsidies and price controls to mitigate the effects of food and energy price increases**



Sources: National authorities and authors' calculations.  
Notes: 35 economies in the EBRD regions; 8 advanced economies (Canada, France, Germany, Italy, Japan, United Kingdom, United State and Sweden). VAT cuts on fuel treated as a subsidy per unit of consumption. As of early August.

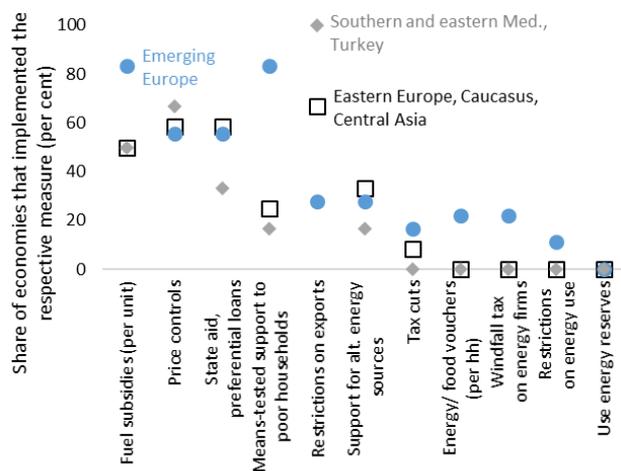
Price controls have been much more widely used in the EBRD regions than in advanced economies, with these having been implemented in 57 per

cent of economies in the EBRD regions. For instance, Croatia, Romania and the Slovak Republic capped electricity and/or gas prices for households. While price controls are also comparatively easy to implement, in some cases they have resulted in shortages (for instance, in Hungary, which introduced price caps on basic food products, such as sugar, wheat flour, sunflower oil, chicken and milk).

State aid, preferential loans and export restrictions have also been more widely used in the EBRD regions than in advanced economies. For instance, Albania scaled up its tax-free oil fund for agricultural producers. Albania also implemented restrictions on energy use, with scheduled power cuts in the public sector to conserve power.

Export restrictions were mostly used in the southern and eastern Mediterranean for food products. For instance, an export ban on wheat was introduced in Egypt (see Chart 13).

**Chart 13. Means-tested support most common in central Europe and the Baltic states**



Sources: National authorities and authors' calculations.

Notes: As of early August.

Targeted measures, such as means-tested support to poor households, were somewhat less common than fuel subsidies or price controls, as their implementation requires greater administrative capacity. They were most common in central Europe and the Baltics, and to a lesser extent south-eastern Europe (see Chart 13).

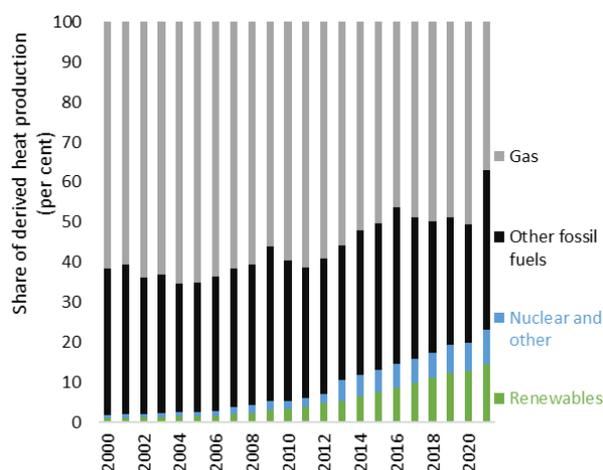
Examples include a one-off payment of 5,000 CZK (€200) per child to poor families in the Czech Republic, energy vouchers to recipients of social welfare in Slovenia and an energy allowance for children, seniors and people with disabilities in Latvia.

Support for alternative energy sources varied widely—including, for instance, support for renewables in the Czech Republic and for nuclear power in Estonia. Some economies, such as Greece and Hungary, have also considered increasing their reliance on coal in the short term, while Armenia secured additional supplies of Russian gas.

### High gas dependence

Many economies in the EBRD regions are highly dependent on gas in their energy mix. While its role has come down over time, gas was still the single largest source of derived heat production in the EBRD regions in 2020, accounting for 37 per cent of derived heat (very similar to the share in advanced Europe; see Chart 14). In some economies, such as North Macedonia, Moldova and Ukraine, gas accounts for over three-quarters of derived heat production (see Chart 15).

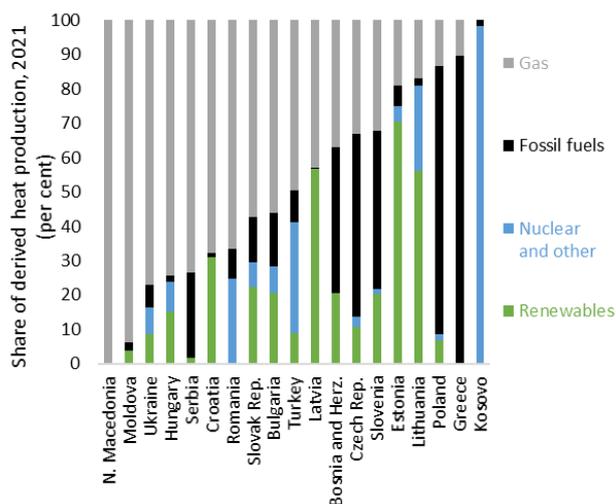
**Chart 14. Gas important for derived heat production in the EBRD regions**



Sources: Eurostat and authors' calculations.

Notes: Gas includes natural and manufactured gas, other fossil fuels include oil shale, oil sands, oil and petroleum and solid fossil fuels, renewables includes biofuels, other includes electricity, peat and peat products and non-renewable waste. EBRD regions based on 20 economies, weighted by total production.

**Chart 15. In some economies gas accounts for over three-quarters of derived heat production**



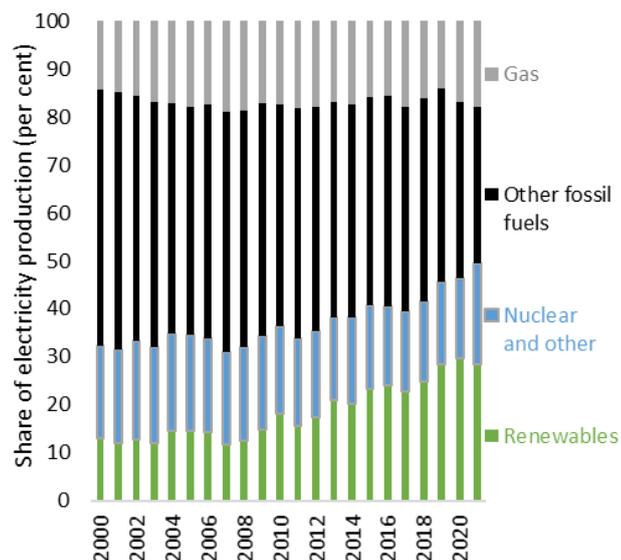
Sources: Eurostat and authors' calculations.

Notes: 2020 for Ukraine.

High gas prices raise affordability concerns. Many households in the EBRD regions could not afford to adequately heat their homes already in 2016, when gas prices were much lower than in recent months. This was the case for almost 30 per cent of households in the poorest income decile, a much higher share than in advanced economies, such as Germany and Italy (based on the 2016 round of the Life in Transition Survey).

Gas is less important for electricity production in the EBRD regions. Most electricity is produced from renewables (in particular hydro, with wind driving most of the increase in recent years), though fossil fuels remain more important in the EBRD regions than in advanced Europe (see Chart 16). In some economies, such as Moldova, Greece, Latvia and Turkey (as well as Italy and the Netherlands) gas is, however, also an important source for electricity production (see Chart 17).

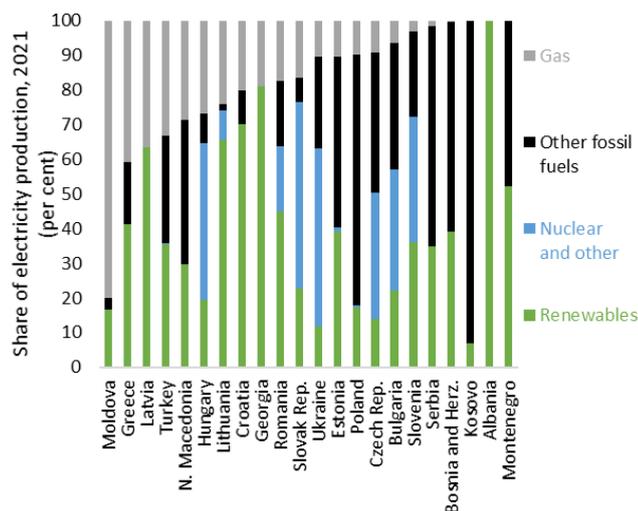
**Chart 16. Gas less important for electricity production in the EBRD regions on average**



Sources: Eurostat and authors' calculations.

Notes: Gas includes natural and manufactured gas, other fossil fuels include oil shale, oil sands, oil and petroleum and solid fossil fuels, renewables includes biofuels, other includes peat and peat products and non-renewable waste. EBRD regions based on 22 economies, weighted by total production.

**Chart 17. Gas is important for electricity production in Moldova, Greece, Latvia and Turkey**

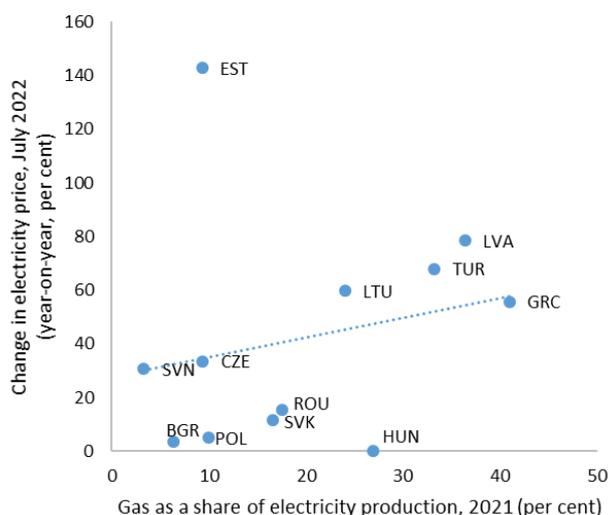


Sources: Eurostat and authors' calculations.

Notes: 2020 for Montenegro and Ukraine.

Electricity prices increased more in 2022 in countries where gas accounts for a larger share of electricity production (see Chart 18). However, even where gas only accounts for a small share of electricity production (such as in Estonia), gas- or coal-powered plants are often the ‘marginal producers’ supplying reliable electricity needed to balance the grid and prices of electricity thus tend to co-move with gas prices.

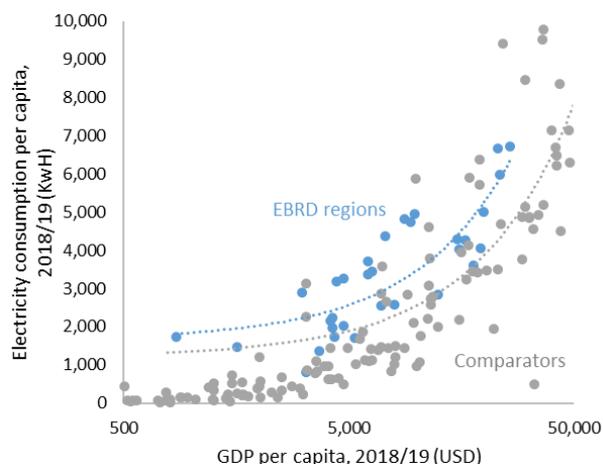
**Chart 18. Electricity prices increased more where gas accounts for a larger share of electricity generation**



Sources: Eurostat and authors’ calculations.

Electricity consumption per capita is high in the EBRD regions relative to other economies at similar levels of development. For instance, Bulgaria, Kazakhstan, Montenegro and Serbia stand out with much higher consumption than comparators with similar levels of GDP per capita (see Chart 19).

