Social Protection for Recovery

Europe and Central Asia Economic Update
Office of the Chief Economist
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Social Protection for Recovery

Office of the Chief Economist

WORLD BANK GROUP

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Abbreviations

bbl	barrel
BGN	Bulgarian lev
BHAS	Bosnia and Herzegovina Agency for Statistics
BiH	Bosnia and Herzegovina
bn	billion
BYN	Belarusian ruble
CAD	current account deficit
CAIT	Climate Watch - country greenhouse gas emissions dataset
CAR	capital adequacy ratio
CBA	Central Bank of Armenia
CBA	Central Bank of Azerbaijan
CBU	Central Bank of Uzbekistan
CDS	credit default swap
CIT	corporate income tax
aCPC	Caspian Pipeline Consortium
CPI	Consumer Price Index
ECA	Europe and Central Asia
ECAPOV	ECAPOV (ECA Poverty) database of standardized household surveys
ECB	European Central Bank
EMDEs	emerging market and developing economies
ENTSOG	European Network of Transmission System Operators for Gas
EPS	Elektroprivreda Srbije (state-controlled power utility in Serbia)
EU	European Union
FDI	foreign direct investment
FX	foreign exchange
G7	Group of Seven
GDP	gross domestic product
GEM	Oxford Economics Global Economic Model
GFCF	gross fixed capital formation
GFS	Government Finance Statistics
GHG	greenhouse gas
GNI	gross national income
GUS	Central Statistical Office of Poland
H1, H2	first and second halves of the year
HBS	household budget surveys
HHS	household surveys
HICES	Household Income and Consumption Expenditures Survey
HICP	Harmonized Index of Consumer Prices
HLCS	Household Living Conditions Survey
ICT	information and communications technology
IDP	internally displaced person
IEA	International Energy Agency

IFPRI	International Food Policy Research Institute
ILCS	Integrated Living Conditions Survey
ILO	International Labour Organization
IMF	International Monetary Fund
INSTAT	Institute of Statistics (Albania)
IT	information technology
KIHS	Kyrgyz Integrated Household Survey
L2T	Listening-to-Tajikistan
LCU	local currency unit
LFS	Labor Force Survey
LMIC	lower-middle-income country
LNG	liquefied natural gas
mn	million
MoF	Ministry of Finance
MoU	memorandum of understanding
MPO	Macro Poverty Outlook (World Bank)
mtCO2e	metric tons of carbon dioxide equivalent
NBG	National Bank of Georgia
NBM	National Bank of Moldova
NBRB	National Bank of the Republic of Belarus
NBU	Regional Bank of Ukraine
NPL	non-performing loan
OECD	Organisation for Economic Co-operation and Development
OPEC+	Organization of the Petroleum Exporting Countries Plus
pc	per capita
PMI	Purchasing Managers' Index
PPP	purchasing power parity
Q	quarter
R&D	research and development
ROA	return on assets
ROE	return on equity
RVC	regional value chain
sa	seasonally adjusted
SDR	special drawing rights
SILC	Statistics of Income and Living Conditions
SMEs	small and medium-sized enterprises
SOE	state-owned enterprise
SOFAZ	State Oil Fund of the Republic of Azerbaijan
SPEC	social protection Engel curve
SPEED	Social Protection Expenditure and Evaluation Database
TSA	Targeted Social Assistance
UMIC	upper-middle-income country
UNHCR	United Nations High Commissioner for Refugees
VAT	value-added tax
WB	World Bank
WDI	World Development Indicators
yoy	year-over-year

Country Codes

Albania	ALB	Latvia	LVA
Armenia	ARM	Lithuania	LTU
Austria	AUT	Luxembourg	LUX
Azerbaijan	AZE	Malta	MLT
Belarus	BLR	Moldova	MDA
Belgium	BEL	Montenegro	MNE
Bosnia and Herzegovina	BIH	Netherlands	NLD
Bulgaria	BGR	Norway	NOR
Croatia	HRV	Poland	POL
Cyprus	CYP	Portugal	PRT
Czechia	CZE	Republic of North Macedonia	MKD
Denmark	DNK	Romania	ROU
Estonia	EST	Russian Federation	RUS
Finland	FIN	Serbia	SRB
France	FRA	Slovak Republic	SVK
Georgia	GEO	Slovenia	SVN
Germany	DEU	Spain	ESP
Greece	GRC	Sweden	SWE
Hungary	HUN	Switzerland	CHE
Iceland	ISL	Tajikistan	TJK
Ireland	IRL	Türkiye	TUR
Italy	ITA	Turkmenistan	TKM
Kazakhstan	KAZ	Ukraine	UKR
Kosovo	XKX	United Kingdom	GBR
Kyrgyz Republic	KGZ	Uzbekistan	UZB

Regional Classification Used in this Report

This report covers 50 countries referred to as Europe and Central Asia (ECA) countries. These are divided into 10 groups: Central Asia, Central Europe and the Baltic Countries, Eastern Europe, Northern Europe, South Caucasus, Southern Europe, Western Balkans, Western Europe, Russia, and Türkiye.

TABLE E.1 Regional classification used in this report

Central Asia	Central Europe and Baltic Countries	Eastern Europe	Northern Europe
Kazakhstan	Bulgaria	Belarus	Denmark
Kyrgyz Republic	Croatia	Moldova	Finland
Tajikistan	Czechia	Ukraine	Iceland
Turkmenistan	Estonia		Norway
Uzbekistan	Hungary		Sweden
	Latvia		
	Lithuania		
	Poland		
	Romania		
	Slovak Republic		
	Slovenia		

South Caucasus	Southern Europe	Western Balkans	Western Europe
Armenia	Cyprus	Albania	Austria
Azerbaijan	Greece	Bosnia and Herzegovina	Belgium
Georgia	Italy	Kosovo	France
	Malta	Republic of North Macedonia	Germany
	Portugal	Montenegro	Ireland
	Spain	Serbia	Luxembourg
			Netherlands
			Switzerland
			United Kingdom

	Russian Federation	Türkiye	

Executive Summary

The Russian Federation's invasion of Ukraine has triggered a massive human displacement crisis, adding to already historically high global refugee levels. Output in Europe and Central Asia (ECA) is forecast to contract by 0.2 percent in 2022, reflecting negative spillovers from the invasion. Escalating geopolitical tensions have triggered a possible energy crunch in Europe. If the war escalates, regional output could decline even further. This update summarizes recent developments and presents the economic outlook for the ECA region. It also focuses on social protection, which is a key policy instrument for protecting workers and households from adverse shocks faced by the region, and on the policy options that countries have to address the energy crisis.

It is projected that ECA's output will barely return to growth in 2023, with gross domestic product (GDP) set to expand 0.3 percent. This outlook is predicated on slowing inflation, tightening global financing conditions, softening external demand, and easing supply chain bottlenecks. A protracted war would likely heighten policy uncertainty and fragment regional trade and investment integration.

This ECA Economic Update focuses on social protection—critical government services in this context of repeated shocks and uncertainty. Globalization, demographic trends, and technological innovations are transforming European labor markets, altering their institutional and contractual arrangements, and creating disparities and vulnerabilities in various segments of the labor force. The green transition will entail a reorientation of economies to sustainable methods of production and consumption, which will adversely affect the well-being of workers employed in "brown" industries. There is also an acknowledgment of the increasingly large role that systemic risks—economic, health, or climate-related—play in driving poverty and vulnerability. Social protection systems in ECA will need to be reformed to address these challenges and provide adequate protection to workers and families. Key policy questions in this context are whether countries should protect jobs or the incomes of workers, and whether social insurance schemes should be contributory and tied to workers' specific employment relationships or noncontributory and unrelated to workers' job characteristics.

Looking back at ECA countries' social protection response to the COVID-19 pandemic, the average country in the emerging and developing part of the region spent about 2.3 percent of GDP on social protection measures, compared to the

average of 1.4 percent of GDP for the rest of the world. ECA countries spent, on average, 1.0 percent of GDP on job protection policies, while the average spending in other regions of the world was only 0.4 percent of GDP.

Cross-country analysis demonstrates that from the beginning of the pandemic until the end of 2021, job protection policies appeared to have contained the decrease in employment, increase in inactivity, and poverty headcount rates, but they had no clear effect on GDP recovery. These effects were significant only in countries with weaker pre-pandemic social insurance systems. In countries with broader coverage of the social insurance system, the income and job protection programs appear to have had limited impacts on employment and poverty. Moreover, firm-level analysis shows that job protection policies—and wage subsidies in particular—interrupted employment reallocation: there was relatively lower labor movement from less to more productive firms in countries with higher job protection expenditures during the pandemic.

The region's social protection systems also must grapple with shocks triggered by the war in Ukraine. Millions of Ukrainian refugees have sought protection in Europe. So far, the ECA region has been successful in providing refugees immediate food and shelter, but over the medium and long term, countries will need to accommodate them in ways that ensure the well-being of the refugees and the host communities. Migrants from Central Asia in the Russian Federation and their families back home may be affected by the economic effects of sanctions. Increases in energy and food prices are already affecting vulnerable groups throughout ECA, and social protection systems in the region have quickly begun to address these challenges by extending utility subsidy schemes in ways that can be inefficient, insufficient, and fiscally unsustainable. A more targeted approach is needed.

Beyond the shocks of the pandemic and the war in Ukraine, labor markets in the region have been undergoing changes for which employment-based social insurance schemes may not be prepared. In emerging market and developing economies in ECA, around 17 percent of the workforce is in nonpermanent and/or part-time employment, and this share exceeds 30 percent for young workers and has increased over the past two decades. As temporary and part-time employment expands, job tenure decreases. The average job tenure is declining for younger cohorts throughout the region. For example, a worker born in the 1980s in the European Union has, on average, 3.3 years shorter tenure than a worker born in the 1950s. This difference was 4.7 years in the Western Balkans and 7.7 years in Türkiye. Tenure is declining faster for women, the less educated, and the young. These transformations in the labor market risk leaving vulnerable groups unprotected. Upon job loss, individuals who were previously in nonstandard employment are less likely to receive benefits than those who were in standard employment. Similarly, employees who have repeatedly changed jobs and gone through unemployment spells can expect to have significantly lower pensions than those who have remained in full-time, permanent employment.

ECA countries will need to reform their social protection systems to address the challenges brought by the pandemic, the war, and the long-term transformations of the labor market. Combining generous income protection measures with specific job protection policies might be optimal to shield the vulnerable groups

of the population from adverse shocks, promoting long-term economic recovery and sustainable growth. This blended approach could be based on publicly financed policies like a guaranteed minimum income, a negative income tax scheme, or a universal basic income—programs designed to protect people from catastrophic losses regardless of their employment status or type of job contract. At the minimum, programs should be means-tested to ensure that they reach the poorest and those who face the most significant shocks. Job losses and transitional unemployment should be insured by national programs supporting unemployment income instead of employer-provided arrangements like severance pay.

When such measures are in place, governments can adapt their social protection policies to rapidly changing labor market conditions by implementing regulatory reforms that gradually remove restrictions on firms' hiring and dismissal practices. This is especially important as countries carry out the green transition, where entire sectors or types of jobs may disappear so that employment-based schemes will not be able to protect the affected groups of the population. Employment assistance programs and other active labor market policies, such as skills training, entrepreneurial support, and intermediation, can be helpful to this end when well-designed.

The social protection systems of ECA countries are heterogeneous in their distance to this optimal design. In many countries, categorical, nontargeted social assistance benefits and contributory insurance schemes are the norm. In others, the transition to means-tested and more effective schemes is already in process. There are clear opportunities for reforms of social protection systems in ECA that will allow countries to better protect their citizens from short-term shocks and longer-term structural changes.

Reforming social protection systems may imply substantial costs. The lasting impacts of the pandemic and the economic shock of war in the region have strained countries' fiscal systems and put many countries in Europe in fiscal distress. The low tax base and high degree of informality create major challenges to raising revenues in a fiscally sustainable way for the lower-middle-income countries in ECA. In this environment, the blended approach of noncontributory (financed by the government) and contributory financing schemes could represent the most cost-effective mechanism to protect vulnerable populations and promote economic recovery. Key to the successful implementation of such systems is also the broader use of digital tools to manage the massive amounts of administrative data needed to monitor the welfare of households and individuals and to design better targeted programs.

The Economic Outlook and Long-term Challenges

Economic Outlook

Global Context

The Russian Federation's invasion of Ukraine has triggered the largest human displacement crisis in the world since World War II—adding to already historically high global refugee levels. Output in Europe and Central Asia (ECA) is forecast to contract 0.2 percent in 2022, reflecting negative spillovers caused by the war. It is projected that the region's output will barely return to growth in 2023, with gross domestic product (GDP) set to expand 0.3 percent. The invasion has also sharply accelerated the deceleration in global economic activity, with the global economy at risk of slipping into a recession in 2023 as major economies continue to slow sharply. Inflation has soared globally on the back of surging commodity prices and supply disruptions, exacerbating the exceedingly difficult trade-offs policy makers face between supporting growth and controlling price pressures. Global financial conditions have tightened and borrowing costs have increased, particularly in emerging market and developing economies (EMDEs), reflecting policy rate hikes in response to inflationary pressures, elevated uncertainty, and heightened geopolitical risks. Commodity markets continue to be volatile, with softening global demand only partly countering supply shortfalls. Escalating geopolitical tensions have triggered a possible energy crunch in Europe. Soaring food and energy prices put millions at risk of food insecurity and poverty. A protracted conflict is likely to heighten policy uncertainty further, magnify existing strains on global supply chains, and fragment global trade and investment networks. Policy makers should keep their focus on promoting an inclusive and more equal recovery by strengthening their social protection systems to protect the most vulnerable, including refugees; improving energy efficiency and the green transition to secure a sustainable future; and address long-standing structural bottlenecks to growth, including by fortifying institutional quality to strengthen stability and foster a favorable business climate.

Global Economic Trends

The global economy continues to weaken as Russia's invasion of Ukraine significantly disrupts activity and trade, an energy crunch looms for Europe, pent-up demand from the pandemic fades, and global financing conditions tighten as policy support is withdrawn and shifts toward a restrictive stance to tame high inflation. Headwinds from the war are adding to large cumulative losses in output since the onset of the pandemic, particularly for economies in ECA. Surging commodity prices have contributed to broadening price pressures globally, pushing inflation above central bank targets in the vast majority of inflation-targeting countries. Against the backdrop of this significantly challenging context, global growth was projected to slow from 5.7 percent in 2021 to 2.9 percent in 2022 and average 3 percent in 2023–24, as reported in the June 2022 edition of *Global Economic Prospects* (figure 1.1, panel a) (World Bank 2022a).

Despite an already subdued global outlook, prospects have further deteriorated since June 2022, with private sector forecasts of global growth in 2022 and 2023 falling 0.1 and 1 percentage points, respectively.[1] World Bank model-based estimates released in September 2022 suggest that baseline global growth could fall to 2.4 percent in 2023 versus the June 2022 projection of 3 percent (Guénette, Kose, and Sugawara 2022).[2] The worsening global outlook reflects the materialization of several key downside risks, including faster tightening of monetary policy in major advanced economies, recurring pandemic-related lockdowns, and difficulties in the real estate sector in China, and the sudden ban of Russian energy exports to European Union (EU) member states.

If these adverse global developments were to be coupled with an upward shift in inflation expectations and, in turn, additional synchronous monetary policy tightening by major central banks, World Bank model-based estimates suggest that global growth could fall further in 2023, from 2.4 percent in the baseline to 1.7 percent (figure 1.1, panel b) (Guénette, Kose, and Sugawara 2022). In this scenario, the global economy would still escape a recession in 2023 but would experience a sharp downturn without restoring low inflation by the end of the forecast horizon. As central banks across the world simultaneously hike interest rates in response to inflation, risks related to a sharp re-pricing of risk in global financial markets could materialize and result in a global recession in 2023 (in output per capita terms) (Guénette, Kose, and Sugawara 2022). The string of financial crises in EMDEs that would follow in this scenario would cause lasting harm in these economies, which were already hard hit by the pandemic-induced recession of 2020.

Global trade growth has weakened alongside falling global demand and earlier trade disruptions associated with the war in Ukraine. Global goods trade growth has decelerated in tandem with softening industrial production growth

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1. Estimates are calculated using the mean forecasted GDP from the June 2022 and September 2022 Consensus Forecasts surveys. Consensus Forecasts surveys are compiled by Consensus Economics from leading financial institutions and investment banks and include country level forecasts for several economic indicators. Sample includes 33 advanced economies and 53 EMDEs, representing 96 percent of the global GDP aggregate used by the World Bank.
2. These scenarios are produced using the Oxford Economics Global Economic Model. Refer to Guénette, Kose, and Sugawara (2022) for further detail.

FIGURE 1.1 Global economic activity
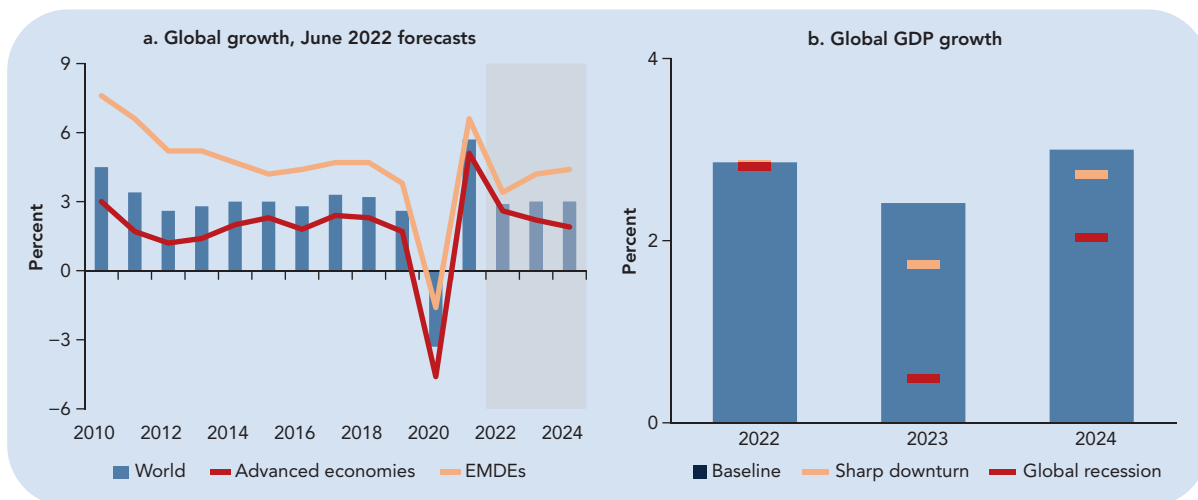
Sources: Guénette, Kose, and Sugawara (2022); Oxford Economics; World Bank.
Note: Unless otherwise indicated, aggregate growth rates are calculated using real U.S. dollar gross domestic product weights in average 2010–19 prices and market exchange rates. EMDEs = emerging market and developing economies.
a. The shaded area indicates forecasts. Data for 2022 are estimates.
b. These scenarios are produced using the Oxford Economics Global Economic Model. In the baseline scenario, it is assumed that headwinds from commodity markets and supply-chain disruptions subside. With respect to monetary policy, global short-term interest rates, measured as GDP-weighted averages of national rates, are assumed to rise from 1.6 percent in 2021 to a peak of 3.8 percent in 2023. Benchmark policy rates are set to rise to 3.7 percent in the United States by the first quarter of 2023. In the sharp downturn scenario, major central banks in advanced economies and EMDEs are assumed to raise their benchmark policy rates by a cumulative 100 basis points above baseline assumptions over 2022Q4–2023Q1 and opt to sustain this differential through 2024. These additional rate hikes would cause the global real short-term interest rate to rise from -4.7 percent in 2022 to an average of 0.6 percent over 2023–24, implying a modest tightening of global financial conditions relative to the baseline scenario. The global recession scenario assumes that policymakers in major economies observe an even larger increase in inflation expectations than assumed in the sharp downturn scenario. They respond by implementing a larger-than-expected, synchronous, policy tightening around the turn of the year, raising policy rates by 200 basis points above the baseline over 2023Q1–2024Q4. Global real short-term rates would surge as a result, rising 560 basis points from 2021 to 2023—an increase roughly comparable to the 440-basispoint rise that took place between 1980 and 1982 (Guénette, Kose, and Sugawara 2022).

and demand for manufactured goods. However, some pandemic-related supply chain bottlenecks appear to be abating (figure 1.2, panel a). Input costs have also eased, partly owing to feeble global demand and earlier relaxation of some pandemic restrictions in China. Services trade has regained its pre-pandemic level, driven by a rebound in non-tourism services. Although the recovery in tourism remains incomplete—with international tourist arrivals about 30 percent below their 2019 levels at the start of the third quarter of 2022—the rebound in 2022 has been robust in some economies, including those in ECA, as pandemic concerns wane and restrictions are lifted (UNWTO (database); World Travel and Tourism Council 2022).

Global financial conditions have continued to deteriorate, reflecting tightening monetary policies across the world, concerns about weakening global activity, and rising risk aversion. Market expectations for advanced-economy monetary policy tightened sharply in the third quarter of 2022, reflecting continued inflation, more hawkish statements by policymakers and energy price-related risks in Europe. Policy rates in the United States and euro area are expected to reach 4.6 percent and 2.7 percent in March 2023, up by around 100 and 160 basis points since mid-August, respectively. Government bonds sold off, with U.S. and German 10-year yields climbing more than 200 basis points above levels a year earlier—the fastest increase in nearly three decades. With global growth concerns

FIGURE 1.2 Recent global economic trends

a. Global shipping times and costs

b. Global headline and core inflation

c. Energy prices

d. Natural gas exports
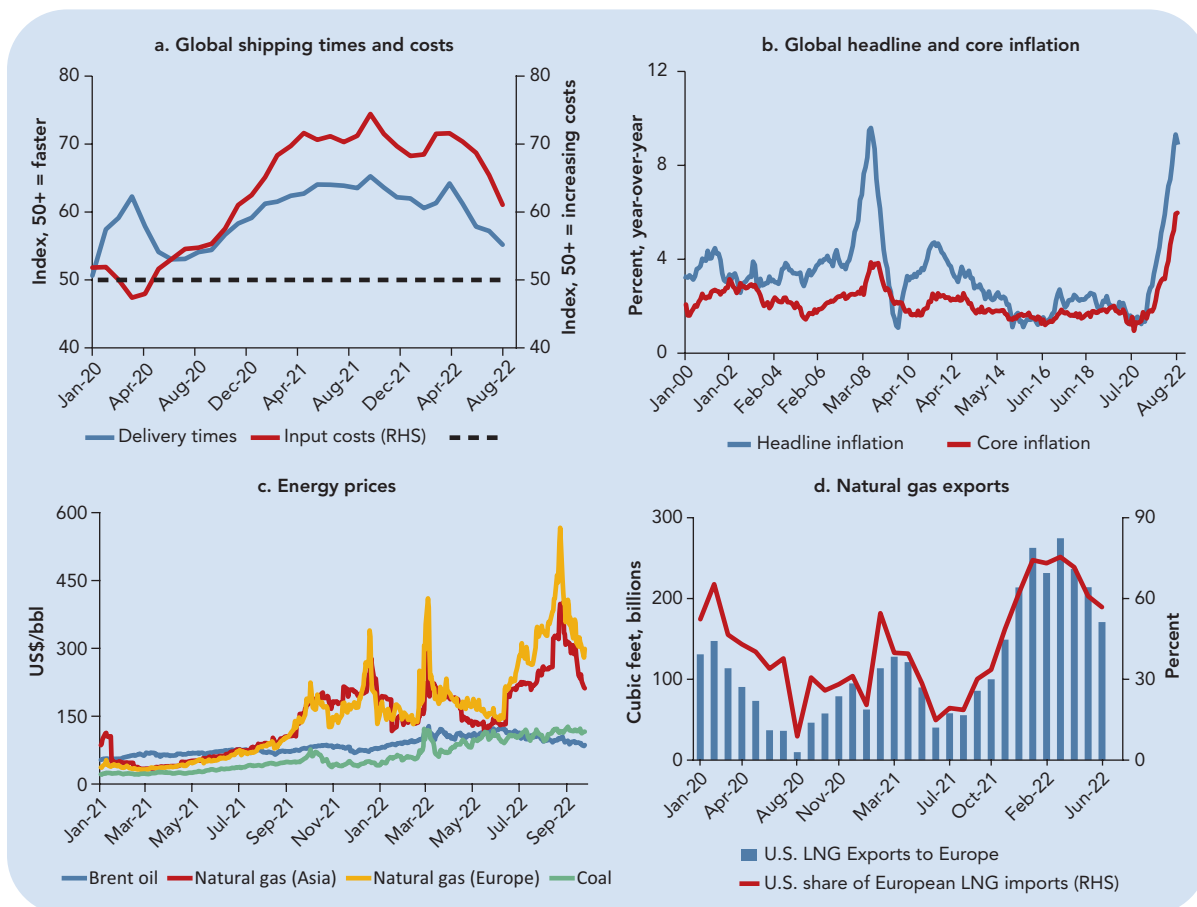
Sources: Bloomberg; Haver Analytics; U.S. Energy Information Administration; World Bank.
Note: bbl = barrel; EMDEs = emerging market and developing economies; LNG = liquefied natural gas.
a. The figure shows the global manufacturing suppliers' delivery times Purchasing Managers' Index (PMI) and global manufacturing input prices PMI. PMI delivery times data are inverted by subtracting the values from 100; therefore, increasing (decreasing) PMI data indicate faster (slower) delivery times. Input costs PMI readings above (below) 50 indicate increasing (decreasing) costs. Dashed black line indicates 50 threshold. The last observation is August 2022.
b. Median headline and core inflation. The last observation is August 2022. Sample includes 24 advanced economies and 108 EMDEs for headline inflation and 30 advanced economies and 30 EMDEs for core inflation.
c. The figure shows daily data. The last observation is September 26, 2022.
d. Europe includes Belgium, Croatia, France, Greece, Italy, Lithuania, Malta, the Netherlands, Poland, Portugal, the Russian Federation, Spain, Türkiye, and the United Kingdom. The last observation is June 2022.

mounting, the dollar has reached unusually strong levels, while equity prices have tumbled. Cumulative EMDE portfolio investment flows since the start of 2020 are barely positive, in marked contrast to the prior three years. Around one-fifth of EMDEs now face sovereign spreads of more than 10 percentage points, up from less than one in fifteen prior to the pandemic.

Inflation has accelerated globally after the earlier release of pent-up demand; persistent supply disruptions; tight labor markets in some countries; and, especially, surging commodity prices, which have been pushed up further by the invasion of Ukraine (World Bank 2022a). Global median headline Consumer Price Index inflation rose to 9.3 percent (year-over-year) in July 2022—its highest level since 2008 (figure 1.2, panel b). While increases in food and energy prices have

mainly driven the sharp rise in headline inflation, core inflation has also risen globally. Inflation is above target in the vast majority of advanced economies and EMDEs that have adopted inflation targeting. In most countries, both market- and survey-based inflation expectations have risen further since Russia's invasion of Ukraine—raising concerns that medium-term inflation expectations could become de-anchored in some cases.

Commodity markets continue to be volatile amid weakening global demand prospects and, for some commodities, shortfalls in supply. Metal prices have experienced steep falls in recent months, reflecting weaker global growth prospects and a decline in demand from China, which accounts for more than 50 percent of global metals demand. Food commodity prices dipped following positive reassessments of the yield for the 2022-23 harvest for key crops, including wheat and soybeans, as well as the partial reopening of Ukraine's Black Sea ports. Grain prices have fallen from their post-invasion highs on the back of positive supply developments, with global wheat production increases more than offsetting a decline in beginning stocks (USDA 2022). Nevertheless, food prices remain high relative to a year ago, straining household budgets—particularly for the most vulnerable—and placing millions at risk of falling into poverty (World Bank 2022a).

Energy prices have remained elevated, but with significant differences across fuel types (figure 1.2, panel c). Crude oil prices have been largely in line with the World Bank June 2022 forecasts (World Bank 2022a), averaging about $100 per barrel since the start of 2022, but with continued volatility. The price of Brent crude oil fell well below $100 per barrel in September—slipping below $85 per barrel for the first time since January 2022—due to global growth concerns and despite the Organization of the Petroleum Exporting Countries Plus (OPEC+) announcement in early September to slightly lower oil production starting in October.

A possible energy crunch looms in Europe this winter. The price of European natural gas continued to soar, reflecting significantly reduced supply from Russia despite increasing imports from the United States (figure 1.2, panel d). European natural gas prices surged toward the start of September after Russia's announcement that it would indefinitely suspend natural gas deliveries to Europe through the Nord Stream 1 pipeline, which accounted for about 35 percent of the EU's natural gas imports before the invasion. Even prior to the suspension of Nord Stream 1 flows, pipeline deliveries from Russia to the EU were down about 60 percent as of June 2022. By the end of the third quarter of 2022, however, European natural gas prices fell sharply (albeit remain nearly 75 percent higher than at the start of 2022), as European governments made plans to cut demand. As a result of high natural gas prices, fertilizer prices also remain elevated, which could affect crop yields and put further pressure on food prices and household incomes.[3]

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3. Natural gas is a key input for the production of fertilizer. Supply disruptions from the war in Ukraine, plant closures in Europe, and bottlenecks to Chinese exports have also contributed to rising fertilizer prices. Critical inputs to agricultural production have also experienced shortages and rising prices because of the war. Together, Russia and Belarus—both of which are under heavy international sanctions—supply nearly 38 percent of the world market in value terms for potassic fertilizers, 15 percent of nitrogenous fertilizers, and about 17 percent of compound fertilizers. Russia is the world's largest exporter of fertilizer, accounting for 13 percent of global exports. In addition to direct exports of manufactured fertilizers, Russia is also a major supplier of natural gas, a key input to the production of nitrogenous fertilizers elsewhere, which could hinder fertilizer production in other economies.

There is considerable uncertainty surrounding energy markets going forward (Baffes and Nagle 2022; World Bank forthcoming a). On the demand side, despite weaker global growth prospects, soaring natural gas and electricity prices may incentivize the switch from natural gas to oil in some economies (IEA 2022a). The impact of adverse weather in 2022 on hydroelectric power could also increase oil demand. Notwithstanding an increase in U.S. shale production (IEA 2022a), supply constraints are likely to continue to exert upward pressure on energy prices. The EU embargo on Russian crude oil imports comes into full effect in February 2023, while EU and partner countries may shift from drawing down strategic oil reserves to replenishing them. Moreover, spare capacity for oil production remains limited—including among OPEC+ members—after years of underinvestment in the extractive sector.

Other policy measures introduced or under consideration may also affect energy markets over the forecast horizon. Fossil fuel subsidies—which tend to be poorly targeted, distortive, costly, and at odds with longer-term climate change goals as they mute price signals and support fossil fuel consumption—have further fueled energy demand (Wheeler et al. 2020). The Group of Seven (G7) countries have announced a price cap on Russian oil purchases, with the mechanism relying on importers to observe the price ceiling to obtain insurance and shipping services from firms based in G7 and EU countries. However, price controls have typically fallen short of stated objectives, distorted markets, generated undesirable outcomes—such as adverse consequences for growth and poverty reduction—and often prove difficult to roll back after price pressures ease (Guénette 2020). If price controls or untargeted subsidies are unavoidable, their longer-term damage can be contained if they are introduced with automatic sunset clauses.

In September, the EU announced a plan to introduce temporary windfall taxes (or a revenue cap) on non-gas power producers—such as nuclear, lignite, and renewable energy companies—with excess profits above €180 MWh redistributed to households and firms. However, additional taxes or revenue caps on renewables could impede the green transition as they disincentivize investments. This comes at a time when investment gaps for the green transition are already large. The EU is also considering a price cap on natural gas, through limits on the price paid for imports from Russia or a country-specific capping system based on the energy mix. Some EU member states have proposed a decoupling of gas and electricity prices, which in theory would allow consumers to benefit from cheaper renewable energy as EU wholesale electricity prices are typically set by natural gas prices. In practice, however, price control policies have exacerbated supply shortfalls and resulted in rollover effects on utilities due to tariff deficits.

Activity in the euro area—ECA's largest economic partner—has deteriorated markedly in the second half of 2022, owing to spillovers from Russia's invasion of Ukraine through distressed supply chains, increased financial strains, and declines in consumer and business confidence. The most damaging effects of the invasion have stemmed from surging energy prices amid sharp reductions in Russian energy imports. Inflationary pressures have continued to mount, with the Harmonized Index of Consumer Prices inflation rising above market expectations to a record 9.1 percent (year-over-year) in August, while unemployment fell to a new low in July—intensifying concerns about a wage-price spiral, with

soaring prices becoming embedded in the formation of price expectations. In response, the European Central Bank (ECB) stepped up its efforts to curb inflationary pressures, by delivering its first rate hike since 2011 in July (50 basis points) and raising interest rates by 75 basis points in September—lifting its benchmark deposit rate to 1.25 percent.[4] Nonetheless, the ECB has revised upward its inflation forecasts, with inflation expected to remain above the 2 percent target beyond 2023.

A key downside risk emanating from the invasion of Ukraine is the energy price shock in Europe—with previous World Bank scenarios estimating large costs to GDP growth should Russia cut off its energy exports to Europe (World Bank 2022a, 2022b). In recent weeks, this risk has rapidly unfolded, with Russia announcing an indefinite cutoff of natural gas supplies to Europe in early September. The EU has managed to offset some of these supply constraints by using an array of policy tools, which allowed the bloc to replenish its storage of natural gas to above 80 percent by August—in line with historical trends and a few months earlier than expected—owing in part to its diversification of imports (as described above). In some member states, this was complemented by temporary measures to decrease fossil fuel demand, including programs that incentivize reductions in energy consumption, such as free public transport. Still, the EU faces near-term challenges related to reduced production of other sources of energy due to drought and could experience a faster drawdown of natural gas supplies if winter proves to be colder than usual. Infrastructure bottlenecks are another constraint given an inadequate number of pipelines to transit natural gas from a well-supplied member state to one facing shortages, although new pipelines are scheduled to come on stream in late 2023.

A persistent lack of available natural gas supplies could have severe impacts on households and firms, subsequently leading to gas rationing this winter. Because nearly a quarter of the energy mix for the EU economy is natural gas (and 35 percent is oil), a sharp economic downturn in the EU cannot be ruled out. Model-based estimates from the IMF suggest that the cutoff of natural gas from Russia could trigger a 1 to 2 percent fall in EU output in 2023, but with wide variation between member states (figure 1.3, panel a) (Di Bella et al. 2022).[5] OECD model-based estimates suggest that overlapping shocks from higher energy prices, enforced energy reductions, weaker confidence, and tighter monetary policy in response to higher inflation could trigger a 1.25 percentage-point fall in 2023 growth relative to the baseline in Europe and similarly raise inflation by over 1.5 percentage points (OECD 2022a).[6]

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4. The September policy rate increase was the second time the ECB has lifted its policy rate by at least 0.75, with the first instance of this in 1999—a short-lived technical adjustment only days after the euro's launch.

5. The IMF uses two models to estimate the impact of a Russian natural gas shutoff: A multisector partial equilibrium model with demand spillovers and a multisector open-economy general equilibrium model. The first approach can illuminate the economic impact when gas markets are fragmented, outright physical shortages exist and the gas market cannot adjust to prices. And the second approach illustrates economic impacts when markets are integrated and there is complete price-pass through.

6. The OECD uses the National Institute Global Econometric Model (NiGEM) of the British National Institute of Economic and Social Research. The NiGEM uses a "New-Keynesian" framework in that agents are presumed to be forward-looking but nominal rigidities slow the process of adjustment to external events.

FIGURE 1.3 Euro area growth prospects

a. EU output loss estimates from Russian natural gas shutoff, 2023

b. Euro area growth forecasts
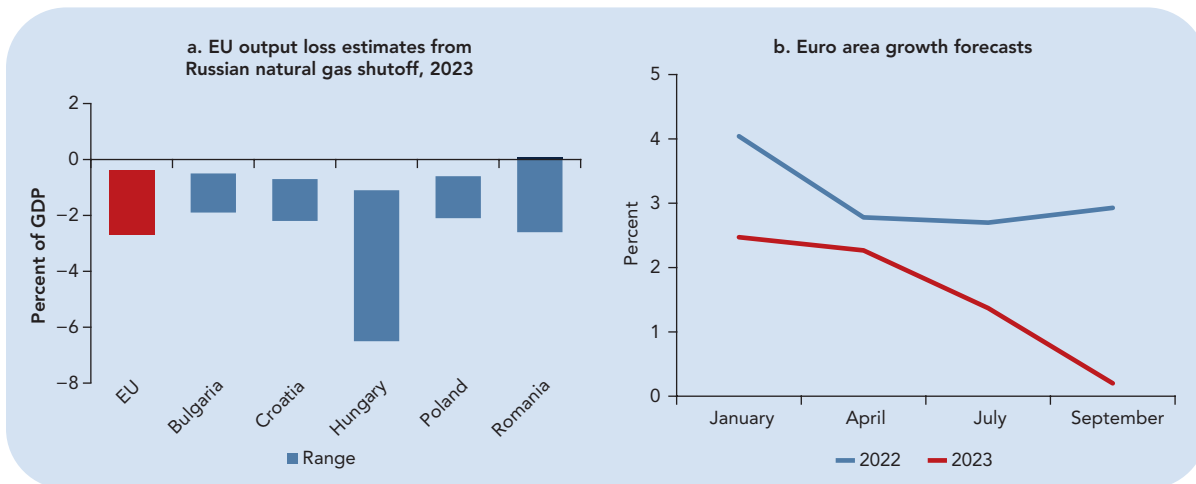
Sources: Consensus Economics; Di Bella et al. 2022; World Bank.
Note: EU = European Union.
a. Estimates are calculated as in Di Bella et al. (2022) using two models to estimate the impact of a Russian natural gas shutoff: 1) A multisector partial equilibrium model with demand spillovers, which can illuminate the economic impact when gas markets are fragmented, outright physical shortages exist and the gas market cannot adjust to prices; and 2) A multisector open-economy general equilibrium model, which illustrates economic impact when markets are integrated and there is complete price-pass through.
b. Figure shows euro zone GDP growth forecasts from Consensus Forecasts by survey month.

The scenarios outlined above for the EU are sensitive to assumptions on weather—a severe winter would imply larger shortfalls and higher prices for natural gas, with the needed demand reduction of households and firms exceeding 15 percent to avoid energy supply curtailment (ENTSOG 2022). Moreover, the risks extend beyond this winter, as EU members would be unable to refill natural gas supplies in the spring and summer. Although weaker growth would dampen demand and thus help ease supply and price pressures, this would be countered by higher prices for other energy sources, as high natural gas prices would incentivize the switch from gas to oil (IEA 2022a). In all, the materialization of a Russian shutoff of natural gas supplies to Europe has triggered a steep downgrade in private sector forecasts—as surveyed by Consensus Economics—for euro area growth in 2023, from 1.4 percent in July to 0.2 percent by September (figure 1.3, panel b).

Europe and Central Asia: Recent Developments and Outlook

The regional economy is expected to contract by 0.2 percent in 2022, with growth barely returning in 2023, as spillovers from the war in Ukraine and an energy crunch in the EU negatively impacts ECA. Growth projections for 2023 have been downgraded throughout most of the region as each country is affected by disrupted supply chains, weakening growth prospects in the euro area, tighter-than-anticipated monetary policy, and severe commodity market shocks and broad uncertainty caused by the war. The forecast is also

predicated on elevated commodity prices, as well as a global environment characterized by tighter global financing conditions, softening external demand, and easing supply chain bottlenecks. If the war escalates such that Russian energy exports are further disrupted, regional output could be far weaker. A protracted war is likely to heighten policy uncertainty further and fragment regional trade and investment integration.

Recent Developments

Since 2020, the ECA economy has suffered two major adverse shocks—the COVID-19 pandemic and Russia's invasion of Ukraine. The regional economy continues to decelerate as energy supply shocks worsen from the invasion, external demand from the euro area weakens, and soaring inflation prompts further monetary policy tightening. As a result of the invasion, regional quarterly GDP shrank over 6 percent (quarter-on-quarter, seasonally adjusted) in the second quarter of 2022, as Ukraine and Russia experienced sharp contractions while growth decelerated elsewhere alongside softening external demand. Incoming data point to further weakness in the third quarter, with confidence sinking to new lows following Russia's interruption of Nord Stream 1 natural gas flows and the manufacturing Purchasing Managers' Index (PMI) remaining in contraction.

Around the onset of the invasion, growth in ECA goods trade volumes slipped into contraction, reflecting supply chain disruptions from the war combined with bottlenecks from the pandemic (figure 1.4, panel a). Although global supply constraints have partly unwound somewhat recently, regional value chains remain interrupted by the attendant effects of the invasion as many ECA economies depend heavily on Russia and Ukraine for imports of key commodities and intermediate goods (Winkler, Wuester, and Knight 2022). The war is also dampening regional trade by weighing on external demand from the euro area—ECA's largest trading partner—and Russia. Despite the resumption of grain exports from the Black Sea, maritime trade remains well below pre-invasion levels (figure 1.4, panel b). The manufacturing PMI new export orders have fallen into a deep contraction in several key economies, suggesting continued weakness in the second half of 2022. Services trade in ECA has also likely been affected by the war, as financial sanctions due to Russia's invasion of Ukraine weigh on financial services activities. Offsetting this drag to services trade, however, has been a marked improvement in tourism, with international tourist arrivals only about 20 percent below their pre-pandemic levels in July 2022 (UNWTO 2022).

Portfolio outflows and currency depreciation continue to be more pronounced in ECA than in other EMDEs, due to a sharp deterioration in confidence from the invasion of Ukraine and elevated policy uncertainty (figure 1.4, panel c). Borrowing costs remain elevated in ECA, with the median Emerging Markets Bond Index spread 141 basis points above its level at the start of 2022, reflecting the impact of the invasion and tighter global and domestic financing conditions (figure 1.4, panel d). As a result, debt issuance has fallen in ECA.

Inflationary pressures have further intensified in ECA. Higher commodity prices—particularly for energy—and exchange rate depreciation have passed through to inflation. Median inflation in ECA accelerated to 14.5 percent (year-over-year) in July—its fastest pace since 1998—with inflation surpassing central

FIGURE 1.4 Economic trends in ECA

a. Goods trade and new export orders in ECA

b. Maritime port calls

c. Portfolio outflows since January 24, 2020

d. ECA bond spread and currency depreciation
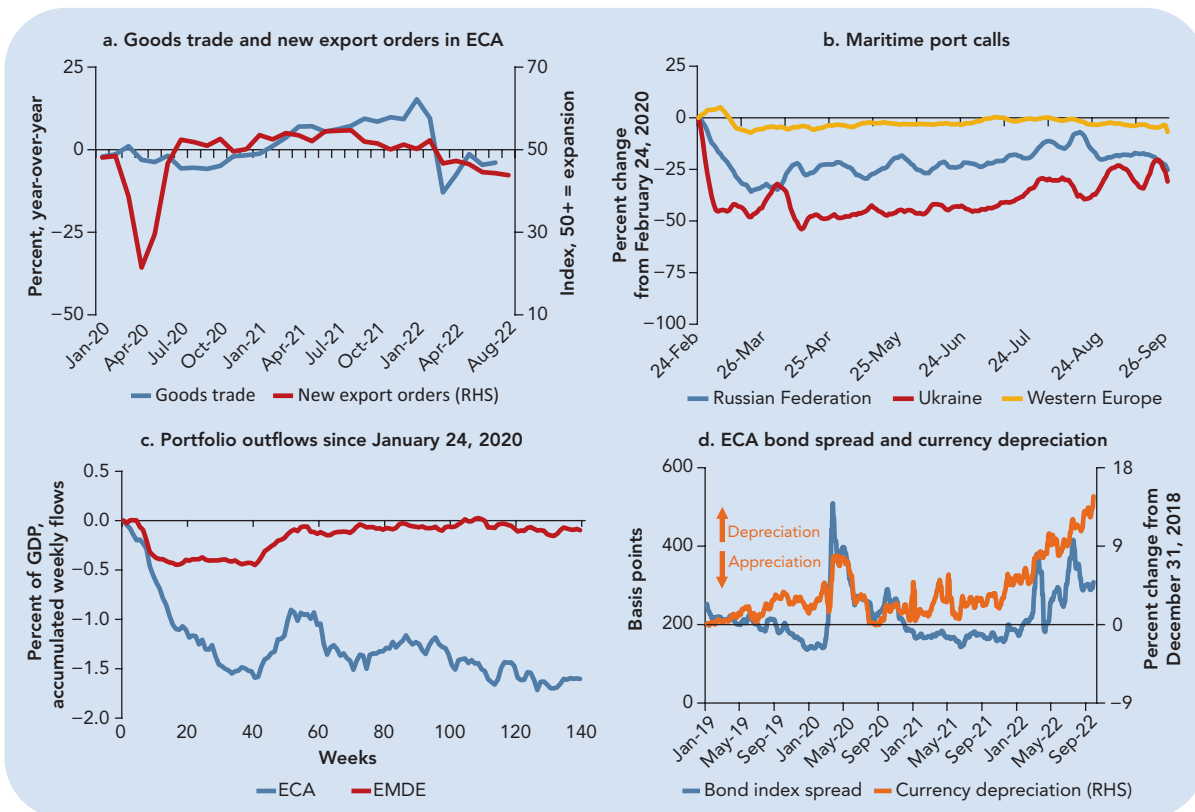
Sources: Bloomberg; Haver Analytics; International Institute of Finance; J.P. Morgan; Netherlands Bureau of Economic Analysis; World Bank.
Note: ECA = Europe and Central Asia; EMDEs = emerging market and developing economies; GDP = gross domestic product.
a. The figure shows year-over-year growth of goods trade and the manufacturing Purchasing Managers' Index (PMI) for new export orders. PMI readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. ECA export orders PMI is calculated as the median. Trade is calculated as the average of import and export volumes. Sample includes Belarus, Kazakhstan, the Russian Federation, and Ukraine for goods trade and Poland and Türkiye for new export orders. The last observation is June 2022 for goods trade and August 2022 for new export orders.
b. Percent change in the seven-day moving average of port calls compared to February 24, 2022, the day when the Russian Federation invaded Ukraine. The last observation is September 26, 2022.
c. The start date of the COVID-19 episode was January 24, 2020. Sample includes 17 EMDEs and Hungary, Poland, Türkiye, and Ukraine for ECA due to data limitations. The last observation is September 23, 2022.
d. Aggregates are calculated as medians. Figure shows seven-day moving averages. Bond index spread calculated using subindices of the Emerging Market Bond Index (EMBI) Global Index, which includes dollar denominated government debt. Last observation is September 28, 2022. Sample includes 11 ECA economies for bond index spread and 20 ECA economies for currency depreciation.

bank targets in every inflation-targeting economy.[7] Moreover, core inflation continued to rise, reaching 15.6 percent (year-over-year) in July and raising concerns that inflation could remain persistently high if additional price increases become embedded in wage and price-setting behavior. Although monetary policy conditions have continued to tighten across most ECA economies, real interest rates remain negative as headline inflation has further outpaced policy rates (figure 1.5, panel a). Since the start of the year, more than 80 percent of the countries in the region have continued to hike policy interest rates amid upside risks to inflation from mounting geopolitical tensions and marked uncertainty.

7. High inflation in 1998 reflected the ongoing adjustment to a market-based economy and the Russian financial crisis.

The sharp rise in commodity prices has passed through to inflation and heightened concerns about food and energy security for vulnerable households in ECA, especially as these items can represent a significant portion of spending in poorer households (figure 1.5, panel b) (Ari et al. 2022; Artuc et al. 2022). As a result of overlapping shocks from the pandemic and war, the poverty headcount at the $6.85 (per person per day, in 2017 PPP) threshold is anticipated to be almost 20 percent higher—or 2 million people more—by 2030 relative to pre-pandemic trends (figure 1.5, panel c). Prior to the cutoff of Nord Stream 1, the cost of living was estimated to have risen 7 percent for the average household in Europe, but with wide variation depending on the reliance on fossil fuels and national regulations on retail energy markets (Ari et al. 2022).

FIGURE 1.5 Inflation and poverty trends in ECA

a. Median inflation and policy rate in ECA

b. Total budget shares for energy products in the EU

c. Poverty headcount in ECA, $6.85 per person per day threshold (2017 PPP)

d. Current account balances in ECA
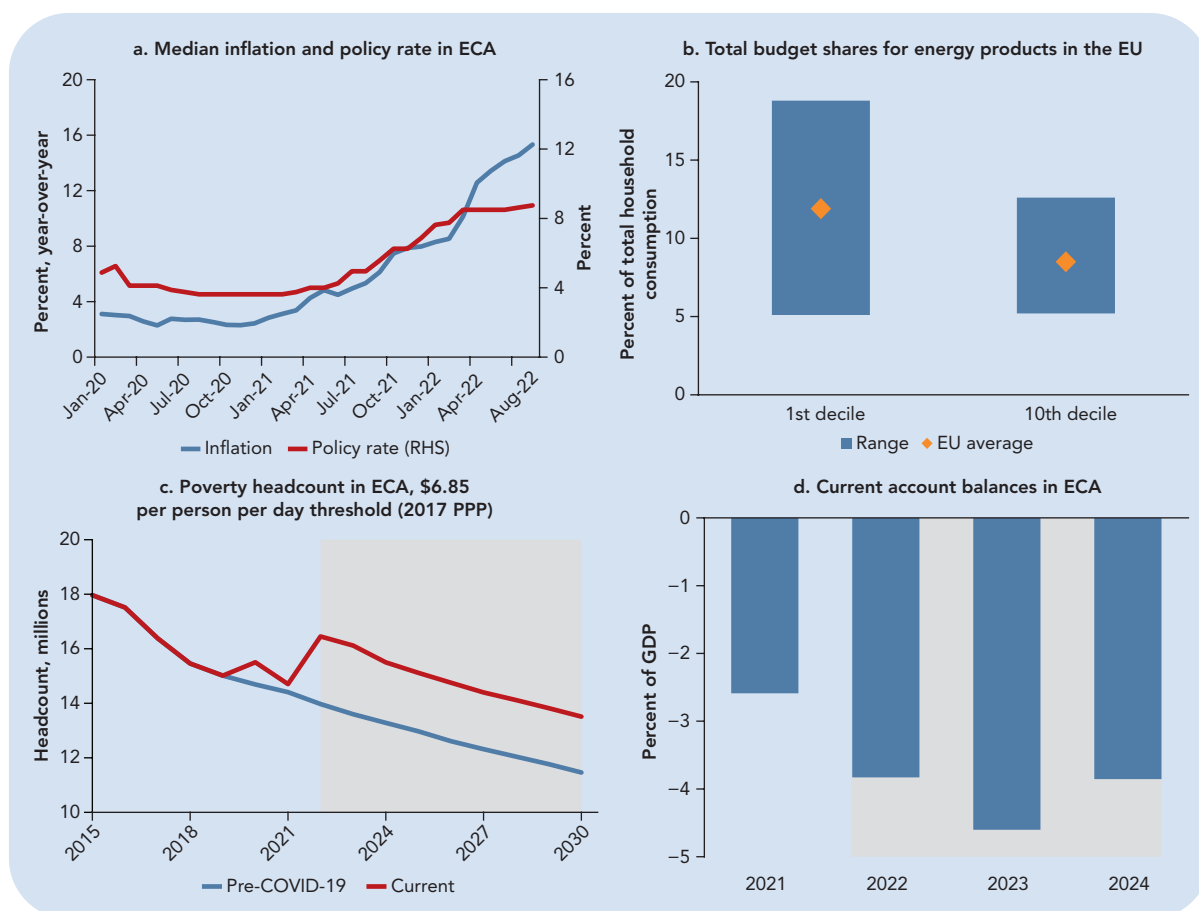
Sources: Ari et al. 2022; Haver Analytics; International Monetary Fund; Mahler et al. 2022; World Bank.
Note: ECA = Europe and Central Asia; EU = European Union; PPP = Purchasing power parity.
a. The figure shows the median seasonally adjusted inflation and the median policy rate for ECA. The sample includes 22 ECA economies. The last observation is August 2022.
b. International Monetary Fund staff estimates using the Carbon Pricing Assessment Tool based on Ari et al. (2022). Energy products include coal, electricity, natural gas, oil, gasoline, diesel, kerosene, and liquefied petroleum gas. The budget share is calculated based on household budget surveys and is assumed to be constant over time.
c. Shaded area indicates forecasts. Figure shows poverty headcounts in ECA, using the upper income poverty line of $6.85 per person per day in 2017 PPP. Projections are calculated as described in Mahler et al. 2022.
d. Shaded area indicates forecasts. Aggregate calculated as median. Sample includes 17 ECA economies.

Higher energy prices have translated directly into larger import bills and wider current account deficits (figure 1.5, panel d). They have also generated sizable fiscal costs in several countries because of fossil fuel subsidies, price caps, and support to households and firms. In Central Europe and the Western Balkans, fiscal support measures in response to the increase in energy prices were estimated to exceed 1.5 percent of GDP from mid-2021 to mid-2022—but ranged from less than 1 percent of GDP in Serbia to around 3 percent of GDP in Bulgaria—with most of this support reflecting price controls and subsidies rather than direct support (Ari et al. 2022).

Median government debt in ECA is expected to increase from 39.6 percent of GDP in 2019 to 46.4 percent of GDP in 2022 (figure 1.6, panel a). Pandemic- and war-related increases in debt levels—combined with tightening global financing conditions—have sharply reduced fiscal space and amplified debt vulnerabilities, including from public debt rollovers and currency mismatches (figure 1.6,

FIGURE 1.6 ECA debt vulnerabilities
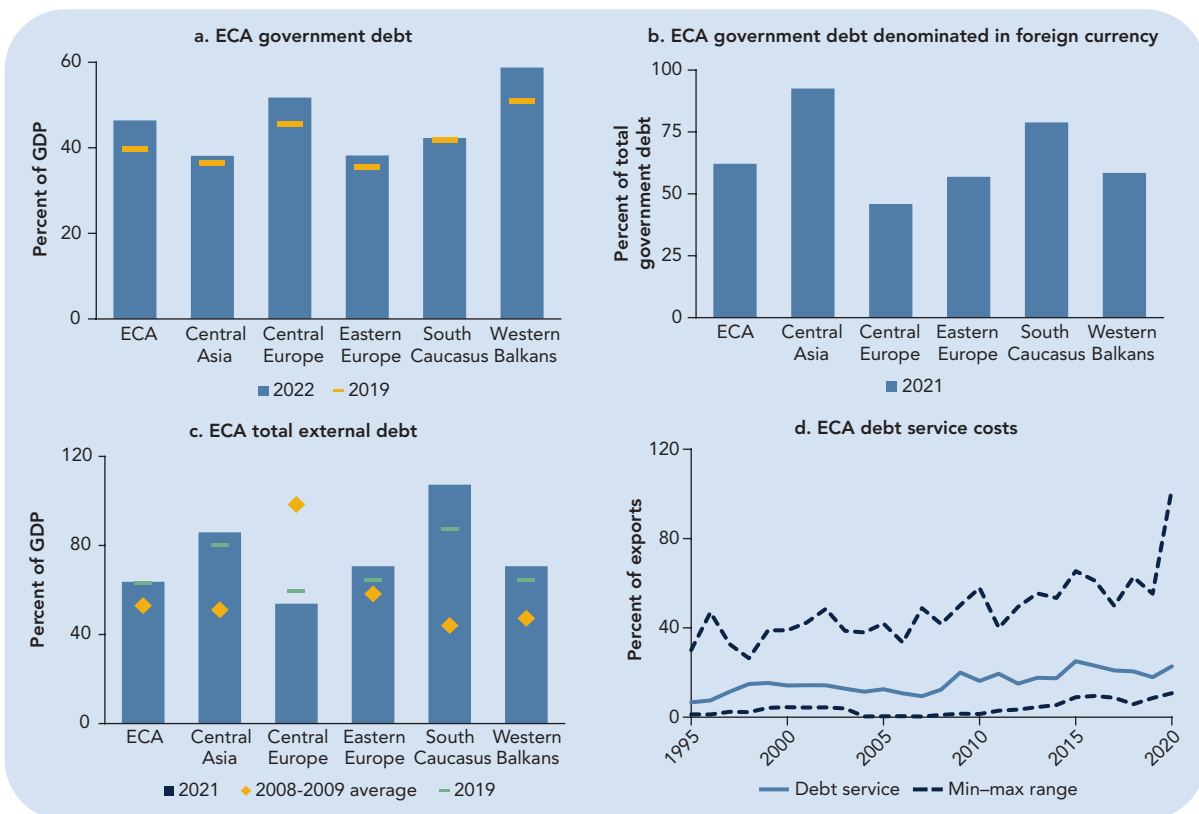
Sources: JP Morgan; Kose et al. 2017; World Bank.
Note: ECA = Europe and Central Asia.
a. Figure shows median government debt as a share of GDP. Data for 2022 are projections. Sample includes 23 ECA economies.
b. Figure shows median general government debt in foreign currency as a share of total in 2021. Sample includes 10 ECA economies, including: 1 Central Asia; 3 Central Europe; 1 Eastern Europe; 1 South Caucasus; and 4 Western Balkan economies.
c. Median external debt as percent of GDP as estimated by Kose et al. 2017. Sample varies between years due to data availability. In 2021, the sample includes 19 ECA economies, including 3 Central Asia; 5 Central Europe; 3 Eastern Europe; 2 South Caucasus; and 4 Western Balkans economies.
d. Figure shows median debt service as percent of exports of goods, services, and primary income. Sample varies due to data availability. Sample includes 12 to 20 ECA economies. The last observation is 2020.

panel b).[8] The war has dented the ability of several economies in ECA to meet external debt obligations by cutting growth, renewing currency depreciation pressures, increasing borrowing costs, and eroding confidence (figure 1.6, panel c). In many of the region's economies, external financing pressures, which were already elevated, have increased sharply because of the war and the acceleration in monetary policy tightening in major economies (figure 1.6, panel d). Moreover, the underlying balance sheet risks could be larger than expected: the proliferating use of debt-like instruments and commodity-based lending, together with the opaque financials of some state-owned enterprises, has likely obscured total public debt levels.

