European Bank
for Reconstruction and Development

REGIONAL ECONOMIC PROSPECTS

JUNE 2021

RECOVERY GATHERING PACE

Regional Economic Prospects in the EBRD Regions

Recovery gathering pace

June 2021

Output in the EBRD regions contracted by 2.3 per cent in 2020. This outcome was better than previously expected, reflecting strong exports of goods, widespread fiscal support and less strict social distancing measures in some economies.

In recent months, a recovery has been gathering pace. The health situation appears to be improving, vaccination is progressing and the average mobility of people in the EBRD regions (measured as trips to work, places of retail and recreation, transit stations and groceries and pharmacies) has returned to its pre-pandemic level. Industrial production and retail sales have largely recovered.

Higher commodity prices have boosted the revenues of commodity exporters and demand for manufacturing exports has been strong.

However, the outlook for international tourism remains highly uncertain due to widespread travel restrictions and tourism-dependent economies, from Croatia to Georgia and from Egypt to Tunisia, remain hard hit. Foreign investments also remain far below their pre-crisis levels in most of the EBRD regions.

Furthermore, fiscal vulnerabilities have increased as large stimulus packages aimed at mitigating the effects of the Covid-19 crisis on individuals and firms, coupled with output declines, raised public debt in the EBRD regions by an average of 11 percentage points of GDP. In many economies, public debt is now at levels last seen during the transition recession of the early 1990s and may rise further. While on average borrowing costs remain low and interest payments stable, some economies have seen sharp increases in interest payments.

Higher commodity prices, increased demand for manufactured goods, currency depreciations, and higher inflation in trading partners have pushed inflation up in the EBRD regions (by an average of 0.8 percentage point relative to its pre-pandemic level), despite slack in labour markets in many economies.

Output in the EBRD regions is expected to grow by 4.2 per cent in 2021 (up from 3.6 per cent expected in September 2020), as social distancing is being phased out, commodity exporters benefit from higher prices and manufacturing exporters gain from a temporary shift towards manufacturing as services remain depressed, while economies dependent on tourism continue to lose out. Growth is projected to moderate slightly, to 3.9 per cent, in 2022. Forecasts are highly sensitive to the path of Covid-19 infections, assumptions relating to government policies and the effectiveness of policy actions to limit persistent economic damage. Country-specific policy initiatives underpinning the recovery are further summarised in the "Coronavirus response in 2021: Building Back Better" pages on ebrd.com.

Headline numbers also hide significant heterogeneity in the individual experiences of countries and workers within economies, with the young and those with lower levels of education and pre-pandemic income being especially hard hit. While bankruptcies have so far remained contained owing to extensive policy support, vulnerabilities may surface when government support measures are withdrawn.

Industrial production and manufacturing exports have rebounded and services are recovering in **central Europe and the Baltic states.** *Output is expected to increase by 4.8 per cent in 2021 and 4.6 per cent in 2022, reflecting strong household consumption and investment, and supported by EU recovery funds.*

GDP in the **south-eastern European Union** *is expected to grow by 5.2 per cent in 2021 and 5 per cent in 2022 as fiscal support and the prospects of major EU recovery funding in the coming years are boosting investor and consumer confidence. However, continued uncertainty around tourism weighs on the outlook.*

Output in the **Western Balkans** *is expected to grow by 5.1 per cent in 2021, reflecting strong outturns in the year so far and sustained fiscal stimulus. However, continued uncertainty around travel restrictions weighs on the outlook for tourism-dependent economies. Growth is expected to moderate to 3.8 per cent in 2022.*

Output in **Russia** *is expected to grow by 3.3 per cent in 2021 and 3 per cent in 2022 as the easing of restrictions on activity supports a recovery in domestic demand. The boost from higher commodity prices is expected to be partially offset by a more neutral fiscal and monetary policy stance.*

Economies in **eastern Europe and the Caucasus** *are expected to grow by 2.8 per cent in 2021 and 3 per cent in 2022 as lockdowns are lifted and demand for exports remains strong. Higher commodity prices support the recovery in commodity exporters.*

The outlook has also been revised up for economies in **Central Asia**, *though the recovery is far from uniform. The region is expected to grow by 4.5 per cent in 2021 and 2022, reflecting higher commodity prices, which benefit commodity exporters, as well as recovering remittances.*

Turkey's *economy is expected to grow by 5.5 per cent in 2021 and 4 per cent in 2022, driven by exports, while domestic demand remains constrained by the impact of still-ongoing containment measures and, more generally, the weaker financial situation of households.*

Output in the **southern and eastern Mediterranean** *is expected to grow by 3.5 per cent in 2021, though the speed of recovery varies across economies reflecting the slow recovery in tourism, mounting fiscal pressures and, in some economies, political uncertainty. Growth is expected to increase to 4.6 per cent in 2022, supported by structural reforms and recovering foreign direct investment and trade flows.*

Table 1. Real GDP growth, in per cent per annum						
	Actual		Forecasts (REP June 2021)		Revision since Sep'20	Change in GDP, 2019-21
	2019	**2020**	**2021**	**2022**	**2021**	**2021**
EBRD Regions	**2.6**	**-2.3**	**4.2**	**3.9**	**0.6**	**1.7**
Central Asia	**5.1**	**-0.8**	**4.5**	**4.5**	**1.3**	**3.7**
Kazakhstan	4.5	-2.6	3.6	3.8	0.6	0.9
Kyrgyz Republic	4.5	-8.6	6.6	4.6	3.6	-2.6
Mongolia	5.1	-5.3	6.3	6.0	1.3	0.6
Tajikistan	7.5	4.5	6.5	6.0	3.5	11.3
Turkmenistan	6.3	5.9	4.6	3.5	3.6	10.8
Uzbekistan	5.6	1.6	5.6	6.0	1.1	7.3
Central Europe and the Baltic states	**3.7**	**-3.9**	**4.8**	**4.6**	**1.3**	**0.7**
Croatia	2.9	-8.4	6.0	4.5	2.5	-2.9
Czech Republic	2.3	-5.6	4.0	3.8	4.0	-1.8
Estonia	4.3	-2.9	3.0	4.5	-1.0	0.0
Hungary	4.9	-5.0	5.5	4.8	1.5	0.3
Latvia	2.2	-3.6	3.5	5.5	0.0	-0.3
Lithuania	3.9	-0.9	3.0	4.0	-1.0	2.1
Poland	4.1	-2.7	5.0	4.8	2.0	2.2
Slovak Republic	2.4	-4.8	4.5	5.0	-0.5	-0.5
Slovenia	2.4	-5.5	5.0	4.0	1.5	-0.8
Eastern Europe and the Caucasus	**3.0**	**-3.9**	**2.8**	**3.0**	**0.2**	**-1.1**
Armenia	7.6	-7.4	4.0	5.0	0.0	-3.7
Azerbaijan	2.2	-4.3	2.0	2.5	-0.5	-2.4
Belarus	1.2	-0.9	0.5	0.5	-0.5	-0.4
Georgia	5.1	-6.2	4.5	5.5	1.0	-1.9
Moldova	3.6	-7.0	4.5	4.0	1.0	-2.8
Ukraine	3.2	-4.0	3.5	3.5	0.5	-0.7
Russia	**1.3**	**-3.0**	**3.3**	**3.0**	**0.3**	**0.2**
South-eastern European Union	**3.3**	**-5.2**	**5.2**	**5.0**	**1.9**	**-0.3**
Bulgaria	3.4	-4.2	4.5	4.0	1.5	0.2
Greece	1.9	-8.2	4.0	5.5	0.0	-4.6
Romania	4.1	-3.9	6.0	5.0	3.0	1.9
Southern and eastern Mediterranean	**4.0**	**-2.1**	**3.5**	**4.6**	**-0.8**	**1.3**
Egypt	5.7	1.5	4.2	5.2	0.7	5.8
Jordan	2.0	-1.6	1.5	2.2	-2.5	-0.1
Lebanon	-6.7	-25.0	-5.0	5.0	-4.0	-28.8
Morocco	2.6	-6.3	4.5	3.5	1.0	-2.1
Tunisia	1.0	-8.8	2.7	2.9	-1.3	-6.3
Turkey	**0.9**	**1.8**	**5.5**	**4.0**	**0.5**	**7.3**
Western Balkans	**3.6**	**-3.2**	**5.1**	**3.8**	**1.7**	**1.7**
Albania	2.2	-3.3	4.5	4.0	0.0	1.0
Bosnia and Herzegovina	2.6	-4.3	3.5	3.0	0.5	-1.0
Kosovo	4.2	-4.1	4.0	5.0	0.0	-0.3
Montenegro	4.1	-15.2	8.5	6.0	3.5	-8.0
North Macedonia	3.6	-4.5	4.0	4.0	1.0	-0.7
Serbia	4.2	-1.0	6.0	3.5	3.0	4.9
Memo: Egypt (fiscal year ending June)	3.6	3.6	2.5	4.5	-0.8	6.2

Notes: Regional aggregates based on updated 2019 GDP at purchasing power parity (PPP) weights; revisions to regional aggregates since September 2020 exclude the impact of changing weights.

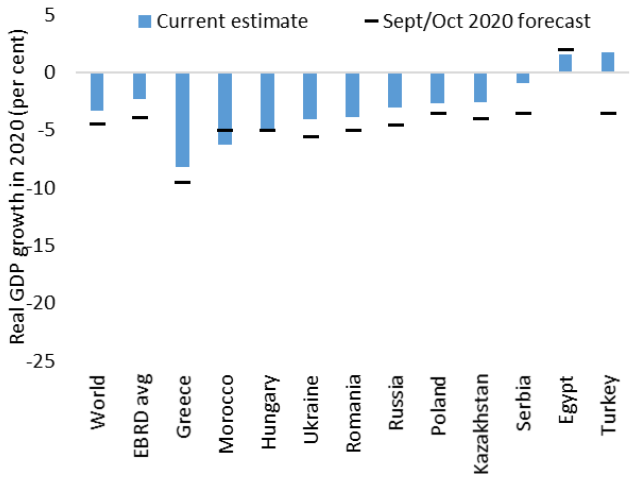
Output in the EBRD regions contracted by 2.3 per cent in 2020

Output in the EBRD regions contracted by 2.3 per cent in 2020 owing to the Covid-19 crisis (see Table 1). Globally, the International Monetary Fund (IMF) estimates that output contracted by 3.3 per cent, with the drop in activity being unprecedented in terms of its speed and synchronized nature. Output losses tended to be particularly large for tourism-dependent economies and economies with limited policy space to respond to the crisis.

The contraction in 2020 is estimated to have been milder than expected

In the majority of economies in the EBRD regions, as well as globally, 2020 outcomes were better than forecast late last year (see Chart 1). Economic activity in the third and fourth quarters of 2020 exceeded expectations, reflecting less strict social distancing relative to the spring, some adaptation of economic activity to restrictions and widespread fiscal support.

Chart 1. In most economies in the EBRD regions 2020 outturns were better than expected

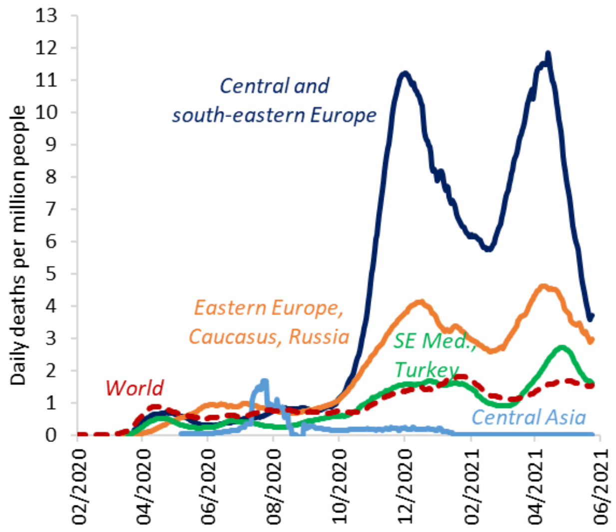


Sources: CEIC, national authorities, September 2020 Regional Economic Prospects forecasts and October 2020 IMF World Economic Outlook global forecasts and authors' calculations. Notes: Selected economies in the EBRD regions.

The health situation appears to be improving in the EBRD regions

Official Covid-19 deaths in the EBRD regions spiked in December 2020 and April 2021, with central and south-eastern Europe reporting higher death tolls (see Chart 2). In April 2021, the reported mortality rates in the EBRD regions were 280 per cent above the world average (see Chart 2).

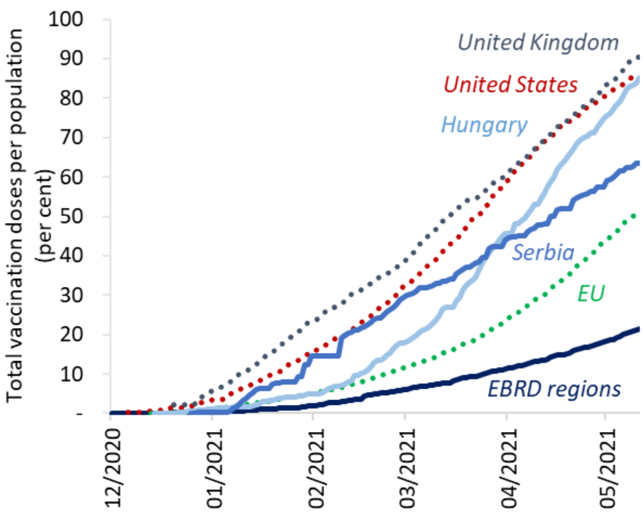
Chart 2. Covid-19 deaths have fallen recently



Sources: Our World in Data based on John Hopkins University and authors' calculations. Notes: 2-week moving average.

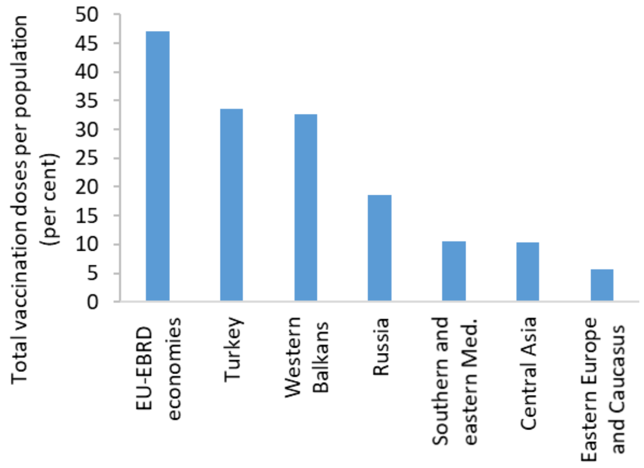
The health situation improved as of end-May 2021 and vaccinations have progressed. As of end-May 2021, around 22 per cent of the EBRD regions' population have received at least one dose of a vaccine, with wide variation in experiences across countries (see Charts 3 and 4). In eastern Europe and the Caucasus, for instance, this partial vaccination rate stood at 6 per cent as of end-May 2021.

Chart 3. Vaccination rates have increased



Sources: Our World in Data based on John Hopkins University and authors' calculations. Notes: As of May 25, 2021.

Chart 4. Vaccination rates vary widely across regions

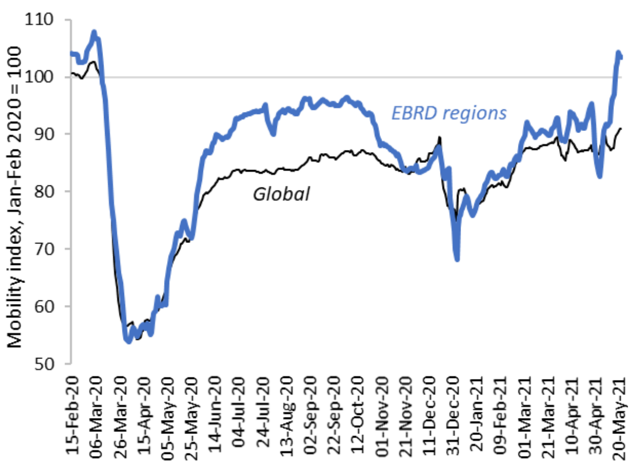


Sources: Our World in Data based on John Hopkins University and authors' calculations. Notes: As of May 25, 2021.