**Chart 19. Electricity consumption per capita is high in the EBRD regions**

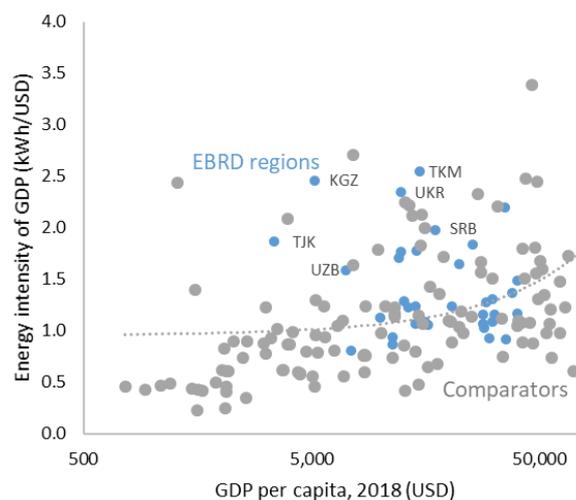


Sources: IMF, US Energy Information Administration and authors’ calculations.

Notes: Log scale.

In some economies in the EBRD regions, such as those in Central Asia, some of the Western Balkans and Ukraine, energy intensity of GDP is also high relative to comparators (see Chart 20). Higher electricity and energy prices will thus have a larger effect on households and firms in the EBRD regions than in other economies at similar levels of development.

**Chart 20. Energy intensity of GDP is high in Central Asia**

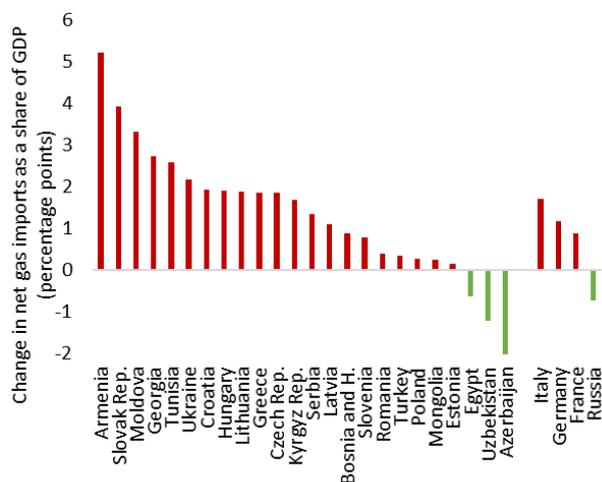


Sources: BP Statistical Review of World Energy (2022); EIA, IMF and authors’ calculations.

Notes: Log scale.

For many economies higher gas prices imply sharp increases in gas import bills, equivalent to up to 4-5 per cent of GDP (see Chart 21).

**Chart 21. Higher gas prices imply significantly larger import bills**



Sources: IMF, UN Comtrade, World Bank via CEIC and authors' calculations.

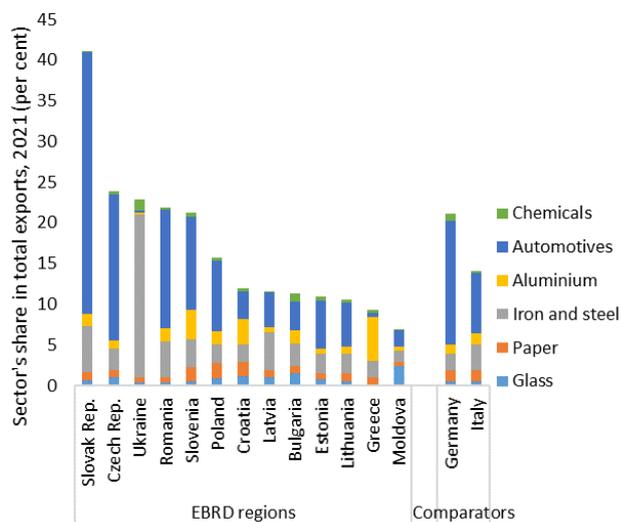
Notes: Difference between estimated 2022 net gas balance and 2021 net gas balance. 2022 estimate based on 2021 net gas balance multiplied by 2.5 (the ratio of the real price since the start of the war in 2022 and the average real price in 2021).

### Gas-intensive sectors struggle

Higher costs and potential disruptions in gas-intensive industries, such as aluminium, glass, iron and steel, paper, and parts of the automotive sector (such as batteries, plastic and tyres) will weigh on growth, in particular in the Slovak and Czech Republics, Romania, Slovenia and Ukraine (see Chart 22).

Furthermore, Germany is the largest exporter in many of these sectors and imports of inputs produced by German gas-intensive industries account for significant shares of the value added of exports from many of these economies (see Chart 23). As a result, disruptions and cost pressures from higher gas prices can quickly propagate through the supply chains.

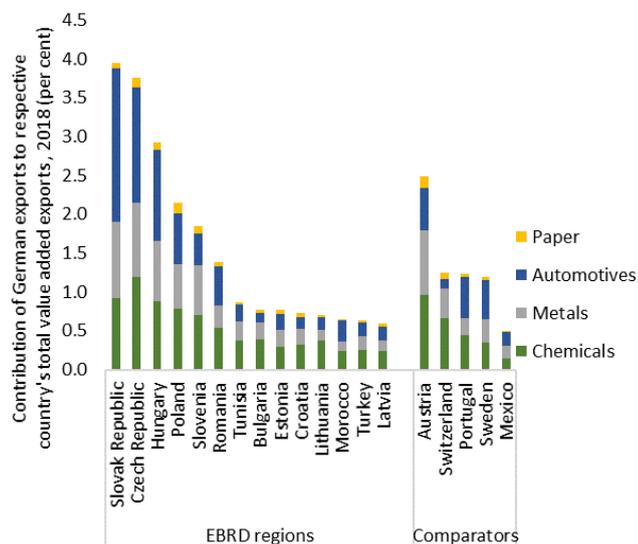
**Chart 22. Many economies in the EBRD regions that are affected by gas supply cuts export gas-intensive products**



Sources: UN Comtrade and authors' calculations.

Notes: Includes economies where gas imports from Russia are fully cut, partially reduced or there are plans to reduce.

**Chart 23. Central Europe also imports gas-intensive inputs from Germany and other advanced European economies**



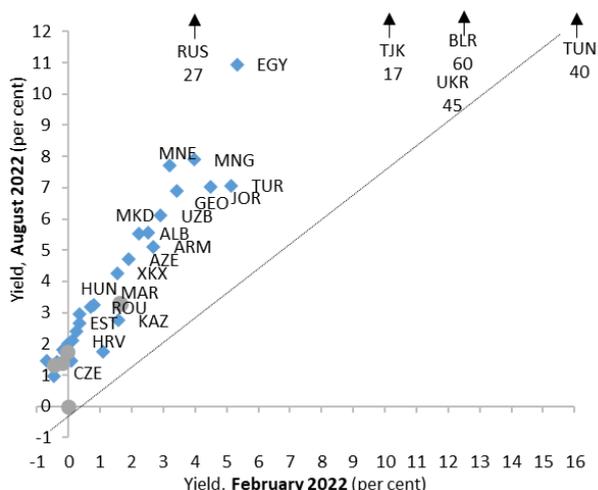
Sources: OECD TIVA Database and authors' calculations.

Some economies in the EBRD regions that are less affected by disruptions to Russian gas imports could potentially gain market shares in gas-intensive industries (for instance, Tajikistan in aluminium, Georgia in iron and steel, Jordan in fertilizers). However, many still face high energy costs relative to global competitors (for instance due to droughts affecting hydro power generation), as well as increased costs of other inputs through supply chains. New export relationships would also take time to develop.

### Fiscal vulnerabilities increased

As of early September, the median yield on 5-year government bonds in the EBRD regions increased by 2.5 percentage points relative to the beginning of February. This reflects tightening of monetary policy in advanced economies (yields on German and US bonds increased by 1.6 percentage points), as well as an increase in the spread between the EBRD regions and Germany/ the United States on reassessment of emerging market economy risks including geopolitical risks (around 0.9 percentage points). Yields increased most in Egypt, Tajikistan and Tunisia as well as Belarus, Russia and Ukraine (see Chart 24).

**Chart 24. The median yield in the EBRD regions increased by 2.5 percentage points since early February**

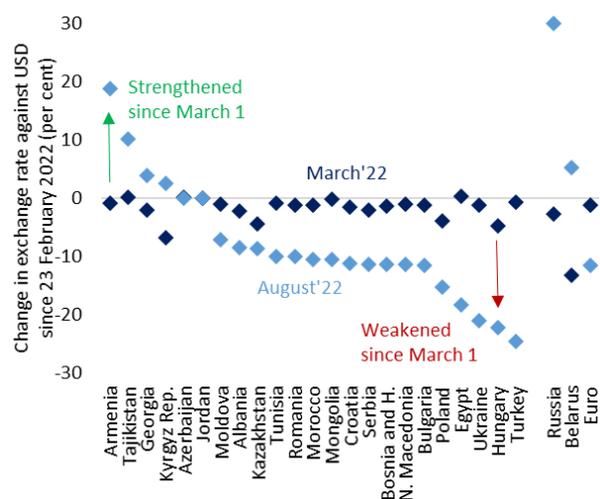


Sources: Bloomberg and authors' calculations.  
Notes: Yields on 5-year government bonds in US dollars or closest benchmark available.

### Pressure on exchange rates amidst US dollar strength

Most economies in the EBRD regions experienced downward pressure on their exchange rates against the US dollar since the start of the war on Ukraine. The euro dropped to a new 20-year low relative to the US dollar in early September as gas supplies to Europe were further restricted following suspension of deliveries via Nord Stream 1, an undersea pipeline running to Germany. Depreciations were particularly stark in central Europe and Turkey, against both the US dollar and the euro. Meanwhile, some currencies in the Caucasus and Central Asia strengthened following sharp initial depreciations (see Chart 25).

**Chart 25. Most currencies in the EBRD regions weakened against the US dollar since February 2022**

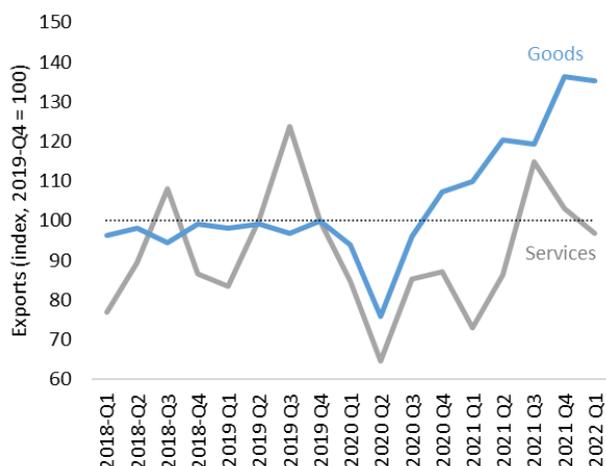


Sources: National authorities via CEIC and authors' calculations.

### Exports have rebounded

Exports in the EBRD regions rebounded in the second half of 2021 and the first quarter of 2022, more strongly than in advanced economies. The rebound was stronger for exports of goods, while exports of services continue to lag behind (see Chart 26).

**Chart 26. Exports of goods have rebounded in the EBRD regions**

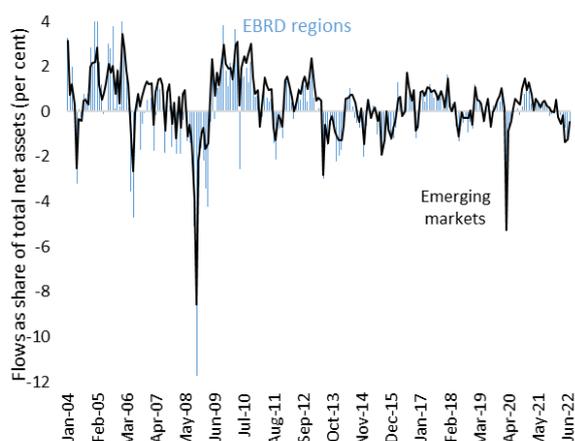


Sources: Refinitiv, International Trade Centre and authors' calculations.  
Notes: EBRD regions includes 35 economies for goods, 28 for services.

