REGIONAL ECONOMIC PROSPECTS

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THE RETURN OF RUNAWAY PRICES

Dealing with expensive food and energy

Regional Economic Prospects in the EBRD Regions

The return of runaway prices

Dealing with expensive food and energy

May 2022

Output in the EBRD regions increased by 6.7 per cent in 2021 after contracting by 2.5 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 1.1 per cent in 2022. This represents a 0.6 percentage point downward revision compared with the forecast made in March 2022 (and a 3.1 percentage point downward revision compared with the forecast made in November 2021). The revision since March is driven mostly by a larger-than-previously-expected contraction in Ukraine as the war drags on.

Growth in the EBRD regions is forecast to recover to 4.7 per cent in 2023. A downward revision of 0.3 percentage points since March reflects mounting inflationary pressures in the global economy and the EBRD regions. Projections are subject to major downside risks should hostilities escalate or should exports of gas or other commodities from Russia become more restricted. For instance, in a scenario where gas supplies are further disrupted, output per capita in the EBRD regions could be 2.3 per cent lower in 2022 and 2 per cent lower in 2023 than in the baseline scenario.

Commodity and food prices have increased sharply in recent months. Oil prices are elevated and gas prices in Europe are above historical highs and around four times the level in the United States, putting European producers at a disadvantage. Prices of wheat, corn, soybeans and other agricultural commodities have also risen rapidly. Many economies in the EBRD regions are highly dependent on gas in their energy mix while some economies in the Caucasus and southern and eastern Mediterranean rely heavily on wheat imports and have historically sourced wheat from Russia and Ukraine.

Recent increases in food and energy prices added to inflationary pressures, which were already high owing to the rebound in global demand as Covid-19 restrictions were being phased out. Average inflation in the EBRD regions reached 11.9 per cent in March 2022, approaching the level last seen at the end of 2008. Energy and food account for a higher share of consumption of poorer households, and they are therefore experiencing even higher effective rates of inflation.

Policymakers have turned to a wide range of measures to mitigate the effects of higher energy and food prices on firms and households, often facing a trade-off between the effectiveness of such measures and the administrative capacity required to implement them. Complex trade-offs also arise between the extent of support afforded to lower-income households, the overall fiscal cost, the environmental impact of such measures and their public perception. For instance, price subsidies per unit of consumption (most common in *the EBRD regions and in advanced economies) are easy to implement and communicate but are poorly targeted and encourage overconsumption and greenhouse gas emissions. On the other hand, means-tested support to lower-income households, which has been introduced or scaled up in around 30 per cent of economies in the EBRD regions, can be well-targeted and cost-effective but requires high administrative capacity and a clear communication strategy.*

In addition to the impact of high food, energy and metals prices, some economies in the EBRD regions are further affected through trade, tourism and migration-remittance links to Russia. Russia is an important trade partner for some economies in the Caucasus and, to a lesser extent, in the Baltics and Central Asia. Central Europe is also closely integrated in manufacturing supply chains with Ukraine. Economies in Central Asia are vulnerable to drops in remittances from Russia, as migrants return home, the rouble faces limited convertibility and flight connections are reduced. In 2019, spending by Russian tourists amounted to between 1 and 2 per cent of GDP in Estonia, Montenegro, and the three Caucasus countries.

The initial market reactions to the invasion of Ukraine largely reflected a reassessment of geopolitical risks in light of the war. While some initial currency depreciations have been reversed (for instance, in Georgia and the Kyrgyz Republic), economies with weaker fiscal and external positions as well as higher reliance on imports of wheat, including Egypt and Turkey, have seen further rises in bond yields and weakening of their currencies.

The conflict resulted in the largest movement of people seen in Europe since the Second World War. As of mid-April, over 5 million Ukrainians had left the country. While in the short term, the refugee influx requires governments to find additional financing for schooling, health care and housing, in the longer term it could provide a boost to the regions' rapidly ageing economies.

In light of these developments, output in ***central Europe and the Baltic states*** *is expected to increase by 3.2 per cent in 2022 and 3.4 per cent in 2023, with broad-based downward revisions for 2022 relative to the March Update, reflecting higher food and energy prices and supply chain disruptions.*

GDP in the ***south-eastern European Union*** *is expected to grow by 2.6 per cent in 2022 and 3.2 per cent in 2023, revised down somewhat since the March Update. Output in the* ***Western Balkans*** *is expected to grow by 3.2 per cent in 2022 and 3.6 per cent in 2023.*

The larger than anticipated contraction in Ukraine weighs on the forecast for ***eastern Europe and the Caucasus****. Output in the region is expected to contract by 18.4 per cent in 2022, rebounding to growth of 17.5 per cent in 2023 (excluding Ukraine, the rest of the region is forecast to grow by 3.3 per cent in 2022 and 3.4 per cent in 2023).*

Growth in ***Central Asia*** *is expected to slow to 3.1 per cent in 2022 and 3.7 per cent in 2023, with a significant downward revision to Mongolia's growth in 2022 since the March Update reflecting the resurgence of Covid-19 in China resulting in additional border restrictions. The forecasts also reflect Central Asia's strong economic links with Russia's economy, which is expected to contract by 10 per cent in 2022 and stagnate in 2023.*

GDP growth in ***Turkey*** *is likely to remain muted at 2 per cent in 2022, supported by a modest recovery in net exports. Growth is forecast to increase to 3.5 per cent in 2023, driven by rising household and government spending ahead of the planned elections.*

Output in ***the southern and eastern Mediterranean*** *is expected to grow by 2.5 per cent in 2022 and 4.8 per cent in 2023. Tunisia's 2022 growth has been revised down since the March Update on account of increasing vulnerabilities and continued uncertainty; Lebanon's forecast for 2023 has been revised up.*

Table 1. GDP growth in real terms

	Actual			Forecast (May'22)		Revision since		
						Mar'22		Nov'21
	2019	2020	2021	2022	2023	2022	2023	2022
EBRD Regions	**3.4**	**-2.5**	**6.7**	**1.1**	**4.7**	**-0.6**	**-0.2**	**-3.1**
Central Asia	**5.1**	**-0.5**	**5.0**	**3.1**	**3.7**	**-0.1**	**0.0**	**-1.6**
Kazakhstan	4.5	-2.6	4.0	2.0	2.5	0.0	0.0	-1.8
Kyrgyz Republic	4.6	-8.6	3.6	1.0	4.0	0.0	0.0	-4.0
Mongolia	5.6	-4.6	1.4	3.5	7.0	-2.5	0.0	-3.0
Tajikistan	7.4	4.4	9.2	3.0	5.0	0.0	0.0	-3.2
Turkmenistan	6.3	5.9	6.2	6.0	5.5	0.0	0.0	0.5
Uzbekistan	5.7	1.9	7.4	4.0	5.0	0.0	0.0	-2.0
Central Europe and the Baltic states	**4.0**	**-3.7**	**5.5**	**3.2**	**3.4**	**-0.2**	**-0.8**	**-1.5**
Croatia	3.5	-8.1	10.4	3.0	3.5	-0.2	-0.5	-1.2
Czech Republic	3.0	-5.8	3.3	2.5	3.5	-0.5	-0.5	-2.1
Estonia	4.1	-3.0	8.3	1.5	2.5	-0.5	-0.5	-2.5
Hungary	4.6	-4.5	7.1	3.5	3.5	0.0	-1.0	-1.3
Latvia	2.5	-3.8	4.7	1.5	2.0	-0.5	-0.5	-4.0
Lithuania	4.6	-0.1	5.0	2.0	3.0	-0.5	-0.5	-2.0
Poland	4.7	-2.5	5.7	4.0	3.5	0.0	-1.0	-0.8
Slovak Republic	2.6	-4.4	3.0	2.0	3.5	-0.5	-0.5	-3.0
Slovenia	3.3	-4.2	8.1	3.5	3.0	-0.1	-0.8	-1.0
Eastern Europe and the Caucasus	**3.5**	**-4.4**	**4.9**	**-18.4**	**17.5**	**-6.6**	**1.3**	**-22.1**
Armenia	7.6	-7.4	5.7	1.5	4.0	0.0	0.0	-3.8
Azerbaijan	2.5	-4.2	5.6	4.5	2.5	-0.5	0.0	1.3
Georgia	5.0	-6.8	10.4	3.0	5.0	1.0	0.5	-2.5
Moldova	3.7	-7.4	13.9	1.0	3.5	-1.0	0.0	-3.0
Ukraine	3.2	-3.8	3.4	-30.0	25.0	-10.0	2.0	-33.5
South Eastern EU	**3.3**	**-5.8**	**6.6**	**2.6**	**3.2**	**-0.2**	**-0.7**	**-1.6**
Bulgaria	4.0	-4.4	4.2	2.5	3.0	-0.3	-0.6	-1.9
Greece	1.9	-9.0	8.3	2.9	3.5	0.0	0.0	-1.0
Romania	4.2	-3.7	5.9	2.5	3.0	-0.3	-1.2	-1.9
Southern and Eastern Mediterranean	**4.1**	**-1.9**	**6.0**	**2.5**	**4.8**	**0.0**	**0.1**	**-1.8**
Egypt	5.7	1.5	7.2	3.1	6.0	0.0	0.0	-1.9
Jordan	2.0	-1.6	2.2	1.9	2.5	0.0	0.0	-0.3
Lebanon	-6.9	-25.9	-10.0	1.0	3.0	0.0	3.0	-2.0
Morocco	2.6	-6.3	7.4	1.2	3.0	0.0	0.0	-2.0
Tunisia	1.3	-8.6	3.5	2.0	2.5	-0.7	0.0	-1.3
Turkey	**0.9**	**1.8**	**11.0**	**2.0**	**3.5**	**0.0**	**0.0**	**-1.5**
Western Balkans	**3.7**	**-3.1**	**7.5**	**3.2**	**3.6**	**0.1**	**0.0**	**-0.8**
Albania	2.1	-3.5	8.5	3.0	3.3	-0.3	-0.2	-0.7
Bosnia and Herzegovina	2.8	-3.1	7.1	3.0	3.0	0.7	0.0	0.0
Kosovo	4.8	-5.3	10.5	4.0	4.0	0.0	0.0	-0.5
Montenegro	4.1	-15.3	12.4	3.7	4.5	0.0	0.5	-2.0
North Macedonia	3.9	-6.1	4.0	3.0	3.0	0.0	0.0	-1.0
Serbia	4.3	-0.9	7.4	3.3	4.0	0.0	0.0	-1.0
Memo: Egypt (fiscal year to June)	5.6	3.6	3.3	5.7	5.0	0.0	0.0	0.8
EEC excl. Ukraine	3.9	-5.6	7.7	3.3	3.4	-0.2	0.1	-0.8
Belarus	1.2	-0.9	2.3	-4.0	0.0	-1.0	0.0	-4.2
Russia	1.3	-3.0	4.8	-10.0	0.0	0.0	0.0	-13.0

Source: National authorities and EBRD. Weights are based on the values of gross domestic product at market exchange rates. 2021 outcomes for Bosnia and Herzegovina, Lebanon and Montenegro are unofficial estimates.

Output in the EBRD regions increased by 6.7 per cent in 2021

Output in the EBRD regions increased by 6.7 per cent in 2021 after contracting by 2.5 per cent in 2020 (see Table 1). The war on Ukraine has, however, been having a profound impact on the economies in the EBRD regions.

Energy prices spiked

Commodity and food prices have increased sharply since the start of the war on Ukraine on 24 February 2022 as markets expected a major drop in exports from Russia, Ukraine and Belarus, important commodity exporters.

Oil prices increased, to around US$ 110 per barrel as of mid-April, but remain below their historical peaks in inflation-adjusted terms (see Chart 1).

Chart 1. Oil prices increased, but remain below historical peaks

Sources: IMF, Swiss National Bank via CEIC and authors' calculations.
Notes: Prices adjusted for US inflation.

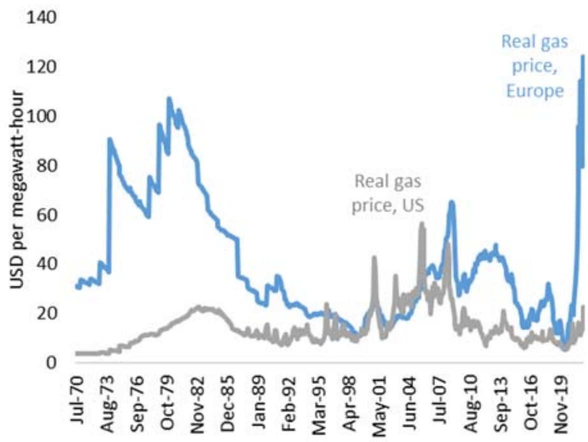
Russian oil has been trading at an increasing discount to Brent (a global benchmark) as some buyers discontinued purchases of oil from Russia (see Chart 2).

Chart 2. Urals oil has been trading at a large discount relative to Brent oil

Sources: Refinitiv Eikon and authors' calculations.
Notes: Prices adjusted for US inflation.

Gas prices in Europe, at around US$ 100 per megawatt-hour as of mid-April, remain above historical highs, despite some moderation in April. They exceed gas prices in the United States by a factor of four, putting European producers at a disadvantage (see Chart 3).

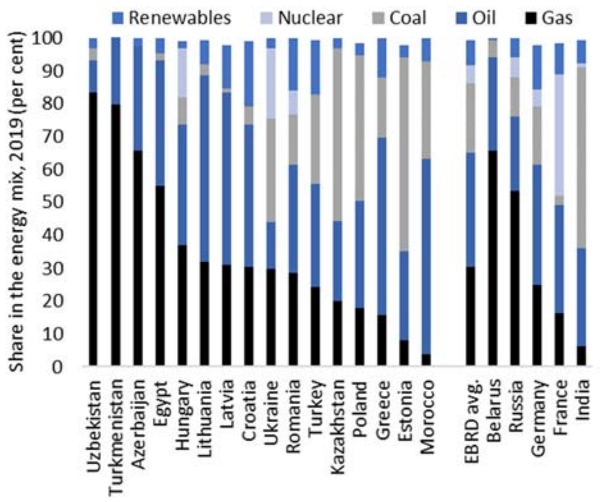
Chart 3. Gas prices in Europe are above historical peaks



Sources: IMF, World Bank via CEIC and authors' calculations.
Notes: Prices adjusted for US inflation.

Many economies in the EBRD regions are highly dependent on gas in their energy mix. On average, gas accounts for around 30 per cent of energy sources of the EBRD regions, and more than half of energy consumption in Egypt and several other economies (see Chart 4).

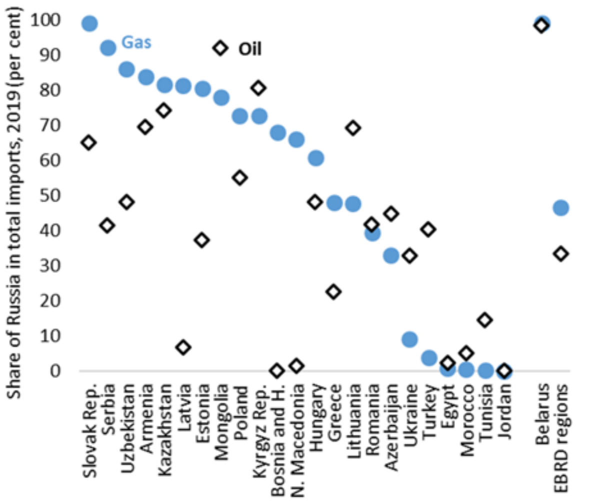
Chart 4. Many economies in the EBRD regions are highly dependent on gas in their energy mix



Sources: Our World in Data based on BP Statistical Review of World Energy and authors' calculations.
Notes: Select economies shown.

In many economies, gas is primarily sourced from Russia (see Chart 5). For instance, Russia accounts for over 90 per cent of gas imports for Serbia and the Slovak Republic. For some economies, such as Armenia and the Kyrgyz Republic, Russia accounts for a high share of both gas and oil imports.