Mobility has returned to its pre-pandemic level

As infections peaked in the winter of 2020, mobility in the EBRD regions (measured as trips to work, places of retail and recreation, transit stations and groceries and pharmacies) declined, although to a lesser extent than in April 2020 (see Chart 5). Unlike in the global economy, mobility in the EBRD regions has since returned to around its pre-pandemic level (that is, the level recorded in January-February 2020), though it could normally be expected to be higher in the summer, in particular in tourism-dependent economies.

Chart 5. Mobility returned to its pre-pandemic level



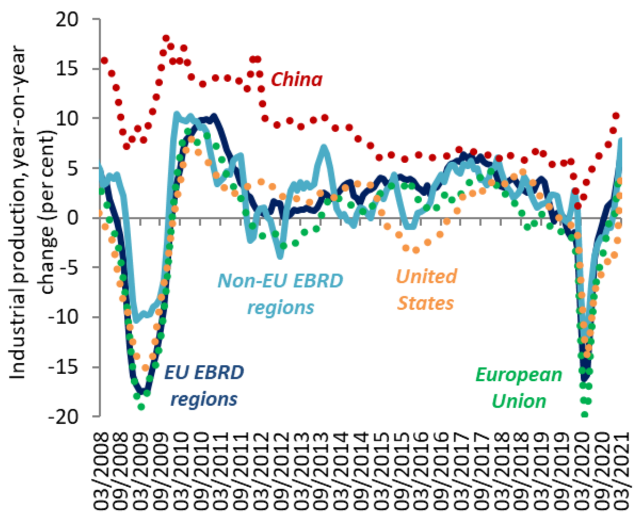
Sources: Google mobility and authors' calculations. Notes: Weighted average of trips to work places, recreation, grocery stores and transit stations with country-specific weights (inversely proportional to the variability of each measure). 7-day moving averages.

While early declines in mobility were associated with sharp drops in output, economic activity appears to have adjusted to social distancing, albeit to a limited extent (see Box 1). In particular, a 10 per cent drop in mobility translates into approximately 2 percentage points lower GDP growth.

Industrial production and retail have largely recovered

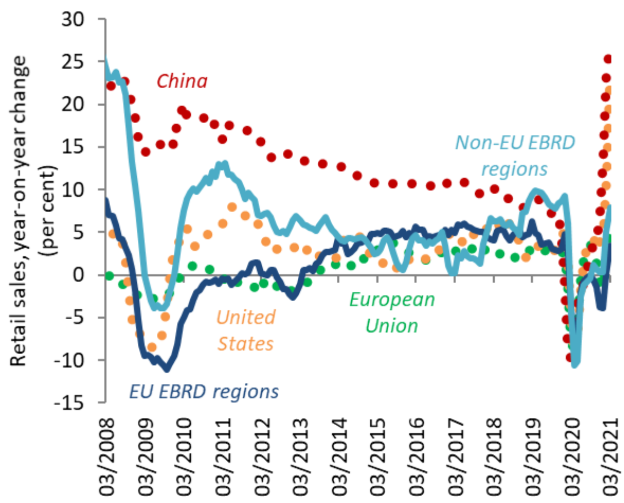
Industrial production fell sharply in spring 2020—a contraction similar to the one observed in 2009 during the global financial crisis. The rebound was somewhat faster this time, as global demand shifted from services (affected by lockdowns) towards manufactured goods (and especially vehicles). Industrial production now exceeds its pre-pandemic level in the EBRD regions, as well as in the European Union and other advanced economies (see Chart 6). Retail sales have also recovered in the first quarter of 2021 (see Chart 7).

Chart 6. Industrial production rebounded faster than after the global financial crisis



Sources: CEIC, national authorities and authors' calculations. Notes: 3-months moving average

Chart 7. Retail sales have also recovered



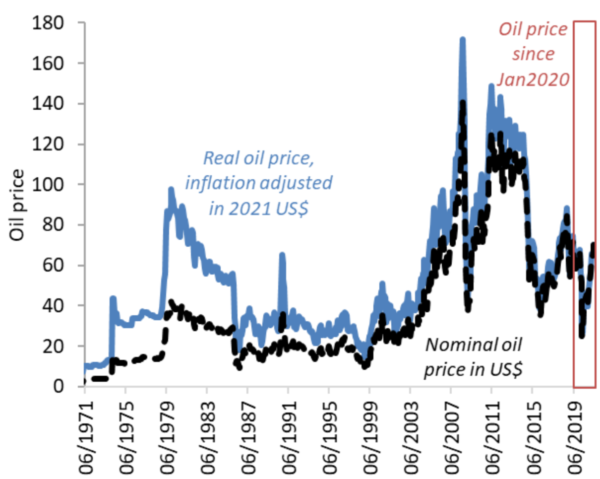
Sources: CEIC, national authorities and authors' calculations. Notes: 3-months moving average

Strong exports and rising commodity prices

The early effects of domestic containment measures were compounded by external shocks whereby economies in the EBRD regions faced low commodity prices, weak demand for exports, a collapse in tourism and drops in remittances (see the April and September 2020 *Regional Economic Prospects*).

Commodity prices have since increased, boosting the revenues of commodity exporters including Russia and economies in Central Asia and the Caucasus. The Brent oil price was back at around US$ 70 per barrel as of end-May 2021 (see Chart 8).

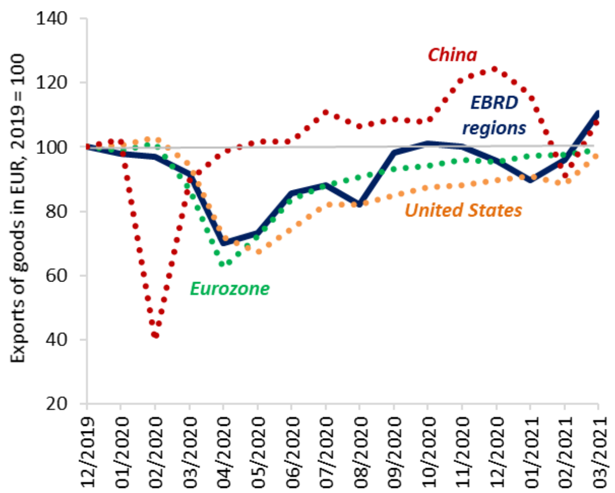
Chart 8. Oil prices have recovered



Sources: Refinitiv Eikon and authors' calculations.

Manufacturing exports have also recovered to their pre-pandemic levels (see Chart 9) benefitting, in particular, countries that are integrated into global manufacturing production networks. Pick-ups were thus stronger in central and south-eastern Europe, the southern and eastern Mediterranean and Turkey.

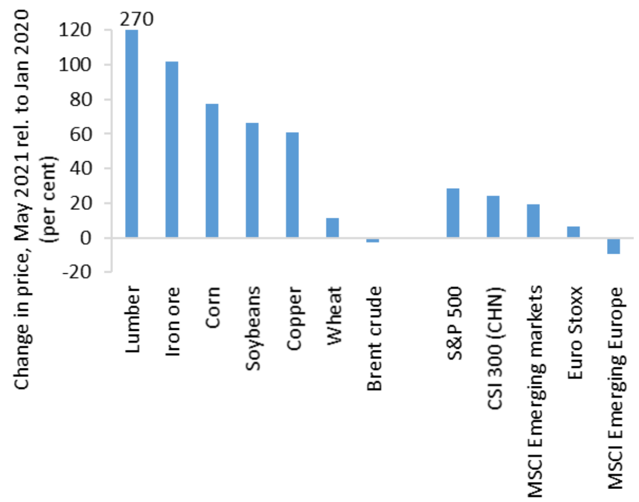
Chart 9. Exports of goods have recovered



Sources: CEIC, International Trade Center 2021 and authors' calculations. Notes: Eurozone refers to France, Germany and Italy.

As a result, the prices of many commodities widely used in construction and manufacturing (such as copper, iron ore and lumber) have spiked (see Chart 10). Food prices have also increased, in part reflecting a poor soy bean harvest, but remain below their 2012 peak.

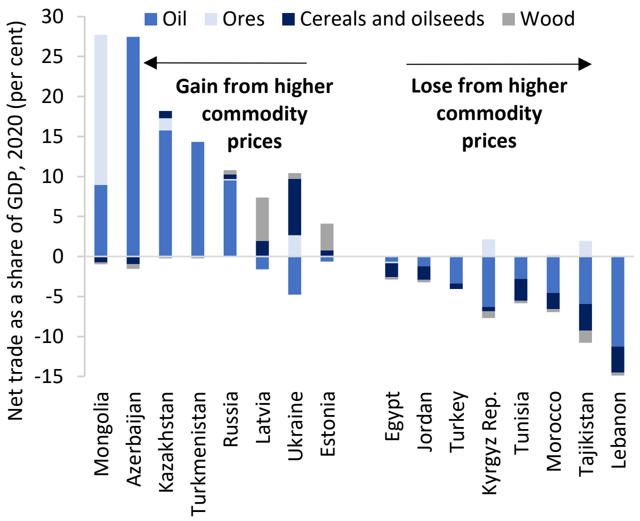
Chart 10. The prices of many commodities increased sharply in 2021



Sources: Refinitiv Eikon and authors' calculations.

Rising commodity prices weigh on the trade balances of oil and food importers, particularly in the southern and eastern Mediterranean (see Chart 11), and put pressure on inflation (see Box 2).

Chart 11. Diverging fortunes owing to higher commodity prices



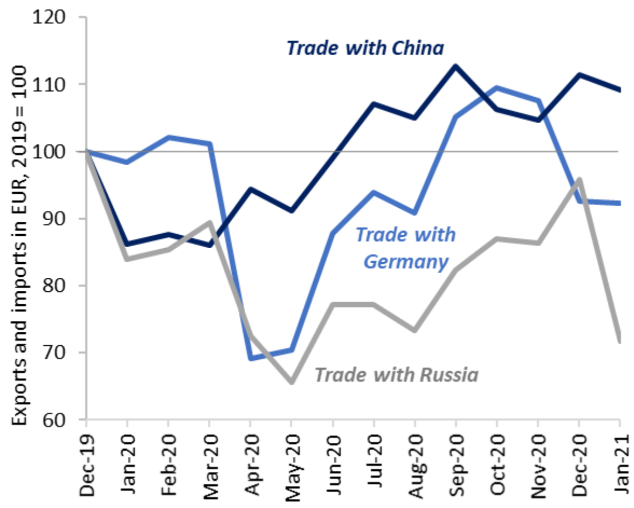
Sources: ITC Trade Center and authors' calculations. Notes: Net balance of exports and imports of mineral fuels and oils (HS 27), ores (HS 26), cereals (HS 10), oil seeds and other grains (HS 12) and wood products (HS 44).

Changing patterns of trade

The EBRD regions' trade with China recovered earlier than that with other trading partners, in line with China's earlier rebound in 2020 (see Chart 12). Trade with China now accounts for 10 per cent of total trade of the EBRD regions, up from 8 per cent in 2019. In particular, China's share in total trade increased significantly in some economies in eastern Europe and the Western Balkans driven by increased Chinese demand for commodities from these regions and imports of medical goods from China during the pandemic.

Following initial demand shocks and supply disruptions in early 2020, the EBRD regions' trade with Germany recovered by the end of 2020, supported by strong demand for manufactured goods. Germany remains the most important single trading partner for the EBRD regions as a whole, accounting for 16 per cent of total trade in 2020, reflecting strong value chain linkages with economies in central Europe, the Western Balkans and Turkey.

Chart 12. Trade with China recovered earlier

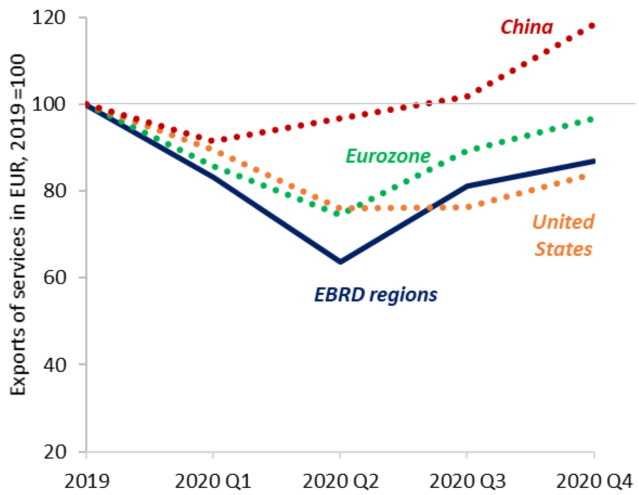


Sources: General Administration of Customs People's Republic of China, International Trade Center and authors' calculations. Notes: EBRD regions' exports and imports by main trading partner.

Uncertain outlook for tourism

Unlike trade in goods, cross-border trade in services, including tourism and transportation, has been hit hard by social distancing and restrictions on international travel. While exports of goods from the EBRD regions fell by around 30 per cent in the second quarter of 2020, exports of services dropped by almost 40 per cent relative to their 2019 levels (see Chart 13).

Chart 13. Exports of services are yet to recover

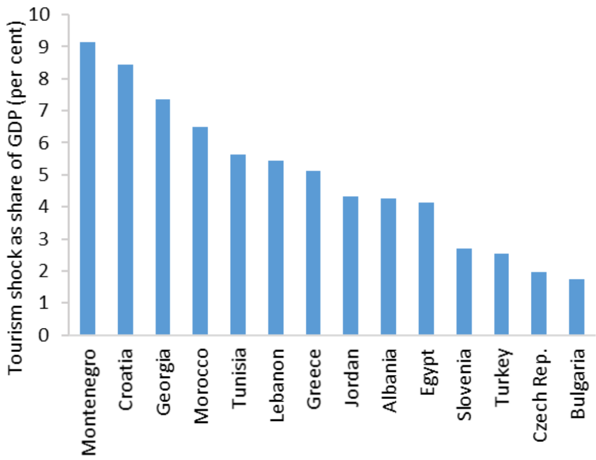


Sources: CEIC, International Trade Center 2021 and authors' calculations. Notes: Based on 20 economies in the EBRD regions with quarterly data for 2020. These accounted for 75 per cent of total services exports in the EBRD regions in 2019.

While service exports have recovered in central and eastern Europe (supported by stronger demand for transport and ITC services from Poland and Ukraine), they still remain below their pre-pandemic levels elsewhere in the EBRD regions, particularly in countries that rely heavily on tourism.

Globally, tourist arrivals dropped by 74 per cent in the twelve months to January 2021, making 2020 the worst year on record for the sector. The tourism shock to GDP—computed as the product of tourism's contribution to GDP prior to the pandemic and the drop in tourist arrivals in the year to January 2021—reached seven to nine per cent of GDP in Croatia, Georgia and Montenegro (see Chart 14). According to projections by the United Nations World Tourism Organization (UNWTO), tourism is unlikely to reach pre-crisis levels in the short term as travel restrictions remain widespread.

Chart 14. Loss of tourism revenues weighs on the economic outlook

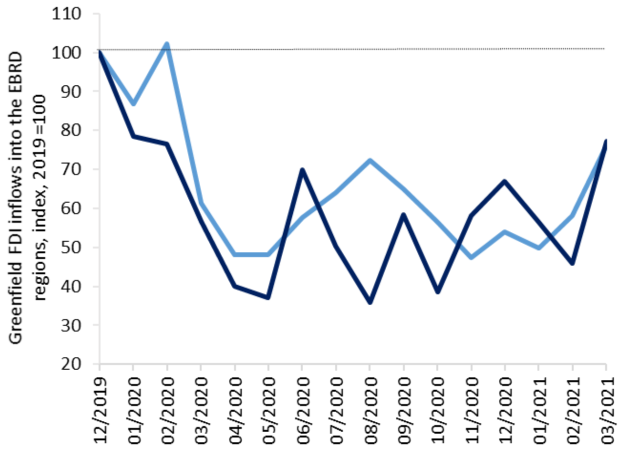


Sources: World Bank, World Tourism Organization and authors' calculations. Notes: Tourism shock computed as the product of tourism's contribution to GDP in 2019 and the drop in tourist arrivals in the year to January 2021.