### Moderate capital outflows

Some economies in the EBRD regions, such as Hungary and Romania, have experienced significant capital outflows since the start of the war on Ukraine. However, the levels of these outflows are not unprecedented. The beginning of the Covid-19 pandemic, the taper tantrum episode of 2013 and the global financial crisis were characterised by sharper, albeit short-lived, outflows (see Chart 27).

**Chart 27. Some capital outflows from the EBRD regions**

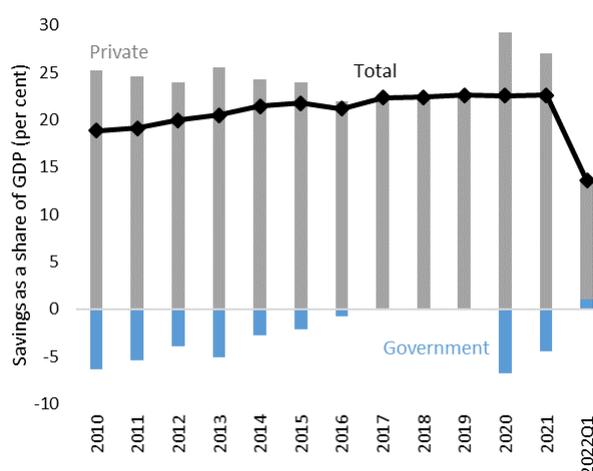


Sources: EPFR and authors' calculations.  
Notes: Net mutual fund flows. EBRD regions based on an unbalanced panel (bonds for 14-24 economies and equities for 13-17).

**A sharp drop in savings helped to sustain consumption levels in the first half of 2022**

During the Covid-19 crisis government current expenditures exceeded revenues by a wide margin, resulting in a sharp drop in public savings. On the other hand, the private sector, facing social distancing restrictions, reduced consumption and increased savings during the pandemic, with virtually no movement observed in total (public plus private) savings (see Chart 28 for central Europe and the Baltic states). As pandemic-related restrictions were lifted, private savings accumulated during the Covid-19 pandemic were run down in the first quarter of 2022. This temporarily boosted consumption in central Europe and the Baltic states despite the rising cost of living (see Chart 28).

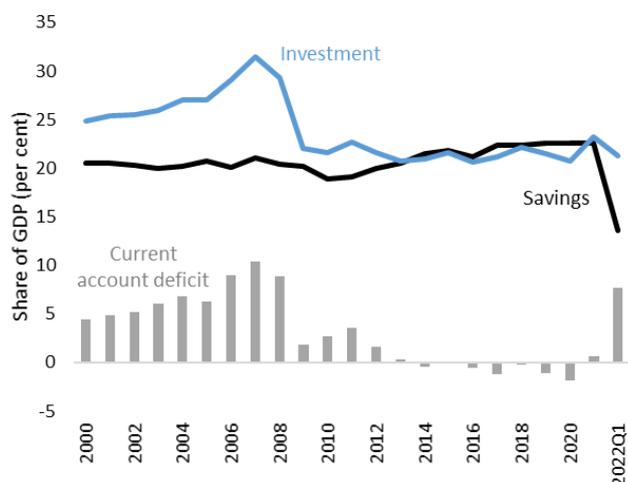
**Chart 28. Private savings dropped sharply in early 2022**



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

The drop in overall savings in the first months of 2022 resulted in a sharp widening of current account deficits (the difference between savings and investment), to the levels last seen in the run-up to the 2008-09 crisis (see Chart 29). As savings recover and consumption declines or investment falls (or both), growth may slow down sharply.

**Chart 29. Current account deficits widened**

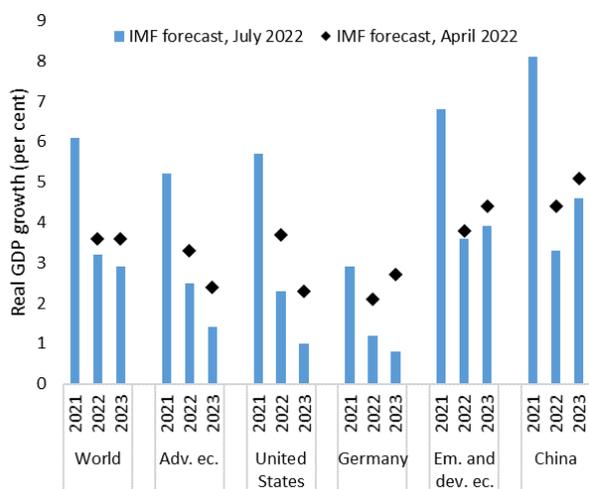


Sources: Eurostat, IMF and authors' calculations.  
Notes: Simple averages across Croatia, Czech Republic, Estonia, Greece, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia.

**Global growth revised down**

The International Monetary Fund revised global growth forecasts for 2022 down by 0.4 percentage points in July, relative to the April 2022 *World Economic Outlook*. The downward revision reflects higher-than-expected inflation triggering tighter financial conditions in advanced economies, a worse-than-anticipated slowdown in China on Covid-19 outbreaks and lockdowns, and spillovers from the war on Ukraine (see Chart 30).

**Chart 30. Global growth forecasts revised down sharply**

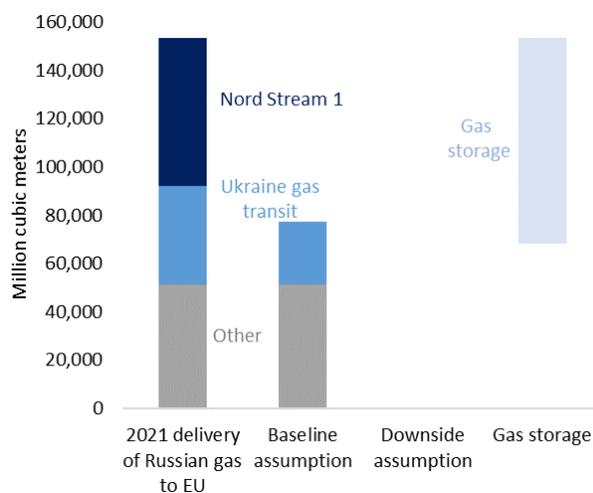


Sources: IMF.

**Output in the EBRD regions is expected to grow by 2.3 per cent in 2022**

The baseline scenario assumes significant disruptions to Russian gas exports to Europe, with shipments declining by around 45 per cent relative to their 2021 level on account of closure of Nord Stream 1 and reduced transshipment through Belarus and Ukraine (see Chart 31). The shortfall, equivalent to around 16 per cent of Europe's total gas consumption in 2021, is smaller than the total gas storage capacity and thus could be managed over the medium term by varying the reserves (which are typically accumulated over the summer and run down over the winter). So far, reduced imports from Russia have been largely accommodated through reduced gas consumption (down up to 10 per cent on 2021 levels) and increased imports from elsewhere, in particular through LNG terminals.

**Chart 31. Illustrative assumptions about delivery of Russian gas to Europe in various scenarios**

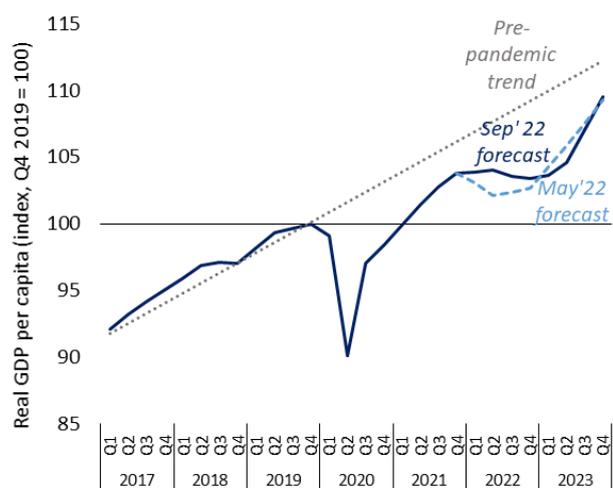


Sources: Bruegel and authors' calculations.

Under these assumptions, output in the EBRD regions is expected to grow by 2.3 per cent in 2022 (see Chart 32 and Table 1). This represents a 1.2 percentage point upward revision compared with the forecast made in May 2022. The upward revision is mostly driven by better-than-expected outturns in the first half of the year in central Europe and the Baltic states, as private dissaving temporarily boosted consumption.

Growth in the EBRD regions is forecast to increase to 3 per cent in 2023. A downward revision of 1.7 percentage points since May reflects the impact of the disruptions to gas supplies, including through spillovers from slower growth in advanced Europe, as well as mounting inflationary pressures in the global economy and the EBRD regions. With growth revised up in 2022 and down in 2023, output in 2023 is expected to be 0.5 per cent lower than forecast in May.

**Chart 32. Growth forecasts have been revised up in 2022 and down in 2023**



Sources: National authorities via CEIC and EBRD forecasts.

Notes: EBRD average based on the values of gross domestic product in 2020 in current US dollars from the IMF.

### Regional outlooks

Output in **central Europe and the Baltic states** is expected to increase by 3.7 per cent in 2022 (see Chart 33). Upward revisions relative to May reflect strong outturns in the first half of the year. Growth is expected to slow sharply, to 1.3 per cent in 2023 on gas supply disruptions and spillovers from slower growth in advanced Europe, in particular Germany and Austria.

GDP in the three **south-eastern European Union** countries is expected to grow by 5 per cent in 2022, with growth slowing to 2 per cent in 2023. As in central Europe and the Baltic states, this reflects better-than-expected outturns in the first half of 2022, but downward revisions in 2023 on

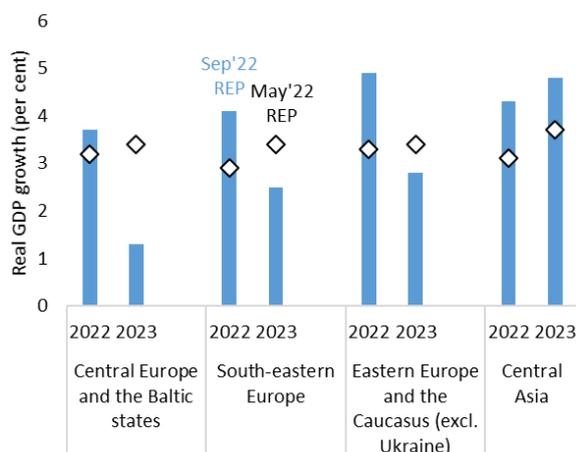
reduced gas supply and spillovers from the slowdown in advanced European economies.

Similarly, output in the **Western Balkans** is expected to grow by 3.2 per cent in 2022 and slow to 3 per cent in 2023 (revised down relative to May), with risks to the economic outlook increasing, in particular in light of the fiscal vulnerabilities.

Output in **eastern Europe and the Caucasus** (excluding Ukraine) is expected to expand by 4.9 per cent in 2022 and 2.8 per cent in 2023 as temporary stays by Russians boost consumption in Armenia and Georgia. The forecast for growth in Ukraine in 2022 (-30 per cent) is unchanged relative to May given high levels on uncertainty, while the rebound in 2023 (8 per cent) is now forecast to be more muted.

Output in **Central Asia** is expected to grow by 4.3 per cent in 2022 and 4.8 per cent in 2023. Upward revisions to both years relative to May reflect a boost to consumption driven by public sector wage hikes, high remittance flows and a sharp increase in shadow trade with Russia, as well as gains in commodity exporters. Russia's economy is forecast to contract by 5 per cent in 2022 (less than previously expected) and by 3 per cent in 2023.

**Chart 33. Growth forecasts for both 2022 and 2023 have been revised up for Central Asia**



Sources: National authorities via CEIC and EBRD forecasts.