Chart 5. Many economies in the EBRD regions are highly dependent on Russian gas

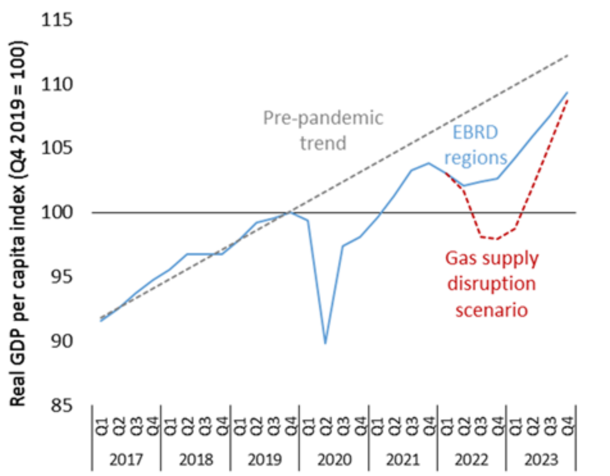


Sources: UN Comtrade and authors' calculations.
Notes: Gas refers to "petroleum gases and other gaseous hydrocarbons", based on direct source of gas. Oil is "petroleum oils, crude" and "petroleum oils, not crude". Select economies shown.

Gas from Russia (and Kazakhstan) is mostly delivered to central and eastern Europe via pipelines running through Belarus and Ukraine. Most liquefied natural gas (LNG) terminals in Europe are located in the west, with most spare LNG capacity in Spain, and at present offer limited pipeline connections with much of the continent.

A hypothetical scenario in which supplies of Russian gas cease abruptly could result in an average output loss of around 2 per cent of GDP per annum in 2022-23 in the EBRD regions, compared with the baseline scenario which assumes continued deliveries of gas (see Box 1 and Chart 6).

Chart 6. In a scenario where gas supplies are disrupted, output per capita in the EBRD regions could be 2.3 per cent lower in 2022 and 2 per cent lower in 2023 than in the baseline scenario



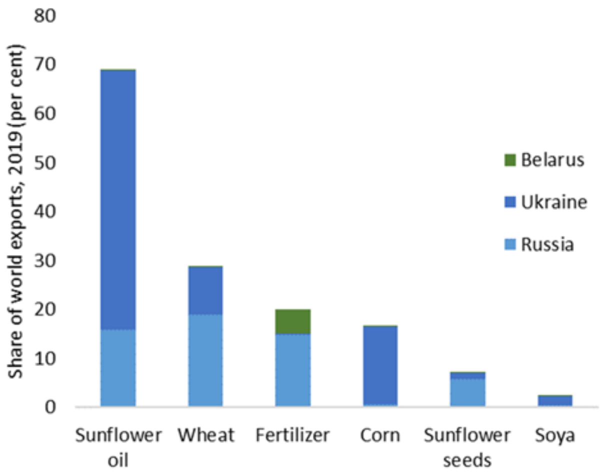
Sources: EBRD and authors' calculations.

The effects would be largest for EU economies with large dependence on gas in their energy mix, such as the Czech Republic, Hungary and the Slovak Republic, where industry may be directly impacted by gas rationing. Other economies may be affected only indirectly, through higher international energy prices and weaker demand from major trading partners such as Germany. Lithuania, for instance, is home to a new LNG terminal and has already discontinued gas purchases from Russia.

Food prices rose

Ukraine and Russia are also major exporters of agricultural commodities (see Box 2). In 2019, they accounted for almost 70 per cent of world exports of sunflower oil and almost 30 per cent of global wheat exports (see Chart 7). Belarus and Russia are also major exporters of fertilisers and fertiliser ingredients such as ammonia and potash. High gas intensity of fertiliser production also means a strong pass-through from high gas prices to fertiliser prices.

Chart 7. Belarus, Russia and Ukraine are major exporters of agricultural commodities and fertiliser

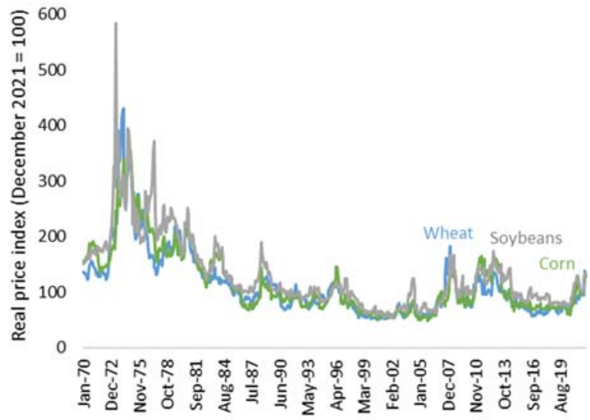


Sources: UN Comtrade and authors' calculations.

As a result, prices of wheat, corn, soybeans and other agricultural commodities have risen sharply. However, they remain below their historical peaks of 2008 and the 1970s in inflation-adjusted terms (see Chart 8).

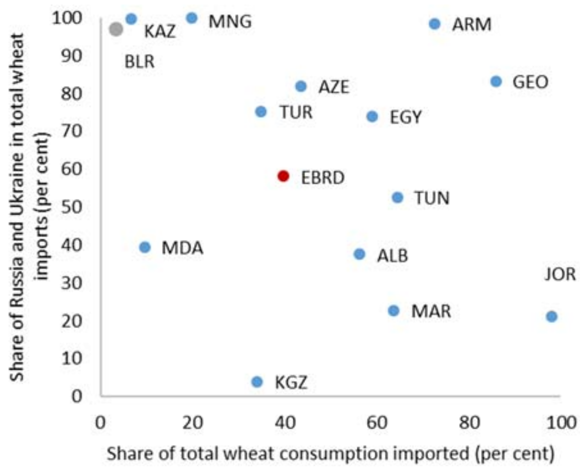
Some economies in the EBRD regions are highly dependent on wheat imports from Russia and Ukraine (see Chart 9). For instance, Armenia and Georgia import over 70 per cent of their wheat consumption and Russia and Ukraine account for over 80 per cent of their total wheat imports. Economies in the southern and eastern Mediterranean also tend to be major importers of wheat as water scarcity limits the scope for expanding local production.

Chart 8. Agricultural prices have increased but remain below their historical peaks



Sources: Refinitiv Eikon and authors' calculations.

Chart 9. Some economies in the EBRD regions are highly dependent on wheat imports from Russia and Ukraine



Sources: UN Comtrade, national authorities and authors' calculations.

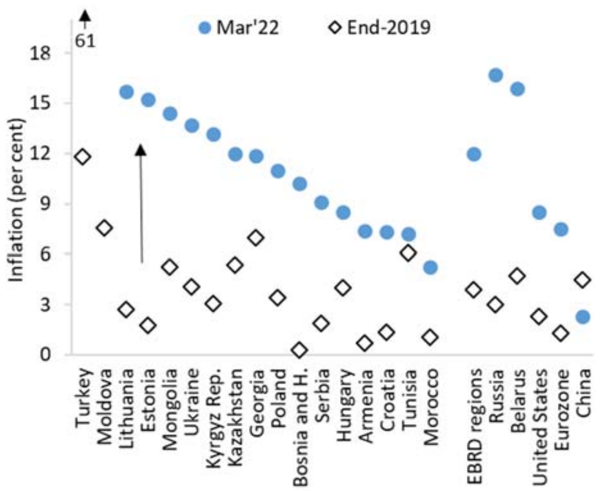
Inflationary pressures increased

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

Average inflation in the EBRD regions reached 11.9 per cent in March 2022, approaching the level last seen at the end of 2008. It exceeded 60 per cent in Turkey and stood at over 15 per cent in Moldova, Lithuania and Estonia, as well as in Russia and Belarus (see Chart 10).

Historically, a 10 per cent increase in global oil inflation increased domestic inflation by 0.4 of a percentage point on average.[1] Effects tended to be larger in economies where transport accounts for a larger share of the consumer price index basket, and smaller in economies with significant energy subsidies. Over time, the inflationary impact of oil price shocks has weakened, as oil-intensity of output has declined.[2]

Chart 10. Energy and food price spikes added to inflationary pressures

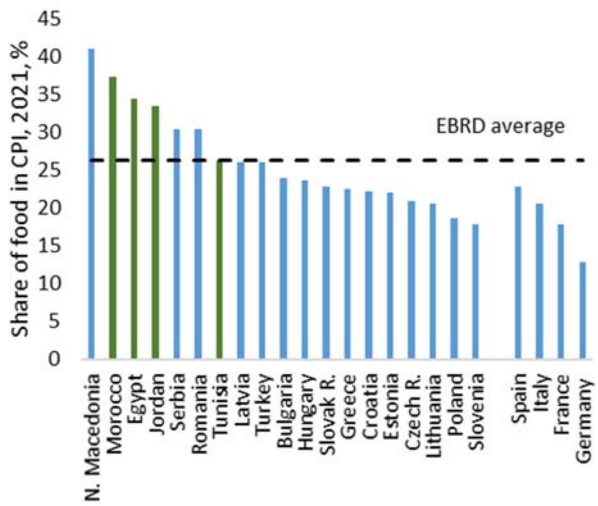


Sources: National authorities via CEIC and authors' calculations.
Notes: Year-on-year changes. EBRD regions refers to a simple average across 33 economies, excludes Lebanon. Select economies shown.

High energy prices tend to put a greater burden on households in poorer economies. For instance, spending on utilities accounts for over 20 per cent of household income in Romania, Armenia and Moldova, compared with only around 7 per cent in Germany.[3] Within countries, poorer households also spend a larger share of their income on utilities than richer households do.

Likewise, food accounts for a higher share of consumption in lower-income economies (see Chart 11). For instance, in 2021, food accounted for 30-37 per cent of the consumer price index in Egypt, Jordan, Morocco, North Macedonia, Romania and Serbia compared with 15 per cent in Germany.

Chart 11. Food accounts for a higher share of the consumer price index in poorer economies



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

Monetary policy tightened

In response to inflationary pressures, 53 per cent of central banks in the EBRD regions have hiked policy interest rates since May 2021 (see Chart 12). The monetary authorities in Armenia, the Czech Republic, Hungary, Kazakhstan, the Kyrgyz Republic, Moldova, Mongolia, Poland and Uzbekistan increased policy rates by more than 3 percentage points, as did those in Belarus and Russia.

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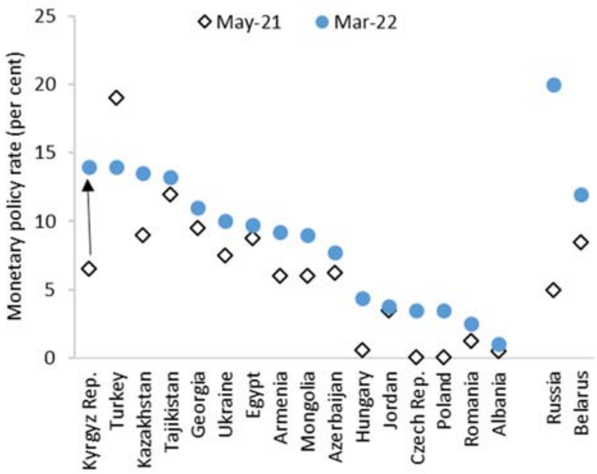
[1] See Abdallah et al. (2020) and Choi et al. (2017).
[2] See Abdallah et al. (2020) and Choi et al. (2017).
[3] See EBRD (2021).

Chart 12. Over half of central banks in the EBRD regions hiked policy rates since May 2021



Sources: National authorities via CEIC and authors' calculations.

Policy responses to higher food and energy prices vary

Policymakers across the EBRD regions have turned to a wide range of measures to mitigate the effects of higher energy and food prices on households and firms. These measures vary in terms of the extent to which they assist those most in need, their targeting (and thus overall fiscal cost), the externalities they may impose (such as greater energy consumption and associated greenhouse gas emissions), the ease of communicating the measures to the wider population, and the administrative capacity required to implement them. As a result, complex trade-offs are at play, for instance, between policy effectiveness and administrative capacity required (see Chart 13).

By mid-April, around 34 per cent of economies in the EBRD regions (and the majority of G7 economies) had introduced fuel subsidies per unit consumed (for instance, litre of diesel or kWh of electricity, see Chart 14). For example, value added tax on petrol was lowered from 23 to 8 per cent in Poland, while the Czech Republic announced a reduction in the excise tax on petrol and diesel of CZK 1.5 (€0.06) per litre.

Such subsidies are usually justified by the fact that lower-income households spend higher shares of income on food and energy. These measures are relatively easy to implement and communicate (being typically well received by populations). On the other hand, subsidising energy prices encourages overconsumption and the benefits accrue largely to the better off who consume more energy and food, potentially making such measures environmentally unfriendly, poorly targeted and fiscally costly.

Price controls on food or energy were also widely used in the EBRD regions, albeit less so in the G7 economies. For instance, Slovenia capped prices of fuel from 15 March 2022 for a month while Hungary capped prices of various food staples. Price controls may help low-income households and are easy to communicate and implement, but they encourage higher energy use and food waste and may result in shortages.

Some economies scaled up means-tested support programmes targeting low-income households. For instance, in Poland an allowance for households should provide a maximum of €106 per person per year based on income, type of heating and the number of people in the household, with the first payment in March 2022 and the second one in December 2022. The Kyrgyz Republic announced handouts of flour as well as a 50 per cent discount on electricity bills (subject to a cap) to low-income households.

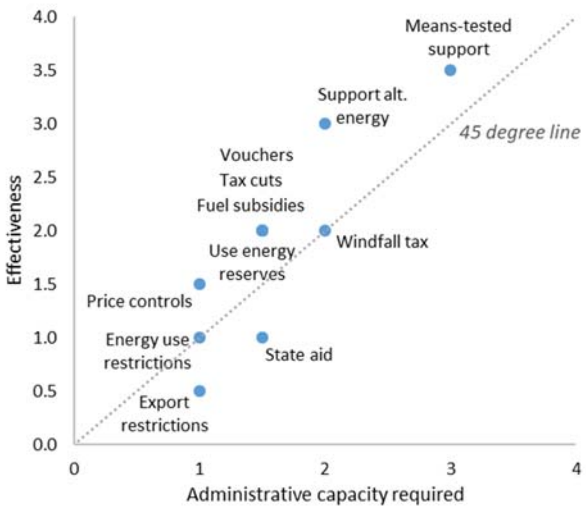
Such means-tested measures are relatively well targeted and lower the overall fiscal cost of support programmes. Depending on their design, they may avoid excessive energy use (for instance, if administered as a voucher per household rather than in the form of a price discount per unit of consumption). However, reaching out to households most in need requires relatively high administrative capacity. Strong communication may also be required to ensure that the narrower targeting of the benefits does not undermine their political appeal.

Support for alternative energy sources, if well designed, is arguably the most effective among options requiring medium levels of administrative capacity but can be effective as a longer-term measure only if they complement policies that yield immediate effects. Several economies in the EBRD regions, such as Estonia, have increased the emphasis on nuclear energy.

Among G7 countries, Germany has raised its focus on renewables. Alternative energy plans in response to rising gas prices have not always been green, with several economies including Bosnia and Herzegovina and Greece considering postponing shifts away from coal.

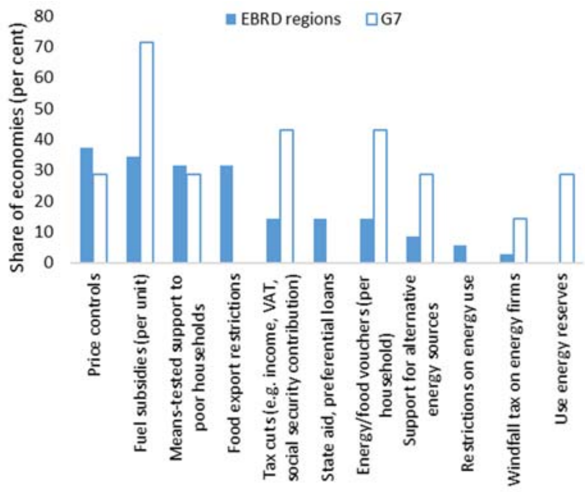
Several economies have provided support directly to firms, through state aid or preferential loans. For instance, Azerbaijan provided subsidised loans to large grain importers, Georgia provided subsidised loans to farmers and Kazakhstan introduced fertilizer and pesticide subsidies for agricultural producers. Temporary restrictions on food exports were introduced in Kazakhstan, the Kyrgyz Republic and a number of other economies.