Weak foreign investment

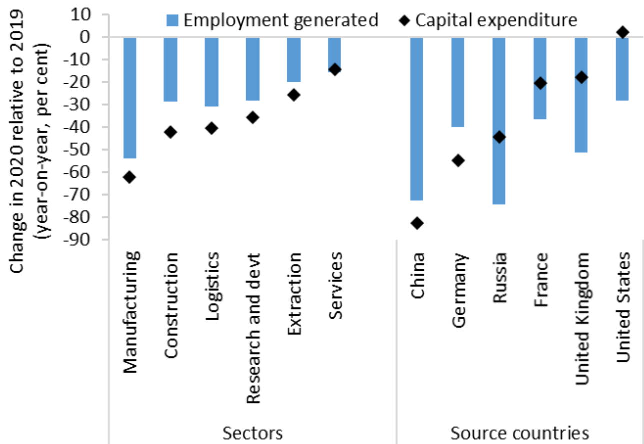
Greenfield foreign direct investment (FDI) also dropped sharply in 2020 and remains at around 80 per cent of its pre-pandemic level in the EBRD regions (see Chart 15). Capital-intensive FDI dropped particularly sharply (see Chart 16), including from China. Total FDI inflows (greenfield as well as brownfield) fell by one percentage point in 2020 in the EBRD regions, to 2.6 per cent of GDP.

Chart 15. Weaker greenfield FDI inflows into the EBRD regions



Sources: fDi Markets Database and authors' calculations. Notes: EBRD regions. Based on a project-level database, which tracks company investments (without information on the equity participation by investors) and thus captures a slightly different concept from FDI flows in balance of payments accounting.

Chart 16. Investments in capital-intensive sectors particularly hard-hit



Sources: fDi Markets Database and authors' calculations. Notes: EBRD regions. Based on a project-level database, which tracks company investments (without information on the equity participation by investors) and thus captures a slightly different concept from FDI flows in balance of payments accounting.

FDI has only recovered to its pre-pandemic level in central Europe and the Baltic states, owing to large manufacturing investments in the first quarter of 2021 (for instance, a Korean company invested in a lithium ion battery company in Poland in March 2021 expanding its production in Silesia).

Remittances started recovering

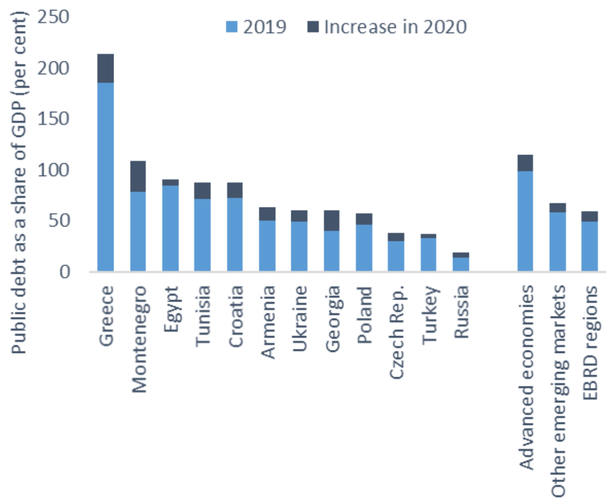
Remittances dropped sharply in 2020 reflecting travel restrictions and labour market shocks in host countries. Mirroring the patterns seen in domestic activity and mobility, recent months have seen a rapid recovery in remittances to several economies in the EBRD regions, for instance to Georgia and the Kyrgyz Republic.

Fiscal vulnerabilities have increased

Many economies in the EBRD regions, as elsewhere, implemented large fiscal stimulus packages aimed at mitigating the effects of the Covid-19 crisis on individuals and firms. Such policy actions contributed about 6 percentage points to global growth in 2020, according to IMF estimates. Early evidence from the Covid-19 Follow-up Enterprise Surveys further suggests that government support helped mitigate the negative impact of the Covid-19 crisis on firms in the EBRD regions (see Box 3).

Additional spending coupled with output contractions raised average general government debt in the EBRD regions from 49 per cent of GDP in 2019 to 60 per cent in 2020 (see Chart 17).

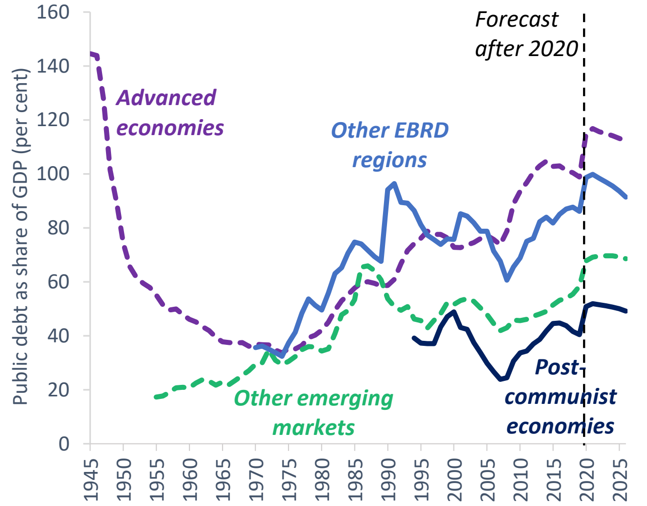
Chart 17. The public debt-to-GDP ratio increased by about 11 percentage points in the EBRD regions



Sources: IMF 2021 and authors' calculations. Notes: Advanced economies includes Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom and the United States. Other emerging markets includes Brazil, Chile, India, Malaysia, Mexico, Pakistan, the Philippines, South Africa and Thailand.

In many economies in the EBRD regions, public debt has risen to levels last seen during the transition recession of the early 1990s; and in some economies it is at historic highs (see Chart 18).

Chart 18. Public debt has increased to historic highs in some economies



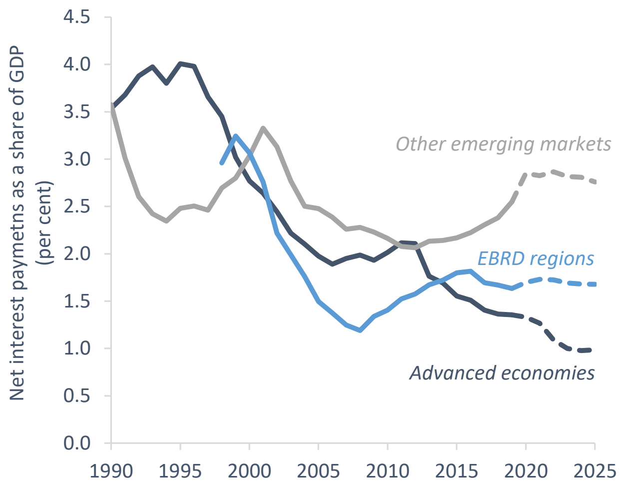
Sources: IMF 2021 and authors' calculations. Notes: Advanced economies includes Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom and the United States. Other emerging markets includes Brazil, Chile, India, Malaysia, Mexico, Pakistan, the Philippines, South Africa and Thailand.

Past experience also suggests that current projections may underestimate public debt ratios in the future (see Flores and others 2021).

Interest rate payments in most economies in the EBRD regions do not exceed their pre-pandemic levels as falling borrowing costs offset the increase in debt levels (see Chart 19), At the same time, interest rate payments are typically higher in the southern and eastern Mediterranean than elsewhere in the EBRD regions, and have increased further recently (to 9 per cent of GDP in Egypt and 4 per cent in Jordan).

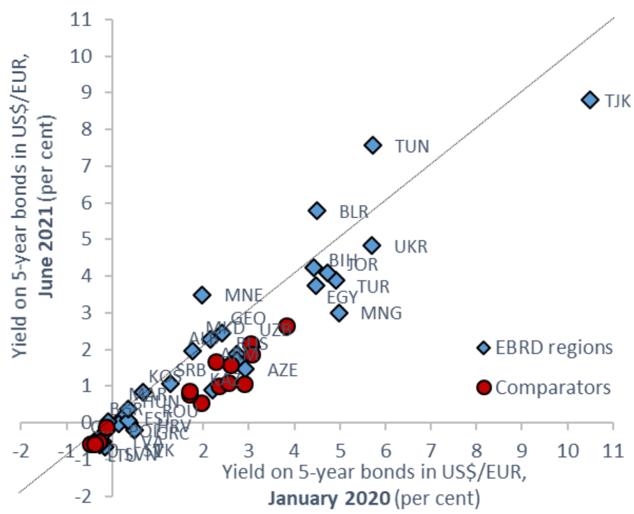
More broadly, bond yields in the EBRD regions have increased by an average of 0.5 percentage point since January 2021 (see Chart 20). Lebanon, Tajikistan, Tunisia, and more recently Belarus and Montenegro are among the economies facing significantly higher borrowing costs.

Chart 19. Interest payments to GDP remain broadly stable in most of the EBRD regions



Sources: IMF 2021 and authors' calculations. Notes: Advanced economies includes Canada, France, Germany, Italy, Japan, the United Kingdom and the United States. Other emerging markets includes Chile, China, Colombia, India, Indonesia, Malaysia, Mexico, Pakistan and the Philippines. Data missing for Lebanon.

Chart 20. Borrowing costs remain below their pre-crisis levels in most economies in the EBRD regions

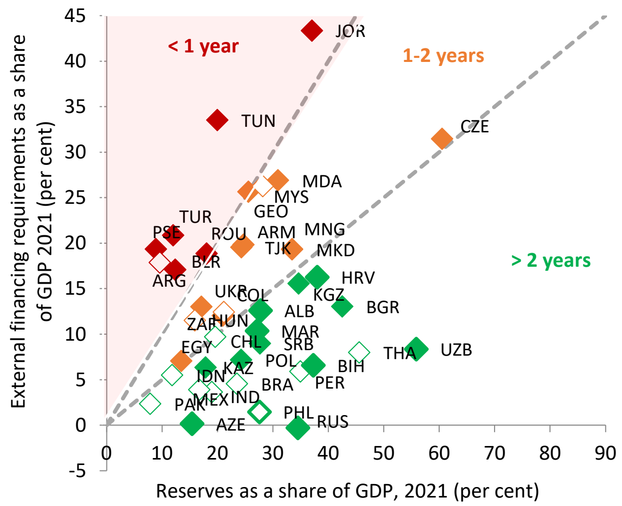


Sources: Bloomberg. Notes: Missing historical bond data for Bosnia and Herzegovina, Estonia, Moldova, Turkmenistan, Uzbekistan, West Bank and Gaza. Bond yields in Lebanon increased from 25 per cent to 81 per cent

External vulnerabilities

External financing needs are large in some economies in the EBRD regions. In Belarus, Jordan, Romania, Tunisia, Turkey and the West Bank and Gaza international reserves cover less than a year of external financing requirements (the sum of current account deficits and short-term external debt, see Chart 21).

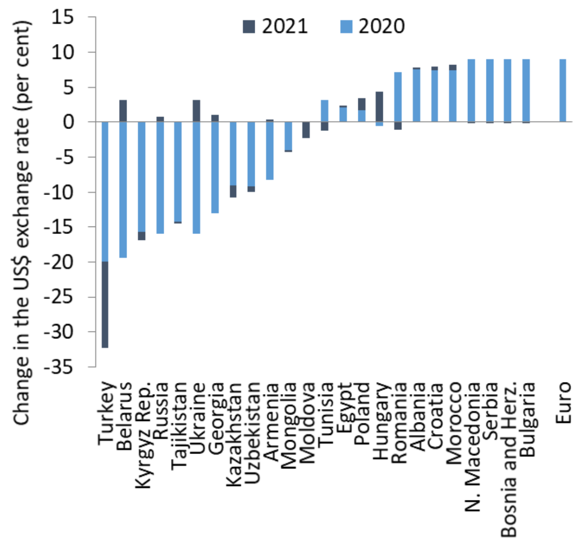
Chart 21. Reserve coverage of external financing needs varies



Sources: CEIC, IMF April 2021 WEO and International Reserves and Foreign Currency Liquidity database, national authorities and authors' calculations. Notes: External financing requirements refer to the sum of current account deficit and short term external debt. Recent data for Lebanon missing, Euro Area excluded.

Following depreciations in 2020, many currencies in the EBRD regions stabilised in 2021 against the US dollar, some of them supported by rising commodity prices. The Turkish Lira, on the other hand, has experienced continued downward pressures (see Chart 22).

Chart 22. Most currencies that depreciated against the US dollar in 2020 stabilized in 2021

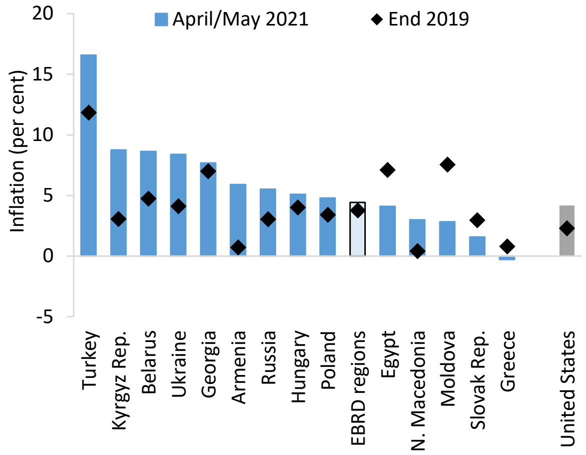


Source: CEIC and national authorities. Notes: As of end-May 2021.

Inflation has picked up

Inflation in the EBRD regions has picked up, reflecting higher commodity prices, fiscal stimulus, pass-through from higher inflation in advanced economies and, in some cases, currency depreciations (see Chart 23). Average inflation in the EBRD regions, at 4.2 per cent year-on-year at end-May 2021, exceeds its end-2019 level by 0.8 percentage point.

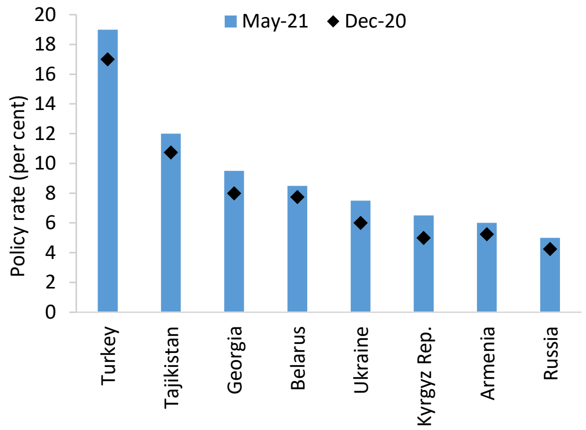
Chart 23. Average inflation in the EBRD regions increased by 0.8 percentage point relative to its pre-pandemic level



Source: CEIC and national authorities. Notes: Year-on-year changes. Simple average across EBRD economies excluding Lebanon. Includes March inflation for Russia.

Faced with inflationary pressures, a number of economies in the EBRD regions, as other emerging markets, have started increasing interest rates this year (see Chart 24).

Chart 24. Some economies in the EBRD regions have tightened monetary policy

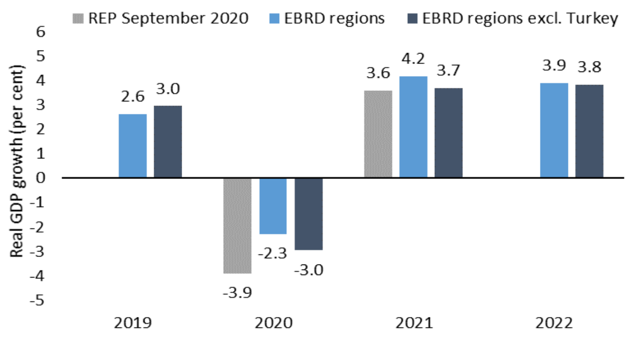


Source: CEIC and national authorities.

Output in the EBRD regions is expected to grow by 4.2 per cent in 2021

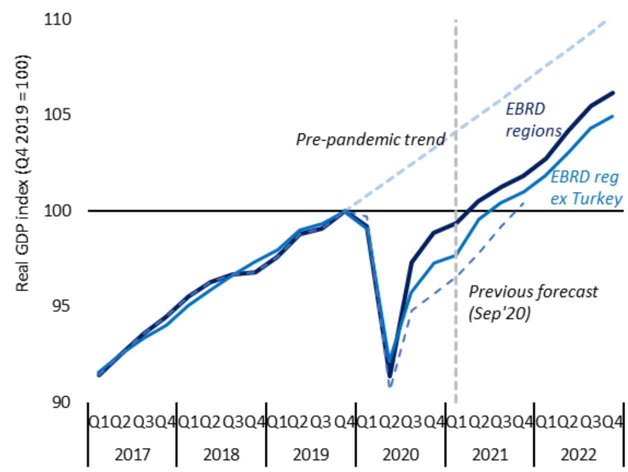
Output in the EBRD regions is expected to grow by 4.2 per cent in 2021 and 3.9 per cent in 2022 (see Charts 25 and 26 and Table 1). This represents an upward revision compared with the forecasts made in September 2020. The revisions reflect strong exports, extended fiscal support packages and faster phasing out of social distancing. These revisions mirror the stronger expected pace of recovery in the global economy.