Regional Outlook

Regional output had nearly returned to its pre-pandemic trend at the start of 2022. Russia's invasion of Ukraine, however, has largely reversed the recovery, with output in 2022 forecast to contract by 0.2 percent (tables 1.1 to 1.3). Excluding Russia and Ukraine, ECA's GDP in 2022 is projected to grow at a relatively robust pace of 4.1 percent, owing to strong momentum before the invasion as economies reopened and pent-up demand was released. The invasion and associated spillovers, however, have led to a downturn in activity in the second half of 2022. Moreover, in addition to Russia and Ukraine, two other ECA economies are expected to shrink this year—Belarus and Moldova—while most of the rest are projected to experience a sharp deceleration in growth.[9]

Despite the weak outlook for 2022, the contraction in regional output is anticipated to be softer than projected, with the improvement reflecting resilience in some of the region's largest economies and subsequent spillovers to other ECA economies,[10] as well as delays in fiscal consolidation. In Russia, the contraction is likely to be shallower than initially projected, owing to higher-than-expected oil production, faster stabilization of financial market conditions than had been assumed, and additional fiscal support. As a result, economies that are tightly linked with the Russian economy through trade, remittances, and financial flows—largely those in the South Caucasus and Central Asia—have also fared better than projected, with elevated energy prices cushioning activity in Azerbaijan and Kazakhstan. In Türkiye, activity has surprised on the upside in 2022, as rising inflation expectations alongside minimum wage hikes caused a frontloading of private consumption spending; a rebound in tourism also helped to support exports and partly offset weakening external demand. Overall, output projections for 2022 have been upwardly revised across all ECA subregions except the Western Balkans, where domestic demand and exports proved more sluggish in the first half of 2022 than previously assumed.

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8. For further discussion, refer to Box 1.3 in World Bank 2022c.

9. World Bank forecasts in April 2022 (World Bank 2022c) and June 2022 (World Bank 2022a) envisioned six ECA economies contracting in 2022—Russia, Ukraine, Belarus, Kyrgyz Republic, Moldova, and Tajikistan.

10. Positive spillovers emanated from stronger-than-expected external demand and remittances in the first half of 2022. Some countries likely also benefited from windfalls in the relocation of Russian investment and consumption.

TABLE 1.1 Europe and Central Asia growth forecast summary

(real GDP growth at market prices in percent, unless indicated otherwise)

	2019	2020	2021[e]	2022[f]	2023[f]	2024[f]	Percentage point differences from June 2022 projections	
							2022[f]	2023[f]
EMDE ECA, GDP[a]	**2.7**	**−1.9**	**6.6**	**−0.2**	**0.3**	**2.9**	**2.7**	**−1.2**
EMDE ECA, GDP excl. the Russian Federation and Ukraine	3.0	−1.2	8.0	4.1	2.4	3.6	1.3	−1.1
EMDE ECA, GDP excl. Türkiye	3.2	−2.9	5.3	−1.6	−0.5	2.5	2.9	−1.5
Central Europe[b]	4.5	−3.3	6.2	4.3	1.9	3.1	0.6	−1.8
Western Balkans[c]	3.7	−3.3	7.7	3.4	2.8	3.0	−0.1	−0.3
Eastern Europe[d]	2.7	−3.1	3.6	−24.2	1.1	3.5	6.4	−0.8
South Caucasus[e]	3.8	−5.3	6.6	5.6	3.3	3.5	2.2	0.0
Central Asia[f]	4.9	−1.3	5.1	3.7	3.9	4.3	1.3	−0.4
Russian Federation	2.2	−2.7	4.8	−4.5	−3.6	1.6	4.4	−1.6
Türkiye	0.8	1.9	11.4	4.7	2.7	4.0	2.4	−0.5
Poland	4.7	−2.2	5.9	4.0	1.6	3.0	0.1	−2.0

Source: World Bank.
Note: World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other World Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time. Due to lack of reliable data of adequate quality, the World Bank is currently not publishing economic output, income, or growth data for Turkmenistan, and Turkmenistan is excluded from cross-country macroeconomic aggregates.
e = estimate; ECA = Europe and Central Asia; EMDE = emerging market and developing economies; f = forecast; GDP = gross domestic product.
a. GDP and expenditure components are measured in average 2010–19 prices and market exchange rates.
b. Includes Bulgaria, Croatia, Hungary, Poland, and Romania.
c. Includes Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia.
d. Includes Belarus, Moldova, and Ukraine.
e. Includes Armenia, Azerbaijan, and Georgia.
f. Includes Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan.

TABLE 1.2 Downside scenario

	2022[f]	2023[f]	Percentage point differences from baseline forecasts		Percentage point differences from June 2022 projections	
			2022[f]	2023[f]	2022[f]	2023[f]
EMDE ECA	−0.4	−1.2	−0.2	−1.5	2.5	−2.7
EMDE ECA excl. the Russian Federation and Ukraine	4.0	1.2	−0.1	−1.2	1.2	−2.3
EMDE ECA excl. Türkiye	−1.9	−1.9	−0.3	−1.4	2.6	−2.9

Sources: Oxford Economics (2020); World Bank.
Note: ECA = Europe and Central Asia; EMDE = emerging market and developing economy; f = forecast; GDP = gross domestic product.

Output in ECA in 2023 is projected to remain anemic, expanding at a subdued pace of 0.3 percent—a downgrade of 1.2 percentage points relative to previous forecasts (figure 1.7, panel a). The deterioration in near-term growth prospects largely reflects the impact of Russia's cutoff of energy supplies to the EU, as regional economies—particularly those in Central Europe—suffer from the subsequent natural gas price shock and negative spillovers from much weaker activity in the euro area (figure 1.7, panels b and c). ECA activity is also likely to continue to be dampened by tightening global financing conditions—and tighter monetary policy in ECA—to confront inflationary pressures. Output in Russia is

TABLE 1.3 Europe and Central Asia country growth forecasts[a]

(Real GDP growth at market prices in percent, unless indicated otherwise)

	2019	2020	2021[e]	2022[f]	2023[f]	2024[f]	Percentage point differences from June 2022 projections 2022[f]	2023[f]
Albania	2.1	−3.5	8.5	3.2	2.3	2.5	0.0	−1.2
Armenia	7.6	−7.2	5.7	7.0	4.3	5.2	3.5	−0.3
Azerbaijan	2.5	−4.3	5.6	4.2	2.8	2.6	1.5	0.6
Belarus	1.4	−0.9	2.3	−6.2	−2.3	2.5	0.3	−3.8
Bosnia and Herzegovina[b]	2.8	−3.1	7.5	4.0	2.8	3.2	−0.7	−0.3
Bulgaria	4.0	−4.4	4.2	2.9	1.7	3.3	0.3	−2.6
Croatia	3.5	−8.1	10.2	6.4	1.8	2.6	2.6	−1.6
Georgia	5.0	−6.8	10.4	8.8	4.2	5.0	3.3	−1.3
Hungary	4.6	−4.7	7.3	4.7	1.7	2.2	0.1	−2.1
Kazakhstan	4.5	−2.5	4.1	3.0	3.5	4.0	1.0	−0.5
Kosovo	4.8	−5.3	10.5	3.1	3.7	4.2	−0.8	−0.6
Kyrgyz Republic	4.6	−8.4	3.6	4.0	4.0	4.5	6.0	0.6
Moldova	3.7	−7.4	13.9	−0.7	2.6	4.2	−0.3	−0.1
Montenegro	4.1	−15.3	13.0	6.9	3.4	3.1	3.3	−1.3
North Macedonia	3.9	−6.1	4.0	2.1	2.7	2.9	−0.6	−0.4
Poland	4.7	−2.2	5.9	4.0	1.6	3.0	0.1	−2.0
Romania	4.2	−3.7	5.9	4.6	3.2	3.9	1.7	−0.5
Russian Federation	2.2	−2.7	4.8	−4.5	−3.6	1.6	4.4	−1.6
Serbia	4.3	−0.9	7.4	3.2	2.7	2.8	0.0	0.0
Tajikistan	7.4	4.4	9.2	4.2	4.8	4.5	4.6	1.5
Türkiye	0.8	1.9	11.4	4.7	2.7	4.0	2.4	−0.5
Ukraine	3.2	−3.8	3.4	−35.0	3.3	4.1	10.1	1.2
Uzbekistan	5.7	1.9	7.4	5.3	4.9	5.1	1.0	−0.4

Source: World Bank.
Note: World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other World Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time. Due to lack of reliable data of adequate quality, the World Bank is currently not publishing economic output, income, or growth data for Turkmenistan, and Turkmenistan is excluded from cross-country macroeconomic aggregates.
e = estimate; f = forecast; GDP = gross domestic product.
a. Data are based on GDP measured in average 2010–19 prices and market exchange rates, unless indicated otherwise.
b. Production approach-based numbers.

anticipated to contract for the second consecutive year in 2023, as exports are hard hit by EU oil embargos going into full effect by February 2023 and Russia's shutoff of natural gas deliveries along the Nord Stream 1 pipeline. Weak global demand, particularly from China, is anticipated to continue to dampen metal prices and weigh on growth in the region's metal exporters. Downgrades to the growth forecasts for 2023 are broad-based across ECA, with growth prospects marked down in nearly 80 percent of the region's economies.

The baseline projections for ECA growth assume that the war in Ukraine will persist in the near term but become increasingly contained to the eastern part of the country. The projections also assume that uncertainty will remain elevated relative to historical norms and sanctions on Belarus and Russia will remain in place over the forecast horizon. Energy prices, especially for natural gas, are

FIGURE 1.7 ECA outlook

a. Downgrades to 2023 growth relative to June 2022 forecasts

b. Growth outlook for 2023

c. Regional growth outlook for 2023

d. Percent deviations of ECA output from pre-pandemic baseline
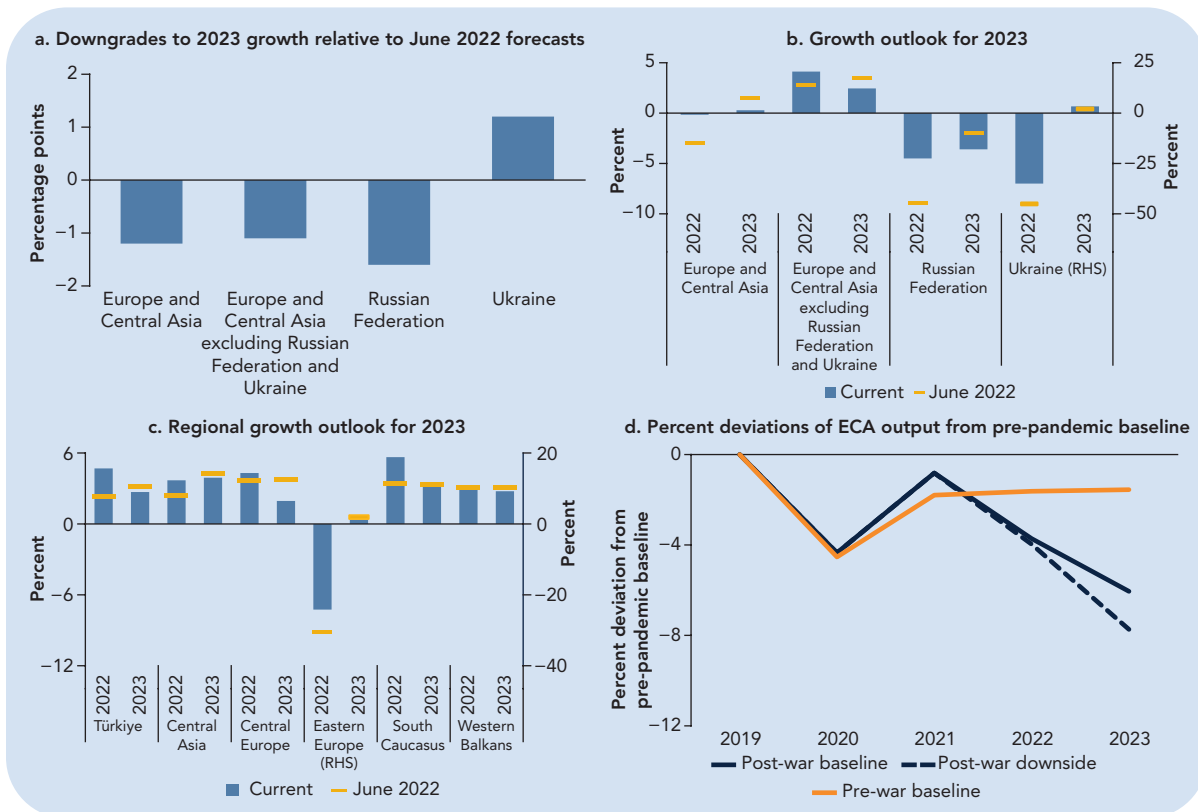
Sources: Oxford Economics; World Bank.
Note: ECA = Europe and Central Asia.
a. The figure shows the percentage point difference between the latest projections and forecasts released in the June 2022 edition of the *Global Economic Prospects* report (World Bank 2022a).
b. and c. Aggregates are calculated using real U.S. dollar gross domestic product weights. The values indicate forecasts.
d. "Pre-war" is defined as projections published in the January 2022 edition of the *Global Economic Prospects* report. "Post-war baseline" entails current projections as reflected in table 1.1. "Post-war downside" entails projections outlined in table 1.2, in which the Nord Stream 1 gas cutoff to Europe results in higher oil and gas prices, reduced Russian oil and gas exports, and a shock to financial confidence in Russia, resulting in a lower Russian equity market. The Oxford Global Economic Model—a large-scale, global, semi-structural projection model—was used to conduct the simulations described here (Oxford Economics 2020).

assumed to remain high due to Russian energy supply disruptions, which will continue to weigh on external demand from the EU for ECA exports as well as on household spending and firm activity in ECA. High energy prices and persistently elevated core inflation suggest that in the near term, headline inflation is unlikely to return to central bank targets in many ECA economies. The near-term outlook also assumes a less favorable global environment owing to tighter financing conditions and decelerating external demand.

The regional outlook is subject to considerable uncertainty due to the ongoing effects of the invasion and its impacts on the regional economy and the euro area—especially in light of worsening energy supply disruptions. A downside scenario is thus constructed, where GDP growth in the euro area is about 2 percentage points lower in 2023, reflecting the impact of commodity price shocks from the escalation of geopolitical tensions emanating from the invasion. In turn, this reduces Russian energy exports to the euro area by about one-third of

baseline volumes in 2023. Natural gas prices would about double from current future prices for 2023. The downside scenario also assumes a shock to financial confidence, where equity prices in 2023 fall by about one-third relative to baseline—in line with previous financial market turmoil in ECA.

The Oxford Economics Global Economic Model (GEM)—a large-scale, global, semi-structural projection model—was used to conduct the simulations described here (Oxford Economics 2020).[11] In the downside scenario, ECA growth in 2023 would be reduced by 1.5 percentage points, with output contracting 1.2 percent rather than expanding 0.3 percent as envisioned in the baseline. The magnitude of the impact on individual countries' growth would depend on the degree of Russian energy reliance and economic linkages with the euro area. The spillovers to growth and inflation would be largest for the ECA economies where the energy mix relies heavily on Russian energy imports or where trade and financial linkages are especially tight with the euro area (and/or Russia). In countries where the main natural gas supply routes are through constrained countries, significant natural gas shortages could occur, with the price to clear the market being extremely high. The damage is expected to be less on economies with sufficient domestic energy production, alternative natural gas supply routes, and where the energy mix does not rely as heavily on natural gas. In the downside scenario, output in 2023 would fall 7.7 percent below pre-pandemic trends—a sharp deterioration compared to the baseline assumption of a 6 percent gap with pre-pandemic trends (figure 1.7, panel d). Nevertheless, even in the baseline, the combined effects of the pandemic and invasion are anticipated to scar the level of output in ECA—at least over the forecast horizon, but likely longer given the magnitude of the gap—implying slower convergence with average EU income and more difficulty in achieving Sustainable Development Goals.

Trends in Europe and Central Asia: Major Economies and Subregions

Russian Federation

Russia's economy weathered the initial storm of international sanctions better than expected, due to a combination of rapidly enacted and extensive capital controls and liquidity operations, and fiscal support to households, firms, and subnational governments worth around 3 percent of GDP. Although the initial plunge in the ruble sent inflation soaring to 17.8 percent (year-over-year) in May, prompting the Central Bank of Russia to hike the policy rate to 20 percent, the closing of the capital account combined with elevated commodity prices saw the ruble quickly retrace losses, lessening price pressures and allowing the central

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11. The results presented in table 1.2 were constructed using the Oxford GEM, which includes data on 120 countries, many of which are available at quarterly frequency, with behavioral equations governing domestic economic activity, monetary and fiscal policy, global trade, and commodity prices. The Oxford GEM includes complex modeling of the money and financial markets, allowing for economic shocks to transmit across countries not only through the typical real channels, but also through changes in financial volatility, credit ratings, bond yields, and related variables.

bank to partially normalize monetary policy by mid-2022. Loosening monetary conditions, combined with increasing government spending, supported a modest rebound in domestic demand in the third quarter of 2022. Although total export volumes declined sharply over the first half of 2022, the current account surplus hit unprecedented levels in the second quarter of 2022, supported by high prices for continued fossil fuels sales to Europe and expanded sales to China, India, Türkiye, and other EMDEs (albeit often at discounts to global price benchmarks). Nonetheless, the Russian economy is expected to contract by 4.5 percent in 2022, as falling real wages erode consumption, while sanctions and voluntary withdrawals by foreign businesses and intense uncertainty weigh on investment. Having declined in the initial post-pandemic recovery, poverty is expected to return to near-2020 levels over the forecast horizon.

In 2023, given the context of continued war and proliferating sanctions, Russia's economy is expected to decline again, by 3.6 percent, as earlier delays in EU oil embargos are fully implemented and all drivers of growth weaken. Although emergency policies forestalled economic collapse, the effects of sanctions are expected to compound over time. Industrial output is expected to decline by more than 3 percent in 2023, as intensifying shortages of key technological inputs ripple through domestic supply chains in unpredictable ways. Consumption is forecast to soften further, given the likelihood of weak real wage growth amid still elevated inflation. Should Europe succeed in rapidly reducing its reliance on Russian gas, Russia's export earnings will fall, curbing the government's fiscal resources, while much of the gas infrastructure in Russia could become effectively frozen. More broadly, the cutoff from international financial markets and freezing of around half of Russia's foreign exchange reserves has left the economy more susceptible to external shocks. A decline in energy prices—an increasing possibility given sharply slowing global growth—would likely weaken the ruble and increase inflationary pressures. The fiscal balance, having already slipped into deficit in 2022, would decline more quickly. The proposed G7 cap on oil export prices could have similar effects, should it gain broad adherence. In such circumstances, financial sector volatility could reemerge in Russia, given eroded bank buffers and an already weak growth outlook, further damaging consumer and business confidence. Additional risks arise from the partial mobilization announced in late September, which could dampen domestic demand, and increase labor market and financial sector pressures.

Beyond next year, the outlook is exceptionally uncertain. Russia's economy may stabilize somewhat, although at a much lower base of activity, and likely still with stagnant investment. Growth in 2024 is forecast at 1.6 percent, largely due to modest consumption growth and a marginal recovery in exports, as Russia's trading relationships start to reorient. Over the long term, the invasion and its consequences are almost certain to reduce Russia's potential growth. The ruptures to trade and investment networks will limit technology transfer, slowing productivity growth. Emigration will drain human capital. An even more prominent role for the state in the economy, as the government attempts to smooth the transition away from G7 trading relationships, likely implies further efficiency losses. In sum, the prospect of an economy geared toward sanctions resilience rather than productive efficiency implies substantially lower living standards.

Ukraine

One-third of Ukraine's population of 44 million people is estimated to be displaced due to Russia's invasion of the country (UNHCR 2022a). GDP is projected to contract by 35 percent in 2022, and according to recent World Bank estimates, recovery and reconstruction needs across social, productive, and infrastructure sectors total at least $349 billion, which is more than 1.5 times the 2021 GDP of Ukraine (World Bank 2022d). Growth is expected to resume in 2023 but remain weak, with reconstruction efforts gathering momentum toward the end of the forecast period. The repercussions of the war are expected to reverberate beyond the short term, with economic activity scarred by the destruction of productive capacity, damage to arable land, and reduced labor supply—especially if refugees do not return, which becomes increasingly likely as the war becomes protracted and they establish their lives in host countries. Wars inflict particularly severe damage to productivity for several years, through reducing and disrupting the labor force, weakening capital deepening, disrupting value chains, hindering innovation, and inducing poverty (box 1.1) (Dieppe, Kilic Celik, and Okou 2020). Based on the global poverty line of $6.85 (per person per day, in 2017 PPP), poverty in Ukraine is projected to increase from 5.5 percent in 2021 to 25 percent in 2022, with high downside risks if the war and energy security

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BOX 1.1 The impact of Russia's invasion on Ukraine's long-term growth prospects

The war hits Ukraine at a time when the recovery from the COVID-19 shock had barely started. Following a sharp slowdown in the aftermath of the 2008-09 global financial crisis, the total factor productivity (TFP) growth accelerated prior to the start of the pandemic amid some progress with institutional and structural reforms; yet it collapsed in 2020 as investment fell sharply (figure B.1.1.1). Meanwhile, the contributions of labor and capital accumulation to potential growth has been consistently negative for most of the past two decades as labor force continued to decline and investment growth weakened substantially. The war could further strengthen these headwinds to sustained productivity growth with labor force depleted by causalities and massive outflows of refugees, investment deterred by insecurity and fragility, even as some capital expenditure can be shifted to safer locations, and human capital accumulation and innovation interrupted.

Wars exert a particularly heavy toll on labor productivity as civilian casualties, the outflow of refugees, and humanitarian catastrophes are exacerbated by the sharp contraction of economic activity. Massive armed conflicts on the scale of Russia's invasion of Ukraine could substantially lower Ukraine's per capita income beyond the next few years and reduce labor and TFP because of the damage to infrastructure and physical capital, disruptions of value-added chains and trade, loss of skills and labor, and lasting interruptions to investment and innovation (Thies and Baum 2020). Moreover, intense wars that affect key economic, commercial, and transportation hubs within a country—as has been the case in Ukraine due to the impact on its ports—have a much larger impact on economic and productivity growth (Fang et al. 2020).

Wars have a particularly devastating impact on labor and total factor productivity, which tend

to persist and occur with a time lag as conflict-induced disruptions exert a lasting impact on all drivers of the long-term productivity growth. On average, emerging market and developing economies (EMDEs) that experienced wars are estimated to suffer a decline in labor productivity of roughly 5-12 percent three years after the beginning of the war; the decline in TFP reaches around 6-10 percent three years after the beginning of the war with only a modest subsequent recovery (Dieppe, Kilic Celik, and Okou 2020; figure B.1.1.1).

Even before the start of the war, Ukraine has been already struggling with slow trend growth as private investment rates remained subdued because of insufficient savings, low foreign direct investment (FDI), and crowding-out by public sector borrowing (Smits et. all 2019). The war could further amplify these structural impediments to long-term growth, causing even bigger and longer-lasting productivity losses, especially if intense fighting continues and reconstruction efforts are delayed.

First, the country already faced unfavorable demographic pressures on long-term productivity because of ageing populations, low birth rates, and emigration; the war made these challenges much more acute. Russia's invasion of Ukraine caused the large-scale displacement of population which severely disrupted the functioning of labor markets and human capital accumulation. As of end-September, one-third of Ukraine's population of 44 million people is estimated to be displaced (UNHCR 2022a). A large majority of refugees and internally displaced people are women and children with nearly two thirds of Ukrainian children being displaced by the war. The loss of labor and skills is particularly damaging as Ukrainian refugees tend to be more highly educated than other refugee groups in Europe and the general Ukrainian population (OECD 2022). Meanwhile, interrupted access to learning for millions of Ukrainian children

and youth compounds pandemic-inflicted schooling losses and could set the stage for large negative spillovers on long-term productivity growth in Ukraine.

Second, wars significantly reduce labor productivity by weakening capital deepening through the destruction of physical assets, the deterrence of productive investment, capital flight, and a diversion of capital and savings to less productive uses, including financing of budget deficits and military expenditure. The destruction of physical assets in Ukraine is already catastrophic, especially in the arears directly affected by fighting, and could grow much bigger if the conflict stalls. As of end-August, the damage and destruction of residential and non-residential buildings, and infrastructure because of Russia's invasion of Ukraine is estimated at about US$114 billion, with private houses and apartment building representing over 40 percent of the total amount (KSE 2022a). As a result, about 10 percent of the estimated US$1.1 trillion of capital stock exposed to war-related damages could have been already destroyed, though the magnitude of physical damages as a percentage of total exposed value is considerably larger in most affected zones in the Eastern and Southern regions of the country (World Bank 2022j). Missile and shelling of road, railway, and bridges and attacks on critical infrastructure such as oil depots and power stations, have caused a particularly significant damage to infrastructure – roughly 15 percent of the exposed infrastructure value could have been destroyed or damaged. The damage to physical assets in agricultures is estimated at about 15 percent of its total capital stock (KSE 2022b).

Third, investment and innovation interrupted by the war and a massive shutdown of economic activity, often affecting entire industries, such as aviation and farming, could result in sizable losses of the total factor productivity. For example, war-affected regions, including Kyiv, account for

(Continued next page)

BOX **1.1** **(continued)**

roughly 60 percent of all fixed capital investment in Ukraine and for an even bigger share in some key industries, such as metallurgy and transportation. The war has also considerably weakened Ukraine's ability to absorb productivity-enhancing innovations and remain competitive globally because of severe disruptions to international trade and foreign capital flows. For example, net FDI in Ukraine fell by over 93 percent and exports of goods by 28 percent during the first seven months of 2022. Despite a gradual recovery in exports of agricultural products following a brokered deal to resume exports of Ukrainian grain through the Black Sea, total exports have struggled to regain footing as exports of iron and steel (about a quarter of all exports from Ukraine) remained over 70 percent lower in March–July 2022, compared to the same five months a year before, reflecting the destruction and damage to the country's largest metallurgical facilities—Azovstal and Ilyich Iron and Steel Works. An open trade and investment regime has been widely recognized as a powerful channel to boost productivity and sustain increases in income per-capita. Russia's invasion of Ukraine has considerably obstructed this channel of cross-border knowledge and technology spillovers.

All of the above indicates that damage to the long-term potential growth of Ukraine could be extensive—based on existing estimates, cumulative losses to TFP growth could easily exceed 10 percent within the next three years and could deepen if the invasion intensifies or spreads (Kilic Celik forthcoming). The scale and severity of the damage already inflicted to the key drivers of productivity points to a long path to recovery and requires significant reconstruction funds from the global community (World Bank 2022d). However, a recovery to pre-war income levels and further improvements in productivity could only take place with a lasting and credible peace agreement, which appears to be far from reach at this juncture. A drawn-out conflict would further intensify the

loss and depreciation of human and physical capital and deepen the productivity decline.

On the upside, many countries experienced higher than average growth rates following the end of war—or otherwise known as the peace dividend. This piece dividend could be strengthened by the rapid deployment of reconstruction efforts and acceleration of reforms that boost private sector investment. Ukraine's reconstruction and recovery needs dwarf other conflicts. The World Bank estimates that at least $349 million (or 1.5 times the 2021 GDP) will be needed (World Bank 2022d). Alternative estimates put total reconstruction costs in the range of $750 billion to $1.1 trillion, or about 500 to 700 percent of 2019 GDP. The reconstruction will have to address the damage to physical assets, such as infrastructure and roads, as well as cover immediate needs in education, healthcare, and housing. In addition, a sizable funding will be required to finance demining activities in Ukraine. Funding of this magnitude could be transformative for Ukraine and even help its economy breakout from the pre-invasion low productivity growth (figure 1).

Although, a post-war recovery will be contingent on securing substantial external support and building a strong international coalition ready to help Ukraine once security situation is restored, encouraging private investment, especially FDI, must be an integral component of the successful reconstruction strategy. Despite lingering fragility and insecurity, foreign investors are often eager to enter countries recovering from conflict when governments create enabling environments and promote country's image effectively (Whyte and Griffin 2014). Ukraine must show an unwavering commitment to domestic structural reforms, including strengthening institutional capacity and the rule of law, reducing corruption, improving protection of investor and property rights, and enhancing fiscal discipline.

BOX 1.1 **(continued)**

FIGURE B.1.1.1 **Estimated effects of war episodes on productivity in EMDEs**

Wars are estimated to result in the steepest productivity losses compared to all other types of adverse events. The effects of wars on labor productivity have occurred immediately after the onset of wars, while their effects on TFP have mainly occurred 1-2 years later. The longer-term losses from external wars have been much more pronounced. If a lasting peace agreement is reached, Ukraine can reap the benefits of the peace dividend, helping its economy recover to pre-war income levels and accelerate productivity growth. The recovery, however, will require substantial external support considering the scale and intensity of the war-inflicted damage

a. Labor productivity

b. TFP

c. Potential growth in Ukraine

d. Estimated reconstruction costs in Ukraine versus post-WWII Marshall Plan for Europe
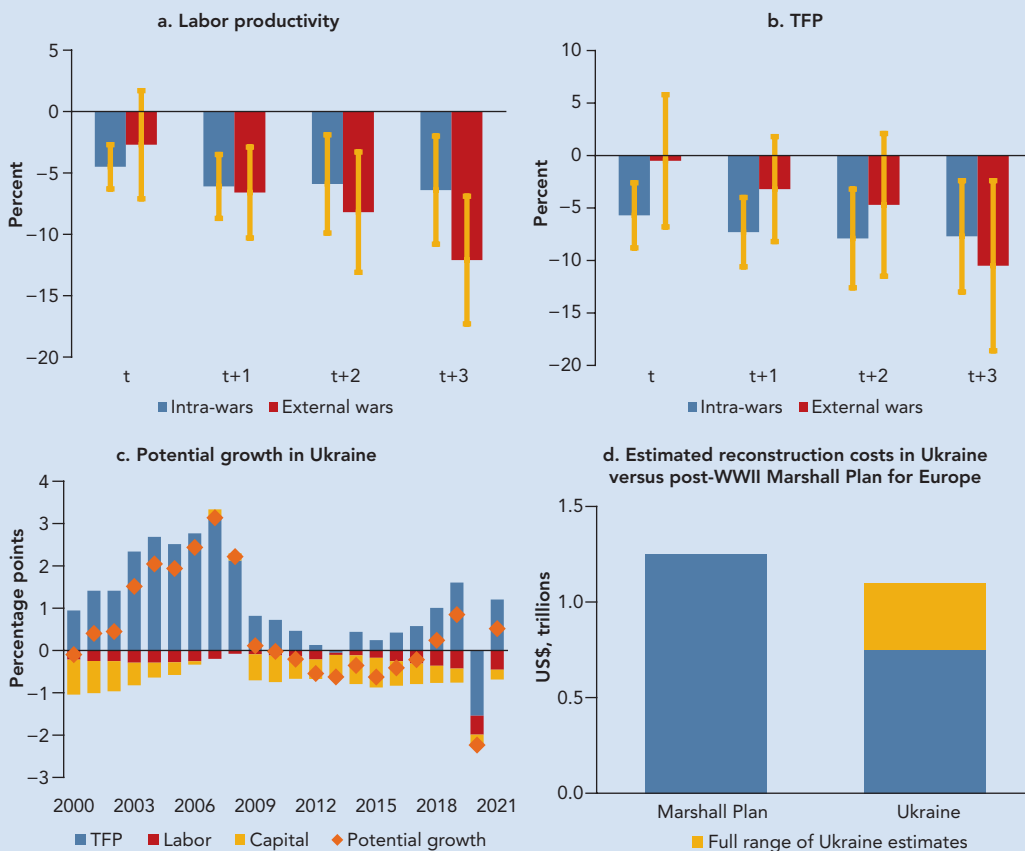
Sources: Dieppe, Kilic Celik, and Okou 2020; Board of Governors of the Federal Reserve; European Investment Bank; Kyiv School of Economics; Ukraine Government; U.S. Bureau of Economic Analysis; World Bank.

Note: a, b. Intra-state wars are conducted between a state and a group within its borders; external armed conflicts include extra-state wars - conflicts between a system member and a non-state entity and inter-state wars - wars conducted between members of the interstate system. An episode dummy for a specific type of event is 1 if the event occurs at least once (≥1) in a country-year pair and 0 otherwise. Blue and red bars indicate the average effect of the event for each horizon and orange lines represent the 90 percent significance range.

c. Potential growth is measured using the production function approach, which considers trends in labor supply, capital accumulation, and productivity growth.

d. Chart shows reconstruction costs in real 2022 U.S. dollars. The GDP deflator for 2022 is estimated by extending the U.S. BEA's GDP deflator series using the Federal Reserve's median 2022 inflation projection, 5.2 percent, released in June 2022. Ukraine reconstruction costs are based on July 2022 estimates by European Investment Bank, Kyiv School of Economics, and Ukraine Government. Under the Marshall Plan, the U.S. provided about $13.3 billion in aid, or close to $1.25 trillion in real 2022 U.S. dollars, to help rebuild Europe after World War II, with about 16 economies signing up for assistance.

situations worsen. Additionally, learning losses stemming from the pandemic are expected to be amplified by the war given the destruction of schools and disruption to schooling.

Eastern Europe Excluding Ukraine

Eastern Europe excluding Ukraine is forecast to contract by 5.4 percent in 2022, as spillovers from the war in Ukraine continue to inhibit economic activity in the subregion. Output in 2022 is forecast to contract 6.2 percent in Belarus and 0.7 percent in Moldova—the only two economies expected to shrink outside of Russia and Ukraine. Surging inflation, higher borrowing costs, lower remittances (Moldova), and additional sanctions (Belarus) are expected to weigh on domestic demand.

Sanctions against Belarus for its involvement in the Russian invasion of Ukraine have triggered a sharp fall in investment and an estimated loss of up to one-third of merchandise export revenues, or 18 percent of GDP. The country has leaned significantly on Russia to help offset losses, including through increased trade and preferential access to energy exports, as well as for external financing given existing sanctions on Belarus's financial sector. Despite external support from Russia, the recession in Belarus is expected to deepen, with output contracting in both 2022 and 2023.

Surging inflation has continued to erode real household incomes and business profitability, with headline inflation reaching about 18 percent in Belarus and nearly 35 percent in Moldova by August 2022. In response, central banks in both countries have increased their key policy rates over the past year—in Belarus from 7.75 to 12 percent and in Moldova from under 3 to nearly 22 percent by August 2022. The influx of refugees to Moldova has at times exceeded 15 percent of Moldova's population. Although a large share has transited to the EU, the remaining refugees will likely have high fiscal costs, squeezing resources for long-term development priorities. Nevertheless, strong government revenues have funded an increase in social spending and subsidies aimed at shielding households from high food and energy prices.

The forecast is subject to significant downside risks derived from uncertainty surrounding energy supplies for the upcoming winter. In addition to worsening energy security, unfavorable weather conditions could reduce agricultural yields in the region, further exacerbating inflationary pressures and food insecurity, particularly for vulnerable households. Over the long term, growth prospects could materially weaken if the fractures in trade and investment become permanent.

Türkiye

Positive economic activity in Türkiye continues despite drags from multi-decade high inflation, significant currency depreciation, and swelling external liabilities. Headline inflation accelerated to over 80 percent in August—the fastest pace since 1998—after energy prices continued to soar and a further two cuts in the key policy rate in August and September drove the lira to new lows. Policy rate cuts have deepened Türkiye's macroeconomic imbalances as real interest rates

continue to be pushed further into negative territory, leaving the economy vulnerable to financial stability risks.[12]

Despite these headwinds, growth is projected to reach 4.7 percent in 2022—2.4 percentage points above June 2022 projections—as strong domestic demand and robust export growth fueled stronger-than-expected output in the first half of 2022, during which the economy grew by 7.5 percent. Private consumption spending grew on rising inflation expectations and multiple, large minimum wage hikes in 2022 that partly helped to offset cost-of-living shocks. Additionally, the rebound in international tourist arrivals has been larger than expected, bolstering export growth, and partially replenishing foreign exchange reserves. In 2023, growth is projected to moderate, to 2.7 percent, as government spending counteracts headwinds posed by macro-financial volatility, elevated prices, and diminished domestic demand amid subdued investment.

Central Asia

Growth in Central Asia is projected to reach 3.7 percent in 2022—1.3 percentage points above the June 2022 projections—as higher global commodity prices have helped to buoy economic activity and fiscal balances in some Central Asian economies (Kazakhstan and Uzbekistan). Activity in Central Asia has also benefited from better external demand than envisioned, reflecting a shallower-than-expected recession in Russia. Although it is expected that output in the Kyrgyz Republic and Tajikistan will substantially exceed the June 2022 projections—owing to stronger-than-expected remittances from Russia—renewed border tensions between the two countries pose considerable downside risks. Growth is expected to increase moderately to 3.9 percent in 2023 and further to 4.3 percent in 2024, with downside risks largely emanating from a deeper contraction in Russia.

Inflation remains elevated despite monetary policy tightening—likely reflecting a strong push from external factors, earlier currency depreciation, and weak monetary policy transmission. As a result of inflationary pressures, two-thirds of the firms surveyed in the Kyrgyz Republic, Tajikistan, and Uzbekistan have experienced increasing costs, with many struggling financially as a result of reduced profitability and greater difficulty accessing new credit financing (World Bank 2022f). However, the monetary policy stance in Central Asia has diverged somewhat, with central banks in Kazakhstan and the Kyrgyz Republic hiking rates by 50 and 200 basis points, respectively, as of August 2022. In contrast, the Central Bank of the Republic of Uzbekistan cut interest rates by 100 basis points in July 2022.

Long-term growth and investment prospects could be dampened by stability concerns, as escalating tensions, political instability, and social unrest erode confidence. Central Asia also faces the difficult challenge of reducing its heavy

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12. The lira has lost over a third of its value this year. Since December, gross reserves have dropped to $113.7 billion as of mid-September and are negative when excluding short term drains; credit risk (represented by credit default swap spreads) surged to a 19-year high in July; and the current account deficit tripled in June from last year on the back of high energy prices, putting further pressure on the currency.

reliance on fossil fuels, with recent carbon emission reduction, or carbon neutrality, initiatives announced in Kazakhstan, Tajikistan, and Uzbekistan. Given weak administrative and investment capacity, governments will need to lean on the private sector and green financing to help facilitate the region's climate goals. Finally, digitalization efforts could help significantly to improve potential growth and productivity, as nearly half of the population in Central Asia remains not digitally connected (World Bank 2022e).[13]

South Caucasus

In the South Caucasus, output is projected to grow by 5.6 percent in 2022—the fastest among ECA's subregions and 2.2 percentage points above the June 2022 projections. The improvement reflects better-than-expected GDP outturns, with activity supported by high energy prices and fiscal support in Azerbaijan, as well as robust domestic demand in all three economies (Armenia, Azerbaijan, and Georgia) in the first half of the year. The easing of COVID-19 restrictions, as well as a surge in money transfers from Russia, have fueled the pick-up in domestic demand and subsequently inflation. Inflation has also increased alongside high prices for imports, food, and fuel.

Growth in 2023 is anticipated to decelerate sharply to 3.3 percent—well below the rate of potential growth for most of these economies. The deceleration reflects weakening momentum after a strong rebound in 2022, the slowdown in the European Union, and a sharper-than-expected contraction of 2023 output in Russia—one of the South Caucasus's closest economic partners—as delayed sanctions related to the EU oil embargo take full effect and energy supplies are further disrupted. Following recent flare-ups in border tensions between Armenia and Azerbaijan, downside risks also emanate from an escalation in conflict in the subregion. Upside risks include a possible acceleration in natural gas output by Azerbaijan, following a deal brokered with the EU to boost energy exports to the bloc.

Price pressures are expected to moderate in 2023, as demand cools and long-term fixed-price contracts with Azerbaijan (Georgia) and Russia (Georgia and Armenia) mitigate energy commodity price shocks. Central banks have continued tightening monetary policy, although Azerbaijan's thin interbank money market and relatively high dollarization have limited monetary price transmission. High dollarization in the subregion has also left the South Caucasus vulnerable to foreign exchange depreciation amid the tightening of global financing conditions, increasing macroeconomic stability risks in some economies. On the other hand, none of these countries need to pursue significant access to international markets in the near term, which mitigates some of the risks.

Long-term growth prospects are inhibited by lingering structural issues, including a lack of diversification of productive sectors, a weak business climate, subdued competition, financing constraints, and the large presence of inefficient state-owned enterprises. Additionally, declining population growth and an

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13. A 10 percent increase in broadband connectivity could increase per capita GDP growth in EMDEs by 1.2 percent (World Bank 2022g).

aging population will present a drag on potential output, with availability of skills preventing meaningful firm productivity growth. Policy reforms that focus on green and inclusive growth will be crucial for improving productivity and accelerating growth, including by developing high-quality jobs in diversified sectors, promoting private sector participation, and incentivizing human capital development and retention.

Central Europe

Central Europe is projected to grow at 4.3 percent in 2022—stronger than previously projected due to upside surprises in the first half of 2022, mirroring relatively robust external demand from the euro area and the release of pent-up demand as pandemic restrictions were lifted in early 2022. Despite accelerating inflation, private consumption benefitted from lower unemployment and increased wages driven by labor shortages.

Industrial activity and consumption will likely weaken in the fourth quarter of 2022, however, as energy prices continue to climb amid Russia's decision to stop Nord Stream 1 gas flows. Gas and electricity subsidies have helped to shield households but are expected to exacerbate fiscal pressures and widen deficits (Bulgaria, Croatia, and Romania). Headline inflation, which was already at multi-year highs and exceeding targets prior to the invasion of Ukraine, is likely to remain elevated amid high energy costs from the war and as core inflation remains persistently high due to earlier wage increases. In response, central banks may be forced to tighten monetary policy further despite the dampening effects on growth.

Growth in 2023 is expected to decelerate sharply to 1.9 percent—1.8 percentage points below the June 2022 projections—as high inflation and energy prices dampen household and firm activity and prompt tighter monetary policy. The slowdown in activity in Central Europe is expected to be exacerbated by weakening external demand, particularly from the euro area.

The outlook faces considerable downside risk given geopolitical uncertainty and energy security in Central Europe and the euro area ahead of the upcoming winter. Although the EU met its natural gas storage target in September—a few months ahead of schedule—unexpected extreme temperatures could force an accelerated drawdown of supplies, creating a scenario in which countries must purchase additional natural gas at historically high prices or enforce severe rationing. Either option would pose a significant drag on growth, as higher prices or rationing translate into lower firm activity and household consumption.

Low productivity growth in Central Europe remains a key obstacle to faster economic growth and convergence toward the EU average, driven by a declining and aging population, barriers to competition, and low investment in research and development. Refugees from the war in Ukraine could present a boost to the Central European economy by partly offsetting the ongoing decline in the working-age population, while also increasing domestic demand. Central Europe is also expected to benefit from funding from the EU Recovery and Resilience Facility—the largest component of the Next Generation EU funds. Meaningful

reforms alongside effective absorption of the upcoming EU funds will be crucial to ensure that the region experiences a boost to potential growth in the coming decade (World Bank 2022h).

Western Balkans

In the Western Balkans, output is forecast to grow 3.4 percent in 2022—the slowest pace among the ECA subregions outside Eastern Europe but slightly stronger than potential growth amid robust exports and tourism (World Bank forthcoming b). Nevertheless, at this pace of growth, output could fully recover and surpass pre-pandemic levels, although with wide variation at the country level. Growth is projected to remain at an average of 2.9 percent over the forecast horizon, as EU accession reforms and investment mitigate the negative impacts imposed by higher energy and food prices, disruptions to trade and investment flows, and spillovers from the slowdown in euro area activity.

The disruption of natural gas flows to the region, which relies on Russia for 67 percent of its natural gas imports, has increased energy prices and amplified pressures for higher electricity subsidies (Albania, North Macedonia, and Kosovo) (World Bank 2022i). Bosnia and Herzegovina, North Macedonia (via the Bulgarian pipeline), and Serbia are completely reliant on Russia for their natural gas supply. However, Serbia's storage capacity has helped to mitigate the supply shock in the short term (World Bank 2022i). In 2022, Russia cut access to its natural gas exports to several Western Balkan economies, raising energy stability concerns domestically and in the EU—the region's largest trading partner and source of foreign investment.

Tightening global financing conditions have constrained the availability of external financing to the region. Increasing borrowing costs, as well as food and energy price controls (Bosnia and Herzegovina and Serbia), have added upward pressure on public debt and its servicing costs, which had already risen sharply following extraordinary pandemic-related government support in 2020. Reduced fiscal space and diminished fiscal sustainability heighten the Western Balkans' vulnerability to external shocks—including from a faster-than-expected tightening in global financing conditions.

Potential growth in the region remains constrained by the need for structural reforms to boost productivity, increase competition, invest in human capital, and strengthen governance (World Bank 2022i). Over the medium term, the EU's recently adopted Economic and Investment Plan for the Western Balkans, which will mobilize funding to support competitiveness and inclusive growth as well as the green and digital transitions, is expected to support reform efforts. However, growing political uncertainty in the region may lead to delays in reform progression as parliamentary impasses prevent efficient absorption of funds and create delays in reform implementation (Bosnia and Herzegovina, Montenegro, and North Macedonia). By the end of 2022, it is expected that all six countries in the region will have applied to join the EU, with the initiation of accession talks in Albania and North Macedonia providing meaningful progress in negotiations toward accelerated memberships for the two countries.

Risks to the Regional and Global Outlook from Russia's Invasion of Ukraine

Risks to the ECA outlook remain heavily skewed to the downside. Prolonged or intensified war or armed conflict could cause significantly larger economic and environmental damage and greater potential for fragmentation of international trade and investment, especially as it comes on the heels of heightened tensions in the region. There would also be a further deterioration of the humanitarian situation, which is already dire in the baseline outlook.

Since June, downside risks associated with war-driven disruptions in energy imports from Russia have materialized and worsened the growth outlook, especially for the euro area—ECA's largest trading partner—and Russia, which is likely to inflict further damage to ECA's economy. Natural gas storage can secure flows during peak demand, but it is not suitable for long duration replacement of piped imports. Even with storage 90 percent full in the EU, if Nord Stream 1 remains closed, most of the EU and several ECA countries can face gas disruptions in the second half of the winter season (IEA 2022b). Even in the EU, total storage capacity represents only about 20 percent of annual consumption, and many countries don't have relevant storage capacities, as over three-quarters of storage in concentrated in six EU countries. The EU target in July 2022 aimed at reaching 80 percent of gas storage capacity levels or 35 percent of national consumption, which assumed uninterrupted import natural gas flows through pipelines—in other words, no further interruption in Nord Stream 1, which has not been the case. In ECA, additional disruptions to supplies of natural gas and oil are acute risks in Central Europe and the Western Balkans. Available stocks of natural gas vary, with limited storage capacity in smaller countries, such as Bosnia and Herzegovina, while in Serbia existing inventory could help mitigate the immediate supply shock.

If record high food prices persist, monetary policy tightening could be accelerated and a significantly higher number of people than currently expected could be pushed into extreme poverty and experience food insecurity, especially in countries that are reliant on Russia and Ukraine for grains. The spike in commodity prices and subsequently higher inflation could also contribute to social unrest in some countries (Kammer et al. 2022). Vulnerable countries typically have weaker governance and social safety nets, fewer job opportunities, less fiscal space, and elevated political tensions.

The outlook remains vulnerable to financial stress, especially given high debt levels and elevated inflation. Russia's sizable macroeconomic buffers are now impaired, increasing the risk of a credit crunch in the banking sector—additional restrictions could cause further dysfunction in domestic financial markets and greater macroeconomic destabilization. There are unknown risks that could materialize in the regional financial system, potentially arising from under-appreciated exposures to Russia, such as leveraged over-the-counter products that depend on underlying Russian assets.

Long-Term Challenges and Policies

In Europe and Central Asia, overlapping shocks from the pandemic and Russia's invasion of Ukraine have exacerbated the slowdown in long-term growth prospects and created difficult policy choices. These shocks have reversed earlier progress made toward the achievement of the Sustainable Development Goals. More than ever, policy makers will need to ensure social safety nets are robust and well targeted to balance the need for fiscal sustainability with that of providing support to vulnerable populations. ECA's economies also need to emphasize spending on growth-enhancing investments to help support the digital and green transitions. For some energy exporters, higher commodity prices represent an opportunity to invest windfall gains in measures that yield long-term growth dividends and promote diversification, which will help these economies adapt to the green transition. Long-standing structural issues related to weak institutions and an incomplete market transition will also need to be addressed to reignite productivity growth.

Strengthening Social Protection to Meet New Challenges in an Inclusive and Adaptive Manner

Robust social safety nets can underpin a productivity-driven recovery from the pandemic and the ongoing cost-of-living crisis if they facilitate the reallocation of labor to more productive employment. These social safety nets should be inclusive and adaptive and should extend coverage to diverse groups of workers and communities that are adversely affected by the cost-of-living crisis and the technology, globalization, demography, and climate change–driven transitions of the labor markets.

Labor market deregulation, technological change, and trade integration are already reshaping employment patterns across ECA. Conventional social protection systems, built around employment-based insurance schemes, may fail to provide adequate coverage as old jobs disappear and novel work arrangements spread rapidly. In addition, over the past two decades, job tenure in EU countries shrunk, particularly for vulnerable groups of the working population, including youth, women, and low-skilled workers. These vulnerable groups are therefore particularly adversely affected by the secular decline in traditional jobs and the shift toward more flexible employment standards. Expected large-scale reallocation of labor across sectors triggered by the transition to a green economy will also test the capacity of many social protection systems to handle that transition smoothly. Technological change and global competition put a premium on the private sector's agility and quick adjustment to ever-changing consumer preferences for new products and services and would entail a higher frequency of transitions between jobs. Against this backdrop, equitable social protection systems should strengthen the protection of vulnerable workers during the green transition without stalling job creation in the green economy.

Formidable challenges confront the systems of social protection in ECA, especially when many governments are already facing increasing fiscal headwinds. Agile, fair, and pro-growth social safety nets need to enhance preparedness and responsiveness to big shocks (such as the COVID-19 pandemic, an influx of

refugees on the scale triggered by the war in Ukraine, or the cost-of-living crisis); catch up with a rapid transformation of European labor markets, which creates new disparities and vulnerabilities in different segments of the labor force; and prepare for the labor market disruptions that are expected to result from the green energy transition.

Building a modern social protection system. Unreformed employment-based, risk-sharing safety nets structured around job protection risk making social protection less inclusive and could leave an increasing share of the labor force unprotected as the ongoing transformation of the ECA labor markets gathers pace. Demographic challenges, such as aging population, falling birth rates, and immigration; increasing job turnover; and proliferation of nonstandard employment, driven by technological change, globalization and regulatory reforms, undermine the ability of traditional pillars of social protection (such as pay-as-you-go pension systems and employer-based provision of social benefits) to respond effectively to shocks and support the labor market transition to a green economy. A modern social protection system should mitigate the shorter-term impacts of shocks, facilitate longer-term economic recovery and economic growth, and support the job reallocation that the green transition will require.

Optimal social protection policy should respond to shocks and long-term changes in the labor market affecting incomes and jobs, such as, for example, the COVID-19 pandemic, the energy price shock, and technology-driven automation of jobs. Optimal social policy should ensure welfare protection of broad groups of the population as well as support sustainable growth without hindering the reallocation of labor to more productive sectors of the economy. Publicly financed policies, such as a guaranteed minimum income, a negative income tax scheme, or a universal basic income program, would shield most people from substantial welfare losses regardless of their labor market status. At the minimum, income support programs should be means-tested, to ensure they reach the poorest and those who face an adverse shock. Social protection systems can also be made more adaptive by setting out in advance the rules that would guide any changes, such as modifications to eligibility criteria, system procedures, and benefit amounts that a sudden shock would necessitate. Such policies could be the base of an equitable social protection system.

Job losses and transitional unemployment should be insured by national unemployment income support programs instead of employer-provided arrangements, which are suboptimal from a risk-pooling perspective. Generous severance payments, for example, may distort firms' labor choices, by deterring formal hiring. Broad unemployment income support programs, financed from mandatory individual savings and complemented by public funding, are less distortionary and more protective.

When such measures are in place, governments can adapt their social protection policies to rapidly changing labor market conditions by implementing regulatory reforms that gradually remove restrictions on firms' hiring and dismissal practices. Uniformly enforced regulations protecting workers, irrespective of their work arrangements, against abuses by employers and hazardous working conditions will guarantee that more flexible labor markets will enhance workers' welfare.

Social protection systems will need to address the challenges of the post-pandemic labor market and the green transition. When entire sectors or types of jobs disappear, employment-based insurance schemes cannot provide adequate protection to the affected groups of the population. Policies to encourage human capital accumulation, employment assistance programs, and other active labor market policies—such as skills training, entrepreneurial support, and intermediation—can be helpful to smooth adjustments to changing labor markets and ongoing economic transformations. Evidence shows that sectoral employment programs can be particularly effective when they provide training for transferrable skills and help match individuals with jobs in high-wage sectors. The private sector could play a role in subsidizing training in sector-specific skills.

Successful implementation of modern social protection systems will increasingly rely on the use of digital tools to manage the massive amounts of labor market data and monitor people's welfare. Countries in ECA need to harness digitalization to improve their capacity to deliver services effectively and target vulnerable populations better. Much stronger cooperation and information sharing between government agencies is required to set up an integrated system that responds quickly to the fast-changing landscape of work.

Protecting refugees. The wave of refugees from Ukraine to neighboring ECA countries, especially Poland, dwarfs previous crises—more than 7 million Ukrainian refugees are estimated to be present in Europe (UNHCR 2022b). While the majority of them will eventually return to their home country, this will not happen soon and will be conditional on the outcome of the conflict. As a result, it will be critical for host countries to mobilize resources to ensure public service delivery and effective absorption of migrants in the short- and medium-term. The main difficulty is designing policies that will allow seamless integration of the refugees into the host country economies and enable the ECA region to take advantage of the gains generated by labor mobility and address the costs (World Bank 2019). This also applies to the integration of internally displaced people within the borders of Ukraine.

On the upside, compared to previous waves of immigration in Europe, Ukrainian refugees could have better integration prospects into European labor markets. A relatively high share of the refugees are well educated, and many have already stayed or worked in the host countries. Many refugees have a good degree of familiarity with the host country labor markets because of information sharing in social networks and sizable Ukrainian immigrant communities that were already present in the EU before Russia's invasion of Ukraine (Eurostat 2022). The previous wave of Ukrainian migrants to Poland, for example, helped alleviate demographic pressures and bolstered Polish growth by an estimated 0.3 to 0.5 percentage point per year. The current wave could help alleviate labor shortages and lift long-term growth in the EU (Kammer et al. 2022; Strzelecki, Growiec, and Wyszyński 2022). The overall impact on the EU labor force of the inflows of Ukrainian refugees is estimated at 0.5 percent by the end of 2022, with Czechia, Poland, and Estonia experiencing the largest gains of about 2 percent (OECD 2022b).

Since many Ukrainian refugees are children, disruption to education could have lasting negative impacts on the future labor market outcomes and social

integration potential of refugee children and youth. Therefore, ensuring adequate access to schooling poses another formidable challenge for the host countries, which need to integrate a large number of refugee students into their education systems and provide social and emotional support to refugee youth.

Securing a Sustainable Future

In the medium term, the green transition would help reduce the region's dependence on fossil fuel imports while also supporting energy security. The current juncture provides an opportunity to put in place effective policies that encourage more efficient consumption of energy—similar to the experience of the United States in the 1970s, when surging energy prices prompted policy makers to impose and tighten fuel efficiency standards on cars and home appliances and lower speed limits (World Bank 2022d). Since then, per capita energy consumption has fallen sharply and oil consumption even more so. It is thus essential for policy makers today to continue carbon reduction efforts and utilize the current energy price shocks to embolden the transition to net zero emissions.

Efforts can be made to incentivize a shift away from fossil fuel consumption, such as by encouraging electric power transport and renewable energy generation. Given reduced fiscal space, it is even more essential that green investments generate the greatest value toward achieving the objectives embedded in the European Green Deal. Policies and incentives must shift away from perpetuating the use of fossil fuels, toward renewable energy sources and improvements in energy efficiency. Higher domestic production of renewable energy coupled with increased energy efficiency will contribute to lowering fossil fuel consumption and imports, achieving greater energy independence in EU member states and other economies, and nurturing the green transition.

Key national policies can include creating climate-smart regulatory frameworks, introducing carbon pricing policy instruments (once prices have fallen and stabilized), addressing building efficiency standards, and strengthening land use regulations. In energy exporters, prudent management of resource rents involves avoiding inefficient and distortive energy subsidies, and instead increasing export diversification, strengthening long-term growth prospects, and building resilience to external shocks.

Policies that aim to dismantle fossil fuel subsidies raise formidable political-economy challenges and should be embedded with supportive frameworks to ensure success (World Bank 2020). Promoting transparency in price setting, such as through clearly stated thresholds or formulas to set energy prices, is crucial to ensuring that subsidy removals are de-politicized (Inchauste and Victor 2017). Additionally, avoiding larger, more disruptive price changes in favor of more frequent price adjustments in price setting formulas will help to avoid price shocks. In several countries, using supporting reforms to offset the removal of energy subsidies, such as through cutting the cost of other household public serves or increasing social benefits, has helped to build public support for energy subsidy reform; however, such an approach requires improved capacity to implement additional benefit programs and should be implemented once energy prices fall from current elevated levels (Inchauste and Victor 2017). Finally,

awareness campaigns should be used to highlight the benefits of subsidy reforms and encourage public support (El-Katiri and Fattouh 2017).

Improving Institutions for a Robust Economic Recovery

Strengthening institutional quality is key for fortifying the foundation for a robust and sustained economic recovery from the pandemic and the war in Ukraine. Strong institutions and conducive business climates set the preconditions for sustained growth. They encourage private sector investment and innovation by minimizing expropriation risk, creating a stable and confidence-inspiring policy environment, lowering the costs of doing business, and encouraging participation in the formal sector where productivity tends to be higher (World Bank 2018, 2019a). Good governance also ensures competitive and flexible markets with limited market concentration, effective regulation, and efficient and equitable provision of public services, including health care, education, and public infrastructure (Acemoglu and Johnson 2005; Dort, Méon, and Sekkat 2014; Gwartney, Holcombe, and Lawson 2006).

Institutional change can raise investment and productivity growth directly by increasing private returns to productivity-enhancing investment in human and physical capital. Institutional reforms can also promote investment and productivity growth indirectly, by removing obstacles to other drivers of long-term growth, such as innovation, openness, competition, and financial development (Acemoglu and 2005; Botero, Ponce, and Shleifer 2012; Glaeser et al. 2004; Glaeser, Ponzetto, and Shleifer 2007). Thus, there is considerable scope for governments to stem or reverse drags on potential growth (such as from adverse demographics) by strengthening institutions, reducing corruption, dismantling regulatory barriers to doing business and entrepreneurship, and ensuring effective regulation that is conducive for the efficient working of competitive markets (Kilic Celik, Kose, and Ohnsorge 2020).

The potential benefits of institutional reforms are underscored by the fact that weak institutions and governance remain a substantial obstacle to sustained growth of investment and productivity in ECA's countries. ECA's economies may be unable to achieve the potential output growth envisioned over the next decade without strong commitment to institutional reforms. Pervasive corruption and large informal sectors are formidable constraints on the ability of private firms to invest, innovate, and close the productivity gap with the EU.

Weaker rule of law can generate an uneven playing field for the private sector when it comes to competing against the state, while unaddressed corruption can contribute to state capture. In turn, this could increase several downside risks, including those related to spillovers from impaired corporate balance sheets to public balance sheets—when realized, these events have historically led to large fiscal costs (Bova et al. 2016). Significant barriers remain, especially with battling corruption—most ECA countries rank below the EU average in the public institutions component of the Global Competitiveness Index, with sizable gaps in ethics and corruption.