Chart 13. Policymakers face trade-offs between effectiveness and ease of implementation



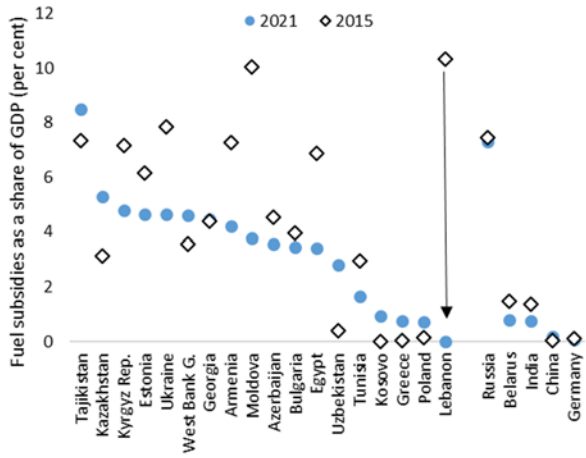
Sources: EBRD and authors' calculations.
Note: Effectiveness captures the extent to which measures can assist those most in need, their targeting (and thus overall fiscal cost), the externalities they may impose (such as greater energy consumption and associated greenhouse gas emissions) and the ease of communicating the measures to the wider population, scored 0-4 as a simple average across these four criteria. The administrative capacity required to implement them is also scored 0-4. Higher scores correspond to more effective measures and those with higher administrative capacity needs.

Chart 14. There have been varied responses to high energy and food prices



Sources: EBRD and authors' calculations.
Notes: Fuel subsidies include fuel tax cuts.

Chart 15. Explicit subsidies have fallen but remain substantial in many economies in the EBRD regions



Sources: IMF and authors' calculations.
Notes: Select economies with significant subsidies shown.

Energy subsidies were in fact widespread even before the latest increase in commodity prices, though they have fallen over time in many economies (see Chart 15). Explicit subsidies (when prices do not cover production costs) were estimated in excess of 4 per cent of GDP in many economies in Central Asia and in eastern Europe and the Caucasus. Estimates of implicit subsidies, which take into account under-pricing of environmental degradation, reach 20-25 per cent of GDP. The fiscal cost of energy subsidies can thus be substantial, in particular in a context of high energy prices.[4]

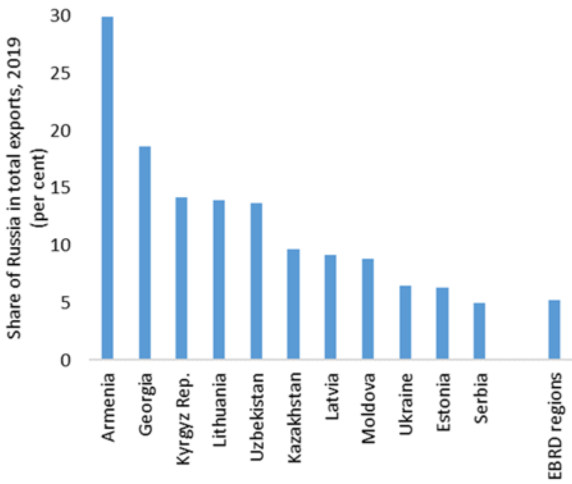
Trade, tourism and remittances linkages increase spillovers

Beyond the broader effects of high energy and food prices, some economies in the EBRD regions are additionally affected through trade, tourism and migration-remittance links to the Russian economy.

Russia is an important trade partner for some economies in the Caucasus and, to a lesser extent, the Baltics and Central Asia (see Chart 16). For instance, it accounts for almost 30 per cent of exports from Armenia and around 19 per cent of exports from Georgia. Even excluding oil and gas imports, Russia accounts for 35 per cent of Kazakhstan's and 26 per cent of Tajikistan's imports (see Chart 17).

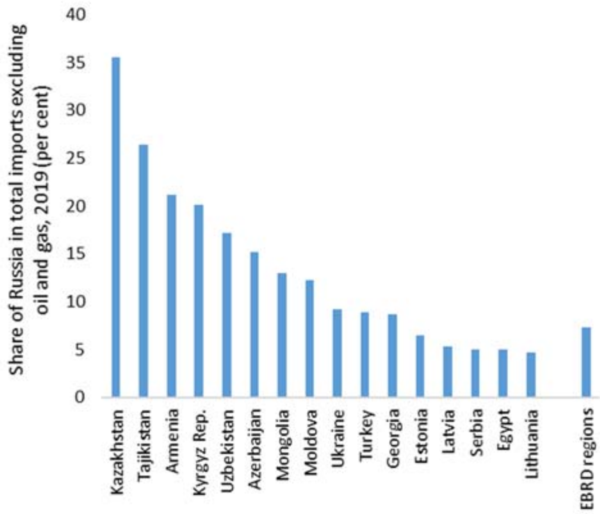
Economies in central Europe are also closely integrated in manufacturing supply chains with Ukraine. For instance, owing to lack of deliveries of parts from Ukraine, a number of car factories had to partially or fully suspend production and look for alternative suppliers as hostilities escalated.

Chart 16. Russia is a significant export market for some economies in the Caucasus



Sources: UN Comtrade and authors' calculations.
Notes: Select economies with significant trade links shown.

Chart 17. Russia is a significant source of imports for some economies in Central Asia

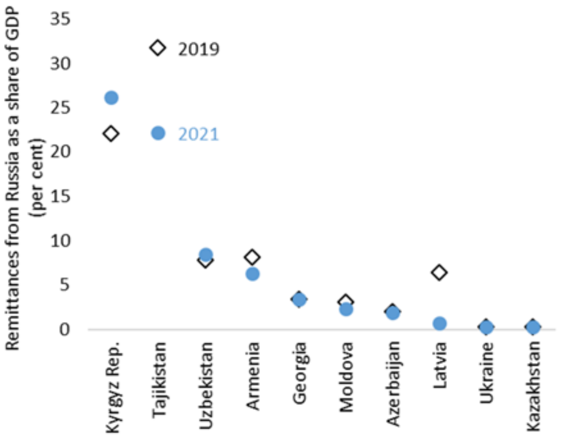


Sources: UN Comtrade and authors' calculations.
Notes: Select economies with significant trade links shown.

Economies in Central Asia are also vulnerable to drops in remittances from Russia, affected by the limited convertibility of the rouble and loss of flight connections. While in many economies remittances have rebounded from their 2020 lows, in others, such as Tajikistan, remittances in 2021 were still below 2019 levels (see Chart 18). Early evidence in 2022 points to some return migration from Russia to Tajikistan and Uzbekistan.

[4] See also IMF (2022a).

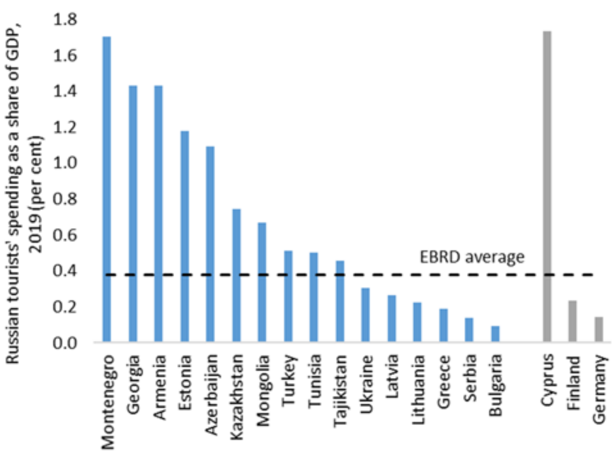
Chart 18. Economies in Central Asia are vulnerable to a drop in remittances from Russia



Sources: Central Bank of Russia, IMF and authors' calculations.

In addition, Russian tourist spending reached 1 to 2 per cent of GDP in Estonia, Montenegro and the three Caucasus countries in 2019 (see Chart 19). A reduction in Russian tourist revenue may be partially offset by arrivals from other countries and longer-term stays by those who recently left Russia. Estimates for the number of recent arrivals from Russia in Armenia, the Baltic states, Georgia, Kazakhstan, the Kyrgyz Republic, Montenegro, Turkey as well as Israel and other countries range from 200,000 to 1 million.

Chart 19. Tourism links with Russia were also significant for some economies in the EBRD regions

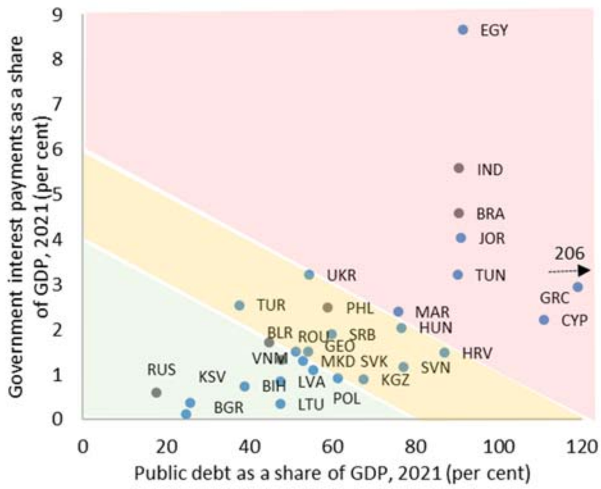


Sources: World Bank, Russia's border service outbound tourism statistics and authors' calculations.
Notes: Select economies with significant spending by Russian tourists shown.

Fiscal space shrank

Fiscal vulnerabilities have increased as a result of the Covid-19 crisis and the war on Ukraine. While fiscal space varies across economies, it narrowed significantly post-Covid reflecting the significant fiscal stimulus packages implemented during the Covid-19 crisis as well as lower revenues. Fiscal space is more limited in several economies in the southern and eastern Mediterranean (see Chart 20). For instance, Egypt has both high debt and substantial interest payments.

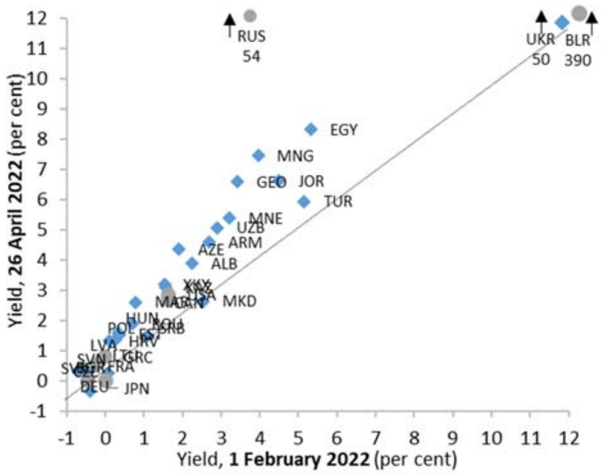
Chart 20. Fiscal space is more limited in the southern and eastern Mediterranean



Sources: IMF, World Bank, national authorities via CEIC and authors' calculations.
*Notes: The lines are drawn based on 20*interest payments + debt stock as a share of GDP, cut-offs at 120 (red) and 80 (yellow).*

As of April 26, yields on 5-10 year government bonds have risen by an average of 1.9 percentage points since the beginning of February in the EBRD regions, with greater increases in Egypt, Georgia, Mongolia, Tajikistan and Tunisia as well as Belarus, Russia and Ukraine (see Chart 21). These increases reflect both a reassessment of geopolitical risks as well as increased differentiation among different emerging market economies based on their perceived fiscal and external vulnerabilities in the context of rising food and energy prices and increases in global interest rates. In general, the dispersion in spreads (a measure of the extent to which investors differentiate between credit risk of different economies) increased more than during previous episodes of global tightening of financing conditions in 2013 and 2018.[5]

Chart 21. Borrowing costs have increased reflecting proximity effects and differentiation

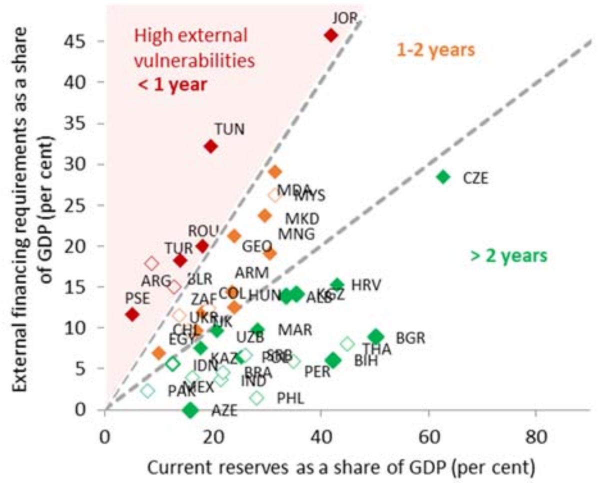


Sources: Bloomberg and authors' calculations.
Notes: Yields on 5-year government bonds in USD or closest benchmark available.

External vulnerabilities increased

External vulnerabilities have also increased in a number of economies, notably in the southern and eastern Mediterranean, reflecting higher food and energy import bills and rising interest payments. Already by late 2021, international reserves covered less than a year of external financing requirements (short-term external debt and the current account deficit) in Jordan, Tunisia, Turkey, the West Bank and Gaza as well as Romania (see Chart 22).

Chart 22. External vulnerabilities are high in some economies in the southern and eastern Mediterranean

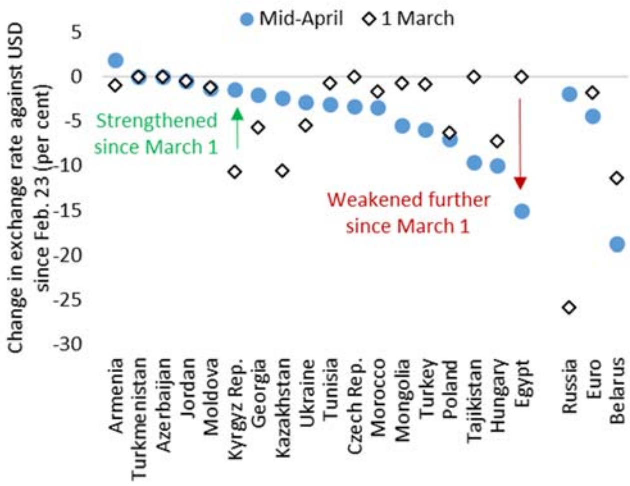


Sources: IMF, national authorities via CEIC and authors' calculations.
Notes: As of the third quarter of 2021.

Some currencies have also faced increased pressures. While initially economies in geographic proximity to the war (such as Georgia, Kazakhstan and the Kyrgyz Republic) experienced significant depreciations, some of these currencies have since regained some ground. In contrast, markets may have reassessed risks in a number of economies with perceived fiscal and external vulnerabilities, such as Egypt and Turkey, where currencies have weakened further against the US dollar (see Chart 23). The euro has also weakened against the US dollar reflecting increased risks to Europe's economic outlook in light of the war.

[5] See IMF (2022).

Chart 23. Some currencies faced increased pressures



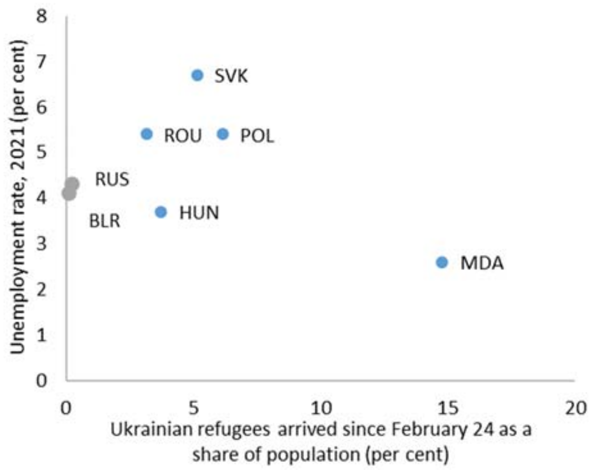
Sources: National authorities via CEIC and authors' calculations.
Notes: Russian rouble has limited convertibility. Select economies shown.