Chart 25. Output in the EBRD regions is expected to grow by 4.2 per cent in 2021



Sources: CEIC, national authorities and EBRD forecasts.

Chart 26. The recovery is expected to be faster than previously projected



Sources: CEIC, national authorities and EBRD forecasts.

Despite the faster projected recovery, 57 per cent of economies in the EBRD regions are expected to reach their 2019 level only in 2022 or later (see Table 1, last column). This is the case in particular for economies dependent on tourism and those with lower medium-term potential growth reflecting structural impediments to economic development.

Regional outlooks

Industrial production and manufacturing exports have rebounded and services are recovering in **central Europe and the Baltic states.** Output is expected to increase by 4.8 per cent in 2021 and 4.6 per cent in 2022, reflecting strong household consumption and investment, and supported by EU recovery funds.

GDP in the **south-eastern European Union** is expected to grow by 5.2 per cent in 2021 and 5 per cent in 2022 as fiscal support and the prospects of major EU recovery funding in the coming years are boosting investor and consumer confidence. However, continued uncertainty around tourism weighs on the outlook.

Output in the **Western Balkans** is expected to grow by 5.1 per cent in 2021, reflecting strong outturns in the year so far and sustained fiscal stimulus. However, continued uncertainty around travel restrictions weighs on the outlook for tourism-dependent economies. Growth is expected to moderate to 3.8 per cent in 2022.

Output in **Russia** is expected to grow by 3.3 per cent in 2021 and 3 per cent in 2022 as the easing of restrictions on activity supports a recovery in domestic demand. The boost from higher commodity prices is expected to be partially offset by a more neutral fiscal and monetary policy stance.

Economies in **eastern Europe and the Caucasus** are expected to grow by 2.8 per cent in 2021 and 3 per cent in 2022 as lockdowns are lifted and demand for exports remains strong. Higher commodity prices support the recovery in commodity exporters.

The outlook has also been revised up for economies in **Central Asia**, though the recovery is far from uniform. The region is expected to grow by 4.5 per cent in 2021 and 2022, reflecting higher commodity prices, which benefit commodity exporters, as well as recovering remittances.

Turkey's economy is expected to grow by 5.5 per cent in 2021 and 4 per cent in 2022, driven by exports, while domestic demand remains constrained by the impact of still-ongoing containment measures and, more generally, the weaker financial situation of households.

Output in the **southern and eastern Mediterranean** is expected to grow by 3.5 per cent in 2021, though the speed of recovery varies across economies reflecting the slow recovery in tourism, mounting fiscal pressures and, in some economies, political uncertainty. Growth is expected to increase to 4.6 per cent in 2022, supported by structural reforms and recovering foreign investment and trade flows.

These forecasts are subject to tremendous uncertainty

Forecasts are highly sensitive to the path of Covid-19 infections, assumptions relating to government policies and their effectiveness in terms of limiting persistent economic damage from the crisis (scarring) as well as commodity prices.

Further vulnerabilities may surface once policy support is reduced

Labour market vulnerabilities are widespread. Despite job retention programmes, wage subsidies and other extensive government support measures, unemployment and underemployment have increased and labour force participation rates have fallen in many economies. In the EBRD regions unemployment rates rose by an average of one percentage point between 2019 and 2020 (based on a sample of 29 economies). Labour force participation rates in turn dropped by an average of 0.9 percentage point between end-2019 and end-2020 (based on a sample of 24 economies with quarterly data). Moreover, the true amount of slack may be even larger than these indicators suggest to the extent that job retention programmes remained in place at the time of labour market surveys.

The employment and earnings impact of the pandemic has been highly unequal across groups of workers (see also Box 4 on digital divides). Younger workers, women, and those with lower levels of education and pre-pandemic income have been hit the hardest, resulting in a divergence between headline growth figures and the personal experiences of many people.

While bankruptcies have remained contained so far owing to extensive policy support, non-performing loans may increase once support measures are withdrawn.

Box 1. Mobility and economic activity during the Covid-19 crisis

Given the unprecedented restrictions on people's movements during the current crisis, this box relies on Google Analytics mobility measures to trace the relationship between mobility and economic activity. While this relationship appears to have been weakening over time as businesses and consumers partially adjusted to social distancing, this adjustment has only been partial. A 10 per cent drop in mobility is associated, on average, with 2 percentage points lower GDP growth. Stronger-than-expected economic performance in recent quarters can be largely attributed to higher mobility (compared with the second quarter of 2020). Economies' adaptation to social distancing has played a smaller role in delivering stronger growth outcomes. Economic forecasts based on mobility perform well and underpin nowcasts of economic activity in the second quarter of 2021.

Individual mobility indices compiled by Google Analytics track trips to recreation venues such as restaurants or retail shops, trips to grocery stores, trips to mass transit stations and trips to workplaces, with average mobility during a reference period in January-February 2020 set as 100. These indices can be combined into a single index of mobility, whereby weights attached to each sub-index vary across countries (less weight is given to noisier measures). Mobility is aggregated across economies using weights based on GDP at purchasing power parity (PPP, see Chart 6 in the main section).

Mobility dropped by around 45 per cent in March-April 2020, both globally and in the EBRD regions. Mobility in the EBRD regions recovered more quickly in the summer of 2020 but recorded a sharper drop in December, to around 70 per cent of its baseline level. By end-May 2021, mobility in the EBRD regions recovered to baseline levels while average global mobility remained around 10 per cent below the reference point.

The elasticity of economic growth with respect to mobility is estimated on a sample of 53 economies with timely seasonally adjusted quarterly GDP growth rates (approximately half of these are advanced economies and half are emerging markets including Argentina, India and Russia). Estimations are based on quarterly observations since the first quarter of 2020; growth rates are expressed in quarter-on-quarter terms.

Normal levels of mobility may correspond to different rates of growth in different economies (say, in India and Ukraine). Seasonal patterns of mobility may also vary. To partially address these difficulties, growth for each economy is evaluated in terms of its deviation from the estimated long-term potential rate of quarterly growth (the latter estimate for India is 1.26 per cent per quarter and the one for Ukraine is 0.38 per cent). The estimates of long-term potential growth are, in turn, obtained from the analysis of annual growth rates over the long term taking into account demographics, skills, the quality of economic institutions and other factors known to influence potential economic growth (see Gamtkitsulashvili and Plekhanov, forthcoming).

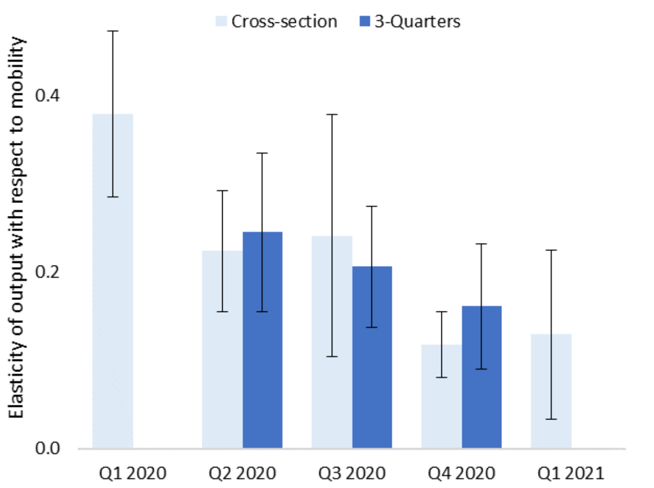
The log-deviation of growth from its potential growth rate in a given quarter is linked to the log-change in the average mobility index from the previous quarter and a constant. The estimates are performed for each cross-section (growth rates reported in a given quarter); these are complemented by fixed-effect estimates from rolling panels of three quarters (which also include quarter effects).

A 10 per cent drop in mobility is associated, on average, with 2 percentage points lower GDP growth (see Chart 1.1). These elasticities do not appear to vary systematically across advanced economies and emerging markets.

The elasticity of output with respect to mobility appears to decline over time, but fairly gradually. This trend could reflect adjustments in economic activity over time, such as increased working from home, online retail, take-away meals and shifts in economic activity toward less mobility-intensive sectors (such as construction). Estimates suggest that the bulk of this adjustment took place in the first weeks of social distancing, with modest further adjustment since the second quarter.

This suggests that stronger-than-expected economic performance in recent quarters can be largely attributed to higher mobility (compared with the second quarter of 2020). Economies' adaptation to social distancing has played a smaller role in delivering stronger growth outcomes.

Chart 1.1. A 10 per cent drop in mobility is associated with 2 percentage points lower GDP growth



Sources: CEIC, Google Mobility, national authorities and authors' calculations. Notes: Whiskers denote 95 per cent confidence intervals.

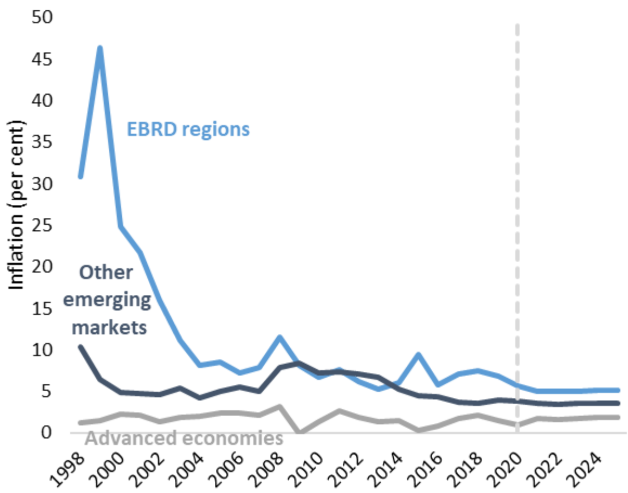
The mobility-based forecasts underpin nowcasts for the second quarter of 2021 (see Chart 26). They perform well relative to random walks, estimates of potential growth and traditional nowcasts. Changes in mobility can explain up to 89 per cent of the variation of quarterly growth outcomes in 2020.

Box 2. Inflation in the EBRD regions

Inflation rates in the EBRD regions have been on a downward trend since the late 1990s. Inflation expectations have become better anchored as inflation targeting became more widespread across the regions. However, recent increases in commodity prices, in some cases currency depreciations and increasing inflation in key trading partners have been putting pressure on prices. These pressures have been moderated by still significant slack in labour markets in most economies.

Inflation rates in the EBRD regions have been on a downward trend since the late 1990s, often coming down from very high levels following the price liberalization reforms of the early transition years (see Chart 2.1).

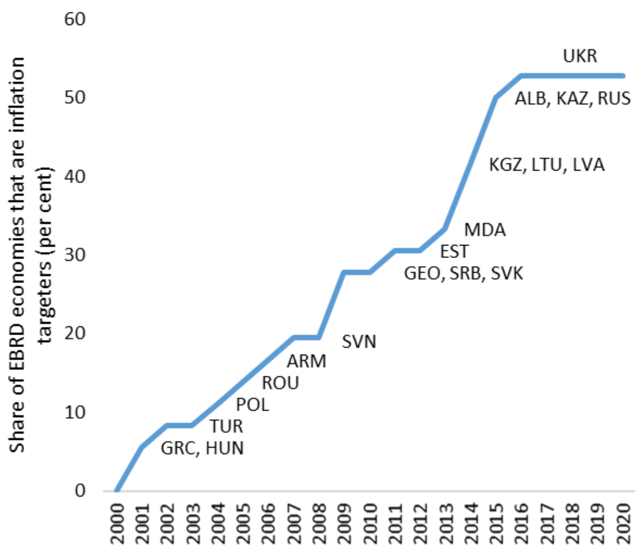
Chart 2.1 Inflation rates have come down from the highs of the 1990s



Sources: IMF and authors' calculations. Notes: Average consumer prices. Simple averages across economies. Advanced economies includes Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom and the United States. Other emerging markets includes Brazil, Chile, India, Malaysia, Mexico, Pakistan, the Philippines, South Africa and Thailand.

Inflation expectations have become better anchored as inflation targeting became more widespread (see Chart 2.2). By 2020, over half of economies in the EBRD regions had inflation targets; some (including Georgia, Serbia, Turkey and Ukraine) have gradually lowered their targets.

Chart 2.2 Inflation targeting became more widespread in the EBRD regions

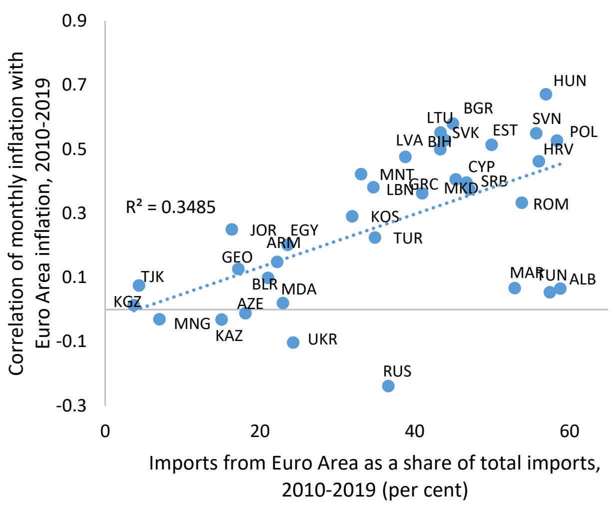


Sources: IMF Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER) and authors' calculations.

However, rising commodity prices, in some cases currency depreciations and increasing inflation in key trading partners have recently been putting pressure on prices in the EBRD regions. The correlation of month-on-month oil price changes with monthly inflation reaches up to 0.4-0.5 in some economies in the EBRD regions. Inflation in Emerging Europe also tends to be closely correlated with Euro area inflation, reflecting close trade links (see Chart 2.3). In some economies Euro area inflation can explain up to two thirds of the variation in inflation. Correlations with United States inflation are similar. Correlations with China's inflation are much lower (below 0.2) including in countries with strong trade links with China.

Significant slack in labour markets in most economies (reflected in higher unemployment and underemployment and lower labour force participation rates on the back of the Covid-19 crisis) has moderated inflationary pressures so far.

Chart 2.3 Inflation in Emerging Europe is highly correlated with Euro area inflation



Sources: CEIC, IMF, national sources and authors' calculations.
Notes: Correlation based on monthly inflation.

Box 3. The effects of the Covid-19 pandemic on firms

This box examines differences across firm responses to the Covid-19 crisis and firm performance during that period relying on the first wave of the Covid-19 Follow-up Enterprise Surveys, covering almost 8000 firms in 29 economies (in the EBRD regions as well as some advanced economies).

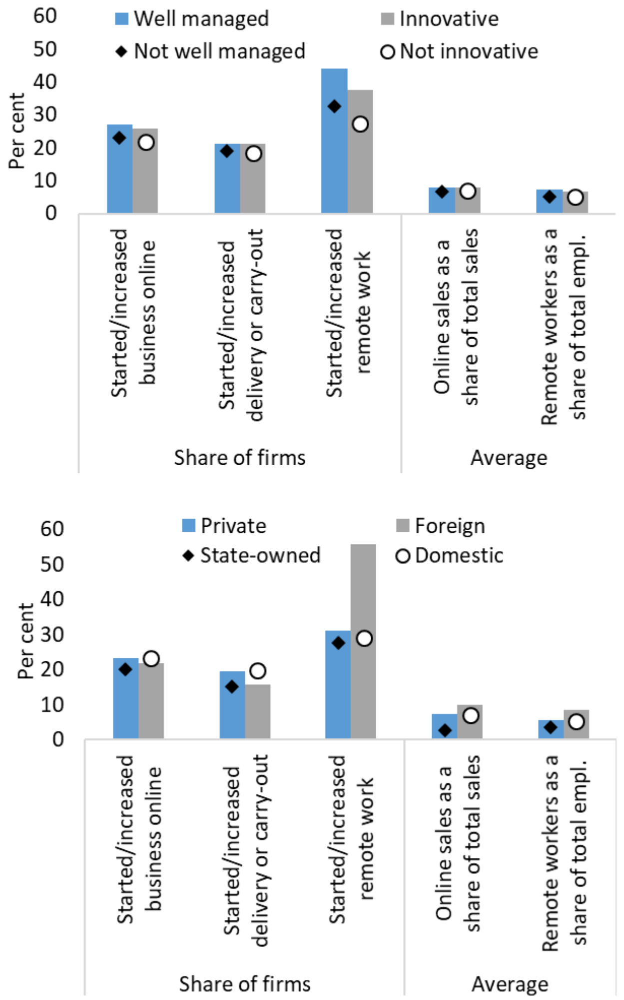
The Enterprise Surveys are large representative surveys of firms with at least five employees conducted globally since 2006. Some of the firms polled shortly before the Covid-19 crisis were approached again during 2020-21 with a special questionnaire about their experiences during the pandemic. The analysis of the results of this follow-up survey reveals a number of remarkable regularities.