Moreover, Enterprise Survey data indicate that institutional weakness may be hindering the private sector—firms highlight the obstacles related to meeting

with tax officials and competition from informal firms, among other constraints. In many ECA economies, the share of firms using credit is lower than in the EU, which may suggest that a weak business environment is constraining firms' ability to access financing. Weak business environments may also diminish complementarities between public and foreign direct investment and domestic investment (Kose et al. 2017). A poor business climate allows anticompetitive practices to flourish, perpetuates corruption, discourages innovation, and distorts the efficient allocation of factors of production (Aghion and Schankermann 2004; Bourles et al. 2013; Buccirossi et al. 2013).

In the nearer term, improving institutional quality can be complemented by measures that strengthen macroeconomic stability and resilience. Given the current macroeconomic policy challenges of the region to temper inflation while protecting against currency depreciation and depletion of reserves, it is imperative that policy makers also move to strengthen legislation for monetary policy and bank supervision in order to help raise the credibility of macroeconomic frameworks and reduce the cost of policies that aim to reduce inflation and maintain currency stability (Gill and Ruta 2022b). Exchange rate pass-through from depreciation to inflation tends to be smaller in countries with more credible, transparent, and independent central banks; inflation-targeting monetary policy regimes; and better-anchored inflation expectations (Ha, Stocker, and Yilmazkuday 2019; Kose et al. 2019).

Annex 1.1 Data and Forecast Conventions

The macroeconomic forecasts presented in this report are the result of an iterative process involving staff from the World Bank Prospects Group in the Equitable Growth, Finance, and Institutions Vice-Presidency; country teams; regional and country offices; and the Europe and Central Asia Chief Economist's Office. This process incorporates data, macroeconometric models, and judgment.

Data

The data used to prepare the country forecasts come from a variety of sources. National income accounts, balance of payments, and fiscal data are from Haver Analytics; the World Bank's World Development Indicators; and the International Monetary Fund's (IMF's) World Economic Outlook, Balance of Payments Statistics, and International Financial Statistics. Population data and forecasts are from the United Nations' World Population Prospects. Country and lending group classifications are from the World Bank. In-house databases include commodity prices, data on previous forecast vintages, and country classifications. Other internal databases include high-frequency indicators—such as industrial production, Consumer Price Indexes, housing prices, exchange rates, exports, imports, and stock market indexes—based on data from Bloomberg, Haver Analytics, the Organisation for Economic Co-operation and Development's analytical housing price indicators, the IMF's Balance of Payments Statistics, and the IMF's International Financial Statistics. Aggregate growth for the world and all subgroups of countries (such as regions and income groups) is calculated as the gross domestic product–weighted average (in average 2010–19 prices) of country-specific growth rates. Income groups are defined as in the World Bank's classification of country groups.

Forecast Process

The process starts with initial assumptions about advanced economy growth and commodity price forecasts. These assumptions are used as conditions for the first set of growth forecasts for emerging markets and developing economies, which are produced using macroeconometric models, accounting frameworks to ensure national accounts identities and global consistency, estimates of spillovers from major economies, and high-frequency indicators. These forecasts are then evaluated to ensure consistency of treatment across similar economies. This process is followed by extensive discussions with World Bank country teams, which conduct continuous macroeconomic monitoring and dialogue with country authorities. Throughout the forecasting process, staff use macroeconometric models that allow the combination of judgment and consistency with model-based insights.

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Social Protection for Recovery

Globalization, demographic trends, and technological innovations are transforming European labor markets, altering their institutional and contractual arrangements and creating disparities and vulnerabilities in different segments of the labor force. The green transition will entail a reorientation of economies to sustainable ways of production and consumption, which will adversely affect the well-being of workers employed in "brown" industries. There is also an acknowledgment of the increasingly large role that systemic risks—economic, health or climate-related—play in driving poverty and vulnerability.

Social protection systems will need to be reformed to address these challenges and provide adequate protection to workers and families. There are important policy questions: in this context of increasing systemic risks and changing labor markets, should social protection systems prioritize the protection of jobs, such that after an adverse shock, workers can go back to their original employments, or should systems prioritize the protection of income, such that an adverse shock does not meaningfully affect the income of workers and families? More broadly, how should social insurance systems be designed—should they be contributory and tied to a worker's specific employment relationship, or should they be noncontributory and unrelated to a worker's job?

This *ECA Economic Update* provides the analytical framework and empirical evidence to answer these policy questions and help countries in the region transform their systems of social protection to respond to the new challenges. It builds on ongoing work by the World Bank on new approaches to social protection and presents the results of new research conducted for this report. It first describes and analyzes the response of the social protection systems to two significant shocks—the COVID-19 pandemic and the consequences of the war in Ukraine. This analysis provides some cues on the short-term effectiveness of social protection systems in addressing sudden shocks. The chapter then discusses the secular changes in the nature of work relationships in ECA labor markets and the

challenges they pose to SP systems over the long-term. The chapter concludes by providing some policy implications—and the direction in which social protection systems should be reformed to improve their effectiveness both in the short- and long-term.

This first section of the chapter analyzes the response of social protection systems in ECA to the COVID-19 pandemic. Compared to the rest of the world, the average social protection response package of ECA countries stands out for the substantial role that job protection policies play. In EMDE ECA countries, the average package of income protection policies represented about 1.3 percent of GDP and that of job protection policies about 0.9 percent of GDP. In non-ECA countries, the average income protection package was 1.4 percent of GDP, and the average job protection package was 0.4 percent of GDP.

The analysis assesses how well income protection and job protection policies in ECA countries promoted economic growth, reduced poverty, and preserved employment between the second half of 2020 and the end of 2021. The findings are based on a new dataset of the budgets of programs implemented as a part of pandemic stimulus packages. They show that, in the short run, higher expenditure on job protection measures was associated with higher employment and less inactivity and poverty, although this effect was significant only in countries with weaker pre-pandemic social insurance systems. In countries with broader coverage of the social insurance system, the income and job protection programs appear to have had a limited impact on employment and poverty. At the firm level, job protection programs seemed to hinder labor reallocation from less productive to more productive firms, suggesting a negative effect of this type of program on economic efficiency.

The second section of this chapter discusses the social protection challenges caused by the war in Ukraine and describes some of the policy responses that have been implemented. Millions of Ukrainian refugees have sought protection in Europe. Countries so far have successfully provided them with immediate food and shelter, but over the medium- and long-term, they will need to accommodate them in ways that ensure both their well-being and that of the host communities. Migrants from Central Asia in the Russian Federation and their families back home may be affected by the economic effect of sanctions. Increases in energy and food prices are already affecting vulnerable groups throughout ECA, and social protection systems in the region have quickly begun to address these challenges.

The experiences of the response to the COVID-19 pandemic and the current challenges caused by the war in Ukraine show that social protection systems in ECA can react effectively to sudden shocks in which the unemployment rate quadruples in a month, schools and childcare close, millions of people become poor and cross borders to protect their lives and livelihoods. But how well can the SP systems react to structural changes that happen over time? This is the subject of the third section of this chapter, which overviews the longer-term evolution of labor markets and discusses the challenges of adjusting social protection systems to them.

Growth in nonstandard employment and the reduction in job tenure—associated partly with the deregulation of the labor market but also with technological change and trade integration—pose challenges to the coverage current systems

provide, as these work arrangements may fall through the cracks of social protection systems built around employment-based insurance schemes. Over the last two decades, job tenure in ECA countries shrunk, particularly for youth, women, and low-skilled workers. Long-term trends in the labor market are thus having particularly severe effects on vulnerable groups of the working population. The transition to a green economy also entails a reallocation of labor across sectors—a process that social protection systems will have to accommodate to ensure smooth transition. Social protection systems geared towards job protection, rather than income protection, risk leaving the most vulnerable groups unprotected.

The last section of this chapter discusses new approaches to the optimal design of social protection policies in Europe to respond to ensure that countries can respond effectively to sudden shocks and to longer-term changes in the economic environment. It presents a design of a social protection system that guarantees minimum income support and worker protection that enables individuals to operate in the rapidly changing labor market by providing them with opportunities for high job mobility and continuous professional growth and skill upgrades while maintaining adequate standards of living. Such systems rely on technology-augmented administration and a hybrid funding approach in which governments provide guaranteed minimum standards of living and protection from large losses. The private sector supplements those benefits with voluntary matching contributions and subsidizes firm-specific skill building. The social protection systems of ECA countries are very heterogeneous in terms of their distance to this optimal design. In many of them, categorical, non-targeted social assistance benefits and contributory insurance schemes are the norm. In others, the transition to means-tested and more effective schemes is already in process. There are clear opportunities for a stepwise reform of social protection systems in ECA that will allow countries to better protect their citizens from short-term shocks and longer-term structural changes.

Social Protection Systems in Europe and Central Asia and Their Response to the COVID-19 Pandemic

Social Protection before the Pandemic

Social protection systems in ECA are among the largest and most generous in the world. The size and scope of these systems reflect the strong preference of the region's people for the job and income security.[1]

Social protection systems consist of social assistance, social insurance, labor market programs, social care services, and general subsidies. Before the pandemic, the average country in ECA spent about 13.5 percent of its GDP on these programs, and emerging market and developing economies (EMDEs) in the

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1. About 59 percent of European respondents considered job security a "very important" and 33 percent considered it an "important" attribute of a job, according to data from the 2015 round of the International Social Survey Programme (ISSP 2017).

region spent on average, about 9.6 percent of GDP (table 2.1). The level of spending ranged from 5 percent of GDP in the South Caucasus to 21.4 percent of GDP in Northern Europe. For comparison, non-European countries in the Organisation for Economic Co-operation and Development (OECD)—almost all of them high-income countries—spent, on average, 9 percent of GDP on social protection.[2]

The largest share of pre-pandemic social protection spending was allocated to social insurance, particularly old-age pensions (figure 2.1). Social assistance programs—which include noncontributory benefits designed to support vulnerable groups and alleviate poverty—represented a smaller share of social protection spending, except in Georgia, Kosovo, and to a smaller degree Ukraine, where social assistance spending was more substantial in relative terms.[3] Labor market programs were the smallest spending category other than social care services and general subsidies. They typically included passive measures (such as unemployment benefits); active measures (such as active labor market programs, training, job search support, and incentives schemes); and intermediation services (typically implemented by public employment services). Countries in the European Union were the biggest spenders in the region, but no country spent more than 1 percentage point of GDP on labor market programs.

Figure 2.2 compares spending on family and child allowances, unemployment benefits, and poverty alleviation/social exclusion programs with poverty rates before the pandemic, in both EU and non–EU ECA countries. It shows that heavy spending on social protection seems to have been associated with lower poverty rates across countries before the pandemic.

Social protection benefits typically target the poorest and most vulnerable segments of the population (examples include last-resort anti-poverty programs, guaranteed minimum income schemes, cash and in-kind transfers for poor households with children). ECA countries fell into two broad groups before the pandemic: countries characterized by high coverage of the poorest population but relatively low benefit adequacy and countries with relatively high benefit adequacy but lower coverage (figure 2.3).

Fiscal Response to the Pandemic

When the COVID-19 pandemic hit, in early 2020, governments around the world implemented massive stimulus packages to mitigate the economic shock. The size of the packages averaged about 5.6 percent of GDP, taking into account the expenditures planned for 2020 and 2021. In high-income countries, the average stimulus package reached 10 percent of GDP; in lower-middle and low-income countries, the average size was about 3 percent of GDP (IMF 2022; Demirgüç-Kunt, Lokshin, and Torre 2022). In ECA, the average country implemented a

2. The 9 percent figure is average public social spending (excluding on health) in 2017 by Australia, Canada, Chile, Colombia, Costa Rica, Israel, Japan, the Republic of Korea, Mexico, New Zealand, and the United States. Data are from the OECD social spending database (https://data.oecd.org/socialexp/social-spending.htm).
3. In Georgia and Kosovo most of the social assistance spending corresponds to non-contributory, old age pensions.

TABLE 2.1 Pre-pandemic social protection budgets and pandemic stimulus spending in Europe and Central Asia, by country (percent of GDP)

Subregion/country	Pre-pandemic social protection budget			Pandemic stimulus budget	Non-social protection stimulus	Pandemic social protection response budget		
	Total	Income protection	Job protection			Total	Income protection	Job protection
Central Asia	*7.37*	*7.04*	*0.33*	*4.36*	*2.40*	*1.96*	*1.96*	*0.01*
Kazakhstan	4.81	4.45	0.36	4.45	1.42	3.03	3.03	0
Kyrgyz Rep.	11.00	10.47	0.53	5.14	4.54	0.60	0.47	0.13
Tajikistan	4.21	3.95	0.27	2.93	2.45	0.48	0.48	0
Turkmenistan	—	—	—	—	—	—	—	—
Uzbekistan	12.35	12.11	0.24	4.27	4.03	0.24	0.24	0.00
Central Europe and Baltic countries	*13.31*	*12.86*	*0.45*	*6.72*	*4.37*	*2.35*	*1.13*	*1.22*
Bulgaria	11.25	10.69	0.56	5.59	1.40	4.17	2.67	1.50
Croatia	13.93	13.24	0.69	5.30	2.20	3.03	0.14	2.89
Czechia	12.26	11.83	0.43	9.88	8.34	1.54	0.73	0.81
Estonia	11.83	10.88	0.95	5.11	3.43	1.68	0.00	1.68
Hungary	12.27	11.48	0.79	9.96	8.28	1.68	0.89	0.79
Latvia	10.94	10.37	0.57	8.55	4.25	4.27	0.11	4.16
Lithuania	11.31	10.67	0.64	10.54	7.00	3.54	1.19	2.35
Poland	15.98	15.53	0.45	6.46	4.36	2.56	1.43	1.12
Romania	10.52	10.45	0.07	3.37	1.65	1.72	1.21	0.51
Slovak Rep.	11.81	11.25	0.56	4.97	2.41	2.55	0.24	2.31
Slovenia	14.49	13.92	0.57	8.59	5.44	3.15	0.57	2.58
Eastern Europe	*15.86*	*14.67*	*1.20*	*3.42*	*0.33*	*3.10*	*2.82*	*0.28*
Belarus	—	—	—	—	—	—	—	—
Moldova	7.92	7.05	0.87	—	—	—	—	—
Ukraine	16.37	15.16	1.22	3.42	0.33	3.10	2.82	0.28
Northern Europe	*21.44*	*19.82*	*1.62*	*10.19*	*7.42*	*2.77*	*0.84*	*1.92*
Denmark	24.53	21.84	2.70	17.55	14.81	2.74	0.14	2.60
Finland	23.02	21.00	2.02	5.20	0.98	4.22	3.30	0.92
Iceland	15.90	15.80	0.10	8.08	6.20	1.88	0.86	1.03
Norway	19.59	18.88	0.71	5.90	4.55	1.35	0.55	0.80
Sweden	20.18	18.77	1.41	11.02	8.02	3.01	0.23	2.77
Russian Federation	*10.12*	*10.10*	*0.02*	*4.35*	*2.84*	*1.52*	*0.66*	*0.85*
South Caucasus	*5.00*	*4.93*	*0.07*	*2.91*	*0.72*	*2.19*	*1.83*	*0.36*
Armenia	5.60	5.39	0.21	1.89	1.05	0.84	0.60	0.24
Azerbaijan	4.36	4.31	0.04	2.17	0.59	1.58	1.10	0.48
Georgia	6.23	6.18	0.04	5.54	0.80	4.74	4.60	0.13
Southern Europe	*19.80*	*18.10*	*1.70*	*9.46*	*6.76*	*2.70*	*0.98*	*1.72*
Cyprus	13.13	12.64	0.49	8.98	6.84	2.14	0.52	1.68

(continued next page)

TABLE 2.1 (continued)

Subregion/country	Pre-pandemic social protection budget			Pandemic stimulus budget	Non-social protection stimulus	Pandemic social protection response budget		
	Total	Income protection	Job protection			Total	Income protection	Job protection
Greece	19.98	19.06	0.93	19.83	16.91	2.93	1.70	1.23
Italy	22.00	20.48	1.52	10.62	8.01	2.61	1.18	1.44
Malta	8.93	8.62	0.31	0.36	0.22	0.15	0.06	0.08
Portugal	17.05	15.89	1.16	5.94	3.66	2.29	0.62	1.67
Spain	17.58	15.37	2.21	6.97	4.07	2.90	0.68	2.22
Türkiye	*8.10*	*7.69*	*0.41*	*3.81*	*1.93*	*1.88*	*1.58*	*0.30*
Western Balkans	*10.00*	*9.53*	*0.60*	*7.86*	*3.06*	*4.80*	*1.56*	*3.23*
Albania	8.81	7.74	1.07	2.18	0.33	1.86	1.24	0.61
Bosnia and Herzegovina	2.99	2.66	0.33	4.31	3.00	1.30	0.64	0.66
Kosovo	—	—	—	9.76	7.84	1.92	1.05	0.87
Montenegro	—	11.80	—	11.08	8.93	2.15	0.29	1.86
North Macedonia	11.67	10.93	0.73	4.17	3.58	0.58	0.51	0.07
Serbia	12.68	12.15	0.53	11.37	2.36	9.02	2.54	6.48
Western Europe	*17.82*	*16.39*	*1.43*	*12.89*	*10.23*	*2.65*	*0.88*	*1.77*
Austria	21.30	19.31	1.99	11.28	6.60	4.68	0.89	3.79
Belgium	20.28	18.29	1.99	7.09	5.30	1.79	1.65	0.14
France	22.41	19.83	2.58	12.14	9.18	2.95	0.90	2.05
Germany	18.59	17.27	1.32	13.35	11.58	1.77	0.68	1.09
Ireland	8.21	7.35	0.86	11.52	6.64	4.88	2.57	2.32
Luxembourg	16.29	15.11	1.18	11.70	8.62	3.08	..	3.07
Netherlands	17.55	15.75	1.79	11.90	9.32	2.58	0.61	1.96
Switzerland	17.70	17.10	0.60	7.95	5.21	2.74	1.57	1.16
United Kingdom	12.48	12.14	0.34	15.78	12.64	3.13	0.73	2.40
Emerging market and developing countries in ECA (country average)	9.56	9. 09	0.47	5.30	3.02	2.29	1.34	0.94
ECA (country average)	13.49	12.63	0.86	7.71	5.18	2.52	1.08	1.45
ECA (GDP weighted)	15.72	14.64	1.08	9.35	6.92	2.44	1.01	1.43

Sources: Pre-pandemic social protection spending: Authors' calculations based on data from the Social Protection Expenditure and Evaluation Database (SPEED) for the ECA region for all countries except Croatia (for which ESSPROS data were used) and countries in Northern, Western, and Southern Europe (for which OECD data were used for all countries except Cyprus and Malta, for which ESSPROS data were used). Pandemic stimulus budget: Data from IMF COVID-19 Policy Tracker. Non–social protection stimulus budget: Authors' calculations based on data from the IMF COVID-19 Policy Tracker. Pandemic social protection response budget: Data from Demirgüc-Kunt, Lokshin, and Torre (2022).
Note: All figures are for last pre-pandemic year for which data were available. Pre-pandemic data are latest available before 2020 for each indicator (years vary by country). Emerging market and developing countries in ECA include Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Hungary, Kazakhstan, Kosovo, the Kyrgyz Republic, Moldova, Montenegro, North Macedonia, Poland, Romania, the Russian Federation, Serbia, Tajikistan, Türkiye, Ukraine, and Uzbekistan.
— Not available.
.. Neglible

FIGURE 2.1 Spending on social protection programs in Europe and Central Asia before the pandemic, by country

a. Spending in EU countries

Legend: Old age and survivors · Social exclusion and housing · Disability · Family/children · Unemployment · Employers

b. Spending in countries outside the European Union

Legend: Social insurance · Social assistance · Labor market programs · Social care services · General subsidies
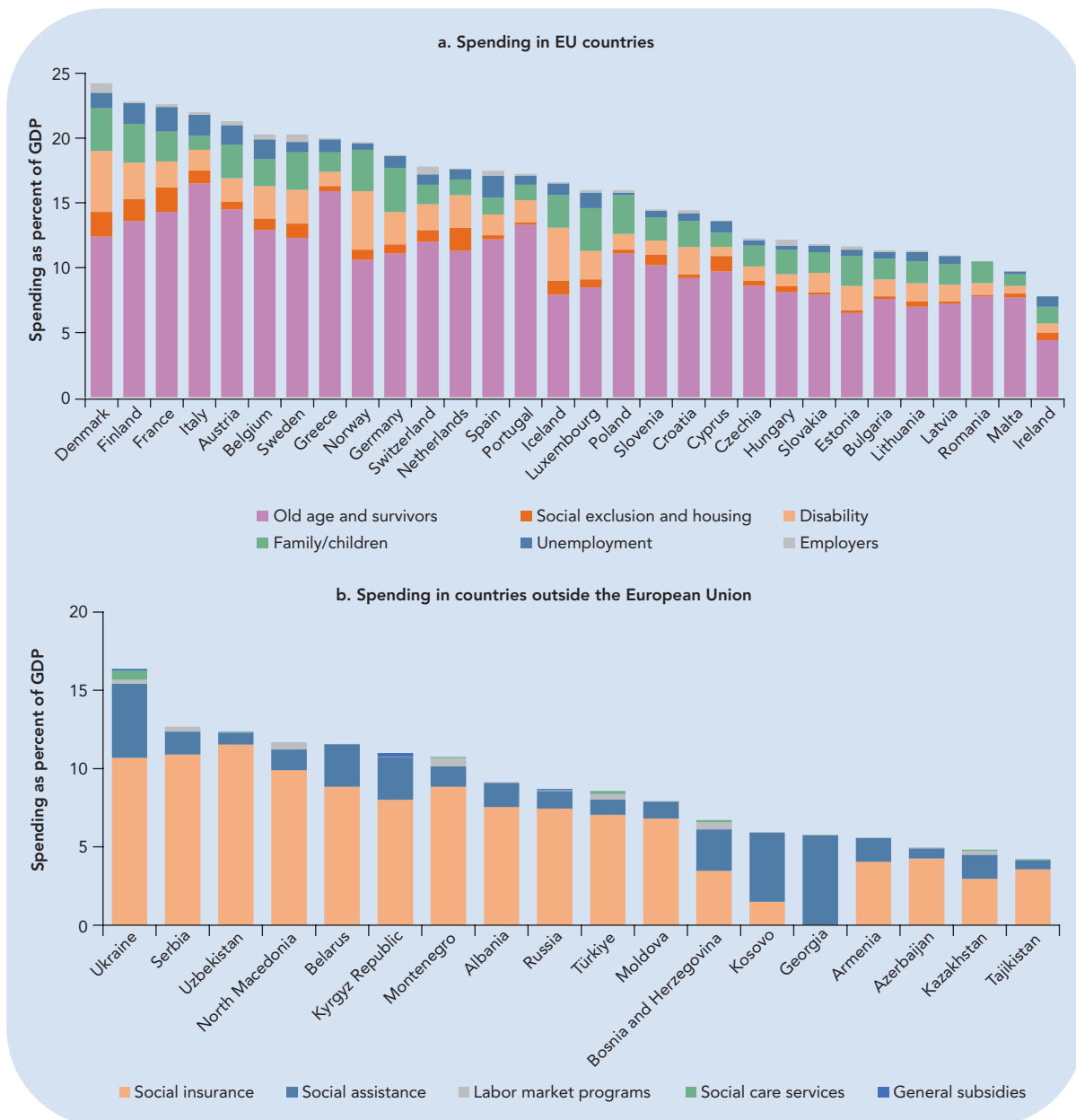
Source: Data for panel a are from the Eurostat ESSPROS database (https://ec.europa.eu/eurostat/web/social-protection/data/database) and LMP database (https://ec.europa.eu/employment_social/employment_analysis/lmp/lmp_esms.htm) . Data for panel b are from SPEED (Social Protection Expenditure and Evaluation Database for the ECA region).

Note: SPEED and Eurostat ESSPROS expenditure data differ in terms of the classification adopted to categorize and aggregate social programs, therefore their comparability remains limited. The main Eurostat ESSPROS database classifies expenditure based on the population group receiving the benefits. In contrast, SPEED first classifies the type of programs by main function and objectives and then breaks them down into recipient groups. In addition, SPEED identifies which programs are contributory (on a tax basis) and which programs are non-contributory, while ESSPROS does not include this information. Lastly, ESSPROS does not include information on transfers to employers, which are sourced from the LMP database. Both databases cover Bosnia, Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, North Macedonia, Poland, Serbia, Slovenia, the Slovak Republic, and Türkiye. Both also cover other countries (Central Asia for SPEED, Western Europe for ESSPROS). In panel b, expenditure years are 2019 for Albania, Azerbaijan, North Macedonia, Montenegro, and Serbia; 2018 for Georgia; 2017 for Armenia, Belarus, Bosnia and Herzegovina, Kazakhstan, Kosovo, the Kyrgyz Republic, Moldova, Tajikistan Ukraine, and Uzbekistan; 2016 for Russia and Türkiye; and 2014 for Croatia.

FIGURE 2.2 Spending on selected social protection categories in Europe and Central Asia and poverty or risk of poverty rate, by country

a. Spending in EU countries

Legend: Family/Children — Unemployment — Social Exclusion — ◆ At risk of poverty rate 2019 — ● At risk of poverty rate 2020

b. Spending in countries outside the European Union

Legend: Unemployment benefit — Family and child allowance — Poverty alleviation programs — ◆ Absolute poverty
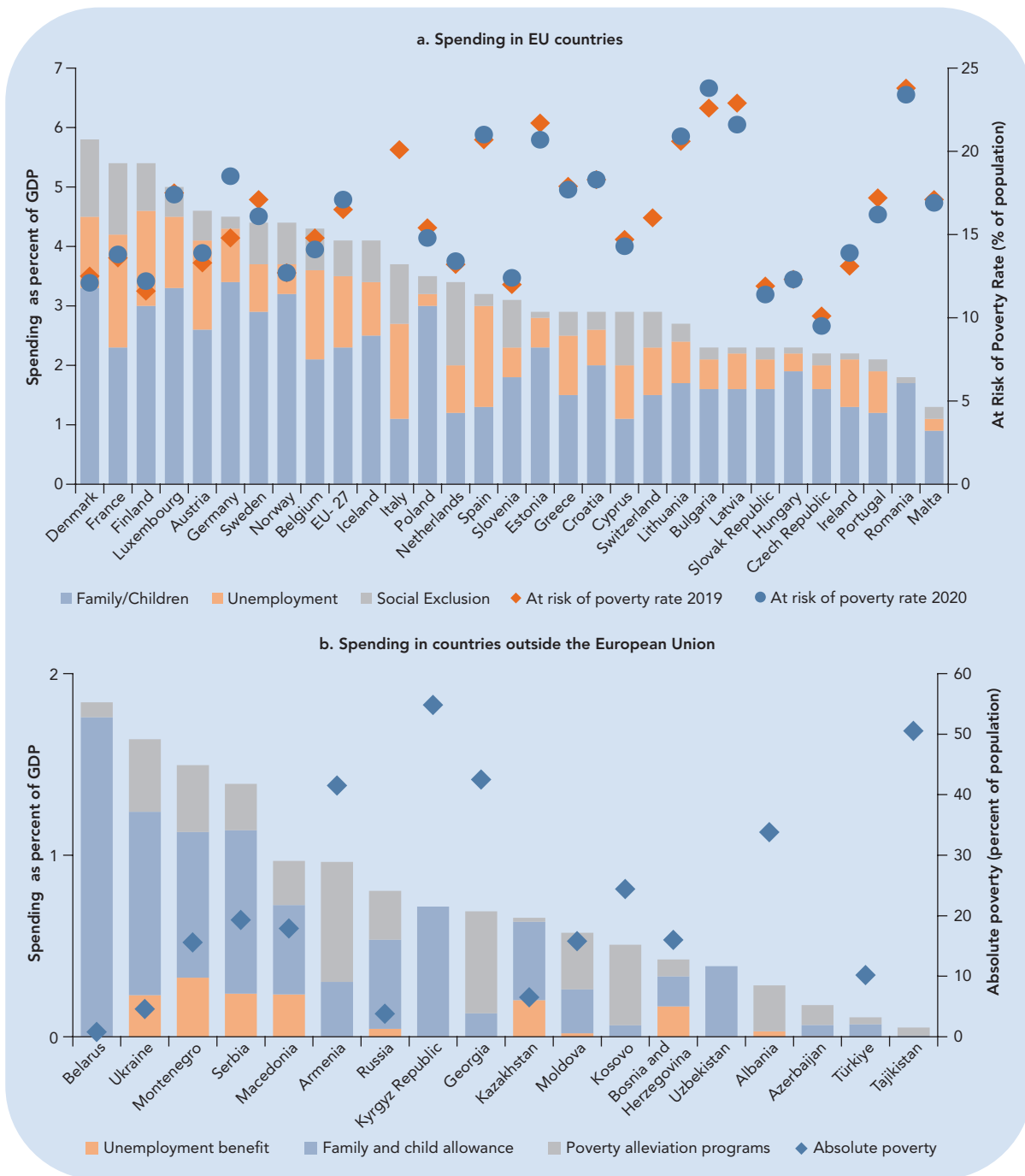
Sources: Data for panel a are from Eurostat. Data for panel b are from SPEED (Social Protection Expenditure and Evaluation Database) and World Development Indicators (poverty rate).

Note: Panel a uses the relative poverty line commonly used by Eurostat for EU countries. Panel b uses the absolute poverty line of $5.50 a day for the most recent year of data. In panel b, the spending data years are 2019 for Albania, Azerbaijan, Montenegro, North Macedonia, and Serbia; 2018 for Georgia; 2017 for Armenia, Belarus, Bosnia and Herzegovina, Kazakhstan, Kosovo, the Kyrgyz Republic, Moldova, Tajikistan, Ukraine, and Uzbekistan; and 2016 for Russia and Türkiye.

Note: All figures are for last pre-pandemic year for which data were available.

FIGURE 2.3 Coverage and adequacy of social assistance benefits in the poorest quintile in Europe and Central Asia before the pandemic
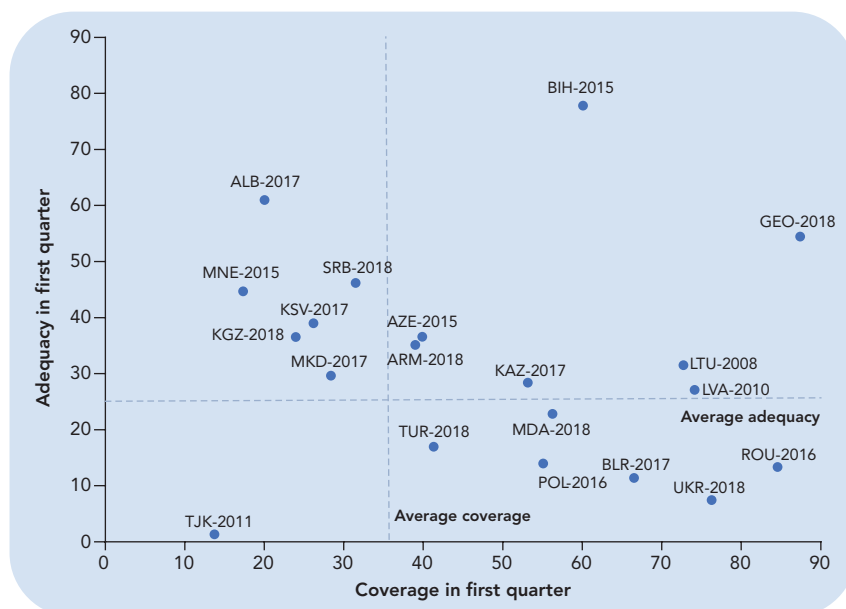
Source: SPEED. Data are reported for 2018 or 2017 for the majority of countries or for the most recent survey year available. Social assistance coverage in the first quarter is defined as the number of people in the poorest quintile living in a household with at least one beneficiary of social assistance benefits as a percent of the population in the first quarter. Adequacy of social assistance benefits in the first quarter is the total amount of social assistance benefits received by the poorest quintile as a percent of the total welfare of social assistance beneficiaries in the first quarter.

package of about 7.7 percent of GDP, with countries in Western Europe implementing the largest packages (almost 13 percent of GDP on average) and those in the South Caucasus the smallest (less than 3 percent of GDP on average) (see table 2.1). The average EMDE in ECA implemented a package of 5.3 percent of GDP.

The stimulus packages also included infrastructure spending and general business support measures. These non–social protection policies were equivalent to more than 10 percent of GDP in Western Europe (almost 80 percent of the stimulus budget there). Non–social protection stimulus policies represented about 7.4 percent of GDP in Northern Europe and about 6.8 percent in Southern Europe (more than 70 percent of the total stimulus budget in both subregions). In Eastern Europe and the South Caucasus, these policies represented less than 1 percent of GDP (figure 2.4).

Social protection policies were an essential part of these fiscal efforts. Globally, the average size of the social protection response budget[4] was 2.0 percent of countries' GDP. Like the overall stimulus budget, the size of the social protection pandemic response varied widely across countries at every income level (figure 2.5). On average, high-income countries allocated almost 3.4 percent of their GDP to social protection responses, with several countries allocating more than 5 percent. Upper-middle-income countries allocated 1.9 percent of GDP on average, almost half of their overall stimulus packages. Lower-middle-income countries allocated just 1.3 percent of GDP to the social protection response, about a third

4. By social protection response budget we refer to the planned budget over 2020 and 2021 of all the social protection policies announced from March 1, 2020 to June 1, 2021. For more details, see Demirgüç-Kunt, Lokshin, and Torre 2022.

FIGURE 2.4 Pandemic stimulus budgets in 2020–21 in Europe and Central Asia, by expenditure type and subregion
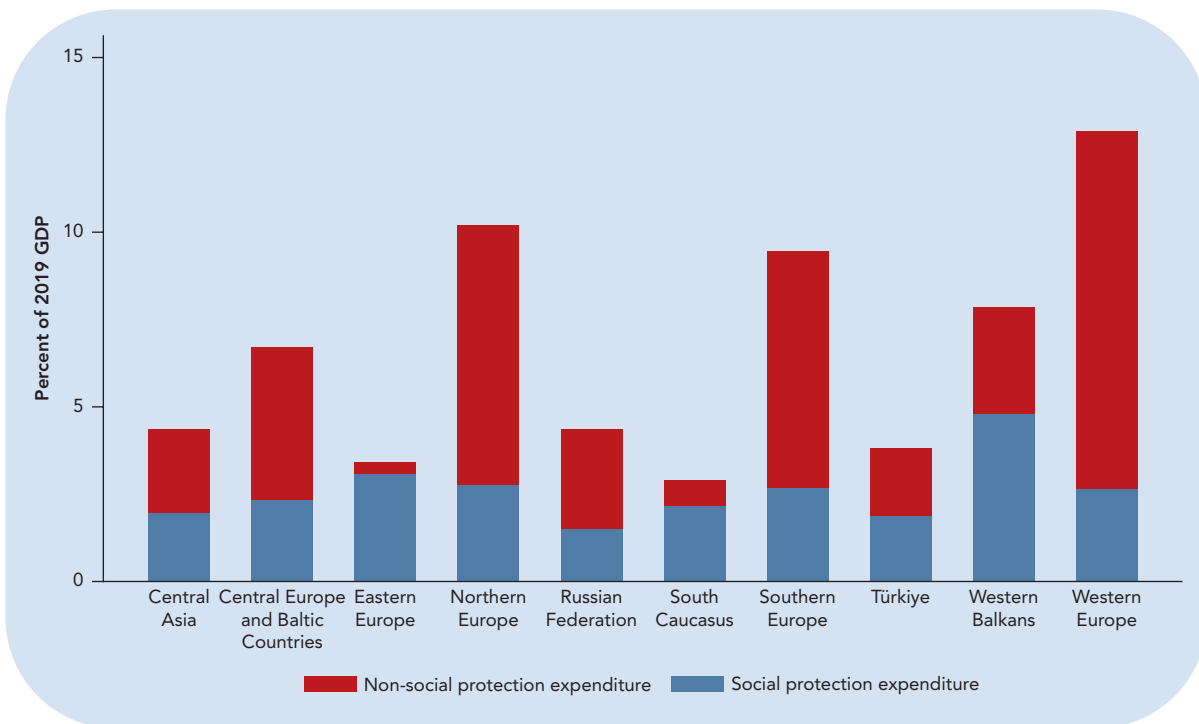
Sources: Authors' calculations based on data from the IMF COVID-19 Policy Tracker and Demirgüç-Kunt, Lokshin, and Torre 2022.

FIGURE 2.5 Social protection pandemic response budget in Europe and Central Asia in 2020–21, by country and income level
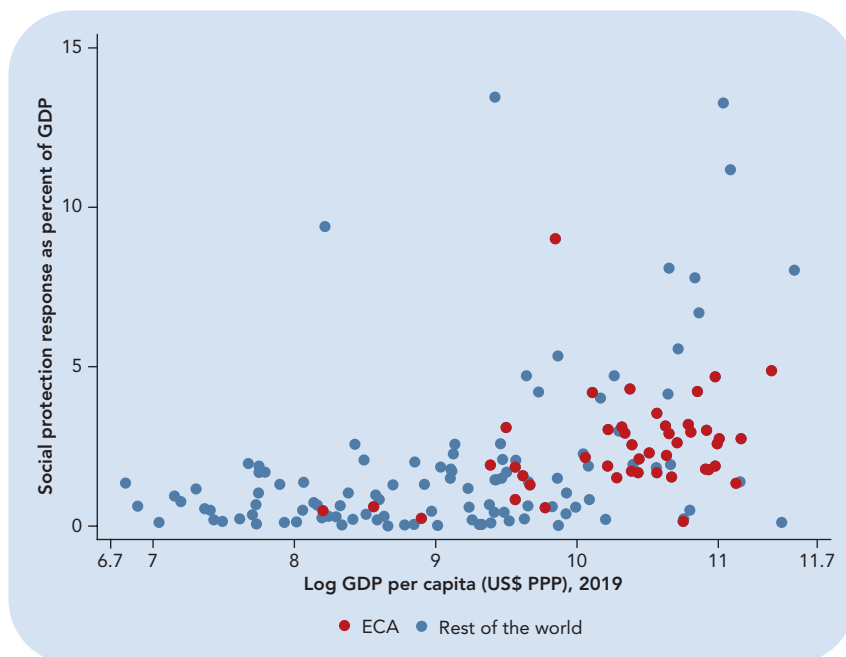
Source: Social protection budget data are from Demirgüç-Kunt, Lokshin, and Torre 2022. GDP data are from World Development Indicators (World Bank 2021b).

of these countries' overall stimulus budget. This positive correlation between the size of the social protection response package and income levels can be partly attributed to differences in government effectiveness (box 2.1).

Variation across countries was smaller in ECA than at the global level. The largest social protection package in the region was implemented by Serbia, at about 9 percent of GDP. Leaving it aside, the average social protection response

BOX 2.1 The social protection Engel curve

Poor countries devote a much smaller share of their national income to social protection than rich countries do. This pattern can be characterized as a rising (Working-Leser) Engel curve for social protection across countries (Lokshin, Ravallion, and Torre 2022).

The social protection Engel curve (SPEC) was rather stable between 1995 and 2019 (figure B.2.1.1). Despite the extra attention social protection has received in development policy discussions, aid programs, and academic research since around 2000, there is no sign that public spending on social protection rose at a given level of GDP per capita. Larger shares of national income devoted to social protection in initially poorer countries have stemmed instead from economic growth in those countries—movement along the (rising) SPEC rather than upward shifts of the curve at the lower end, as one would expect if there had been a change in development policy priorities.

FIGURE B.2.1.1 Nonparametric social protection Engel curves for various years
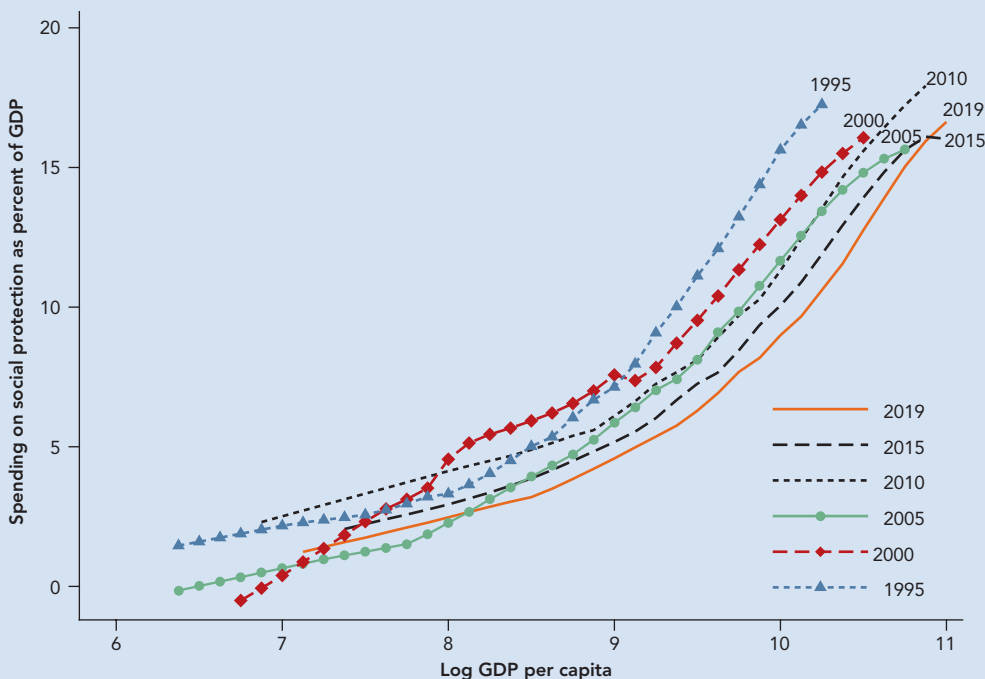
Source: Lokshin, Ravallion, and Torre 2022.
Note: The nonparametric regression lines are smoothed cross-country scatter plots (using the "lowess" command in Stata) of each country's income levels (horizontal axis) and its expenditure on social protection as a percent of GDP (vertical axis). The five richest countries in the income distribution of every year are excluded from each lowess estimation.

(continued next page)

The social protection response to the pandemic did not reflect a general departure from the pre-pandemic pattern of smaller shares of national income being devoted to social protection in poorer countries.

The upward slope of the SPEC can be potentially explained by factors other than just economic growth. Lokshin, Ravallion, and Torre (2022) explore several of these drivers. Several factors, notably the accountability of governments, their governance, the aging of the population, and information, communications, and technology (ICT) coverage (as proxied by Internet use) account for the positive income effect on social protection spending. Once these factors are taken into account, the

shape of the SPEC changes direction and is negative sloping, suggesting that social protection is not a "luxury good" but, rather, a necessity.

When looking at the social protection response to the pandemic, however, one factor appears to fully account for the positive association between income levels and spending: government effectiveness. In fact, controlling only for government effectiveness (set at the global mean and measured by the indicator of the same name in the World Governance Indicators), the share of GDP devoted to social protection during the pandemic is essentially no different in rich and poor countries (figure B.2.1.2). In other words, social protection during the pandemic was neither a necessity nor

FIGURE B.2.1.2 Social protection Engel curve during the pandemic
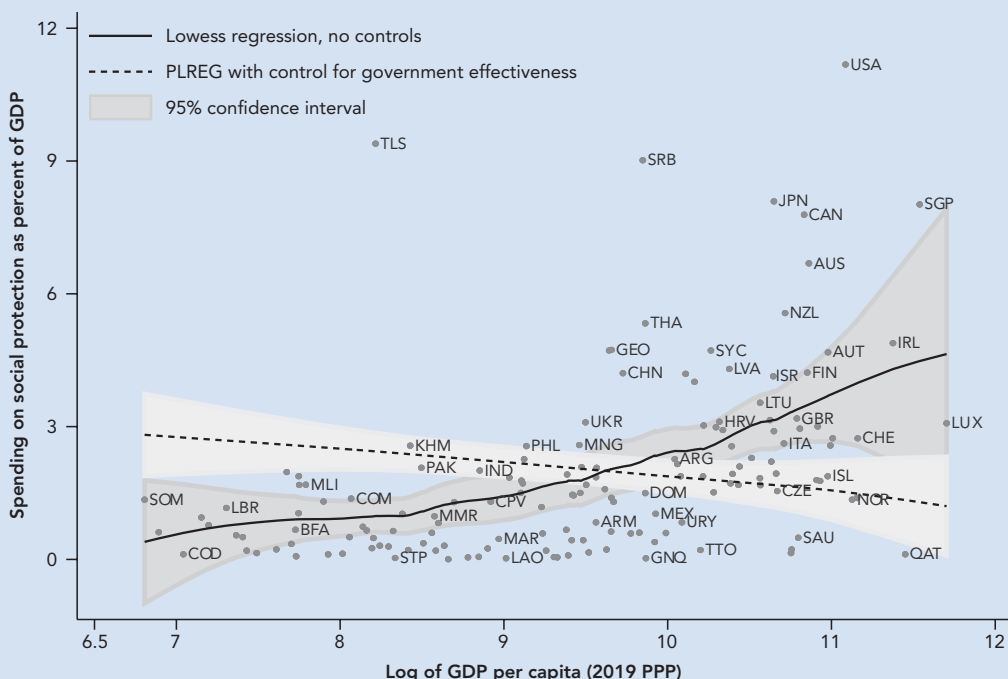
Source: Lokshin, Ravallion, and Torre 2022.
Note: The graph plots, for 154 countries with the required data, the social protection response budget to the COVID-19 pandemic, as a percent of the 2019 GDP (vertical axis) against log GDP per capita for 2019, in USD PPP prices (horizontal axis). The dark line shows the simple nonparametric social protection Engel curve with no controls. The dashed line shows the nonparametric social protection Engel curve after controlling for the government effectiveness indicator from the World Governance Indicators, set at its global mean value. PLREG stands for partially linear regression.

BOX 2.1 (continued)

a luxury. When it comes to implementing social protection policy responses to the pandemic, or any other big shock, the effectiveness of government in delivering public services more generally may well be a decisive factor. Scaling up existing programs will no doubt play a role, but rapid responses to a shock often require rapid resource mobilization and the ability to design and imple-

ment new policies (with new target beneficiaries, such as people whose employment is at risk), all of which will be easier with greater (pre-pandemic) capabilities for effective public service delivery. For instance, ICT development and government effectiveness reinforce each other, as government digitalization has shown to be associated with better service delivery (World Bank 2021a).

package in the region represented about 2.5 percent of GDP (2.3 percent of GDP for EMDE ECA countries [see table 2.1]). In Northern, Southern, and Western Europe, the average country allocated about 2.7 percent of GDP; in Central Asia, Central Europe, the South Caucasus, and Türkiye, the figure was closer to 2 percent of GDP. In the Western Balkans, excluding Serbia, the average social protection response package was 1.6 percent of GDP. Box 2.2 describes some examples of policies implemented as part of the pandemic social protection response in ECA.

BOX 2.2 Social protection response policies in Europe and Central Asia

Social protection response policies took three main forms in ECA: social assistance, labor market programs, and social insurance.

Social assistance

Some countries adjusted their existing social support programs by relaxing eligibility criteria, increasing benefit levels, and expanding the duration of coverage. Azerbaijan increased both the number of beneficiaries and the benefit level of its Targeted Social Assistance (TSA) program. As a result of these changes, the number of beneficiaries increased by 12,000, and the annual TSA benefit per capita increased from $303 in 2019 to $353 in 2020. Georgia expanded its main social assistance program, the TSA, by increasing the benefit amount to people with disabilities and relaxing eligibility and verification requirements for poor households to include those who were relatively poor, leading to a 22 percent increase in the number of beneficiaries. Kosovo doubled the amount

of its main social assistance program, the Social Assistance Scheme.

Other countries increased the flexibility of some of their programs by eliminating eligibility requirements, automatically renewing benefits, and softening conditionalities. Belarus reduced the reference period for the income that determined the eligibility of its main social assistance program, GASP (targeted social assistance), from six months to three months, allowing households affected by the crisis to access benefits. It also extended benefits to recipients whose benefits were set to expire between May and July 2020 until August of that year. North Macedonia removed eligibility criteria of its main social assistance program (GMA) that apply in normal circumstances but are not relevant in an emergency for all new applicants (for example, a 12-month ban for applying and awarding of the GMA, vehicle possession, and real estate property; relaxation of the three-month rule for income assessment; relaxation of the acti-

vation requirement) (World Bank 2022a). Serbia automatically renewed benefits for an additional three months for people whose benefits were set to expire on or after March 15, 2020.

Many ECA countries also introduced new benefits. Georgia provided emergency cash support of $534 per capita to laid-off/furloughed workers who lost income in 2020. Montenegro provided everyone who was registered as unemployed but did not receive any social assistance benefits, one-time cash assistance of $60. Serbia adopted two new measures, a one-time transfer of $115 to every adult and a $40 transfer to every pensioner (World Bank 2022b). Ukraine introduced a one-time $35 benefit for vulnerable pensioners, beneficiaries of disability programs, and social assistance beneficiaries not receiving any pensions.

Labor market programs

The most common labor market measures introduced in response to the pandemic were job retention schemes, such as wage subsidies and support for short-term work. Many countries introduced wage subsidy programs to help workers retain jobs or help reintegrate workers who lost jobs because of COVID-19. In September 2020, Albania introduced a program that subsidized the wages and insurance payments of workers in formal jobs who were laid off between March and June 2020; it later extended the cut-off date to December 2020 (Jorgoni 2021). Armenia introduced a wage subsidy program to firms with 2–50 workers that covered 20 percent of those firms' total wage bill.

Other programs were introduced to encourage a reduction in working hours. In 2020, Türkiye introduced the "reduced hours employment program" (*kisa calisma odenegi*), which banned lay-offs and provided subsidies to private sector firms to supplement wages.[1] Private sector employees could decrease their weekly working hours by as much as two-thirds of their full-time employment. In exchange, the government subsidized two-thirds of firms' employees' salaries. The program, which was initially expanded for three months, has been renewed multiple times.[2] Fifteen of the EU-27 countries introduced short-term work pro-

grams, and six introduced wage subsidy programs (Baptista and others 2021).

Social insurance

Social Insurance measures included the introduction of or changes to the rules for unemployment benefits, waivers, subsidies for social security contributions, and changes in the pension system.

Several countries introduced or expanded their unemployment benefit programs.

Albania introduced a program that guaranteed 12 months of employer and employee social insurance contributions. It had reached 2,417 workers by June 2021. Azerbaijan extended unemployment payments for people whose benefits had expired but who remained unemployed. It reduced its mandatory social insurance contribution rates between April 2020 and January 2021. Kosovo allowed participants to withdraw up to 10 percent of their pension fund balances (and repaid by the government) in order to cope with the effects of the COVID-19 shock and boost consumption. In April 2020, the Turkish government introduced a new cash assistance (*nakdi ucret destegi*) program for the employed that targeted employees who remained officially employed but were furloughed by their employer because of lack of income or closures during the COVID-19 pandemic.

Most EU-27 countries also made changes to their unemployment benefit programs, expanding the duration of benefits, relaxing eligibility and verification conditions, and/or increasing benefit levels. Some EU countries also provided additional unemployment support to the self-employed. In Sweden, self-employed individuals who received unemployment benefits were allowed to continue with activities related to their business, in order to prepare them for when the economy reopens (Spasova and others 2021). Countries in the European Union also introduced waivers and subsidies for social security payments and made changes to pension systems.

Notes

1. See https://www.iskur.gov.tr/isveren/kisa-calisma-odenegi/genel-bilgiler/.

2. See https://www.iskur.gov.tr/duyurular/kisa-calisma-odenegi-3-ay-daha-uzatildi/.

The Social Protection Response to the Pandemic: Protect Incomes or Protect Jobs?

Social protection policies implemented in response to the pandemic can be broadly categorized as policies that aim to protect income and policies that aim to protect jobs. Among the first group are the massive income support programs deployed during the pandemic through stimulus packages that incorporated cash transfer programs, expanded existing social assistance programs, and introduced new ones. Cash-based measures, which 203 countries implemented, and 61 social pension programs, which 48 countries introduced, represented 44 percent of the world's total social assistance measures (Gentilini and others 2022a). These measures were fundamental to reaching vulnerable individuals outside social protection systems, such as migrants, whose jobs were typically more exposed to both the economic and health consequences of the pandemic (box 2.3). Throughout the world, cash transfers reached higher levels of coverage, but they did so unevenly across countries and were concentrated in the early phase of the pandemic (Gentilini 2022).

The second group of policies includes job retention schemes. These short-time work arrangements, furloughs, and wage subsidies funded by the government (Drahokoupil and Müller 2021) tend to provide stronger support to workers who are temporarily not working than unemployment benefits (OECD 2021). In mid-2020, during the first peak of the pandemic, governments of OECD countries supported about 50 million jobs.

In theory, the relative weights of job protection and income protection measures in the policy response depend on the government's perception of the nature of the crisis. The optimal response to transitory and exogenous shocks, such as natural disasters, is to subsidize businesses to maintain existing jobs and limit the losses to workers' welfare. Such policies support workers and ensure that firms can jumpstart their activities once the crisis is over. Among these efforts are short-time work and temporary layoff schemes and administrative measures to limit workers' dismissal (Giupponi and Landais 2018).

The impact of the pandemic shock may be more structural and permanent. Pandemic-induced changes forced businesses to develop new value chains that rely on digitization and automation processes, and many companies learned to operate with fewer active workers (McKensie 2020). In developed countries, automation and digitalization are expected to increase the demand for high-skilled occupations. At the same time, the experience of remote work and reduced travel will likely suppress demand and wages in less-skilled service sectors, such as hospitality, food, and janitorial services (Ding and Molina 2020). The cost of capital, the high degree of informality, and barriers to technology diffusion may depress wages and increase unemployment in developing countries and emerging economies. These structural changes will require significant reallocation of resources. Policies focusing on job protection could hinder the movement of labor from unviable jobs to better-performing industries and slow the recovery (Barrero, Bloom, and Davis 2020).

To assess how much countries spent on either type of social protection policy, Demirgüç-Kunt, Lokshin, and Torre (2022) built a global database on social protection response expenditure that includes expenditure on social protection

Addressing the social protection needs of migrant workers during the pandemic

The impact of COVID-19 has been devastating for all vulnerable groups. But the shock has been especially harsh for international migrants in ECA, which hosts more than a third of the world's migrant workers.

The sudden increase in uncertainty and the restrictive mobility measures implemented by governments to prevent the spread of COVID-19 led to drastic reductions in the flows of migrants across the region (figure B.2.3.1). In 2020, annual inflows of migrants dropped by more than a quarter in EU-27 countries and by 30 percent in the United Kingdom; arrivals of migrants fell by 15 percent in the Russian Federation and by almost 7 percent in Kazakhstan. In Türkiye, the number of foreign-born adults (15 and older) fell by just 0.2 percent between 2019 and 2020, likely because of the different nature of inward migration there.

Migrants who were already overseas were also disproportionately affected by the pandemic. Migrant workers are concentrated in occupations that are more sensitive to business cycle fluctuations, exposing them to economic downturns and shocks (Dustmann, Glitz, and Vogel 2010; Orrenius and Zavodny 2010). In ECA, they are more likely to

hold nonstandard or informal contracts, have shorter job tenure, and be on fixed-term contracts (Fasani and Mazza 2020). As a result, they are more likely than natives to be let go in the event of a negative employment shock (Blanchard and Landier 2002).

Migrant workers are also concentrated in manual occupations and occupations that require lower levels of communication with the native population (D'Amuri and Peri 2014; Foged and Peri 2016), which are more exposed to the income and health risks of the COVID-19 pandemic (Bossavie and others 2020, 2021). They are also more likely to be employed in face-to-face jobs, exposing them to COVID–related health risks. During the last decade, the migrant–native gap in economic and health vulnerabilities remained constant in the European Union. Most migrants in the European Union are significantly more exposed to COVID-19-related risks than natives. The exception is migrants from the EU-15, whose risks are very similar to those of natives (Bossavie and others 2020).

In line with their higher vulnerabilities to the COVID-19 shock, migrants suffered more severe

FIGURE B.2.3.1 Change in inflows of migrants and first-time asylum seekers in selected regions of Europe and Central Asia in 2020
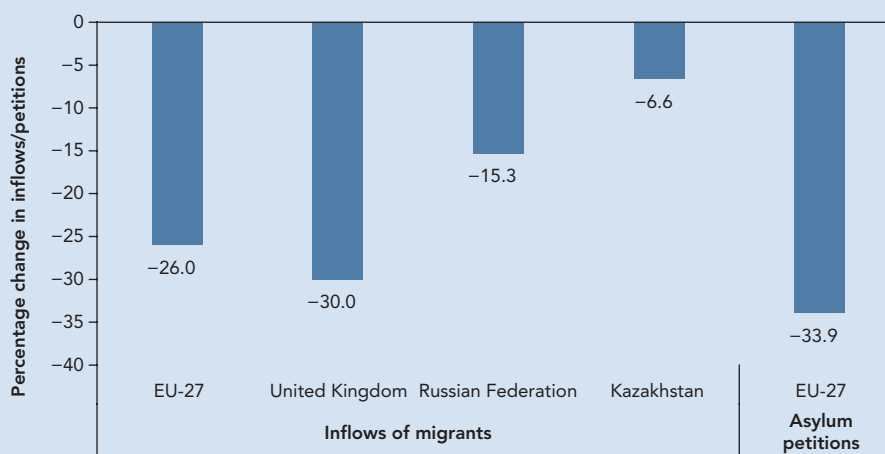
Sources: Eurostat, Kazakhstan Bureau of National Statistics, OECD International Migration Outlook 2021, and Russian Federal State Statistics Service (ROSSTAT).
Note: Figures for the Russian Federation and Kazakhstan include arrivals of nationals. Figures for the United Kingdom and the EU-27 are for arrivals of non-nationals only.

BOX 2.3 (continued)

job losses during the pandemic than nationals in most ECA countries. Employment of migrants fell 3.8 percent in the EU-27 in 2020—almost four times the 1 percent decline among native workers. In some countries—including Czechia, Denmark, Estonia, Finland, and Slovenia—total employment among the foreign-born increased, suggesting a possible increase in demand for essential workers during the pandemic. In the Russian Federation, several surveys find that employment losses were larger for migrants from Central Asia and the Caucasus than for natives in the first two months of the pandemic (Vershaver, Ivanova, and Rocheva 2020; Denisenko and Mukomel 2020). In Türkiye, where employment losses were significant, the year-on-year drop in employment among immigrants (9.0 percent) was more than twice as large as for natives (4.2 percent).