Increasing number of displaced people

The conflict has already resulted in the largest movement of people seen in Europe since the Second World War. As of mid-April, over 5 million Ukrainians had left the country, with major inflows of refugees into Hungary, Moldova, Poland, the Slovak Republic and other economies (see Chart 24). Refugees already account for about 15 per cent of Moldova's population.

While in the short term, the refugee influx requires additional financing for schooling, health care and housing, in the longer term it could provide a boost to the regions' rapidly ageing economies.

Chart 24. Refugees from Ukraine exceed 5 per cent of local population in some economies



Sources: United Nations High Commissioner for Refugees, national authorities and authors' calculations.
Notes: Arrivals as of 30 March 2022.

Global growth revised down

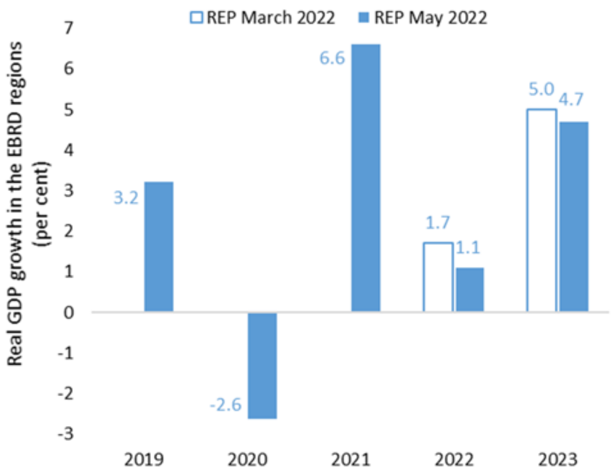
The International Monetary Fund revised global growth forecast for 2022 down by 0.8 percentage points since the January 2022 *World Economic Outlook* Update. The downward revisions are broad-based, reflecting in part worldwide spillovers from the war through commodity markets, trade disruption and tighter financing conditions in response to rising inflationary pressures. The global growth forecast for 2023 was also revised down.

Output in the EBRD regions is expected to grow by 1.1 per cent in 2022

Output in the EBRD regions is expected to grow by 1.1 per cent in 2022 (see Chart 25 and Table 1). This represents a 0.6 percentage point downward revision compared with the forecast made in March 2022 (and a 3.1 percentage point downward revision compared with the forecast made in November 2021). The revision since March is driven mostly by a larger-than-previously-expected contraction in Ukraine as the war drags on.

Growth in the EBRD regions is forecast to recover to 4.7 per cent in 2023. A downward revision of 0.3 percentage points since March reflects mounting inflationary pressures in the global economy and the EBRD regions.

Chart 25. Output in the EBRD regions is expected to grow by 1.1 per cent in 2022



Sources: National authorities via CEIC and EBRD forecasts.
Notes: EBRD average based on the values of gross domestic product in 2020 in current USD from the IMF.

Regional outlooks

Output in **central Europe and the Baltic states** is expected to increase by 3.2 per cent in 2022 and 3.4 per cent in 2023, with broad-based downward revisions for 2022 relative to the March Update, reflecting higher food and energy prices and supply chain disruptions.

GDP in the three **south-eastern European Union** countries is expected to grow by 2.6 per cent in 2022 and 3.2 per cent in 2023, revised down somewhat since the March Update.

Output in the **Western Balkans** is expected to grow by 3.2 per cent in 2022 and 3.6 per cent in 2023.

The larger than anticipated contraction in Ukraine weighs on the forecast for **eastern Europe and the Caucasus.** Output in the region is expected to contract by 18.4 per cent in 2022, rebounding to growth of 17.5 per cent in 2023 (excluding Ukraine, the rest of the region is forecast to grow by 3.3 per cent in 2022 and 3.4 per cent in 2023).

Growth in **Central Asia** is expected to slow to 3.1 per cent in 2022 and 3.7 per cent in 2023, with a significant downward revision to Mongolia's growth in 2022 since the March Update reflecting the resurgence of Covid-19 in China and additional border restrictions. The forecasts also reflect Central Asia's strong economic links with the Russia's economy, which is expected to contract by 10 per cent in 2022 and stagnate in 2023.

GDP growth in **Turkey** is likely to remain muted at 2 per cent in 2022, supported by a modest recovery in net exports. Growth is forecast to increase to 3.5 per cent in 2023, driven by rising household and government spending ahead of the planned elections.

Output in **the southern and eastern Mediterranean** is expected to grow by 2.5 per cent in 2022 and 4.8 per cent in 2023. Tunisia's 2022 growth has been revised down since the March Update on account of increasing vulnerabilities and continued uncertainty.

Risks to the outlook

These projections are subject to major downside risks should hostilities escalate or should exports of gas or other commodities from Russia become more restricted (see Box 1 and Chart 25). In a scenario where gas supplies are further disrupted, output per capita in the EBRD regions could be 2.3 per cent lower in 2022 and 2 per cent lower in 2023 than in the baseline scenario.

Risks of social tensions in the context of the sharp rise in energy and food prices further weigh on the economic outlook.

At times of high inflation, relative prices tend to move more, making it more difficult to estimate deflators precisely. Deflators, in turn, are used to derive real GDP based on nominal GDP. Initial growth estimates may thus be subject to significant revisions.[6]

[6] See also EBRD (2020).

Box 1. Reducing dependence on Russian gas

Motivated by the European Commission's recent proposal to reduce the EU's dependence on gas and the recent halt of gas supplies to Bulgaria and Poland, this box examines the potential growth implications of a hypothetical scenario in which many economies in the EBRD regions fully shift away from importing gas from Russia. Output in the EBRD regions could be 2.3 per cent lower in 2022 and 2 per cent lower in 2023 than in the baseline scenario, reflecting higher energy prices and rationing of gas on the one hand and significant investment needed to switch to alternative energy sources on the other hand. Growth impacts would be largest for EU member economies in the EBRD regions with both significant gas imports from Russia and large dependence on gas in their energy mix, such as the Czech Republic, Hungary and the Slovak Republic.

In 2021, around 45 per cent of EU gas imports came from Russia, accounting for close to 40 per cent of the EU's gas consumption. Most imported gas arrives in the EU via pipelines from Azerbaijan, Norway, Russia or North Africa; the rest comes from LNG, imported to regasification facilities mainly located on the Iberian peninsula and on the west coast of the continent, in Belgium, France and the Netherlands.

The EU is also highly dependent on Russia for coal and oil, with Russia accounting for 46 per cent and 26 per cent of the EU's imports of these commodities respectively in 2020. However, deliveries of oil and coal are less dependent on specific import infrastructure, making it easier for importing countries to switch suppliers.

The European Commission has issued a proposal on March 8, entitled REPowerEU, to reduce the EU's dependence on gas imports from Russia by two-thirds (or 100 BCM) in the course of 2022 and eliminate it by 2030. This would be achieved through a combination of reducing gas demand (about one third) and procuring alternative supplies (about two thirds). Demand would be reduced mostly by switching electricity generation from gas to other fuels (20 BCM), increasing energy efficiency and other measures to reduce demand (about 38 BCM in total). The supply of gas would be substituted through additional LNG supplies (about 50 BCM), and to a lesser extent additional pipeline gas from other suppliers and other energy sources (about 64 BCM in total).

On April 27, Gazprom completely suspended gas supplies to Bulgargaz and PGNiG citing their failure to make payments in roubles.

Motivated by these developments, this box examines the potential growth implications of a scenario in which deliveries of gas from Russia to the European Union and several neighbouring economies in the EBRD regions (for instance, in parts of Western Balkans) may cease indefinitely with immediate effect.

In the short term, such an energy realignment would result in sharply higher energy prices. The scenario assumes a 40-50 per cent increase in the European gas price, a 15 per cent increase in the Brent oil price (and a 15 per cent decline in the Urals oil price as the two benchmarks diverge further) and a related 20 per cent increase in electricity prices.

In the medium term, significant investments in alternative energy supplies, including greener sources of energy, and their integration into industrial production may follow. These are assumed to start with a delay of several quarters to allow for feasibility studies to be conducted and various approvals to be obtained.

In the short run, households and firms will be faced with higher energy costs and supply disruptions. For instance, the German Bundesbank assumes that industrial consumers could not replace Russian gas with alternative energy sources or procure alternative gas supplies for three quarters.[7] Chemicals, food and metal industries would find it particularly difficult to replace gas from a technological viewpoint. These industries typically account for a higher share of GDP (though a lower share of employment) than the air transport, hospitality and entertainment sectors, which were most severely affected by the Covid-19 crisis. The

[7] See Storbeck (2022).

economic effects of a gas supply shock might thus be comparable to the fallout from the global financial crisis.

Estimates on the overall macroeconomic effects of a gas supply shock vary widely. For instance, for Germany they range between 0.25 per cent and 6 per cent of GDP per annum.[8] These estimates are highly sensitive to the assumptions about the elasticity of substitution both inside firms (changing energy inputs) and in the aggregate economy (the speed with which capital and labour may move away from gas-intensive production processes). This scenario assumes a 3 per cent year-on-year output decline in Germany (spread across quarters spanning 2022 and 2023).

Overall, growth in the EBRD regions could be 2.3 per cent lower in 2022 than in the baseline scenario. In 2023, output per capita would remain around 2 per cent lower than in the baseline scenario, with output per capita dipping below the pre-Covid level again for several quarters (see Chart 25). The output gap (with respect to the baseline scenario) would almost close towards the end of 2023 on the back of investments in new technologies and infrastructure.

Effects would be largest for EU economies with both significant gas imports from Russia and large dependence on gas in their energy mix, such as the Czech Republic, Hungary and the Slovak Republic. They would be somewhat more muted where, even though Russia accounts for a high share of gas imports, gas accounts for a smaller share in the energy mix, such as Estonia and Poland. Lithuania benefits from a new LNG terminal and ceased imports of Russian gas earlier in 2022.

Economies in the Western Balkans, Turkey, Slovenia and in the southern and eastern Mediterranean would predominantly be affected indirectly, through trade and investment links with Germany and other advanced economies in the EU as well as through higher energy import bills. Albania and Montenegro currently import little Russian gas, and coal accounts for a significant share of the energy mix in Bosnia and Herzegovina, Kosovo and North Macedonia; Serbia may continue to buy Russian gas and oil in this scenario.

Economies in the Caucasus and Central Asia could benefit from lower prices of Russian oil, but would be affected by the slowdown in Russia through trade, investment and remittance linkages.

Box 2. Agricultural output in Ukraine

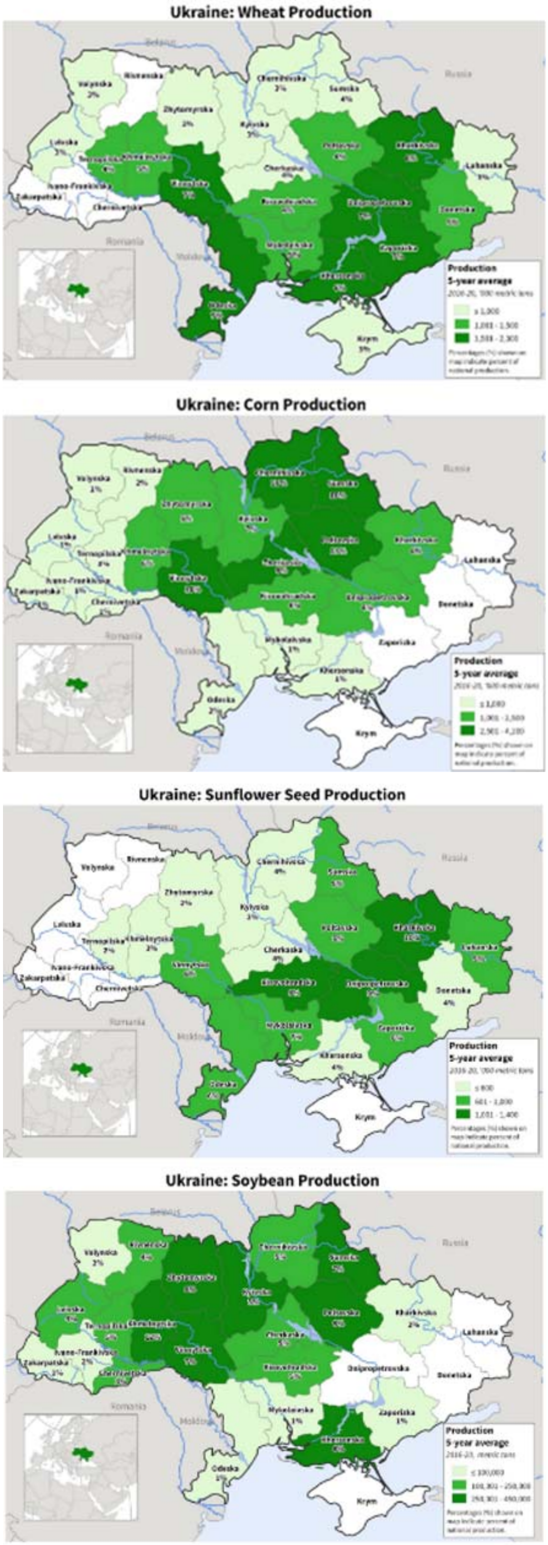
Ukraine is a large agricultural exporter, accounting for significant shares of global exports of corn, sunflower oil and wheat. Wheat and sunflower are mostly grown in the south-east of Ukraine, while corn is mostly in the north-east, both areas which experienced large-scale war damage. Agricultural production is further hampered by lack of fuel, access to seeds, fertiliser and equipment. While other wheat and corn exporters account for similar shares of global exports, other exporters of sunflower oil are much smaller. The war has exacerbated the effects of earlier agricultural shocks.

Ukraine is a significant food exporter, accounting for almost 10 per cent of global wheat exports, as well as 14 per cent of corn and 37 per cent of sunflower oil exports.

Wheat (as well as sunflower) is mostly grown in the south-east of Ukraine, where war damage is the most significant. The Kharkivska, Dnipropetrovska, Khersonska, Zaporizka, Luhanska and Donetska regions together account for 36 per cent of the country's wheat production and 38 per cent of its sunflower seed output. Corn and soybean production is mostly concentrated in the north-east of the country (in the regions of Chernihivska, Sumska and Kyivska), which also experienced large-scale war damage. These regions account for 28 per cent of the country's corn production and 20 per cent of soybean production (see Chart 2.1).

[8] See Bachmann et al. (2022) or DIW et al. (2022)

Chart 2.1. Agricultural production in Ukraine is concentrated in territories affected by the war

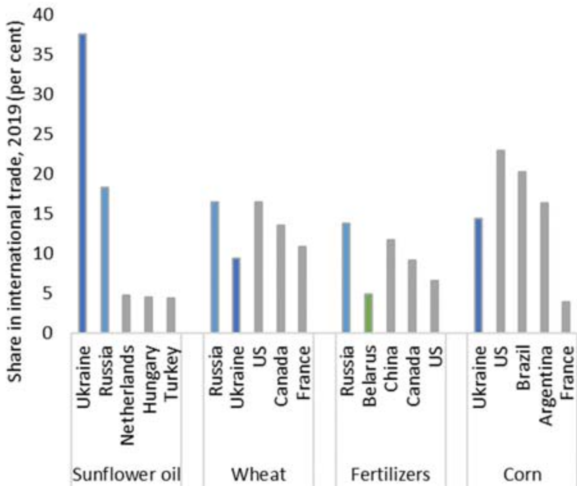


Source: Foreign Agricultural Service, US Department of Agriculture.

Aside from direct war damage, agricultural production is hampered by lack of fuel, access to seeds, fertiliser and equipment. According to estimates of the Food and Agricultural Organization, only 20 per cent of agribusinesses have sufficient fuel to start planting this spring, while only 58 per cent of required seeds are available, 40 per cent of nitrogen fertiliser, 55 per cent of NPK fertiliser, 28 per cent of pesticides and 41 per cent of equipment. Around 20 to 30 per cent of agricultural land in Ukraine is expected not be planted or harvested this year. Significant damage to seaports and transport infrastructure, as well as limitations on ships operating in the Black Sea add longer-term logistical risks.[9]

Other wheat exporters include Canada, France and the United States, accounting for around 11 to 16 per cent of global trade (see Chart 2.2). Other exporters of sunflower oil (such as Hungary, the Netherlands and Turkey) are much smaller, accounting for less than 5 per cent of trade each.