Notes: Regional averages based on the values of gross domestic product in 2020 in current US dollars from the IMF.

GDP growth in **Turkey** is expected at 4.5 per cent in 2022, supported by government spending ahead of the planned elections and better-than-expected net exports, reflecting in part increased exports to Russia. The forecast for 2023, at 3.5 per cent, is unchanged relative to May.

Output in **the southern and eastern Mediterranean** is expected to grow by 2.9 per cent in 2022, though structural problems, external vulnerabilities and limited progress on reforms continue to weigh on growth. Growth is expected to increase to 4.7 per cent in 2023.

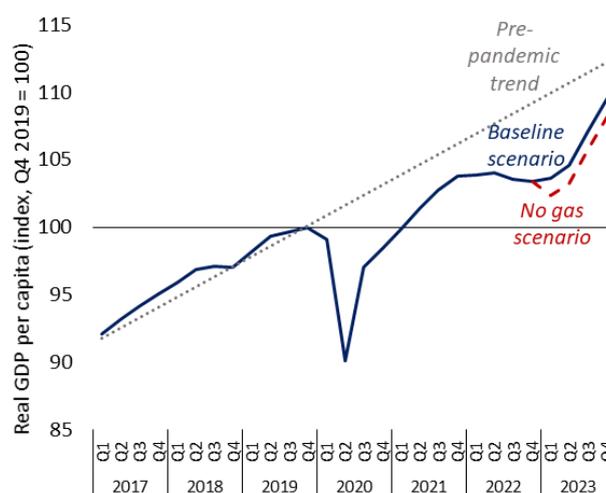
### Risks to the outlook

These projections are subject to major downside risks should hostilities escalate or should imports of gas from Russia be further restricted.

In a downside scenario where gas supplies from Russia to Europe are cut off completely, the reduction in gas supplies relative to the 2021 volume exceeds current gas storage levels almost by a factor of two. As a result, gas consumption would need to be curtailed sharply in the short term. Shifting to alternative energy sources (such as renewables) or alternative gas suppliers in the medium term would require additional investments in infrastructure, such as new LNG terminals and pipelines or expansion of the southern gas corridor.

Reflecting this, as well as spillover effects from much slower growth in advanced Europe and in particular Germany, GDP growth in the EBRD regions could be 1.3 percentage points lower in 2023 than in the baseline scenario (see Chart 34), with further impact in 2024. The difference between the two scenarios is smaller than between similar scenarios presented in the May *Regional Economic Prospects*, on account of lower deliveries of Russian gas assumed in the updated baseline scenario.

**Chart 34. Further disruptions to Russian gas would weigh on GDP in the EBRD regions**



Sources: IMF, national authorities via CEIC, EBRD and authors' calculations.

## Regional updates

### Central Asia

*Most Central Asian economies appear to be resilient to the geopolitical developments unleashed by Russia's war on Ukraine. Kazakhstan and Turkmenistan are enjoying windfall oil and gas revenues as a result of elevated prices and increased export volumes. The Kyrgyz Republic, Uzbekistan and Tajikistan continue to receive substantial remittances from Russia, and these show no signs of abating as the rouble strengthens, migrant numbers in Russia reach record levels and Russian households seek to obtain international payment cards and park their foreign currency savings outside the country. Many Russian speakers are relocating and moving their businesses to Central Asia, taking advantage of "IT Parks" and special economic zones catering to digital nomads and exporters of IT services. Central Asian economies are also seeing significant gains in re-exports of computers, consumer electronics and home appliances, spare auto parts, electrical and electronic components to Russia. And economies in this region are experiencing very strong growth in wages and public revenues. Unlike its Central Asian peers, however, Mongolia's post-pandemic recovery in the first quarter of 2022 has been hampered by intermittent closures of its border with China, as well as a drop in the price of its main export commodities, coal and copper. The main challenges facing all Central Asian economies are inflation (now) and debt service costs (in the future). With CPI inflation typically in the 10-16 per cent range, way above the target corridors, central banks are ratcheting up policy rates, while governments are failing to tighten fiscal policies fast enough as they enjoy record high tax revenues and have political reasons to spend them.*

#### **Kazakhstan**

Despite a very significant exposure to Russia and the challenges associated with a complicated political transition, the Kazakh economy achieved broad-based growth of 3.4 per cent year-on-year in the first half of 2022. Repeated disruptions at CPC's Novorossiysk terminal notwithstanding, the country's oil exports in the first half of 2022 reached US\$ 24.8 billion (up 85 per cent year-on-year). Total exports in the first half of the year stood at US\$ 42.2 billion, a level not seen since

2014. Elevated prices of oil were the main contributor to oil export growth, but volumes increased as well by almost 10 per cent. While the EU (the Netherlands and Italy) remains the main market for Kazakh oil exports, China, South Korea and Singapore are more than doubling their purchases in physical volumes. Banks in Kazakhstan are enjoying a steady flow of new clients from sanctioned countries. Kazakh subsidiaries of the Russian banks (Sberbank and Alfa bank) have been wound down and sold to Kazakh banks. Payments bottlenecks between Kazakh and Russian companies have been by and large resolved, with businesses shifting to payments in national currencies. As the economy shows clear signs of overheating, the main challenge for Kazakh policymakers is to implement fiscal consolidation measures over the medium term. The central bank continued ratcheting up its policy rate throughout 2022, bringing it to 14.5 per cent in July. However, the pass-through from the policy rate to inflation (16.1 per cent in August) remains limited due to the prevalence of government-subsidised credit programmes and procyclical fiscal policies. Overall, the economy is expected to post 3.0 per cent growth in 2022, and 3.5 per cent in 2023. Significant downside risks relate to possible continued interruptions of oil transit through Novorossiysk.

#### **Kyrgyz Republic**

The Kyrgyz economy is on a vigorous recovery path, with GDP growing by 7.7 per cent year-on-year in the period January-July 2022. Contrary to early expectations, the strong Russian Rouble and Russia's record high demand for migrant workers resulted in remittances to the Kyrgyz Republic increasing by 11 per cent in the first half of 2022, supporting domestic demand and enabling growth in industrial production, hospitality, trade and trucking. Wage increases for public sector employees and strong demand for qualified labour, coupled with the government's efforts at reducing informality, led to a more than 30 per cent increase in nominal wages – well above inflation (currently at close to 14 per cent). The country is also enjoying a significant increase in money transfers by Russian households seeking to obtain and replenish international payment cards, keep their forex savings abroad and finance "shadow imports" to Russia. Re-exporting of (mostly) Chinese goods to Russia has become a major business activity often undertaken by small

Kyrgyz companies and physical persons, helping spread the benefits across all population strata. Inflation remains a key challenge, however. Although the central bank raised the policy rate from 8.5 per cent in February to 14.0 per cent in March 2022, CPI inflation reached 13.8 per cent in July. On the positive side, higher prices and improvements in tax administration (introduced in January 2022) led to very strong growth in public revenues and a budget surplus of 2.4 per cent of GDP. The government's success is settling the long-standing conflict over the Kumtor gold mine with Canada's Centerra clears a major roadblock for gold exports and foreign direct investment (FDI), and in January-June 2022, incoming foreign direct investments doubled, reaching US\$ 628 million. Further FDI is expected in major hydropower and railway projects in the coming years. Overall, the economy is likely to benefit from increased re-export opportunities, money transfers as well as relocation of Russian companies and individuals, justifying a forecast of 7.0 per cent GDP growth in both 2022 and 2023.

### **Mongolia**

Intermittent border closures with China have hindered Mongolia's post-Covid recovery, crippling the country's coal exports in the first four months of 2022 and leading to a weakening of the domestic currency. Measures to streamline border management and the relaxation of Covid-related restrictions by China have, however, improved the situation in the second quarter of 2022. Coal exports in the first seven months of 2022 have surpassed last year's levels, helping bring real GDP growth in the first half of 2022 to 1.9 per cent year-on-year. Strong external demand resulted in overall exports rising by 36 per cent year-on-year in the first seven months of 2022, and agriculture and services have also performed well, the latter helped by a partial revival of tourism. However, significant bottlenecks emerged in Ulaanbaatar and in Mongolian border ports. Inflation reached 16.1 per cent in June 2022, easing slightly to 15.7 per cent in July as lending by domestic banks remains limited. The central bank's policy rate remains at 10 per cent. Having settled its differences with Rio Tinto, the government has paved the way for expansion works to begin at the Oyu Tolgoi underground site and to increased production in 2023. Real GDP is expected to grow by 3.5 per cent in 2022 and 7.0 per cent in 2023. Significant upside potential is related to tourism activities fully recovering in

2023, continued investment in the Tavan Tolgoi and Oyu Tolgoi mining projects, as well as public investment in railway, oil processing and other pieces of critical infrastructure.

### **Tajikistan**

Despite much reduced gold exports, Tajikistan has continued during 2022 on a path of robust post-Covid recovery, with real GDP rising by 7.4 per cent year-on-year in the first half of the year. Domestic demand received strong support from a boost in labour remittances, which, contrary to early expectations, have increased on the Rouble's strength and Russia's record high demand for migrant workers. This has in turn enabled growth in industrial production, agriculture, hospitality, retail trade and trucking. In the first seven months of 2022, Tajikistan has seen an 85 per cent increase in imports from China (according to Chinese customs administration data), suggesting that the country is serving as a conduit of shadow imports to Russia. Many businesses have shifted to payments in national currencies, and banks are profiting from the sanctions-driven 'frictions' associated with international transactions. The Tajik Somoni almost fully recovered to its pre-war value against the US dollar. In January-May 2022, despite rising global food and commodity prices, Tajikistan was the only Central Asian country to keep inflation within the target corridor. In August 2022, however, as inflation accelerated to 8.3 per cent (slightly above the target range), the National Bank of Tajikistan increased the policy rate by a largely symbolic 25 basis points, from 13.25 to 13.5 per cent. The country has met the conditions for a new Rapid Credit Facility (RCF) framework with the IMF, further bolstering macroeconomic stability, balance of payments and foreign currency reserves. Tajikistan's ambitious infrastructure plans, including the Rughun HPP, are well positioned for IFI financing through the G7-pledged Partnership for Global Infrastructure and Investment. All in all, the Tajik economy is expected to continue expanding at a rapid pace of 7.0 per cent in 2022 and 8.0 per cent in 2023. Downside risks are related to potential violence in Afghanistan spilling over to Tajikistan's territory and possibly derailing regional efforts to connect Central Asia to Pakistan and further south to India and Iran.

## Turkmenistan

The authorities continue to report a remarkably robust economic performance. Official data suggest that real GDP grew by 6.1 per cent year-on-year in January-July 2022, with the strongest gains achieved in manufacturing and services, foreign trade, and retail trade turnover. The official exchange rate peg continues to be maintained at 3.5 Turkmen Manat (TMT) per US dollar. The parallel market exchange rate appreciated from the lows of 40 in April 2021 to 19 TMT per US dollar, potentially reflecting greater availability of foreign currency at the heavily subsidised official rate to SMEs in priority sectors (such as food and beverages) in exchange for price cuts, and/or as a means of encouraging export and import substitution activities. Turkmenistan has a healthy fiscal balance, supported by elevated gas revenues and low public debt. While official estimates are not available, inflation is likely to remain in low double digits, below the end-2021 level of 21 per cent. Administratively set prices for fuel and energy products have not been adjusted in 2022 whereas food inflation is likely to be moderated by a high base effect given that prices were allowed to increase rather sharply in 2021. Turkmenistan continues efforts to strengthen international trade, as reflected in a recent decision on joining the International North-South Corridor, as well as agreements to develop bilateral trade, simplify visa regimes, and improve transport connectivity. The country's self-imposed isolation, a strong focus on import substitution activities (financed by windfall export revenues), geopolitical neutrality and elevated gas prices will continue to drive the economy in the foreseeable future. Turkmenistan's real GDP is expected to grow by 7 per cent in 2022 and 6 per cent in 2023.