Data from the early months of the COVID-19 pandemic show that COVID-19-related mortality was twice as high for migrants than natives (Papon and Robert-Bobée, 2020). Migrants were twice as likely to be infected with COVID-19 as their native peers in Denmark, Norway, Sweden, and Portugal (OECD 2020b).

Policies implemented to mitigate the impact of the pandemic on migrant workers

Migrant workers are both more vulnerable to the pandemic and less likely to be protected by social protection systems. In several countries, the pandemic exacerbated and brought to light the limited coverage of migrants by existing social protection schemes. Even in the European Union, which has the most advanced and complex system of portability of social benefits, foreigners can obtain full nondiscriminatory access to most social benefits only after a certain period of residence (Avato, Koettl, and Sabates-Wheeler 2010). Outside the European Union, social protection systems for international migrants are much less developed (Lafleur and Vintila 2020).

Given the limitations of social protection systems in protecting migrants even before the pandemic, several governments in ECA countries took measures to alleviate the impact of the pandemic on labor migrants. In Austria, immigrants ineli-

gible for health insurance were eligible for free COVID-19 care (Freier 2020). Both Kazakhstan and Russia approved regulations granting migrants access to free medical care for COVID-19, even if they are undocumented (Moroz, Shrestha, and Testaverde 2020). The mayor of Moscow approved medical assistance to all migrants. Poland extended eligibility for COVID-19-related services and treatment to all residents, including uninsured people and migrants; the United Kingdom made such services free for everyone (Baptista and others 2021).

Social protection programs in ECA countries have not explicitly targeted immigrants, but they introduced several programs to help buffer vulnerable families, including migrants, from the economic impacts of the pandemic. Ireland's €350 weekly pandemic unemployment payment targeted everyone who lost his or her job because of the COVID-19 crisis, regardless of migration status. Italy allowed all migrants with residence permits to apply for the €600 income subsidy for self-employed and temporary workers, agriculture workers, domestic workers, and seasonal workers in the tourism sector (Moroz, Shrestha, and Testaverde 2020). Spain opened its Minimum Living Income to anyone that can prove at least one year of residence in the country (Open Society Foundation 2020). Russia temporarily halted evictions of all individuals, even undocumented migrants.

Migrants' access to healthcare and other social services has been limited, however. Among the most binding constraints are limited financial resources and access to health insurance (IOM 2020), language proficiency (Berntsen and Skowronek 2021), cultural differences (IOM 2020), and fears of deportation (Fanjul and Dempster 2020). Some of these barriers became more salient during the COVID-19 pandemic, given the limited functioning of services providing in-person support to migrants (Bruzelius and Ratzmann 2020). Digitalization of the integration process and language programs has accelerated since the pandemic began, increasing efficiency and reducing costs, but it risks excluding vulnerable migrant groups with limited digital literacy and access to the Internet (OECD 2021).

policies implemented specifically as part of pandemic stimulus packages.[5] It shows that across the world, low- and lower-middle income countries devoted most of their (small) social protection budgets to preserving the income of their citizens through direct cash transfers or provision of in-kind and food transfers, particularly in the poorest countries (table 2.2 and figure 2.6). Higher-income countries aimed their (larger) social protection budgets at preserving jobs by directly subsidizing wages and reducing the social insurance costs to employers. Upper-middle-income countries combined both policy approaches, with unconditional cash transfer taking the lead.

Across ECA, the average country spent about 1.1 percent of GDP on income protection policies in response to the pandemic and 1.4 percent of GDP on job protection policies. For EMDE ECA countries, the average package of income protection policies costs about 1.3 percent of GDP and that of job protection

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5. This expenditure is in addition to the regular social protection expenditure.

TABLE 2.2 Classification of social protection programs by social protection area and policy focus

Social protection area	Social protection category	Policy focus
Social assistance	1.1 Unconditional cash transfers	Income protection
	1.2 Conditional cash transfers	
	1.3 Social pensions (noncontributory)	
	1.4 Unconditional food and in-kind transfers	
	1.5 Conditional in-kind transfers (school feeding)	
	1.6 Public works	
	1.7 Utility and financial obligations waivers/reductions	
Social insurance	2.1 Pensions	
	2.2 Social insurance contributions[a]	Job protection
	2.3 Paid leave	
	2.4 Workers' compensation	
	2.5 Health insurance	
	2.6 Unemployment/out-of-work income support	Income protection
Labor market policies	3.1 Activation measures	
	3.2 Redistribution of labor	Job protection
	3.3 Wage subsidies	
	3.4 Other active labor market policies[b]	Income protection
	3.5 Labor income support	Job protection
	3.6 Labor regulatory adjustment and enforcement	
	3.7 Firm liquidity support	

Source: Data from Demirgüç-Kunt, Lokshin, and Torre 2022.
Notes: The classification of social protection categories and related code numbers is from Gentilini and others. (2022a).
a. Measures that involve withdrawals from individual retirement accounts were excluded from the analysis, because their fiscal impact was not clear. Waivers of social insurance contribution for firms were included when budget cost estimates were available; all measures in this category were classified as focusing on job protection.
b. This category includes entrepreneurship support, start-up incentives, and employment measures for people with disabilities. Given their focus on bringing individuals into employment (similar to activation measures), these measures were classified as focusing on income protection, as they are not tied to an individual having had a job.

FIGURE 2.6 Social protection response budgets across the world in 2020–21, by program type
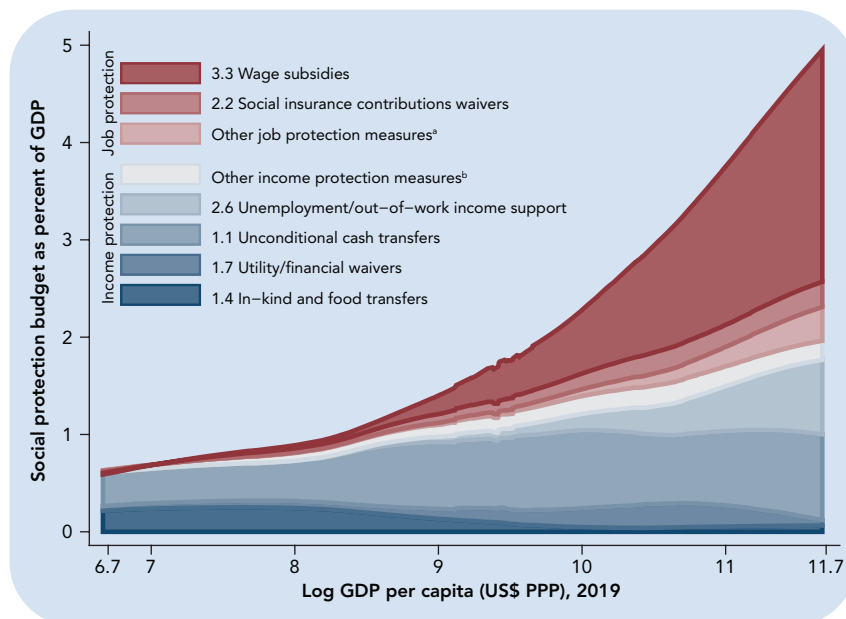
Source: Data from Demirgüç-Kunt, Lokshin, and Torre 2022.
Note: Sample includes 154 countries. Figure plots the share of each type of program, using a lowess smoother function. See table 2.2 for program codes.
a. Includes program codes 2.3, 2.4, 2.5, 3.2, 3.5, 3.6, and 3.7.
b. Includes program codes 1.2, 1.3, 1.5, 1.6, 2.1, and 3.4.

policies about 0.9 percent of GDP (see table 2.1). In non-ECA countries, the average income protection package was 1.4 percent of GDP, and the average job protection package was 0.4 percent of GDP. In this sense, the average social protection response package of ECA countries distinguishes itself from that of other regions by the substantial role played by job protection policies.

The policy mix exhibits substantial variability across subregions (figure 2.7). At one extreme is Central Asia, where almost all of the social protection response budget was devoted to income protection policies, with a significant contribution allocated to cash-for-work programs and unconditional cash transfers. Eastern Europe, the South Caucasus, and Türkiye also allocated substantially larger budgets to income protection policies than to job protection policies. In contrast, more than two-thirds of the social protection response budget in Northern and Western Europe was allocated to job protection policies—notably, wage subsidies and social insurance contribution waivers. The remaining subregions—Central Europe, the Russian Federation, the Western Balkans, and Southern Europe— had more even policy mixes, with roughly equal shares of income protection and job protection.

The pre-pandemic nature of the social protection systems in each country may have driven the relative sizes of income protection and job protection programs. Figure 2.8 plots the share of the pre-pandemic social protection budget for every country in ECA and the pandemic response package that went to job protection programs. It shows wide variation in the way countries allocated the spending of their social protection packages both before and during the pandemic, and the magnitudes of spending are different. Before the pandemic, the size of the social

FIGURE 2.7 Social protection response budgets in Europe and Central Asia in 2020–21, by program type
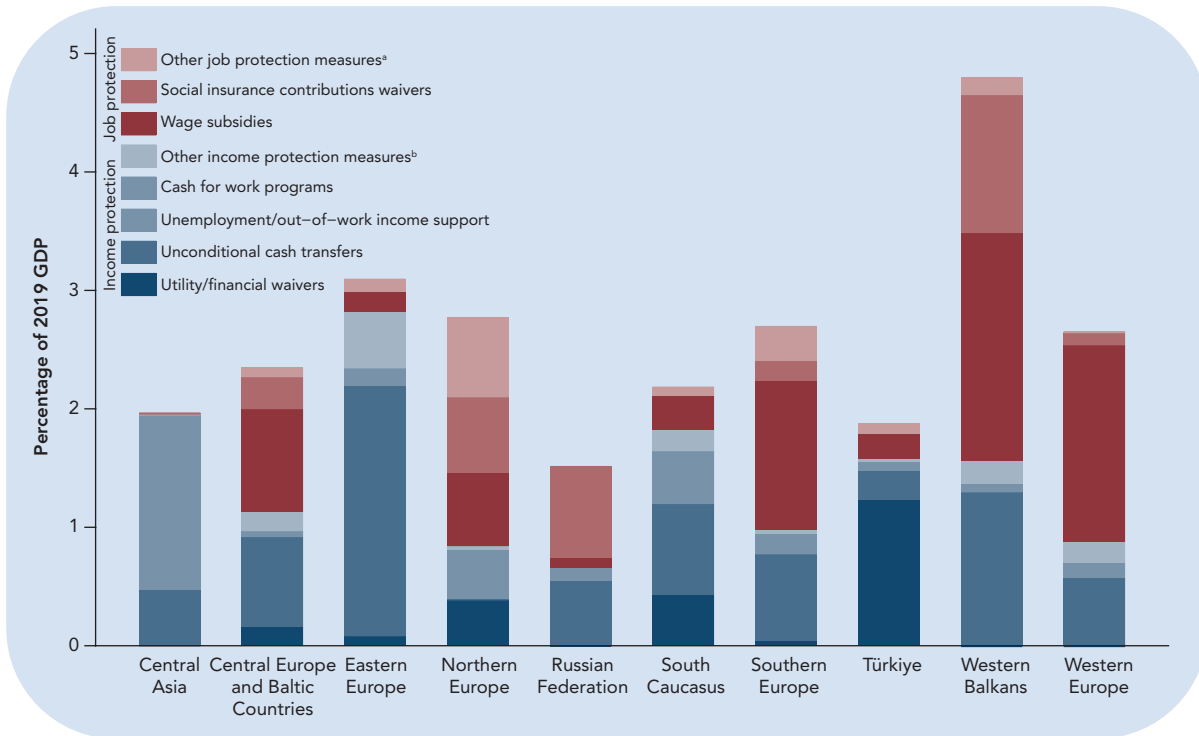
Source: Data from Demirgüç-Kunt, Lokshin, and Torre 2022.
Note: Figures plots subregional averages (GDP weighted). See table 2.2 for program codes.
a. Includes program codes 2.3, 2.4, 2.5, 3.2, 3.5, 3.6, and 3.7.
b. Includes program codes 1.2, 1.3, 1.5, 1.6, 2.1, and 3.4.

FIGURE 2.8 Correlation between job protection expenditure before and during the pandemic in countries of Europe and Central Asia
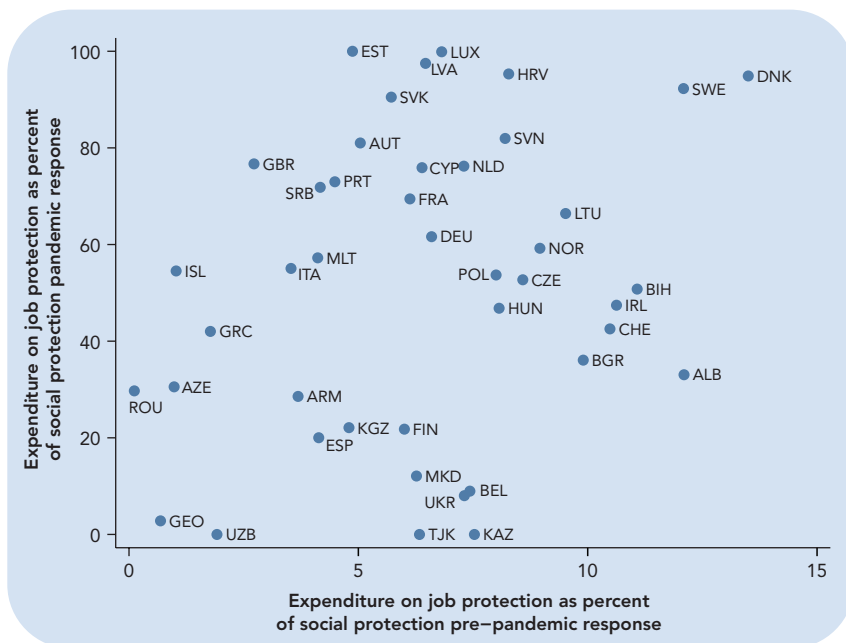
Source: Social protection pandemic response data are from Demirgüç-Kunt, Lokshin, and Torre 2022.

protection budget allocated to job protection averaged 0.8 percent of GDP (0.6 percent for EMDE ECA), about 6 percent of pre-pandemic social protection expenditure. In the pandemic response packages, job protection measures accounted for 1.4 percent of GDP (0.9 percent for EMDE ECA), almost (or more than) half of the social protection pandemic response budget. Income protection policies represented a substantial part of the social protection response package in EMDE ECA, especially in lower-income countries. In upper-middle and high-income countries, the unprecedented expansion of job protection policies was the main characteristic of the pandemic response, even in countries with high rates of employment informality (World Bank forthcoming a).

Short-term Effects of Social Protection Response Policies

Around the world, the social protection policies introduced in response to the COVID-19 pandemic pursued two main goals: to limit hardship caused by the pandemic and to ensure rapid and sustainable post-pandemic economic recovery. The effects of the two broad types of policy instruments—income protection measures or job protection measures—on both differ.

By allowing firms to jumpstart their operations immediately after pandemic restrictions are lifted, job protection measures could promote faster short-term recovery. However, such recovery might come at the cost of subsidizing inefficient businesses, reducing the rate of creative destruction, and ultimately hindering long-term recovery (Barrero, Bloom, and Davis 2020). In contrast, generous unemployment benefits and cash transfer programs could slow recovery in the short run but facilitate the reallocation of workers to the most productive sectors of the economy, securing sustainable long-term recovery.

Both policy approaches directly improve the welfare of beneficiaries by smoothing their consumption, thereby reducing poverty. Unemployment insurance, cash, and in-kind transfers help households mitigate the impact of negative income shocks. Such measures could directly affect economic growth through the fiscal multiplier effect of increased consumption (McKay and Reis 2016).

Job protection programs also have a direct consumption-smoothing effect on the well-being of formal workers who would have been laid off without such programs. They may play a dual role of preserving productive job matches and protecting workers' incomes. Unemployment insurance and other transfers primarily protect vulnerable groups, such as youth and people with little education; employment protection programs tend to protect mostly insiders and better-educated workers (Cahuc and Carcillo 2011).

In countries with large informal sectors, income protection programs could be the dominant mode of social protection because they can reach a broader share of the population, particularly the vulnerable (Bottan, Hoffmann, and Vera-Cossio 2021). Job protection measures can be effective at the national scale in countries with primarily formal economies. The generosity of unemployment insurance, direct cash transfers, and job protection policies also affects labor market tightness, unemployment, and job participation rates (Giupponi and Landais 2020).

Simple correlations suggest that the policy focus of the social protection re-sponse appears to have been associated with changes in socioeconomic outcomes during the first year of the pandemic (figure 2.9). Countries that spent larger shares of their social protection response budget on job protection measures (as opposed to income protection) observed smaller decreases in employment (panel b) and smaller increases in inactivity and poverty (panels c and d). The pattern for changes in GDP (panel a) is not clear.

A similar pattern is found in a multivariate analysis in which the relationship between each socioeconomic outcome and expenditure on either income or job protection measures is estimated conditional on the following controls: stimulus expenditure in non–social protection sectors, pre-pandemic level of GDP per capita, share of services in the pre-pandemic GDP, and size of the informal sector, as these sectors, suffered disproportionately from the pandemic (OECD 2020a; World Bank 2020). The degree of informality is also a relevant control variable because it may indirectly affect the effectiveness of job protection and income protection policies in mitigating the impact of the pandemic.

FIGURE 2.9 **Effect of the job protection pandemic response budget on GDP, the employment rate, the inactivity rate, and the poverty headcount**
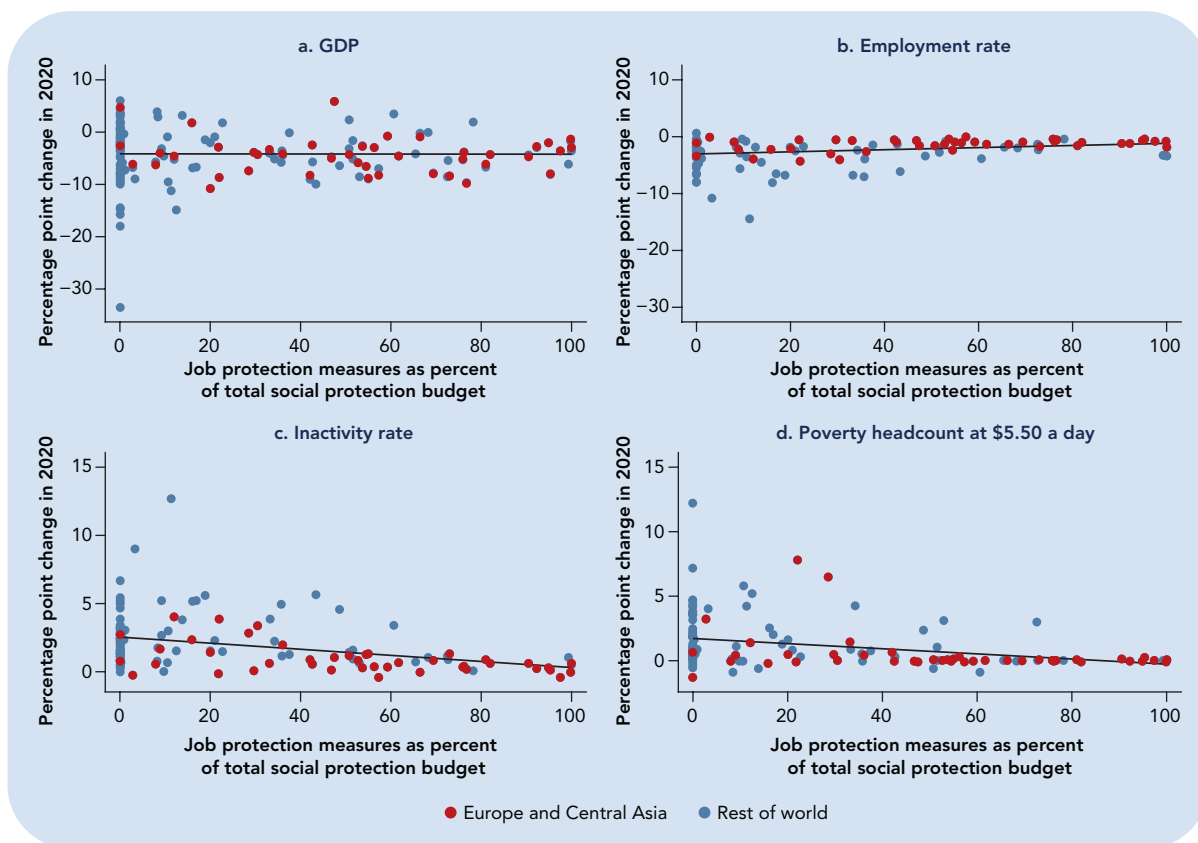
Source: Social protection budget data are from Demirgüç-Kunt, Lokshin, and Torre 2022. Employment data are from ILOSTAT 2021) GDP data are from *World Development Indicators* (World Bank 2021b).
Note: Figure is based on data on 133 countries.

Table 2.3 presents the result of this multivariate analysis for four socioeconomic outcomes across 133 countries. It shows:

- the pace of economic recovery, measured by the difference in GDP levels between the pre-pandemic forecast for 2021 and the 2021 World Bank Global Economic Prospects estimate for the same year
- the change in poverty, measured by the difference in the pre- (January 2020 forecast) and post-pandemic (2020 actual) poverty headcount rates
- the difference in the employment rate between 2019 and 2020
- the difference in the inactivity rate between 2019 and 2020.

These measures are used to assess the impact of the various allocations of social policies on labor market outcomes.[6]

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6. Unlike the measures used for GDP and poverty, the measures of labor market outcomes are not expressed in relation to a counterfactual forecast but relative to their pre-pandemic values. The measures used for labor market outcomes may therefore include some variation caused by pre-pandemic trends. The estimation results based on these measures may have to be interpreted with caution.

TABLE 2.3 Nature of social protection response and its short-term economic effects (percent of GDP, except where indicated otherwise)

Item	Change in GDP		Change in employment rate		Change in inactivity rate		Change in poverty rate	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Social protection response								
Expenditure on income protection	−0.092	0.145	−0.162	−0.175	0.104	0.127	0.127	0.195
	(0.267)	(0.289)	(0.125)	(0.201)	(0.098)	(0.153)	(0.116)	(0.151)
Expenditure on job protection	0.583	1.132**	0.446***	0.324	−0.405***	−0.382**	−0.444***	−0.488***
	(0.391)	(0.502)	(0.165)	(0.196)	(0.155)	(0.156)	(0.136)	(0.178)
Non–social protection response expenditure	0.282**	0.220*	0.049	0.055	−0.018	−0.015	−0.129**	−0.141**
	(0.125)	(0.122)	(0.065)	(0.087)	(0.053)	(0.073)	(0.052)	(0.055)
Country characteristics								
Log GDP per capita, 2019	0.097	0.874	−0.183	−0.054	−0.095	−0.203	−0.014	−0.230
	(0.402)	(0.520)	(0.143)	(0.251)	(0.122)	(0.206)	(0.157)	(0.209)
Share of service sector		−0.157**		−0.043		0.038*		0.049*
		(0.080)		(0.027)		(0.021)		(0.027)
Share of informal output (dynamic general equilibrium model-based estimates of informal output)		0.002		−0.044		0.035		0.015
		(0.047)		(0.033)		(0.028)		(0.018)
Number of countries	147	134	145	134	145	134	148	134
R^2	0.09	0.15	0.07	0.12	0.10	0.16	0.14	0.19

Source: Demirgüç-Kunt, Lokshin, and Torre 2022.
Note: All estimations are ordinary least squares with robust and heteroscedasticity consistent standard errors (HC3) in parentheses. See Elgin and others (2021) for details on the methodology.
*** significant at the 1 percent level, ** significant at the 5 percent level, * significant at the 10 percent level.

The results presented in table 2.2 show that expenditure on income protection measures appears to have no significant correlation with any of the four socioeconomic outcomes. This, however, could be because there was little variation in income protection expenditure across countries—all countries implemented programs of this type, and the difference across countries in the volume of expenditure involved was considerably smaller than the one on job protection programs. In this sense, the analysis does not allow us to identify the correlations between expenditure in income protection programs and socio-economic outcomes. Expenditure on job protection measures seems to be associated with an increase in employment, a decrease in the inactivity rate, and a decrease in the poverty headcount rate. The correlation between job protection expenditure and short-term recovery, as measured by the difference in GDP between the pre and post-pandemic forecast for 2020, is positive but not as strong, with a coefficient that is not statistically significant in the main specification. These correlations are in line with the theoretical priors, although the association with the poverty rate is stronger than expected, given that no statistically significant correlation is found between poverty and income protection measures. These results suggest that subsidizing firms' wage bills during 2020 preserved employment and may have contributed to short-term recovery, although it is important to stress that these are cross-country statistical associations that do not represent a causal link.

The nature of the pandemic social protection response is partly correlated with the preexisting system of social protection: About 30 percent of the social protection programs implemented during the pandemic were adaptations to or new benefits of preexisting programs (Gentilini and others 2022a). New programs may also have benefited from the existing social protection infrastructure. In this sense, the economic effects of the social protection measures could be a function of preexisting social protection systems.

The multivariate analysis presented in table 2.4 interacts the expenditure on income and job protection measures with the coverage of social insurance and social assistance programs (defined as the share of a country's population covered by either type of program) to explore whether this is indeed the case. A dummy variable indicating whether a country's coverage of either program is above the pre-pandemic sample median captures the interaction.

Once the pre-pandemic coverage of social insurance and social assistance programs are included as interacting variables, the effects on the economic activity of the expenditure on both income and job protection become statistically not significant. However, the effects on employment and inactivity during the pandemic appear to depend on the pre-pandemic coverage of social insurance programs. In countries with low coverage of social insurance programs, expenditure on income protection measures is correlated with a decrease in employment and an increase in inactivity, while expenditure on job protection measures is positively correlated with increased employment and shows no correlation with inactivity rates. In countries with higher coverage of social insurance programs, the effects of both types of social protection expenditure are much smaller, as shown by the statistically significant interaction effect. These results suggest that the social protection response during the pandemic may have had stronger effects on labor markets in countries with low pre-pandemic social insurance coverage.

TABLE 2.4 Pre-pandemic social protection coverage and its effects on the pandemic response (percent, except where indicated otherwise)

Item	Change in GDP		Change in employment rate		Change in inactivity rate		Change in poverty rate	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Expenditure on income protection (percent of GDP)	−1.674 (1.250)	1.041 (0.711)	−1.308** (0.510)	0.172 (0.198)	1.129** (0.438)	−0.132 (0.175)	1.222** (0.603)	−0.096 (0.159)
Expenditure on income protection × high social insurance coverage	2.060 (1.262)		1.142* (0.580)		−1.052** (0.490)		−1.239** (0.621)	
Expenditure on income protection × high social assistance coverage		−1.546 (0.946)		−0.500 (0.524)		0.452 (0.445)		0.276 (0.339)
Expenditure on job protection (percent of GDP)	2.628 (2.175)	1.477* (0.853)	1.790** (0.749)	0.132 (0.312)	−1.166 (0.802)	−0.176 (0.249)	−2.137*** (0.790)	−0.305 (0.218)
High job protection × high social insurance coverage	−1.221 (1.961)		−1.539** (0.692)		0.779 (0.755)		1.630** (0.759)	
Expenditure on job protection × high social assistance coverage		0.403 (1.034)		0.480 (0.343)		−0.452* (0.268)		−0.567* (0.323)
High social insurance coverage (above the median)	0.484 (2.332)		0.442 (0.753)		−0.230 (0.590)		−0.471 (0.922)	
High social assistance coverage (above the median)		−0.280 (1.592)		−0.829 (0.820)		0.605 (0.704)		0.897 (0.624)
Number of countries	115	109	115	109	115	109	113	107
R^2	0.18	0.20	0.22	0.21	0.25	0.24	0.32	0.25

Source: Demirgüç-Kunt, Lokshin, and Torre 2022.
Note: All regressions include the following control variables: log GDP per capita (2019), share of services sector (percent of GDP), and share of informal output (percent of GDP). All estimations are ordinary least squares with robust (HC3) standard errors (standard errors in parentheses).
*** significant at the 1 percent level, ** significant at the 5 percent level, * significant at the 10 percent level.

This finding is not surprising given the objective of social insurance systems: to insure individuals and households against shocks and allow them to smooth consumption over time. To the extent that the programs implemented during the pandemic play a role similar to that of social insurance systems in terms of protecting people against economic shocks, their effects should be weaker in countries where an advanced social insurance system was already in place.

Pre-pandemic coverage of social insurance programs appears to be a significant factor determining the effectiveness of social protection responses in poverty reduction. The effect of job protection expenditures on poverty rates is stronger in countries with low social insurance coverage. These programs have a much smaller effect in countries that had more extensive social insurance systems in place before the pandemic.

This country-level assessment of the economic effects of social protection response policies does not pinpoint the mechanisms through which such effects occur at the micro-level. A complement to this analysis would look at the effects of the policy responses at the firm level.

COVID-19 had a profound and heterogeneous impact on firms. Using data on about 8,000 firms in 23 EMDEs in ECA, Bruhn, Demirgüç-Kunt, and Singer (2021) examine the impact of the COVID-19 crisis on the reallocation of economic activity across firms and whether it depended on the competition environment (box 2.4). They find that economic activity was reallocated toward more productive firms during the COVID-19 crisis and that countries with a strong competition environment saw more reallocation from less productive to more productive firms than countries with a weak competition environment.

To examine how social protection policies introduced in response to COVID-19 affected the reallocation of economic activity across firms directly, this report extended the analysis by Bruhn, Demirgüç-Kunt, and Singer to include an interaction term of productivity and social protection. The results, reported in Annex 2.1, table A2.1.1, show that income protection spending is not statistically significantly correlated with changes in sales or employment and thus does not affect reallocation. Job protection expenditure and wage subsidy expenditure (a subcategory of job protection expenditure) do interrupt employment reallocation: Countries with higher pandemic job protection expenditures experienced less employment reallocation from less productive to more productive firms. This new result is consistent with the earlier finding that broad government support was more likely to go to less productive firms. Job protection expenditure may thus hamper innovation and productivity growth in the longer run.

BOX 2.4 Effect of competitive environment on the reallocation of economic activity from less productive to more productive firms during the pandemic

Bruhn, Demirgüç-Kunt, and Singer (2021) build on the analysis presented in the 2021 *Fall ECA Economic Update* to explore the reallocation of economic activity across firms in 23 countries in ECA during the COVID-19 crisis. Using data from the World Bank's Enterprise Surveys COVID-19 Follow-up Surveys for about 8,000 firms, matched with 2019 Enterprise Survey data, they study the relationship between firms' pre-COVID-19 labor productivity and their performance during the crisis.

The results show that economic activity was reallocated toward more productive firms during the crisis. Firms with high pre-crisis labor productivity experienced smaller drops in sales and employment than firms with low pre-crisis labor productivity. More productive firms were also more likely to adapt to the crisis by increasing online activity and remote work. The analysis

indicates that the relationship between productivity and firm growth was stronger during COVID-19 than before the crisis (2017–18), suggesting that creative destruction increased during COVID-19.

When markets are competitive, they do a better job of allocating resources toward more productive firms (Arnold, Nicoletti, and Scarpetta 2011; Brown and Earle 2002; Caballero 2008). This feature may be particularly relevant in a crisis. In countries with a weak competition environment, market power and political connections may have more influence than productivity on which firms do better during a crisis. Weak competition can also limit firms' innovation and ability to respond to shocks (Barrero, Bloom, and Davis 2020).

Bruhn, Demirgüç-Kunt, and Singer (2021) find that more reallocation took place from less productive to more productive firms in countries

(continued next page)

BOX 2.4 (continued)

with a strong competition environment than in countries with a weak competition environment. In countries with high competition, firms in the 10th percentile of the pre-crisis labor productivity distribution experienced an 18 percentage point larger drop in sales than firms in the 90th percentile; this difference is only 10 percentage points in countries with low competition (figure B.2.4.1, panel a). In countries with high competition, firms in the 10th percentile of the labor productivity distribution were 15 percentage points more likely to decrease employment than firms in the 90th percentile. The corresponding difference in countries with low competition was 5 percentage points (figure B.2.4.1, panel b).

They also examine what type of firms received government support during the COVID-19 crisis and assesses whether the distribution of support measures may hamper competition and slow the recovery process. Many governments implemented broad support schemes to address the economic fallout from the COVID-19 crisis. Half

the firms in the sample reported receiving government support during the pandemic. The large economic shock required quick action, making it difficult for governments to target these support measures. The authors find that more productive firms were less likely to receive any type of government support, even controlling for the drop in sales or employment experienced by the firm. Larger firms were more likely than smaller firms to receive government support, indicating that support was more likely to go to politically connected firms. Governments provided support to firms regardless of their pre-crisis level of innovation.

These findings suggest that, as economies enter the recovery phase, it will be important for policy makers to phase out broad policy support measures as soon as appropriate and focus on fostering a competitive business environment while continuing to protect vulnerable households. Such an environment is key to a strong recovery; resilience to future crises; and sustainable, long-term economic growth.

FIGURE B.2.4.1 Correlation between competitive environment and firm performance and labor productivity

a. Percentage change in monthly sales compared with one year ago

b. Percent of firms that reduced number of permanent workers in 2020

● High market competition ● Low market competition
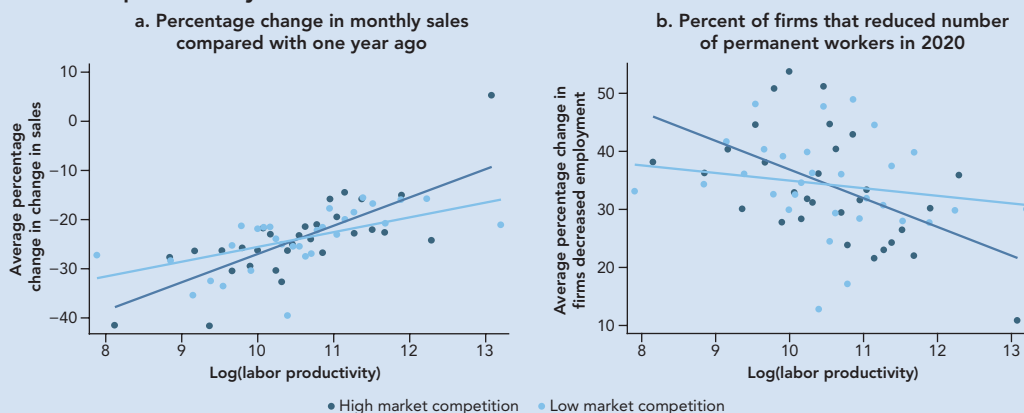
Sources: Authors' calculations based on data from the most recent Enterprise Surveys COVID-19 Follow-up Surveys and Enterprise Surveys for 23 countries in Europe and Central Asia and the Bertelsmann Stiftung Transformation Index (BTI) 2020.
Note: Low or high market competition is defined as having a BTI market organization rating below or above the median across countries. BTI market organization is based on responses to the question "To what level have the fundamentals of market-based competition developed?" The figure shows average values in 30 percentiles of log(labor productivity)—that is, the average y-value plotted against the average productivity in a bin/percentile range of productivity. The plots control for the number of employees; firm age; gender of the top manager; innovation; state ownership; foreign ownership; access to credit or loan; ownership of a website; location of the main market (local, national, or international); sector; and country fixed effects. Both the y- and x-axis variables are residuals (with the mean added back in). The fitted lines are estimated using the underlying data, not the binned data.

The empirical analysis presented here suggests that countries that allocated larger shares of their stimulus packages to job protection measures seems to have enjoyed higher employment and lower inactivity and poverty rates than countries that allocated smaller sums. Income protection policies may have also contributed to better outcomes, but the lack of significant statistical variation across countries along this dimension precludes making a conclusive assessment. Additionally, firm-level evidence suggests that job protection may have come at the expense of reduced reallocation of resources from less productive to more productive firms, potentially hampering recovery in the long term. In this sense, these results highlight that the long-term effect of any policy choice will depend on whether it is temporary or permanent, as the effects may differ over different time periods. The empirical results also show that the effect of the social protection response package differed depending on the pre-pandemic coverage of social insurance programs. In countries with broader coverage, the income and job protection programs implemented during the pandemic had smaller economic effects. The social protection response had a significant effect only in countries with limited pre-pandemic social insurance coverage. In countries with relatively extended social protection systems before the pandemic, some social protection programs implemented during the pandemic may have been partly redundant, as automatic stabilizers were already in place.

Social Protection Challenges of the War in Ukraine

Just as the pandemic was giving way to a new normal, another shock hit the region in early 2022—the war in Ukraine. Beyond the cost in human lives of an armed conflict not seen in ECA since the war in the Balkans during the 1990s, the war in Ukraine has had immediate and dramatic consequences for the region's socioeconomic landscape.

The first consequence was the unprecedented number of refugees who crossed the borders of Ukraine into neighboring countries in a matter of weeks. A second consequence was the effect on the livelihoods of millions of migrant workers in Russia, given the scale of the economic sanctions imposed on Russia. A third consequence was the sharp increases in the prices of energy and food. All of these developments represent challenges that social protection systems in the region will need to address.

Meeting the Needs of Refugees and Forcibly Displaced People

The war in Ukraine has triggered the largest wave of refugees in Europe since World War II. As of September 13, 2022, the United Nations High Commissioner for Refugees (UNHCR) had recorded more than 7.3 million refugees from Ukraine. Half of these refugees are in Poland (1.4 million) and Russia (2.6 million) (table 2.10). This refugee wave is larger than the one triggered by the war in the Balkans during the 1990s (about 1.5 million refugees in the first half of the decade and 700,000 in the Kosovo conflict in 1998–99 [UNHCR 2000]) and the 2015–16 refugee crisis (about 1.5 million asylum applicants in EU countries and 2.5

million in Türkiye [Dustmann and others 2017]). The refugee wave is not only the largest in Europe in more than 70 years, it also developed at an unprecedented speed, with more than 3 million refugees fleeing Ukraine in the first three weeks after the conflict began, on February 24, 2022. Moreover, the number of internally displaced people in Ukraine exceeds 7.1 million.

A first step in managing any refugee crisis is to register individuals to provide them with the protection ensured by the 1951 Geneva Convention. Just one week after Russia's invasion of Ukraine, the European Union implemented a temporary protection scheme for Ukrainian refugees. As of September 13, 2022 3.9 million people had registered under it (table 2.5), and 122,500 refugees had registered for the United Kingdom's scheme for Ukrainian refugees. Registration of refugees allows host countries to deploy a series of measures aimed at providing refugees with food and shelter. Several countries in ECA implemented in-kind and cash transfer schemes for Ukrainian refugees. Some of these efforts are ad hoc schemes, but in most cases, temporary protection status allows beneficiaries to receive basic cash allowances that already exist under each host country's social protection schemes, which can be substantial. In Poland, for instance, Ukrainian refugees have received access to that country's flagship 500+ child benefit program, which provides a monthly payment of PLN 500 ($118) per child, and to a series of other programs aimed at children and large families (box 2.5). The rapid expansion of existing programs benefited from the experience of the pandemic response, when new programs were created, and others were expanded in a matter of weeks.

Providing accommodation to the millions of refugees who arrived in a very short time is critical to avoid a humanitarian crisis. Countries that received the largest number of refugees have been overwhelmed by the size of the flows. Some, including Poland, Romania, and the Slovak Republic, resorted to subsidizing private households to accommodate refugees (Gentilini and others 2022b). More permanent arrangements will need to be implemented. The experience of the influx of Syrian refugees into Jordan after 2011 suggests that the housing supply will need to be responsive to prevent host communities from facing increased housing expenditures (Rozo and Sviatschi 2021).

Beyond short-term challenges, host countries will need to understand that refugee crises generally last several years. According to some estimates, about 80 percent of Ukrainian refugees will eventually return to their country (Becker and others 2022), but the experience of the refugees of the Balkans war suggests that return will not be immediate. Of the 700,000 refugees from the Balkans that Germany accommodated in the first half of the 1990s, only 10 percent settled permanently in Germany; 85 percent went back to the former Yugoslavia or resettled in other third countries, but this process started only after most refugees had spent at least a few years in Germany. The stock of refugees from the former Yugoslavia increased every year between 1991 and 1996, not declining until a year after the signing of the Dayton peace agreements (UNHCR 2005; Bahar and others forthcoming). Critical to the return of refugees will be the outcome of the war in Ukraine, as structural and political conditions in the origin country heavily influence refugees' return intentions (Zakirova and Buzukurov 2021; Kulu and others 2022). Host countries need to design policies with the understanding that many Ukrainian refugees will not go back to their countries soon. Socioeconomic

TABLE 2.5 Number of refugees from Ukraine in Europe as of September 13, 2022, by country

Country	Number of Ukrainian refugees recorded	Number of Ukrainian refugees registered for temporary protection or similar schemes
Central Europe and Baltic countries	*2,331,559*	*2,230,248*
Bulgaria	133,775	67,467
Croatia	17,717	17,718
Czechia	431,462	431,285
Estonia	54,765	34,490
Hungary	29,170	29170
Latvia	38,104	39,954
Lithuania	64,950	65,369
Poland	1,379,470	1,379,470
Romania	81,158	64,533
Slovak Rep.	93,384	93,188
Slovenia	7,604	7,604
Eastern Europe (excludes internally displaced people [IDPs])	*104,167*	*—*
Belarus	13,422	—
Moldova	90,745	—
Ukraine (IDPs)	7,134,000	—
Northern Europe	*148,252*	*144,441*
Denmark	34,557	32,556
Finland	38,588	38,588
Iceland	1500	1500
Norway	26,669	26,669
Sweden	46,938	45,128
Russian Federation	*2,593,209*	*—*
South Caucasus	*31,159*	*—*
Armenia	489	—
Azerbaijan	4,639	—
Georgia	26,031	—
Southern Europe	379,002	387,514
Cyprus	13,642	16,048
Greece	18,663	18,663
Italy	153,664	159,968
Malta	1,469	1,366
Portugal	49,718	49,623
Spain	141,846	141,846
Türkiye	*145,000*	*—*
Western Balkans	*51,411*	*6,932*
Albania	2,780	—
Bosnia and Herzegovina	228	—
Kosovo and Serbia[a]	18,792	957
Montenegro	24,482	5,975
North Macedonia	5,129	—
Western Europe	*1,549,962*	*1,198,118*
Austria	81,261	81,261
Belgium	55,130	54,457
France	101,369	101,369
Germany	1,003,029	655,800
Ireland	50,423	46,481
Luxembourg	6,561	6,561
Netherlands	68,050	68,050
Switzerland	61,239	61,239
United Kingdom	122,900	122,900
Total (Excluding IDPs)	7,333,721	3,967,253

Source: UNHCR (https://data.unhcr.org/en/situations/ukraine) data as of September 13, 2022. The number of IDP in Ukraine is from the internal displacement report of the International Organization on Migration (General Population Survey Round 7 (July 17–23, 2022).
Note: a UNHCR data presents only aggregated data for Kosovo and Serbia.
— Not available.

BOX 2.5 Cash transfers for Ukrainian refugees in Europe

Cash transfers have been an important means of supporting Ukrainian refugees across Europe. As of June 2022, 57 measures have been announced or implemented across 25 countries. Collectively, host governments are planning to spend $152.4 million on cash transfers during 2022.

The average transfer was about $14 a day, with considerable variation across 34 programs. These transfers averaged 46 percent of the host countries' median income/expenditure. Transfers in Romania (133 percent), Croatia (86 percent), and Bulgaria (85 percent) were the most generous. In contrast, transfers in Belgium, Cyprus, Czechia, Iceland, and the Slovak Republic represented less than 25 percent of median income/expenditure. As of June 2022, 250,000 Ukrainian refugees had received these benefits, and another 455,600 were expected to be reached.

Cash transfers have been provided as compensation for accommodation and housing, as direct emergency income support, and as part of pre-existing programs (OECD 2022). Countries have used a combination of new programs and adaptation of existing programs to support refugees. Implementation of new programs has been more prevalent (61 percent of the number of cash transfer programs). Some of these new programs offer refugees immediate income support to cover their necessities upon arrival. Bulgaria granted a one-time cash benefit of Lev 375 (US$202) to meet emergency needs. In Poland, refugees who declare their willingness to remain in Poland receive a one-off allowance of Zl 500 (US$115) for a one-person household and Zl 300 (US$70) for each person in a multi-person household. In the United Kingdom, every Ukrainian refugee hosted is entitled to an initial payment of £200 (US$247.5) from the local council to help with the costs of settling in and meeting immediate needs. Four countries (Belgium, Finland, Iceland, and Italy) offered income support at reception centers. Italy, for example, provides €033 (US$34.8) per day for refugees at its reception centers.

Most adaptations of pre-existing programs were simple horizontal expansions by which Ukrainian refugees were incorporated into the pool of the eligible population. In some cases, this horizontal expansion was also combined with administrative simplification. Examples of these horizontal expansions include Germany's expansion of the Asylum Seekers' Benefits Act (Asylbewerberleistungsgesetz); Ireland's expansion of the Child Benefit program and supplementary welfare allowance; and Poland's expansion of the 500+ child benefit, the Family Care Capital RKO program, the Good Start program, and the Nursery Benefit program.

Source: Gentilini and others (2022b).

integration of refugees will be important to ensure the well-being of both refugees and host communities.

A primary challenge is to provide education for refugee children. This is fundamental given the profile of refugees, which consists almost exclusively of working-age women with children. It is estimated that 700,000 children will need to be incorporated into the Polish educational system alone. In Romania, a small proportion of parents plans to or has integrated their children into the Romanian education system; the vast majority have requested support to continue in the Ukrainian education system. Providing refugee children with education not only helps reduce the disruption that displacement has caused to learning and the development of their human capital in general,[7] it also makes it possible for refugee mothers to work. Investing in the expansion of early childhood development

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7. Human capital losses in Ukraine from disrupted schooling alone are estimated to be on the order of $90 billion (Angrist and others 2022)—almost as much as the losses in physical capital to date.

services, also critical for mothers' labor market integration, is fundamental as capacity in these services is very low in many countries in the region.

Providing refugees with a legal right to work is important to ensure they integrate into the local economy. Poland and Romania have granted Ukrainian refugees access to work without applying for asylum. In some countries, Ukrainians are able to work as soon as they request residence permits; in others, a work permit is required.

Evidence on refugees in Switzerland indicates that early entry into the workforce, as measured by lower unemployment rates at the time of arrival, is associated with better long-term employment prospects (Müller, Pannatier, and Viarengo 2022). To help integrate workers into local labor markets, it is important for the skills of refugees to be recognized and assessed. The EU Qualifications Passport for Refugees could help receiving countries reduce the mismatch between labor demand and refugee labor supply. Dispersal policies should take into account local labor market demand and conditions and the absorption capacity of local labor markets.

Bansak and others (2018) developed an algorithm that uses a combination of supervised machine learning and optimal matching to discover and leverage synergies between refugee characteristics and resettlement sites. Their approach, tested with data from the United States and Switzerland, led to average gains of 40–70 percent in refugees' employment outcomes relative to current assignment practices.

In terms of active labor market policies, evidence from the integration of refugees in Nordic countries and throughout Europe shows that the most effective policy is subsidized private sector employment (Butschek and Walter 2014; Calmfors and Sánchez Gassen 2019). Language training is also important, particularly in the long run. Access to banking and financial services is also key for successful insertion into the labor market.

To promote integration and social cohesion, is it important that host communities receive as much attention as refugees: service delivery (in education, health, security, and infrastructure) for the local population where refugees resettle should be guaranteed, as it has proven fundamental to prevent public backlash and promote local development (Zhou, Grossman, and Ge 2022). Similarly, some groups of the local population—particularly the vulnerable and people working in the informal sector will have to be protected from the expected increase in job competition that will be triggered by a sudden inflow of refugees (Ceritoglu and others 2017).

Monitoring the Impact on Migrants from Central Asia

The invasion of Ukraine triggered the imposition of wide sanctions on Russia. These sanctions are expected to have a sizable impact on economic activity. This impact could affect a particularly vulnerable group of the population: migrant workers from Central Asia.

Working in Russia is a prime source of income for households in Central Asia. In 2021, remittances accounted for 34 percent of GDP in Tajikistan and 33 percent in the Kyrgyz Republic—comparable to the share of exports of goods and services in each country. In Uzbekistan, the most populous country in Central Asia,

remittances accounted for more than 13 percent of GDP in 2021 (Ratha and others 2022). Roughly two-thirds of total remittance receipts for the Kyrgyz Republic, Tajikistan, and Uzbekistan, as well as for Armenia and Azerbaijan, originated in Russia in 2021.

Remittances are important for the overall economy of Central Asian countries; they are particularly important for the poorest households. According to estimates from the Listening to Central Asia surveys carried out by the World Bank in 2019–21, about 21 percent of households in the poorest 20 percent of districts in Central Asia reported having a member abroad; households in the highest quintile districts reported almost none (figure 2.10). Remittances are especially progressive in the Kyrgyz Republic and Uzbekistan, more than 20 percent of the poorest quintile receives some remittance income. In contrast, in the highest quintile, just 7 percent of households in the Kyrgyz Republic and 1 percent in Uzbekistan did so. In Tajikistan, a much larger proportion of households report having at least one member working abroad (43 percent in March 2022). In 2021, about 36 percent of the poorest quintile in Tajikistan received remittances each month; in the top quintile, this figure fell to about 27 percent. Remittance income supplements food consumption: 81 percent of the households that receive remittances in Tajikistan reported use it primarily for food consumption. This figure is 70 percent in Kazakhstan, 49 percent in Uzbekistan, and 46 percent in the Kyrgyz Republic.

Sanctions can affect migrant workers through two channels. The first is the loss of employment caused by the decline in demand. The second is fluctuations

FIGURE 2.10 Share of households in Central Asia with one or more members working abroad, by district, circa 2019–21
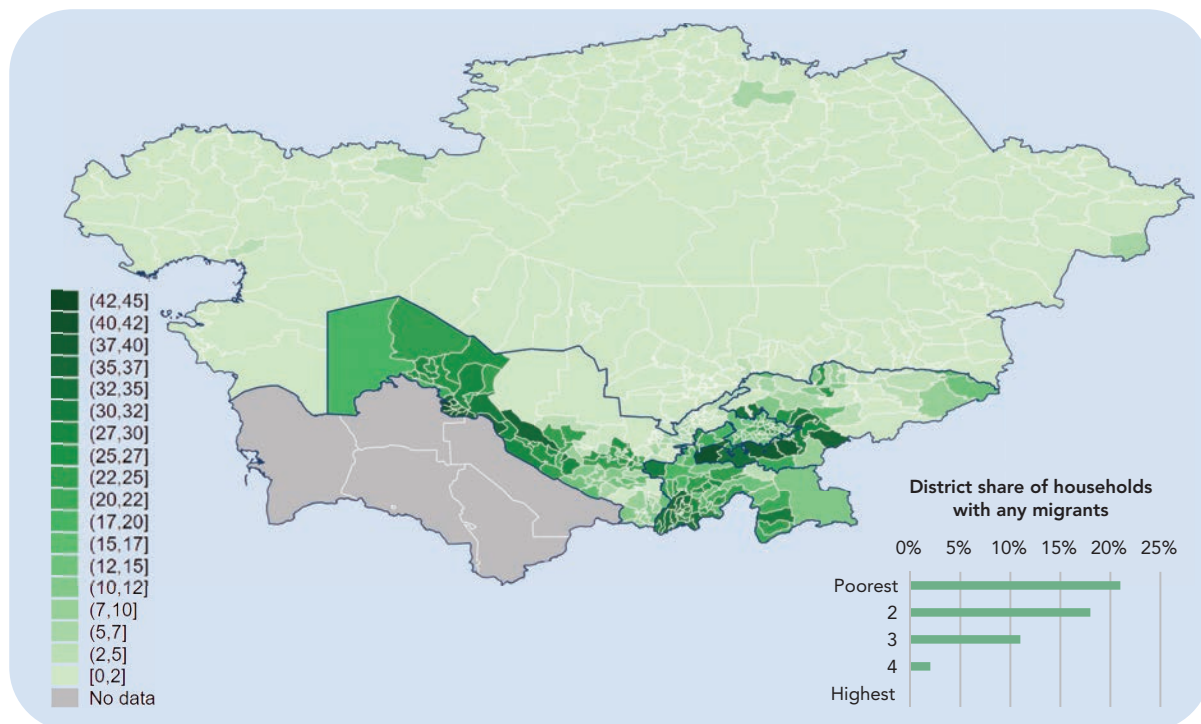
Source: Data from the Listening to Central Asia surveys, conducted by the World Bank.

of the Russian ruble and the difficulties associated with exchanging rubles for other currencies. So far, the first channel has failed to materialize, despite concerns at the beginning of the war about a potential wave of migrants returning to their origin countries.[8] Evidence from the Listening to Central Asia surveys indicates that as of July 2022, there had not been a substantial increase in return migration. The number of migrants abroad was at or above the level of the previous year and above pre-war levels. Between January and July, the share of households with a migrant rose from 14 percent to 17 percent in Uzbekistan, from 13 percent to 16 percent in the Kyrgyz Republic, and from 41 percent to 50 percent in Tajikistan. Following a brief decline in reported employment among migrants, the levels of their employment rate reached 89 percent among Uzbek, 92 percent among Kyrgyz, and 97 percent among Tajik migrants, all at or above pre-war levels. Since then, intentions to migrate have significantly declined. In January 2022, 15 percent of Kyrgyz households had a member considering migration; by July, this figure had dropped to 6 percent. In Tajikistan, the share fell from 12 percent to 7 percent between January and July; in Uzbekistan, no household reported any member considering migration.

The second channel through which migrant workers can be affected has seen a reversal of trends. The initial shock of the war had an immediate effect on the share of households in Central Asia receiving remittances. The Listening to Central Asia surveys reveal that the share of Uzbek households receiving any remittance transfer fell from 7.8 percent in January to 2.7 percent in March (a 65 percent decline), from 33 percent to 23 percent in Tajikistan (a 31 percent decline), and from 17.5 percent to 14.8 percent in the Kyrgyz Republic (a 16 percent decline). The transfers that continued were also smaller: After adjusting for inflation and exchange rates, the value of a typical remittance transfer fell 18 percent in Uzbekistan, 15 percent in the Kyrgyz Republic, and as much as 57 percent in Tajikistan between January and March 2022 (driven by both exchange rate fluctuations and the amounts migrants chose to send). This shock was temporary, however. The Russian ruble quickly recovered and has since strengthened by 14–47 percent over pre-war levels with respect to Central Asian currencies, leading to a strong rise in the purchasing power of remittances in receiving countries. Central banks throughout the region reported aggregate remittances in the first quarter above 2021 levels, and survey respondents reported a surge in the typical value of a transfer in local currency terms of up to 57 percent over January levels in Uzbekistan, 11 percent in Tajikistan, and 8 percent in the Kyrgyz Republic. Compared with the nadir reached in March, the share of households receiving remittances was up 6.7 percentage points in Uzbekistan, 5.5 percentage points in Tajikistan, and 1.5 percentage points in the Kyrgyz Republic. Recent developments, such as the suspension of MIR, the main Russian payments system, by banks in Kazakhstan, Türkiye, and Uzbekistan may potentially affect the flow of remittances, however.

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8. A survey conducted in April by Uzbekistan's State Migration Agency of 15,000 migrants currently in Russia a reported that 40 percent expressed a desire to return to Uzbekistan because they had lost their employment or run into financial difficulties, 36 percent were not willing to move because they held a stable job, and 24 percent reported that they would make a decision about returning home if they lost their jobs. A similar poll among Kyrgyz migrants in Russia found that 40 percent intended to return to their country (Hashimova 2022).

So far, the impacts of the war on the livelihoods of migrant workers have thus been less severe than expected. But the unpredictability of the conflict will require governments in Central Asia and other migrant-sending countries in ECA to ensure that social protection systems can respond to an increase in return migrants and a decrease in remittances, should they occur. The policy experience of the COVID-19 pandemic response leaves a valuable legacy. In Uzbekistan, for instance, coverage of the social protection system increased from 566,000 families in January 2020 to more than 1.5 million in February 2022, on the eve of the war in Ukraine. This increased coverage will allow the government to implement a social protection response package to a new crisis more quickly.

Addressing the Effects on Energy and Food Prices and Security

Russia and Ukraine are among the world's most important producers and exporters of cereal grains, oil seeds, and fertilizers.[9] Russia is also one of the world's main exporters of gas and oil and a critical supplier of energy for many countries in ECA.[10] The disruption of both countries' agricultural and mineral exports—in Russia as a result of sanctions and domestic export bans, in Ukraine because of the war and the blockade of Ukrainian ports by Russian forces—is likely to seriously affect many food- and energy-importing countries. The resulting shortages and subsequent price increases of agricultural commodities can reduce food security in Africa, the Middle East, and Central Asia. A prolonged reduction in food exports from Russia and Ukraine could cause the number of undernourished people in the world to soar from 8 million before the war to 13 million by the end of 2022/beginning of 2023, according to the Food and Agriculture Organization (FAO 2022b).

The situation is likely to worsen as increased food prices may drive further export restrictions by food-exporting countries other than Russia and Ukraine to prevent local prices from rising excessively. As of September 2022, the number of countries imposing food export bans had increased from 3 before the war to 19, according to the International Food Policy Research Institute (IFPRI) (Glauber, Laborde, and Mamun 2022). Exports affected by these restrictions represent about 17 percent of the calories traded in the world, and countries implementing these export restrictions represent a large share of key commodities traded globally. Some restrictions affect 78 percent of global exports of sunflower oil, 55 percent of palm oil exports, and almost 36 percent of wheat exports. Other affected commodities include corn (17 percent) and soybean oil (6 percent).

The food-importing countries most affected by the disruption of agricultural commodities are in ECA (figure 2.11). According to IFPRI estimates as of September 2022, the hardest hit country in the world in terms of the share of calories imported is Tajikistan, where export restrictions affect 76 percent of food calories imported. It is followed by Uzbekistan (69 percent); Azerbaijan (62 percent);

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9. Russia and Ukraine are among the top three global exporters of wheat, maize, rapeseed, sunflower seeds, and sunflower oil. Russia is the world's top exporter of nitrogen fertilizers and the second leading supplier of both potassic and phosphorous fertilizers (FAO 2022a).
10. Russia is among the top three producers of crude and the second largest producer of natural gas in the world (IEA 2022).