Chart 2.2. China is the largest exporter of fertilizers after Russia



Sources: Harvard Growth Lab Atlas of Economic Complexity.

The war exacerbated the effects of earlier agricultural shocks. Agricultural production in 2021 was weighed down by drought and heatwaves in Canada, wildfires in key agricultural regions of the United States, drought in Latin

[9] See FAO (2022).

America, floods in Australia and three consecutive failed rainy seasons in the Horn of Africa.

Box 3. Green transition and global value chain vulnerabilities

Recent attempts to reduce dependence on Russian gas called for substantial increases in renewable energy use. Such energy transitions would imply a sharp increase in the demand for minerals. While some economies in the EBRD regions may benefit from such shifts, the war on Ukraine and geopolitical tensions also revealed vulnerabilities in global value chains, for instance through dependence on metals, such as palladium, or noble gases.

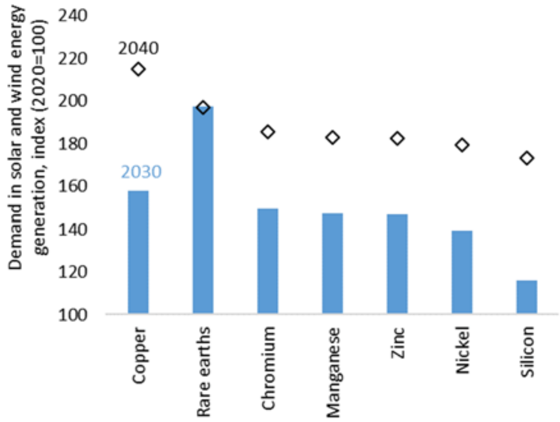
Recent attempts to reduce dependence on Russian gas also called for substantial increases in renewable energy use (see also Box 1). Such energy transitions would imply a sharp increase in the demand for minerals. For instance, a typical electric car requires six times the mineral inputs of a conventional car, and an onshore wind plant requires nine times more mineral resources than a gas-fired power plant. [10]

Lithium, nickel, cobalt, manganese and graphite are crucial to battery performance, longevity and energy density. Rare earth elements are essential for permanent magnets, which are vital for wind turbines and electric car motors. Electricity networks need large quantities of copper and aluminium, with copper being a cornerstone for all electricity-related technologies.[11]

Until the mid-2010s, the energy sector represented only a small part of total demand for most minerals, but renewable energy technologies are now becoming the fastest-growing segment of demand. In their most conservative "stated policies" scenario, the IEA predicts that demand for major minerals required for solar and wind energy will rise about twofold between 2020 and 2040. Demand for rare earths may increase by between 200 and 600 per cent by 2040, depending on how ambitious greening targets are (see Chart 3.1).[12]

[10] See IEA (2022b)
[11] See IEA (2022b)

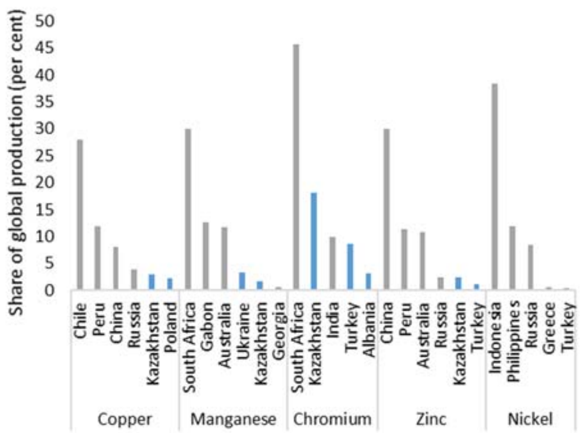
Chart 3.1. The shift to renewable energy increases demand for minerals



Sources: IEA and authors' calculations.

The production of these minerals is concentrated in economies in Latin America (Chile and Peru are the world's largest copper and zinc producers), Africa (Gabon and South Africa are the largest manganese, and South Africa chromium producers) and China (the world's largest zinc producer and important for copper; see Chart 3.2). In the EBRD regions, Poland, Kazakhstan, Turkey and Ukraine could benefit from increased demand for these minerals.

Chart 3.2 Leading producers of minerals are different from major fossil fuels producers



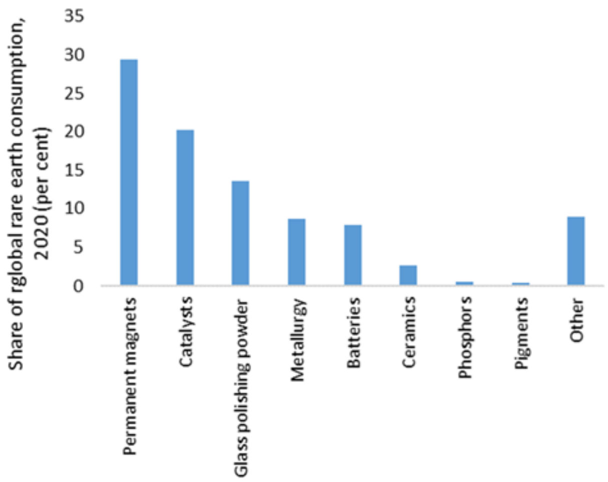
Source: British Geological Survey, 2019.
Note: Select large producers and large producers in the EBRD regions shown. Only mined varieties are included.

[12] See IEA (2022b)

Rare earths are also critical for the green energy transition. Overall, renewables are much more dependent on minerals than fossil fuels. Wind power is especially dependent on rare earths as it relies on very powerful magnets to generate electricity.[13]

Rare earths are also key inputs for the production of high-tech consumer electronic equipment, from phones to computers and cars, as well as defence industries. Rare earth permanent magnets are particularly important given their high energy to weight ratio, allowing for smaller and lighter devices (see Chart 3.3).

Chart 3.3 Rare earths are used in the production of high-tech electronic equipment



Sources: IEA.

China is the world's largest producer of rare earths, though its share has been declining, from about 80 per cent of global production in 2017 to around 60 per cent in 2021.[14] China accounts for around 80 per cent of rare earth imports of the United States, and around 60 per cent of the European Union and Japan.

Vulnerabilities in global value chains

The war on Ukraine and geopolitical tensions also revealed vulnerabilities in global value chains, for instance through dependence on metals, such as palladium, or noble gases.

Noble gases, in particular neon gas, are essential for the manufacture of semiconductor chips. Two companies in Ukraine (based in Mariupol and Odessa) account for about 35 per cent of the global supply of purified neon, mostly used for semiconductor manufacturing (and about half of high-purity neon used in the United States). Neon prices already rose about three-fold (they increased six-fold after the invasion of Crimea in 2014).[15]

Russia accounts for around 25 per cent of world palladium exports— a key input for some types of semiconductors and used for catalytic converters in the exhaust pipes of all non-electric cars. While palladium prices spiked shortly after the start of the war, they have largely normalised as exports from Russia continue. Other important exporters of palladium are Germany, South Africa, the United Kingdom and the United States.

[13] See Biello (2010).
[14] See Hui (2020).
[15] See Alper (2022).

Regional updates

Central Asia

The economies of Central Asia grew by 5 per cent in 2021. Spillover effects from the Russian invasion of Ukraine weigh on growth through supply chain disruptions and higher transportation costs, increased uncertainty holding back investment, inflation driven by rising food and commodity prices and pressures on currencies. There are early signs of return migration from Russia; a drop in remittances would disproportionately affect low-income households. Growth in the region is expected to slow to 3.1 per cent in 2022 and 3.7 per cent in 2023.

Kazakhstan

In 2021, Kazakhstan remained reasonably resilient to external shocks, owing to significant fiscal buffers and National Fund reserves. Real GDP grew by 4 per cent amid the easing of Covid-19 restrictions, a recovery of domestic demand, and strong export performance. The January 2022 events, while shaking the country's political foundations, did not have a major impact on the economy. In January-February 2022, the economy was helped by strong external demand, with exports rising by 71.4 per cent year-on-year, supported by higher oil prices. However, Kazakhstan has been negatively affected by the war on Ukraine. Like other regional currencies, the Tenge suffered a speculative attack in late February but almost fully recovered in the second half of March, helped by the Rouble's comeback and an adequate reaction by the Kazakh regulator. That said, the general mood among investors and financiers is one of severe uncertainty. Inflation soared to 12.0 per cent year-on-year in March 2022 owing to rising food and commodity prices. Facing higher costs of funding (the central bank hiked its policy rate from 10.25 per cent in January to 13.5 per cent in February and to 14 per cent in late-April 2022), commercial banks raised interest rates and cut back on long-term lending, negatively affecting consumer spending and investment. Another major concern is the possibility of secondary sanctions being imposed on Kazakh banks for dealings with Russian entities. Transportation and logistics have also become a major worry. The CPC pipeline – accounting for two-thirds of Kazakhstani oil exports – is partially blocked since March 23 due to technical issues at the Novorossiysk port. Another wave of Covid-19 in China led to additional border crossing and trade restrictions. Most importantly, as Western companies pull out of Russia, Kazakhstan has to seek replacement suppliers and alternative supply routes. The extra costs of more complicated trade logistics (over the Caspian Sea and Georgia) will likely be passed onto Kazakh consumers and producers, adding to inflationary pressures and detracting from the country's international competitiveness. Overall, the economy is expected to grow at a slower pace of 2.0 per cent in 2022, and 2.5 per cent in 2023, assuming commodity prices remain elevated and Kazakhstan maintains its access to export markets.

Kyrgyz Republic

Having suffered a severe recession of 8.6 per cent in 2020, the Kyrgyz economy expanded by 3.6 per cent in 2021 despite a major drop in gold exports. Economic recovery continued in the first quarter of 2022, with GDP growth estimated at 4.5 per cent year-on-year. A near doubling of imports in the first two months of 2022 (up by 91.3 per cent year-on-year) is indicative of the government's success in reducing corruption in customs administration at the country's border with China. Accompanied by a new tax code mandating the use of cash registers at all points of sale, this reform is likely to help the authorities clamp down on shadow economic activities, thus contributing to public revenues, levelling the playing field for companies operating in the formal economy, and creating incentives for investment in manufacturing. The government and Centerra have reached a tentative settlement over Kumtor, the country's largest gold mine, potentially clearing a major roadblock for gold exports and FDI. However, remittances are likely to fall as sanctions start to bear on the Russian economy, and inflation has already picked up from 11.2 per cent in January to 13.2 per cent year-on-year in March 2022, putting further pressure on vulnerable households. The Kyrgyz Som experienced the largest drop in value compared with other Central Asian currencies in the immediate aftermath of the war on Ukraine, reflecting the country's dependence on Russia and its membership in the Russia-led Collective Security Treaty Organization and Eurasian Economic Union. A sharp increase in the central bank's policy rate (from 8.5 to 14.0 per cent) and the Rouble's recovery helped restore the value of the Som in the second half of March 2022. However, a further escalation of the geopolitical crisis is likely to put more pressure on the country's currency and balance of payments given the large share of imports in energy, intermediary and consumer goods. The economy is projected to grow at 1.0 per cent in 2022, and 4.0 per cent in 2023, subject to strong downside risks.

Mongolia

Mongolia's economic performance continues to be closely connected to China's demand for its key export products (coal, copper and iron ore), though gold is rising in importance too (increasing from 7.3 to 20 per cent of total exports in 2020). In addition to the continued slump in tourism and hospitality activities, the recovery process in 2021 was hampered by intermittent border closures. Overall, in 2021 Mongolia achieved modest real GDP growth of 1.4 per cent. Tucked between Russia and China, Mongolia is affected by the war on Ukraine due to supply chain disruptions and currency devaluation (with an immediate pass-through to inflation). Given its location, the country depends on Russia for transportation of fuel and other key supplies. Moreover, the renewed outbreak of Covid-19 in China reduces the choice of alternative supply routes while also hampering Mongolia's ability to benefit from elevated commodity prices. Inflation is a key concern for some time, reaching 14.4 per cent in March 2022, the highest level among regional peers. In response, the Bank of Mongolia (BOM) raised its benchmark interest rate by 300 basis points to 9 per cent in March 2022. The MNT lost 7.5 per cent of its value against the US Dollar since late February 2022. The BOM's current international reserves (about US$ 3 billion, covering seven months of imports and 53 per cent of upcoming debt payments) are stronger than in 2016, but may have to be further bolstered to fully withstand external shocks. On the positive side, Covid-19 restrictions have added to the urgency of digitalising government services and commerce, opening up new possibilities for Mongolia's cashmere garment industry to reach lucrative markets in Europe and the US. Another important breakthrough concerns Rio Tinto's recent agreement to write off US$ 2.3 billion of Mongolia's debt related to Oyu Tolgoi. By resolving this long-standing dispute, Mongolia was able to put to rest concerns about its investment climate and increase the country's share in any benefits from future FDI in the mining sector. Overall, Mongolia's real GDP is forecast to grow by 3.5 per cent in 2022 and 7.0 per cent in 2023, with significant downside risks related to the geopolitical situation.

Tajikistan

Tajikistan's real GDP grew by 9.2 per cent in 2021, the strongest growth performance in Central Asia. On the demand side, the economy was driven by the fast increasing exports of precious metals and minerals (overall exports rose by 52.8 per cent), investment in fixed capital (up by 23.3 per cent, reflecting a construction boom) and domestic consumption. Supported by a surge in remittances, stronger consumer demand led to expansion in imports (up by 33.6 per cent) and retail trade turnover (12.7 per cent growth). The National Bank increased its policy rate from 10.75 per cent in January to 13.25 per cent in October 2021, helping to keep inflation in check (at 7.3 per cent in March 2022, the lowest level in Central Asia, within the National Bank's target corridor). Tajikistan's monetary authorities were the only ones in the Central Asian region not to hike the policy rate following Russia's invasion of Ukraine. However, the war on Ukraine did put significant pressure on Tajikistan's national currency, resulting in the nominal TJS/USD exchange rate depreciating by almost 10.6 per cent. The Tajik economy can be expected to take a big hit as the Russian economy faces a severe downturn. Some 60,000 Tajik workers returned home in the first quarter of 2022. Many more will lose their jobs in Russia's construction industry if that country goes into a protracted recession. Remittances in 2022 are likely to fall by around 20-25 per cent, which is equivalent to almost 6 per cent of GDP. This drop in incomes will disproportionately affect the lower strata of the population, but a weakening of consumer demand will have a strong ripple effect throughout the entire economy, including a worsening of the country's balance of payments and debt carrying capacity. On the bright side, the country has accumulated reasonable reserves (providing a seven-month import cover) and will likely react to external pressures by ratcheting up gold exports (taking advantage of elevated prices) and compressing imports. GDP growth is expected to continue, albeit at a significantly slower pace of 3.0 per cent in 2022 and 5.0 per cent in 2023.

Turkmenistan

According to data released by the Turkmen authorities, the country's economic growth has been remarkably stable throughout the pandemic. Officially reported real GDP growth was 5.9 and 6.2 per cent year-on-year in 2020 and 2021, respectively. The official exchange rate peg continues to be maintained at 3.5 Turkmen Manat (TMM) per USD. Access to foreign currency at this rate is strictly regulated to provide for critical consumption and capital investment needs, as part of a long-term import substitution strategy. That said, the parallel market exchange rate appreciated from TMM 40 in April 2021 to TMM 19 per US dollar as of April 2022, at least in part reflecting the government's willingness to sell foreign currency at the official rate to SMEs operating in priority sectors, such as food and beverages, in exchange for significant price cuts. Turkmenistan's trade policies may be further liberalised as the country starts negotiating its accession to WTO. Turkmenistan formally applied for WTO membership in November 2021, and agreement to start negotiations was reached in February 2022. For now, however, private sector development continues to be inhibited by the extremely illiberal business environment, and highly centralised decision-making coupled with weak institutional capacity and an outsized state presence in the economy. Turkmenistan is the largest producer of gas in Central Asia and the only one with the ability to ramp up production and exports, though the country is heavily dependent on China as a destination for exports of gas. A recent swap deal with Iran and Azerbaijan will allow exporting small amounts of gas via Azerbaijan, however the future of the southbound TAPI pipeline megaproject is unclear following the Taliban takeover of government in Afghanistan and ADB's recent decision to pause all due diligence and processing activities until further notice. The country's stability in the highly uncertain international environment caused by Russia's war on Ukraine is further supported by a strong external balance sheet, sizeable reserves (sovereign net foreign assets were 57 per cent of GDP at end-2020) and very low gross external debt (12 per cent of GDP at end-2020). Moreover, as the global economy braces for major turbulence, Turkmenistan stands to benefit from elevated gas prices and its 'splendid isolation' – from Russia and global capital markets. Overall, the Turkmen economy is expected to expand by 6 per cent in 2022 and 5.5 per cent in 2023.