Firms that were growing faster before the pandemic, had higher management quality, had been more innovative in the past and made greater use of digital technologies adapted better during the pandemic and experienced smaller losses than their peers. In particular, they were more likely to have started or increased business activity online, introduced home delivery or carryout services or switched to remote work; they also had higher shares of online sales in total sales and remote workers in their total workforce (see Chart 3.1). These differences hold up when taking into account other firm characteristics such as their age, size, sector, country, ownership and trading status. They are both statistically and economically meaningful.

For instance, firms that introduced a new product or process in the three years before the Covid-19 crisis were almost 50 per cent more likely to start or increase remote work during the pandemic than similar firms that did not innovate. Firms that had a website in 2019 were almost twice as likely to start or increase business activity online than similar firms that did not have a website.

Firms with international linkages—through foreign ownership, exports, imports or use of foreign technology—were more likely to introduce remote working arrangements. Majority foreign-owned firms were 77 per cent more likely to start or increase remote work during the pandemic than similar domestic firms; global value chain participants (firms with imports and exports exceeding 10 per cent of their sales) were about 32 per cent more likely to start or increase remote work than similar firms without active involvement in global value chains. Traders were also more likely to receive government support than non-traders (controlling for their other characteristics), likely due to support measures having been targeted to mitigate the effects of value chain disruptions and travel restrictions on companies.

Chart 3.1 Firms responded differently to the Covid-19 crisis



Sources: Covid Enterprise Survey and authors' calculations.

Majority state-owned enterprises were significantly less likely to introduce changes in response to the crisis than similar private firms—in line with earlier studies that documented that they are less likely to innovate (see also the 2020-21 *Transition Report*). Nonetheless, state-owned firms were less likely to close and experienced smaller drops in sales than similar private firms, reflecting, in part, more widespread government support (controlling for their other characteristics). More generally, government support appears to have helped avoid some permanent closures.

Box 4. The rise of e-commerce during the Covid-19 crisis

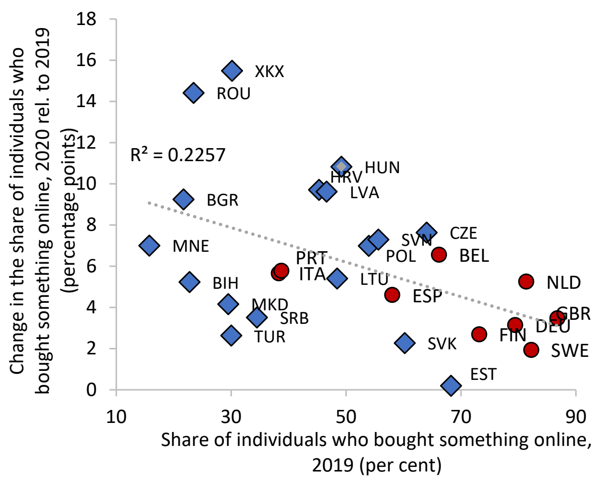
This box draws on the 2020 Eurostat ICT survey and points to large but narrowing digital divides in online shopping behaviour across and within countries as the Covid-19 pandemic appears to have accelerated the expansion of e-commerce.

The Covid-19 crisis accelerated the expansion of online retail across the world, providing customers access to goods and services from the convenience and safety of their homes and enabling firms to continue their business activity despite the social distancing measures imposed during the pandemic. Some of these changes could have lasting effects as consumers may keep some of their new purchasing habits and firms may capitalise on their investments in new online sales channels.

The following analysis draws on the 2020 Eurostat ICT survey covering the European Union, economies in the Western Balkans and Turkey and points to significant variation in the share of individuals who bought something online across this subset of economies (see Chart 4.1). In some advanced European economies over 75 per cent of the population made a purchase online in 2019. In the EBRD regions this share was highest in Estonia, the Czech Republic and the Slovak Republic (at around 60-70 per cent), while in Bosnia and Herzegovina, Bulgaria, Romania and Montenegro the corresponding share was below 25 per cent prior to the Covid-19 crisis.

The gap across economies appears to have narrowed somewhat in 2020 as economies with relatively low penetration of e-commerce in 2019 (such as Kosovo and Romania) saw the largest increases in online shopping (see Chart 4.1).

Chart 4.1 Digital divides in e-commerce between economies narrowed during the Covid-19 crisis

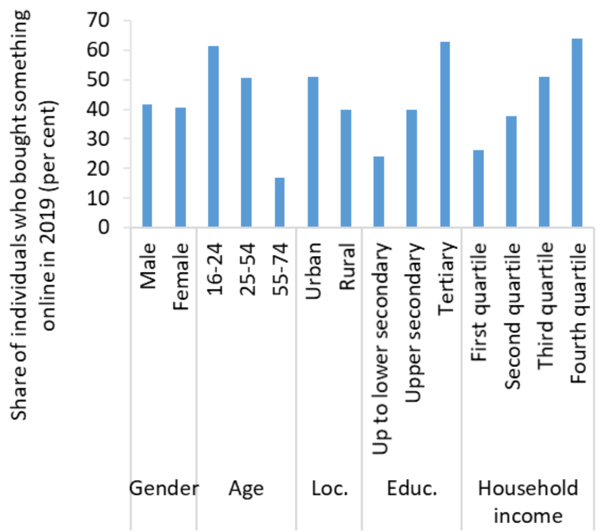


Sources: Eurostat ICT survey 2020 and authors' calculations.

While online retail was increasing already before the Covid-19 crisis, the pandemic accelerated this trend. Restrictions on mobility and contact-intensive services such as retail resulted in a widening of the scope of e-commerce activities, including the emergence of new online firms and expansion into new consumer segments (such as serving the elderly) and products (such as groceries). The share of individuals who bought something online increased by around five percentage points between 2018 and 2019, but by around seven percentage points between 2019 and 2020.

The survey points to large digital divides within economies as well. Online shopping was most common among younger, better-educated individuals and those living in richer households and in urban areas (see Chart 4.2). More limited access to fast internet, lack of digital skills, low financial inclusion and trust may have held back online shopping among older, less educated, poorer, rural respondents. Such digital divides were typically larger in poorer economies with weaker digital infrastructure.

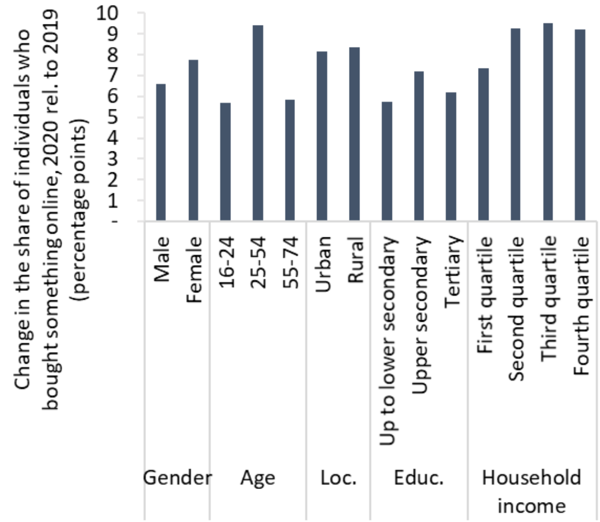
Chart 4.2. Prior to the Covid-19 crisis, online shopping was most common among younger, urban, higher educated, richer respondents



Sources: Eurostat ICT survey 2020 and authors' calculations.
Note: EU-EBRD economies, economies in the Western Balkans and Turkey.

Digital divides within economies in the EBRD regions, however, narrowed somewhat in 2020. In particular, the increase in the share of those shopping online was highest among women, middle-aged, those with medium levels of education and income, and was slightly higher among respondents in rural areas (see Chart 4.3).

Chart 4.3. Digital divides in e-commerce narrowed during the Covid-19 crisis in the EBRD regions



Sources: Eurostat ICT survey 2020 and authors' calculations.
Note: EU-EBRD economies, economies in the Western Balkans and Turkey.

Regional updates

Central Asia

Central Asian economies contracted by an average of 0.8 per cent year-on-year in 2020, the smallest reduction among EBRD regions. As low base effects kicked in only in April 2021, the region's recovery in the first quarter of 2021 was moderate, with real growth averaging 1.4 per cent year-on-year. Moreover, the pace of recovery is far from uniform, ranging from 9.4 per cent contraction in the Kyrgyz Republic to 15.7 per cent growth in Mongolia, the first economy in Central Asia to suffer from border closure and lockdown measures in 2020. Global stimulus spending is trickling down to Central Asia through commodity price inflation, which is directly benefiting major exporters of oil, gas, metals, and cereals, such as Kazakhstan, Mongolia, Turkmenistan and Uzbekistan. Indirectly, they also benefit the Kyrgyz Republic and Tajikistan, which rely on remittances from Russia and Kazakhstan. Remittances have surged in 2021, supporting consumer demand and fuelling inflationary pressures, but most central banks in the region have so far decided against hiking the policy rate as private sector investment activity remains subdued. Nominal exchange rates have stabilised in the first half of 2021 on the back of recovery in external demand and remittances. Fiscal policy is expected to remain accommodative across the region but will be constrained by elevated public debt levels in the Kyrgyz Republic, Mongolia and Tajikistan and the risk of inflation. Assuming the pandemic is brought under control, Central Asian economies are on track to achieving high growth rates in 2021 and continuing on a path of recovery in 2022. Regional real GDP is forecast to grow by 4.5 per cent year-on-year on average in both 2021 and 2022.

Kazakhstan

Real GDP grew by 0.7 per cent year-on-year in January-April 2021 compared to 0.2 per cent contraction in the same period of 2020, signifying the beginning of a gradual recovery. Construction was a major driver (up 12.5 per cent year-on-year) benefitting from the inflow of pension savings – a stimulus measure introduced by the Kazakh government in January 2021. Manufacturing, agriculture and trade contributed to the economic expansion. The slump in transportation continues: after losing 17 per cent in 2020, the sector is down 9 per cent (year-on-year) in the first four months of 2021. The recovery is constrained by domestic restrictions to contain the spread of Covid-19 and reduction in mining output, to comply with OPEC+ agreements. Fixed investment declined 6.6 per cent year-on-year in January-April 2021, dragged down by contraction of investment into mining, while investment in other sectors surged. Exports shrank by 17 per cent year-on-year in the first quarter of 2021 due to a substantial reduction of oil and gas exports. The exchange rate bottomed out in early April, after a short bout of depreciation triggered by new sanctions imposed on Russia in March 2021. It is currently stable, supported by elevated commodity prices. While real estate prices surged, consumer price inflation (7.2 per cent year-on-year in May 2021) remains only slightly above the central bank target thanks to exchange rate stability and subdued demand. The policy rate has been kept at 9.0 per cent since July 2020. Fiscal policy will remain accommodative in 2021, with authorities targeting a budget deficit of 3.5 per cent of GDP. Real GDP is expected to grow by 3.6 per cent in 2021 and 3.8 per cent in 2022, supported by higher oil prices, fiscal stimulus and recovery of private consumption. Significant downside risks remain, including those related to the path of Covid-19 infections.

Kyrgyz Republic

Real GDP declined by 3.8 per cent in January-April 2021, the lowest contraction since the beginning of the pandemic. Economic and political uncertainty, as well as longer-term Covid-related disruptions, weigh on the supply side of the economy. Fixed investment continued to contract; gold production is down 9.8 per cent year-on-year, and construction and manufacturing dropped by 17 and 16.4 per cent year-on-year, respectively. However, excluding the Kumtor gold mine, real GDP increased by 1.1 per cent year-on-year on the back of a sharp increase in remittances (up 22 per cent year-on-year in US dollar terms in the first quarter of 2021). A remittance-financed surge in consumer demand led to a recovery in services (up 1.3 per cent year-on-year) and food price inflation. To quell inflationary pressures, the central bank raised the policy rate from 5.5 to 6.5 per cent in April 2021. As a result, annual inflation decelerated to 8.7 per cent in April 2021 from the peak of 10.6 per cent in February

2021, but remains above the target corridor of 5-7 per cent. The volume of newly issued loans increased by 38.8 per cent year-on-year in January-April 2021, with strong growth in agriculture, trade and consumer loans. At the same time, the non-performing loan (NPL) ratio climbed to 11.24 per cent in April 2021 from 8.67 per cent a year ago, signifying a build-up of risks in the banking sector. The economy is expected to grow by 6.6 per cent in 2021, fuelled by strong recovery in remittances from Russia and growth in private consumption, which will positively affect the services industry. However, fixed investment is expected to remain subdued in 2021 due to political risks and investment climate concerns resulting from the temporary takeover of Kumtor by the authorities in May 2021 and the ratcheting up of inspections and regulatory pressure on medium-size businesses. Hence, real GDP growth is projected to decelerate to 4.6 per cent in 2022.

Mongolia

Having absorbed large losses from early lockdowns and border closures (starting from February 2020), Mongolia recorded real GDP growth of 15.7 per cent year-on-year in the first quarter 2021 thanks to a very low base. Growth was driven by China's recovery and elevated commodity prices. Exports rose by 81.8 per cent year-on-year in the first four months of 2021 thanks to strong performance in iron ores and concentrates, copper concentrates and coal. Overall, mining output increased 34 per cent year-on-year. Services grew by a much more modest 3.6 per cent year-on-year. With the economy recovering, inflation accelerated to 5.6 per cent in April 2021 from the low of 2.3 per cent in December 2020. However, the policy rate has been kept unchanged at 6.0 per cent since November 2020, supporting credit expansion (up 3 per cent year-on-year in March 2021). Fiscal policy will be supporting growth in 2021 with the budget deficit planned at 5.1 per cent of GDP. A large stimulus package is envisaged for 2021-23, estimated at 5 per cent of GDP, to be mainly financed by the central bank. Still, the government's ability to continue to redistribute income from the mining sector will be constrained by the elevated level of public debt (76.6 per cent of GDP at the end of 2020), and large bond maturities in 2021-24 (equal to roughly half of international reserves). Overall, Mongolia's GDP is expected to grow by 6.3 per cent in 2021 and 6.0 per cent in 2022, supported by China's demand for Mongolia's key exports, private and public consumption, and recovery of investment, contingent on a successful conclusion of the negotiations over Oyu Tolgoi, Mongolia's largest foreign direct investment-financed project.

Tajikistan

Tajikistan's real GDP expanded by 7.5 per cent in the first quarter of 2021. Domestic demand started recovering with retail trade turnover growing 9.2 per cent year-on-year, and fixed investment increasing 7.4 per cent year-on-year in the first quarter of 2021. Industrial output grew at a very high rate (18.4 per cent year-on-year in the first four months of 2021) with strong gains in mining (27.1 per cent year-on-year) and manufacturing (20.2 per cent year-on-year). Exports surged by 86.3 per cent (driven by precious metals), while imports rose by only 6.2 per cent, resulting in the trade balance deficit narrowing to US$ 132.3 million in January-April 2021 from US$ 520 million a year ago. Strong growth in remittances in the fourth quarter of 2020 (up 14 per cent year-on-year) led to higher household spending and inflationary pressures. The central bank reacted by increasing the policy rate stepwise from 10.75 to 11 per cent in February and to 12 per cent in April 2021. As a result, inflation decelerated to 8.3 per cent in April 2021 from 9.45 per cent in December 2020. The country's public debt reached almost 48 per cent of GDP in 2020 up from 43 per cent in 2019, as the government relied on external financing to mitigate the impact of the pandemic. However, debt sustainability is not an immediate concern thanks to the current account reverting to a surplus of around 4 per cent of GDP in 2020, and a build-up of convertible foreign currency reserve assets. The IMF emergency assistance received in spring 2020 is conditioned on fiscal consolidation – a challenge given continued investment in Roghun, the country's flagship hydropower project. The economy is expected to grow by 6.5 per cent in 2021 with remittances supporting private consumption and expenditure on Roghun driving public investment. In 2022, real GDP is forecast to grow by 6.0 per cent. Downside risks relate to the pandemic continuing to disrupt trade and mobility. The main upside risk is associated with a rapid intensification of trade, transport and investment linkages with Uzbekistan.