FIGURE 2.11 Share of imported calories affected by trade restrictions imposed as a result of the war in Ukraine as of September 2022

Impact of restrictions on imports
0%   78%
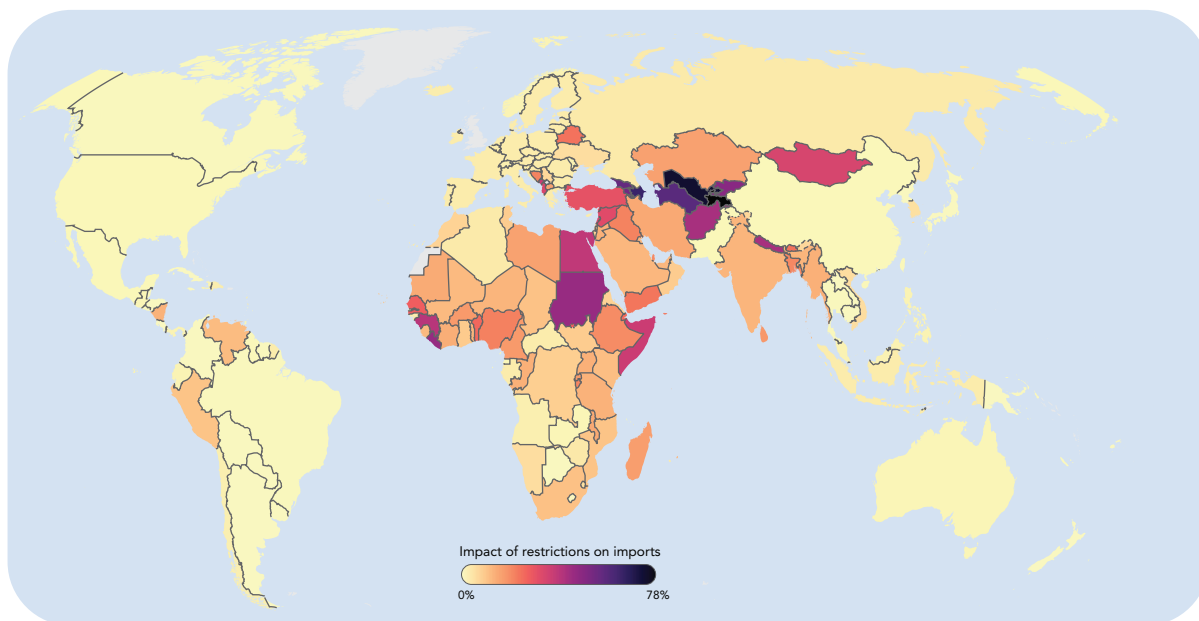
Source: IFPRI Food & Fertilizer Export Restrictions Tracker.

Armenia, Georgia, and Turkmenistan (more than 50 percent); and the Kyrgyz Republic (47 percent).

The disruption in the international agricultural market has not yet translated into increased food insecurity in ECA, although there are concerns about afford-ability (in Uzbekistan, for instance, 24 percent of households reported not being able to afford food costs in July 2022, up from 10 percent in January, according to data from the Listening to the Citizens of Uzbekistan survey). Since the war began, however, standard indicators of food insecurity—ranging from the share of household heads worried about having enough food to feed their families to going a whole day without eating—had improved from recent highs in Kazakhstan, the Kyrgyz Republic, and Uzbekistan and were much lower than the region-wide spike in food insecurity around the outbreak of the COVID-19 pandemic. So far, only in Tajikistan have affordability concerns translated into a significant increase in reports of reduced food consumption to pay for other basic needs.

The impact of the war on energy prices has been geographically more exten-sive than that of food prices. This Economic Update's companion piece on the energy crisis provides a more extensive analysis. In ECA, energy prices have in-creased across all regions. In the euro-area countries, the annual increase in con-sumer energy prices reached a record 45 percent in March 2022, before slightly declining a 40 percent in April 2022 (Kuik and others 2022). Consumer prices of energy rose by less in the Western Balkans, where regulators have not increased electricity tariffs—at the expense of the finances of utilities and network opera-tors—but industrial consumers are already facing substantial increases (World Bank 2022c). The fuel prices have also increased substantially In Central Asia (WFP 2022).

Countries across the region and the world have implemented various measures in response to high energy and food prices. According to an International Monetary Fund (IMF) survey of 134 countries, about 71 countries (including 26 of 31 advanced economies and 45 of 102 EMDEs) had implemented some kind of policy response (Amaglobelli and others 2022). In advanced economies, cash and semi-cash transfers (which include vouchers and utility bill discounts) were the most frequent measure (adopted in about half of the countries surveyed). Other measures focused on lowering prices (by, for example, reducing value-added tax [VAT]) and excise taxes. In EMDEs, reductions in VAT and excise taxes were the most commonly applied measure (24 percent of all countries in this group). Across all countries, 55 percent of all announced measures were intended to mitigate the impact of higher energy prices, and 30 percent were intended to mitigate the impact of higher food prices.

Subsidies of some sort were the predominant measures introduced in response to high commodity prices in ECA (60 percent of all measures recorded by Gentilini and others 2022c). Within the subsidies group, fee subsidies were the most extensively used intervention in ECA, with 33 countries implementing some version of this measure, which accounted for 76 percent of all subsidy measures in the region. Fees subsidies across the region typically involve moratoriums on energy price increases, reduced public transport fees, and caps on electricity and natural gas prices for both households and businesses. Estonia, Luxembourg, and the Slovak Republic announced measures to reduce electricity prices. In lower-income ECA countries, reductions in VAT and excises—such as Poland's reduction in VAT on food and energy and Serbia's temporary reduction of excise taxes—were popular. In any case, inn many ECA countries, energy bills are already subsidized through price caps that are below cost recovery, resulting in poorly targeted and highly regressive redistribution of fiscal resources (see companion piece on high energy prices).

Fuel subsidies were the second-most common measure in ECA. They typically came in the form of caps on price raises (Croatia, Czechia, Hungary, Kazakhstan, Slovenia); discounts (€0.18 per liter in France, €0.20 in Spain, and €0.22 in Greece); and vouchers (in Italy, private companies provide free vouchers to their employees, up to a limit of €200 per worker). Hungary, Kazakhstan, and Romania implemented measures in late 2021, which they extended following Russia's invasion of Ukraine. Direct food subsidies are limited to Czechia (which has capped prices for food, gasoline, and diesel) and Tajikistan (which sells fixed amounts of staple food to the public at relatively low prices).

In the short term, many ECA governments will have no option but to adapt and scale-up social assistance in the face of the increasing commodity prices—in particular, of energy. A key social protection challenge in ECA countries is to ensure sufficient coverage and adequacy of energy assistance to those who need it. According to the World Bank's social protection shock response tracker, few countries in the ECA region have targeted energy assistance. In countries where targeted energy assistance programs do exist, they are inadequate in coverage, especially of non-standard beneficiaries as they are often tied to the recipiency of existing anti-poverty programs. Going into the heating season in many ECA countries, the impulse is to support either a very narrow group of formally

defined poor households or without any targeting by capping prices below cost recovery. Price caps and finely targeted compensatory mechanisms straddle two extremes, on the one end, support is universal and thus both thinly spread out and expensive; on the other end, support is missing the appropriate scale to effectively cushion the shock that is affecting bottom 40 percent of households by income (see companion piece on high energy prices).

Changing Labor Markets and the Challenge of Inclusion for Social Protection Systems

The performance and design of social protection systems have a very close relationship with the structure and institutional arrangements of labor markets. Social insurance schemes—which represent the majority of the social protection spending in ECA—are funded mainly through contributions from individuals' labor earnings. These contributory schemes were designed in a context in which full-time, permanent wage relationships ("standard employment") were the norm.

This type of employment gives way to nonstandard forms of employment; even where wage relationships remain most prevalent, their duration may be shortened. These changes in labor markets may weaken the salience of employment-based contributory social insurance schemes (Packard and others 2019), potentially leaving many households and individuals unprotected if social protection systems do not adapt.

This section starts by describing the driving forces behind changes in labor markets. These changes affect different aspects of employment—like its sectoral composition, the wage dynamics, and the role played by the public sector. While acknowledging that changes are occurring in these relevant dimensions, this section reviews the latest trends in two dimensions of the nature of work relationships in ECA, which are seeing changes that are very different across generations: the prevalence of nonstandard forms of employment across the region, which is increasing for the young, and the evolution of job tenure, which is shortening for the younger cohorts.

These trends in the labor market call for new approaches to social protection. Standard social insurance schemes will cover a declining share of the workforce, limiting mobility and preventing labor reallocation to the most productive sectors. Growing shares of the labor force in nonstandard employment require more flexible policies that protect the well-being of workers and their families without tying them to specific firms—in particular, protecting these groups of workers against unemployment risk, maternity, and sickness.

Drivers of Transformations of Labor Markets—and their Social Consequences

During the second half of the 20th century, developed countries transitioned from industrial, manufacturing, and goods-based economies to service-based economies. In OECD countries, employment in the service sector increased by an average of 15 percent between 1965 and 2000 (Wren 2013), while at the same time,

the industrial sector shed labor (World Bank 2019). In developed countries, low-skill, millions of low-wage workers moved from manufacturing jobs to low-skill service occupations. These structural changes in employment patterns are often attributed to technological change and globalization.

The rapid advances of modern technologies, especially in artificial intelligence and machine learning, fuel fears that a large proportion of jobs in developed countries could be automated and become redundant (Frey and Osborne 2017). These fears may be unwarranted. Arntz, Gregory, and Ziera (2016) show that only 9 percent of US workers are at risk of automation. Comparable figures are reported for other OECD countries, ranging from about 6 percent in Estonia to 12 percent in Germany.

Standard economic theory suggests that by increasing labor productivity, technological progress raises demand for both unskilled and skilled workers. As a result, wages and employment increase for all categories of workers (Katz and Murphy 1992). Changes in the labor market over the last decade were not consistent with these predictions. In the past, it was common for every new machine to require more than one human operator, and subsidies and tax incentives to capital helped reinstate labor in the production process. Neither is now the case (Acemoglu, Manera, and Restrepo 2020). Evidence suggests that technological progress generated skilled and nonroutine employment but caused a decline in routine employment in basic, light manufacturing sectors (Stansbury and Summers 2018). In this sense, ICT innovations and new technologies affected different groups of workers differently and the skill bias accelerated over the last several decades (Acemoglu 2002). The consensus in the literature is thus that technological progress has mostly led to positive net aggregate employment effects but that these effects are heterogeneous across industries and sectors.

An essential aspect of this heterogeneity is the so-called "hollowing out" of middle-income jobs (Frey and Osborne 2017) driven by the information technology (IT) revolution of the second half of the 20th century. The share of precarious and high-skilled jobs is likely to increase in the coming years, while the number of routine jobs is expected to decline. In the United Kingdom, the increase in the number of jobs in top fields was equivalent to 80 percent of the losses in medium-skilled occupations. The shrinking employment share of occupations in the middle of the wage distribution has been accompanied by increasing employment at both poles of the distribution in Germany, Greece, the Netherlands, Norway, Spain, Sweden, and the United Kingdom (Goos and others 2019). However, some economists suggest that job polarization is unlikely to be sustained in the future, as middle-class jobs will continue demanding a mixture of skilled tasks (Autor 2019).

As the global economy becomes increasingly interdependent through trade, the impact of automation in high-income countries can have consequences on national labor markets in offshore countries (Stapleton and Webb 2020). Technology and trade are closely related, as both can reduce costs. Firms can replace labor with machines and/or offshore production to foreign firms. The impact of offshoring is similar to that of technology in that it causes employment loss in developed countries (Mankiw and Swagel 2006; Blinder 2007, 2009). Evidence from the United States and Europe shows that globalization has had strong effects on labor markets (Acemoglu and Autor 2010; Autor, Dorn, and Hanson 2013).

However, although both technology and international trade can structurally change labor markets, the impact of technology outperforms trade as a driver of job polarization and wage inequality (Autor 2015; Goos, Manning, and Salomons 2014). Autor, Dorn, and Hanson (2015) find that the impact of technology on labor markets is observed across the United States, whereas the impacts of trade tend to be more geographically concentrated in labor-intensive manufacturing subregions

The COVID-19 pandemic and the threat of future epidemic events have the potential to accelerate automation and robotization, as employers substitute workers with computers and robots, which are not susceptible to pandemics (Chernoff and Warman 2020). Analysis of technology adoption in 40 countries across the Americas, Asia, and Europe in 2000–18 finds that the adoption of robots (robot installations per 1,000 employees) increased significantly after epidemic events (Sedik and Yoo 2021). These results suggest that the COVID-19 pandemic may accelerate automation and robotization, which, absent redistributive policies, can increase inequality.

The rise of automation in global value chains creates new demand for skills and capabilities that are more abundant in developed countries than in developing countries (Di Tella and Rodrik 2020). This change could potentially undermine the traditional comparative advantage of low-skilled labor in developing countries, as automation increases the demand for high-skilled labor. Moreover, as automation and robotics become more widespread and gain further cost advantage, firms may choose to produce closer to, or within, domestic markets to save transportation costs. The fact that European firms are particularly strong in robotics and other operational technologies (Hallward-Driemeier and others 2020) could lead to reshoring of manufacturing to advanced economies (Baldwin and Forslid 2020). This could be associated to a process of deglobalization, which according to some scholars, has already started to take place (Garcia Herrero 2020; Goldman Sachs 2022)

In any case, technological progress and globalization have so far resulted in a large share of the labor force moving across sectors faster than before. This transition can adversely affect displaced workers' earnings and income, especially after periods of unemployment (Baymul and Sen 2020). Job displacement can also lead to larger numbers of discouraged workers (workers who stop looking for a job) and to significant wage losses. It also exacerbates the job-matching problem when displaced workers cannot find jobs that match their skills. Labor mobility from low-skilled to medium-skilled jobs looks bleak, further exacerbating wage inequality (Balliester and Elsheikhi 2018). High-level skills and socio-emotional skills are becoming a necessary condition to finding good-quality employment and safeguarding against technological advancements (World Bank 2019).

The need for more flexible labor markets in light of the megatrends of ICT-driven technological change and globalization has led to significant changes in European employment laws, providing employers with more options to hire fixed-term, part-time, and temporary workers (Cazes and Tonin 2010). These changes in employment protection legislation mainly affect new hires, leaving job protection practices unchanged for incumbent workers. Because of this asymmetry, reforms may have had a heterogeneous impact on the employment outcomes of younger, lower-educated, and female workers. The flexibility of

employment protection in the transition economies of Europe had a particularly severe effect on the job stability of younger workers. Some countries in the region recently undertook reforms to reduce labor market segmentation by removing the barriers these vulnerable groups face in accessing jobs (O'Higgins 2010). Reforms to incentivizing tenure were implemented in France in 2013 (Insarauto and others 2015), Italy in 2014 (Pinelli and others 2017), Slovenia in 2013 (Vodopivec 2019), and Spain in 2012 (Corral 2015). Evidence from Italy's reform experience suggests that hiring subsidies and lower firing costs lead to the transformation of fixed-term into open-ended contracts without substantially increasing the number of firings (Boeri and Garibaldi 2019).

The megatrends of technological change and globalization, coupled with the regulatory reforms to accommodate them, may have driven important changes in labor mobility and job stability in ECA. Two aspects of employment are relevant in this respect, as they are informative of the degree to which the labor force moves across jobs: the type of work arrangement—standard or nonstandard—and job tenure. These two dimensions are not only relevant as indicators of the degree to which employment relationships have changed but also affect the way in which social protection systems insure workers against adverse shocks. Contributory insurance schemes, like the ones prevalent in ECA, were built around the model of a standard, long-term employment relationship. Any changes to the prevalence of this type of work model risk leaving groups of workers unprotected. In this sense, current insurance systems are geared toward protecting the job of workers (and, specifically, standard, long-term ones) rather than protecting the income of workers (which could be sourced from different jobs).

Prevalence of Nonstandard Forms of Employment

The growth in nonstandard forms of employment became ubiquitous across ECA labor markets in the last two decades. These forms of employment differ from the two most common forms of employment—full-time permanent wage ("standard") employment and self-employment. They include part-time work, work under temporary contracts, agency work, and wage work with no legal contract (see ILO 2016 for more details on the definition of nonstandard forms of employment). These forms of employment were traditionally understood as arrangements specific to limited circumstances—jobs taken by students or young people early on in their professional lives or by women with simultaneous home care duties, for example. They are becoming more and more prevalent and have garnered much public attention.[11]

Today, about 20 percent of the employed workforce in ECA is in nonstandard employment (table 2.6), with a substantial subregional variation. In EMDE ECA

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11. The gig economy has, in particular, become a very discussed topic in the public arena, though its size is not clear. A narrow definition of the gig economy can be conceptualized as ex ante specified work mediated by online platforms and carried out by independent contractors (Koutsimpogiogo and others 2020). Standard population surveys fail to capture nontraditional work arrangements, which leads to discrepancies in understanding work activity and productivity growth (Abraham and others 2018). For example, estimates of the share of the working population employed by the gig economy in the Netherlands range between 0.4 percent population (Weel and others 2018) and 10.6 percent (Pesole and others 2018).

TABLE 2.6 Nonstandard employment and length of job tenure in Europe and Central Asia (percent of employed population)

Country/region	Nonstandard employment							
	Total employed population	Age group				Years of job tenure		
		20–24	25–34	34–49	50–64	Less than 1	1–5	More than 5
Central Asia	*34.7*	*43.0*	*37.2*	*35.0*	*25.7*	*—*	*—*	*—*
Kazakhstan	—	—	—	—	—	—	—	—
Kyrgyz Rep.	29.5	54.4	35.3	27.9	18.1	21.5	38.7	39.8
Tajikistan	—	—	—	—	—	—	—	—
Turkmenistan	—	—	—	—	—	—	—	—
Uzbekistan	35.6	40.9	37.6	36.2	27.1	—	—	—
Central Europe and Baltic countries	*12.3*	*32.9*	*15.7*	*9.5*	*9.0*	*5.6*	*35.9*	*58.5*
Bulgaria	5.4	17.0	5.2	4.5	5.0	5.5	32.5	62.0
Croatia	16.9	44.7	27.8	13.4	9.6	7.0	34.2	58.7
Czechia	11.6	26.0	12.9	9.4	8.4	6.3	34.1	59.6
Estonia	12.2	32.7	11.3	8.6	10.1	9.2	40.5	50.3
Hungary	11.6	16.3	11.4	9.4	12.3	8.5	41	50.5
Latvia	9.0	13.9	7.0	7.3	9.5	7.8	37.5	54.7
Lithuania	8.0	18.5	5.2	5.8	7.7	10.3	39.8	49.9
Poland	19.2	56.9	25.7	14.4	12.9	5.4	35.6	59.0
Romania	1.5	4.3	2.3	1.3	1.1	2.8	36.1	61.2
Slovak Rep.	12.1	19.4	13.1	9.7	10.9	5.8	34.1	60.1
Slovenia	15.5	55.9	22.7	10.6	9.3	6.1	33	60.9
Eastern Europe	*8.8*	*6.7*	*6.6*	*7.5*	*11.9*	*—*	*—*	*—*
Belarus	—	—	—	—	—	—	—	—
Moldova	8.8	6.7	6.6	7.5	11.9	—	—	—
Ukraine	—	—	—	—	—	—	—	—
Northern Europe	*24.6*	*59.1*	*28.3*	*19.2*	*19.6*	*9.1*	*37.6*	*53.3*
Denmark	24.7	64.9	28.2	17	19.4	10.9	43.6	45.5
Finland	17.7	54.6	24.6	12.9	12.4	5.5	18.9	75.7
Iceland	21.7	51.1	23.8	14.6	19.0	7.6	41.6	50.8
Norway	25.9	61.2	27.4	19.7	20.0	7.3	39.9	52.9
Sweden	27.8	56.9	30.9	23.5	23.8	11.1	43.1	45.8
Russian Fed.	*27.7*	*30.1*	*25.9*	*27.7*	*29.0*	*13.5*	*39.1*	*47.5*
South Caucasus	*7.5*	*8.6*	*8.6*	*7.5*	*7.2*	*—*	*—*	*—*
Armenia	17.4	24.4	19.9	17.2	15.4	—	—	—
Azerbaijan	4.7	4.4	5.2	4.3	5.1	—	—	—
Georgia	6.7	12.1	9.1	8.2	5.2	—	—	—
Southern Europe	*25.2*	*64.5*	*38.1*	*24.6*	*17.3*	*7.7*	*28.8*	*63.5*
Cyprus	17.5	36.3	21.8	16	13.5	10.3	37.6	52.1
Greece	13.1	41.5	22.7	13.3	7.6	6.3	23.8	69.9
Italy	24.8	61.8	36.4	24.5	18.1	6.5	27.1	66.4
Malta	17.2	23.8	13.6	17.3	15.0	5.5	42.2	52.3
Portugal	19.3	64.9	33.9	16.1	12.8	8.1	29.4	62.5
Spain	30.1	75	45.8	29.1	19.6	9.3	31.7	59.0
Türkiye	*9.3*	*16.7*	*9.6*	*8.9*	*8.2*	*16.9*	*33*	*50.1*
Western Balkans	*18.8*	*36.7*	*30.3*	*15.3*	*11.5*	*7.1*	*29.8*	*63.2*
Albania	4.4[a]	7.1[a]	6[a,b]	—	2.5[a,c]	4.6	26.9	68.6
Bosnia and Herzegovina	20.0	35.4	28.3	18.6	17.1	6.9	31.4	61.7

(continued next page)

TABLE 2.6 (continued)

Country/region	Nonstandard employment							
	Total employed population	Age group				Years of job tenure		
		20–24	25–34	34–49	50–64	Less than 1	1–5	More than 5
Kosovo	54.3[a]	61.5[a]	64.0[a,b]	—	44.0[a,c]	5.1	31.2	63.7
Montenegro	25.3[a]	65.4[a]	51.9[a,b]	—	9.6[a,c]	—	—	—
North Macedonia	11.5	28.9	16.6	10.4	7.1	7.7	34.2	58.1
Serbia	17.0[a]	44.8[a]	35.6[a,b]	—	7.5[a,c]	8.5	28.6	63.0
Western Europe	*27.4*	*47.3*	*26.6*	*24.8*	*26.1*	*7.6*	*35.4*	*57.0*
Austria	30.8	38.9	32.1	31.8	26.9	8.2	34.8	57.1
Belgium	28.5	44.6	26.9	26.3	29.6	7.2	33.1	59.7
France	24.9	59.3	27.1	21.5	21.1	7.2	30.3	62.4
Germany	—	—	—	—	—	—	—	—
Ireland	21.3	46.8	18.7	17.0	21.1	7.8	36.4	55.8
Luxembourg	22.9	42.8	19.9	22.4	22.5	6.9	36.0	57.1
Netherlands	47.9	71.9	47.1	45.7	45	7.9	34.3	57.8
Switzerland	40.2	59.2	39.3	39.9	37.6	7.5	37.6	55.0
United Kingdom	22.6	29.9	19.4	20.2	23.6	8.0	40.8	51.2
Emerging market and developing countries in ECA (country average)	17.2	30.1	22.3	14.0	13.1	8.8	34.0	57.2
ECA (country average)	19.9	39.2	23.5	17.3	16.2	8.1	35.2	56.6
ECA average (weighted by population)	22.7	41.2	25.6	20.9	19.8	8.7	33.6	57.7

Sources: Authors' calculations based on microdata from labor force surveys for all countries except Albania (SEE Jobs Gateway), Azerbaijan (ECA International Income Distribution Database), Kosovo (SEE Jobs Gateway), the Kyrgyz Republic (Kyrgyz Household Integrated Survey), Moldova (Household Budget Survey), Montenegro (SEE Jobs Gateway), Serbia (SEE Jobs Gateway), and Uzbekistan (baseline round of Listening to the Citizens of Uzbekistan survey).
Note: Nonstandard employment includes nonpermanent and/or part-time employment. Nonpermanent employment includes work without a legal contract. Data are for 2019 for all countries except Albania (2018), Azerbaijan (2015), Georgia (2018), Kosovo (2018), the Kyrgyz Republic (2018), Moldova (2018), Montenegro (2018), North Macedonia (2018), the Russian Federation (2017), Serbia (2018), Türkiye (2017), and Uzbekistan (2018). Subregional values are population-weighted averages.
— Not available.
a. Includes only workers with temporary contracts (values therefore represent a lower bound).
b. Workers 25–29.
c. Workers 55–64.

countries, the figure is 17 percent. In Central Asia, more than a third of the employed population works in some type of nonstandard employment. About 25 percent of the labor force in Russia, Southern Europe, and Western Europe is engaged in nonstandard employment (figure 2.12). In Eastern Europe, Türkiye, and the South Caucasus, the share of employed in nonstandard forms of employment is below 10 percent. In the other subregions, 10–20 percent of employment is nonstandard. At the country level, the highest prevalence is in Kosovo, where more than half of the employed have temporary or part-time contracts. The lowest prevalence is in Belarus, where less than 4 percent of the employed is in nonstandard employment.

Nonstandard employment is disproportionately prevalent among the young. Overall, 20 percent of the people employed in ECA are in nonstandard employment. This share increases to more than 40 percent among people 20–24 (30 percent in EMDE ECA countries). In some subregions, including Northern and

FIGURE 2.12 Prevalence of nonstandard employment in Europe and Central Asia, by age group and subregion
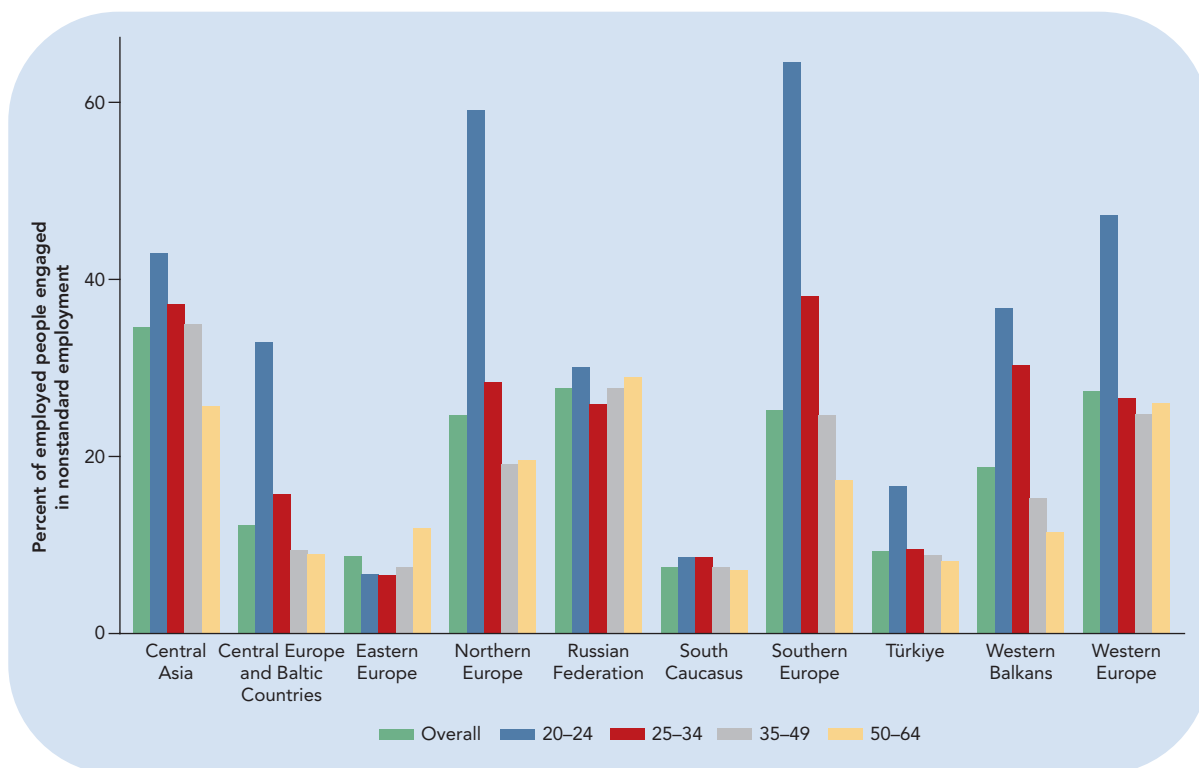
Source: Data from national labor force surveys.
Note: Data are for 2019 or the latest year available.

Southern Europe, more than two-thirds of employed people 20–24 have nonstandard jobs. The prevalence of nonstandard employment is lower among people 25–34, although it exceeds 30 percent in Central Asia, Southern Europe, and the Western Balkans.

This high prevalence of nonstandard employment among the young is relatively new. For the workforce as a whole, the figure increased from about 10 percent in the early 1980s to more than 20 percent in 2020 (figure 2.13, panel a). Among workers 20–24, it grew from about 12 percent to more than 40 percent over the same period (panel c). For people 25–34, the figure rose from about 10 percent to almost 30 percent. This increase in nonstandard employment among young people is mirrored by a substantial decrease in the prevalence of standard jobs (panel d). Self-employment rates decreased more uniformly for all age groups (panel b). These trends reflect the growing prevalence of nonstandard employment across the workforce, particularly among the young.

Historical data are not available for all ECA subregions, but the trends observed in figure 2.14 indicate that the increase in nonstandard employment was particularly large in Southern and Western Europe. In Central and Northern Europe, the increases were more moderate.

FIGURE 2.13 Types of employment in the European Union, by age group, 1990–2020
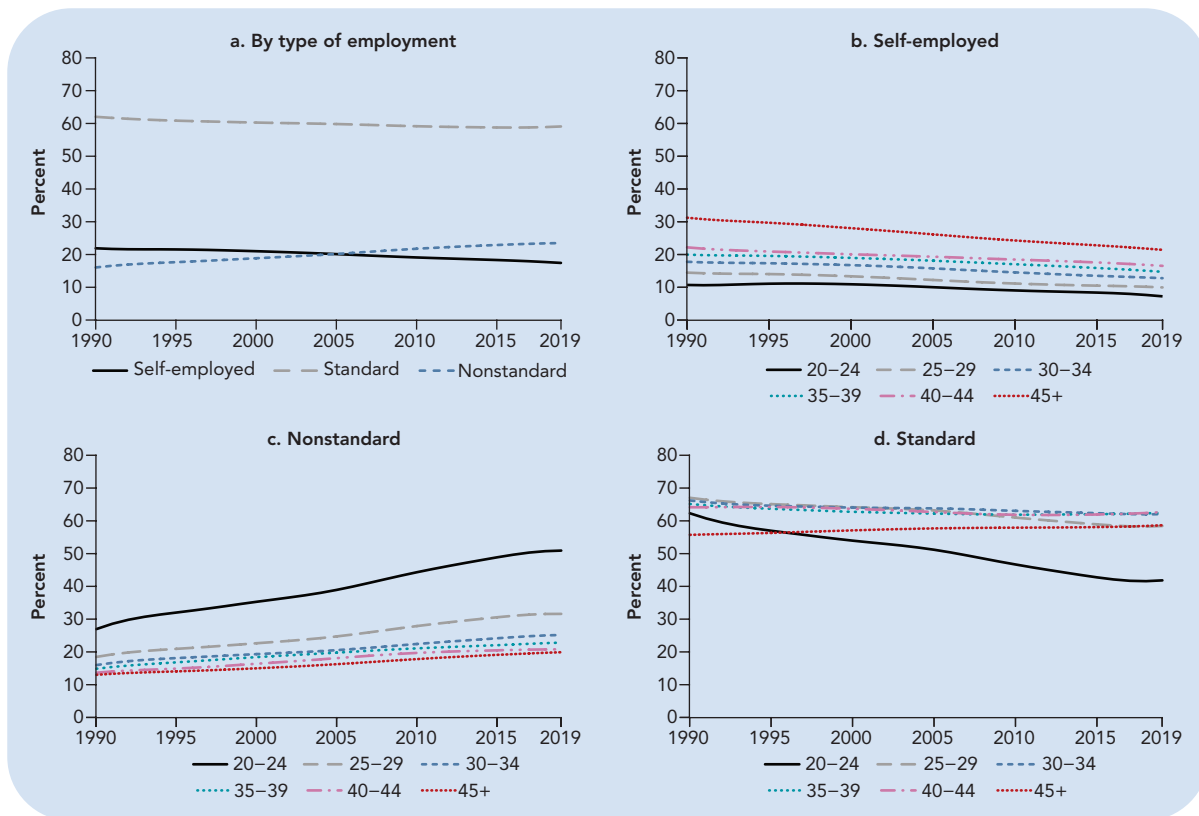
Source: Authors' calculations based on data from labor force surveys from the European Union.

FIGURE 2.14 Prevalence of nonstandard employment in the European Union, by subregion, 1990–2020
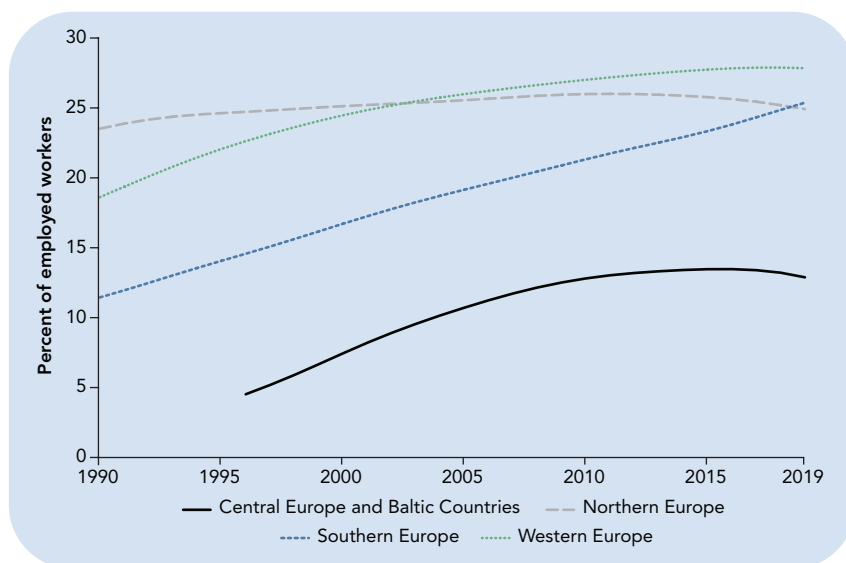
Source: Authors' calculations based on data from labor force surveys from the European Union.
Note: Subregional values are population-weighted country averages. A lowess smoother was applied to the annual trend.

Changes in Job Tenure

The increased prevalence of nonstandard employment—in particular, the rise of temporary employment and the slow decline of permanent employment—may be associated with increased job turnover, with workers remaining for shorter periods in a given job. Differences in job tenure across individuals have been associated with the type of contracts they hold (temporary or permanent). Recent evidence suggests that temporary employment serves as a trap rather than a stepping stone to tenured contracts by creating dual labor markets and making mobility from temporary work toward open-ended contracts increasingly difficult (Fauser 2020; Kiersztyn 2021; Mattijssen and Pavlopoulos 2019; Reichenberg and Berglund 2019). Almost all temporary workers in Austria, Estonia, and Germany move into permanent jobs, but half of the temporary workers in Spain and Italy remain in temporary jobs for more than a decade (Eichhorst, Marx, and Wehner 2017). The transition from fixed-term to permanent contracts is lower for foreign-born workers, who are more likely to work for longer periods on fixed-term contracts (Skedinger 2018).

A decrease in job tenure is not innocuous for the coverage provided by social protection systems. In many systems in the region, benefits and the level of insurance are associated with the length of employment spells, with individuals who stay in a job longer enjoying higher benefits, such as larger pensions, more days of leave, and better insurance. Shorter job tenures thus risk decreasing the level of protection social protection systems provide.

As of about 2019, more than half of the employed in ECA had been in their current job for more than five years, about a third had been employed in their current job for one to five years, and only 8 percent had started their current job within the past year (see table 2.6). These proportions are similar across subregions for which data are available (figure 2.15).

Using data from labor force surveys, Bussolo and others (forthcoming a and b) document the evolution of job tenure in 36 countries in ECA from 1995 to 2019 (figure 2.16). Over this period, there was no clear trend; macroeconomic fluctuations seem to have driven most of the movement in these aggregate measures.[12] The average worker in Europe spent about 10 years in his or her current job.

There is some heterogeneity across subregions. On average, workers in the Western Balkans had job tenure that was more than two years longer than the regional average. Workers in Southern Europe had average tenure that was more than 1.5 years longer than that of the average worker in the region. Average job tenure in Russia was considerably shorter (between seven and eight years), although it increased slightly over the period. Tenure in Central and Western Europe remained mostly stable, at 10 years, during the sample period.

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12. Tenure varies across the business cycle, with mean tenure rising during recessions (Bell and Blanchflower 2010, 2011a, 2011b). During economic downturns, short-tenured and temporary jobs are more likely to be destroyed than longer-tenured jobs, as workers with more seniority are less likely to lose their job (see, for example, Rothstein 2021, Burgess and others 2003, and Aslund and Rooth 2007). Exit flows of short-tenured workers, coupled with low rates of new jobs creations, increase mean tenure (Bachmann and Felder 2018).

FIGURE 2.15 Share of employment in Europe and Central Asia by duration of job tenure, by subregion
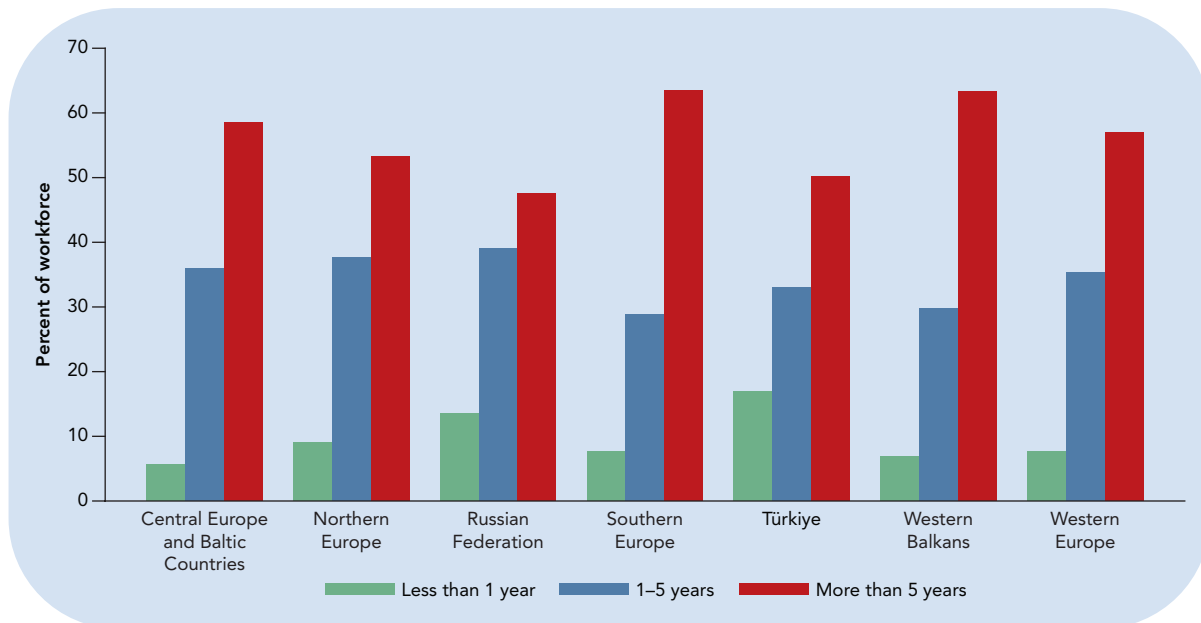
Source: Authors' calculations based on data from national labor force surveys.
Note: Data are for 2019 or the latest available year.

FIGURE 2.16 Average job tenure in Europe and Central Asia, by subregion, 1995–2020
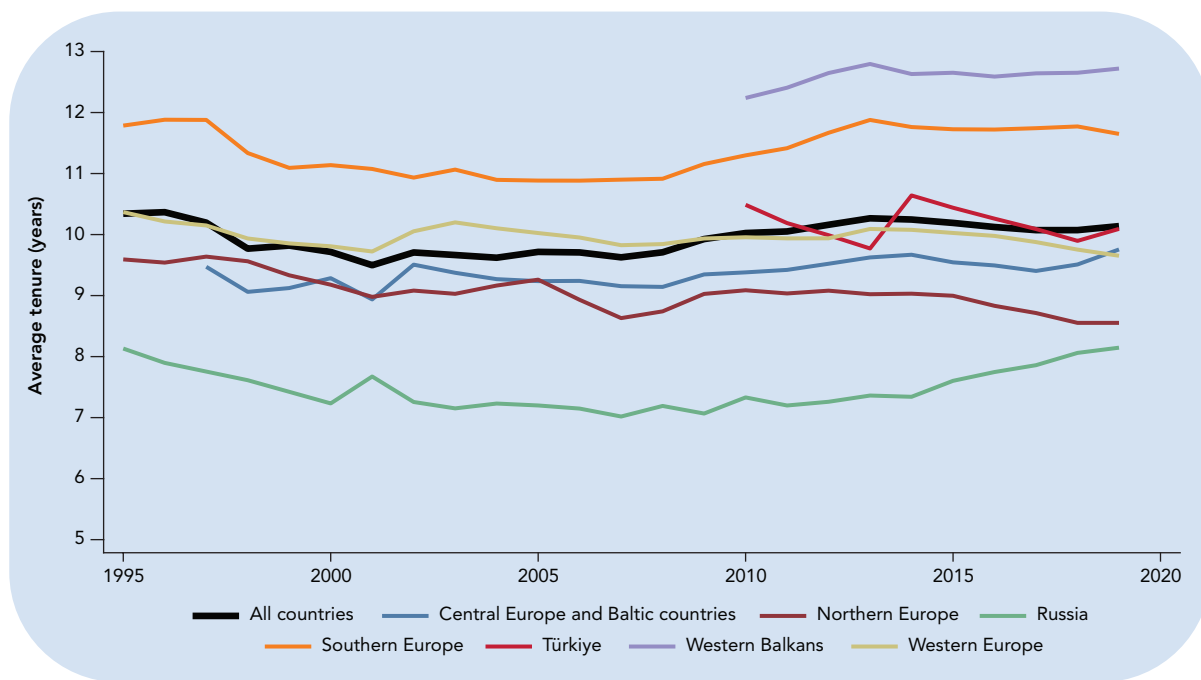
Source: Bussolo and others (forthcoming a and b), based on data from EU labor force surveys, national labor force surveys, and the Russia Longitudinal Monitoring Survey.
Note: Subregional values are simple averages of countries within the region. The Western Balkans average does not include Montenegro, because of limited data availability. Tenure is calculated only for the employed population 20–65.

Table 2.7 presents average tenure by subgroup of the population. It shows that women have shorter average tenure than men, although the gap narrowed over time. In 1995, men had average tenure that was almost two years longer than women; by 2019, the difference had narrowed to just 0.3 years.

The fact that women have lower mean tenure than men may be linked to women's participation in atypical and low-paid precarious jobs. Ortiz, Díez, and Apaolaza (2020) report higher participation of women in part-time jobs and temporary contracts, which allow them to balance work and family care duties. Workers with lower-secondary diplomas have consistently higher average tenure than workers with upper-secondary diplomas or tertiary degrees. However, workers with upper-secondary diplomas saw an increase in their average tenure of about 0.4 years between 1995 and 2019. All age groups saw a decrease in tenure, but the decrease was greatest for workers 50 and older, among whom average tenure decreased by 2.7 years. The average tenure for workers with

TABLE 2.7 Average years of job tenure in Europe and Central Asia, 1995–2019, by subgroup

Subsample	1995	2000	2005	2010	2015	2019
Total	10.34	10.04	9.72	10.03	10.19	10.14
Gender						
Men	11.05	10.43	9.87	10.17	10.34	10.29
Women	9.30	9.46	9.47	9.85	10.01	9.94
Education						
Lower-secondary	12.00	11.31	10.84	11.00	10.71	10.62
Upper-secondary	9.39	9.40	9.19	9.50	9.90	9.82
Tertiary	10.12	9.63	9.57	9.75	9.72	9.79
Age group						
25–29	4.10	3.84	3.58	3.51	3.33	3.08
30–39	7.74	7.33	6.82	6.58	6.53	6.19
40–49	12.96	12.44	11.43	11.10	10.94	10.61
50+	19.04	18.17	16.73	16.86	16.65	16.36
Type of contract						
Permanent	10.55	10.25	10.11	10.15	10.50	10.25
Temporary	2.21	2.17	2.50	2.20	2.27	2.26
Subregion						
Central Europe	—	9.29	9.24	9.38	9.55	9.76
Northern Europe	9.59	9.18	9.26	9.09	9.00	8.55
Russian Federation	8.13	7.23	7.20	7.33	7.60	8.15
Southern Europe	11.79	11.14	10.89	11.30	11.73	11.65
Türkiye	—	—	—	10.49	10.44	10.09
Western Balkans	—	—	—	12.24	12.65	12.72
Western Europe	10.37	9.81	10.03	9.96	10.03	9.65

Source: Bussolo and others (forthcoming a and b), based on data from EU labor force surveys, national labor force surveys, and the Russia Longitudinal Monitoring Survey.
Note: Subregional values are simple averages of countries within the region. Tenure is calculated only for the employed population 20–65. The Western Balkans average does not include Montenegro, because of limited data availability.

permanent contracts remained stable in the last two and half decades. Average tenure for workers with temporary contracts increased slightly.

The subgroup values presented in table 2.7 suggest that the picture of stability in average job tenure hides considerable subgroup variability, particularly across age groups. To uncover actual trends in job tenure, it is possible to use an age-period-cohort decomposition to estimate changes in tenure across cohorts of workers born in different years, controlling for the aging of the labor force and the macroeconomic shocks common to all workers. This method estimates the life-cycle profile of tenure, the effects of shocks common to all individuals and specific to a period, and the effects specific to each cohort by maximum entropy estimator.[13]

Figure 2.17 presents the cohort effects on tenure estimated by the maximum entropy method (Browning, Crawford, and Knoef 2012) for EU countries, Russia, Türkiye, and the Western Balkans. It shows that average tenure declined for younger age cohorts. On average, a worker born in 1950 had 3.3 years' longer tenure than a worker born in the 1980s in the European Union. This difference was 4.0 years in Russia, 4.7 years in the Western Balkans, and 7.7 years in Türkiye.

Figure 2.18 shows the cohort effects by subsample in EU countries. This analysis explores the heterogeneity of the period, age, and cohort effects on tenure duration across different groups of workers, accounting for potential

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13. The maximum entropy estimator generates a distribution of estimates that satisfy the linear constraints of the standard age-period-cohort (APC) models. It produces estimates of the expected values of parameters corresponding to the maximum entropy probability distribution (Browning, Crawford, and Knoef 2012). An appealing feature of the APC maximum entropy method is that it overcomes the potential arbitrariness of identification restrictions.

FIGURE 2.17 Changes in job tenure between 1930 and 1995 in Europe and Central Asia, by birth cohort
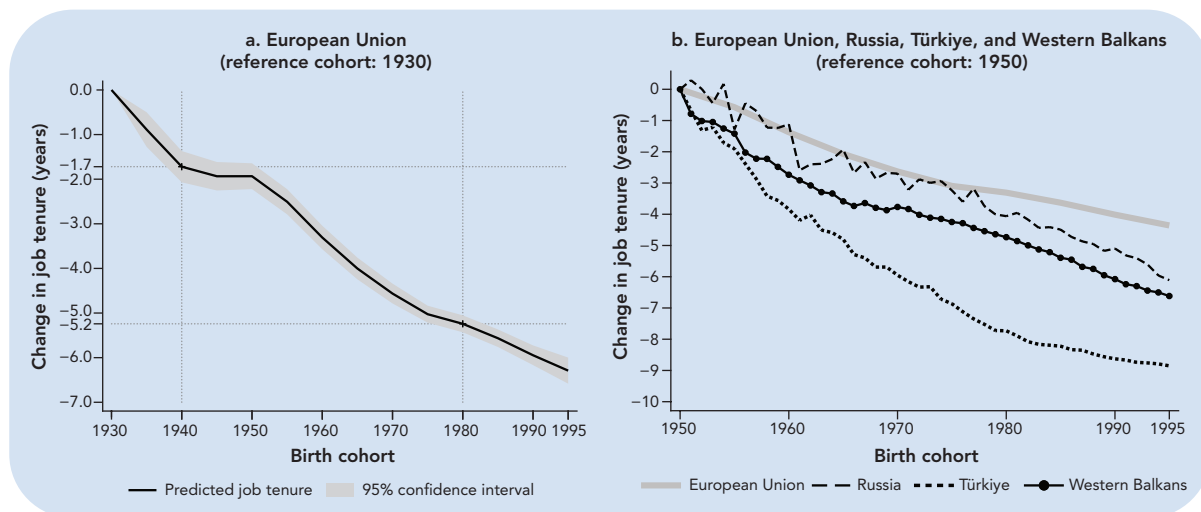
Source: Panel a: Bussolo and others (forthcoming a); panel b: Bussolo and others (forthcoming b).
Note: Figures show change in year of job tenure relative to the reference birth cohort of workers. The synthetic panel is based on the pulled sample of all workers 20–65 in 29 countries from 26 years of labor force surveys in the European Union (panel a) and from the Russia Longitudinal Monitor Survey and labor force surveys of Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Serbia, and Türkiye (panel b). The horizontal dotted lines in panel a show the changes in job tenure relative to 1930 age cohort for the 1940 age cohort (a decline of 1.7 years) and the 1980 cohort (a decline of 5.2 years).

FIGURE 2.18 **Cohort effect on job tenure in the European Union between 1930 and 1995, by gender, education, region, and type of contract**
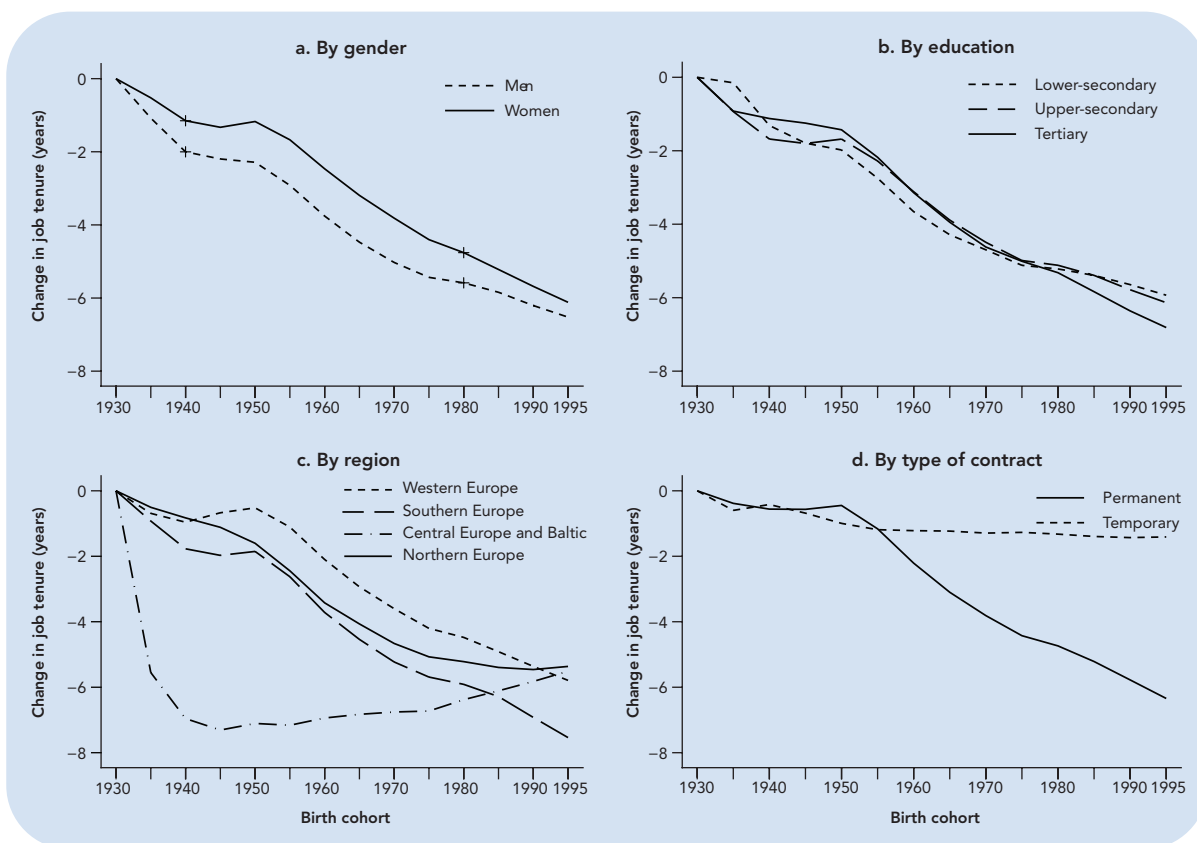
Source: Bussolo and others (forthcoming a).
Note: Figures show change in job tenure by survey period relative to 1995. The synthetic panel is based on the pulled sample of all workers 20–65 in 29 countries from 25 years of labor force surveys in the European Union.

compositional changes in the labor market from 1995 to 2020. Tenure declines for younger cohorts almost uniformly in all subsamples. Among younger cohorts, the decline was steeper for men than for women (panel a). The tenure trajectory by birth cohort declined for all educational levels (panel b). The tenure of workers on temporary contracts remained almost constant by age cohort. Tenure of workers employed in permanent jobs exhibited a decline similar to that for the gender and education subsamples. Panel d shows the common secular trend over birth cohorts for workers in Western, Northern, and Southern Europe.

In Central European and Baltic countries, the cohort effect declines for older workers, stabilizing at a low level for younger cohorts of workers. This trend may reflect structural changes in the economies of these countries during the period of transition to a market economy in the early 1990s, when large numbers of state-owned enterprises were closed, and many new privately owned firms opened, interrupting job tenure for most workers.

The analysis so far shows then that the stability in average job tenure across ECA actually hides opposing trends within subgroups of the population that

compensate each other: on the one hand, the younger cohorts—who are smaller in size, due to demographic aging—have seen a decline in their average tenure, while older cohorts—who are larger in size—remain in their jobs for a longer time. This stability in the average job tenure across the whole population may not persist over time. In fact, the retirement of the post–World War II generation and the decline in youth labor force participation over the last two decades could lead to shorter average tenure.

An important limitation of the age-period-cohort decomposition approach is that it does not control for other compositional changes, such as changes in marriage and fertility decisions, family composition, mobility, and employer characteristics (such as firm size).

These deficiencies can be addressed by analyzing job tenure conditional on workers' and employers' characteristics by estimating the probability that a person holds a job for less than a year, more than 5 years, and more than 10 years over the span of the surveys. By covering these tenure periods, the analysis captures both the short-term and long-term (countercyclical) effects of the business cycles on job tenure.[14]

The probabilities of having tenure of different duration are estimated conditional on the set of individual, household, and employer characteristics; country fixed effects; and time dummies corresponding to periods of the survey. The marginal effects of each year dummy are then estimated at the sample means. These marginal effects could be interpreted as conditional sample-year average proportions of each of the three tenure durations. These marginal effects are then regressed on a linear time trend.

Table 2.8 shows the results of the marginal effect regressions for three categories of tenure as dependent variables (columns) and different subsamples (rows). The first column of results shows the annual percentage changes in the probability of holding short-term (tenure of less than one year) jobs. For the total pooled sample of EU countries, this probability increases by 0.10 percentage points a year. Extrapolating this result over the period covered by the survey yields an increase in the probability of holding a short-term job between 1995 and 2020 of about 2.55 percentage points.

The probability of having job tenure of less than a year increased more quickly among female workers than male workers. This result is consistent with other studies of the European labor market (for example, Cipollone, Patacchini, and Vallanti 2014). The likelihood of having short-term jobs increased more for better-educated workers than their less-educated peers. Better-educated workers were likely to have more job opportunities and, as a result, higher job mobility. The probability of having a short job tenure increased almost twice as rapidly for younger workers (30–40) than for workers 50 and older.

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14. In periods of economic expansion, new workers (with zero job tenure) are hired, reducing the average tenure; during economic contraction, hires are reduced, increasing average tenure (Arozamena and Centeno 2006). If job turnover increase over time, the share of employees with less than 1 year of tenure (short-term jobs) should have increased while the shares of employees with more than 5 years (medium-term jobs) and more than 10 years (long-term jobs) should have declined.

TABLE 2.8 Estimated annual percentage point changes in tenure in the European Union between 1995 and 2020 for three tenure lengths

	Years of tenure					
	Less than 1		5–10		More than 10	
Subsample	Coefficient	Standard error	Coefficient	Standard error	Coefficient	Standard error
Total	0.098	0.018	0.046[ψ]	0.036	−0.269	0.035
Gender						
Men	0.079	0.019	0.070	0.033	−0.288	0.036
Women	0.119	0.017	0.014[ψ]	0.039	−0.240	0.036
Education						
Lower-secondary	0.069	0.021	0.063[ψ]	0.038	−0.307	0.040
Upper-secondary	0.091	0.019	0.048[ψ]	0.034	−0.263	0.033
Tertiary	0.128	0.017	0.024[ψ]	0.039	−0.191	0.029
Age group						
30–40	0.104	0.018	0.050[ψ]	0.053	−0.265	0.047
40–50	0.079	0.012	0.113	0.032	−0.324	0.031
50+	0.056	0.008	0.054	0.018	−0.196	0.021
Subregion						
Central Europe	−0.135	0.040	0.153	0.033	−0.044[ψ]	0.037
Northern Europe	0.149	0.026	0.020[ψ]	0.043	−0.454	0.026
Russian Federation	−0.388	0.052	0.338	0.043	0.090[ψ]	0.054
Southern Europe	−0.002[ψ]	0.024	0.068[ψ]	0.046	−0.156	0.036
Türkiye	0.096[ψ]	0.172	0.787	0.126	−0.895	0.161
Western Balkans	0.040[ψ]	0.120	0.315	0.092	−0.354	0.120
Western Europe	0.211	0.021	−0.006[ψ]	0.042	−0.302	0.047

Source: Bussolo and others (forthcoming a and b), using data from EU labor force surveys for 1995–2020, the Russia Longitudinal Monitoring Survey, and national labor force surveys for Türkiye and the Western Balkans (Montenegro was not included because of limited data availability). *Note*: Coefficients and standard errors are estimated by the linear regression of 26 marginal effects of the year dummies on the linear time trend. Marginal effects are derived by estimating the probability of a worker having one of three durations of job tenure. Gender, education, and age group estimates correspond to the EU country sample. Estimation of the probability of a worker having less than one year of job tenure is conducted on a sample of respondents 20 and older. The probability of a worker having five or more years of tenure is estimated on a sample of respondents 25 and older. The probability of having tenure 10 and more years is estimated on a sample of workers 30 and older. The values for Türkiye are estimated for 2011–19; values for the Western Balkans correspond to 2008–19. All coefficients, except those marked with ψ, are significant with at least 95 percent confidence; ψ indicates not significant at the 90 percent level. Standard errors are bootstrapped.

Trends in the probability of having job tenure of less than a year vary significantly across the subregions of Europe. That probability increased in Western and Northern Europe and exhibited no significant change in Southern Europe and the Western Balkans (the time coefficient is not significant). A decline in the probability of having short job tenure in Central Europe and Russia could be associated with the period of transition to the market economy in the early-mid 1990s, when many state-owned enterprises were privatized (see, for example, Nellis 2001).