Uzbekistan

Uzbekistan enjoyed a broad-based economic recovery in 2021 resulting in real GDP growth of 7.4 per cent. Reflecting the somewhat higher base, growth slowed to 5.8 per cent year-on-year in the first quarter of 2022, led by very strong expansion in fixed investment (up by 26.3 per cent) and a near tripling of exports (+173 per cent year-on-year in January-February 2022). The latter was entirely due to the government's' decision to accelerate gold exports given the favourable price environment. Sanctions against Russia have put significant pressure on Uzbekistan's Sum, threatening a quick pass-through to prices. The Central Bank of Uzbekistan (CBU) responded to this pressure on March 17, 2022 by raising the policy rate by 300 basis points to 17 per cent. The nominal Sum/USD exchange rate depreciated by a relatively modest 4.3 per cent in April compared with early-January, while annual inflation inched up from 9.7 per cent in February to 10.5 per cent in March 2022. Uzbekistan's fundamentals (strong external and fiscal buffers, low government debt and a record of high growth relative to peers) bode well for the country's ability to weather the storm. On the negative side, a protracted recession will reduce Russia's demand for Uzbek workers. Remittances are likely to take a big hit, estimated at 2-3 per cent of GDP, disproportionately affecting low-income households. A related weakening of consumer demand will ripple through the entire economy. Uzbekistan's exports to Russia are concentrated in the fresh fruit and vegetable category, with limited potential for diversion to other markets. And, given its double-landlocked position, Uzbekistan will be affected by higher costs of overland transport and logistics. All in all, therefore, the ongoing crisis has led to a downward revision of our growth projections for Uzbekistan. The economy is now expected to grow at 4.0 per cent in 2022, and 5.0 per cent in 2023.

Central Europe and the Baltic States (CEB)

Bolstered by a strong recovery in private consumption and investments, the economies of the CEB region increased, on average, by 5.5 per cent in 2021, and GDP in most countries has now exceeded pre-pandemic levels. However, positive developments in industrial production, construction and retail sales in 2022 have been overshadowed by the knock-on effects of the Russian invasion of Ukraine. Continued disruptions in supply chains and rising commodity and energy prices, intensified by the war on Ukraine, resulted in a sharp increase of inflation rates in March 2022, ranging from 6.0 per cent in Slovenia and 7.3 per cent in Croatia to a high of 15.6 per cent in Lithuania. Inflation will likely remain elevated at least during the first half of 2022 and will negatively affect the disposable income of households. In order to mitigate inflationary pressures, central banks in the Czech Republic, Hungary and Poland have increased interest rates. Wide-ranging government responses to inflation, from reducing VAT to zero per cent on basic products in Poland to price caps on basic food and fuel in Hungary and on electricity prices in the Slovak Republic, will likely cause general government deficits to rise further in 2022. Labour shortages in certain industries persist but may be partially alleviated in some countries by the employment of Ukrainian refugees. The disruption of trade relations with Russia will have a negative effect on Baltic countries' exports in the short term, with Russia accounting pre-war for 30 per cent of Latvia's and 26 per cent of Lithuania's exports outside the EU. As gas constitutes on average 21 per cent of CEB countries' energy mix, with Russia as a major gas supplier, higher energy prices are likely to weigh further on consumers.

Poland

Following an easing of anti-pandemic measures, private consumption growth in the fourth quarter of 2021 increased to 7.9 per cent year-on-year, bringing the full 2021 GDP growth to 5.7 per cent. In 2022, rising commodity and energy prices and broken supply chains, amplified by elevated geopolitical uncertainty, will likely weigh on GDP performance. However, domestic demand will be supported by the more than two million refugees arriving from Ukraine. Structural challenges linked with the refugee inflow are substantial, with housing, health and education services under great pressure. However, refugees could help fill skill shortages (unemployment was just 3.0 per cent in February 2022). The combination of supply shocks and robust demand has driven inflation into double-digit territory, reaching 10.2 per cent in March 2022. While the National Bank of Poland continues to increase the reference rate, to 4.5 per cent in April 2022, the government is attempting to use tax cuts to dampen the effects of inflation. These included a reduction of VAT to zero per cent on basic food products, gas and fertilizers. Additional tax cuts were announced in March 2022, including a plan to slash the bottom personal income tax rate from 17 to 12 per cent, effective from mid-2022. These cuts plus various fiscal expenditures will likely lift the general government deficit to above 4 per cent of GDP in 2022. We expect GDP growth to reach 4.0 per cent in 2022 and 3.5 per cent in 2023, but downside risks include uncertainty on the impact of the war and humanitarian crisis, further elevated energy prices and continued trade disruptions.

Slovak Republic

The Slovak economy expanded by 3.0 per cent in 2021. The pace of recovery slowed down due to persistent supply-chain issues, which largely affected the manufacturing sector, and higher price levels. Household consumption increased by 2.8 per cent year-on-year in the fourth quarter of 2021, but investments are still below pre-pandemic levels. Persistent shortages of semiconductors and transport disruptions have been intensified by the war on Ukraine, forcing some car plants to temporarily pause production in March and April 2022. Labour market shortages and inflation growth are putting pressure on wage and salary costs, which increased by 8.6 per cent year-on-year in the fourth quarter of 2021. The rise of housing, energy and food prices underpinned an inflation rate growth of 9.5 per cent in March 2022, harming real disposable incomes of households, and further increases in inflation are expected in the short term. The government has reacted by capping electricity prices for households until 2024. GDP is expected to rise by 2.0 per cent in 2022 and 3.5 per cent in 2023, but the Slovak Republic's high exposure to Russian gas access and further supply chain disruptions are significant downward risks.

Czech Republic

After a solid, broad-based 3.3 per cent GDP growth in 2021, the Czech economy faces headwinds in 2022 related to a combination of the war on Ukraine and related disruptions, and to ongoing inflation pressures. In April 2022, the Czech National Bank raised its two-week repo rate to a 20-year high of 5 per cent to help counter rising inflation, while the government has cut excise taxes and has expanded social benefits. While the economy was running hot before the war, and low unemployment should help in absorbing Ukrainian refugees into the labour market, the Czech economy is also exposed to war-related risks. The energy-intensive industry sector is dependent on imports of Russian gas, with limited external alternatives. Manufacturing, especially the car industry and its exports, will likely further suffer from higher energy prices, trade and supply disruptions, with some car plants already limiting their production. GDP growth is anticipated to slow down in 2022 reaching 2.5 per cent, before recovering to 3.5 per cent in 2023.

Hungary

The Hungarian economy grew strongly in 2021 by 7.1 per cent, supported by private consumption growth of 7.1 per cent year-on-year in the fourth quarter of 2021, higher than in most peer countries. Industry production has been recovering since September 2021, despite supply-chain disruptions. Automotive industry output in February 2022 exceeded levels in the second half of 2021, with a significant increase in production of electric-car batteries. The labour market remains strong, with the employment rate exceeding pre-pandemic levels. While the high inflow of Ukrainian refugees could partially alleviate labour force shortages, especially in the manufacturing sector, the inflation rate, which was already 8.4 per cent in February 2022, is set to grow further amid surging energy and food prices. Since mid-2021, the central bank has raised its main policy rate nine times, from 0.9 per cent to 4.4 per cent by March 2022. In 2022, the government has introduced temporary price caps for basic food products and fuel, while stimulating consumption with a one-off tax rebate and limiting retail mortgage interest rates. In addition, the war on Ukraine could likely further negatively influence trade and raw materials supplies, which would harm manufacturing industry. Hungary is highly reliant on gas imports from Russia, and increased energy prices could therefore have a significant negative effect on export-orientated and energy-intensive industries, such as the automotive sector. These are the main risks to our baseline GDP growth forecasts of 3.5 per cent in 2022, and 3.5 per cent in 2023.

Estonia

The Estonian economy grew strongly by 8.3 per cent in 2021, with GDP now exceeding pre-pandemic levels. Increased economic activity was especially visible in the manufacturing sector. Exports also grew strongly, but rising inflation contributed to a moderate slowdown in private consumption growth in the fourth quarter of 2021 and, at 14.8 per cent in March 2022, is affecting the disposable income of households. In order to mitigate the effects of inflation, government measures so far include indexation of pensions from April 2022, energy price subsidies for vulnerable households and compensation for higher electricity prices. Although exports to Russia are low, the war on Ukraine still affects the Estonian economy mainly through the disruption of imports of mineral fuels, fertilisers and related products. Shortages of workers in services sectors could be alleviated by granting jobs to refugees from Ukraine. Estonia has announced a suspension of gas imports from Russia (gas makes up 8 per cent of its energy-mix, but more than 80 per cent was imported from Russia), putting pressure on the LNG terminal in Paldiski. Overall, GDP growth is anticipated to reach 1.5 per cent this year, before recovering to 2.5 per cent in 2023.

Latvia

The economic recovery of 4.7 per cent GDP growth in 2021 was supported by the growth of household consumption and a 7.4 per cent growth in manufacturing. An almost complete removal of pandemic restrictions in 2022 is further supporting demand and household consumption. Labour shortages and a tightened labour market contributed to a rise in wage and salary costs of 8.5 per cent year-on-year in the fourth quarter of 2021. Inflationary pressures, especially in energy and food prices, have been intensified by the war on Ukraine, with inflation reaching 11.2 per cent in March 2022. The government has introduced compensation for the increased energy prices and has brought in monthly allowances for vulnerable groups, such as the elderly and disabled. The overall cost of these measures amounts to around 1.6 per cent of GDP. Following its decision from April 2022 to stop gas imports from Russia, Latvia will need to access other sources and increase the capacities of its underground gas storage facility. Given the overall geopolitical uncertainties, GDP growth is likely to slow down in 2022 to 1.5 per cent, before recovering to 2.0 per cent in 2023.

Lithuania

A strong economic recovery of 5 per cent in 2021 was supported by the growth of household consumption and a noteworthy increase in the retail and services sectors, as well as in manufacturing. Employment growth was also strong, reaching pre-pandemic levels. The inflow of Ukrainian refugees in 2022 could partially alleviate shortages in the labour force and limit the substantial growth seen last year in wage and salary costs (10.6 per cent growth in the fourth quarter of 2021 year-on-year). Inflation reached 15.6 per cent in March 2022 and, with higher energy and food prices on the short-term horizon, is set to grow further throughout the year. The government's support package to mitigate the influence of rising prices includes tax cuts, compensation for higher energy prices and support for businesses. The cost of these measures amounts to around 4 per cent of GDP. Following the decision from April 2022 to stop gas imports from Russia, Lithuania intends to increase its gas imports through the Klaipeda LNG terminal. In addition to reduced exports to China after a bilateral dispute, the war on Ukraine and related sanctions on Russia and Belarus are continuing to negatively affect Lithuania's exports of transport services and overall exports to Russia (13 per cent of its total non-EU exports pre-war). Given the overall uncertainties, higher energy and food prices, as well as continued trade disruptions, GDP growth is anticipated to reach 2.0 per cent this year, before recovering to 3.0 per cent in 2023.

Croatia

After a steep drop of 8.1 per cent in 2020, the Croatian economy expanded by 10.4 per cent in 2021. Growth was broad-based in 2021, with private consumption, net exports, and investment recording significant improvements. The tourism sector recovered strongly, with visitor stays in 2021 at about 90 per cent of 2019 figures. However, in the fourth quarter of 2021 GDP declined by 0.1 per cent quarter-on-quarter, and figures for retail turnover in January and February 2022 showed a weakening economy, as real income growth was marginally negative. The unemployment rate fell to 6.6 per cent in March 2022, implying good prospects for the labour market. Nevertheless, as in other countries in the region, inflation will continue to affect consumer demand, although the extent of the increase has been more muted when compared with regional peers, with the rate reaching 7.3 per cent in March 2022. In reaction to increasing prices, the authorities announced a package of measures in February 2022 focused mainly on decreasing VAT rates on critical products and energy subsidies to vulnerable households. Regulated energy prices will continue to limit the full pass-through to the economy. The fiscal space improved visibly in 2021 and the government is targeting a considerable consolidation in 2022, aiming to bring the general government deficit below 3 per cent of GDP, in light of euro adoption planned for January 2023. On the monetary side, long-term yields spiked from about 0.5 per cent at end-2021 to over 2.0 per cent by mid-April 2022, in line with regional peers and repricing at the EU level. GDP growth is expected to fall to around 3 per cent in 2022 on the back of a slowdown in private consumption and goods exports, while investment should remain robust amid the earthquake reconstruction efforts. In 2023, a slowdown in inflation, Eurozone entry and EU funds could bring growth to 3.5 per cent, with upside potential for even higher growth. Downside risks from a potential shutdown of energy imports from Russia are mitigated by the country's limited dependence on Russian gas and the presence of an LNG terminal.

Slovenia

After a decline of 4.2 per cent in 2020, the Slovenian economy rebounded by 8.1 per cent in 2021. Domestic demand drove growth, but net exports had a negative contribution as imports accelerated. Private consumption was sustained by the removal of Covid-19 restrictions, strong pent-up demand, fiscal support and a tightening labour market. In the first two months of 2022, retail turnover remained strong, but industrial production declined in February, reflecting supply chain issues especially in the automotive sector. Unemployment fell to 4.1 per cent in March 2022, while the number of employed persons continued to be at record high levels. Inflation in March 2022 was just 5.4 per cent, lower than in regional peers, as the waiver of network fees and excise tax on energy led to a 30 per cent decrease in the electricity price year-on-year. However, the inflation rate is expected to be high throughout 2022. Fiscal consolidation is set to continue in 2022 as Covid-related spending pressures fade. GDP is forecast to grow by 3.5 per cent in 2022, with risks tilted to the downside, subject to potential escalations of trade frictions. In 2023, growth is expected to shift towards the medium term potential growth rate at around 3 per cent. Downside risks include the possibility of recession in major European economies such as Germany and Italy, with which Slovenia has strong trade links, as well as the country's reliance on Russian gas.

Eastern Europe and the Caucasus (EEC)

Aside from Ukraine's economy, which is currently functioning under war conditions, other countries in this region are being hit by trade disruptions, high energy and grains prices, inflows of refugees and reduced access to international financial markets. The consequences of the war on Ukraine will keep inflation at elevated levels, straining household budgets and public finances. In this region, Armenia and Georgia have high export shares to Russia, Ukraine and Belarus, all of which face severe recessions in 2022. Georgia may additionally suffer from a slowdown in tourism from Russia and Ukraine, strongly affecting an already battered hospitality industry, while Armenia is vulnerable to a major drop in remittances from Russia. Moldova's fragile economy is struggling to cope with an influx of Ukrainian refugees and suffers from weak energy resilience. Azerbaijan is the only country in EEC that is likely to benefit from current energy sector developments, at least in short term, due to its status as a major hydrocarbons exporter and one of the potential alternative (to Russia) gas suppliers of Europe. Beyond the short term, the economic implications of possible post-conflict scenarios are difficult to assess at present but are extremely sensitive to geo-political developments in the region.