## Uzbekistan

Having avoided recession in 2020, Uzbekistan's economy enjoyed very strong growth of 7.4 per cent in 2021 and continues in 2022 to demonstrate exceptional resilience in the face of strong geopolitical headwinds since Russia's invasion of Ukraine. With Russia's demand for migrant workers breaking records and the rouble gaining recently versus other currencies, Uzbekistan has seen domestic demand supported by a surge in remittances, which were up by 96 per cent year-on-year in the first half of 2022. Many Russian households travelled to Uzbekistan

in order to open bank accounts and obtain international payment cards, and numerous IT businesses and developers relocated to Tashkent to take advantage of the newly introduced "IT visas" and favourable tax regime afforded by Uzbekistan's IT Park. Overall, real GDP grew by 5.2 per cent year-on-year in the first six months of 2022, with services, industrial output and construction growing by 7.6, 5.1 and 6.2 per cent, respectively. Exports and imports are both up by more than 30 per cent, though the country has not played a major role as a source of shadow imports to Russia. Having dipped in early March 2022, the Uzbek Som regained its pre-war value thanks to a timely action by the Central Bank of Uzbekistan (CBU) and the rouble's recovery. The CBU's policy rate has been on a downward trajectory since the peak of 17 per cent in March 2022, set at 15 per cent in July 2022. CPI inflation reached 12.3 per cent in July 2022 on the back of rising food and commodity prices. The fiscal position is also improving as total external debt inched down from US\$ 39.6 billion to US\$ 38.8 billion, the first such decline since 2013. Overall, Uzbekistan continues to enjoy very strong economic development, relying on a large and industrious labour force, a sizeable domestic market, strong and diversified manufacturing capacity and market-oriented reforms. The economy is therefore forecast to grow at 5.5 per cent in 2022, and 6.5 per cent in 2023.

## Central Europe and the Baltic States (CEB)

*Most CEB countries registered a strong post-pandemic recovery in 2021 and at the beginning of 2022, propelled by a shift in household demand towards services from accumulated savings. However, the second half of 2022 is seeing a significant reduction in economic activity in this region. In the second quarter of 2022, GDP growth had already started to decelerate, dragged down by fast-rising inflation, especially in energy and food prices, weakening currencies, waning external demand, droughts and a strained geopolitical situation. Governments have launched price-curbing measures to reduce the high energy cost burden to households, though such measures can in the short term provide the wrong incentives for energy efficiency measures. The frequency and magnitude of droughts have been on the rise, hurting agriculture yields and poisoning rivers. In light of the major growth slowdown under way, GDP growth in the CEB region is expected to reach 3.7 per cent in 2022*

and decline significantly to 1.3 per cent in 2023. Major uncertainty surrounds these forecasts, depending on the persistence of high energy prices and the possibility of gas rationing if supplies from Russia dry up completely.

### **Croatia**

The Croatian economy fully recovered from the pandemic in 2021 as GDP expanded by 10.2 per cent, with private consumption, exports, and investment all recording robust contributions. In the first half of 2022, GDP expanded by a still strong 7.4 per cent year-on-year, driven again by domestic demand and continued expansion of exports. Private consumption has remained robust in spite of an average 1.9 per cent decline of real wages in this period, but consumer confidence fell amid rising inflation, which reached 12.3 per cent in July 2022. In September 2022, the government announced a package of support, amounting to 4.9 per cent of 2021 GDP and focused on capping electricity prices until March 2023, tax reliefs and fuel excise tax cuts, energy subsidies to vulnerable households, and capping prices on basic foods, on top of earlier measures such as limited increases in gas and electricity tariffs and fuel price caps. With consumption and investment weakening, the tourism sector will be key in supporting growth and budget inflows in the third quarter. Tourist stays in June 2022 already exceeded those in June 2019. Croatia is relatively protected from the Russian gas import shutdown, given its majority state-owned energy sector, adequate share of renewables and access to alternatives through the Krk LNG terminal. GDP growth is expected to reach 6.5 per cent in 2022, but in 2023, weak Eurozone demand will likely contribute to a slowdown in growth to 2 per cent.

### **Czech Republic**

GDP grew robustly at 4.2 per cent year-on-year in the first half of 2022, but the economy remains one of the most vulnerable in the region in the current environment, owing to very high inflation, energy security risks, and a potential recession in the EU economy. Growth in 2022 has so far been driven by a rebound of investment and private consumption, although household spending stalled in the second quarter. Inflation reached 17.5 per cent in July 2022, taking its toll on household income, as real wage growth declined by a significant 9.8 per cent in the second

quarter. The central bank has raised its two-week repo rate to a 20-year high of 7 per cent to help counter rising inflation. Industrial production growth has seen monthly fluctuations this year and will be affected by higher energy prices, and further trade and supply disruptions. In terms of energy security, the Czech Republic is one of the most exposed economies in the face of the shutdown of Russian gas imports. Moreover, most of the energy price increases are yet to be channelled to consumers, further inflating prices, while the government is yet to introduce significant support measures. GDP growth is still forecast at 2.5 per cent for 2022, as the economy will likely fall into a technical recession over at least the next two quarters. Therefore, given the overall slowdown of the economy in late 2022, GDP growth is forecast at just 0.5 per cent in 2023.

### **Estonia**

Following rapid growth in 2021, GDP growth in Estonia slowed down to 2.4 per cent year-on-year in the first half of 2022. Household consumption supported GDP growth, especially via higher spending on services that are rebounding from the pandemic. High levels of accumulated savings, money taken from the funded pension scheme as well as the government's energy price compensations were able to offset partially the negative impact on GDP of the historically high inflation rate. However, exports have slowed down due to weaker demand from the EU. In July 2022, the annual inflation rate reached 22.8 per cent, the highest level since 1995. It is mostly driven by high households' expenditures on energy, heating, gas and solid fuels. Inflation is expected to remain at around 20 per cent throughout 2022, and is likely to decelerate to single digits around the second half of 2023. Households' disposable incomes will suffer, as average real wages will shrink this and next year. The subdued corporate investments in 2022 are likely to rebound around end-2023, when inflation eases and fresh EU funds will be more vigorously utilised by companies as the outlook improves. GDP growth is anticipated to remain subdued this and next year, at 1.5 per cent and 1.0 per cent, respectively.

### **Hungary**

Following strong GDP growth in 2021, the Hungarian economy continued to grow rapidly

during the first half of 2022, at 7.3 per cent year-on-year. The weakening forint supported exports, while the tourism sector rebounded somewhat from the low base registered during the Covid-19 pandemic. Domestic demand was fuelled by high corporate investment, especially in the automotive sector, but the agriculture sector was adversely affected by a drought. Unemployment was just 2.6 per cent in June 2022, one of the lowest levels in the EU. Forint depreciation, elevated commodity and energy prices, increasing wages and strong domestic demand have all fuelled high inflation rates during 2022, with the rate reaching 13.7 per cent in July 2022. In response to rising prices, the central bank has been gradually raising the policy rate since June 2021, moving to 10.75 per cent in July 2022. Private sector investments, especially those by automotive manufacturers, will add to GDP growth and employment in the coming years, but the deteriorating outlook, including potential new energy supply disruptions, will weigh on economic activities. In 2022, GDP growth is forecast to remain high, at 5.0 per cent, but followed by a sharp slowdown to 1.5 per cent in 2023.

### **Latvia**

The economy grew by a robust 4.7 per cent year-on-year in the first half of 2022. Since then, however, Russia's war on Ukraine and trade disruptions, coupled with the energy crisis and surging inflation, are constraining economic activity and households' disposable incomes. Unemployment remains relatively low at 6.6 per cent in the second quarter of 2022, the lowest since pre-pandemic levels, but the effects of the economic slowdown and refugee inflows are yet to materialise and are expected to lead to a temporary easing of labour market shortages towards the end of 2022 and beginning of 2023. Consumer prices are on the rise, with CPI inflation hitting 21.5 per cent year-on-year in July, the highest rate since the 1990s. Housing and utility sectors' prices faced the strongest growth (up 50.7 per cent year-on-year), mainly driven by a steep increase in natural gas prices, followed by the food sector with a significant 24.3 per cent year-on-year increase. As a result, the government established a series of support packages to mitigate the effects of rising prices on households and businesses alike. Subdued economic activity in the EU, accompanied by supply chain disruptions and running inflation will likely negatively affect Latvian exports and

consumption, partially offset by sustained demand for some of the country's main export products, including wood and food products. GDP growth is forecast at 2.5 per cent and 0.8 per cent in 2022 and 2023, respectively. Additional funds under the EU's Recovery and Resilience Facility will become available in 2023 and should support economic growth.

### **Lithuania**

Following a strong rebound of economic activity in 2021, growth slowed down to 3.2 per cent year-on-year in the first half of 2022. Household consumption was hit by eroding real disposable incomes amid soaring inflation, though unemployment remains low at 5.2 per cent in the second quarter of 2022. Inflation reached 21.1 per cent in August 2022, largely triggered by sharp rises in housing, food, energy and transport prices. In order to combat the effects of these price hikes, especially heating, the government approved a €2.26 billion package to alleviate some of the inflation burden for households. Amid reduced exports to Belarus, Russia and Ukraine, and weakening demand in the EU, GDP growth in Lithuania is expected to slow down to 2.0 per cent and 1.5 per cent in 2022 and 2023, respectively. Trade tensions with China are expected to negatively affect economic activity in Lithuania in the short term, but investments under the RRF will positively stimulate GDP growth.

### **Poland**

Following a strong beginning of 2022, the Polish economy is losing momentum in the second half of the year because of reduced investment amid higher financing costs, high energy prices and ongoing supply chain pressures. The current high level of inflation has impacted negatively households' disposable incomes, thus weighing on consumption and consumer confidence. By mid-2022, about 260,000 Ukrainian refugees had taken up work in Poland. As of then, about 5.6 million people had crossed the Ukraine-Poland border, with about 3.7 million leaving Poland to other destinations, according to official statistics. Overall, more than three million Ukrainians were estimated to be in Poland, including those who migrated to Poland before the war. Refugees found employment mostly in retail trade and home care facilities, whereas pre-war, these were mostly men working in heavy industry or construction. In August 2022, the CPI inflation

rate reached 16.1 per cent, the highest level for nearly 25 years. Core inflation, excluding food and energy prices, contributes nearly half to the overall figure. Inflation is likely to peak in autumn of 2022, though substantial uncertainty about energy price developments remain. Economic growth is forecast to reach 4.0 per cent growth in 2022, before dropping sharply to 1.5 per cent in 2023.

### **Slovak Republic**

The war in Ukraine has hit the Slovak Republic through various channels. While direct trade with Russia and Ukraine is modest, the Slovak Republic is heavily exposed to disruptions of Russian energy imports and mounting import costs, which have adversely hit the supply side of the economy. Together with persistent supply-side bottlenecks, which increase goods prices, the economy is exposed to an adverse cost-push shock. In mid-2022, inflation exceeded 12 per cent year-on-year, and average inflation in 2022-23 is expected to remain at 10 per cent. Nominal wages increased by 6.8 per cent in 2021, and are expected to rise by 7-9 per cent in 2022-23. As a result, households' disposable incomes are declining in real terms. All of these factors are weighing on GDP growth in the short term. On the upside, accelerated investments that engage funding from the EU's Recovery and Resilience Facility, as well as new capacity investments in automotive sectors, will help overcome the negative factors linked to the war. GDP growth is therefore expected to decelerate to 2.0 per cent this year and remain subdued at 1.0 per cent in 2023.

### **Slovenia**

GDP rebounded strongly by 8.2 per cent in 2021, spurred by generous government spending which supported the recovery of domestic demand. In the first half of 2022, GDP grew by 8.9 per cent year-on-year, the fastest growth rate across the EU, driven by resilient domestic demand and an inventory build-up. Exports were also resilient, especially in the second quarter, but the domestic economy increased demand for imports, leading to a negative contribution of net exports. Private consumption, the main growth driver over the past year, has recorded a quarterly decline in the second quarter, with a 7.5 per cent wage cut in real terms, as the generous support to government employees last year was terminated.