The probability of having job tenure of 5–10 years increased for male workers; older workers; and workers from Central Europe, Russia, Türkiye, and the Western Balkans. The probability of having tenure of more than 10 years declined for all gender, education, and age groups and all subregions except Central Europe and Russia. The dynamics of the intertemporal changes in medium- and long-term tenure are also consistent with changes in the probability of having

short-term jobs. Over the sample period, the shares of long-term jobs declined more rapidly for male workers than for female workers. The trend estimates imply a decline in the probability of having long tenure between 1995 and 2020 of about 7.5 percentage points for men and 6.2 percentage points for women in EU countries. This decline in long-tenure jobs could be associated with increased layoffs, particularly of men, as Bergmann and Mertens (2011) found for Germany.

Comparing the coefficients on educational categories reveals that the shares of long-term jobs declined more rapidly for less-educated than better-educated workers. Younger workers experienced a sharper drop in long-term tenures than older workers. The share of workers with more than 10 years of tenure declined most in Türkiye, followed by Northern Europe, the Western Balkans, and Western Europe. These shares decreased only slightly in Southern Europe. No significant trends in the probabilities of having long-term jobs were evident in Central Europe of Russia.

Extending the approach used to estimate individual probabilities of having job tenure of different duration allows investigation of the extent to which the megatrends in labor markets—technological change and globalization—and regulatory reforms over the last 25 years affected the dynamics of job tenure in Europe across various groups of workers. The results of this analysis, focused on EU countries, is presented in Annex 2.1, table A2.1.2. They show that changes in employment protection legislation, such as stricter dismissal policies (measured by the EPR index), reduce the probability of having tenure of less than one year. Fewer workers were fired from regular jobs, and the number of people changing jobs declined. The effect of this regulation appears to be stronger for female workers and younger workers—the groups that are probably first to be laid off during economic downturns. Better-educated workers seem to be less affected by these regulations. Increasing the costs of hiring temporary workers (as measured by the EPT index) increases the probability of having a medium- or long-term tenure job but has no statistically significant effect on short-term tenure. This policy seems to protect more senior workers; the tenure duration of younger workers is not affected.

Including trade openness in the analysis show that increases in openness were associated with a higher probability of holding a short-term job. However, there appears to be no correlation with changes in the probability of holding a medium- or long-term job. The investigation also reveals a positive association between a higher capital stock of ICT and the share of short-term tenure jobs. The technological change appears to increase these shares more among female, better-educated, and more senior workers. Shorter job tenure among better-educated workers might result from increased job mobility and voluntary movement to better job matches, but the larger share of short-term jobs among senior workers could indicate higher dismissal rates of such workers.

The COVID-19 pandemic continues to alter the structure of European labor markets in profound ways. Emerging evidence indicates that it could negatively affect employment and job tenure (von Wachter 2021). The adoption of technology and structural shifts in the workforce that are expected to accelerate in the aftermath of the pandemic bring the issues of job security and job stability to the forefront of the European policy agenda.

Social Protection Systems in the Face of a Changing Labor Market

Labor markets in ECA are changing. In the last 25 years, nonstandard employment increased and job tenure declined. As these changes appear to have the worst effects on vulnerable groups on the labor market—the young, people with low levels of education, and women—they pose a substantial challenge to traditional social protection systems. The growing sense of discontent among citizens of ECA is partly related to job insecurity (Bussolo and others 2018).

Employment-based risk-sharing models are not well adapted to transformations in the labor market like the ones countries in ECA are going through, as Packard and others (2019) note. An aging population, for instance, puts pressure on pension systems based on pay-as-you-go, high-value defined benefits, as individuals live longer after leaving full employment. To fund their pension systems, many countries increased payroll tax–based contributions to high and damaging levels, changed eligibility requirements, and raised the retirement age. Increased job turnover affects the ability of a central intermediation agent in traditional systems (the employer) to provide protection. Forms of employment that are less attached to a given employer (such as gig jobs or other nonstandard work relationships) may increase vulnerability to shocks.

Estimates for a subset of countries in ECA by the OECD (2019) show that independent workers receive fewer illness and injury benefits, fewer unemployment benefits, and lower old-age pensions than workers in standard employment relationships; they are also less likely to receive maternity and family benefits and to be treated by social protection systems as independent workers. Following job loss, nonstandard workers are much less likely than standard workers to receive unemployment benefits. In Czechia, Latvia, Portugal, and the Slovak Republic, the probability of nonstandard workers receiving unemployment benefits is 20 percentage points lower than that of standard workers; in Estonia, it is 30 percentage points lower (figure 2.19).

Increased job turnover (shorter job tenure) is also associated with lower old-age pensions. A simulation for OECD countries (OECD 2017) shows that, on average, employees with longer out-of-work spells and a late-career start will receive pensions that are 20 percent lower than those of a full-time employee with no work interruptions. In Poland and Türkiye, the difference is closer to 30 percent (figure 2.20).

Changes in the labor market leave vulnerable workers unprotected by traditional employment-based social protection systems. Schemes geared towards job protection may thus leave the income of many workers unprotected. The policy response is clear: Income-based, or means-tested, social protection is needed to ensure protection in contexts in which full-time, long-term, and permanent work relationships are less and less common.

FIGURE 2.19 Probability of receiving benefits upon job loss in OECD countries, given employment history
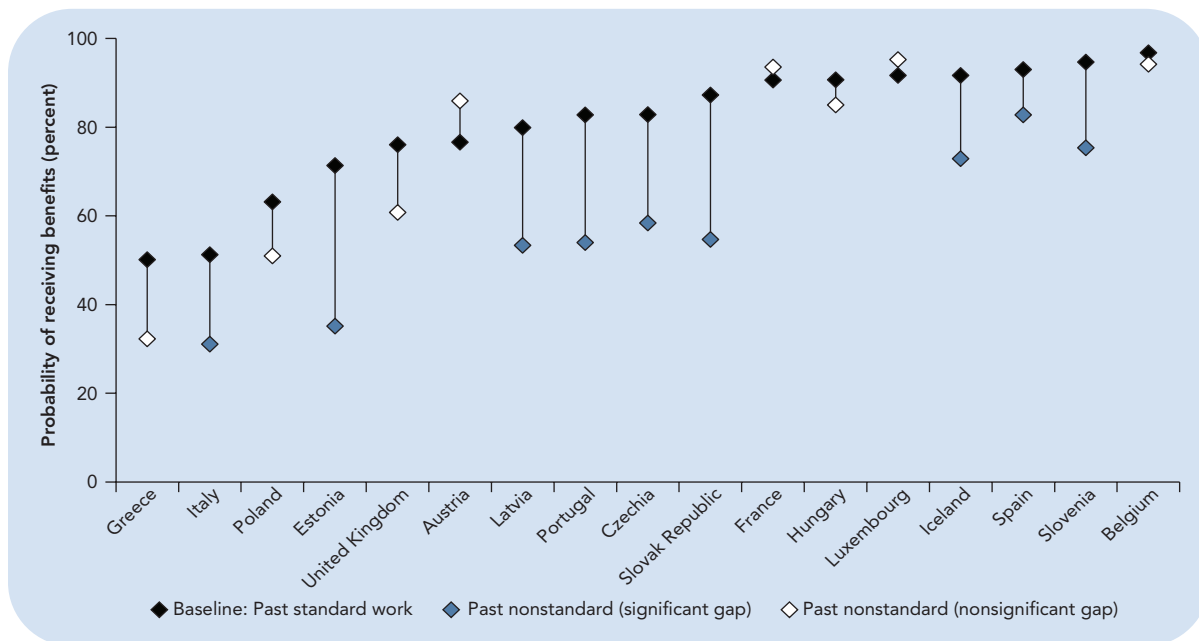
Source: OECD 2019.
Note: The baseline is the benefits expected by an able-bodied working-age adult who is out of work, had uninterrupted full-time dependent employment with median earnings in the preceding two years, and lives in a two-adult low-income household without children. Nonstandard work refers to part-time work, self-employment, or interrupted work patterns during the two years preceding the reference. Statistical significance refers to gaps between baseline and comparator cases (90 percent confidence interval). Full-time students and retirees are excluded from the sample. For more details, see box 7.3 in OECD (2019).

FIGURE 2.20 Loss in pension benefits in OECD countries associated with incomplete versus full career
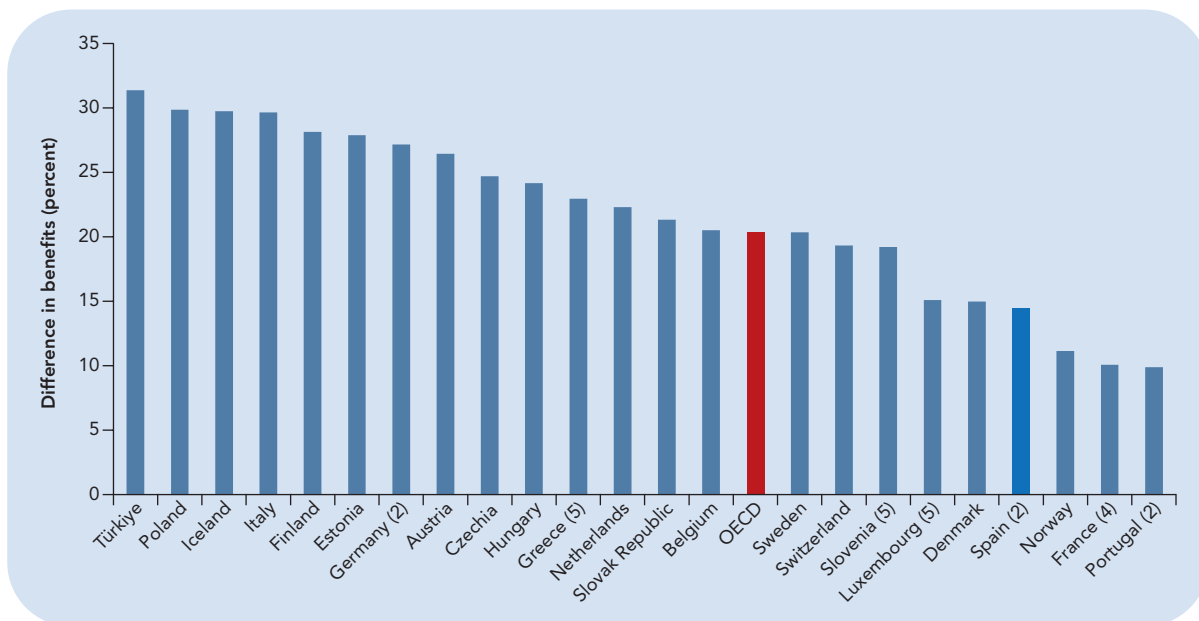
Source: OECD 2017.
Note: Figure shows difference in benefits of a worker who began work at 25 and had 10 years of unemployment between age 25 and 45 and a worker who worked uninterruptedly between age 20 and 45. Figures in parentheses show additional years required to receive a full pension in countries in which later retirement allows people with incomplete careers to access one without actuarial penalty.

Policy Implications

Government provision of social insurance and social assistance and the labor market regulations that support them affect all dimensions of the modern economy. Social protection systems should therefore be understood as integral components of the general policy framework of countries' economic development.

Social protection both mitigates the shorter-term impacts of shocks and promotes longer-term economic recovery and economic growth. To achieve these objectives, social protection systems need to become adaptive and inclusive. This kind of transformation is particularly important given the changes in employment that technological changes and globalization have driven, and the significant job reallocation that the green transition will require.

Faced with the systemic shock of the COVID-19 pandemic, countries took unprecedented steps to shield individuals and households from catastrophic welfare losses. All regions and countries expanded income support programs, although the expansion of their coverage was heterogeneous. In ECA, a large share of the economic stimulus budget was also channeled through firms in the form of job protection programs. The empirical evidence suggests that job protection programs may have been effective in achieving these objectives in the short term. These programs may also have created labor market frictions that reduced labor reallocation from less productive to more productive firms, however. They may have also left some groups of the population uncovered, particularly those in informal or nonstandard jobs. The social protection systems of ECA proved resilient in their ability to quickly expand their reach in the face of unexpected shocks, such as the displacement of millions of Ukrainians and the soaring food and energy prices that accompanied the conflict. Their role in promoting economic recovery is less clear.

Beyond the immediate challenges brought about by the pandemic and the consequences of the war in Ukraine, long-term labor market transformations may make social protection systems less inclusive. Social policies structured around job protection may leave a growing share of the labor force unprotected, as nonstandard forms of employment become more prevalent and job tenure declines. Nonstandard forms of employment are more common among women, people with little education, and youth; traditional social protection systems risk leaving these vulnerable groups unprotected.

Combining job protection policies with programs that protect the incomes of broad groups of the population might be optimal in shielding them from adverse shocks and promoting long-term economic recovery and sustainable growth. This blended approach could be based on publicly financed policies such as a guaranteed minimum income (Deeming 2019), a negative income tax scheme (Friedman 1962), or a universal basic income program (Ravallion 2019), all of which are designed to protect people from catastrophic losses regardless of their employment status or type of job contract. At the minimum, these programs should be means-tested to ensure they reach the poorest and those who face an adverse shock. This kind of approach may represent a significant departure from the way social protection systems are organized in many countries in the region,

where categorical, non-targeted benefits (disability benefits, birth grants, social pensions, war-veteran benefits, and to utility subsidies) represent the bulk of social assistance spending. Among these countries are Azerbaijan, Bosnia and Herzegovina, Kazakhstan, Kosovo, the Kyrgyz Republic, Moldova, Serbia, and Ukraine. Pro-natal categorical programs, which have yet to show evidence of their effectiveness in increasing fertility, take up a substantial part of the social assistance budget in Serbia and were also substantial in North Macedonia before they were phased out in 2019, as explained later.

Category-based systems are not able to provide a minimum coverage against adverse economic shocks because, by definition, they are rigid, and, moreover, the categories which organize the system may not correlate with the factors that drive income loss in a given shock. The COVID-19 shock is particularly relevant in this regard: the characteristics of the people falling into poverty as a result of the pandemic differed from the characteristics of those who were already poor (World Bank forthcoming). In Moldova, for instance, those who became poor were more likely to be employed and in the industry and services sectors, while those that were already poor were mostly self-employed and in the agriculture sector (World Bank 2021c).

Means-tested benefit systems, while *a priori* more capable of reaching the poor than categorical ones, also need to incorporate flexibility into the targeting scheme by design. Social protection systems can also be made more adaptive by setting out in advance the rules that would guide any changes, such as modifications to eligibility criteria, system procedures, and benefit amounts that a sudden shock would necessitate. Otherwise, targeted, means-tested programs may end up suffering from similar rigidities than those of categorical, non-means-tested ones. In both entities of Bosnia and Herzegovina, for instance, legislation didn't allow the expansion of social assistance programs in a timely manner when the pandemic shock hit, and therefore the government of Republika Srpska implemented a one-off solution to address the immediate needs of income support. Updating the legislation to allow for flexibility on eligibility rules in extraordinary circumstances would give social protection systems the possibility to quickly expand when needed.

A successful example of moving away from a category-based social assistance system towards one where actual household income determines the receipt of benefits is the reform package implemented by North Macedonia in 2019. This reform package's main initiative was the creation of the Guaranteed Minimum Allowance (GMA), which consolidated the fragmented, often overlapping benefit schemes that were in place before the reform. In terms of payments, GMA is a targeted program that provides the difference between household income and an established minimum income threshold. The implementation of the 2019 reform package is leading the country to improve the coverage and adequacy of social assistance spending (World Bank 2022a).

Some countries in the region have gradually started moving in a similar direction. Partly with the support of the World Bank, Tajikistan has implemented the Targeted Social Assistance (TSA) scheme, which was signed into law in 2018 and achieved national scale in mid-2020. The TSA program covers close to 15 percent

of the households in the country, which is close to the extreme poverty line. The benefit level remains relatively small, but it was recently redefined in a way that allows its regular annual indexation. The country could look into introducing differentiation in the benefit level, so it can be linked to family composition, specifically the number of children, to make the assistance more meaningful. Romania's guaranteed minimum income program (VMI, for its acronym in Romanian) faces similar challenges, given its low coverage and low adequacy. Türkiye has been able to respond strongly to the pandemic shock thanks to both its emergency measures and its social assistance system relying on targeted benefits managed effectively through an integrated registry of beneficiaries, though, at the same time, the country still has a large number of categorical benefits and would benefit from moving to a more comprehensive and unified targeting system. Uzbekistan is still in the process of consolidating its social assistance programs, helped by the creation of two new administration systems: the Single Social Registry (SSR) and the Labor Market Information System (LMIS), which should be fundamental for the implementation of a single evidence-based framework of targeted support. Other countries in ECA that have made important progress in moving to a means-tested benefited system are Albania, Armenia, and Montenegro.

Job losses and transitional unemployment should be insured by national unemployment income support programs instead of employer-provided arrangements such as severance pay, which is suboptimal from a risk-pooling perspective (Packard and others 2019). Generous severance payments may distort firms' labor choices, by deterring formal hiring. Broad unemployment income support programs, financed from mandatory individual savings and complemented by public funding, are less distortionary and more protective. Countries that currently do not have an unemployment insurance program should consider setting one up. Armenia, Georgia, and Kosovo, which do not have unemployment insurance schemes, implemented programs to compensate job losses during the pandemic with generally low and of short duration benefits (World Bank forthcoming a). Other countries, like Albania, Kazakhstan, and Serbia, have unemployment insurance schemes but with demanding eligibility criteria and, in some cases, low benefit levels, which result in extremely low take-up rates for the allowance. The unemployment insurance schemes have, therefore to be meaningful to be effective.

When such measures are in place, governments can adapt their social protection policies to rapidly changing labor market conditions by implementing regulatory reforms that gradually remove restrictions on firms' hiring and dismissal practices. Uniformly enforced regulations protecting workers, irrespective of their work arrangements, against abuses by employers and hazardous working conditions will guarantee that more flexible labor markets will enhance workers' welfare. Modernizing labor regulations and institutions may also enhance the creation of formal jobs in the private sector and reduce informality.

Social protection systems need to be able to address the challenges of the green transition. When entire sectors or types of jobs disappear, employment-based insurance schemes cannot provide adequate protection to the affected groups of

the population. Social protection programs will play a key role in identifying and assisting individuals who are harmed by the green transition (World Bank forthcoming b). Employment assistance programs and other active labor market policies—such as skills training, entrepreneurial support, and intermediation—can be helpful when well-designed. Doing so is no easy feat, however; many active labor market programs in developing countries are not effective (McKenzie 2017). Evidence from high-income countries suggests that some programs, particularly those aimed at improving workers' human capital, may increase employment rates in the long run (Card, Kluve, and Weber 2018). New evidence also shows that sectoral employment programs can be particularly effective when they provide training for transferrable skills and help place individuals in high-wage sectors (Katz and others 2022). The private sector could play a role in subsidizing training in sector-specific skills. Active labor market policies like these can also help integrate those displaced by other shocks—like, for instance, Ukrainian refugees in Poland, Syrian refugees in Türkiye, or return migrants in the Kyrgyz Republic, who are currently not being adequately profiled in terms of their skills and qualifications by the public employment services.

Successful implementation of inclusive and adaptive social protection systems requires digital tools to manage the massive amounts of administrative data involved and monitor people's welfare. Countries in ECA need to harness digitalization to improve their capacity to deliver services effectively (World Bank 2021a). Even where administrative data allowing for better targeting of social protection programs exist, governments may not have an integrated system that allows different agencies to share the information under their control. This is the case, for instance, of Croatia, where the social protection system is composed of different programs without an integrated administrative system. Bulgaria and Romania could also benefit from the creation of a proper case management system to enable social care services to reach those in need.

The effectiveness of new systems will depend on the alignment of the incentives bureaucrats face to minimize errors of inclusion and exclusion. Bureaucrats often try to minimize errors of inclusion because public opinion is usually more sensitive to including ineligible individuals than excluding people who should have received benefits (Rose-Ackerman 1986). From a welfare point of view, however, errors of exclusion may be more costly than errors of inclusion. A scheme in which the agency distributes the benefits differs from the one that identifies beneficiaries could split the reputational risks of bureaucrats, reducing the bias toward minimizing errors of inclusion. It could be complemented by actively monitoring the program's performance in welfare outcomes through regular household surveys carried out by a third agency. In this sense, a common challenge throughout the region is the lack of activities aimed at monitoring and evaluating the effectiveness of social protection programs.

Lastly, for social protection systems to be inclusive, addressing the demand-side challenges many of these systems face is essential. Marginalized communities in ECA struggle to access both social assistance and social services. Challenges include the lack of information and the low coverage or unavailability of social services in marginalized communities and lagging regions. Evidence

moreover shows that some marginalized, poor and vulnerable citizens, who need support the most, end up not applying at all due to discouragement, suspicion, poor information about entitlements, difficulties with administrative procedures, or discriminatory treatment by administrative counterparts and service providers. Therefore, enabling inclusive social protection systems requires a thorough review of the systemic and institutional practices that may improve the ability to reach vulnerable groups. Social accountability and feedback mechanisms need to be established to improve access, quality, quantity, and relevance of the services the most vulnerable population groups need and entitled to.

Annex 2.1 Additional Empirical Results

TABLE A2.1.1 Social protection response and firm-level reallocation in Europe and Central Asia

Item	Expenditure on income protection measures (percent of GDP)			Expenditure on job protection measures (percent of GDP)			Expenditure on wage subsidies (percent of GDP)		
	Change in sales	Change in employment	Decrease in employment	Change in sales	Change in employment	Decrease in employment	Change in sales	Change in employment	Decrease in employment
Log(labor productivity)	4.226***	2.757***	-3.286***	4.088***	2.653***	-2.820***	4.080***	2.627***	-2.758***
	(0.641)	(0.939)	(0.892)	(0.595)	(0.890)	(0.834)	(0.602)	(0.886)	(0.786)
Log(labor productivity) x BTI market organization	0.826*	0.062	-1.624***	0.958**	0.244	-2.111***	0.992**	0.343	-2.276***
	(0.448)	(0.599)	(0.459)	(0.432)	(0.525)	(0.431)	(0.452)	(0.487)	(0.406)
Log(labor productivity) x social protection expenditure variable	-0.148	0.300	0.278	-0.367	-0.865	1.512***	-0.514	-1.468	2.211***
	(0.320)	(0.566)	(0.559)	(0.310)	(0.612)	(0.514)	(0.509)	(1.030)	(0.648)
Constant	-76.563***	-53.477***	73.669***	-75.328***	-52.533***	69.708***	-75.352***	-52.275***	69.749***
	(6.715)	(11.285)	(11.763)	(6.336)	(10.561)	(9.374)	(6.376)	(10.410)	(9.395)
R^2	0.144	0.120	0.072	0.144	0.121	0.075	0.144	0.121	0.075
Number of observations	7,115	6,111	7,106	7,115	6,111	7,106	7,115	6,111	7,106

Sources: Most recent COVID-19 Follow-up Surveys and Enterprise Surveys for 21 countries in Europe and Central Asia; Bertelsmann Stiftung Transformation Index (BTI) 2020; Demirgüç-Kunt, Lokshin, and Torre 2022.

Note: All regressions are ordinary least squares and include sector and country fixed effects, as well as the following firm characteristics: log(number of employees), log(firm age), top manager female dummy, innovated during 2017–19, state ownership (10 percent), foreign ownership (10 percent), has a line of credit or loan, owns a website, national market dummy, and international market dummy. BTI market organization is based on responses to the question "To what level have the fundamentals of market-based competition developed?" Social protection data were not available for Belarus or Moldova. Change in employment was not available for the Russian Federation. BTI market organization, expenditure on income protection measures (percent GDP), expenditure on job protection measures (percent GDP), and expenditure on wage subsidies (percent GDP) are centered on their mean to facilitate interpretation of the coefficients. Standard errors (I parentheses) are clustered at the country level.
*** significant at the 1 percent level, ** significant at the 5 percent level, * significant at the 10 percent level.

TABLE A2.1.2 Impact of employment protection legislation, trade openness, and technological change on the probability of having short-, medium-, and long-term job tenure in the European Union between 1995 and 2020

Subsample	Years of tenure					
	Less than 1		5–10		More than 10	
	Coefficient	Standard error	Coefficient	Standard error	Coefficient	Standard error
Total						
EPR index (see note)	−0.861**	0.333	0.021	0.317	0.347	0.931
EPT index (see note)	−0.121	0.157	0.230**	0.165	1.233**	0.408
Trade openness	3.846**	1.267	2.129	1.522	−0.050	3.397
Capital stock of information and communications technology (ICT)	1.605*	0.938	1.898*	0.969	0.979	2.808
Men						
EPR index	−0.788**	0.346	0.308	0.330	−0.863	0.939
EPT index	−0.157	0.161	−0.169	0.164	1.197**	0.407
Trade openness	4.907***	1.290	2.097	1.432	−1.266	3.360
ICT capital stock	1.458	0.929	0.746	0.907	0.893	2.741
Women						
EPR index	−0.940**	0.333	0.285	0.346	1.774*	0.989
EPT index	−0.072	0.158	−0.249	0.185	1.260**	0.441
Trade openness	2.669*	1.283	2.154	1.753	1.252	3.697
ICT capital stock	1.725*	0.979	3.271*	1.149	0.767	3.071
Lower-secondary education						
EPR index	−0.987**	0.480	−0.323	0.375	0.400	1.078
EPT index	−0.159	0.211	−0.111	0.195	0.915*	0.461
Trade openness	3.991**	1.644	1.587	1.750	2.092	3.744
ICT capital stock	1.014	1.171	1.899**	1.115	−0.306	3.096
Upper-secondary education						
EPR index	−1.024**	0.364	0.132	0.339	0.207	0.973
EPT index	−0.167	0.165	-0.085	0.179	1.023*	0.425
Trade openness	4.342***	1.310	1.761	1.614	0.438	3.532
ICT capital stock	1.913**	0.964	2.666**	1.067	1.052	2.941
Tertiary education						
EPR index	−0.728**	0.284	0.012	0.306	-0.405	0.849
EPT index	0.010	0.137	−0.605***	0.163	1.603***	0.364
Trade openness	2.829**	1.131	3.467	1.608	-2.334	2.965
ICT capital stock	1.575*	0.846	1.218	1.039	1.757	2.329

Source: Bussolo and others (forthcoming a), using data from EU labor force surveys for 1995–2020.
Note: Coefficients and standard errors are estimated using the panel regression of 26 marginal effects of the year dummies estimated on subsamples of 29 countries on the linear time trend and either (a) the EPR index, which measures the difficulty of dismissing regular workers; (b) the EPT index, which measures the ease of hiring temporary workers; (c) the annual change in trade openness (measured as imports + exports as a share of GDP); or (d) the annual change in the per capita ICT capital stock. Marginal effects are derived from the estimation of the probability of a worker having one of three durations of job tenure. The probability of a worker having less than one year of job tenure is estimated on a sample of respondents older than 20. The probability of a worker having five or more years of tenure is estimated on a sample of respondents 25 and older. The probability of having tenure 10 and more years is estimated on a sample of workers 30 and older. Standard errors are bootstrapped.
*** significant at the 1 percent level, ** significant at the 5 percent level, * significant at the 10 percent level.

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Selected Country Pages

ALBANIA

Table 1	2021
Population, million	2.8
GDP, current US$ billion	18.3
GDP per capita, current US$	6447.7
International poverty rate ($2.15)[a]	3.9
Lower middle-income poverty rate ($3.65)[a]	11.3
Upper middle-income poverty rate ($6.85)[a]	34.2
Gini index[a]	36.0
School enrollment, primary (% gross)[b]	100.2
Life expectancy at birth, years[b]	78.7
Total GHG emissions (mtCO2e)	7.9

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2017 PPPs.
b/ Most recent WDI value (2020).

Following a strong growth in Q1 2022, GDP is likely to decelerate, as rising inflation affects disposable income, and a slowdown in the global economy translates into tighter financing conditions and lower exports. Medium-term prospects hinge on the global recovery, structural reforms, and fiscal consolidation. Poverty is expected to decline but persistent inflation could lead to smaller declines in the future or to reversals of past gains.

Key conditions and challenges

Albania's GDP growth rebounded to 8.5 percent in 2021, reflecting the economy's resilience following two exceptionally large shocks: the 2019 earthquake and the COVID-19 pandemic. The post-earthquake reconstruction supported strong investment growth, while consumption benefited from the growth in employment and wages, and credit growth.

Towards year-end 2021, closure of the output gap and rising global prices started affecting domestic inflation. Pressures intensified after the start of the war in Ukraine, with food and energy prices being the most affected. Rising interest rates have also hardened borrowing conditions while global supply chain shortfalls still persist following the pandemic and contribute to inflationary pressures. The global slowdown and rising inflation brought new trade-offs for macroeconomic policies. While macroeconomic policies were geared towards providing a stimulus during 2021, increased inflation expectations prompted a change in the course of monetary policy with the key rate increasing 3.5 times since March 2022.

Against further erosion of disposable income, social assistance is still needed to continue supporting the most vulnerable, but the budget now faces increased refinancing and interest rate risks on its public debt.

Public debt is expected to decline further in 2022, reaching 67.9 percent of GDP, largely on account of higher nominal GDP. The energy sector SOEs represent a key risk to the government's further consolidation plans, in addition to higher costs of public works. At around 27 percent of GDP, public revenues provide little space to increase investment in public infrastructure and human capital. A Medium-Term Revenue Strategy under preparation has the potential to increase revenues over the medium run.

Growth prospects are uncertain with many downside risks. Higher energy, food, and commodity prices could further shrink households' purchasing power and consumption. Additional risks include new, vaccine-resistant COVID-19 variants, tighter global financial and trade conditions, and renewed travel restrictions.

Recent developments

GDP grew by 6 percent in Q1 2022. Private consumption, exports, and investment expanded, as business and consumer confidence remained strong despite increasing prices. Household consumption rose by 8.6 percent yoy. Net foreign demand contributed positively to GDP growth as exports increased by 25.3 percent yoy, while imports rose by 17.6. Gross fixed capital formation slowed (15.5 percent yoy vs 16.9 percent in Q4 2021) while government spending declined significantly with the earthquake

FIGURE 1 Albania / Headline inflation and core inflation
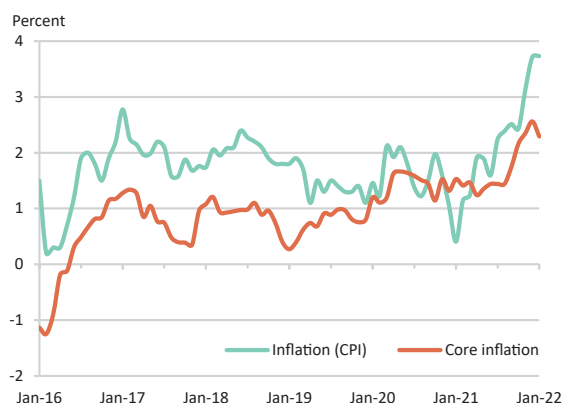
Sources: INSTAT and World Bank.

FIGURE 2 Albania / Actual and projected poverty rates and real GDP per capita
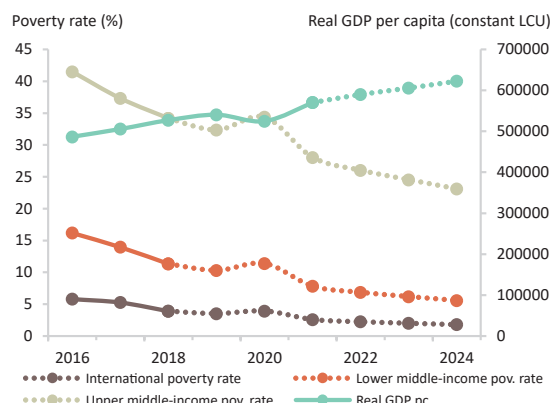
Source: World Bank. Notes: see Table 2.

reconstruction winding down. On the supply side, trade and construction led growth in Q1 2022. Surveys indicate continued growth in the following trimesters on account of tourism.

Labor markets improved during Q1 2022. Employment grew by 3.4 percent, from 2.7 percent in the previous quarter. For the same period, unemployment fell to 11.3 percent from 11.4 percent a quarter earlier, while labor force participation increased. Given the strong growth in GDP per capita in 2021, poverty is estimated to have dropped from 34.4 percent in 2020 to 28.1 percent in 2021.

The annual inflation rate rose to 7.4 percent in June 2022, the highest since March 2020, from 6.7 percent in the previous month. Core inflation was at its peak July 2022 (at 7.3 percent) indicating raising inflation expectations. The Central Bank raised its key policy rate by 50 basis points to 1.75 percent in August, marking the third hike since the start of the war in Ukraine. Credit to the private sector grew at 13.8 percent yoy in H1 2022.

Fiscal revenues increased by 19.2 percent yoy in H1 2022 on account of increased inflation, formalization efforts, and higher profit tax. In response to higher food prices stemming from the war in Ukraine,

the government increased support to vulnerable groups and increased the subsidies to the energy SOEs, while keeping the tariffs for households and SMEs unchanged.

Outlook

Economic activity is projected to expand at an average of 2.7 through 2024, below the pre-earthquake historical rate, following global conditions and persistent supply side shocks. Enduring geopolitical tensions could further increase inflation, disrupt supply chains, and disturb financial markets; all of which could further dim Albania's growth prospects. In turn, a sluggish job market combined with diminished purchasing power could dampen progress on poverty reduction.

While the government plans to contain spending in line with fiscal consolidation plans, higher costs of public service provision create additional pressures on growth. Higher spending may be needed to guarantee energy supply through more costly energy imports and support to the fragile energy SOEs.

On the external account, services exports, including tourism and fast-expanding

business-process operations should gradually recover. The current account deficit is expected to reach 7.7 percent of GDP in 2024 reflecting high demand for infrastructure-related imports.

Public debt is expected to decline to 68.9 percent of GDP in 2022, and more significantly over the medium term. This is based on the assumption that the primary balance turns positive in 2024 in line with the fiscal rule. However, the fiscal balance could further deteriorate in a worsening international context, which may force the government to cut public spending to prevent a hike in the debt-to-GDP ratio. Given Albania's growing reliance on external financing, interest rate and refinancing-related risks remain elevated. Contingent liabilities in the form of guarantees to cover energy purchases also represent a significant risk.

In the medium term, private consumption is projected to return as a key driver of GDP growth. Private investment could provide further support to growth if business climate reforms are implemented. After the significant reduction in 2021, poverty is expected to continue declining in 2022, but persistent inflationary pressures could hamper further poverty reduction.

TABLE 2 **Albania** / Macro poverty outlook indicators · (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	2.1	-3.5	8.5	3.2	2.3	2.5
Private Consumption	3.2	-3.5	4.2	2.8	2.2	2.4
Government Consumption	2.9	1.5	7.8	-3.3	-0.2	2.0
Gross Fixed Capital Investment	-3.7	-0.9	19.8	3.9	-0.1	0.1
Exports, Goods and Services	2.6	-27.9	46.0	6.5	5.7	5.6
Imports, Goods and Services	2.3	-19.8	31.7	3.5	2.7	2.9
Real GDP growth, at constant factor prices	2.4	-2.9	8.6	3.2	2.3	2.5
Agriculture	0.6	0.3	1.5	1.5	1.2	1.2
Industry	0.9	-3.5	10.8	5.0	5.0	5.0
Services	3.8	-3.8	10.3	2.9	1.3	1.7
Inflation (Consumer Price Index)	1.4	2.2	2.6	6.7	4.0	3.5
Current Account Balance (% of GDP)	-7.9	-8.5	-7.7	-7.9	-8.1	-7.7
Net Foreign Direct Investment Inflow (% of GDP)	7.5	6.7	6.4	6.3	6.4	6.4
Fiscal Balance (% of GDP)	-1.9	-6.7	-4.5	-3.8	-4.7	-3.8
Debt (% of GDP)	67.4	75.9	74.0	68.9	67.4	66.9
Primary Balance (% of GDP)	0.1	-4.6	-2.6	-1.3	-1.1	0.0
International poverty rate ($2.15 in 2017 PPP)[a,b]	3.5	3.9	2.6	2.2	2.0	1.8
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	10.3	11.4	7.8	6.9	6.2	5.6
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	32.4	34.4	28.1	26.0	24.5	23.1
GHG emissions growth (mtCO2e)	-4.8	-8.7	-1.7	-4.2	-4.4	-4.0
Energy related GHG emissions (% of total)	47.7	44.5	44.6	42.9	40.7	38.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2016-SILC-C and 2018-SILC-C. Actual data: 2018. Nowcast: 2019-2021. Forecasts are from 2022 to 2024.
b/ Projection using point-to-point elasticity (2016-2018) with pass-through = 1 based on GDP per capita in constant LCU.

ARMENIA

Table 1	2021
Population, million	3.0
GDP, current US$ billion	13.9
GDP per capita, current US$	4670.3
International poverty rate ($2.15)[a]	0.4
Lower middle-income poverty rate ($3.65)[a]	6.9
Upper middle-income poverty rate ($6.85)[a]	53.5
Gini index[a]	25.2
School enrollment, primary (% gross)[b]	91.2
Life expectancy at birth, years[b]	75.2
Total GHG emissions (mtCO2e)	9.6

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent WDI value (2020).

Growth has surprised on the upside and is expected to reach 7 percent in 2022, prior to slowing in 2023. The economy has benefited from a surge in money transfers and visitors from Russia that is expected to subside. Risks to this outlook are mostly on the downside, related to the duration and severity of the conflict, inflationary pressures, and the tensions at Armenia's borders.

Key conditions and challenges

Despite the twin shocks of COVID-19 and the war in Ukraine in 2020, the Armenian economy has shown resilience thanks to prudent macroeconomic management (flexible exchange rate, active inflation targeting regime; effective fiscal rule), and a sound financial sector.

In early 2022, the country was expected to be negatively impacted by the war and the associated sanctions, given the strong economic linkages with Russia and the increase in global commodity prices. However, the economy has performed better than anticipated, supported by strong domestic demand and large money transfers and visitors from Russia. It is unclear whether these inflows are temporary and could be reversed.

Armenia's long-standing structural bottlenecks include closed borders with two of its four neighbors, low productivity and firm competitiveness, and skills mismatches.

Recent developments

Contrary to expectations, the economic rebound has continued in 2022, with real GDP growing by 11 percent (yoy) during the first half of 2022. This was mostly driven by services (16 percent growth, yoy), in particular tourism, finance, and IT. Manufacturing and construction grew

by 11 and 22 percent, respectively, while mining contracted by 11 percent, partly reflecting the closure of the Teghut mine in mid-March 2022 following the Ukraine-Russian war. According to the official statistics, agriculture contracted in real terms by 1.8 percent (yoy), partly reflecting constraints relating to land and irrigation.

After some moderation in late 2021, inflation picked up again in early 2022, and reached 10.3 percent (yoy) in June 2022, prior to easing to 9.3 percent in July. Food and fuel price increases have contributed to about two-thirds of total inflation in the year to date. In response, the Central Bank of Armenia (CBA) has increased the policy rate three times in 2022, to 9.5 percent.

During the first half of 2022, the budget balance has remained in surplus, at 0.9 percent of the annual projected GDP, compared to a planned deficit of 1.5 percent. In this period, total revenues grew by 24 percent (yoy) in nominal terms while expenditures grew by just 5 percent (yoy), a decline in real terms. While capital expenditures have increased by 30 percent, recurrent expenditures just grew by 3 percent, partly due to some savings in the procurement of goods and services. While faster growth in outlays is expected during the second half of the year, the budget is likely to remain under-executed.

The current account deficit (CAD) has widened in the first half of 2022, as goods import growth has outpaced exports (49 vs. 36 percent, yoy), driven by higher food and fuel import prices and the economic recovery. Remittances declined in nominal terms, but this was compensated by a 2.5-fold increase in total net money

FIGURE 1 **Armenia** / GDP growth, fiscal and current account balances
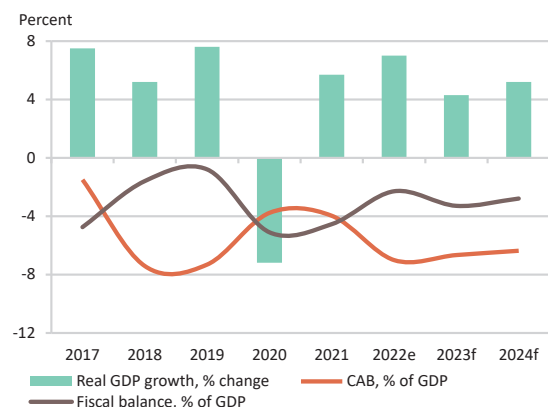
Sources: Statistical Committee of Armenia, Central Bank of Armenia, and World Bank staff projections.

FIGURE 2 **Armenia** / Actual and projected poverty rates and real GDP per capita
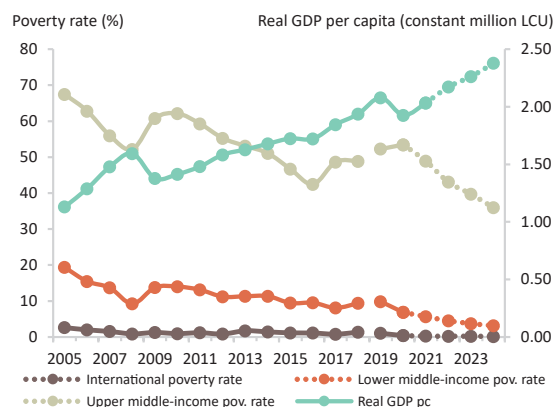
Source: World Bank. Notes: see Table 2.

transfers from abroad (mostly driven by Russia). The net positive arrivals (single entry) of Russian visitors in this period increased by about 21 percent compared to the same period in 2019 (pre-pandemic). FDI increased by 4.5-fold in the first quarter of 2022, mostly driven by investments into the financial sector. As a result of these trends, international reserves increased to USD 3.5 billion by end-July (4.7 months imports). After a short depreciation period at the onset of the Ukraine war, the dram has recovered vis-à-vis the USD and by mid-August it was 18 percent stronger (yoy), while remaining almost flat against the Ruble.

The unemployment rate declined to 14.8 percent by end-March 2022 (compared to 16.7 percent in March 2021).

Outlook

The strong economic performance in recent months has led to an upgrade of the growth forecast for 2022 to 7 percent. Growth is expected to be supported by services, and, to a lesser extent, by industry. The slowdown in trading partners will likely result in slower growth in 2023. Agriculture growth, on the other hand, is expected to remain flat in 2022, while picking up in the medium term, supported by policies in the government's five-year program.

The deficit is expected to be lower than planned in 2022 (at around 2 percent of GDP). As the economy decelerates in 2023, the fiscal stance may loosen, with consolidation expected to continue in 2024 and 2025. Public debt (excluding CBA) is expected to decline by the end of 2022 below the fiscal rule's statutory limit of 60 percent of GDP.

The CAD is projected to widen in 2022 due to weaker external demand and rising import prices and will remain elevated in the medium term, at above 6 percent of GDP.

Inflationary pressures are expected to ease in the remainder of 2022 and in the coming years, as external price pressures subside and inflation targeting helps keep expectations anchored.

Based on the forecasted macroeconomic impact, poverty could reach 43.1 percent of the population in 2022 (measured by the upper middle-income poverty line of $6.85). Poverty is forecasted to continue declining due to strong economic performance. However, the higher food and energy prices may have a negative distributional impact, disproportionately hurting the poor. Moreover, the impacts can have a long-lasting effect, as lower-income households may be forced to reduce food consumption and investments in assets, hampering human capital accumulation.

Downside risks include continued or heightened clashes with Azerbaijan, a protracted Ukraine conflict, a slowdown in main trading partners, and monetary tightening in advanced economies. On the upside, the significant influx of international visitors from Russia, if sustained, could provide a longer-term boost to the economy.

TABLE 2 Armenia / Macro poverty outlook indicators   (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	7.6	-7.2	5.7	7.0	4.3	5.2
Private Consumption	11.5	-13.9	3.7	8.9	4.2	5.4
Government Consumption	12.9	9.2	8.4	-4.1	4.4	7.1
Gross Fixed Capital Investment	4.4	-1.5	6.3	18.3	8.1	7.1
Exports, Goods and Services	16.0	-33.5	16.6	16.3	8.7	9.2
Imports, Goods and Services	11.6	-31.5	12.9	18.6	9.0	9.7
Real GDP growth, at constant factor prices	7.7	-6.8	5.5	7.0	4.3	5.2
Agriculture	-5.8	-3.7	-0.6	0.0	2.0	3.5
Industry	10.5	-2.5	3.4	3.6	4.5	5.1
Services	9.7	-9.6	8.0	10.3	4.6	5.5
Inflation (Consumer Price Index)	1.4	1.2	7.2	8.5	6.7	4.8
Current Account Balance (% of GDP)	-7.3	-3.8	-4.0	-7.0	-6.7	-6.4
Net Foreign Direct Investment Inflow (% of GDP)	1.7	0.7	2.5	2.7	2.9	3.2
Fiscal Balance (% of GDP)	-0.8	-5.1	-4.6	-2.3	-3.3	-2.8
Debt (% of GDP)[a]	53.7	67.4	63.4	61.3	61.0	59.9
Primary Balance (% of GDP)	1.6	-2.4	-2.0	0.3	-0.8	-0.4
International poverty rate ($2.15 in 2017 PPP)[b,c]	1.0	0.4	0.2	0.2	0.2	0.2
Lower middle-income poverty rate ($3.65 in 2017 PPP)[b,c]	9.8	6.9	5.7	4.5	3.7	3.1
Upper middle-income poverty rate ($6.85 in 2017 PPP)[b,c]	52.3	53.5	48.9	43.1	39.7	36.0
GHG emissions growth (mtCO2e)	5.5	-10.8	7.3	7.1	6.8	6.5
Energy related GHG emissions (% of total)	59.9	56.3	60.5	62.1	63.5	64.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Includes Governement and CBA debt.
b/ Calculations based on ECAPOV harmonization, using 2020-ILCS. Actual data: 2020. Nowcast: 2021. Forecasts are from 2022 to 2024.
c/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

AZERBAIJAN

Table 1	2021
Population, million	10.2
GDP, current US$ billion	54.6
GDP per capita, current US$	5367.1
School enrollment, primary (% gross)[a]	95.8
Life expectancy at birth, years[a]	73.1
Total GHG emissions (mtCO2e)	56.7

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent WDI value (2020).

The rebound in economic activity in 2021 continued in the first half of 2022, fueled by strong activity in non-energy sectors. Recovering domestic demand supported growth, while high global energy prices boosted external and fiscal accounts. Risks to the outlook have become balanced. However, the war in Ukraine could increase poverty and inequality given the high food inflation and the larger share of household budgets spent on food among the less well-off.

Key conditions and challenges

Azerbaijan is at a critical juncture in its development journey. The current economic model is unlikely to deliver the growth necessary for Azerbaijan to meet its long-run goals. Azerbaijan's integration into the global economy is largely limited to the energy sector, and relatively inefficient state-owned enterprises remain present in several sectors. In addition, structural headwinds – in the form of declining oil reserves, falling population growth, and an aging population – are expected to dampen long-run growth prospects.

While the poverty rate has been stable at about 5-6 percent over the past decade, households remain vulnerable to shocks. Providing greater access to quality services in higher education and health services is essential to enhance inclusive growth in the longer term.

Accelerating growth is possible by focusing on improving productivity in the non-oil/gas sectors and building human capital. The newly approved socio-economic development strategy emphasizes the need to transition to a private-sector-led economic model and aims at attaining greener growth, inclusion, and social justice, and a more competitive human capital base. Private sector growth will require a level playing field and access to skilled labor.

Recent developments

Real GDP expanded by 6.2 percent in the first half of 2022 (yoy). The energy sector edged up, by 0.2 percent (yoy), driven by an expansion in natural gas production, while crude oil production fell. Higher-than-expected growth in the non-energy sector (9.6 percent, yoy) was supported by recovery in traditional services amid removal of COVID-19 restrictions and by increased domestic demand due to the release of pent-up consumption as well as fiscal expansion. The war in Ukraine has had a relatively muted impact on the economy, with some positive effects on the transport sector. Double-digit growth rates were recorded in transport, hospitality, ICT, and non-oil manufacturing.

On the demand side, investments inched up by 0.7 percent during the first half of 2022. Consumption was supported by solid nominal wage growth (13.5 percent, yoy) owing to public sector wage increases, soaring remittance inflows from Russia (2.3 times, yoy), and robust consumer lending.

Inflation jumped to 13.7 percent (yoy) by July and has been broad-based, driven by high import prices. Food inflation rose the most, by 20.3 percent (yoy). To counter inflation, the central bank increased the policy rate twice in the first half of 2022, raising it by 50 basis points in total to 7.75 percent, but with muted impact on inflation as the monetary transmission is weak, including due to

FIGURE 1 **Azerbaijan** / Non-oil GDP growth and oil price
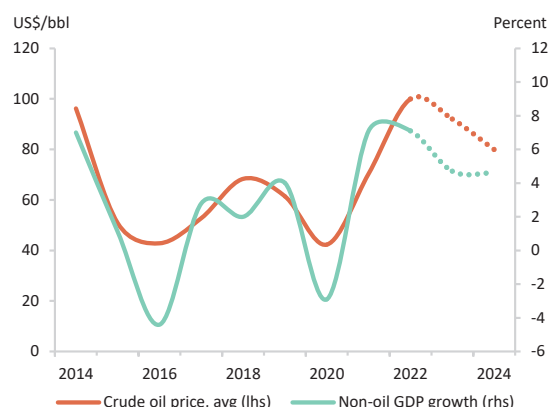
Sources: State Statistical Committee of Azerbaijan and World Bank staff estimates.

FIGURE 2 **Azerbaijan** / Official poverty rate and unemployment rate
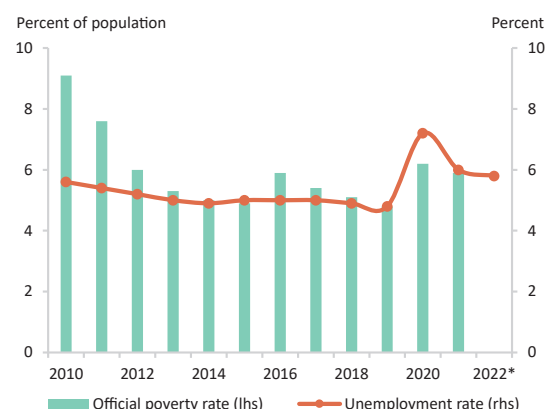
Source: State Statistical Committee of Azerbaijan.
Note: The World Bank has not reviewed the official poverty rates for 2013–20.

dollarization and an underdeveloped inter-bank money market.

The trade balance recorded a surplus of 32.5 percent of GDP in the first half of 2022, supported by high energy prices. Exports doubled compared to a year ago (with 90 percent of the increase in oil and gas exports due to price effects), while imports rose by 18 percent. CBA reserves increased by 4.2 percent while State Oil Fund (SOFAZ) reserves leveled off as higher revenues were offset by the loss in asset value.

The fiscal balance was in surplus of 6 percent of GDP as higher energy prices boosted the fiscal revenues while fiscal spending saw a rise by 12.5 percent in nominal terms (a slight drop in real terms). Higher energy prices prompted the government to revise the budget in June and increase spending by around 2 percent of GDP, largely on public investment.

The financial sector has demonstrated resilience as the credit portfolio expanded steadily while non-performing loans declined to 3.5 percent as of June. The dollarization rate stabilized at 50 percent.

Outlook

Real GDP growth is projected to reach 4.2 percent in 2022, and to slow to an average of 2.7 percent during 2023-24. A moderate decline in crude oil production is expected to be offset by expansion in natural-gas production, with growth in the energy sector stabilizing at 0.1 percent. In non-energy sectors growth is projected to average 4.6 percent during 2023-24 as service sectors' growth will converge to the pre-COVID levels. On the demand side, consumption is expected to moderate as households' real incomes are negatively affected by high inflation, and investments are projected to moderate.

Inflation is projected to ease in 2023 and 2024, while remaining significantly above the CBA's target range of 4+/-2 percent, and is expected to have negative distributional impacts, as the less well-off are disproportionately affected.

High energy prices in the medium term are expected to bolster the external sector, with the current account surplus remaining in double digits. Export growth will remain strong, propelled by high prices, while import growth is expected to ease beyond 2022, in line with the moderation in domestic demand.

The fiscal surplus is projected to moderate gradually over 2022-2024, reflecting the projected path in oil and gas revenues. The new fiscal rule should help to avoid pro-cyclicality during the current commodity boon while reducing non-oil fiscal balance in the medium term.

Implementation of the new socio-economic development strategy is likely to require additional public spending in certain areas, which will need to be reconciled with the fiscal rule.

There are upside risks to the outlook such as the possibility to ramp up natural gas production, enabled by the MoU signed with the EU, and the possible adoption of reforms to foster non-oil sector growth in line with the new socio-economic development strategy. Downside risks include continued or heightened clashes with Armenia, a protracted Ukraine conflict, the slowdown in main trading partners, and monetary tightening in advanced economies.

TABLE 2 **Azerbaijan** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	2.5	-4.3	5.6	4.2	2.8	2.6
Private Consumption	4.2	-5.1	7.0	4.5	4.0	3.6
Government Consumption	7.9	4.8	3.8	7.4	4.2	3.1
Gross Fixed Capital Investment	-2.4	-7.1	-6.0	3.0	3.2	3.3
Exports, Goods and Services	1.5	-8.1	5.6	3.2	1.7	1.8
Imports, Goods and Services	2.2	-10.5	2.5	3.2	2.7	2.7
Real GDP growth, at constant factor prices	2.5	-4.4	5.6	4.2	2.8	2.6
Agriculture	7.3	1.9	3.3	1.1	2.0	2.2
Industry	0.4	-5.2	4.1	2.7	1.5	1.3
Services	5.1	-4.4	8.6	7.3	5.0	4.6
Inflation (Consumer Price Index)	2.7	2.8	6.7	12.5	9.5	8.0
Current Account Balance (% of GDP)	9.1	-0.5	15.2	24.5	16.7	13.4
Net Foreign Direct Investment Inflow (% of GDP)	-2.9	-1.5	-4.1	-1.6	-1.1	-1.1
Fiscal Balance (% of GDP)	9.0	-6.5	4.2	9.3	4.3	2.3
Debt (% of GDP)	18.8	18.4	16.2	11.8	10.7	11.0
Primary Balance (% of GDP)	9.7	-5.7	4.8	9.7	4.6	2.6
GHG emissions growth (mtCO2e)	6.2	2.0	5.1	5.2	3.9	4.0
Energy related GHG emissions (% of total)	64.9	63.8	65.2	65.2	65.1	65.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.

BELARUS

Table 1	2021
Population, million	9.4
GDP, current US$ billion	68.4
GDP per capita, current US$	7294.5
Upper middle-income poverty rate ($6.85)[a]	1.3
Gini index[a]	24.4
School enrollment, primary (% gross)[b]	95.3
Life expectancy at birth, years[b]	74.2
Total GHG emissions (mtCO2e)	61.7

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent WDI value (2020).

Recession deepens as exports are hampered by sectoral sanctions and disruptions of trade with Ukraine. As inflation picked up, real interest rates fell, helping to alleviate credit constraints for enterprises, but stretching household budgets. A contraction of economic activity and higher poverty are projected in 2023 as businesses continue to face supply-side bottlenecks, while the effects of policies to support the economy and promote import substitution are yet to materialize.

Key conditions and challenges

In recent years, Belarus's economy has faced a series of external and domestic shocks related to the COVID-19 pandemic and packages of economic sanctions adopted in the aftermath of the disputed 2020 elections and in response to Belarus's involvement in Russia's military invasion of Ukraine. While 2020-21 restrictive measures had a limited negative impact on the economy, the expanded sanction packages of 2022 affect commodities exports, generating a loss of up to one-third of merchandise export revenues, which is equal to about 18 percent of 2021 GDP. Increased trade with Russia (by 23 percent y/y in US$ nominal terms in H1 2022) – driven by higher prices rather than volumes – curb these losses only partially. Yet, preferential gas and oil prices cushion the impact of these external shocks by containing cost pressures generated by sanctions and related supply-side bottlenecks as well as lowering energy bills for industrial consumers.

While businesses seek adaptation to a sanctions-shaped environment, the authorities count on the effects of the 2022 support package for the economy, which includes some business liberalization measures. At the same time, import-substitution policies are expected to alleviate supply-side constraints and boost domestic manufacturing. As the effects of these measures are yet to materialize, GDP is projected to decrease in both 2022 and 2023. However, this scenario is subject to uncertainties related to the ongoing Ukraine-Russia war and its economic repercussions for the country and the region. Also, forecasting is affected by an increasing lack of access to important data, including on the production and trade of sanctioned commodities, the structure of foreign reserves, and fiscal accounts.

Recent developments

In the first half of 2022, real GDP declined by 4.2 percent y/y as exports continued to fall and domestic demand weakened. Logistics and supply chain constraints led imports to fall faster than exports (7.3 vs 4.4 percent y/y in H1 2022 in nominal US$), improving trade balance and containing exchange rate pressures. After a short-lived depreciation in March, the BYN/US$ rate bounced back, falling below its pre-war level. Sales of FX by non-residents – close to US$900 million on a net basis over January-July 2022 – helped to maintain the exchange rate stable.

CPI inflation picked up in March and remains elevated at 18.1 percent y/y as of July 2022. Higher inflation has lowered real interest rates, but the subsequent increase in corporate borrowing has not translated into higher investment, as companies seek to fund ongoing activities.

The assessment of fiscal situation is prevented by the lack of publicly available data on budget execution through 2022. The GFS data for Q1 2022 show a considerable

FIGURE 1 Belarus / Foreign reserves
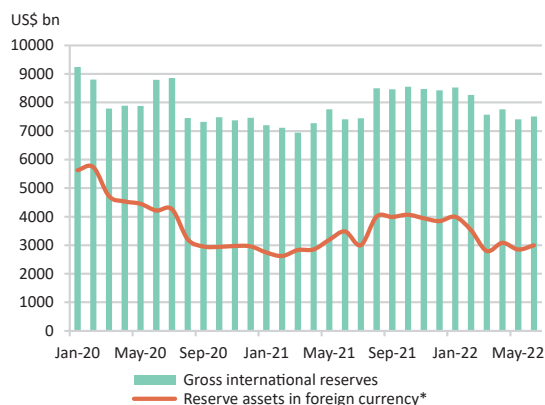
Source: NBRB.
Note: *gross reserves net of monetary gold and SDR.

FIGURE 2 Belarus / Actual and projected poverty rates and real private consumption per capita
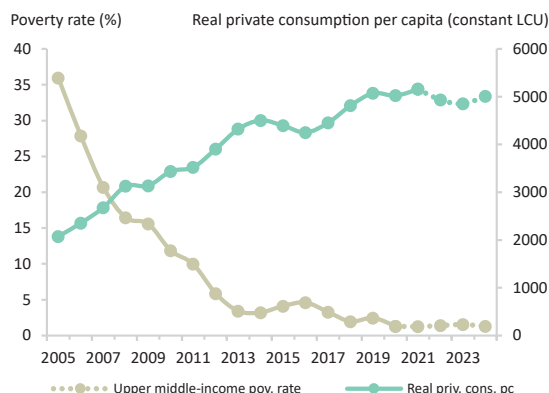
Source: World Bank. Notes: see Table 2.

decline in tax revenues from foreign trade, while reduction of other tax revenue occurred on a smaller scale.