Turkmenistan

Turkmenistan reported real GDP growth of 5.9 per cent year-on-year in 2020 and 6.1 per cent year-on-year in January-May 2021. Such a strong growth performance in 2020 is hard to reconcile with the wider economic context and disruption of regional trade and mobility linkages. Exports, a major source of growth, plummeted by 39 per cent year-on-year in 2020, according to the IMF. The economy was estimated by the IMF to have grown by only 0.8 per cent year-on-year in 2020. The current account balance turned from a surplus of 1.3 per cent of GDP in 2019 to a deficit of 0.5 per cent in 2020. While the official exchange rate peg is maintained at 3.5 manats per US$, the parallel market exchange rate has depreciated from 18 manats per US$ in December 2019 to 28 manats in December 2020, and further to 35 manats in June 2021. Average annual inflation accelerated from 5.1 per cent in 2019 to 7.6 per cent in 2020. Due to data paucity, forecasts are aligned with IMF projections, at 4.6 per cent and 3.8 per cent in 2021 and 2022, respectively.

Uzbekistan

Real GDP increased by 3 per cent year-on-year in the first quarter of 2021 (compared to 4.6 per cent a year ago). Growth was recorded in all main sectors: services, industry, construction and agriculture. A surge in remittances (up 34 per cent year-on-year in US$ terms in the first four months) stimulated private consumption and growth in retail trade (up 2.8 per cent year-on-year). However, investment activity has not yet recovered, with fixed investment down by 3.5 per cent year-on-year in the first quarter of 2021. Exports contracted by around 20 per cent year-on-year in January-April 2021, primarily as exports of gold were brought to a halt. Imports were up by 7 per cent year-on-year. Inflation is slowing down (10.9 per cent in May 2021 versus 14 per cent a year earlier) thanks to lower growth in food prices. The policy rate has been kept unchanged since September 2020 at 14 per cent. Public debt rose from 30.8 per cent of GDP at end-2019 to 40.1 per cent in March 2021. Fiscal policy will continue to support the economy in 2021 with the consolidated fiscal deficit targeted at 5.5 per cent of GDP. Ambitious market reforms, including privatisation and improved governance of state-owned enterprises, continue to advance despite the crisis. GDP growth is projected to ratchet up to 5.6 per cent in 2021 and 6 per cent in 2022 as private consumption and investment are expected to rebound. However, the forecast is subject to a high degree of uncertainty.

Central Europe and the Baltic states

The Covid-induced recession in central Europe and the Baltic states turned out to be less severe than expected, with economic output contracting by an average of 3.9 per cent in 2020. Those economies in this region that are more diversified and have a greater exposure to trade with other EU member states proved to be more resilient to the pandemic. While supply chain disruptions also affected the manufacturing sector in the region, especially in the automotive industry, the region's continued price competitiveness helped exports perform relatively well. Labour markets have suffered somewhat, but generous public sector support measures aided job retention, with some companies reducing only the amount of working time. The recovering domestic demand has boosted inflation rates in the region, in line with expectation, but the average price hikes in Hungary and Poland exceeded the central banks' targets considerably; some tighter monetary policies should therefore be expected if inflation expectations remain elevated. The region is expected to recover by 4.8 per cent in 2021 and 4.6 per cent in 2022, supported mostly by pent-up household consumption and investment. The EU recovery funds are likely to add between 0.6 and 1 percentage point to annual GDP growth rates, depending on the use of those funds.

Croatia

The Covid-19 pandemic inflicted significant damage on the Croatian economy in 2020. GDP declined by over 8 per cent, with private consumption, net exports and investment recording negative contributions to growth. A key channel for disruption was tourism, which normally accounts for around 20 per cent of GDP. Tourist arrivals in the summer months of 2020 exceeded initial expectations, but the total fall for the year was about 68 per cent. A third wave of Covid-19 infections in April 2021 brought additional headwind to the recovery path, as reflected by the retail turnover dynamics. Nevertheless, the economy inched closer to pre-pandemic levels in the first quarter of 2021, with GDP growth at -0.7 per cent year-on-year (5.8 per cent quarter-on-quarter) on the back of robust exports of goods, investments in construction and a partial recovery in private consumption. The labour market proved to be quite resilient given the significant public support measures, with the unemployment rate at 7.5 per cent in April 2021, versus 5.9 per cent in February 2020. Public debt significantly increased to 88.7 per cent of GDP at end-2020 and erased the progress of fiscal consolidation of previous years. Nevertheless, a strong monetary stimulus brought sufficient liquidity, while ERM II accession and a projected decrease of the fiscal deficit to 3.8 per cent of GDP in 2021 points to a normalisation of public finances. The strong momentum of the economy will likely be maintained in the remaining quarters of 2021 as the vaccination campaign progresses and tourism picks up. If tourism invoices reach 70 per cent of 2019 levels, as expected, GDP could expand by 6 per cent in 2021. In 2022, incoming EU funds and post-earthquake reconstruction will boost investment, and together with expanding private consumption and recovering tourism, will continue the high-growth momentum at around 4.5 per cent. The main risk to the outlook remains the pandemic evolution, as new variants and insufficient vaccination could lead to other infection waves.

Czech Republic

Robust pre-Covid-19 growth was followed by 5.6 per cent reduction in GDP in 2020, which qualifies as a "one in 25 years event". The GDP decline was comparable with the EU average but worse than in all other EU-EBRD economies apart from tourism-dependent Croatia and Greece. The importance of industry and exports, typically a mitigating factor, failed to dampen the recession, with the troubled automotive sector being one of the factors. The severity and length of the Covid-19 restrictions were additional reasons. Still, labour markets fared quite well, as unemployment grew from 2.0 per cent to just 3.3 per cent between February 2020 and January 2021. Asset quality remains strong in early 2021, even if credit slowed down (aside from housing loans). As elsewhere in the region, inflation is picking up, and the central bank's re-introduction of the cyclical capital buffer signifies phasing out of the direct monetary policy crisis-response mode. Prior to the Covid-19 crisis, public finances looked very solid. Fiscal surpluses were recorded in recent years on the back of growing fiscal revenues, while public debt edged down to 30 per cent of GDP at end-2019. This created decent space for fiscal policy to react to the Covid-19 crisis, the space readily used. However, the Czech Fiscal Council has noted that income tax cuts combined with longer term aging trends will lead to growing debt, reaching a projected 55 per cent of GDP in 2024, low compared with the EU average, but historically high for Czech standards. Overall, these strong foundations should help the Czech economy to recover first by 4.0 per cent in 2021 and then by 3.8 per cent in 2022.

Estonia

The recession in Estonia was shallower than expected, with output contracting by 2.9 per cent in 2020, mainly driven by poor household consumption but somewhat offset by relatively strong exports and investment. According to Swedbank's estimates, about three-quarter of the economy remained unaffected by the containment measures or only partially affected through supply chains, while the remaining part has been suffering, particularly the tourism sector. Investment picked up sharply in the final quarter of 2020 and the first quarter of 2021 year-on-year, by 71 per cent and 55 per cent, respectively. It was mostly on the back of substantial investments in dwellings, transportation equipment, buildings and infrastructure, and machinery and equipment, including a large investment into software by VW Group. Economic recovery is expected to be driven mainly by a rebound of household consumption, boosted by increased household disposable incomes, as individuals will be able to withdraw their second-pillar pension savings from September 2021. The EU recovery funds should positively affect public sector investment, whereas the recent software investments in a local subsidiary made by VW Group will likely add to production and exports in the coming years. GDP growth is expected to reach 3.0 per cent in 2021 and 4.5 per cent next year.

Hungary

In 2020, GDP declined by 5.0 per cent in Hungary, but the economy started to recover from the second half of 2020, in quarter-on-quarter terms, with the rebound especially visible in exports and, to a lesser extent, in household consumption. The unemployment rate has remained stable, mostly below 4.5 per cent, throughout the entire pandemic period so far. At the same time, nominal wages continued to increase by almost 10 per cent annually, close to the double digit pace before the Covid-19 crisis. Generous public sector support measures, the low interest rate environment, a weakening currency and rebounding domestic demand all contributed to high inflation rates. In April 2021, annual inflation reached 5.2 per cent, the highest rate in the EU and well above the mid-term inflation target of the National Bank of Hungary of 3.0 per cent (the current policy rate is 0.6 per cent). In the short term, the economic recovery will likely be driven by investments, propelled by higher FDI inflows and the EU recovery fund, and improving household consumption thanks to accumulated savings during the lockdown periods. The share of total population that received at least one vaccine dose reached 55 per cent at the beginning of June 2021, the highest share in the regions and significantly above the EU average of 43 per cent, which lowers the risk of another pandemic wave amid lifted restrictions. As a result, GDP is expected to register strong growth of 5.5 per cent in 2021 and 4.8 per cent in 2022.

Latvia

Output contracted by 3.6 per cent in Latvia in 2020, mostly caused by a sharp decline in household consumption amid severe lockdowns. Job losses were common during the worst of the pandemic, but the unemployment rate has started to recover towards pre-pandemic levels, reaching 7.8 per cent in April 2021. Wages continued to grow, at about 6 per cent on average in 2020, which translates into real wage growth given the close-to-zero inflation rate last year. GDP growth forecast remain unchanged relative to September 2020, at 3.5 per cent for 2021, but the recent slow pace of the vaccination programme constitutes a substantial risk to that forecast as containment measures may need to remain in place for longer. At the beginning of June 2021, the share of total population that received at least one vaccine dose was below 30 per cent, one of the lowest shares in the EU. Amid the rebounding foreign demand, exports are expected to recover earlier than household consumption, whereas investment should improve as economic sentiment rises, supported by the EU recovery funds. As a result, the GDP growth rate should accelerate to 5.5 per cent in 2022.

Lithuania

GDP performance in 2020 turned out to be a positive surprise in Lithuania, as output dropped by just 0.9 per cent, among the smallest GDP contraction in the EU. The negative shock in domestic demand was largely offset by a sizable positive contribution to growth from net exports. While domestic services such as tourism, accommodation and catering suffered substantially, those sectors account for a relatively small share of the Lithuanian economy. The unemployment rate fell to 7 per cent in April 2021, close to pre-Covid levels, while the growth of nominal wages exceeded 10 per cent throughout 2020, effectively boosting households' disposable incomes amid a low inflation rate of 1.1 per cent. The vaccination programme is going well, with more than 40 per cent of the total population receiving at least one vaccine dose by early June 2021. The EU recovery funds, amounting to EUR 2.2 billion and available during the 2021-2026 period, are expected to expedite the recovery and also address longer-term structural challenges. The agile vaccination programme reduces the risk of new severe lockdowns this year, which will likely result in a massive increase in household spending, given the current record-high savings, as the economy reopens. GDP growth will likely accelerate to 3.0 per cent in 2021 and then to 4.0 per cent in 2022.

Poland

The recession in Poland turned out to be milder than anticipated, with GDP contracting by 2.7 per cent in 2020, mostly due to Poland's diversified economic structure and generous public support. The labour market proved to be resilient throughout the strictest lockdowns in 2020, with unemployment rates at only around 3 per cent, as companies mostly reduced working hours rather than laying off workers. Nominal wages continued to rise, at 7.8 per cent in 2020, which is faster than in the previous year and clearly indicates persistent labour shortages in the economy. Inflation has risen sharply, reaching 5.1 per cent year-on-year in April 2021, driven by pent-up household consumption, and a significant rise in service, waste disposal and energy prices. At the same time, the central bank's monetary policy committee has not envisaged any policy rate hikes as yet. GDP is expected to recover strongly in 2021, mostly driven by private and corporate savings being channelled to greater household consumption and investment. The latter rose in the first quarter of 2021 by 15.4 per cent, quarter-on-quarter, helped by historically low financing costs, rising capacity utilisation and improving external demand. The EU recovery funds are expected to further boost investment starting in the second half of 2021. GDP is thus expected to grow strongly: by 5.0 per cent in 2021 and 4.8 per cent in 2022.

Slovak Republic

The Covid-19 pandemic pushed the Slovak economy into a deep recession, with output contracting by 4.8 per cent in 2020. Domestic demand, especially investment, experienced the hardest hit, but exports started to recover from the second half of 2020. Car manufacturers, on which the Slovak economy is highly reliant, successfully managed to organise work in their production plants. As a result, there have been no significant production shutdowns linked to staff incapacity since mid-2020. However, some factories decided to halt production because of persistent shortages of parts, such as semiconductors. The labour market saw some deterioration, with unemployment rising from 6 per cent at the beginning of 2020 to 7.3 per cent in April 2021. As some of the car producers are planning to expand their capacities, more job vacancies will likely become available in the coming years. The anticipated recovery in foreign demand, boosted somewhat by the latest US stimulus package and its spill-overs, together with a sharp rebound in domestic spending amid gradually lifted restrictions and the impact of the EU recovery funds, should all contribute to GDP growth of 4.5 per cent and 5.0 per cent in 2020 and 2021, respectively. The negative risk to the forecast is the current slow pace of the vaccination programme.

Slovenia

The Covid-19 pandemic significantly affected Slovenia's economy in 2020, with GDP declining by 5.5 per cent. The key channels for disruption were private consumption and investment, which declined by a severe 9.7 per cent and 4.1 per cent, respectively. Private consumption was largely correlated with the spikes in Covid-19 infections, as the decline of 17.2 per cent year-on-year in the second quarter of 2020 was followed by an almost full recovery in the third quarter, only for consumption to again decline by a significant 14.4 per cent year-on-year in the fourth quarter. As a small open economy highly integrated into global value chains, Slovenia was also affected through the shock to global trade, although goods exports recovered already by the end of 2020. Goods exports continued expanding at 4 per cent year-on-year in the first quarter of 2021, supporting GDP growth of 1.6 per cent year-on-year, but service exports remain significantly below pre-pandemic levels. Investment activity also swiftly recovered by the end of 2020. The fiscal deficit is projected to deepen in 2021 to 8.6 per cent of GDP from 8.4 per cent in 2020 as the government maintains a largely expansionary fiscal policy. Unemployment increased marginally during 2020 thanks to significant support measures, and the latest reading from April 2021 sits at 5.2 per cent (4.0 at end-2019). The government projects public debt to remain around the levels of 80 per cent of GDP in 2021. The vaccination rollout and gradual phase-out of restrictions will lead to a partial recovery in consumption and services, while exports of goods and investments should further support growth. GDP is expected to expand by 5 per cent in 2021, and moderate to 4 per cent in 2022. Nevertheless, risks are on the downside, particularly in the short term, as new waves of infections could limit the recovery of tourism and other services, while supply constraints in global trade could affect manufacturing and goods exports.

Eastern Europe and the Caucasus

A gradual rebound of economic activity in the second quarter of 2021 is coinciding with the drop in the Covid-19 infection rate. Following a sharp drop in economic growth in 2020, recovery is accelerating in most countries across eastern Europe and the Caucasus as lockdowns are gradually lifted and global demand is increasing. Higher commodity prices additionally support recovery in countries that depend on commodity exports. GDP in the region as a whole is expected to rebound by 2.8 per cent in 2021, rising further to 3 per cent in 2022. A slow rate of vaccination and the possibility of a new Covid-19 wave in the autumn constitute risks to the outlook. Political volatility and slowdown of reforms pose additional risks in some countries.

Armenia

The Armenian economy has embarked on a broad-based recovery. The economy contracted by 7.4 per cent in 2020 as household consumption, investments and exports plummeted. A strong import contraction outweighed the steep decline in export revenues, while macroeconomic stability was supported by maintained access to external financing, including under the augmented IMF programme. A ten-year Eurobond in the amount of US$ 750 million, issued in January 2021, helped to refinance the existing Eurobond and boosted international reserves to an all-time high of US$ 3.2 billion in February. Inflation picked up to 5.9 per cent year-on-year in May 2021 on the back of higher international food prices and dram depreciation, following seven years of below-target inflation. This prompted the central bank to increase the refinancing rate three consecutive times from 4.25 per cent in September 2020 to 6 per cent in May 2021, the first rate rises since early 2015. High-frequency indicators of economic activity point to strong growth in April 2021, offsetting negative or slow growth in the first three months of the year and reaching 2.6 per cent year-on-year growth overall for the period January to April. Growth is broad-based as almost all sectors posted positive developments, in particular the construction sector. The Armenian economy is projected to grow by 4.0 per cent in 2021 and by 5.0 per cent in 2022. Economic recovery depends on the speed of vaccinations, political stability and prompt continuation of structural reforms after the elections.