Inflation reached 11 per cent in June and July, and further inflationary pressures are likely from an expected rise in government spending later in the year. Despite strong dependence on Russian gas, Slovenia has access to a number of alternatives, particularly LNG, while state-owned domestic production should be able to keep up with demand. GDP is forecast to grow by 6 per cent in 2022, with risks tilted to the downside, especially if households significantly cut down spending in the remainder of the year. In 2023, growth is expected to slow down significantly to 1.8 per cent, due to the drop in domestic demand and the weaker Eurozone economy, which will hold back Slovenian exports.

### **Eastern Europe and the Caucasus (EEC)**

*Economic developments in 2022 vary enormously across different countries in this region. Ukraine's economy is being ravaged by the war and is suffering heavy losses of human capital, infrastructure and production capacities. The economy is likely to be reduced by almost one-third in 2022, with bleak prospects for full recovery until the war is over. Moldova has been hit by the consequences of the war in its neighbourhood, as well as by a three-fold increase of domestic gas prices. Inflation exceeded 20 per cent in Ukraine and 30 per cent in Moldova. On the other hand, the Caucasus economies are enjoying some of the highest economic growth rates in recent years. Azerbaijan is benefiting from high energy prices, while many Russian businesses and people who found refuge in Armenia and Georgia have flooded these small economies with foreign inflows and boosted the services sectors. Inflation calmed down recently in all three economies though it remains high at around 10 per cent. Nevertheless, economic growth in all three Caucasus economies is driven by temporary factors which will not drive sustainable growth in the medium term.*

### **Armenia**

The solid post Covid-19 recovery seen in 2021 has accelerated further during 2022, with economic growth reaching 13.1 per cent in the period January-July 2022. Negative spillovers from the country's high exposure, through trade, remittances, and foreign direct investment, to the sanctions-hit Russian economy were outweighed by the arrival of many people and businesses from Russia who found a temporary refuge in

Armenia and boosted demand for services. The net inflow of money transfers increased by 113 per cent year-on-year in the January to July 2022 period due to a more than three-fold increase of transfers from Russia. These inflows helped to finance the widening trade deficit, as import growth of 50.1 per cent year-on-year exceeded strong export growth of 43.9 per cent during this period. Foreign reserves have increased by almost 20 per cent since the beginning of the year and the exchange rate appreciated by 18 per cent. Initially, inflation slightly accelerated under pressure of the new wave of rising energy and food prices, but later moderated to 9.1 per cent year-on-year in August 2022. The Central Bank of Armenia reacted by increasing the refinancing rate several times during 2022, the latest to 11 per cent in August. Uncertainty remains high, however, robust growth of 8.0 per cent is forecast for 2022, with a significant drop to 4.0 per cent likely in 2023. Current growth is driven by temporary factors that could be easily reversed, and the ongoing isolation of the Russian economy from Western markets could have long-term negative consequences for the Armenian economy.

### **Azerbaijan**

The strong performance of the non-energy sector led to economic growth of 6.2 per cent year-on-year in the first seven months of 2022. The non-energy sector increased production by 9.9 per cent, while hydrocarbon sectors decreased by 0.4 per cent, with oil production down 4.5 per cent, though gas production increased by 15.3 per cent. However, rising prices of hydrocarbons almost doubled export revenues and generated a large current account and budget surplus. This created a favourable environment to sustain household real incomes, despite rising inflation, which in turn supported the strong growth of non-tradable sectors of the economy. Inflation accelerated further from 12.0 per cent at the end of 2021 to 14.2 per cent in June 2022, but slowed down to 13.7 per cent in July as a first sign of abating inflationary pressures. The Central Bank of Azerbaijan responded firmly to rising inflation in the initial stage and raised the policy rate by 150 basis points between September 2021 and March 2022, but remained cautious afterwards. High energy prices are expected to support economic growth in the near term, but weak investment activity raises doubts about its medium-term sustainability. Hence, GDP growth of

4.5 per cent is forecast in 2022, with a moderation to 2.5 per cent in 2023. The risks are balanced and largely arise from the direction of energy prices and, to a smaller degree, from the likely inflation path.

### **Georgia**

Economic growth has been very strong in 2022, at 10.3 per cent year-on-year in the first seven months of 2022. The tourism sector revival continued, with inflows from foreign tourists reaching almost 80 per cent of the level achieved in the first half of pre-pandemic 2019. Double-digit growth was recorded in many other sectors too, including energy, transport, and manufacturing. The inflow of Russian businesses and ICT professionals who found a refuge in Georgia boosted money transfers and further supported the services and hospitality sectors. At the same time, the trade deficit has widened as exports and imports have increased more than 30 per cent year-on-year in the first seven months of 2022, benefiting from the geographical diversification of trade. However, rising current account inflows helped to cover the trade deficit and supported the appreciation of the Georgian lari since the low point in March 2022, and led to an increase of foreign reserves. The appreciation of the domestic currency mitigated some of the pressure from imported prices of food and energy, resulting in a moderation of inflation from the recent peak of 12.5 per cent in June to 10.9 per cent in August 2022. That allowed the National Bank of Georgia to keep the refinancing rate at 11.0 per cent since March 2022, after a 300 basis points increase in the preceding 12 months. Amid the high geopolitical uncertainty, the authorities secured a US\$ 280 million precautionary Stand-By Agreement with the IMF in June 2022, which creates a more predictable business environment. GDP growth is likely to reach 8.0 per cent in 2022 as negative spillover from the war on Ukraine have not materialised yet, but then moderate to 5.0 per cent in 2023. The risks remain high due to extreme uncertainty and a significant probability of external adverse shocks.

### **Moldova**

The war on Ukraine and subsequent rise of energy prices brought economic growth to a halt during the first half of 2022. Increased government spending and net export growth could not

compensate for the stagnation of private consumption and contraction of investments. Inflation reached 34.3 per cent in August 2022 due to rising energy and food prices, seriously reducing households' real incomes. The authorities have ramped up social welfare schemes to cushion the impact of rising inflation on households, through energy price subsidies and loans to farmers. However, expanded social spending, including as a response to the major inflow of Ukrainian refugees, has widened the budget deficit to an estimated 7.2 per cent of GDP in 2022, according to the IMF. Therefore, public debt is expected to increase by 6 percentage points in 2022 and reach 38.4 per cent of GDP. Increased external financing needs were initially covered by a depletion of foreign reserves, but the agreed augmentation of the IMF Programme in May 2022 helped to mobilise additional funds from the EU and the World Bank and reversed that trend. The economy is likely to decline by 1.0 per cent in 2022 and stagnate with zero per cent growth in 2023. The forecast is sensitive to the duration and intensity of the war in Moldova's neighbourhood as well as to the availability of gas supplies.

## Ukraine

Ukraine's economy has been functioning since 24 February 2022 under war conditions. Though combat operations in more recent months have become more concentrated, covering territory that generates around 20 per cent of GDP, the heavy devastation of human capital, infrastructure, and production capacities has been enormous. Approximately 15 per cent of the pre-war population were abroad in mid-August 2022 and an additional 15 per cent were displaced within the country. Economic activity is severely disrupted, even in the regions without combat activities, due to supply bottlenecks, logistical challenges, financial difficulties, and lack of an adequate labour force. The blockade of ports and devastation of many steel producing capacities in the east of the country have decimated exports of the two major product groups that generated almost half of total pre-war export revenues. GDP plunged by 15.1 per cent year-on-year in the first quarter of 2022 and by 37.2 per cent in the second quarter when the most severe and widespread fighting took place. Inflation picked up to 23.8 per cent in August 2022 due to supply disruptions and a plummeting fiscal deficit. The initial high reliance on monetary financing of the

fiscal deficit, amid a significant external financing gap, depleted foreign reserves by 20 per cent until July 2022, despite capital controls being in place. That prompted the central bank to increase the policy rate from 10 to 25 per cent in June and to make a one-off devaluation of the currency by 20 per cent in July. The situation improved afterwards, also because of higher inflows of external financing throughout August and September. As a result, foreign reserves replenished half of the losses by the end of August. The recent resumption of export of grains from some ports and the expectation for sufficient external financing could be positive factors for economic activity until the end of the year. It is likely that GDP will decline by 30.0 per cent in 2022 as a whole, but gradually start to recover by growing 8.0 per cent in 2023. Risks to the forecasts are exceptionally high, and depend mainly on the length and intensity of the war.

## South-eastern European Union

*All three economies in this region have enjoyed a strong first half of 2022, continuing the post-Covid recovery that began in 2021, but signs of a significant slowdown are emerging in the second half of the year. Inflation has moved into double-digit levels, prompting the governments to respond with measures to alleviate the impact on businesses and households, but uncertainty over energy supplies in the coming months is weighing on confidence and investment. GDP growth rates will remain strong, especially in Greece and Romania, for 2022 as a whole, but all three economies are forecast to see a major reduction in growth in 2023.*

## Bulgaria

The economy expanded by 4.2 per cent in 2021, and remained quite resilient in the first half of 2022 with growth of 4.5 per cent year-on-year, driven by strong accumulation of inventories, private and government consumption. Private consumption also expanded by 4.2 per cent year-on-year in the same period, but momentum has declined amid rising inflation and decreasing consumer confidence. Investment declined sharply in the second quarter, as firms confront increased uncertainty, and was 14 per cent below pre-pandemic levels. Nevertheless, industrial production increased by almost 17 per cent year-on-year in the first half of 2022, as manufacturing remained resilient in spite of the Russian gas

shutdown since April 2022. Inflation has significantly worsened, reaching 17.3 per cent in July 2022, and above 20 per cent for food, utilities and housing, transport and restaurants and hotel prices. The government's main measure against rising energy costs is full compensation of firms' electricity bills above €125/MWh. Households have been protected by means of regulated prices, and pensions were increased by 10 per cent in July 2022. The ongoing political crisis may cause delays in the absorption of the second disbursement of the EU's Recovery and Resilience Facility. Due to the robust performance in the first half of the year, GDP growth has been revised up for 2022 to 3 per cent, but uncertainty over gas supply, weakening domestic and foreign demand amid high inflation and deterioration of confidence, as well as political uncertainty, could translate into modest growth of 1.5 per cent in 2023.

### **Greece**

After a major post-pandemic rebound in 2021, the economy continued to post strong growth in the first half of 2022. GDP grew by 8 per cent year-on-year in the first quarter and by 7.7 per cent in the second quarter (seasonally adjusted). The low base effect of lockdowns in the first half of 2021 help explain some of this high year-on-year growth, but the expansion was also driven by buoyant private consumption and rising government spending. Exports have also continued to perform strongly, including high-technology exports which are now approaching those of Germany as a share of GDP. The tourism sector is also contributing once again in a major way to growth in 2022, with the season as a whole expected to almost match the record-breaking pre-pandemic year of 2019.

Unemployment has continued to decline, reaching 12.3 per cent in June 2022. However, inflation has picked up significantly during 2022, reaching 11.3 per cent (HICP measure) in July. The government has put in place measures to help alleviate the cost-of-living crisis, including subsidies to households and enterprises to help meet the increasing cost of electricity, a voucher to help address rising costs for vulnerable households, a three-month fuel subsidy for low income families, and reduced VAT on public transportation (already in place during the Covid-19 crisis but extended to December 2022). Nevertheless, short-term confidence indicators have started to move in a negative direction – the

purchasing managers index fell to 48.8 in August on the back of weaker demand and lower orders – as global energy markets face increasing uncertainty and turbulence and the Eurozone is at risk of a recession. As a downturn in growth in the latter part of the year seems inevitable, GDP growth is forecast to reach 5.2 per cent for 2022 as a whole, and 2.2 per cent in 2023, with growth holding up in part due to implementation of projects, funded by both loans and grants, under the EU's Recovery and Resilience Facility.