In mid-July international rating agencies reported about the sovereign default as interest payments on 2027 Eurobonds were made in the national currency instead of FX and in September Fitch has downgraded four Belarussian sovereign Eurobonds to 'D' and affirmed Belarus's Default Rating at 'RD'. The Ministry of Finance claimed this was due to sanctions preventing bondholders from collecting payments rather than inability to service. Although from the beginning of 2022 gross foreign currency reserves declined by US$962 mln, reaching US$7.56 bn by August 1, they remain equivalent to two months of goods and services imports. However, restricted access to international financial markets makes meeting a US$800 mln principal payment on Eurobonds due 28 February 2023 much more challenging.

Declining real household incomes in 2022 have not yet translated into poverty increase. The number of households below the national poverty line fell in 2021 and remained at 4 percent in Q1 2022, very close to 2021 levels.

Outlook

The outlook is driven by the effects of external restrictions imposed on Belarus's economy and adjustment strategies by businesses and the government. The use of suboptimal transportation routes and financing mechanisms increases transaction costs and weakens the price competitiveness of exports. Sanctions against the financial sector deprive banks of possibilities to borrow from abroad. In this situation, external financing needs could only be met via bilateral borrowing – from Russia and/or affiliated financial institutions. The lack of certain inputs creates constraints for producers, only partially alleviated by 'parallel' imports occurring without the consent of the trademark or copyright holder. Announced import substitution policies – initially focusing on making auto components – are unlikely to address these immediate supply-side bottlenecks.

To finance these policies, authorities seek to attract US$1.5 bn from Russia. Earlier this year, it has been announced that Belarus seeks to place government bonds in Russia at the amount of RUB100 bn, which is equivalent to US$1.5 bn.

In this environment, accommodating monetary policy to support credit expansion, coupled with increased lending through the Development Bank could limit the magnitude of economic downturn, but elevate risks for financial and macroeconomic stability going forward.

Recession will put the growth of real wages on hold, while higher inflation will further bite real household incomes, decreasing purchasing capacity of the population and weakening household consumption. Poverty and household vulnerability are expected to increase in 2022 and 2023.

The medium-term prospects will be shaped by the patterns of adjustment to the sanctions regime and spillovers from the Russian economy, also being affected by various restrictions. To enter new, 'unsanctioned' markets, Belarusian producers have to address numerous challenges related to costs, logistics, and supply chains. Given structural weaknesses accumulated in the past, all these factors make the timing and sustainability of the recovery uncertain.

TABLE 2 Belarus / Macro poverty outlook indicators   (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	1.4	-0.9	2.3	-6.2	-2.3	2.5
Private Consumption	5.1	-1.4	2.6	-4.5	-1.8	3.1
Government Consumption	0.4	-1.1	-0.5	-1.8	-1.5	1.3
Gross Fixed Capital Investment	6.2	-6.8	-5.6	-12.1	-2.7	4.9
Exports, Goods and Services	1.0	-3.2	9.5	-11.8	2.1	6.2
Imports, Goods and Services	5.2	-7.9	5.8	-13.7	3.5	8.0
Real GDP growth, at constant factor prices	1.5	-0.9	2.3	-6.2	-2.3	2.5
Agriculture	3.0	4.9	-4.2	-2.4	3.5	1.9
Industry	1.4	-0.7	6.5	-7.9	1.5	4.5
Services	1.3	-2.0	0.2	-5.5	-6.3	0.9
Inflation (Consumer Price Index)	4.7	7.4	10.0	18.7	11.9	7.2
Current Account Balance (% of GDP)	-1.8	-0.2	2.6	1.4	0.1	-1.2
Net Foreign Direct Investment Inflow (% of GDP)	2.0	2.1	1.7	3.3	2.2	2.3
Fiscal Balance (% of GDP)	2.5	-1.7	0.0	-1.1	-0.3	0.0
Debt (% of GDP)	37.5	41.1	36.0	50.5	54.6	51.2
Primary Balance (% of GDP)	4.3	0.0	1.6	0.4	1.1	1.3
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	2.4	1.3	1.2	1.4	1.5	1.3
GHG emissions growth (mtCO2e)	-2.1	-2.3	-3.4	-7.1	-3.6	1.7
Energy related GHG emissions (% of total)	85.9	85.6	85.2	85.3	85.6	86.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2020-HHS. Actual data: 2020. Nowcast: 2021. Forecasts are from 2022 to 2024.
b/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on private consumption per capita in constant LCU.

BOSNIA AND HERZEGOVINA

Table 1	2021
Population, million	3.3
GDP, current US$ billion	21.3
GDP per capita, current US$	6517.2
Life expectancy at birth, years[a]	77.5
Total GHG emissions (mtCO2e)	22.9

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent WDI value (2020).

After accelerating to 7.5 percent in 2021, real GDP growth is expected to slow to 4.0 percent in 2022. Inflation, meanwhile, surged to 16.7 percent in July 2022 (yoy) driven by food and energy prices, creating risks for poverty reduction. Annual inflation is expected to reach 11 percent in 2022 compared to 2 percent in 2021. Delayed structural reforms could take off following the general election in October 2022.

Key conditions and challenges

BiH has been a potential EU candidate country since 2016. To become a candidate country, 14 reform priorities need to be addressed as endorsed by the EU Council in December 2019. These priorities reflect reforms in the areas of democracy, the rule of law and fundamental rights, and public administration. In parallel, economic criteria for accession require more progress on the fragmentation of the internal market and of the state institutional set-up, on the oversized public sector, and on weak state supervisory and regulatory institutions.

The authorities built fiscal buffers prior to the pandemic by running fiscal surpluses between 1 and 3 percent of GDP from 2015 to 2019. These surpluses helped rein in the current account deficits, financed by FDI inflows, and contributed to macroeconomic stability. Macroeconomic stability has been maintained over the past decade largely facilitated by three economic anchors: the currency board linked to the euro, the state-wide collection of indirect taxes through ITA, and EU membership prospects. Despite real income growing around 3 percent annually since 2015, per capita GDP has remained at one-third of the EU27 average. Faster convergence toward the EU27 average will be difficult to achieve with the country's low investment rates and growth model that relies on private consumption.

The pandemic, the Russia-Ukraine war, and persistent internal political tensions have inflicted a significant cost on BiH's economy. As a result, BiH is unlikely to catch up with the pre-pandemic forecasted growth levels.

Implementation of structural reforms remains sluggish due to political frictions, pressures from frequent elections, corruption that pervades all levels of society, and fragmentation of responsibilities between the two entities and cantons. Because of the resulting poor welfare prospects, BiH exhibits one of the highest emigration rates in the Western Balkans.

Recent developments

Real GDP rebounded 7.5 percent in 2021, and strong economic activity continued in H1 of 2022 with real output growing 5.9 percent (yoy), with investments surging 24 percent, while private consumption stayed robust, supported by remittances and credit growth.

Inflation jumped to 12.3 percent during January-July of 2022 compared to 0.4 percent during the same period last year, weakening real disposable income. Sharply rising inflation was mainly driven by higher food and transport prices, which surged to 25 percent and 34 percent respectively in July 2022 (yoy), putting disproportionate stress on lower

FIGURE 1 **Bosnia and Herzegovina** / Real GDP growth and contributions to real GDP growth, 2019-2024

Percent, percentage points
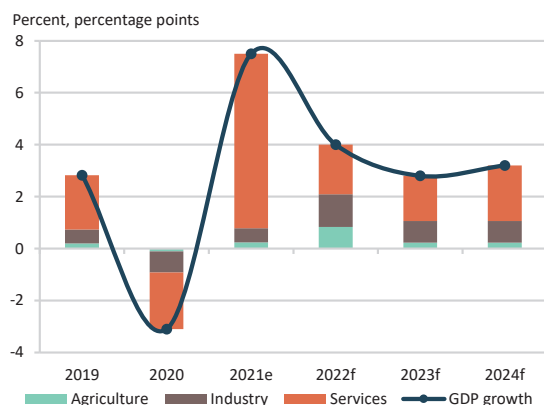
Sources: BiH Agency for Statistics (BHAS) and World Bank staff calculations.

FIGURE 2 **Bosnia and Herzegovina** / Labor market indicators, 2021-2022

Percent of GDP
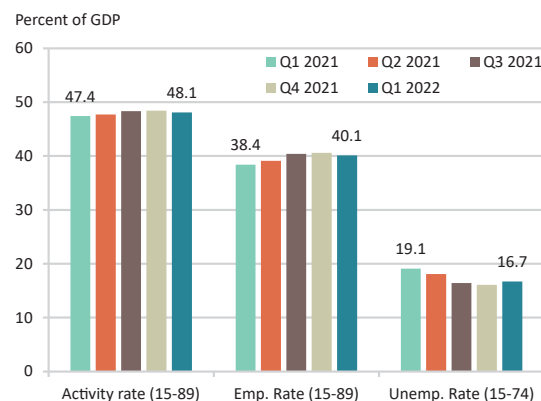
Sources: LFS 2021 - 2022 report and World Bank staff calculations.

income groups, and generating risks of poverty reduction in 2022.

Nevertheless, improvements in labor market participation and the employment rate continued throughout the first half of 2022, although high unemployment persists at about 17 percent.

Stronger tax revenues supported by high inflation was more than offset by higher spending, which is expected to result in a fiscal deficit of 1.2 percent of GDP in 2022.[1] This compares to a deficit of 0.3 percent of GDP last year, and 5.3 percent of GDP in 2020. Expenditures in 2022 are driven by social measures softening the inflationary impact on households and pre-election spending, including wage hikes and robust growth in capital expenditures. Public debt hovers around 35 percent of GDP.

Adverse terms of trade helped widen the merchandise deficit by 46 percent in the first half of 2022. The current account deficit is therefore expected to broaden to 3.4 percent of GDP in 2022 compared to 2.3 percent in 2021. External financing largely entails net FDI

1/ BiH draft Global Fiscal Framework for 2022-2024 and World Bank staff estimates.

inflows, mainly into the foreign-owned banking sector, which remained stable during the first half of 2022 as authorities in both entities acted swiftly to address concerns surrounding one Russian bank affected by sanctions.

Outlook

Real GDP is set to decelerate to 4.0 percent in 2022 as private consumption growth halves due to weakening real disposable income. Over the medium term, real output growth is projected to reach 3.2 percent by 2024 driven largely by private consumption supported by remittances and a tightening labor market. Investment in energy and infrastructure (windmills, Corridor Vc, etc.) will add to the growth stimulus over the medium term, although not to the same extent as in 2021 and 2022. Strong exports are likely to be offset by higher imports in part for infrastructure projects. As general elections are completed, and results implemented, the attention of policy makers could turn to the structural reform agenda for EU accession.

Phased-out pre-election spending and one-off expenditures in response to the price shock will be in part offset by higher interest payments. However, a return to fiscal surplus is expected by 2024.

Considering energy market disruptions by the war in Ukraine, inflationary pressures are now assumed to last longer than initially expected. Hence, inflation is projected at close to 11 percent in 2022, stabilizing in 2023-24 at rates seen prior to the pandemic, at around 2 percent and lower.

Downside risks dominate the outlook. Protracted effects of the war in Ukraine could have a negative impact on aggregate demand through depressed consumer and business confidence. Furthermore, war-related uncertainties and sanctions can dampen the recovery in the EU, adversely impacting demand for BiH exports, except for energy. Adverse labor market developments across the EU could also limit remittances inflows (about 8 percent of GDP), which support private consumption. Finally, geopolitical risks could further aggravate domestic political frictions with adverse consequences for the much-needed structural reform push.

TABLE 2 **Bosnia and Herzegovina** / Macro poverty outlook indicators   (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	2.8	-3.1	7.5	4.0	2.8	3.2
Private Consumption	2.8	-4.5	4.0	2.0	2.5	2.3
Government Consumption	2.6	0.5	6.1	0.5	0.7	0.5
Gross Fixed Capital Investment	2.4	-20.9	35.5	25.1	3.9	2.7
Exports, Goods and Services	-0.3	-8.5	5.0	10.0	7.0	7.2
Imports, Goods and Services	0.2	-13.4	8.0	12.0	5.0	3.5
Real GDP growth, at constant factor prices	2.8	-3.1	7.5	4.0	2.8	3.2
Agriculture	2.9	-1.5	3.4	3.5	3.1	3.1
Industry	1.9	-3.0	2.0	2.6	3.2	3.2
Services	3.2	-3.3	10.2	4.6	2.6	3.2
Inflation (Consumer Price Index)	0.6	-1.1	2.0	11.0	2.0	0.5
Current Account Balance (% of GDP)	-2.9	-3.9	-2.3	-3.4	-5.7	-5.4
Net Foreign Direct Investment Inflow (% of GDP)	3.5	2.0	3.3	3.0	3.2	3.4
Fiscal Balance (% of GDP)	1.9	-5.3	-0.3	-1.2	-0.3	0.3
Debt (% of GDP)	34.5	40.2	37.8	35.6	35.2	34.9
Primary Balance (% of GDP)	2.8	-4.0	1.0	-0.4	0.5	1.1
GHG emissions growth (mtCO2e)	-5.7	-8.1	2.4	3.6	1.4	1.3
Energy related GHG emissions (% of total)	86.8	85.8	85.7	86.1	86.1	86.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.

BULGARIA

Table 1 — **2021**

Population, million	6.9
GDP, current US$ billion	80.2
GDP per capita, current US$	11664.6
International poverty rate ($2.15)[a]	0.9
Lower middle-income poverty rate ($3.65)[a]	2.8
Upper middle-income poverty rate ($6.85)[a]	7.2
Gini index[a]	40.3
School enrollment, primary (% gross)[b]	85.9
Life expectancy at birth, years[b]	73.6
Total GHG emissions (mtCO2e)	48.1

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ WDI for School enrollment (2019); Life expectancy (2020).

Following robust growth in the first half of 2022, the Bulgarian economy is set to slow down in line with global and regional trends. The spike of inflation on energy and food prices is already outpacing wage growth and may increase poverty. The fiscal position remains strong but is likely to worsen in the remainder of 2022, as new anti-inflationary measures take effect. Political instability may weaken the reform agenda and reduce the country's ability to fully absorb EU funds.

Key conditions and challenges

The long-term challenges facing Bulgaria include negative demographic trends, institutional and governance weaknesses and suboptimal public services, with large variation in quality and access across the regions. Institutional gaps have also hindered private sector expansion as they lead to resource misallocation away from the most productive firms. Progress on inclusive growth and shared prosperity has been limited given high rates of poverty and inequality of incomes and opportunities. The latter are reinforced by the lowest level of relative intergenerational mobility of education in the EU-27, meaning that the education of children is highly correlated with that of their parents and the education system does little to give children from disadvantaged backgrounds a better start in life. In addition, inadequacies in the targeting, coverage and generosity of the social security system limit its role as a redistributive mechanism. Tackling these challenges will require enforcement of the rule of law and good governance, investment in human capital, and removal of hindrances to competition and private investment while improving public investment management. Prompt eurozone accession – officially targeted for 2024 - can also contribute to faster convergence to EU living standards.

More recently, the shock of the war in Ukraine has had an adverse impact on Bulgaria, with the key channels of influence being imported price inflation and security of natural gas supply. After Russia's Gazprom – previously the dominant gas provider to Bulgaria – unilaterally cut supplies in April 2022, the government has been trying to secure alternative supplies. Uncertainty on the sufficiency of gas for the coming heating season remains, however. Even if a potential shortage will not have a significantly disruptive impact on the economy, it may inflict high costs on several industrial consumers, as well as household consumers of gas and heating, and force emergency switching to alternative energy sources.

Recent developments

GDP growth exceeded expectations in the first half of 2022, with the economy expanding by 4.5 percent y/y. The main growth driver on the expenditure side remains final consumption on the back of labor market recovery, coupled with increased government spending. The labor market continued to trend back towards its pre-Covid readings, with the employment rate up by 0.3pp y/y to 53.7 percent in Q2 of 2022, and unemployment down by 0.9pp to 4.7 percent. Yet, investment continues to disappoint with negative growth rates. The export expansion was outpaced by import growth, leading to widening trade and current account deficits.

Bulgaria had one of the highest inflation rates among EU countries with the CPI

FIGURE 1 Bulgaria / Real GDP growth and contributions to real GDP growth
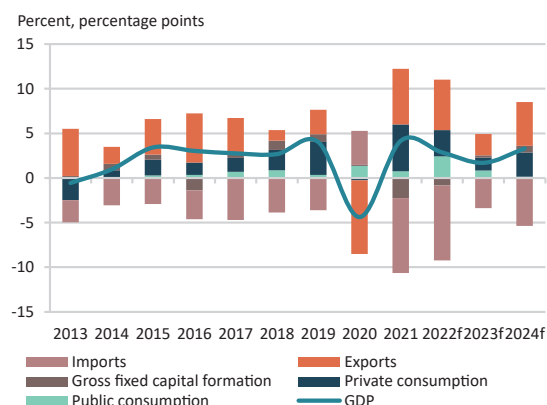
Sources: World Bank and Bulgarian National Statistical Institute.

FIGURE 2 Bulgaria / Actual and projected poverty rates and real GDP per capita
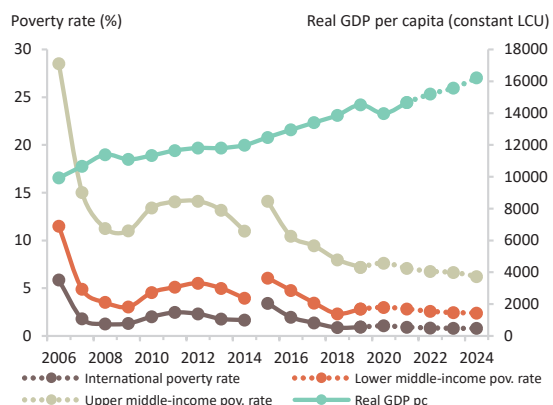
Source: World Bank. Notes: see Table 2.

reaching 17.3 percent y/y in July. Imported inflation of tradable energy and food prices was the key factor behind the recent inflationary spike. The WB-estimated core inflation (i.e., energy and food prices excluded) has also picked up as a result of second-round effects, reaching 9.1 percent y/y in July. Given that the nominal wage growth (11.6 percent), on average, has already been falling behind y/y inflation (13.1 percent) in the first half of 2022, purchasing power is likely to be eroded.

The fiscal position remained strong in the first seven months, but a worsening of the general government balance is expected going forward. Following a BGN 1.65bn surplus in the year to August (1.1 percent of the government's GDP projection), recently passed anti-inflationary measures – including indirect tax reductions for energy consumers, pension increases and energy price subsidies - will impact negatively both on the revenue and the expenditure sides of the budget in the coming months. The projected slowdown of the economy in H2 is also to tone down revenue growth.

Outlook

Bulgaria's growth projection for 2022 has increased to 2.9 percent on better-than-expected performance in the year to date. Growth deceleration is forecasted to start in H2 of 2022 and continue in 2023, in line with global and EU trends. Going forward, reforms and investment under the National Recovery and Resilience Plan and the EU Multiannual Financial Framework will help sustain growth. Yet, risks remain titled to the downside and further downward revisions are likely in case of prolonged supply and price shocks in international markets.

Inflation is projected to remain elevated and end 2022 in double digits, with a gradual reduction in 2023. The fiscal deficit is likely to expand to 4.2 percent of GDP due to the expected slowdown of the economy and recently approved anti-inflationary measures. The current account deficit is also expected to widen in 2022, to 2.7 percent of GDP, as import prices soar.

Amidst better-than-expected growth for 2022, poverty as measured by the US$6.85

2017PPP poverty line is projected to decline from 7.1 percent in 2021 to 6.8 percent in 2022. Despite that, the potential for downside risks remains high, particularly in the context of the war in Ukraine. Rising food and energy prices continue to put pressure on poorer Bulgarians who spend a disproportionately high share of their income on these items. Social assistance and wages not keeping pace with inflation will further undermine the purchasing power of households. Poverty is projected to remain relatively unchanged at 6.7 percent in 2023, though downside risks are likely to persist.

Separately, Bulgaria's outlook is marred by the latest bout of political instability that started with a no-confidence vote against the government in June. Early elections are scheduled on October 2, which will reveal whether the country will attain some degree of political stability.If not, the political crisis will linger as it did in 2021, which may well negatively impact the pace of absorption of EU funds and structural reforms, slowing Bulgaria's convergence towards average EU incomes.

TABLE 2 **Bulgaria** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	4.0	-4.4	4.2	2.9	1.7	3.3
Private Consumption	6.0	-0.4	8.0	4.3	2.1	3.9
Government Consumption	2.0	8.3	4.0	13.2	4.1	0.7
Gross Fixed Capital Investment	4.5	0.6	-11.0	-4.8	1.5	4.6
Exports, Goods and Services	4.0	-12.1	9.9	8.5	3.4	6.9
Imports, Goods and Services	5.2	-5.4	12.2	11.3	4.2	6.5
Real GDP growth, at constant factor prices	3.7	-4.5	3.6	2.9	1.7	3.3
Agriculture	4.1	-3.3	6.1	5.4	1.8	4.0
Industry	-0.1	-8.2	6.6	7.4	5.2	7.9
Services	5.2	-3.2	2.4	1.1	0.4	1.4
Inflation (Consumer Price Index)	3.1	1.7	3.3	14.4	6.8	3.6
Current Account Balance (% of GDP)	1.9	-0.1	-0.4	-2.7	0.1	1.4
Net Foreign Direct Investment Inflow (% of GDP)	2.0	4.5	1.7	4.4	2.1	3.6
Fiscal Balance (% of GDP)	-1.0	-2.9	-2.9	-4.2	-3.3	-2.5
Debt (% of GDP)	20.1	24.8	25.1	28.6	29.5	28.0
Primary Balance (% of GDP)	-0.4	-2.4	-2.4	-3.9	-3.0	-2.2
International poverty rate ($2.15 in 2017 PPP)[a,b]	0.9	1.1	0.9	0.8	0.8	0.8
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	2.8	3.0	2.8	2.6	2.4	2.4
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	7.2	7.6	7.1	6.8	6.6	6.2
GHG emissions growth (mtCO2e)	-2.7	-3.4	7.3	3.7	3.6	4.1
Energy related GHG emissions (% of total)	82.7	80.5	78.0	76.7	74.7	73.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2019-EU-SILC. Actual data: 2019. Nowcast: 2020-2021. Forecasts are from 2022 to 2024.
b/ Projection using neutral distribution (2019) with pass-through = 0.87 based on GDP per capita in constant LCU.

CROATIA

Table 1	2021
Population, million	3.9
GDP, current US$ billion	67.7
GDP per capita, current US$	17402.4
International poverty rate ($2.15)[a]	0.3
Lower middle-income poverty rate ($3.65)[a]	0.6
Upper middle-income poverty rate ($6.85)[a]	2.4
Gini index[a]	29.0
School enrollment, primary (% gross)[b]	93.2
Life expectancy at birth, years[b]	77.7
Total GHG emissions (mtCO2e)	16.4

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ WDI for School enrollment (2019); Life expectancy (2020).

GDP in Croatia continued to strongly expand in the first half of 2022 despite high and rising inflation and geopolitical tensions. Exports of goods and services maintained double-digit growth, and domestic demand remained robust. Looking ahead, economic activity is likely to slow down towards the end of the year and in 2023 with rising uncertainties in external environment and inflation weighing on real incomes and external demand. Poverty is expected to have declined to 1.6 percent in 2022.

Key conditions and challenges

Croatia is set to join the eurozone and the Schengen area in 2023. While these achievements are expected to strengthen the country's resilience and bring long-term economic benefits, raising potential growth will still primarily depend on prudent national policies. Croatia's relatively low productivity growth remains a key obstacle for faster convergence towards the average EU income levels. Data suggests that the sectoral composition of Croatia's economy and relatively large role of low-skilled services such as tourism explain only a small part of the lagging productivity. The main challenges lie within sectors and are related to market frictions and barriers to competition between firms as well as low investment in R&D and low technology adoption rates. This highlights the need to increase the dynamism of the Croatian business environment, reduce market inefficiencies, level the playing field, and promote investment. In addition, demographic forecasts suggest that strengthening long-term growth will also require policies to mitigate the negative economic impact of a declining and aging population. Some of these challenges will be tackled through reforms included in the National Recovery and Resilience Plan and investments finance from different EU funds. While the economy is expected to continue growing over the medium-term, albeit at a subdued pace, risks to the outlook are tilted to the downside. The main challenges pertain to the implications of the war in Ukraine, particularly, gas imports from Russia, decline in real incomes as a result of rising inflation, monetary policy tightening, rising financing costs, and uncertainty. In addition, a slowdown in key trading partners like Germany could also have a negative impact on exports. Furthermore, monetary tightening by the ECB might be stronger than currently expected. Lower growth and higher inflation would require additional fiscal support, with negative consequences for the elevated debt level.

Recent developments

After a marked rebound in 2021, real GDP in Croatia continued to expand strongly in the first half of 2022. The country benefited from the reopening of economies after the COVID-19 lockdowns, with pent-up demand and consumer savings built up during the pandemic boosted tourism, the most important sector in the economy. Exports of goods and domestic demand also remained strong despite rising global uncertainties and increasing prices. Employment continued to increase with the largest job gains in tourism and ICT. The growth in nominal wages accelerated but not enough to offset the negative impact of inflation on real incomes. The annual increase in CPI reached 12.3 percent in July, showing that underlying

FIGURE 1 Croatia / Real GDP growth and contributions to real GDP growth

Percent, percentage points
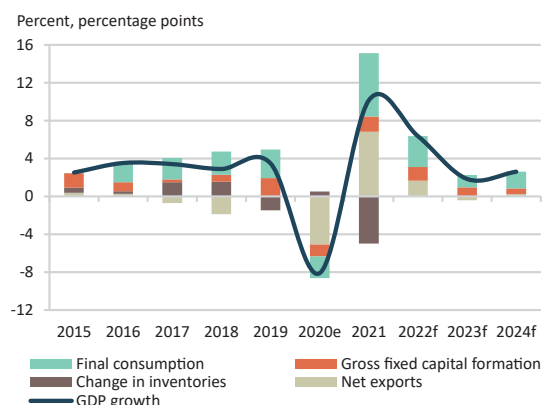
Sources: CROSTAT and World Bank.

FIGURE 2 Croatia / Actual and projected poverty rates and real GDP per capita
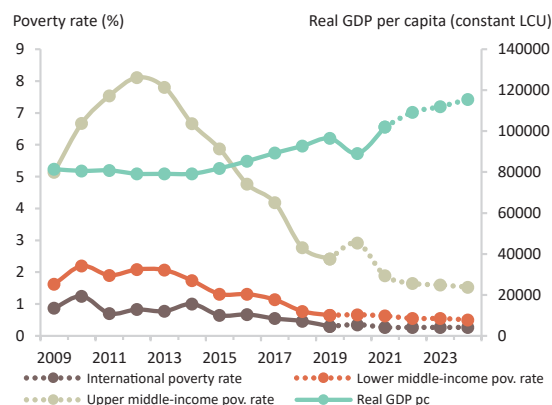
Source: World Bank. Notes: see Table 2.

price pressures remain strong and broad-based. The largest contribution came from food and energy which surged by around 20 percent. Despite real exports growing strongly, the current account deficit widened in the first half of the year, following a deterioration in the terms of trade, which can largely be linked to the increase in food and energy prices. The fiscal deficit, on the other hand, narrowed in the first half of 2022 due to robust revenue growth and a reduction in pandemic-related support to firms and households. The government has, however, introduced fiscal support schemes to ease the negative economic and social impact of soaring energy prices from April this year, which will add up to 1.0 percent of GDP. Additional support package worth 4.2 percent of GDP was announced in September, but its fiscal implications are expected to be contained. Improved fiscal performance and the increase in nominal GDP led to a reduction in the debt-to-GDP ratio to 74.3 percent in May 2022 compared to 79.6 percent at the end of 2021.

Soaring food and energy prices hurt consumers, especially the poorest and most vulnerable who spend above 60 percent of their budget on these essentials. Worries about the economy, food prices, and energy prices are almost universal. Results from the World Bank's Rapid Assessment Survey in April 2022 show that more than 90 percent of Croatians expressed these concerns. Nearly 80 percent of Croatians stated they would cut back spending. The fiscal support packages introduced earlier this year could help. Although economic growth is strong, poverty will decline only modestly from 1.9 percent in 2021 to 1.6 percent in 2022.

Outlook

In the backdrop of a strong first-half economic performance and indications that tourism could exceed pre-pandemic levels, real GDP growth in 2022 is expected at 6.4 percent. However, economic activity is likely to moderate by the end of the year and the weak growth is projected to carry over to 2023, before returning to the pre-pandemic trend in 2024. The strong growth in the export of goods and services witnessed in 2021 and 2022 is also expected to moderate with weaker growth prospects in the EU and globally. Personal consumption is likely to continue to increase next year but at a decelerated pace given the erosion of real incomes. Meanwhile, investments will be supported by the EU funds. However, risks are tilted to the downside due to high uncertainty, a slowing global economy, and potentially costlier financing. Inflation is expected to decline gradually with improvements in the supply chain and base effects, but CPI growth might remain relatively elevated and reach 2 percent only after 2024. The current account balance is projected to remain in surplus owing to continued growth in exports and an eventual improvement in the terms of trade. At the same time, the fiscal deficit is projected to stay below 2 percent of GDP, as additional increases of public sector wages, social benefits, and the health care budget are expected. Nonetheless, the public debt-to-GDP ratio is expected to remain firmly on a declining trend, given still favorable interest-growth rate differential.

Positive economic growth projection translates in poverty reduction in the next couple of years. However, after a fall to 1.6 percent in 2022 due to strong growth and government support measures, poverty is expected to decrease only marginally over the following two years, reaching 1.5 percent by 2024. The poorest Croatians remain vulnerable to the high level of food and energy prices.

TABLE 2 **Croatia** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	3.5	-8.1	10.2	6.4	1.8	2.6
Private Consumption	4.1	-5.3	10.0	4.4	1.1	2.5
Government Consumption	3.3	4.1	3.1	3.0	3.2	1.5
Gross Fixed Capital Investment	9.8	-6.1	7.6	7.1	4.6	2.8
Exports, Goods and Services	6.8	-22.7	33.3	25.0	3.4	5.1
Imports, Goods and Services	6.5	-12.3	14.7	21.5	4.1	4.7
Real GDP growth, at constant factor prices	3.6	-6.3	8.8	6.6	1.8	2.6
Agriculture	1.8	3.6	5.5	3.5	3.0	3.3
Industry	4.8	-1.6	6.7	3.5	1.2	3.0
Services	3.3	-8.4	9.8	7.8	1.9	2.4
Inflation (Consumer Price Index)	0.8	0.2	2.6	10.1	3.9	2.3
Current Account Balance (% of GDP)	3.0	-0.1	3.3	2.2	1.8	1.7
Net Foreign Direct Investment Inflow (% of GDP)	6.1	1.4	4.8	5.2	2.5	3.2
Fiscal Balance (% of GDP)	0.2	-7.3	-2.9	-1.8	-1.4	-1.8
Debt (% of GDP)	71.1	87.3	79.6	70.9	67.7	66.1
Primary Balance (% of GDP)	2.4	-5.3	-1.3	-0.5	-0.2	-0.8
International poverty rate ($2.15 in 2017 PPP)[a,b]	0.3	0.3	0.3	0.3	0.3	0.3
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	0.6	0.7	0.6	0.5	0.5	0.5
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	2.4	2.9	1.9	1.6	1.6	1.5
GHG emissions growth (mtCO2e)	-1.1	-12.8	4.6	3.0	1.0	0.9
Energy related GHG emissions (% of total)	86.8	85.1	84.7	84.4	83.8	83.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2019-EU-SILC. Actual data: 2019. Nowcast: 2020-2021. Forecasts are from 2022 to 2024.
b/ Projection using neutral distribution (2019) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

GEORGIA

Table 1 — **2021**

Population, million	3.7
GDP, current US$ billion	18.7
GDP per capita, current US$	5039.4
International poverty rate ($2.15)[a]	5.8
Lower middle-income poverty rate ($3.65)[a]	21.4
Upper middle-income poverty rate ($6.85)[a]	58.3
Gini index[a]	34.5
School enrollment, primary (% gross)[b]	99.4
Life expectancy at birth, years[b]	73.9
Total GHG emissions (mtCO2e)	17.4

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent WDI value (2020).

Growth averaged double digits during the first half of 2022, and employment is recovering. In addition to robust domestic demand, Georgia has benefited from a strong influx of money transfers from Russia, as well as from the recovery of tourism. The growth forecasts for 2022 have been upgraded, while the current account deficit is expected to narrow. Significant risks persist, although they have become more balanced.

Key conditions and challenges

Over the past decade, Georgia has had a successful development record, underpinned by prudent economic management. Growth averaged 4 percent per annum between 2011 and 2021. The poverty rate declined from 69 percent in 2011 to 53 percent in 2021 (using the international upper-middle-income line at $6.85 per capita per day 2017 PPP). Nevertheless, structural challenges persist notably weak productivity and difficulties to create high-quality jobs. Many Georgians in rural areas remain engaged in low-productivity agriculture. Human capital formation remains weak, and poor learning outcomes and skills are a problem for doing business and firm growth.

Due to trade openness and reliance on income from tourism, Georgia is vulnerable to external and global shocks, as shown by recent events. High dollarization and dependency on external savings increase the risks associated with currency depreciation. Still, the swift post-pandemic rebound and the recovery from the initial impact of the Ukraine war and associated sanctions have demonstrated the growing resilience of Georgia's economy.

Recent developments

Economic activity has been stronger than expected, with real GDP growth estimated at 10.5 percent (yoy) in the first half of 2022. Growth has been broad-based, driven by transport, energy, hotels and restaurants, and industry. Construction permits increased by 15.6 percent during the first half of 2022 (yoy), suggesting a recovery in domestic investment.

After unemployment increased to 20.6 percent in 2021, labor markets have started to recover, with unemployment decreasing to 18.1 percent in Q2 2022.

After peaking in June, inflation has eased slightly, reaching 10.9 percent (yoy) in August. Higher food and energy prices (as well as utility tariffs) account for most of the inflation this year. According to high-frequency surveys from May 2022, about three-quarters of the respondents from low-income households reported having reduced food consumption in response to rising prices. The National Bank of Georgia (NBG) has kept the monetary policy rate unchanged since March, at 11 percent, after gradually increasing the rate since March 2021 by a total of 300 bps.

During January-July 2022, exports grew by 36 percent (yoy) in nominal terms. Merchandise exports growth was driven by both increased demand for key commodities (copper ore, ferroalloys, nitrogen fertilizers) and higher prices. Imports expanded by 34 percent (yoy), leading to the widening of the trade deficit by 33 percent (yoy). This has been partly compensated by the recovery in tourism arrivals and a surge in net volume of money transfers (69 percent, yoy) driven by inflows from Russia. These comprise both remittances and transfers (Figure 1) from non-nationals.

FIGURE 1 **Georgia** / Money inflow by country of origin
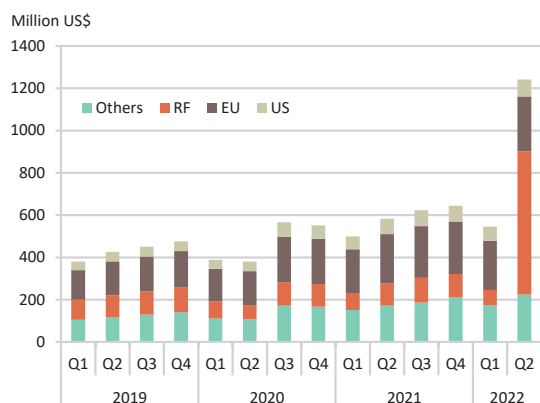
Source: National Bank of Georgia.

FIGURE 2 **Georgia** / Actual and projected poverty rates and real GDP per capita
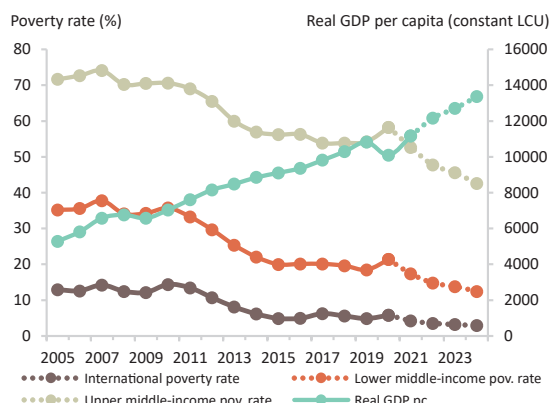
Source: World Bank. Notes: see Table 2.

Banking sector indicators remain healthy. Return on assets (ROA) and return on equity (ROE) reached 3.1 percent and 24.9 percent by end-July, respectively. NPLs declined to 1.9 percent in July, from 2.3 percent in December 2021.

Tax collection by the general government increased by 33.6 percent (yoy) during the first half of 2022, supported by the recovery in consumption. Meanwhile, public expenditures grew by 9.3 percent (yoy) in nominal terms during the first half of 2022, (a reduction in real terms). The fiscal deficit during January-June was about 0.6 percent of GDP, overperforming the fiscal consolidation path planned for the year. The public debt stock has continued to decline, benefiting from the contained deficit and the appreciation of the lari.

Outlook

Projections have been upgraded on account of the strong performance recorded during 2022 so far, with growth projected to reach 8.8 percent by the end of the year.

In the medium term, growth is expected to stabilize around potential.

Inflation will remain in double digits in 2022, although price pressures are expected to diminish towards the end of the year. Inflation would decline in 2023 and beyond, as international oil prices and supply-side bottlenecks ease. The long-term fixed-price contracts for gas supply and a shared border with Russia are expected to help offset any commodity price spikes. Monetary policy is expected to remain tight until inflationary pressures subside. Inflation is likely to have regressive impacts, disproportionately affecting lower-income households and those reliant on incomes from social assistance. These may have longer-term welfare impacts through losses in human capital and other assets.

On the external side, despite the widening trade deficit, the current account balance is expected to improve in 2022, supported by tourism and by the large net money inflows. This unanticipated windfall from the conflict is nonetheless expected to subside by the end of the year.

Following its temporary suspension in the aftermath of the COVID-19 outbreak, the

government of Georgia is expected to comply with the fiscal rule by 2023. The authorities intend to reduce government debt to around 40 percent over the medium term while also increasing the share of domestic debt to close to 30 percent, which would reduce FX vulnerabilities and support capital market development. The authorities are also pursuing further tax administration improvements and a reduction in tax expenditures.

Risks to this outlook are broadly balanced. On the downside, persistent inflation coupled with the tightening of global financial conditions could impact the lari, potentially affecting macro-financial stability due to the high levels of dollarization. The Russian economy could also suffer a more pronounced slump next year, affected by protracted conflict and sanctions, which would negatively affect tourism and remittances in Georgia. Domestic political uncertainty could increase volatility and affect business confidence, as well as the pace of planned reforms. On the upside, money inflows could last longer than initially expected, and Georgia could benefit from some trade diversion as transport corridors are reconfigured.

TABLE 2 **Georgia** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	5.0	-6.8	10.4	8.8	4.2	5.0
Private Consumption	7.2	8.8	8.7	6.6	2.2	3.8
Government Consumption	5.7	7.1	7.7	-4.8	4.8	5.2
Gross Fixed Capital Investment	-0.1	-16.5	-7.6	8.4	0.1	3.1
Exports, Goods and Services	9.8	-37.6	30.5	20.0	12.0	13.0
Imports, Goods and Services	6.6	-16.6	12.8	13.0	6.0	9.0
Real GDP growth, at constant factor prices	5.1	-6.6	10.3	8.8	4.2	5.0
Agriculture	0.7	8.1	0.1	3.0	5.0	4.0
Industry	2.7	-6.8	5.9	6.0	5.0	4.0
Services	6.3	-8.1	12.9	10.2	3.9	5.4
Inflation (Consumer Price Index)	5.0	5.2	9.6	10.6	7.0	4.0
Current Account Balance (% of GDP)	-5.5	-12.4	-10.5	-7.5	-6.6	-6.4
Net Foreign Direct Investment Inflow (% of GDP)	6.0	3.5	5.9	6.1	4.8	5.0
Fiscal Balance (% of GDP)	-3.4	-9.8	-7.1	-3.2	-2.8	-2.6
Debt (% of GDP)	41.8	60.1	49.4	42.3	40.4	40.1
Primary Balance (% of GDP)	-2.2	-8.2	-5.8	-1.9	-1.6	-1.5
International poverty rate ($2.15 in 2017 PPP)[a,b]	4.8	5.8	4.2	3.5	3.2	2.9
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	18.5	21.4	17.4	14.8	13.8	12.4
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	54.2	58.3	52.7	47.7	45.6	42.6
GHG emissions growth (mtCO2e)	2.9	-3.4	2.0	3.4	3.7	1.4
Energy related GHG emissions (% of total)	54.0	53.8	55.0	57.3	59.3	60.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2020-HIS. Actual data: 2020. Nowcast: 2021. Forecasts are from 2022 to 2024.
b/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

KAZAKHSTAN

Table 1	2021
Population, million	19.0
GDP, current US$ billion	197.1
GDP per capita, current US$	10387.9
Upper middle-income poverty rate ($6.85)[a]	14.3
Gini index[a]	27.8
School enrollment, primary (% gross)[b]	100.3
Life expectancy at birth, years[b]	71.4
Total GHG emissions (mtCO2e)	270.2

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2017 PPPs.
b/ Most recent WDI value (2020).

GDP growth is projected to decelerate to 3 percent in 2022 as real incomes are squeezed by high inflation and disruptions caused by the war in Ukraine. Rising inflation negatively impacts low-income households, putting at risk the prospects of poverty reduction. In 2023, the growth momentum is expected to strengthen and inflation to moderate. Stronger slowdown in major trading partners economies and disruptions in oil transportation pose downside risks to the outlook.

## Key conditions and challenges

Since the 2000s Kazakhstan has seen impressive economic growth driven by the first generation of market-oriented reforms, abundant mineral resources extraction, and strong FDI. Sustained economic growth has transformed the country into an upper middle-income economy, commensurately raising living standards and reducing poverty. This progress, however, masks vulnerabilities and unevenness in the country's development model. Slowing economic growth, growing inequality and elite capture, and weak institutions reflect the flaws of the resource-based and state-led growth model and raise the risk that Kazakhstan could become stuck in the "middle-income trap".

The January protests have strengthened the authorities' resolve to push for reforms. Disruptions arising from war in Ukraine have strengthened efforts to diversify trade and logistics routes. Kazakhstan needs to strengthen competition and human capital, and improve public sector and SOEs performances. The country should also initiate reforms in carbon and energy pricing, strengthen social protection, and invest in climate adaptation.

Recent developments

Growth slowed in 2022, mainly due to the negative spillovers from the war in Ukraine.

It reached 3.4 percent yoy in H1, from 4.1 percent in 2021. Household spending is expected to have weakened in H1 as inflation accelerated and real incomes contracted by 2.5 percent yoy over May to July. Retail sales growth slowed to 1.2 percent yoy in the same period. Investment grew by 3.6 percent yoy in H1 as FDI rebounded in the oil and gas sector after two years of decline. On the supply side, manufacturing and services both contributed to growth.

A sharp increase in international oil, gas and metal prices were a boon to exports, driving a trade balance improvement and flipping the current account into surplus in H1 2022 (of US$6.6 bn, compared to a deficit of US$2.8 bn in H1 2021).

Consumer price inflation reached 16.1 percent yoy in August, almost double the rate a year earlier, driven by rising costs of food. The authorities tightened monetary policy and imposed price caps on staple products and limited fuel and utility price increases. Since January, the tenge exchange rate against U.S. dollar depreciated 10 percent.

The central bank raised the policy rate in July to 14.5 percent, its fourth hike this year, and scaled up interventions in the FX market. FX reserves, as a result, fell by 4.8 percent y-o-y in August but remain comfortable.

After the social unrest in January, the government introduced fiscal support measures estimated at 3 percent of GDP, to be financed partly by additional withdrawals from National Oil Fund. These measures include increased spending on social programs, transfers to local governments, infrastructure and food security oriented projects. As a result, the fiscal deficit in 2022 is projected to remain little changed at 2.6 percent of GDP.

FIGURE 1 **Kazakhstan** / Real GDP growth and contributions to real GDP growth

Percent, percentage points
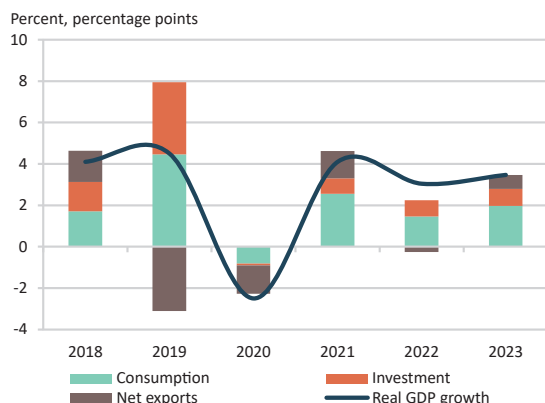
Sources: Statistical Office of Kazakhstan and World Bank staff estimates.

FIGURE 2 **Kazakhstan** / Poverty rate, percent of population living on less than $6.85 (PPP) per day

Percent of population
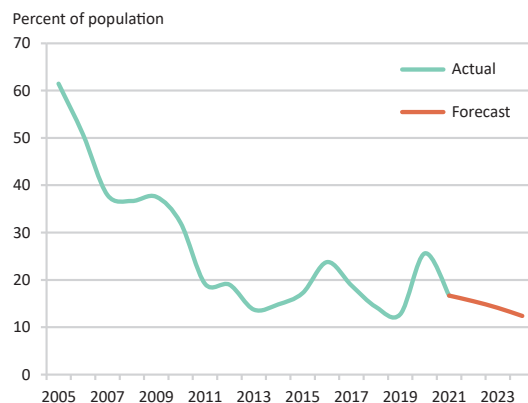
Source: World Bank staff estimates.

The banking system has proved resilient so far. With sanctions on Russia from March, subsidiaries of Russian banks experienced difficulties with FX transactions and ultimately sold their subsidiaries to Kazakh banks and institutions. In July, bank loan growth to households slowed (especially for mortgages), while lending to firms have contracted in real terms. Weakening economy has started affecting banks' asset quality, with NPLs increasing to 3.8 percent in July.

Official unemployment rate remained unchanged at 4.9 percent and real wages rose by 8.9 percent in Q2, despite high inflation. The poverty rate is expected to decline further to 15.5 percent in 2022 from a high of 25.6 observed in the midst of the pandemic. The poverty line for Kazakhstan was updated from the previous $5.5 in 2011 PPP to a new $6.85 level based on 2017 PPP.

Outlook

There are several downside risks to the growth outlook. The Ukraine war could result in the shutdown of the Caspian Pipeline Consortium (which carries about 80 percent of Kazakhstan's oil exports) leading to large economic and fiscal revenue losses. Inflationary pressure may further erode incomes and exacerbate social tensions. Tightening global financial conditions could increase risk aversion, reduce inflows of FDI, and put pressure on the tenge exchange rate.

Economic growth is expected to decelerate to 3 percent in 2022, as economic activity has been affected by lower-than-expected production of oil, high inflation and monetary policy tightening that is constraining consumer spending and private sector borrowing.

Inflation is expected to moderate through 2023 but remain above the target range, which may warrant tighter monetary policy.

In 2023-24, GDP growth is expected to accelerate to 3.5 and 4.0 percent (below expectations prior to the war in Ukraine), aided by additional oil coming on stream from the Tengiz expansion project. The outlook is conditional on the assumption that crude oil shipment through the CPC pipeline will not be disrupted. Consumer spending is expected to gather steam as inflation subsides, whereas exports are projected to remain subdued, due to weakening demand from China and the eurozone. The current account is expected to return to balance over 2023 and 2024 as commodity prices stabilize and demand for imported capital and consumer goods strengthen. The poverty rate is expected to continue to decline in 2023-24, as growth picks up and inflation subsides.

The government plans to reduce budget expenditures and embark on a long-delayed consolidation plan. While expenditure is projected to fall to pre-pandemic levels, efforts to raise in tax collection and a crack-down on graft in the customs system are expected to increase tax revenues. Thus, the fiscal deficit is expected to decrease to 2.2 percent of GDP in 2023 from 2.6 percent this year.

The authorities are seeking to accelerate reforms to combat corruption and money-laundering, strengthen competition and reduce the influence of vested interests and monopolies, and increasing human capital.

TABLE 2 Kazakhstan / Macro poverty outlook indicators   (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	4.5	-2.5	4.1	3.0	3.5	4.0
Private Consumption	6.1	-3.8	5.1	3.2	3.7	3.8
Government Consumption	15.5	12.8	-1.1	1.7	0.8	0.9
Gross Fixed Capital Investment	13.8	-0.3	2.6	3.3	3.4	4.0
Exports, Goods and Services	2.0	-12.1	2.0	1.4	3.8	5.0
Imports, Goods and Services	14.9	-10.7	-2.7	3.0	3.3	3.6
Real GDP growth, at constant factor prices	4.5	-2.5	3.9	3.1	3.5	4.0
Agriculture	-0.1	5.6	-2.2	2.3	2.6	2.6
Industry	4.1	-0.4	3.6	2.1	3.6	5.1
Services	5.2	-4.5	4.6	3.9	3.6	3.4
Inflation (Consumer Price Index)	5.3	6.8	8.0	14.0	8.2	6.3
Current Account Balance (% of GDP)	-4.0	-3.8	-2.9	2.1	0.4	0.8
Net Foreign Direct Investment Inflow (% of GDP)	3.1	-3.4	-0.9	-2.2	-2.6	-2.5
Fiscal Balance (% of GDP)	-1.3	-3.3	-2.7	-2.6	-2.2	-1.9
Debt (% of GDP)	19.6	24.9	23.7	23.9	24.1	23.9
Primary Balance (% of GDP)	-0.3	-2.2	-1.5	-1.1	-0.8	-0.4
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	12.7	25.6	16.7	15.5	14.1	12.4
GHG emissions growth (mtCO2e)	-1.4	4.3	-4.7	1.3	1.5	2.2
Energy related GHG emissions (% of total)	76.4	76.6	75.5	76.1	76.3	76.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2018-HBS. Actual data: 2018. Nowcast: 2019-2021. Forecasts are from 2022 to 2024.
b/ Projection using neutral distribution (2018) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

KOSOVO

Table 1	2021
Population, million	1.8
GDP, current US$ billion	9.2
GDP per capita, current US$	5209.0
Upper middle-income poverty rate ($6.85)[a]	34.2
Gini index[a]	29.0
Life expectancy at birth, years[b]	71.1

Global inflationary pressures interrupted Kosovo's boisterous recovery path. Real GDP growth is expected to decelerate to 3.1 percent in 2022 following a slowdown in investment and private consumption. Exports continued to boost growth. In the current context, support to mitigate the impact of surging energy and food prices should be targeted towards the most vulnerable. Over the medium-term, accelerated implementation of structural reforms in energy, education, social protection, and healthcare is critical to enhance inclusive and sustainable growth.

Key conditions and challenges

With a history of strong growth compared to peers, Kosovo exits the COVID-19 crisis facing a renewed imperative: addressing key structural bottlenecks to enhance competitiveness and support sustainable and inclusive growth. During the past years, Kosovo experienced economic growth with limited firm-level productivity growth and higher-quality job creation, in a context of persistent structural informality and high trade deficit. Given the initial low base, new post-pandemic momentum in exports could be leveraged to break the circle of consumption-driven growth that relies on diaspora inflows.

Low labor force participation and employment, especially among women, continue to remain a strong binding constraint to growth and poverty reduction. The labor market continues to be also characterized by informality and skills mismatches: firms increasingly report difficulties in filling vacancies.

Outdated power generation capacity remains a key source of vulnerability. Rising energy import costs represent a key challenge for 2022 and could adversely impact the fiscal position given the higher need to subsidize electricity imports. Kosovo has a good track record of prudent fiscal management. However, without access to international financial markets, resources to cover growing development needs are limited. Continued public investment under-spending is a lost opportunity to close faster the looming infrastructure gap.

As a unilaterally Euroized economy, Kosovo has limited room to mitigate the impact of rising inflation, exacerbated by the war in Ukraine. Despite high levels of spending on social protection, the social assistance scheme is inflexible and can provide only limited protection for the most vulnerable. Rising inflation is also exerting upward wage pressures. Persistence of energy and food price pressures could further erode disposable incomes and hurt more the less well-off who spend a larger share of their budget on these essential items.

Recent developments

After reaching a record of 10.5 percent in 2021, GDP growth moderated to 3.2 percent in H1 of 2022, driven by domestic demand and exports. On the production side, the service sector – driven by remittances, credit growth, and higher public transfers – was the main contributor to economic growth. Inflation soared reaching 13 percent (y-o-y) in August 2022, triggered by an increase in import prices. Food and transport price increases surpassed 20 percent by August 2022, disproportionally impacting the most vulnerable.

The average number of pension contributors for the first half of 2022 suggests an increase of 8 percent (y-o-y) in formal employment. For the same period, the number of

FIGURE 1 **Kosovo** / Consumer price inflation
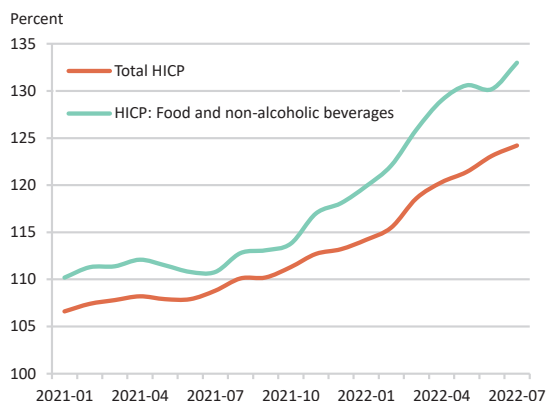
Source: Kosovo Statistics Agency.

FIGURE 2 **Kosovo** / Actual and projected poverty rates and real GDP per capita
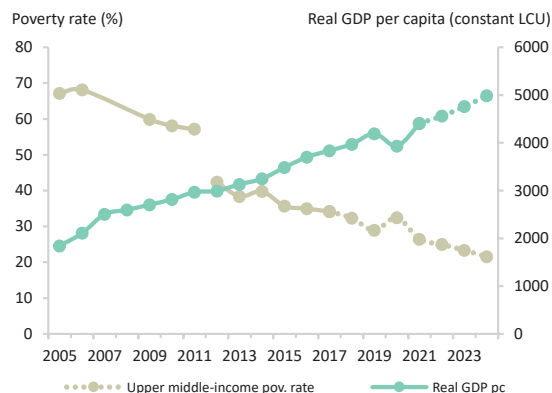
Source: World Bank. Notes: see Table 2.

registered job-seekers at employment centers dropped by 32 percent (y-o-y).

Exports – particularly for manufactured goods – increased by 29.4 percent (y-o-y) in July. Diaspora-driven service exports also increased by 46 percent by May; and travel data suggest a positive momentum continued during the summer season. Against a significant increase in prices, merchandise imports – which represented 53.4 percent of GDP in 2021 –increased nominally by 26 percent until July 2022, further exacerbating Kosovo's structurally high trade deficit. After declining by 0.3 percent (y-o-y) between January and June, remittance inflows have plateaued.

Supported by inflation and formalization, total tax revenues increased by 15.4 (y-o-y) percent until end-August, 2022. Current spending increased by 17.6 percent for the same period and is expected to continue increasing as the government implements over 4.5 percent of GDP in inflation-mitigation and energy subsidy measures. Capital spending remained exceptionally low with an execution rate of 17 percent by end-August, and almost 30 percent lower than a year before.

The banking sector remained stable, with the annual change in loans at 18 percent in July. Bank capital buffers and asset quality remain adequate, with non-performing loans remaining stable at 2.1 percent.

Outlook

GDP growth in 2022 is expected to slow down below potential to 3.1 percent. Inflationary pressures are expected to subdue purchasing power, slowing private consumption growth. Net exports are expected to drive growth. On the other hand, investment - driven by a plunge in public capital spending and a slowdown in construction - should subtract from growth. On the production side, services – supported by higher diaspora demand, credit growth, and public transfers - are expected to be the main driver of growth. After a significant reduction in 2021, poverty is expected to marginally decline in 2022, but the continuation of inflationary pressures could lead to a stagnation of poverty rates.

The medium-term outlook remains positive. However, it is also mired by downside risks related to food and energy price increases and upward pressures on interest rates.

Consumer inflation is expected to average 12.1 percent in 2022, before moderating gradually over the medium-term. With high import inflation leading to a nominal increase in the level of trade imbalances, and with slowing remittances, the current account is expected to deteriorate until 2023. In the medium-term, non-debt creating FDIs and external lending will be the key source of financing for the current account.

The fiscal deficit is expected to reach 0.8 percent of GDP in 2022. Further spending on energy subsidies could, however, increase the deficit. Over the medium-term, compensation of employees, transfers, and a gradual improvement in capital investment execution, are expected to drive spending and push the fiscal deficit above 2 percent of GDP.

Over the medium-term, there is a pressing need to preserve fiscal buffers by containing spending on untargeted transfers to respond to the changing macroeconomic environment, and accelerate implementation of structural reforms in energy, education, social protection, and healthcare to enhance inclusive and sustainable growth.

TABLE 2 Kosovo / Macro poverty outlook indicators   (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	4.8	-5.3	10.5	3.1	3.7	4.2
Private Consumption	5.6	2.5	7.6	0.5	1.9	3.4
Government Consumption	10.1	2.1	9.1	3.0	5.1	2.0
Gross Fixed Capital Investment	2.9	-7.6	10.7	-2.3	8.5	5.9
Exports, Goods and Services	7.6	-29.1	78.7	11.5	6.0	8.0
Imports, Goods and Services	4.5	-6.0	32.8	1.4	5.2	5.5
Inflation (Consumer Price Index)	2.7	0.2	3.4	12.1	4.0	3.0
Current Account Balance (% of GDP)	-5.7	-7.0	-8.3	-11.3	-13.1	-12.3
Net Foreign Direct Investment Inflow (% of GDP)	2.7	4.2	3.9	3.7	4.9	5.0
Fiscal Balance (% of GDP)	-2.9	-7.6	-1.3	-0.8	-1.6	-2.1
Debt (% of GDP)	17.0	22.0	21.5	20.9	21.9	23.2
Primary Balance (% of GDP)	-2.6	-7.1	-0.9	-0.4	-1.1	-1.6
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	28.9	32.4	26.4	25.0	23.3	21.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2017-HBS. Actual data: 2017. Nowcast: 2018-2021. Forecasts are from 2022 to 2024.
b/ Projection using neutral distribution (2017) with pass-through = 0.7 (Low (0.7)) based on GDP per capita in constant LCU.