Azerbaijan

The gradual recovery of Azerbaijan's economy is being driven by sectors other than oil and gas. After being hit by a triple shock—the Covid-19 pandemic, a slump in oil prices and the flare up of the conflict over Nagorno-Karabakh—Azerbaijan's GDP declined by 4.3 per cent in 2020. A strong contraction in the oil and gas sector of 7.2 per cent was balanced by a softer decline in the rest of the economy, which was helped by the government's extensive support package. Lower oil revenues on the back of the price slump and the production decline under the OPEC+ deal turned external and fiscal surpluses to deficits. However, Azerbaijan's public debt remained low despite the ensuing gaps as funding needs were met domestically by drawing upon the large assets of the State Oil Fund of Azerbaijan (SOFAZ). Non-hydrocarbon sectors started to recover in 2021, posting 4.5 per cent year-on-year growth in the first five months. However, the overall GDP growth, estimated at 0.8 per cent year-on-year in the same period, continues to be weighed down by lower oil and gas production. Rising demand for and price of oil, supported by an expected gradual increase of oil quotas in the coming months, will strengthen the overall economic performance in the second half of 2021. The economy is forecast to grow by 2.0 per cent in 2021 and 2.5 per cent in 2022. Risks are related to structural weaknesses of the economy, the speed of vaccinations and possible volatility in commodity prices.

Belarus

Economic recovery in 2021 is unlikely amid rising uncertainties. The economy contracted by only 0.9 per cent in 2020 due to the absence of a full lockdown and increased support to the state sector. The Covid-19 impact on non-tradable services was less severe than in other countries, while ICT services and agriculture even enjoyed 5.3 per cent and 7.0 per cent growth, respectively. On the other hand, the large export sector was particularly affected by the global pandemic, falling by 26.4 per cent year-on-year in 2020. Lower access to external financing and rising fiscal deficits led foreign reserves to decline from a historical high of US$ 9.4 billion at the end of 2019 to US$ 7.3 billion in April 2021. The currency also came under renewed pressure after presidential elections in August 2020, bringing total depreciation against the US dollar to 18.2 per cent throughout 2020, before stabilising in 2021. Consequently, inflation has soared to 9.4 per cent year-on-year in May 2021, prompting the National Bank of Belarus to raise the refinancing rate from 7.75 per cent to 8.5 per cent in April 2021. The economy is expected to stagnate, with growth of just 0.5 per cent in both 2021 and 2022. The build-up of economic sanctions, possibly hitting the export-oriented potash and petroleum industries, is a serious risk for growth prospects. While renewed direct lending by state-owned banks to state-owned enterprises sustained the resilience of the economy throughout last year's crisis, it increases vulnerabilities in the medium term.

Georgia

The Georgian economy is demonstrating signs of strong recovery. As one of the most tourism-dependent countries in the EBRD regions, Georgia's economy was strongly hit in 2021 by border closures and health measures around the world. Tourism revenues were slashed by 83 per cent in 2020, leading to a 38 per cent decline in the exports of goods and services. Investment contracted on the back of uncertainty and adverse conditions in the economy. However, household consumption demonstrated resilience despite the two lockdowns and grew by 5.4 per cent. Overall GDP contracted by 6.2 per cent in 2020. Sustained access to external financing enabled the authorities to cover the rising fiscal and external gaps while at the same time maintaining international reserves at record levels of US$ 4.2 billion in May 2021. Remittances grew by approximately 30 per cent in the first quarter of 2021 and goods exports expanded by 20 per cent in current US$ terms in the first four months (both in year-on-year terms), driven in large by rising demand from the near region and China. Tourism is slow to return so far, however. Inflation reached 7.7 per cent year-on-year in May 2021 because of the pass-through effect of last year's depreciation, prompting the National Bank of Georgia to raise the refinancing rate two consecutive times, from 8 per cent in February 2021 to 9.5 per cent in May 2021. GDP is expected to grow by 4.5 per cent in 2021, and by 5.5 per cent in 2022. A revival of the hospitality sector remains the main driver of overall economic recovery, while major risks stem from the slow rate of vaccination.

Moldova

The Moldovan economy is poised to recover in 2021 after a 7.0 per cent contraction in 2020, on the back of growing export demand and revived household consumption. Exports and private consumption plummeted by 15.5 and 7 per cent respectively in 2020, while investments in fixed assets declined by 2.1 per cent. On the production side, agriculture was the main contributor to the economic decline, contracting by 27.1 per cent. The current account deficit narrowed from 9.3 per cent of GDP in 2019 to 6.7 per cent at the end of 2020, mainly financed by debt instruments. As a result, international reserve assets remained high at US$ 3.8 billion in May 2021. Moldova has the fiscal space to continue a comprehensive support package focused on medium-term recovery. Short-term indicators suggest the economy is on a recovery path in 2021. Remittances have been exceptionally high in the first four months of 2021, increasing by 39.1 per cent year-on-year. Industrial production is up 17.1 per cent year-on-year in the first quarter of 2021, with exports of goods in March 2021 being 36.6 per cent higher than in 2020 and 5.6 per cent higher in the first quarter overall, largely due to a pick-up in exports to the EU market. Inflation reached 3.1 per cent year-on-year in May 2021, below the target of 5 per cent. On this basis, GDP growth is forecast at 4.5 per cent in 2021, followed by 4.0 per cent in 2022. Since Moldova is highly integrated in global supply chains, especially in the automotive industry, this pace of recovery is highly dependent on an overall global recovery.

Ukraine

The economy is returning to growth in 2021 but structural weaknesses continue to hold back a more rapid recovery. A combination of reduced foreign demand and the impact of repeated lockdowns on domestic demand caused GDP to decline by 4 per cent in 2020. Improved macro-financial management proved to be an asset in the crisis, helping the country to maintain macroeconomic stability. However, the declining public debt trend of recent years was reversed, as it increased from 50.2 per cent of GDP in 2019 to 60.8 per cent in 2020. A strong decline in the trade deficit and an increase in the primary income surplus helped turn the current account deficit into a large surplus of 4.0 per cent of GDP in 2020. While the economy declined by 2 per cent year-on-year in the first quarter of 2021 due to prolonged lockdown measures, there are indications it is gradually returning to growth in the second quarter, benefitting from higher commodity prices. Industrial production was up 1.5 per cent year-on-year and retail trade 14 per cent year-on-year in January-April, while exports and imports increased by 12 per cent and 11 per cent year-on-year respectively in the first quarter. Remittances have increased by 7 per cent year-on-year in the period January-April 2021. Inflation has been accelerating in 2021 on the back of rising global food prices, reaching 9.5 per cent year-on-year in May 2021 and causing the National Bank of Ukraine to raise its key policy rate twice, to 7.5 per cent in April 2021. GDP is expected to increase by 3.5 per cent in both 2021 and 2022. Major risks are associated with the slow progress of reforms and the relatively slow speed of vaccinations.

Russia

Despite the twin shocks of lower oil prices as well as the Covid-19 pandemic, the Russian economy weathered 2020 comparatively well, contracting by a relatively moderate 3 per cent. In part, this reflects structural factors including the large public sector and relatively small service sector, but it also reflects the strong macroeconomic position of the country at the start of the crisis, with extensive buffers built up in response to several years of sanctions.

Private consumption was behind the contraction of 2020, in the face of rising uncertainty and falling household income. This was partly offset by increased public consumption and rising net exports, notably non-oil exports in the context of a weak rouble, which compensated for the impact of oil production cuts. At the same time, the weaker outlook for the oil sector saw private investment fall, and public expenditure was diverted from investment in National Projects towards public consumption.

The economy grew by 1 per cent in the first quarter of 2021 compared with the fourth quarter of 2020, as previous containment measures helped avoid a third wave of the pandemic, enabling the authorities to lift some restrictions on activity, which in turn supported a recovery in domestic demand. Forward-looking indicators suggest that activity remained robust into the second quarter, and oil production should recover in response to the recent easing of output quotas.

However, the recovery in domestic demand has resulted in concerns of overheating, and policy rates are being increased in response to inflation, which is well in excess of the central bank's target. Furthermore, the desire to maintain buffers to guard against the threat of further geopolitical risks means the authorities are not likely to delay the withdrawal of fiscal stimuli. Nevertheless, some support should be received from recently-announced social transfers and cash handouts in advance of the parliamentary elections in September 2021.

GDP is expected to grow by 3.3 per cent in 2021 and 3 per cent in 2022, provided the country can avoid a third wave of the pandemic. This will in part depend on acceleration of the vaccination exercise, which has been rather slow. The forecast is subject to a number of risks, not least geopolitical tensions, notably the risk of further sanctions, and volatility in oil prices and demand.

South-eastern European Union

The three countries in this region were all badly affected by the Covid-19 crisis in 2020, with an average contraction of 5.2 per cent, the worst performance among all EBRD regions. The global collapse of tourism had a particularly damaging impact on Greece but also (to a lesser extent) on Bulgaria. Strong fiscal packages helped alleviate much of the worst effects of the crisis on *households and businesses, and the prospects of major EU recovery funding in the coming years is boosting confidence. A recovery is underway in all three countries, especially in Romania, and overall growth in 2021 is projected at 5.2 per cent, with further growth of 5 per cent in 2022. However, major uncertainties remain around the future path of the pandemic and vaccinations and their impact on vital sectors such as tourism.*

Bulgaria

The Bulgarian economy contracted by 4.2 per cent in 2020 due mainly to a weak performance of exports and investment, with falls of 11.3 per cent and 5.1 per cent, respectively. In contrast to regional peers, private consumption did not decline in 2020, largely because of relatively milder containment measures and robust wage growth throughout the year. Moreover, government spending notably increased in 2020 by 7.5 per cent, through increases in minimum and public wages and support measures worth about 3 per cent of GDP. As such, after several years of fiscal surpluses, the government balance was -3.4 per cent of GDP in 2020, with a similar deficit projected also in 2021. Goods exports have been slower to recover compared with regional peers, while exports of services (including tourism) were severely affected and declined by 28.6 per cent in 2020. Some recovery was evident in the first quarter of 2021 (2.5 per cent quarter-on-quarter) in spite of new containment measures imposed in March. However, investment recovered only partially, while net exports had a negative contribution to growth of 5.3 per cent as imports are growing rapidly. GDP is forecast to grow by 4.5 per cent in 2021 and 4 per cent in 2022. The main upside risks are a stronger rebound of consumption amid high wage growth and a swifter recovery in investments and goods exports. On the downside, the slow vaccination rollout could damage the tourism season this summer, and the current political difficulties could delay public investments and absorption of EU funds through the Recovery and Resilience Facility.

Greece

After nearly a decade of deep economic crisis, the Greek economy was on a steady upward trend for several years by early 2020, but the Covid-19 pandemic brought this recovery to a sharp halt. GDP fell by 8.2 per cent in 2020, due mainly to a collapse of the all-important tourism sector, contributing to a decline in the export of services of 44 per cent. Private consumption also fell by 4.7 per cent. A strong policy response in 2020, amounting to around 10 per cent of GDP, mitigated some of the worst effects of the crisis by focusing on income support for vulnerable individuals, liquidity support for businesses and budgetary support for the health sector. Signs of recovery are apparent in 2021, with GDP in the first quarter rising by 4.4 per cent on a quarter-on-quarter basis. Exports of goods continue to perform strongly and industrial production has been rising since late-2020. Covid-19-related fiscal measures in 2021 are projected at €15.4 billion (8.9 per cent of GDP), including suspension of the solidarity tax, concessional state loans, lower social-security contributions and subsidies for long-term unemployment. Substantial EU funds are also available to boost the recovery; Greece is expected to receive more than €70 billion in EU funding over the next seven years, with more than €30 billion of that coming from the EU's €750 billion Recovery Plan. Growth is expected to continue in the short term at 4 per cent in 2021, rising to 5.5 per cent in 2022 as the recovery accelerates and important infrastructure projects advance. However, significant downside risks remain, mostly associated with the future path of the pandemic and its impact on tourism and other services.

Romania

Romania weathered the Covid-19 crisis better than initially expected, as GDP fell by 3.9 per cent in 2020. Overall, private consumption had the steepest decline in 2020 of 4.9 per cent, while resilient investments and improved net exports had positive contributions to growth. In the last two quarters, the economy has expanded at a robust pace, as containment measures had a limited impact on economic activity. In the first quarter of 2021, GDP reached pre-pandemic levels in adjusted terms, signalling a strong momentum for short-term recovery driven by domestic demand. On the external front, goods exports already recovered by the end of 2020 but momentum weakened in the first quarter of 2021, most likely reflecting supply shortages in manufacturing, while service exports recovered to pre-pandemic levels in the first quarter. On the fiscal side, the high structural deficit and support measures of about 4.5 per cent of GDP led to a significant deterioration of the government balance to -9.2 per cent of GDP in 2020 and an increase in public debt to 47 per cent of GDP. Unemployment remains moderate at 5.7 per cent in April 2021, compared with 3.9 per cent at end-2019. Inflationary pressures increased at the start of 2021 due to the liberalisation of electricity market and recovering global energy prices, with inflation reaching 3.8 per cent in May 2021. Overall, the current momentum of the economy is expected to lead to 6 per cent GDP growth in 2021. In 2022, the Recovery and Resilience Facility should start boosting investments in particular, while private consumption and gradually improving net exports could translate into growth of up to 5 per cent. The key downside risks to the forecast are related to the evolution of the pandemic.

Southern and eastern Mediterranean

As the region continues to tackle the ramifications of the Covid-19 pandemic, variations in the uptake of vaccination programmes, virus containment measures and fiscal response to the crisis among economies in the southern and eastern Mediterranean are likely to be reflected in varying speeds of economic recovery. Meanwhile, the recovery across the region will likely be undermined by the slow resumption of tourism worldwide, the mounting fiscal pressures, and the limited fiscal space necessary to support recovery, while political uncertainty in some countries is delaying the reforms needed to boost growth and sustain recovery. The region is expected to grow by 3.5 per cent in 2021, after a contraction of 2.1 per cent in 2020. Stronger growth is expected in 2022 (at 4.6 per cent), supported by a recovery in global economic activity, reduced uncertainty, the implementation of business environment reforms, and healthier tourism, FDI and trade flows.

Egypt

Economic growth in the first three quarters of fiscal year 2020/21 (July 2020 – March 2021) in Egypt averaged 1.9 per cent year-on-year, following a slowdown in growth in fiscal year 2019/20 to 3.6 per cent. Growth was led by improvements in wholesale and retail trade, agriculture, telecommunications and construction, but the sluggish manufacturing activity, coupled with weak tourism, slowed down the recovery. The pace of recovery of GDP is expected to decelerate to 2.5 per cent growth in fiscal year 2020/21, before picking up to 4.5 per cent in fiscal year 2021/22. The boom in the telecommunications sector will continue to sustain growth, falling unemployment rates will support consumption, and private investment and FDI flows will pick up. However, risks include a slow uptake of vaccination, the weak outlook in the tourism sector in view of a probable global delay in tourism recovery, as well as the slowing momentum of major projects implemented in different parts of the country. On a calendar year basis, growth is forecast to rebound to 4.2 per cent in 2021 and 5.2 per cent in 2022, from 1.5 per cent in 2020, when Egypt was among the few countries worldwide to have positive growth.

Jordan

In 2020, the Jordanian economy contracted for the first time in 30 years due to the Covid-19 pandemic but the recession was modest when compared with regional counterparts. The authorities estimate that the economy shrank by 1.6 per cent, despite stricter lockdown enforcement than in comparable countries which suffered significantly stronger economic contractions. The sectors of finance (insurance, real estate and business services) and agriculture were the principal sources of growth, but tourism, which had been the main driver of growth in recent years, declined by 76 per cent in 2020. GDP growth is forecast to rebound to just 1.5 per cent in 2021, with the economy held back by the lingering effects of the Covid-19 pandemic, a sluggish recovery of tourism, and fiscal tightening to rein in the growing public debt. In 2022, growth is expected to pick up to 2.2 per cent, as Jordan advances reforms and global tourism resumes. The main risks to the outlook include the erosion of real competitiveness stemming from an overvalued exchange rate, regional instability, and slower-than-expected recovery in partner economies.