### **Romania**

After a rebound of 5.9 per cent in 2021 driven by strong private consumption, GDP surprised on the upside in the first half of 2022 by expanding 5.8 per cent year-on-year. The lifting of all Covid-related restrictions spurred private consumption, especially of services. However, inflation accelerated to a peak of 15 per cent in July and August 2022, leading to a 2.4 per cent decline of real wages in the second quarter. Retail sales have slowed down since May 2022, reflecting a deterioration of consumer confidence. Industrial production declined by 2.6 per cent year-on-year in the first half of the year, reflecting weakening Eurozone demand and supply chain issues. The large inflow of foreign currency, the overall depreciation of the euro, and the tight liquidity management of the central bank led to an appreciation of the local currency against the euro in August 2022 to levels seen when Covid-19 first hit, alleviating inflationary pressures. On the fiscal side, the government has accelerated social transfers, compensated by the above-expectations revenues. The main measure related to the energy prices was the cap on the consumer end, modified by the authorities in early September to extend state intervention in the wholesale market until September 2023. GDP growth is expected at 5.4 per cent in 2022 as a whole. Despite a relatively high share of gas in gross energy consumption, Romania is one of the least economically exposed countries in the region in the face of the Russian gas import shutdown and amid the limited pass-on of energy prices to consumers, but industry and large firms will be impacted. In 2023, the deterioration of household income, financing and energy costs constraining investment and weak foreign demand, particularly from Germany, will lead to modest GDP growth of 1.9 per cent, but still with downside risks in case of a steeper than expected recession in the Eurozone.

## Southern and Eastern Mediterranean (SEMED)

*The impact of the war on Ukraine on the SEMED region is felt through higher oil and food prices for consumers, with significant spillovers for public budgets, food security and medium-term growth drivers. All countries are dependent on importing food products (especially Egypt, Tunisia, and Jordan) and most are also net fuel importers. As a result, inflation has soared in 2022 and pressures on foreign reserves have increased. The impact on tourism varied but overall weighed on the recovery in most SEMED countries. Moreover, supply chain disruptions hold implications for more export-reliant economies, notably Morocco and Tunisia, which are impacted by the slowing demand from Europe. At the same time, new opportunities could arise for Egypt as a gas exporter. The region's growth is expected to slow down to 2.9 per cent in 2022, after a strong recovery of 6.0 per cent in 2021. The absence of strong growth drivers in some SEMED economies post-pandemic, as well as heightened risks to food and energy security, underscore the need for decisive reforms to boost private sector growth and accelerate the green transition. Fiscal pressure has raised financing needs in all countries, and progress on agreeing new IMF programmes in Lebanon, Tunisia and Egypt could also boost investor confidence. Stronger growth is expected in 2023 (at 4.7 per cent), as the recovery gathers pace and reforms potentially advance in all countries.*

### Egypt

GDP growth doubled in Egypt to 6.6 per cent in the 2021/22 fiscal year ending in June 2022, driven by strong manufacturing growth, an uptick in Suez Canal revenues and an expansion in construction activities. However, the recovery levelled off considerably in the second half of the fiscal year (January-June 2022) as global conditions worsened. Egypt benefits from the rising value of its natural gas exports, but depends on imported oil, food and manufacturing products. As a result, inflation reached 13.6 per cent in July, fuelled by rising food and energy prices. Given deteriorating foreign exchange reserves, the currency was allowed to depreciate by around 20 per cent since March 2022. Growth in the fiscal year 2022/23 is expected to slow down to 4.7 per cent, and will be held back by adverse global conditions, as well as structural domestic factors that suppress the recovery of the

non-oil private sector. Agreement on an IMF-supported programme is necessary to support reform implementation, boost investor confidence, and enhance current account balance management. Downside risks to economic performance include continued volatility in global energy and food prices as well as the global recovery challenges spilling over into key sectors and supply chains, which in turn could lead to social unrest as well.

### Jordan

The economic recovery in Jordan remains moderate but robust, with growth reaching 2.5 per cent year-on-year in the first half of 2022, led by a broad-based expansion of the services and industrial sectors, as well as a strong rebound in tourism. However, annual inflation continued to rise, reaching 5.3 per cent in July 2022, driven by rising food prices, as well as a 30.6 per cent increase in energy prices following the introduction of electricity tariff reforms. GDP growth is expected to level off to 2.0 per cent in 2022, as the implications of the war on Ukraine weigh on trade flows and tourism. Faster growth in the non-services sector and stronger recovery in global tourism and trade flows could push growth in 2023 to 2.7 per cent. Achieving the country's medium-term growth potential will depend on the successful implementation of announced reforms under the government's "Economic Modernisation Plan" to attract foreign direct investment and promote new growth drivers. Growth will also likely continue to benefit from the ongoing IMF-supported reforms. The main risks to the outlook include the erosion of real competitiveness stemming from an overvalued exchange rate, regional instability, and slower-than-expected recovery in partner economies.

### Lebanon

Lebanon is sinking further into a financial, economic and social crisis as economic challenges are exacerbated by rising energy and food prices, as well as supply chain disruptions. Key reforms necessary for a potential IMF programme have faced further delays, thus limiting access to external sources of financing and hindering the authorities' ability to shore up reserves. Against this backdrop, the exchange rate deterioration deepened, with multiple rates still in place. Repeated price increases and reductions in the few remaining subsidies have

left large segments of the population in poverty, coupled with electricity and fuel shortages, and limited access to basic commodities. Inflation continued to grow in triple-digits, reaching 168 per cent in July 2022. A further GDP contraction of 2.0 per cent is expected in 2022 as the ongoing crisis is exacerbated by costlier and intermittent supply of energy and food, as well as delays in implementing critical reforms and the drying-up of financial resources. The economy could return to growth in 2023 at 4.0 per cent, conditional on an IMF-supported programme, which would also allow negotiations to resume with international partners.

### **Morocco**

The economic recovery in Morocco is slowing down considerably in 2022, with GDP expanding by only 0.3 per cent year-on-year in the first quarter, following a record 7.4 per cent rebound in 2021. Growth is mainly held back by a sharp contraction in agriculture due to a severe drought. The unfavourable weather along with global inflationary pressures have driven Morocco's inflation rate up to 5.1 per cent in the first half of the year. The poor agricultural season is increasing demand for imported food at higher international prices, amid global supply-chain disruptions. Overall, GDP growth is expected to slow down to 1.1 per cent in 2022, as demand for exports and tourism remain weak. Morocco is also vulnerable to sharp increases in hydrocarbon prices as it imports most of its energy needs, despite rising renewable electricity generation. The same downside risks will likely carry over into the next year. However, 2023 could see a rebound in growth, projected at 3.3 per cent, as agriculture recovers and the pace of growth in other sectors returns to pre-pandemic levels.

### **Tunisia**

Tunisia's economic growth has been modest in the first half of 2022 at 2.6 per cent year-on-year, after a recovery of 3.5 per cent in 2021. Growth is supported by a rebound in tourism, transport and industrial production, despite the otherwise adverse environment. Rising global prices led to 7.5 per cent inflation in the first seven months of 2022, reaching a 30-year high in July. Progress on agreeing a new IMF programme has been slow, given domestic opposition to the painful reforms this would entail (notably on the public sector wage bill and subsidy reform) but remains a

priority for the government. The programme would provide much-needed external financing and technical assistance and would boost the authorities' ability to tackle critical reforms. As a result of all these developments, a 1.7 per cent GDP growth rate is expected in 2022. Prospects for 2023 could be more positive as IMF negotiations progress and global headwinds ease, with growth expected to reach 2.9 per cent in 2023. The main risks to the outlook are further delays in agreeing required reforms or political standoffs, spillovers from the war on Ukraine on Tunisia's main economic partners in Europe, and social unrest in the face of economic hardships.

### **Turkey**

During 2022, the authorities have persisted with the New Economic Model – an unorthodox policy approach introduced in September 2021, which aims to increase export competitiveness and private investment, and relies on a rebalancing of the current account to bring price stability. This is in spite of significant external challenges to the model. These include the Russian invasion of Ukraine, which has caused commodity prices to increase sharply, and a tightening of monetary policy in advanced economies which has resulted in rise in perceived risks of emerging markets. These headwinds have put pressure on the lira, which has fallen by 30 per cent against the US dollar in the year to date, and in turn caused inflation to increase to a two-decade high of close to 80 per cent. The poor credibility of the central bank has fostered expectations of further rises in inflation, with the rate expected to peak at around 90 per cent and year-end inflation forecasts standing at around 70 per cent.

In line with the New Economic Model, rather than increasing policy rates, the authorities' response to these challenges has focused on supporting the lira through 'liratisation' policies, to encourage use of the lira and to reduce the significant dollarisation that characterises the economy, and use of the central bank's extremely limited foreign exchange reserves. A variety of macroprudential measures and other regulatory measures have been introduced to restrict credit growth which has supported a widening of the current account deficit to its current level of around US\$ 33 billion, or 4 per cent of GDP. This trend, alongside Turkey's short-term external debt in excess of US\$ 180 billion, remains a significant concern and threat to macroeconomic stability, particularly as

the depletion of reserves – which currently stand at around US\$ 15 billion on a net basis, but are heavily negative if swaps with commercial banks are excluded – mean that the country has few buffers to deal with a potential crisis.

On the positive side, banks remain well capitalised, with a headline non-performing loan ratio below 3 per cent, while public finances remain one of the anchors of the economy, with the public debt to GDP ratio standing at a relatively modest 38 per cent. However, the new foreign exchange-linked deposit schemes, which were introduced as part of the push towards liraisation, shift exchange rate risks to the public sector, and create a potentially sizeable contingent liability.

Despite the challenges, economic activity has remained relatively robust and the anticipated negative impact of Russia's war on Ukraine on tourism has not materialised. GDP growth of 4.5 per cent is expected in 2022, driven mainly by a modest recovery in net exports, although the boost to competitiveness of the weak lira has been offset by high inflation. Growth is forecast to moderate slightly to 3.5 per cent in 2023, driven by rising household and government spending ahead of the planned elections. Nevertheless, there are significant downside risks to the forecast, including an escalation of geopolitical tensions and spillovers from aggressive policy tightening in developed economies.

## Western Balkans

*Economies in the Western Balkan region continue to grow, but face an increasingly difficult macroeconomic environment. Double-digit inflation figures in all but one country weigh on people's disposable incomes and consumption habits, though steady inflows of remittances, good tourism seasons and still growing export inflows are propping up most economies. Elevated oil prices are hitting the external accounts and at least four of the six countries in the region are additionally hit with high electricity prices, though these remain largely regulated for households. While the tax windfall from elevated inflation somewhat supports the budgets, fiscal space and liquidity management are already being tested, ahead of a winter with likely high energy prices.*

## Albania

The economic expansion seen in 2021 continued into the first quarter of 2022 as output grew by 6 per cent year-on-year, driven by strong export and private investment growth, alongside persistently robust household consumption. High credit growth to the private sector, at 9 per cent year-on-year in July, and stable remittances continue to support investments and household consumption. The tourism season is on track for a record year, with foreign tourist arrivals and nights spent well above pre-pandemic levels in the first half of 2022. Inflation reached 8 per cent annual in August 2022, the highest in the last 20 years but below regional peers. The central bank tightened monetary policy three times in 2022, from 0.5 per cent in March to 1.75 per cent in August, to help contain inflation. Economic growth is projected at 3 per cent in 2022 and 2023. Key risks to the near-term outlook include rising inflation and tightened financing conditions, which are set to dampen household consumption and investment. On the positive side, the strong tourism season will boost external and fiscal accounts ahead of the challenging heating season and lead growth in the third quarter of the 2022.