Armenia

GDP growth in 2021 is estimated at 5.7 per cent and was based on growth of almost all sectors of the economy except agriculture and some service activities. The current account and fiscal deficits narrowed slightly to 3.7 per cent and 4.6 per cent of GDP respectively. Inflation reached a peak of 9.6 per cent year-on-year in November 2021 as a result of high international food prices and pass-through from previous dram depreciation before moderating to 6.5 per cent year-on-year in February 2022. However, inflation picked up again to 7.4 per cent in March on the back of a new wave of rising international energy and grain prices, which threaten to keep inflation elevated for longer. The Central Bank of Armenia continues to tighten monetary policy and raised the refinancing rate several times in recent months reaching 9.25 per cent in March 2022. The ongoing war on Ukraine threatens to stop the growth momentum of the Armenian economy. Trade and remittances are expected to suffer from an expected severe recession in Russia, which accounted pre-war for 28 per cent of Armenian exports, 33 per cent of imports and 40 per cent of money transfers to Armenia. The dram initially came under pressure after the Russian invasion of Ukraine, but has since managed to recover its losses. International reserves remain at comfortable levels of US$ 2.9 billion in March 2022, covering approximately six months of imports. The close linkages to the Russian economy dampen the outlook for growth in 2022, with GDP expected to grow by 1.5 per cent this year and 4.0 per cent in 2023.

Azerbaijan

Economic recovery in Azerbaijan in 2021 was led by the non-energy sectors, with the non-hydrocarbon part of the economy posting 7.2 per cent growth in 2021, driven in particular by services and manufacturing. However, overall GDP growth of 5.6 per cent, while exceeding expectations, was weighed down by restrained oil production on the back of the OPEC+ oil production quotas. On the demand side, consumption recovery was robust but investment declined by 7.3 per cent. Exports, which are dominated by hydrocarbons, increased by 17 per cent in real terms in 2021, and rising demand and prices of oil and gas led to significant external surpluses. GDP growth accelerated further to 6.8 per cent year-on-year in the first quarter 2022. High food prices caused inflation to accelerate to an average 12.2 per cent year-on-year in the period January to March 2022. The Central Bank of Azerbaijan reacted by hiking the refinancing rate five times since the beginning of 2021, to 7.75 per cent in March 2022. Rising energy prices will likely support economic growth in Azerbaijan, at least in the short term. Fuelled by high export revenues, non-energy sectors are expected to retain strong growth momentum, although exports of agricultural products to Russia and Ukraine might be negatively affected. Therefore, GDP growth is expected to reach 4.5 per cent in 2022 before moderating to 2.5 per cent in 2023 as one-off growth factors diminish in importance. In the medium term, there remains a serious risk that a combination of elevated inflation with a fixed exchange rate could lead to a loss of competitiveness of the non-oil sector, holding back the necessary diversification of the economy.

Georgia

Economic recovery in 2021 was stronger than expected, with GDP growth reaching 10.4 per cent. Consequently, the economy has fully recovered to pre-Covid-19 levels, even though the tourism sector, usually one of the main growth drivers, is still far from pre-pandemic levels. Instead, the recovery was mainly based on revived trade, manufacturing and ICT services on the production side and rising household consumption and net exports on the demand side. The strong recovery has been accompanied by increasing inflationary pressures on the back of higher international food and oil prices. Inflation reached a high of 13.9 per cent year-on-year in January 2022, before dropping to 11.8 per cent year-on-year in March 2022. The National Bank of Georgia reacted by tightening monetary policy multiple times, with the refinancing rate standing at 11 per cent in March 2022. The current account deficit remained at a high level of 9.8 per cent of GDP in 2021, but international reserves rose to US$ 4.0 billion in March 2022, helped by significant financing from international development partners and covering more than four months of imports. The growth momentum is likely to be inhibited by the war on Ukraine as trade disruptions are likely and high energy and grain prices will keep inflation at elevated levels. Georgia has a high export share to Russia, Belarus and Ukraine (approximately 23 per cent in 2021), and FDI might be negatively affected by rising security risks in the region. As a result of these factors, moderate GDP growth of 3.0 per cent is expected in 2022, before strengthening to 5.0 per cent in 2023. While risks remain high, the new three-year US$ 289 million Stand-By Agreement with the IMF, expected to be approved by the IMF Board in May 2022, would further support macroeconomic and financial stability.

Moldova

An exceptionally strong GDP growth of 13.9 per cent in 2021 was driven by double-digit growth of household consumption, fuelled in turn by robust growth of salaries, social assistance and remittances, and by revived export demand from European automotive value chains. However, higher food prices since the beginning of 2021, and a threefold increase of gas prices since October 2021, have pushed inflation from almost zero at the beginning of last year to 22.2 per cent year-on-year in March 2022. These developments prompted the National Bank of Moldova (NBM) to raise the base rate by almost 1000 basis points since June 2021, to 12.5 per cent in March 2022. Rising gas prices are a major risk for Moldova. High gas prices contributed to a current account deficit of 11.6 per cent of GDP in 2021, prompting NBM interventions on the foreign exchange market and thus decreasing international reserve assets from US$ 4 billion in October 2021 to US$ 3.4 billion in March 2022, but still covering approximately five months of imports. In addition, energy subsidies to households and businesses are putting pressure on government finances and crowding out public investments. Moldova's fragile institutions are struggling to cope with the influx of Ukrainian refugees and trade disruptions caused by the war on Ukraine. The recent additional rise of energy and grain prices will keep inflation at elevated levels for longer. Because of these stresses to the economy, GDP growth of just 1.0 per cent is expected this year, and a moderate acceleration to 3.5 per cent for next year. In light of the adverse shock on Moldova's economy, the authorities have asked for augmentation of the IMF's 40-month US$ 558 million ECF/EFF program approved in December 2021. International support will help alleviate some of the immediate financing concerns, but downside risks from high inflation and the impact of the war on Ukraine remain substantial.

Ukraine

The war has brought an ongoing economic recovery (3.4 per cent GDP growth in 2021) to an abrupt halt and put Ukraine's economy under enormous stress, with the heavy devastation of infrastructure and production capacities. It is estimated that between 30 and 50 per cent of businesses have stopped their operations completely, causing about half of all employees to lose their jobs and income. Approximately 10 per cent of the pre-war population has fled Ukraine and an additional 15 per cent are displaced within the country. All this is severely weakening companies' finances, thus exposing the banking sector to a drastic deterioration of asset quality, once the moratoria on changing the risk classification of banks' credit exposures are withdrawn. In order to preserve macroeconomic stability, on the day of the invasion (24 February 2022) the National Bank of Ukraine fixed the exchange rate, limited cash withdrawals and introduced capital controls by preventing most cross-border transactions. However, huge production and logistical disruptions have caused inflation to rise 13.7 per cent year-on-year in March 2022, and it is likely that inflationary pressures will persist throughout the year. Plummeting tax revenues combined with government spending way above the budget opened a fiscal gap of at least US$ 5 billion a month. Yet, because the fiscal gap is accompanied by a substantial external gap as well, it is clear that war bonds purchased by domestic banks and monetary financing of fiscal deficit allowed under Martial Law could plug only a small portion of the gap. In March, the external gap was largely covered by IFI lending, but more sustainable financing predominantly based on grants is needed. Several multi-donor accounts are being created in the IMF, World Bank and European Union. A Multi-Donor Administered Account created in the IMF is intended as a secure vehicle for donors to channel grants and loans for Ukraine. Funds will be used for balance of payments and budgetary needs. Under this unprecedented level of uncertainty, GDP is expected to decline by 30 per cent in 2022 to be followed by an increase of 25 per cent in 2023 on the assumption that massive reconstruction efforts will be able to take place. The forecast is sensitive not only to the duration of the war, but also to the post-war geopolitical situation, the robustness of reconstruction efforts and the extent of return of refugees.

South-eastern European Union

Growth rates in these three south-eastern European Union countries are falling in 2022 after robust recoveries in 2021. Rising inflation is a concern in all three cases, prompting government efforts to protect the most vulnerable. In Bulgaria and Greece, both of which have major tourism industries, there were partial recoveries in tourism numbers in 2021, and the hope is for a tourism season close to or even exceeding 2019 levels this year. The war on Ukraine is causing spillovers for supply chains, and rising energy prices are a major challenge in all cases given the dependence on energy imports.

Romania

After a rebound of 5.9 per cent GDP growth in 2021, which was mainly driven by strong private consumption, the rate of growth will slow down significantly in 2022. The economy entered 2022 on a weak footing, as GDP declined in the last quarter of 2021 by 0.1 per cent quarter-on-quarter due to a fall in investment and slowing inventory build-up. Accelerating inflation from the second half of 2021 has already put pressure on consumers and firms. While real net wages have temporarily recovered in early 2022 and the removal of Covid-19 restrictions has improved confidence, the war on Ukraine has brought an additional layer of inflationary and supply chain difficulties. Consumer prices increased by 10.2 per cent (year-on-year) in March 2022, despite the cap on energy prices which is set to remain until March 2023. The government has adopted a range of measures to support vulnerable households and firms affected by the war. As such, the fiscal consolidation envisaged for this year could be constrained by these expenses and by weaker economic growth. The National Bank of Romania (NBR) has raised the policy rate to 3 per cent by April 2022 and, facing a tightening of liquidity since the start of the war, has intervened in the secondary market for sovereign debt to calm debt markets. GDP is projected to grow by 2.5 per cent this year, with risks tilted to the downside and contingent on the evolution of the war and other supply pressures. In 2023, lingering inflation pressures, fading pent-up demand and supply chain issues are expected to restrain growth to a forecast 3.0 per cent.

Bulgaria

The Bulgarian economy expanded by 4.2 per cent in 2021, driven mainly by private consumption growth. In contrast, investment declined in 2021 by 11 per cent, partly reflected by the decline in value added of the construction sector. Tourism recovered only partially in 2021, with visitor arrivals at just 57 per cent of 2019 figures. Industrial production recovered strongly in 2021, however, but the war on Ukraine poses risks for robust growth, given the country's significant import dependency on Russia (almost 10 per cent of GDP in 2020). Another key channel of war disruption is elevated inflation, as Bulgarian consumers will be relatively more affected than those in other EU countries by higher food and energy prices, given low average income levels. Inflation accelerated to 12.4 per cent in March 2022, with food prices up by 17.4 per cent compared with March 2021. The government has some fiscal space to adopt several short-term measures to counteract increasing prices, given low public debt levels. The government has also pledged to increase public investment, although there may be absorption capacity constraints in the short term. After delays in the Recovery and Resilience Plan's adoption, increased EU funds will start to have an impact on the economy from 2023 onwards. The 2022 GDP growth forecast has been revised up to 2.5 per cent, as supply-side issues will likely persist, while in 2023 a modest recovery of 3.0 per cent is plausible, with upside risks in case of a faster normalisation of inflation and robust investment.

Greece

The economy recovered strongly in 2021, with GDP growing by 8.3 per cent on the back of increased investment and consumption and a partial recovery of the tourism sector; tourism arrivals doubled in 2021 relative to 2020, though they were still well below 2019 levels. Confidence has returned to all parts of the economy, as the economic sentiment indicator reached pre-pandemic levels (114.0) in February 2022 and the purchasing managers index (PMI) has also been at elevated levels in recent months. The growth momentum across the Greek manufacturing sector has been slowing down in 2022 but remains significant, with manufacturing production rising (up 2.6 per cent year-on-year in January 2022). Unemployment has continued to decline, reaching 13.2 per cent in the fourth quarter of 2021, the lowest rate since 2010, and falling further to 11.9 per cent in February 2022. However, inflation has picked up significantly during 2022, reaching 8.9 per cent in March. The general government deficit in Greece was 7.4 per cent of GDP in 2021, driven by extensive pandemic-related support packages. While Greece's sovereign debt remains exceptionally high at around 200 per cent of GDP, the relatively low cost of market funding has enabled the state to support the economy during the Covid-19 crisis. Looking ahead, the war on Ukraine may impact the economy not so much through direct linkages but indirectly through higher energy prices (given the high dependence on energy imports), supply chain disruptions, rising costs of financing, and possibly lower than expected tourist arrivals if a recession takes hold in major western European source countries. Taking all these risk factors into account, the economy is forecast to grow at 2.9 per cent in 2022, rising to 3.5 per cent in 2023, with the economy being helped by increased disbursement of funds from the EU's Recovery and Resilience Facility.

Southern and Eastern Mediterranean (SEMED)

The impact of the war on Ukraine on the SEMED region will be felt through higher oil and food prices for consumers, and secondary effects for budgets, food security and medium-term growth drivers. All countries in this region are dependent on imported petroleum products, and several are dependent on imported food products as well (notably Egypt, Tunisia, and Jordan). As a result, imported inflation will be a drag on growth and will weigh down the post-pandemic recovery. Moreover, the war on Ukraine will have a negative impact on tourism in most SEMED countries, and on supply chains, notably in Morocco and Tunisia, which will be affected by the slowdown in 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 2.5 per cent in 2022, after a strong recovery of 6.0 per cent in 2021. Higher growth is expected in 2023 (at 4.8 per cent), as the recovery gathers pace in most countries (after three years of low growth due to the pandemic and the war on Ukraine) and as reforms advance in all countries.

Egypt

Economic growth in the first half of fiscal year 2021/22 (July – December 2021) in Egypt averaged 9.0 per cent year-on-year, driven by improvements in tourism, manufacturing, construction, wholesale and retail trade, and agriculture. The recovery is expected to continue and growth is projected to reach 5.7 per cent GDP growth in fiscal year 2021/22 and 5.0 per cent in fiscal year 2022/23, although rising prices for wheat, food products and petroleum due to the war on Ukraine will have an impact. Egypt is a net oil importer and one of the world's biggest wheat importers, and it depends on imports for other food products as well, all of which are likely to face elevated prices in the short and medium term. On the upside, higher demand and prices for Egypt's gas exports could sustain growth in the medium term, and the IMF-supported programme could support reform implementation and investor confidence. The latter could also help manage external imbalances, as might recent EGP devaluation. Downside risks to economic performance include the volatility in global energy and food prices and the possibility that a faltering global recovery spills over into key sectors and supply chains. On a calendar year basis, growth is forecast to slow down to 3.1 per cent in 2022, from 7.2 per cent in 2021, before picking up to 6.0 per cent in 2023.

Jordan

The Jordanian economy rebounded in 2021, helped by the gradual easing of health restrictions. GDP growth was 2.2 per cent, supported by strong performances in the mining and agriculture sectors, as well as in financial and business-related services. However, growth in other sectors, while positive, remained below pre-pandemic levels, with only a limited recovery in the tourism sector. In tandem, inflation continued to rise, particularly for energy and food, reaching

2.5 per cent year-on-year in March 2022. GDP growth is forecast at just 1.9 per cent in 2022, as the implications of the war on Ukraine weigh on tourism and trade flows, and rising commodities prices dampen private consumption. In 2023, growth is expected to pick up to 2.5 per cent, as global headwinds ease, supporting stronger cross-border trade and a recovery in the tourism sector. Growth is expected to benefit from IMF-supported reforms in the medium and long term, but will likely remain moderate as the necessary return to fiscal discipline caps government spending, more so as the government is raising social spending in 2022 to mitigate the impact of the war on Ukraine. The main risks to the outlook include the erosion of real competitiveness stemming from an overvalued exchange rate, regional instability, and a possible slower-than-expected recovery in partner economies.

Lebanon

GDP in Lebanon is estimated to have contracted by 10.0 per cent in 2021, as the country continued to experience its most painful crisis in decades. Slow progress on negotiating an IMF-supported programme delayed much-needed reforms, thus limiting access to external sources of financing which could help shore up reserves. Against this backdrop, the authorities struggled to contain exchange rate depreciation and maintain subsidies on basic commodities, leaving large segments of the population to face electricity and fuel shortages, limited access to basic commodities and spiralling price rises. Inflation has picked up pace in recent months, growing by as much as 214.6 per cent year-on-year in February 2022, driven mostly by large jumps in food and transport prices. A limited rebound in GDP growth of 1.0 per cent is expected in 2022, as the economic collapse bottoms out and the political deadlock eases following the May 2022 elections, allowing for some progress on reforms. However, increasing energy and food prices due to the war on Ukraine are expected to weigh negatively on consumption. The recent staff-level agreement on an IMF-supported programme raises hopes for an economic recovery based on some fundamental reforms, but formal agreement and disbursement are expected to face delays, particularly with serious central bank reforms and parliamentary milestones as prerequisites. In this light, economic recovery is expected to remain modest in the short-term, and GDP growth likely will not exceed 3.0 per cent even in 2023.