Lebanon

During 2020, Lebanon’s economy sank deeper into a fully-fledged stagflation as the political paralysis persisted in the absence of a new government. The country's economic woes were deepened by subsequent episodes of social unrest, the considerable damage caused by the explosion at the Port of Beirut in August 2020, and the spread of Covid-19. As a result of falling tourism, dwindling capital inflows, lower demand for exports and the derailed implementation of structural reforms, the contraction of the economy in 2020 is estimated at 25 per cent. The upward spiral of inflation continued unabated, averaging 85 per cent in 2020 and 140 per cent year-on-year in the first four months of 2021, in view of the depreciation of the Lebanese pound (by over 85 per cent) and Lebanon's high import dependence. Coupled with worsening health conditions, the dire economic situation led to steady jumps in unemployment and poverty. The political stalemate is adding to the uncertainty of the outlook. A further contraction of 5 per cent is expected in 2021 as a result of the ongoing economic crises, the government's inability to borrow on international markets, delays in implementing critical reforms and the drying-up of financial resources. The economy is expected to record positive growth in 2022 (5 per cent), conditional on the successful implementation of an IMF-supported programme by a reform-minded government, which would allow for the resumption of negotiations with international partners.

Morocco

The economy in Morocco contracted by 6.3 per cent 2020, in light of the Covid-19 crisis and related containment measures. The drought-burdened agricultural sector declined by 8.6 per cent, while non-agricultural activities, mainly tourism, transport, retail and manufacturing, dropped by 5.8 per cent. A solid recovery is expected in 2021 (at 4.5 per cent GDP growth) as Morocco benefits from the relative success in its vaccination campaign (20.1 per cent of the total population are fully vaccinated as of mid-June) and therefore a relatively faster increase in tourist arrivals, despite a cautious resumption of tourism globally. The economy will also benefit from a good rain season, and the expected recovery in Europe, Morocco's main trading partner, as well as the strengthening in exports from the phosphate and automotive sectors. In 2022, a slower expansion is projected (at 3.5 per cent), as base effects subside and the pace of growth returns to pre-pandemic levels.

Tunisia

The Covid-19 crisis and related containment measures resulted in an 8.8 per cent contraction in Tunisia's economy in 2020. Significant reductions were observed in the tourism, transport, manufacturing, construction, trade and textiles sectors. Meanwhile, the agriculture and the food processing sectors posted strong growth, thanks to a record-breaking olive oil harvest in 2019-20. The economic downturn continued in the first quarter of 2021 as GDP contracted by 3 per cent year-on-year. However, some recovery is expected in the rest of the year, and GDP is projected to grow by 2.7 per cent in 2021 and 2.9 per cent in 2022, supported by the impact of improved weather conditions on agriculture, notably olive oil production. Meanwhile, the recovery will depend on the pace of vaccination allowing the reopening of the economy, including for the tourism sector. However, the reforms needed for a strong and sustainable recovery are being held back by the lack of political consensus and limited ambition in overhauling public administration and state-owned enterprises. IMF-supported structural reforms may be delayed further, and the economic impact is likely to be slow as fiscal tightening is expected to hold back a stronger recovery. Other downside risks include lingering effects of the pandemic and the slow recovery in tourism worldwide.

Turkey

Like most countries worldwide, the Turkish authorities implemented significant policy loosening in response to Covid-19. But in line with their response to previous crises, the authorities leaned particularly heavily on monetary loosening and credit expansion. In one sense this was a successful approach, with Turkey achieving GDP growth of 1.8 per cent in 2020, making it the only G20 country other than China to record positive growth in 2020.

However, this growth came at a cost in terms of macroeconomic and financial stability, most notably a significant depletion of reserves in a failed attempt to support the lira. The country's gross reserves currently stand at US$ 88 billion, while net reserves excluding swaps are estimated to be negative US$ 45 billion. These figures need to be considered in the context of external liabilities due within the next 12 months of around US$ 220 billion, including a current account deficit which currently stands at US$ 36 billion. Inflation remains stubbornly high, almost 17 per cent in May 2021, partly due to the pass through of the depreciation of the lira in 2020.

The recognition of these macroeconomic fragilities was behind the change in the economic team in November 2020, including a new central bank governor. This saw the introduction of a more orthodox monetary policy including the provision of liquidity at a more transparent single policy rate, improved communication and forward guidance, and a total of 875 basis points hikes in policy rates. This resulted in a significantly reduced risk premium, the stabilisation of the lira and a return of portfolio flows. However, the positive sentiment associated with the shift to orthodoxy was reversed when the central bank governor was replaced in March 2021. So far, investors' fears of a return to unorthodox policies have not yet been realised. Policy rates have been unchanged, and the Governor has pledged that the central bank will maintain tight policy until inflation returns to the 5 per cent target, currently forecast for 2023. But with four changes in governor in the past two years, central bank policy credibility is low, making Turkey vulnerable to changes in global investor sentiment.

In terms of activity, the strong momentum in the second half of 2020 carried over into the first quarter of 2021, with year-on-year growth of 7.0 per cent being recorded. But high frequency indicators suggest that the recovery started to lose pace in the second quarter. GDP is expected to grow by 5.5 per cent in 2021, moderating to around 4 per cent in 2022. Growth will be driven by exports, with domestic demand being constrained by the weaker financial situation of households and the impact of ongoing containment measures. There are a number of risks to the forecast, including a slower than expected return of tourism and interruptions to vaccination programmes in Turkey, possibly requiring further containment of activities. Other potential headwinds include further tightening of domestic financial conditions, the return of inflation in advanced economies, and adverse geopolitical developments.

Western Balkans

The Western Balkans region as a whole has withstood the impact of the pandemic relatively well, with GDP contracting by just 3.2 per cent in 2020. However, the extent of the impact differed among the economies. In Montenegro, where the tourism sector normally accounts for around one-fifth of the economy, GDP fell sharply by 15.2 per cent, while the GDP contraction in Serbia—a country with a more diversified economic structure—was more moderate, at just 1 per cent. All economies have adopted expansionary fiscal policies with various support packages aimed at mitigating the impact of the pandemic. Additionally, in the banking sector, loan repayment moratoria were allowed as well as loan restructuring. As a result, fiscal deficits increased sharply across the region, with concomitant increases in public debt. Accommodating fiscal policy has continued throughout the region in 2021 and this should further aid the recovery. GDP growth in the region is expected to be 5.1 per cent in 2021, moderating to 3.8 per cent in 2022. Downside risks mainly relate to the pace of recovery of the tourism sector from the pandemic where travel restrictions still remain in source countries. Another risk is the extent of economic rebound in the EU, the main export destination for the region. While debt sustainability is not an immediate concern, some economies will have less fiscal space to manoeuvre in the future without fiscal consolidation.

Albania

GDP contracted by 3.3 per cent in 2020 due to the Covid-19 outbreak, mostly on the back of lower exports (down by 26 per cent), especially that of services (mainly consisting of tourism), as well as a household consumption contraction (by 2.3 per cent). The smaller than expected GDP contraction was mainly due to accommodative fiscal policies and an expansion of construction (by 1.6 per cent) and real estate sector activities (up 6.7 per cent) due to reconstruction activities from the November 2019 earthquake, especially in the second half of 2020. The government adopted two economic support packages in 2020, worth 2.8 per cent of GDP. The packages focused on businesses and employees affected by the pandemic as well as the health sector, and consisted mainly of increased government expenditures, sovereign guarantees and deferred tax payments. The total budget for Covid-19-related expenditures in 2021 is 1 per cent of GDP and targets increased spending on healthcare, higher wages for healthcare workers, and increased social assistance and unemployment benefits. Regulatory flexibility measures for the financial sector such as deferred payments and loan restructuring were adopted in 2020, alongside suspension of dividend payments by banks. A rebound is forecast in 2021 with GDP expected to grow by 4.5 per cent, as household consumption demand and the tourism sector recover. The planned large public investment programme, including continued reconstruction activities from the earthquake, should also boost domestic demand, and goods exports are picking up strongly. The economy is expected to grow further at 4 per cent in 2022. These forecasts assume that there will be no resurgence of the pandemic; downside risks include the extent of recovery of tourism during the post-pandemic phase.

Bosnia and Herzegovina

Economic activity contracted by 4.3 per cent in 2020 due mainly to the pandemic, though economic growth had already been decelerating before the outbreak of Covid-19. Once the pandemic took hold, growth turned negative on the back of falling exports, consumption and investment. The tourism sector was severely affected; foreign tourists arrivals decreased by 70 per cent in 2020. Trade, transport, and accommodation and food services recorded a combined decline of 15 per cent. The crisis also hit the manufacturing sector, with output falling by 7.6 per cent. Certain manufacturing industries decreased their output significantly (e.g., production of base metals, motor vehicles and other transport equipment by around 25 per cent, and production of furniture, clothes and beverages by around 15 per cent). Because of the pandemic, remittances from the country's large diaspora also shrank by 15 per cent, negatively affecting consumption. Fiscal measures related to the Covid-19 response in 2020 were around 2.5 per cent of GDP, targeting increased spending on the healthcare sector, subsidising social security contributions by firms and paying minimum wages to workers in the affected sectors. In addition, both the FBiH and RS governments established guarantee funds to support on-lending activities by commercial banks. The accommodating fiscal policy is continuing in 2021, targeting support to firms but also to households and the health sector. A partial recovery is expected in 2021, with GDP forecast to grow by 3.5 per cent on the back of recovery in exports and resumption of consumption. In the first four months of 2021, industrial turnover and goods exports have increased strongly (by 12 and 26 per cent year-on-year, respectively). GDP is expected to grow by 3 per cent in 2022. Downside risks are slower recovery in the main Eurozone export markets and a possible prolonged impact of the pandemic on tourism as well as lack of impetus to undertake structural reforms and increase investor confidence.

Kosovo

The economy experienced a recession of 4.1 per cent in 2020. While investment and exports of services fell strongly (by around 20 and 40 per cent, respectively), household consumption recorded a significant (and surprising) growth of 7 per cent, supported by strong remittances inflows. On the production side, manufacturing recorded a strong growth of around 12 per cent, reflected also in a double-digit growth in exports of goods (primarily base metals and chemicals), but the trade, transport and construction sectors decreased their outputs between 20 and 25 per cent. To ease the crisis, the government adopted first an emergency package, followed by a recovery package of around 4.3 per cent of GDP in 2020. These packages focused on income support for vulnerable individuals, budgetary support to the healthcare sector, and support to firms through wage subsidies and easier access to borrowing. The support package was complemented by loan repayment moratoria and restructuring. The expansionary fiscal policy is continuing in 2021 with pandemic-related support packages of 3.1 per cent of GDP, envisaging additional spending in healthcare sector, transfers to households and firms and increased capital expenditures in healthcare and education. GDP is forecast to grow by 4 per cent in 2021, mainly driven by the recovery in investment and in travel and tourism activities related to the country's large diaspora (assuming an easing of travel restrictions during the second half of the year). In the first four months of 2021 goods exports continued to rise, recording a strong 65 per cent year-on-year growth. In 2022, GDP growth is expected to pick-up further, to 5 per cent. Risks to the projections relate to the pace of recovery of diaspora visits and a weak public investment management. Regarding the latter, a swifter economic recovery would be helped by the acceleration of the hitherto slow implementation of key infrastructure projects.

Montenegro

The economy experienced a major recession in 2020. GDP growth had already slowed in 2019 (to 4.1 per cent), as large investment projects neared (the Bar-Boljare highway) or achieved (power link to Italy) completion, although the tourist season was the strongest on record. In Montenegro, around one-fifth of GDP normally comes from tourism. Due to the Covid-19 pandemic and strict border policies, foreign tourist arrivals declined by 85 per cent in 2020. Consequently, GDP contracted sharply by 15.2 per cent, primarily on the back of falling services exports (tourism). Investment and consumption also declined strongly, and the economy entered deflation in the second quarter of 2020, with year-on-year inflation averaging -0.2 per cent for the year as a whole. In response to the pandemic, a fiscal package of around 7 per cent of GDP was adopted, targeting the most affected businesses (such as those in tourism and agriculture) and their employees as well as vulnerable households, along with wage and electricity subsidies, increased social spending and provision of liquidity through the Investment Development Fund. The expansionary fiscal stance is continuing in 2021, targeting vulnerable population groups and businesses affected by the pandemic. The economy is expected to partially rebound in 2021, with GDP growth of 8.5 per cent, helped by the strong contraction last year and the consequent positive base effect. Changes to the border policy this year should also support a partial recovery in the tourism sector. In the first quarter of 2021, retail sales were 7 per cent lower than in the same period last year, but industrial output picked up, increasing by 12 per cent year-on-year. In 2022 further recovery is expected, with GDP growth of 6 per cent. Downside risks are a possible weaker than expected recovery in tourism due to a prolonged impact of the pandemic as well as limited fiscal space (gross public debt exceeds 100 per cent of GDP) to accommodate further spending should such needs arise.

North Macedonia

In 2020, GDP declined by 4.5 per cent year-on-year, on the back of a double-digit fall in investments and exports and a 6 per cent decline in private consumption. These falls were somewhat counter-balanced by an increase in government consumption (10 per cent rise). Industrial output contracted by 10 per cent, and the trade, transport and accommodation sector only slightly less (8 per cent). A series of aid packages was implemented, focusing on liquidity support to affected businesses, protecting jobs and supporting the most vulnerable population groups through subsidies, income tax deferrals, provision of loans at favourable terms and guarantees, and sector-specific support. The general government deficit jumped from 2 per cent of GDP in 2019 to 8.1 per cent in 2020. As a consequence, general government and government-guaranteed debt rose to over 60 per cent of GDP at end-2020, more than 10 percentage points higher than at the end of 2019. The expansionary fiscal stance is continuing in 2021, involving further support measures such as wage subsidies, investment incentives and liquidity support to firms. A partial recovery is expected in 2021, with real GDP growth of 4 per cent on the back of recovery of exports and private consumption as well as sustained government consumption. In the first four months of 2021, industry grew modestly (below 4 per cent year-on-year), but retail sales and exports picked up strongly (by over 20 and 40 per cent year-on-year, respectively). Growth momentum is expected to continue in 2022 at 4 per cent on the back of the resumption of private investments. However, forecasts are subject to significant uncertainty. Both upside and downside risks are present and primarily relate to the speed of recovery of external demand and the government’s ability to realise its ambitious infrastructure agenda given the narrowed fiscal space.

Serbia

The effects of the Covid-19 pandemic on the economy were moderate in 2020. The structure of the economy—limited reliance on tourism and a relatively high share of basic goods such as food and some chemicals in manufacturing—combined with large government aid packages and less restrictive lockdown measures for most of the year, contributed to a GDP contraction of only 1 per cent. The government's Covid-19 response package of around 13 per cent of GDP (€5.8 billion) in 2020 consisted of support to the healthcare sector, wage subsidies, financial support to citizens, tax deferrals and liquidity support to small and medium sized enterprises through credit guarantee schemes. Public debt increased by around 5 percentage points in 2020, reaching 58 per cent of GDP at year-end. In the first quarter of 2021 GDP grew by 1.7 per cent year-on-year, underpinned by a strong recovery in the construction sector, but also by growth of industrial output and an increase in trade, transport and tourism activities. Expansionary fiscal policy is continuing as the government has adopted additional fiscal stimulus measures to the tune of 4.5 per cent of GDP (€2.0 billion) for 2021, consisting of increased expenditures in healthcare, wage subsidies and one-off payments to pensioners and some adults. The budget for 2021 also includes a significant increase in public investment. Consequently, GDP growth of 6 per cent is forecast for 2021, mainly on the back of recovery of consumption and increase in public investments. In 2022, a growth rate of 3.5 per cent is forecast, as the economy is expected to return to the pre-pandemic speed of expansion and fiscal consolidation might commence. Risks to the forecast are balanced. They relate primarily to the pace of recovery of external demand and speed of implementation of public infrastructure projects and structural reforms.

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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 of Economics, Policy and Governance 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 2020-21, which are all available on the Bank's website at www.ebrd.com.

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