## Bosnia and Herzegovina

The economic recovery of 2021 continued into 2022, as GDP expanded by 5.5 per cent year-on-year in the first quarter of the year. The expansion comes on the back of the base effect of last years' moderate growth, reflected in strong investment and household consumption, alongside robust external demand. Financing for households and business has picked up in the first half of 2022, and the share of non-performing has fallen to just to 5.2 per cent of total loans in the second quarter of 2022. Goods exports were nominally up by 38 per cent in the first seven months of 2022 year-on-year, led by base metals and mineral fuels (mainly electricity), as industrial producers benefitted from surging prices. Import of goods, rising by 40 per cent in the same period, overshoot export growth as oil and gas imports became more expensive. Inflation reached 16.7 per cent annually in July 2022, the highest rate in the Western Balkans region. Fiscal measures in response include temporary increases in state aid, higher than envisaged pension hikes and an export ban on wood pellets, while electricity prices for households are kept fixed countrywide. Overall,

output growth is projected at 3 per cent in 2022 and 2.3 per cent in 2023. Risks to the outlook are tilted toward the downside as elevated inflation and tighter commercial financing conditions are likely to dampen domestic demand. The worsening external environment and an anticipated economic slowdown in the second half of 2022 and into 2023 in Eurozone export markets are also serious risks.

### **Kosovo**

GDP growth moderated from a very strong 10.5 per cent in 2021 to 4.9 per cent year-on-year in the first quarter of 2022 as the scope for recovery from the pandemic narrowed. Household consumption continued to lead growth, supported by a steady inflow of remittances, while gross investment remained robust, helped by strong credit growth which reached 18 per cent year-on-year in July 2022. Good exports continued to post high growth rates of nearly 30 per cent year-on-year in nominal terms in the first seven months of 2022, driven by furniture exports to the US, Kosovo's largest export market since 2021. Although the services trade balance posted a strong surplus in the first five months of 2022 in nominal terms, sizeable goods imports grew by 26 per cent year-on-year in the first seven months of the year to meet demand and accommodate higher electricity imports. Inflation reached 14.2 per cent in July 2022 mainly as a result of higher food and oil prices. In response to elevated inflation and food security concerns, the authorities introduced an export ban on certain agricultural products, scaled up agricultural subsidies, introduced wage bonuses in the public sector, approved temporary increases in social transfers and pensions, and capped fuel prices. Electricity prices have not yet contributed to inflationary pressures as the prices remain regulated, but a 60-day energy emergency with rolling power cuts was reinstated in August 2022. GDP is expected to grow by 4 per cent in 2022 and 3.7 per cent in 2023. Key risks to the outlook include elevated consumer prices weighing on disposable incomes, an anticipated global growth slowdown affecting external demand and surging prices of energy imports ahead of the heating season.

### **Montenegro**

After double-digit growth in 2021, the economy grew by 7.2 per cent year-on-year in the first

quarter of 2022. Household consumption remained robust, supported by an 80 per cent hike in the minimum wage from January 2022, but investment remains muted and imports increased. Initial figures point to a satisfactory tourism season, set to boost external accounts alongside robust foreign direct investment inflows. In the first seven months of 2022, tourist arrivals increased relative to 2021 levels in the same period by 79 per cent, alongside a 66 per cent rise in overnight stays, still some 10 and 8 per cent below pre-pandemic levels respectively. Foreign direct investment, mainly coming from Russia and UAE and mainly in real estate, rose by 80 per cent year-on-year in the first half of 2022. Inflation, as elsewhere, has been elevated in Montenegro during 2022 on the back of surging global food and energy prices, and exacerbated by high wage growth. The inflation rate reached 14.9 per cent in July. Policy responses were delayed until a new government was formed in April 2022, after which VAT on cooking oil and flour was temporarily cut and excise duty on fuel was halved. Retail profit margins of basic food items were limited in June, while VAT on bread was cut and excise duties single-use plastic was abolished. The price of wood pellets has been capped since end-July. Growth is forecasted at 3.7 per cent in 2022 and 4 per cent in 2023, but there is major uncertainty around the outlook. Key risks to the outlook include elevated inflation and political instability, both of which may delay public investment and reform efforts.

### **North Macedonia**

Growth moderated to 2.4 per cent and 2.8 per cent year-on-year in the first two quarters of 2022, following a 4 per cent recovery in the previous year. Gross investment led the expansion, while household consumption continued to be robust in the second quarter of 2022, rising by 4 per cent in real terms. This was supported by a minimum wage hike effective from April and continued credit growth. In nominal terms, goods exports increased by nearly 20 per cent year-on-year in the first seven months of 2022, but energy imports have become more frequent and expensive, driving overall import growth to 27 per cent in nominal terms in the first seven months and widening the current account deficit. Inflation reached 16.8 per cent year-on-year in August 2022, driven by rising food and energy prices. The central bank tightened monetary policy four months in a row in 2022, from 1.25 per cent in

April to 2.5 per cent in July. Following the government's package of social measures adopted in March to shield the economy from rising prices, fiscal consolidation was delayed as the Parliament adopted a budget rebalance in July envisaging a higher budget deficit of 5.3 per cent of GDP. Electricity and gas prices paid by enterprises are driven by market forces weighing on their performance, though they are regulated for households. Growth is forecast at 2.7 per cent in 2022 and 2.3 per cent in 2023, with key risks being continually elevated prices, fiscal and external sector vulnerabilities and a prolonged lockdown in China together with a forecasted slowdown in EU export markets, which would affect the automotive industry in North Macedonia.

### Serbia

The economic recovery witnessed in 2021 continued into the first half of 2022, albeit at a slower pace, with output expanding by 4.3 and 3.9 per cent year-on-year in the first two quarters, respectively. As prices increased and monetary policy tightened, household consumption continued to lead growth, though the rate slowed to 4 per cent in real terms in the second quarter following a 7 per cent expansion in the first. While investment remained muted in the second quarter of the year, exports continued to grow strongly, by 20 per cent year-on-year in the second quarter, led by goods exports as industry expanded by 4.6 per cent. Globally rising energy prices were reflected in a rising import bill and a widening of the current account deficit in the first half-year. Global rises in food and oil prices helped drive the annual inflation rate in Serbia to 13.2 per cent in August 2022. In response, the central bank has increased the key interest rate six times in 2022, from 1 per cent in March to 3.5 per cent in September. Various measures on basic foodstuffs, wood pellets and oil are in place to support the budgets of the most vulnerable households. While electricity tariffs were moderately increased, the upcoming winter season will be a test for the energy sector and the government's fiscal space. GDP growth is projected at 3.3 per cent in 2022 and 2023, with risks to the near term reflected in elevated inflation, weighing on disposable incomes, and worsening external demand due to the anticipated slowdown in EU markets.

### Belarus

The economy has been badly hit by the heavy sanctions imposed as a result of the country's support for Russia's invasion of Ukraine. GDP decreased by 5.2 per cent year-on-year in the period January to July 2022, with declines of 7.5 per cent in manufacturing, 8.1 per cent in agriculture, 9.3 per cent in trade, 12.7 per cent in construction and up to 16.0 per cent in transport. Strengthened sanctions involving the cut-off of access to international financial markets and transit of goods through the EU have seriously impacted the export of potash, oil derivatives, wood, chemicals and machinery, even to third countries not applying sanctions on Belarus. At the same time, the largest trade partner, Russia, is also in recession. Inflation reached 17.9 per cent in August 2022. Although the authorities are making efforts to find new transport routes and resume the export of main products to countries still willing to buy them, the near-term prospects for the economy remain bleak. GDP is forecast to decline by 5.5 per cent in 2022 and by 1.0 per cent in 2023. In the current geo-political situation the risks remain skewed on the negative side.

### Russia

Russia's invasion of Ukraine on 24 February 2022 resulted in the gradual imposition of widespread sanctions. The sanctions went much further than had been anticipated, with Russia finding itself cut off from much of the international financial system, including the freezing of over half of the central bank's international reserves; an embargo on exports of critical technological components including semiconductors to Russia; the withdrawal of more than 1000 multinational companies from Russia in a form of self-sanctioning; and the direct sanctioning of more than 600 individuals.

The initial shock of sanctions saw the rouble depreciate heavily to over 130 roubles per US dollar, but it has now recovered to pre-invasion levels. This reflects the dissipation of the initial shock, the introduction of capital controls, and the rise in the current account surplus as imports have collapsed and energy exports have continued to flow at high global prices.

The central bank was quick to respond to the inflationary impact of sanctions, hiking policy rates from 8.5 per cent to 20 per cent over the course of a month. The subsequent strengthening

of the rouble has had a disinflationary impact, helping to bring inflation back down to 15.1 per cent in July, and weak consumer demand is likely to dampen inflation further in the coming months.

The impact of sanctions on activity has been severe, but not as bad as expected. This results on the one hand from the steps taken by the central bank to prevent a financial crisis, and on the other due to the limited sanctioning of the energy sector, reflecting the significant dependence of those imposing the sanctions on Russian energy. But the non-oil economy, particularly sectors dependent on foreign imports, has been hit hard. The economy is expected to contract by 5 per cent in 2022 and by a further 3 per cent in 2023. The medium-term growth outlook is likely to remain bleak in the absence of a peace agreement that results in a loosening of sanctions, and the economy's shift towards autarky and the loss of qualified workforce to emigration means that long-term growth potential will remain significantly eroded.

## References

A. Ari, N. Arregui, S. Black, O. Celasun, D. Iakova, A. Mineshima, V. Mylonas, I. Parry, I. Teodoru and K. Zhunussova (2022). Surging energy prices in Europe in the aftermath of the war: How to support the vulnerable and speed up the transition away from fossil fuels. IMF Working Paper No. 22/152.

X. Jaravel (2021). Inflation inequality: Measurement, causes and policy implications. *Annual Review of Economics*, Vol. 13, pp. 599-629.

## About this report

The Regional Economic Prospects are published twice a year. The report is prepared by the Office of the Chief Economist and the Department for Policy Strategy and Delivery and contains a summary of regional economic developments and outlook, alongside the EBRD's growth forecasts for the economies where it invests. The estimates and projections are based on statistical information available through September 16, 2022.

For more comprehensive coverage of economic policies and structural changes, see the EBRD's country strategies and updates, as well as the Transition Report 2021-22, which are all available on the Bank's website at [www.ebrd.com](http://www.ebrd.com).

## Acknowledgements

The report was edited by Zsoka Koczan ([koczanz@ebrd.com](mailto:koczanz@ebrd.com)) and Alexander Plekhanov ([plekhana@ebrd.com](mailto:plekhana@ebrd.com)), under the general guidance of Beata Javorcik, Chief Economist.

Colleagues in the Communications Department, Policy Strategy and Delivery Department, the Office of the Chief Economist and other departments of the EBRD provided valuable comments and suggestions. Maxim Chupilkin and Joseph Sassoon provided research assistance.

Regional updates were edited by Peter Sanfey ([sanfey@ebrd.com](mailto:sanfey@ebrd.com)). The writing teams covering individual countries and regions were:

**Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia:** Ana Kresic and Olja Belic

**Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine:** Dimitar Bogov, Lia Alscher and Jongwoo Lim

**Bulgaria, Croatia, the Czech Republic, Romania and Slovenia:** Mateusz Szczurek and Radu Cracan

**Greece:** Peter Sanfey and Julia Brouillard

**Egypt, Jordan, Lebanon, Morocco and Tunisia:** Alexa Tiemann, Rafik Selim and Reem Jodeh

**Estonia, Hungary, Latvia, Lithuania, Poland and the Slovak Republic:** Mateusz Szczurek, Marcin Tomaszewski and Beatrice Ravanetti

**Kazakhstan, the Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan and Uzbekistan:** Eric Livny and Kamilla Mamatova

**Russia and Turkey:** Roger Kelly and Altan Olgun

European Bank for Reconstruction and Development  
One Exchange Square London  
EC2A 2JN  
United Kingdom  
Tel: +44 20 7338 6000  
[www.ebrd.com](http://www.ebrd.com)

Discover more at [tr-ebrd.com](http://tr-ebrd.com)

Find us on:

 @EBRD

 ebrdhq

 EBRD

 ebrd\_official

 ebrdtv