Morocco

The economy in Morocco recovered strongly in 2021 with GDP growth of 7.4 per cent, after a pandemic-driven contraction of 6.3 per cent in 2020. The recovery was mainly driven by a record harvest season, and rebounds in manufacturing, trade, construction and business services, amid one of the best vaccination programmes in the EBRD regions. A drop is expected in 2022 (at 1.2 per cent GDP growth) because of unfavourable weather affecting agricultural output and the impact of the war on Ukraine. Morocco is currently suffering a severe drought, which will likely impose pressure on domestic food prices and require the country to raise food imports, also at a higher international price. Global supply-chain disruptions are providing further headwinds to growth. Moreover, Morocco imports most of its energy and remains vulnerable to sharp increases in hydrocarbon prices, despite rising renewable electricity generation. These downside risks will likely carry over into the next year, although 2023 could see a rebound in growth, projected at 3.0 per cent, as agriculture recovers and the pace of growth returns to pre-pandemic levels.

Tunisia

The recovery in Tunisia was moderate in 2021, with GDP growth of 3.5 per cent, driven by the rebound in manufacturing, mining and trade, but tourism and services continued to be held back by Covid-19 restrictions (for most of the year) and agriculture (and agri-foods industries) contracted. The growth outlook for 2022 and 2023 is subdued (at 2.0 and 2.5 per cent GDP growth respectively). The war on Ukraine and rise in prices (notably oil and wheat) will hit both households and the public budget, the latter because of government subsidies. Progress on a new IMF-supported programme has been slow, given political developments since July 2021, although technical negotiations have been ongoing and an agreement may be found soon. A new programme would provide much-needed (external) financing and technical assistance. It would also boost the government's ability to tackle contentious but essential reforms like lowering the public sector wage bill and fuel subsidies, which face strong opposition from unions and parts of the population. The main risks to the outlook are further delays in implementing reforms and reaching an agreement with the IMF, a deterioration in the existing political situation, the impact of the war on Ukraine on international food and energy prices (Tunisia is dependent on imports of both), and spillovers from the war on the outlook for Europe, Tunisia's main economic partner.

Turkey

A combination of rising net exports and strong household consumption saw the Turkish economy grow by 11 per cent in 2021. However, this performance was achieved at the expense of significant macroeconomic instability. Aiming to increase export competitiveness and private investment, and relying on a rebalancing of the current account to bring price stability, the authorities cut interest rates deep into negative real territory starting in September 2021, allowing the currency to depreciate – at one point by 60 per cent compared with the start of the year – and spurring a shift in bank deposits to foreign currencies. The authorities managed to stabilise the currency thanks to the Central Bank (CBRT) intervening by using its reserves, and the introduction of a scheme to compensate lira deposit holders for foreign exchange losses. While these measures seem to have succeeded in reversing some of the depreciation and dollarisation, they have increased vulnerabilities in the longer run.

The hoped-for rebalancing of the current account has failed to materialise, as higher commodity prices linked to the conflict in Ukraine have increased Turkey's commodity import bill. Turkey's large short-term external debt also remains a concern, particularly as the cost of servicing it has increased dramatically following the depreciation.

Meanwhile, the combination of negative real interest rates, rapid currency depreciation and rising global commodity prices have pushed inflation to 61 per cent in March 2022 – a 20-year high. The poor credibility of the CBRT has fostered expectations of further rises in inflation, with the rate expected to peak at around 70 per cent and year-end inflation forecasts standing at around 55 per cent.

On the positive side, banks remain well-capitalised, with a headline non-performing loan ratio at 3 per cent, while public finances remain one of the anchors of the economy, with the debt to GDP ratio standing at 38 per cent. However, the new FX-linked deposit schemes shift exchange rate risks to the public sector, and create a potentially sizeable contingent liability.

With leading indicators pointing to a slowing down of economic activity in the first quarter of 2022, and tourism revenues being threatened by Russia's war on Ukraine (both countries normally being important sources of tourists), GDP growth is likely to remain muted at 2.0 per cent this year, driven mainly by a modest recovery in net exports, which are helped by the historically low real exchange rate. Growth is forecast to increase 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

Following a better-than-expected performance in 2021, Western Balkan economies are forecast to continue growing in 2022, though at a slower pace than initially predicted. Overall, economies in the Western Balkans have limited exposure to Russia, Ukraine and Belarus in terms of direct economic links such as trade, investments and remittances. Montenegro has some exposure via the tourism channel given the high share of tourists coming in normal times from Russia and Ukraine. Rising inflation will affect disposable incomes of households, more than in more developed countries given that food makes up a larger part of the consumer baskets, and in particular those of poorer households. There are close interlinkages between the Western Balkan *and EU economies, in particular in manufacturing-heavy North Macedonia, Serbia and Bosnia and Herzegovina, where the EU is the main export partner. A slowdown in EU growth or further supply chain bottlenecks, in particular in the automotive sector, would affect these Western Balkan economies as well. All countries in the region are adversely affected by higher oil prices, some by rising gas prices (Serbia, North Macedonia, and Bosnia and Herzegovina to a small degree), while North Macedonia and Albania are more exposed than others to an increase in electricity prices as they import significant amounts of power. Domestic weaknesses in the energy sectors across the Western Balkan economies increase the vulnerability to a potential global energy crisis, and weigh also on government budgets, given the high level of subsidies.*

Albania

The economy is expected to achieve slower growth in 2022 following a strong recovery in 2021, when GDP increased by an estimated 8.5 per cent on the back of growing tourism and a recovery in domestic demand. Robust growth in investments was supported by earthquake-related public reconstruction. The macroeconomic environment remains largely stable; inflation increased to 5.7 per cent year-on-year in March 2022 reflecting globally rising commodity prices, but while this breaches the central bank's target of 3 per cent, it remains lower than in most regional economies. The Bank of Albania raised the key monetary policy rate from 0.5 per cent to 1 per cent at end-March 2022. The banking sector remains well capitalised and liquid, with strong credit growth in the first two months of the year and non-performing loans at their lowest levels since 2014. Meanwhile, Albania's fiscal accounts are feeling the impact of the energy crisis due to heavy imports of electricity under significantly higher prices. The government is also under pressure to support households in light of rising prices and fears of food shortages. While direct economic and financial links with Ukraine and Russia are negligible, high uncertainty around the war and its economic repercussions, an expected slowdown in European markets and rising food and energy prices all pose serious risks to the outlook and are expected to drag down short term growth. GDP is expected to grow at 3.0 per cent in 2022 and 3.3 per cent in 2023.

Bosnia and Herzegovina

The economic recovery in 2021 was much stronger than anticipated, with GDP surging well past the pre-pandemic level. The economy grew in 2021 by 7.1 per cent according to initial estimates, outperforming most forecasts. Economic activity in 2021 was driven by very strong external demand and domestic consumption. Exports rose by more than 40 per cent in real terms compared with 2020 on the back of higher demand from EU countries, while household consumption grew by 6 per cent in real terms, driven by post-Covid pent-up spending and supported by remittances (up by 20 per cent versus 2020, and above 2019 levels). Investment growth was mildly positive on the back of the strong contraction in 2020, but did not reach pre-pandemic levels. Rising prices, as elsewhere, are a concern, with inflation reaching 10.2 per cent year-on-year in March 2022 as a result of higher food and energy prices. The impact of the war on Ukraine is expected to be reflected in further rising prices, which will adversely affect disposable incomes, an economic slowdown in Eurozone export markets (especially relevant for the large export-oriented manufacturing sector), as well as rising uncertainties more generally, including in domestic politics. However, the continued strong impetus of export growth in the first two months of 2022 is expected to partially offset the anticipated slowdown later in the year. GDP growth is expected to slow down to 3.0 per cent in 2022, and remaining at the same rate in 2023. The continued lack of real reform progress and ongoing political instability continue to prevent the economy from moving to a higher potential growth path.

Kosovo

The economy rebounded rapidly in 2021, growing by 10.5 per cent according to preliminary estimates, on the back of renewed post-Covid mobility and strong support from the diaspora. Household consumption was upheld by high inflows of remittances and significant credit growth. Inflows from exports of services nearly doubled compared with 2020 on the back of diaspora visits, surpassing the 2019 level. While still modest compared to services, goods exports receipts increased by 58 per cent in 2021 in nominal terms and nearly doubled compared with the 2019 value. GDP growth is expected to slow down significantly in 2022. The first two months of the year were characterised by the continuation of robust annual credit growth of 16 per cent and remittances (30 per cent above the pre-pandemic level), which bodes well for consumption. But this is balanced against strong inflationary pressures, which are affecting disposable incomes. The energy crisis and rising food prices have been exacerbated by the economic impact of the war on Ukraine, and inflation surged to 10 per cent year-on-year in March 2022. This resulted in increased spending on electricity imports and social measures to support the economy, weighing on the fiscal accounts. The economy is forecast to grow by 4.0 per cent in both 2022 and 2023. The main risks to the outlook are rising uncertainties, growing commodity prices and potential weaknesses in the external sector.

Montenegro

The economy recovered well in 2021, growing by 12.4 per cent after a deep contraction in 2020, largely on the back of a successful summer tourism season, which helped to prop up the fiscal accounts and led to a narrowing of the current account deficit. Following a record high in 2020, the ratio of public debt to GDP started to fall in 2021 on the back of public debt repayments and strong economic growth. An 80 per cent hike in the minimum wage and a cut in social contributions leading to a significant reduction in the labour tax wedge were introduced in 2022, resulting in a 32 per cent annual increase in the average net wage as of the first two months of the year. The rebound of the economy is expected to continue in the short term, albeit at a lower rate than previously expected. Inflation accelerated to 9.7 per cent year-on-year in March 2022, adversely affecting households' disposable incomes, and this year's tourism season is unlikely to be as successful as previously expected since Russia and Ukraine have in recent years made up around a fifth of tourist arrivals in the country. Also, extended political uncertainty is delaying the implementation of reforms which may affect medium-term growth prospects. Taking all factors into consideration, the economy is forecast to grow by 3.7 per cent in 2022 and by 4.5 per cent in 2023, but important downside risks to the outlook remain, including the current political uncertainty and the possibility of disruptions to the tourism season.

North Macedonia

The economy rebounded in 2021 following a 6.1 per cent contraction in 2020, with GDP up by 4 per cent in 2021 driven by both domestic and external demand. Household consumption was supported by rising wages, credit growth and cash remittances from Macedonians employed abroad. Although export of goods grew on the back of the strong manufacturing sector, its positive contribution to GDP was outstripped by a rise in imports due to the strong increase in domestic demand, rising commodity prices and dependence of production in the free economic zones on imported products. Exports of goods continued to expand in the first part of 2022, growing by 14 per cent year-on-year in nominal terms in the first two months of the year, alongside double-digit growth of the industry turnover index. The growth momentum is expected to continue through 2022, but at a more moderate pace than initially expected because of spillovers from the war on Ukraine. North Macedonia has limited exposure to Russia or Ukraine in terms of direct economic links, but the effects of the war are being reflected in higher food and energy prices and in the close trade linkages with EU economies, in particular in the automotive sector. Annual CPI inflation accelerated to 8.8 per cent year-on-year in March 2022, prompting the Central Bank of North Macedonia to increase the monetary policy rate from 1.25 per cent to 1.5 per cent. In parallel, the government introduced a sizeable package of support measures for the economy alongside an increase in the minimum wage early in 2022, thus delaying previous fiscal consolidation plans. In light of the newly constrained fiscal space, the authorities submitted a request for a Precautionary and Liquidity Line Arrangement to the IMF in mid-April 2022 which, if agreed, would provide upfront access to IMF resources following an agreement with the authorities on policies. The economy is expected to expand by 3.0 per cent in both 2022 and 2023, but downside risks are significant associated mainly with uncertainty about the duration and longer term consequences of the war on Ukraine.

Serbia

After a very strong economic performance in 2021, the economy is expected to continue growing, albeit at a reduced rate, in 2022. GDP grew by an estimated 7.4 per cent in 2021, outperforming expectations. The expansion reflects a strong expansion of exports and industry due to the rebound in the EU, Serbia's main trading partner, robust household consumption on the back of post-Covid pent-up demand, and sizeable public investments. Exports of goods increased by 28 per cent year-on-year in nominal terms in the first two months of 2022, largely on the back of the mining sector's metal exports. Imports, however, increased by 52 per cent year-on-year in the same period, reflecting much higher energy prices. Inflation increased to 9.1 per cent year-on-year in March 2022, largely on the back of rising energy and food prices, which prompted the National Bank of Serbia to increase the policy rate by 50 basis points to 1.5 per cent in April. The government has a price cap on basic foodstuffs in place since end-2021. In terms of trade, Serbia has the highest exposure to Russia out of all Western Balkan countries, with goods imported from Russia mostly relating to mineral fuel (all gas imports are sourced from Russia), while exports are more diversified (around 5 per cent of the overall export basket goes to Russia). The authorities have introduced a temporary price cap on fuel, and reduced excise duties and export quotas on basic agricultural products to shield the economy. Exports of wheat and maize to certain countries in the near region, including Albania and North Macedonia, have been approved, however, despite the overall ban. GDP growth is forecast at 3.3 per cent in 2022 and 4.0 per cent in 2023. Key downside risks include rising inflation, increased uncertainty over geopolitical developments, and a possible sharper than expected slowdown of growth in Serbia's main export markets in Europe.

Belarus

After a better than expected performance in 2021, the economy entered a period of high uncertainty and stress in 2022. Despite being under sanctions, GDP growth reached 2.3 per cent in 2021 on the back of double-digit (in percentage terms) real growth of exports and revived household consumption. On the production side, the growth of industrial production has been decelerating since May 2021, due to the ending of base effects and possibly some early impact from international sanctions. The current account posted a surplus largely due to a strong trade surplus. Such an outcome alleviated external financing pressures and the currency stabilised in 2021. However, inflation accelerated in the second half of 2021 and then stabilised in the narrow range above 10 per cent at the beginning of 2022, before soaring to 15.9 per cent in March due to the new wave of stricter sanctions and associated shortages. Exports of main commodities will likely be severely hit by the disrupted logistics of the new sanctions regime. In addition, close trade links to a recession-hit Russian economy would affect the rest of the export industry, leading to a decline of economic activity in 2022. The economy is forecast to contract by 4.0 per cent in 2022. Bleak prospects remain in 2023, when stagnation of the economy is expected. The uncertainty remains exceptionally high and economic prospects are subject to geo-political developments.

Russia

Following higher-than-expected GDP growth of 4.8 per cent in 2021, the economy is already showing signs of a deep, sanctions-driven recession starting in the first quarter of 2022. Leading indicators show a steep decline in economic activity in March 2022, reflecting falling confidence amid business closures and shortages driven by supply chain disruptions. While official trade data have not been published, data from trading partners suggest a sharp contraction in Russia's imports in March, pointing to a decline in domestic consumption. The rouble weakened significantly in the wake of the announcement of Western sanctions, falling by over 40 per cent compared with the start of the year at one point in March, although it has pared back most of its losses since then. Inflation jumped from 9.2 per cent in February 2022 to 16.7 per cent in March, reflecting the currency depreciation as well as panic buying by consumers. To contain the rampant inflation, the Central Bank of Russia more than doubled its policy rate to 20 per cent in late February, although it has rolled back some of this hike in its April meeting. Although a large part of the central bank's foreign assets are frozen, proceeds from energy exports and capital controls have helped the authorities stabilise the exchange rate and avoid balance of payments pressures. That said, although external debt remains at a low level, problems in accessing foreign currency have been affecting the repayments of external debt, with the authorities attempting in some cases to settle foreign currency denominated debt with roubles. The economy is forecast to contract by 10 per cent in 2022, followed by zero growth in 2023. The growth outlook is likely to remain bleak in the absence of a peace agreement that may lead Western countries to relax sanctions, and the economy's shift towards autarky and the loss of qualified workforce to emigration mean that the economy's long-term growth potential will remain significantly eroded.

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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.

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.

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