KYRGYZ REPUBLIC

Table 1	2021
Population, million	6.7
GDP, current US$ billion	8.3
GDP per capita, current US$	1235.8
International poverty rate ($2.15)[a]	1.3
Lower middle-income poverty rate ($3.65)[a]	18.7
Upper middle-income poverty rate ($6.85)[a]	67.6
Gini index[a]	29.0
School enrollment, primary (% gross)[b]	102.6
Life expectancy at birth, years[b]	71.8
Total GHG emissions (mtCO2e)	10.1

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent WDI value (2020).

The economy has so far proved more resilient than expected to spillovers from Russia's war in Ukraine. Growth accelerated to 7.7 percent in January-July 2022 and is projected to be 4 percent in 2022. Inflation has increased and is expected to reach 15 percent in 2022 and moderate thereafter. The fiscal deficit is projected to widen this year but decline to under 3 percent of GDP in the medium term.

Key conditions and challenges

The Kyrgyz Republic has experienced volatile growth in the past decade. The economy remains heavily dependent on gold production (10 percent of GDP and 35 percent of exports), remittances (25 percent of GDP), and foreign aid.

The Kyrgyz economy was heavily impacted by the COVID-19 pandemic in 2020 as GDP contracted by 8.4 percent and the poverty profile deteriorated. The last two years have also seen significant political and governance upheavals, with a new Constitution shifting back to a presidential form of governance, and snap parliamentary and presidential elections. Political uncertainties continue to hamper the government's ability to implement reforms. The nationalization of the largest gold producer, Kumtor Gold Company, dented investor confidence. New risks have emerged following Russia's war in Ukraine and subsequent sanctions on Russia.

While there has been some progress towards fiscal consolidation in recent years, broadening the tax base and improving the public spending efficiency remain key challenges. The private sector is hindered by an excessive bureaucratic burden. Accelerating economic growth will require stronger institutions and policies to foster private sector growth, spur international trade, and improving the commercial soundness of the energy sector.

Recent developments

The Kyrgyz economy has so far proved more resilient than expected to the spillovers of the war in Ukraine. Real GDP grew 7.7 percent during January-July, yoy, driven by gold production (43.1 percent growth, yoy), agriculture (8.4 percent), construction (3.6 percent), and services (3.5 percent). Domestic demand was supported by remittance inflows (7.5 percent growth in US$ terms) from Russia, aided by a strong Russian ruble.

Gold was mainly purchased by the Central Bank, reducing gold exports in the first half of the year. As a result, total exports declined by 40.5 percent, yoy, while imports grew by 68.7 percent, yoy, mainly driven by fuel and consumer goods. This led to an increase in the current account deficit to an estimated 15 percent of GDP. The Central Bank also sold US$217 million of forex reserves in Q1 to avoid sharp fluctuations of the Som and purchased US$46 million in Q2. As of end-June 2022, gross reserves are about 5 months of imports.

Inflation increased to 13.8 percent in July from 11.2 percent in December 2021, driven by global food and fuel prices. To combat inflation, the Central Bank gradually raised the policy rate from 8 to 14 percent between December and March. Credit growth slowed to 9.6 percent in June 2022 from 11.8 percent in December 2021, mainly due to a decline in FX loans.

The fiscal position was solid in the first 7 months of 2022. The budget ran a surplus of 1.4 percent of GDP, slightly better than

FIGURE 1 Kyrgyz Republic / Headline, food and fuel inflation
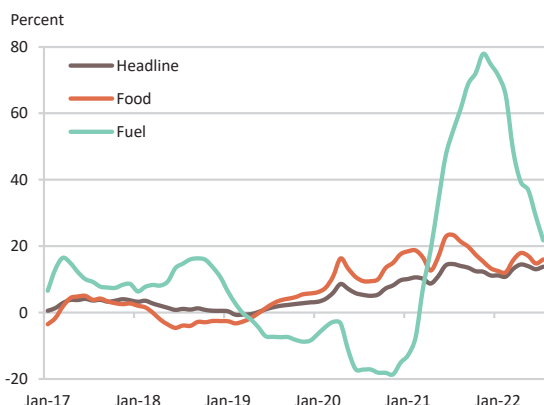
Source: Kyrgyz authorities.

FIGURE 2 Kyrgyz Republic / Actual and projected poverty rate and real GDP growth
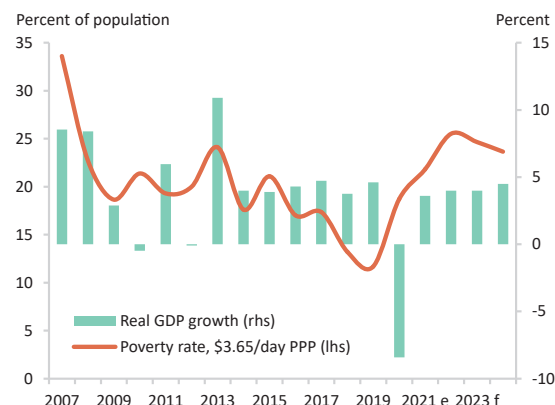
Source: Kyrgyz authorities and World Bank staff.

the previous year. Total revenues increased to 45.9 percent of GDP from 38.6 percent a year ago, driven by higher tax receipts. At the same time, spending increased to 44.5 percent of GDP from 37.2 percent a year ago driven mainly by capital outlays. The surplus, along with the appreciation of the Som, helped reduce public debt to below 50 percent of GDP in July 2022.

The COVID-19 pandemic increased the poverty rate from 11.7 percent in 2019 to 18.7 percent in 2020 (at the US$3.65 a day, 2017 PPP). Poverty is estimated to have deteriorated further in 2021, mainly due to increased food prices, lower real incomes, and limited job opportunities. High inflation is the most significant immediate concern for the welfare of the population. The public sector salary increases in April and August 2022 and enhancement to the social assistance program (targeted to the poor), have softened the negative impact of the food price increase on the population.

Outlook

GDP growth for 2022 is expected to be 4 percent, because of moderate growth of the gold sector in the second half of the year. On the demand side, consumption will be supported by remittances and investments spurred by high public outlays, while net exports are expected to contribute negatively to growth. GDP growth is expected to remain at 4 percent in 2023 and 4.5 percent in 2024, assuming that the economy adjusts to the spillovers from the Russian sanctions.

Inflation is expected to remain elevated at about 15 percent by end-2022, driven by further food and energy price increases. With the Central Bank expected to keep its policy rate at the current level to bring inflation down to its target range of 5-7 percent, inflation is projected to gradually moderate to 7 percent by end-2024.

The current account deficit is projected to be 12.7 percent of GDP in 2022, reflecting the fall in gold exports, with a decline in 2023-24 reflecting an export revival.

The fiscal deficit is expected to widen in 2022 due to the increases in social transfers and public sector salaries in H2 2022. The deficit is expected to narrow to under 3 percent of GDP over 2023-24 mainly thanks to higher revenues from the mining sector and containment of expenses.

High food prices and job insecurity will continue to be the most significant challenge that impact and deepen poverty in 2022. The poverty rate will likely increase up to 25.5 percent (3.65$ a day, 2017PPP). The government's measures, such as increases in pensions and scaling up and extension of the coverage of the social protection program targeted to the poor will help to mitigate the adverse effects produced by the loss of labor incomes and higher inflation.

TABLE 2 **Kyrgyz Republic** / Macro poverty outlook indicators   (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	4.6	-8.4	3.6	4.0	4.0	4.5
Private Consumption	0.8	-8.3	13.5	3.6	4.0	4.3
Government Consumption	0.5	0.9	0.3	0.7	0.8	0.6
Gross Fixed Capital Investment	7.1	-16.2	-3.6	14.7	14.0	11.3
Exports, Goods and Services	16.2	-27.3	24.5	12.1	12.0	12.5
Imports, Goods and Services	6.1	-28.0	39.1	14.0	14.3	12.1
Real GDP growth, at constant factor prices	3.6	-8.4	3.6	3.9	4.1	4.5
Agriculture	2.5	0.9	-5.0	4.4	2.0	2.5
Industry	6.6	-7.0	7.2	10.0	8.7	8.0
Services	3.2	-16.5	10.4	0.7	3.5	4.4
Inflation (Consumer Price Index)	1.1	6.3	11.9	15.2	8.0	6.0
Current Account Balance (% of GDP)	-12.1	4.8	-8.7	-12.7	-11.8	-10.2
Net Foreign Direct Investment Inflow (% of GDP)	3.8	-7.5	7.0	1.9	2.7	2.6
Fiscal Balance (% of GDP)	-0.5	-4.2	-0.3	-3.2	-3.0	-2.8
Debt (% of GDP)	51.6	67.7	60.3	55.2	52.3	50.9
Primary Balance (% of GDP)	0.5	-2.9	1.4	-1.7	-1.6	-1.6
International poverty rate ($2.15 in 2017 PPP)[a,b]	0.7	1.3	1.3	1.2	1.2	1.1
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	11.7	18.7	21.8	25.5	24.7	23.6
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	63.7	67.6	67.3	67.0	66.6	66.2
GHG emissions growth (mtCO2e)	-7.8	-20.9	-6.7	-5.3	1.1	-0.1
Energy related GHG emissions (% of total)	69.5	64.0	62.0	61.4	61.8	60.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2009-KIHS, 2019-KIHS, and 2020-KIHS. Actual data: 2020. Nowcast: 2021. Forecasts are from 2022 to 2024.
b/ Projection using point-to-point elasticity (2009-2019) with pass-through = 0.87 based on GDP per capita in constant LCU.

MOLDOVA

Table 1	2021
Population, million	2.6
GDP, current US$ billion	13.7
GDP per capita, current US$	5233.5
International poverty rate ($2.15)[a]	0.0
Lower middle-income poverty rate ($3.65)[a]	0.4
Upper middle-income poverty rate ($6.85)[a]	14.7
Gini index[a]	26.0
School enrollment, primary (% gross)[b]	106.3
Life expectancy at birth, years[b]	72.0
Total GHG emissions (mtCO2e)	13.9

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ Most recent WDI value (2020).

The war in Ukraine and the recent drought have brought significant challenges to the Moldovan economy. Trade disruptions, lower foreign inflows, and high inflation have a significant toll on private consumption and investment. GDP will contract by 0.7 percent in 2022, with a slow recovery in the subsequent years provided that the war does not escalate further. Over eleven thousand people are projected to fall below the poverty line.

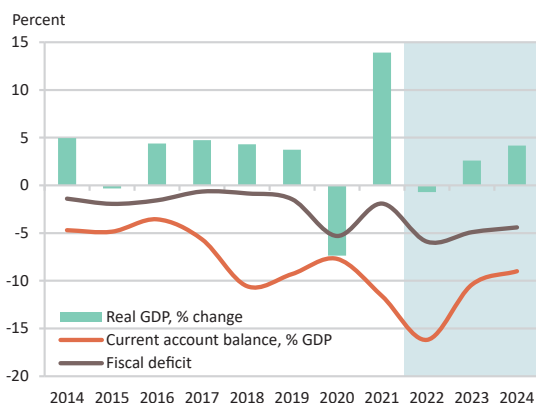## Key conditions and challenges

Moldova's economic outlook after the Covid-19 pandemic and robust recovery in 2021 has been overtaken by the war in Ukraine and a rapid surge in inflation. Russia's invasion of Ukraine poses major threats to the economic prospects of Moldova through the overall stability of the macro-fiscal framework, trade and remittances channels, and increasing geopolitical risks undermining domestic and foreign investment appetite. Key infrastructure networks are primarily connected to Ukraine despite recent efforts to better connect the country to the EU. The surge in inflation represents the biggest challenge for authorities. Monetary policy faces a trade-off between controlling inflation and supporting economic activity, as well as potential pressure on the domestic currency while maintaining sufficient levels of international reserves. Moldova's fiscal position is confronted with the need to mitigate the eroding purchasing power of the households due to inflation with the need to support the ambitious medium-term reform program to address low productivity growth, persistent structural and governance weaknesses, significant state-owned enterprises footprint, low competition, uneven playing field, and tax distortions. Extreme weather events

and the propagation of economic and energy shocks have been a traditional risk for a small open economy like Moldova. Persistent inequality of opportunity limits the ability of low-income households to access public services, reducing their resilience and cementing low intergenerational mobility. Moldova remains one of the poorest countries in Europe.

Recent developments

GDP expanded by 1.1 percent in the first quarter of 2022 due to a strong export performance (36.9 percent). Investment declined by 6.1 percent due to a deterioration of confidence as the war escalated and the monetary policy tightened. On the production side, trade, financial activities, and health were the most buoyant sectors, while spillovers from the war have started affecting the manufacturing sector.

The monetary stance has tightened significantly since 2021 when the policy rate was just 2.5 percent and now it has reached 21.5 percent. The scope was to counteract high food and energy prices, culminating with an inflation rate of 33.6 percent in July 2022, and stabilize the exchange rate, which has lost 8 percent of its value against USD since the beginning of the war. The current account deficit doubled in the first quarter of 2022, reaching 17.1 percent of GDP as the cost of energy imports expanded quickly, while remittances

Percent

- Real GDP, % change
- Current account balance, % GDP
- Fiscal deficit

Source: Author's calculations based on national statistics.

Poverty rate (%) Real GDP per capita (constant LCU)

- International poverty rate
- Lower middle-income pov. rate
- Upper middle-income pov. rate
- Real GDP pc
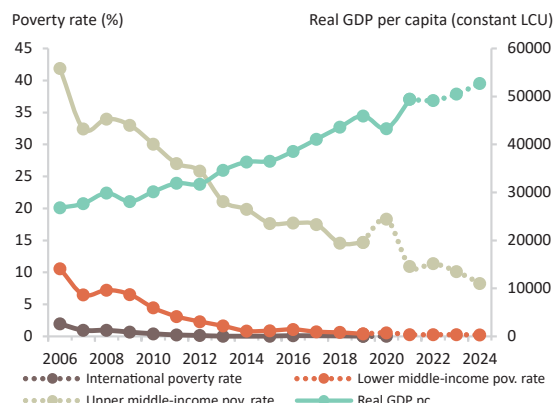
Source: World Bank. Notes: see Table 2.

decreased by 9.4 percent. The CAB deficit was financed primarily by reserve assets and FDI. The external debt marginally decreased and reached 64 percent of GDP.

The fiscal position proved to be resilient with a deficit was smaller than expected in the first half of 2022 (1.2 percent of GDP) thanks to an increase in revenues by 19.4 percent. Spending has increased by 18 percent, driven by social spending (30 percent) and subsidies (39 percent). As a result, public and publicly guaranteed debt decreased to 30 percent of GDP, with the authorities refinancing only the existing debt.

Amidst a more favorable labor market conditions, poverty using the US$6.85 2017PPP poverty line is projected to have fallen from 18.3 percent to 10.9 percent in 2021. Recovery in the labor market continued into the first quarter of 2022 with the number of employed up by 3.8 percent and the number of unemployed down by around 30 percent.

Outlook

GDP growth is expected to contract in 2022. The negative impact on private consumption and investments is partly compensated by a positive contribution from net exports and a large fiscal impulse. Growth is expected to slowly rebound to 2.6 percent in 2023 and reaching potential only in 2024. High inflationary pressures will persist throughout 2022 and 2023 with the inflation rate remaining above the NBM target of 5 percent +/-1.5 percent. Current account is expected to be higher than in the pre-Covid period reflecting high import prices and will rely on financing from foreign debt instruments.

The fiscal deficit is estimated to reach 5.9 percent of GDP in 2022 and remains higher than pre-Covid-19, as the authorities will need to protect the population from increasing prices, support the refugees and bolster investments and the reform program. As a result, public

debt is expected to increase but stabilize just above 40 percent of GDP in the medium term.

Poverty as measured by the US$6.85 2017PPP poverty line is expected to increase from 10.9 percent in 2021 to 11.4 percent in 2022. With growth anticipated to accelerate in 2023, poverty is projected to fall to 10.1 percent in 2023.

Downside risks remain high due to Moldova's proximity to the war in Ukraine and the uncertainties related to energy or natural gas prices and supplies. With the cold season approaching, inflationary pressures could further erode consumer confidence and deteriorate the twin deficits. High input costs and dry weather conditions may reduce agricultural yields, resulting in additional inflationary pressures and dumped economic activity. Despite a 40 percent increase in deposits, escalation of the conflict may put under stress the banking system, which still has to fully recover from the 2014 banking fraud. Finally, higher interest rates may pose roll-over risks on the domestic market.

TABLE 2 **Moldova** / Macro poverty outlook indicators   (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	3.7	-7.4	13.9	-0.7	2.6	4.2
Private Consumption	3.2	-8.3	15.5	0.6	3.7	4.4
Government Consumption	1.3	3.1	3.8	2.6	1.3	2.1
Gross Fixed Capital Investment	11.9	0.4	1.7	-1.2	3.3	4.3
Exports, Goods and Services	8.2	-9.6	17.5	15.9	4.1	4.3
Imports, Goods and Services	6.2	-5.0	19.2	10.2	4.6	3.9
Real GDP growth, at constant factor prices	4.0	-7.6	15.6	-0.8	2.6	4.2
Agriculture	-2.3	-26.4	45.0	-5.4	6.0	6.3
Industry	7.1	-4.3	8.3	0.3	2.2	4.9
Services	4.3	-4.8	13.6	-0.2	2.0	3.4
Inflation (Consumer Price Index)	4.7	4.1	5.1	30.1	12.5	6.2
Current Account Balance (% of GDP)	-9.3	-7.7	-11.6	-16.2	-10.4	-9.0
Net Foreign Direct Investment Inflow (% of GDP)	4.2	1.3	1.6	0.4	1.4	2.5
Fiscal Balance (% of GDP)	-1.4	-5.3	-1.9	-5.9	-4.9	-4.4
Debt (% of GDP)	27.5	36.4	33.8	38.2	39.7	41.7
Primary Balance (% of GDP)	-0.7	-4.5	-1.1	-4.6	-3.7	-3.4
International poverty rate ($2.15 in 2017 PPP)[a,b]	0.0	0.0				
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	0.4	0.5	0.3	0.3	0.3	0.2
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	14.7	18.3	10.9	11.4	10.1	8.3
GHG emissions growth (mtCO2e)	0.8	-5.6	8.9	-1.1	1.8	2.7
Energy related GHG emissions (% of total)	63.6	63.5	65.4	64.8	65.1	65.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2019-HBS. Actual data: 2019. Nowcast: 2020-2021. Forecasts are from 2022 to 2024.
b/ Projection using neutral distribution (2019) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

MONTENEGRO

Table 1	2021
Population, million	0.6
GDP, current US$ billion	5.9
GDP per capita, current US$	9438.7
Upper middle-income poverty rate ($6.85)[a]	18.5
Gini index[a]	36.9
School enrollment, primary (% gross)[b]	101.7
Life expectancy at birth, years[b]	75.9
Total GHG emissions (mtCO2e)	3.3

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2017 PPPs.
b/ Most recent WDI value (2020).

While still recovering from the pandemic, Montenegro is facing renewed headwinds. Growth is estimated at a strong 6.9 percent in 2022, led by private consumption. Inflation surged to new highs but its adverse impact on the cost of living was largely mitigated by an increase in real disposable incomes. Due to the tax reform and increased social spending, the fiscal deficit is expected to widen to 5 percent of GDP in 2022. High public debt and a deteriorating global environment require near-term fiscal consolidation.

Key conditions and challenges

The pandemic has exposed Montenegro's vulnerabilities to external shocks. These stem from the open and service-based nature of the economy and its small size, but also from the country's choice of strategies and policies. While the economy had a strong recovery in 2021, growing by 13 percent, it remains below its 2019 level and is now facing new challenges from global geopolitical and economic uncertainties.

Given unilateral euroization, Montenegro relies on fiscal policy and structural reforms to maintain macroeconomic stability. However, the debt-financed highway construction, the pandemic, and a lack of commitment to fiscal targets have increased fiscal vulnerabilities and increased public debt, which peaked at 105 percent of GDP in 2020. Despite a significant decline to 84 percent of GDP in 2021, public debt remains high.

In January 2022, Montenegro started implementing a tax reform program that aims to reduce inequalities and increase growth in the medium term. It removes healthcare contributions, introduces personal income tax allowance, progressive personal and corporate income taxation, and increases the net monthly minimum wage from €250 to €450. The program also poses significant fiscal risks, further amplified by the Parliament's rejection of several revenues compensating measures

and additional increases of social spending resulting in a wider-than-planned fiscal deficit in 2022 and beyond. An adopted increase of the minimum monthly pension from €150 to over €250 (effective September 2022), without compensating reform measures, is further weakening pension system sustainability and equity. In August, there was a vote of no confidence in the government - the second government to collapse in 2022. The complexity and fragility of the political landscape exacerbates already high uncertainties, slows the reform process, and diverts focus from imminent economic challenges. Prudent fiscal policy based on continuous public debt reduction and policies to support growth is of critical importance in such environment.

Recent developments

In 2022, economic activity was driven by an increase in real disposable incomes owing to further recovery in tourism, employment growth, and household lending. As a result, by June, retail trade grew by 20 percent y/y, while the number of tourist overnights increased by 150 percent y/y, reaching 91 percent of the 2019 level. However, industrial production declined by 2.3 percent as unfavorable hydrological conditions affected electricity generation.

Administrative data show employment reached a record high in July. The registered unemployment rate declined from 22 percent in July 2021 to 16 percent in

FIGURE 1 Montenegro / Real GDP growth and contributions to real GDP growth

Percent, percentage points
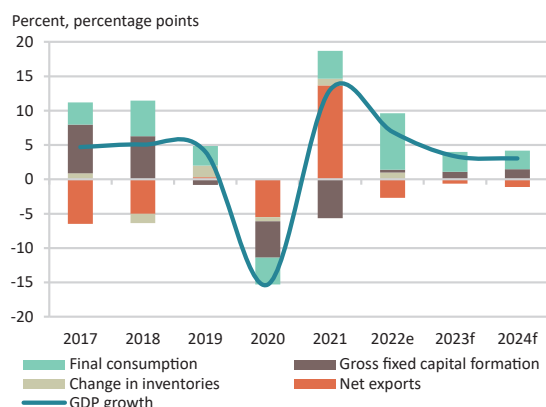
Sources: MONSTAT and World Bank.

FIGURE 2 Montenegro / Actual and projected poverty rates and real GDP per capita

Sources: World Bank. Notes: see Table 2.

July 2022. Poverty (income below $6.85/day in 2017PPP) is projected to decline to 17.1 percent in 2022.

Inflation peaked at 15 percent y/y in August, led by a surge in food (26.2 percent y/y) prices. The inflationary impact on households has been largely mitigated by a wage increase through the tax reform program.

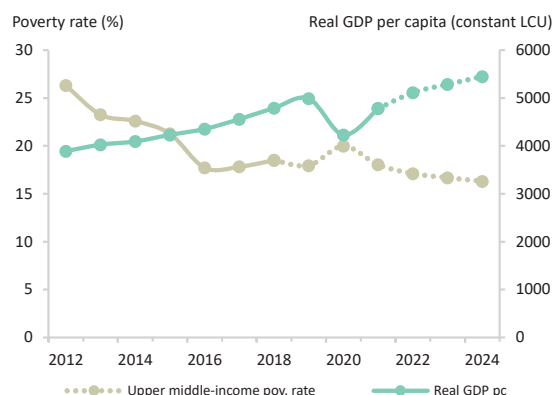The financial sector is performing well. By July, lending and deposits increased by 4.4 and 20.4 percent y/y, respectively. The average capital adequacy ratio was at 18.9 percent, while non-performing loans increased to 6.9 percent of total loans from 6.3 percent a year earlier.

By June, the growth of exports outpaced that of imports, supported by further tourism recovery and higher metal and electricity prices. Net income accounts further reduced the current account deficit, which was largely financed by net FDI and reserves.

Shortfall in social security contributions and personal income tax, new spending commitments (child and mothers' benefits, pensions), clearance of health insurance arrears, and high capital spending are expected to drive an increase in the fiscal deficit from 1.9 percent of GDP in 2021 to an estimated 4.9 percent of GDP in 2022. Public debt is estimated to remain high at 73.4 percent of GDP in 2022.

Outlook

The unfavorable global economic outlook and high uncertainty are weighing on Montenegro's recovery prospects. Growth is expected to moderate to 3.4 percent in 2023 and further to 3.1 percent in 2024, as private consumption growth slows. The projections do not assume that the remaining sections of the highway will start by 2025, as fiscal space is limited. Tourism is expected to continue recovering in 2023, although deteriorating growth prospects in the EU and the region can slow its recovery.

Inflation is expected to decelerate to 5.9 percent in 2023 and further to 2.6 percent in 2024. While higher energy prices are disproportionately affecting the poor, they are also supporting a reduction in the trade deficit as Montenegro's growing electricity capacities are used for energy exports.

These factors, together with exports of tourism and transport services are projected to support a reduction in the current account deficit to 9.7 percent of GDP in 2024. The fiscal balance is expected to moderate over the medium term but will remain elevated at 4 percent of GDP in 2023 and 2.7 percent of GDP in 2024, due to higher social and capital spending. As a result, public debt will stay high at around 72 percent of GDP in 2023 and 2024. Given the tightening of global financial conditions and Montenegro's sizable financing needs of around 9 percent of GDP in 2023, Montenegro will require very careful debt management and stronger control over its expenditures.

The outlook is surrounded with multiple downside risks. High geopolitical uncertainties and swelling global inflation weaken growth prospects in Montenegro and its trading partners. Inflationary pressures are accelerating monetary tightening which translates into more expensive external financing. Political instability and delays in government formation are major domestic risks. The severity of challenges ahead requires strong political commitment and actions to mitigate these risks.

TABLE 2 **Montenegro** / Macro poverty outlook indicators   (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	4.1	-15.3	13.0	6.9	3.4	3.1
Private Consumption	3.1	-4.6	4.0	9.1	3.1	2.9
Government Consumption	1.0	0.8	0.5	0.2	0.0	0.5
Gross Fixed Capital Investment	-1.7	-12.0	-12.3	1.2	3.3	4.4
Exports, Goods and Services	5.8	-47.6	81.9	27.1	5.1	4.1
Imports, Goods and Services	2.7	-20.1	13.7	18.6	3.8	3.6
Real GDP growth, at constant factor prices	4.2	-14.4	13.2	6.9	3.4	3.1
Agriculture	-2.2	1.1	-0.5	-2.0	0.1	0.1
Industry	5.6	-12.0	0.3	2.0	4.0	4.5
Services	4.5	-16.9	19.9	9.4	3.6	2.9
Inflation (Consumer Price Index)	0.4	-0.3	2.4	12.3	5.9	2.6
Current Account Balance (% of GDP)	-14.3	-26.1	-9.2	-10.2	-10.3	-9.7
Net Foreign Direct Investment Inflow (% of GDP)	6.2	11.2	11.7	10.3	9.0	7.9
Fiscal Balance (% of GDP)	-2.7	-11.0	-1.9	-4.9	-4.0	-2.7
Debt (% of GDP)	76.5	105.3	84.0	73.4	72.7	71.9
Primary Balance (% of GDP)	-0.5	-8.3	0.5	-3.3	-2.2	-0.6
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	17.9	20.0	18.0	17.1	16.7	16.3
GHG emissions growth (mtCO2e)	2.5	-17.4	3.9	2.6	0.4	0.6
Energy related GHG emissions (% of total)	69.3	65.8	67.8	69.3	69.7	69.9

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2015-SILC-C and 2019-SILC-C. Actual data: 2018. Nowcast: 2019-2021. Forecasts are from 2022 to 2024.
b/ Projection using point-to-point elasticity (2014-2018) with pass-through = 0.7 based on GDP per capita in constant LCU.

NORTH MACEDONIA

Table 1	2021
Population, million	1.8
GDP, current US$ billion	13.9
GDP per capita, current US$	7556.6
International poverty rate ($2.15)[a]	3.4
Lower middle-income poverty rate ($3.65)[a]	7.1
Upper middle-income poverty rate ($6.85)[a]	20.8
Gini index[a]	33.0
School enrollment, primary (% gross)[b]	98.2
Life expectancy at birth, years[b]	75.7
Total GHG emissions (mtCO2e)	11.3

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2017 PPPs.
b/ Most recent WDI value (2020).

As the war in Ukraine and the energy crisis dim growth prospects, inflation is heading towards all-time highs, disproportionately eroding real incomes of the poor. With limited fiscal space, elevated public debt, and increased cost of financing, fiscal support needs to target the most vulnerable. Monetary policy tightened to tame inflationary pressures. Medium-term growth is expected to moderate, but risks are significantly tilted to the downside.

Key conditions and challenges

Just as the economy started to recover from a pandemic-induced recession, the energy crisis and the war in Ukraine cut the recovery short and amplified inflationary pressures in early 2022. Energy and food prices have soared, while the minimum wage increase of 18.5 percent in March 2022 further fueled inflationary expectations. Double-digit inflation is weighing on economic growth prospects and is exacerbating balance sheet vulnerabilities for both sovereign and corporate borrowers. Poverty reduction (using the upper middle income class poverty line of US$6.85/day at 2017 PPP) is likely to stall in 2022 given rising food and energy prices that hurt the poor relatively more, as they spend a larger share of their income on these items.

Although non-performing loans do not yet point to increased insolvency, worsening firm performance is affecting the outlook for the banking sector. Sequential crises have markedly reduced fiscal space for additional emergency support. The recent shocks have worsened fiscal sustainability and reduced fiscal space for supporting growth in North Macedonia. General government spending with the roads company reached 40 percent of GDP; yet, low spending efficiency and high mandatory spending (80 percent of spending) undermine the contribution of spending to growth. At the same time, revenues at 32 percent of GDP are still below the EU peers' average. Public debt remained elevated at 61 percent of GDP at the end of 2021, amidst sharply increasing financing costs.

The focus of the reform agenda needs to be geared towards boosting tax compliance, restructuring spending while launching the green transition, improving the efficiency of public investment management, and ensuring the resilience of the financial sector. Given limited fiscal resources, widespread state aid through direct budget transfers, temporary subsidies, and broad tax exemptions that are not cost-effective or sustainable, should be revised and redirected toward long-term growth-supporting spending.

Recent developments

After a 4-percent growth in 2021, output increased by 2.6 percent in H1 2022, helped by a continued recovery in investments and a moderate consumption stimulus. Imports surged, leading net exports into negative territory. Growth was driven by services, as industry struggled, and construction saw a further decline in activity.

The census-adjusted activity rate declined to 55.3 percent in Q2 2022, led by a drop in female participation. The employment rate stood at 47.3 percent in Q2 2022 and remained below the pre-pandemic peak. The unemployment rate decreased to 14.5 percent, but the youth unemployment rate remained high at 30.9 percent.

FIGURE 1 North Macedonia / Fiscal performance
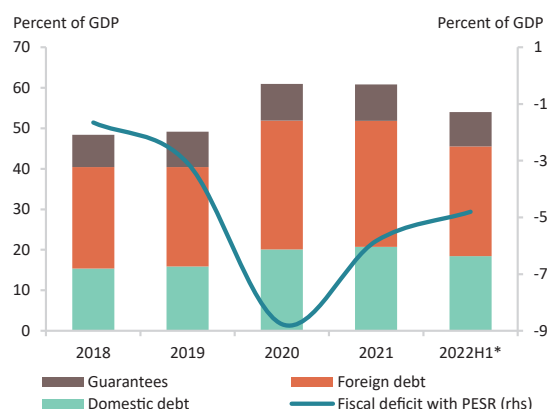
Sources: North Macedonia State Statistics Office, Ministry of Finance, and World Bank staff calculations. Note: * Central government on a 12-month rolling basis.

FIGURE 2 North Macedonia / Actual and projected poverty rates and real GDP per capita
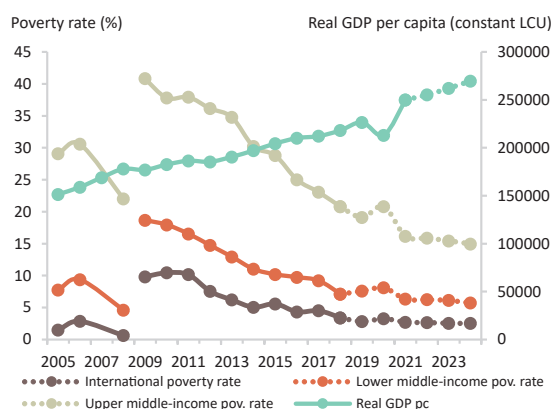
Source: World Bank. Notes: see Table 2.

The banking sector remained stable, but the liquidity and the capital adequacy ratios decreased to 20.5 and 17 percent in Q1 2022, respectively. Credit growth continued at 9.7 percent in July 2022, led by accelerated corporate and mortgage lending. Consumer price inflation surged to 16.8 percent in August 2022, with food and energy prices rising by more than 20 percent. To tame inflation expectations, the Central Bank increased the main policy rate four times within a year to 2.5 percent until August 2022. The pegged exchange rate remained stable with FX interventions to contain sustained pressures, leading to a more than 20 percent loss of reserves since mid-2021.

With the supplemental budget in May, the government's projected fiscal deficit for 2022 increased by 1 p.p. to 5.3 percent of GDP, marked by a rise in current expenditures along with cuts in capital expenditures. Total revenues surged by close to 14 percent y-o-y helped by inflation which led to a decline in public and publicly guaranteed debt towards 55.4 percent of GDP in June 2022. However, expenditure arrears remained high at 3 percent of GDP in Q2 2022 owing to health sector, state enterprises, and local governments.

Outlook

Output growth over the medium term is expected to moderate and downside risks remain elevated. The 2022 growth forecast is downgraded further to 2.1 percent as the energy and Ukraine crisis continue to take a toll on the domestic economy. Disruptions related to the war in Ukraine, overstretched supply chains, mounting inflationary and wage pressures and the intensifying energy supply crisis continue to weigh on the outlook. The baseline scenario is built on the assumption that the impact of the energy crisis and the war in Ukraine on the domestic economy will gradually subside while inflationary pressures tail off over the forecast horizon. However, the underlying assumptions are significantly tilted to the downside, dampening growth, and lifting inflation at the same time. With looming stagflation risks, the country will need to start delivering on reform promises that can reinvigorate the potential growth momentum over the medium term. Policy efforts need to be geared towards restoring fiscal and financial sustainability whilst building social and climate resilience that will reduce the country's vulnerability to shocks and revamp the country's long term growth prospects. At the current juncture, heightened political uncertainty and a parliamentary impasse, following the results of the local elections and a removal of obstacles for opening the EU accession negotiations, amidst a food and energy crisis, may lead to delays in reforms implementation needed to boost potential growth and consolidate public finances. Moreover, lower domestic and external demand, high input costs and liquidity shortages could lead to further layoffs and increase poverty, stretching already tight public finances. Finally, tightening financial conditions may affect financing options and costs going forward.

TABLE 2 **North Macedonia** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	3.9	-6.1	4.0	2.1	2.7	2.9
Private Consumption	3.7	-4.5	5.9	6.2	2.9	2.8
Government Consumption	2.5	6.4	4.1	1.0	0.3	0.2
Gross Fixed Capital Investment	8.7	-14.8	6.8	20.0	8.0	8.0
Exports, Goods and Services	8.9	-10.9	12.3	11.0	7.2	6.1
Imports, Goods and Services	9.5	-10.0	12.9	16.5	7.0	6.0
Real GDP growth, at constant factor prices	3.8	-5.2	2.5	2.1	2.7	2.9
Agriculture	0.1	-3.2	-1.2	1.8	2.0	1.5
Industry	3.4	-9.1	-2.4	1.6	4.8	5.3
Services	4.4	-3.9	4.7	2.3	2.1	2.2
Inflation (Consumer Price Index)	0.8	1.2	3.2	12.1	6.1	3.0
Current Account Balance (% of GDP)	-3.3	-3.4	-3.5	-9.8	-5.0	-3.0
Net Foreign Direct Investment Inflow (% of GDP)	3.2	1.5	3.7	3.3	3.4	3.4
Fiscal Balance (% of GDP)	-2.1	-8.3	-5.4	-5.2	-4.1	-3.6
Debt (% of GDP)	49.2	61.0	60.8	59.4	59.9	61.4
Primary Balance (% of GDP)	-1.0	-7.1	-4.1	-3.9	-2.6	-2.2
International poverty rate ($2.15 in 2017 PPP)[a,b]	2.8	3.2	2.7	2.7	2.5	2.5
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	7.6	8.1	6.3	6.2	6.1	5.7
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	19.1	20.8	16.1	15.9	15.4	14.9
GHG emissions growth (mtCO2e)	8.6	-2.4	2.7	1.1	0.7	-0.2
Energy related GHG emissions (% of total)	71.9	71.5	72.6	72.9	72.9	72.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2019-SILC-C. Actual data: 2018. Nowcast: 2019-2021. Forecasts are from 2022 to 2024.
b/ Projection using neutral distribution (2018) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

POLAND

Table 1	2021
Population, million	37.8
GDP, current US$ billion	661.7
GDP per capita, current US$	17487.0
International poverty rate ($2.15)[a]	0.4
Lower middle-income poverty rate ($3.65)[a]	0.5
Upper middle-income poverty rate ($6.85)[a]	1.6
Gini index[a]	30.3
School enrollment, primary (% gross)[b]	97.2
Life expectancy at birth, years[b]	76.6
Total GHG emissions (mtCO2e)	308.1

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2018), 2017 PPPs.
b/ Most recent WDI value (2020).

Poland's GDP grew 7 percent in the first half of 2022 as investment surprised to the upside and the boom in private consumption continued. The risk of a technical recession is looming, however, due to strong inflationary pressures and policy uncertainties. The war in Ukraine continues to affect the economy, through commodity prices, trade, and confidence effects channels. The large influx of displaced Ukrainians. The share of the population at risk of poverty is expected to remain elevated through 2024.

Key conditions and challenges

The well-diversified Polish economy has proven to be one of the most resilient in the EU, recovering strongly in 2021 after a relatively small contraction in GDP of 2.2 percent in 2020.

A sound macroeconomic framework, effective absorption of EU investment funds, a sound financial sector, better access to long-term credit, and access to European labor markets have supported long-term inclusive growth and poverty reduction. Strong domestic labor markets and increases in median and bottom 40 real incomes have supported private consumption. With an improving business environment, Poland integrated well into regional value chains (RVCs). Higher private investment, an improved innovation ecosystem, and further upgrading of RVCs are needed to boost productivity and growth.

The full economic impact of the ongoing COVID-19 remains uncertain as new variants emerge amidst a vaccination rate of 67 percent of the adult population.

The unprecedented policy response to mitigate the impacts of the COVID crisis and high inflation have narrowed the available policy space.

Increased spending and tax expenditure efficiency is needed to rebuild fiscal buffers, accommodate higher spending on health, defense, the green transition, and to prepare for the growing fiscal burden arising from aging. Over the medium term, a key challenge is a tightening labor supply made more acute by the aging population. The large influx of displaced people from Ukraine could help address the labor market tightness. Achieving decarbonization commitments is another challenge. Institutional strengthening is needed for sustained and inclusive growth and for narrowing regional disparities.

Recent developments

Economic growth remained strong in the first half of 2022, well above potential GDP growth, expanding nearly 7 percent year-on-year. This follows a 5.9 percent GDP recovery in 2021 from the COVID-related 2020 recession. Household consumption expanded by 6.4 percent year-on-year in the first half of 2022, investment rose 6.2 percent, and there was a significant contribution to growth from rebuilding of inventories..

Private consumption benefitted from the tight labor market with continued employment growth, record low unemployment, increased labor force participation and strong wage growth. It was also supported by pent-up demand and demand from the nearly 1.4 million displaced Ukrainians in Poland. High capacity utilization and strong corporate balance sheets supported investments so far.

Robust domestic demand growth fueled import growth while supply side disruptions and lower external demand from Russia, Ukraine, and Belarus weighed on

FIGURE 1 Poland / Real GDP growth and contributions to real GDP growth

Percent, percentage points
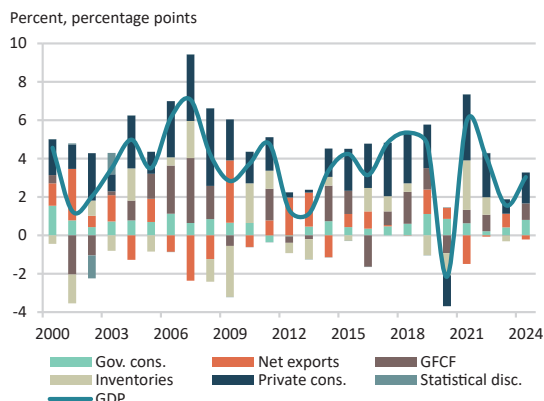
Sources: GUS and World Bank staff calculations.

FIGURE 2 Poland / Actual and projected poverty rates and real GDP per capita

Source: World Bank. Note: see Table 2.

export growth, jointly contributing to a negative contribution from net exports. Inflation has continued to accelerate markedly since mid-2021, reaching more than 16 percent in August, sharply higher than the targeted range. Hikes in energy and agricultural commod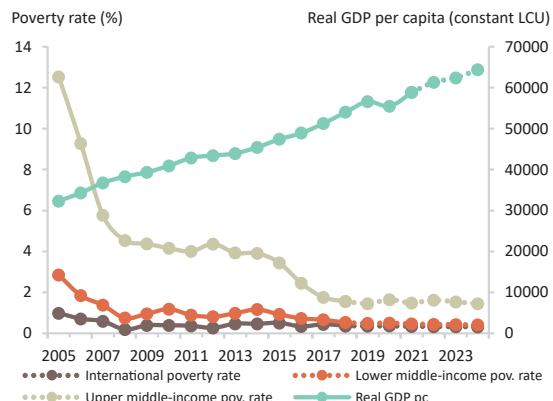ities as well as continued disruptions in supply chains fueled inflation. Price increases continued to accelerate notwithstanding the fiscal package aimed at limiting inflation.

High inflation triggered a faster than expected monetary policy tightening, with the central bank raising its reference rate by 665 basis points since October 2021. Meanwhile, the zloty depreciated 15.4 percent so far this year.

Temporary protection was given to 1.4 million Ukrainian refugees, granting them temporary residence and access to the labor market and key public services (health, education), social assistance, and housing. The current account widened sharply to 3.9 percent of GDP in the year-to-June 2022, on account of sharply higher import prices in particular for energy and intermediate goods. The trade account recorded a 2.7 percent of GDP deficit over this period, compared with a 2.4 percent surplus during the year-to-June 2021. Meanwhile, the primary income account deficit increased slightly to 5 percent of GDP over this period, on account of strong foreign investors' income from capital investments in Polish enterprises.

The unwinding of the large 2020 fiscal stimulus and the strong increase in tax revenues brought the general government deficit to 1.9 percent of GDP in 2021, down from 6.9 percent of GDP in 2020.

Poverty rates declined in 2021, reversing the rise linked to the COVID-19 pandemic in 2020; the Gini coefficient of inequality however continued the upward trajectory visible since 2017.

The financial sector remains well capitalized and has limited direct exposure to Russia, Ukraine, or Belarus.

Outlook

Economic growth is expected to decelerate to 4 percent in 2022 and to 1.6 percent in 2023, on account of high inflation, monetary policy tightening, negative confidence effects related to the war in Ukraine, and slowing demand in key trading partners.

Supply-side disruptions, high input costs, and uncertainty related to the war in Ukraine will affect private investments. The National Recovery and Resilience Plan is expected to support public investment, but any delays in disbursements represent a downside risk.

Higher energy and food prices will weigh on household demand and will affect heavily poorer segments, who devote 50 percent of their monthly spending on food and energy. Minimum wage growth is expected to be outstripped by inflationary pressures, leading to a decline in the real minimum wage in 2022, which will be moderated by the phased adjustment of the minimum wage in 2023. While measures under the Anti-inflation Shield, 14th-month pension, and energy subsidies will soften household impacts, the share of the population at risk of anchored relative poverty is expected to remain elevated at 1-2 percentage points above 2021 levels.

Sharply higher import prices and larger primary income outflows are expected to result in a deterioration in the current account deficit to 4.2 percent of GDP in 2022, with a moderate improvement over 2023-2024 as terms of trade improve.

The fiscal deficit is expected exceed 3.5 percent of GDP, as a result of the structural tax reform (Polish Deal), the temporary impact of the anti-inflation measures, and the public assistance provided to Ukrainian refugees. The fiscal cost of these packages is estimated at 1 percent, 1.7 percent, and 0.4 percent of GDP respectively in 2022. With increased geopolitical risks, defense spending is also expected to increase over the coming years.

TABLE 2 **Poland** / Macro poverty outlook indicators   (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	4.7	-2.2	5.9	4.0	1.6	3.0
Private Consumption	3.9	-2.8	6.0	4.0	1.3	2.8
Government Consumption	6.5	4.9	3.4	1.2	2.4	4.5
Gross Fixed Capital Investment	6.1	-4.9	3.8	4.9	-0.1	4.9
Exports, Goods and Services	5.2	0.0	11.8	3.4	4.0	4.8
Imports, Goods and Services	3.0	-1.1	15.9	3.7	3.0	5.5
Real GDP growth, at constant factor prices	4.6	-2.2	5.6	4.0	1.6	3.0
Agriculture	-0.8	13.9	1.9	1.9	1.1	1.2
Industry	2.2	-4.3	11.4	5.1	3.0	3.3
Services	6.0	-1.7	2.9	3.6	0.8	3.0
Inflation (Consumer Price Index)	2.3	3.4	5.1	13.2	10.1	4.9
Current Account Balance (% of GDP)	0.5	2.9	-0.7	-4.2	-3.6	-2.3
Net Foreign Direct Investment Inflow (% of GDP)	2.0	2.1	3.8	3.6	2.2	2.4
Fiscal Balance (% of GDP)	-0.7	-6.9	-1.9	-3.6	-3.5	-2.6
Debt (% of GDP)	45.6	57.1	53.8	51.7	49.3	47.5
Primary Balance (% of GDP)	0.6	-5.6	-0.8	-2.2	-1.9	-1.2
International poverty rate ($2.15 in 2017 PPP)[a,b]	0.4	0.4	0.3	0.3	0.3	0.3
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	0.5	0.5	0.5	0.4	0.4	0.4
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	1.4	1.6	1.5	1.6	1.5	1.4
GHG emissions growth (mtCO2e)	-5.2	-6.2	2.6	-0.5	-2.5	-1.7
Energy related GHG emissions (% of total)	91.6	91.7	91.3	91.0	90.7	90.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2008-EU-SILC and 2019-EU-SILC. Actual data: 2018. Nowcast: 2019-2021. Forecasts are from 2022 to 2024.
b/ Projection using point-to-point elasticity (2007-2018) with pass-through = 1 based on GDP per capita in constant LCU.

ROMANIA

Table 1	2021
Population, million	19.2
GDP, current US$ billion	284.9
GDP per capita, current US$	14872.7
International poverty rate ($2.15)[a]	2.5
Lower middle-income poverty rate ($3.65)[a]	5.1
Upper middle-income poverty rate ($6.85)[a]	11.3
Gini index[a]	35.1
School enrollment, primary (% gross)[b]	87.5
Life expectancy at birth, years[b]	74.4
Total GHG emissions (mtCO2e)	71.7

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ Most recent WDI value (2020).

The Romanian economy performed better than expected, growing at 5.8 percent in the first half of 2022 on the back of robust private consumption performance and early signs of investment recovery. Prospects depend on the evolution of the war in Ukraine and its impact on the European economy. The fiscal deficit is on a downwards trend, but it remains elevated. Poverty is expected to decline to 11.7 percent in 2022.

Key conditions and challenges

Romania has achieved impressive success in growth and prosperity over the past two decades. However, the shocks induced by the COVID-19 pandemic and the war in Ukraine exposed the structural vulnerabilities of the economy, including persistent poverty and disparities in economic opportunity across regions and between urban and rural areas, structural rigidities in the product and labor markets, weaknesses in fiscal policy and significant institutional constraints hindering the efficient use of resources.

Poor and vulnerable households have been disproportionally affected by rising food and energy prices, despite the capping of gas and electricity prices to reduced levels, until March 2023, for households with lower average monthly consumption. The strong economic rebound helped reduce the share of the Romanian population living on less than $6.85 a day at 2017 PPP prices to 11.7 percent in 2022 from 12.1 percent in 2021.

The key challenges in the short term are to contain the socio-economic effects of the conflict in the region and the COVID-19 flare-ups. Significant inflationary pressures led to monetary policy tightening, following an accommodative stance. Elevated external imbalances add to the currency pressures and markets' risk aversion. Maximal and effective absorption of the EU Multiannual Financial Framework and Next Generation EU funds alongside reforms supported by these programs will be crucial to a sustainable recovery while aiding fiscal consolidation efforts.

Recent developments

The Romanian economy grew by 5.8 percent in H1, 2022, supported by strong private consumption (up 7.5 percent y-o-y) in response to the phasing-out of COVID-19 restrictions, higher wages, and lower unemployment. Investment showed signs of recovery (up 2.2 percent y-o-y) boosted by new construction works. Robust private consumption coupled with global value chain disruptions and the terms of trade shock led to a widening goods trade deficit. The primary income balance also deteriorated, adding to the already sizable current account deficit. On the supply side, growth was led by the ICT sector (up 23.9 percent y-o-y), which benefited from businesses adopting digital technologies. Construction bounced back (up 2.8 percent y-o-y), supported by the revival of the non-residential buildings segment. The economic recovery and labor supply constraints reduced unemployment to 5.3 percent in June 2022 from the height of the COVID-19 pandemic of 6.7 percent in June 2020. Labor shortages coupled with higher inflation led to wage increases, with nominal net wages up by 12.3 percent y-o-y in June 2022. Meanwhile, annual inflation accelerated to 15 percent in July 2022, led by soaring electricity, gas, and central

FIGURE 1 Romania / Real GDP growth and contributions to real GDP growth

Percent, percentage points
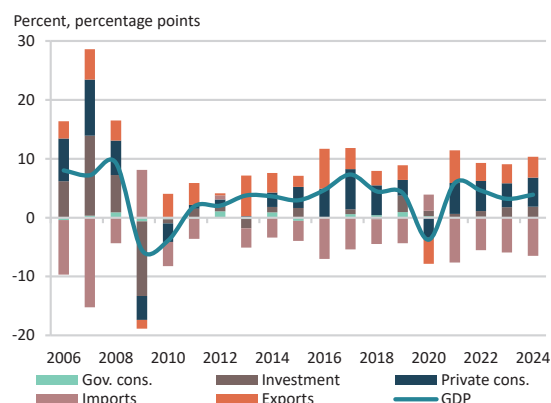
Source: World Bank.

FIGURE 2 Romania / Actual and projected poverty rates and real GDP per capita
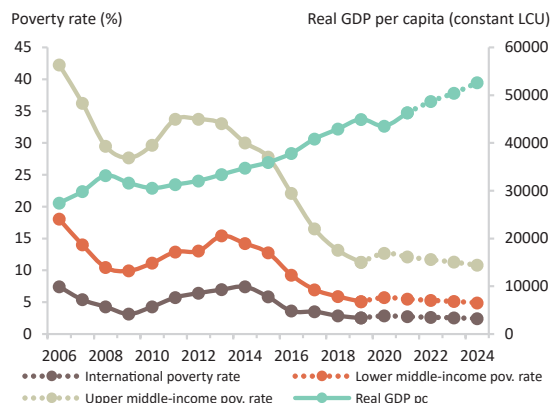
Source: World Bank. Notes: see Table 2.

heating prices (up 35.6 percent). Inflationary pressures prompted the National Bank of Romania to gradually increase the monetary policy rate to 5.5 percent in early August 2022. Nevertheless, private sector credit growth remained strong, up by 17.5 percent y-o-y in June 2022, led by loans to non-financial corporations.

The fiscal deficit decreased to 1.7 percent of GDP in H1, 2022, 1.2 percentage points lower than in the same period of last year. Higher revenues (up 22.9 percent y-o-y), especially from VAT (up 26.6 percent y-o-y), off-set the 14.3 percent y-o-y increase in expenditure, but fiscal pressures remain significant as recurrent expenditure and energy subsidies could swell the deficit this year.

An economic and employment rebound meant that most workers have returned to work, helping to bring household labor income close to the pre-crisis level. However, the Rapid Household Survey in June 2022 showed that 75 percent of Romanians were still worried about the economy. Moreover, rising food and energy prices have depleted households' real purchasing power, especially among the poor and vulnerable. Nearly 90 percent of households in the bottom 40 percent indicated they would have to sacrifice other expenses to cope with food and energy inflation. The war in Ukraine and further disruptions to the global supply chains will continue to affect the economies of host countries for Romanian migrants, reducing remittances. Thus, despite economic and employment recovery, poverty is expected to have declined only modestly to 11.7 percent in 2022 and remains above the pre-crisis level.

Outlook

The economy is projected to expand by 4.6 percent in 2022, with projections subject to a high degree of uncertainty. A global slowdown and a possible recession in the main trading partners could impact Romania's growth in 2023. Growth prospects hinge on several factors, including the new COVID-19 flare-ups, the dynamics of inflation, especially related to energy and food prices, and the severity of the conflict in the region and its impact on the European economy in which Romania is strongly integrated. Romania's capacity to absorb the EU funds will be critical to a sustainable, green, and inclusive recovery process. The sizable investment and reforms under the Resilience and Recovery Facility, the multiannual financial framework 2021-2027, and other EU-funded programs should partially mitigate the impact of higher interest rates and uncertainty on private investment. The sizable funds should also alleviate some of the fiscal pressures resulting from the war and heightened energy and food prices. Over the medium term, fiscal deficits will remain elevated. The fiscal consolidation efforts remain critical and should address the large structural deficit, which requires reforms to strengthen revenue mobilization and increase spending efficiency.

Poverty is projected to decline to the pre-crisis level by 2024. However, rising food and energy prices and declining remittance incomes could mean a longer recovery process for vulnerable population segments in the coming years. A protracted war in Ukraine may significantly weaken growth and lead to an increase in poverty in the short run.

TABLE 2 **Romania** / Macro poverty outlook indicators　　　　　(annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	4.2	-3.7	5.9	4.6	3.2	3.9
Private Consumption	3.9	-5.1	7.9	7.6	5.8	6.9
Government Consumption	7.3	1.8	0.4	1.1	0.9	0.8
Gross Fixed Capital Investment	12.9	4.1	2.3	3.9	6.9	7.0
Exports, Goods and Services	5.4	-9.4	12.5	6.5	6.7	7.1
Imports, Goods and Services	8.6	-5.2	14.6	9.8	10.0	10.3
Real GDP growth, at constant factor prices	4.0	-3.5	5.6	4.6	3.2	3.9
Agriculture	-5.0	-14.9	13.5	-7.5	6.0	2.1
Industry	-0.1	-2.2	3.7	0.8	1.3	3.4
Services	7.1	-3.2	6.1	7.4	3.9	4.2
Inflation (Consumer Price Index)	3.8	2.6	5.1	13.3	9.7	4.8
Current Account Balance (% of GDP)	-4.9	-5.0	-7.0	-9.2	-7.9	-6.8
Net Foreign Direct Investment Inflow (% of GDP)	2.3	1.4	3.0	3.6	3.7	3.7
Fiscal Balance (% of GDP)	-4.3	-9.3	-7.1	-6.6	-5.6	-4.7
Debt (% of GDP)	35.3	47.2	48.8	51.2	52.5	53.3
Primary Balance (% of GDP)	-3.2	-7.9	-5.6	-4.9	-4.0	-3.1
International poverty rate ($2.15 in 2017 PPP)[a,b]	2.5	2.9	2.7	2.6	2.5	2.4
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	5.1	5.7	5.5	5.3	5.1	4.9
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	11.3	12.7	12.1	11.7	11.3	10.8
GHG emissions growth (mtCO2e)	-1.9	-10.4	2.2	2.6	2.4	2.3
Energy related GHG emissions (% of total)	91.9	92.1	92.2	92.6	92.9	93.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2009-EU-SILC and 2019-EU-SILC. Actual data: 2019. Nowcast: 2020-2021. Forecasts are from 2022 to 2024.
b/ Projection based on elasticities calibrated on 2009-2019 growth periods and rapid assessment data, allowing for elasticities to vary between periods of contraction, recovery and expansion.

RUSSIAN FEDERATION

Table 1	2021
Population, million	144.1
Upper middle-income poverty rate ($6.85)[a]	4.1
Gini index[b]	36.0
School enrollment, primary (% gross)[c]	104.2
Life expectancy at birth, years[c]	71.3

Sources: WDI, MPO, Rosstat.
a/ Most recent value (2020), 2017 PPPs.
b/ Most recent value (2020).
c/ WDI for School enrollment (2019); Life expectancy (2020).

Russia's economy will contract by 4.5 percent in 2022, less than initially expected thanks to the strong fiscal response and the surge in energy prices which helped increase fiscal revenues. The economy has experienced a sharp drop in imports, and a fall in real incomes. The recession will continue in 2023 due to the sanctions and reduced fiscal expansion. Thereafter the economy is expected to stabilize. However, medium to long-term growth is expected to be very low as Russia has lost access to key sources of productivity.

Key conditions and challenges

The sanctions imposed on Russia following its war in Ukraine are having significant adverse economic impacts, albeit less severe in the short term than first expected. The initial shock was mitigated by the authorities' strong fiscal response (3 percent of GDP), capital controls, monetary tightening, swift action to stem financial sector risks, as well as high FX inflows driven by the surge in global commodity prices. The combination of smaller accessible international reserves (as half of Russia's US$630bn international reserves were frozen because of sanctions), the suspension of its fiscal rule, and the reduction in domestic non-oil/gas revenues, all imply that Russia is now more exposed if fossil fuel prices and/or volumes fall as the global economy cools down. Moreover, the sanctions have led to a dramatic drop in total imports, restricting access to new technologies and equipment, and external financing, and thereby dampening medium- to long-term growth prospects.

Recent developments

Following the Russian invasion of Ukraine, GDP dropped by 4.1 percent (yoy) in Q2, as the shocks to confidence, transaction systems, and supply chains led to a collapse in domestic demand and export volumes. As the ruble depreciated sharply and inflation spiked, lower real wages contributed to a deep, sustained decline in retail sales volumes—a proxy for private consumption—which remains 9 percent lower by July (yoy). Investment is also estimated to have fallen, exacerbated by the departure of many foreign investors.

The drop in domestic demand would have been even greater had the government not mitigated the impact with a fiscal support package amounting to 3 percent of GDP, including boosting social benefits, providing subsidized loans and tax breaks, and raising minimum wages. The increase in expenditures was financed by oil/gas revenues (25.1 percent up in real terms January–August, yoy), and a reduction in the federal budget surplus to US$1.9 billion from US$14.5 billion over the same period. This has exacerbated the vulnerability of Russia's public finances to a drop in global energy prices and/or volumes—as non-oil/gas revenues dropped by 14.7 percent in real terms yoy and the federal non-oil deficit grew to US$106.9 billion from US$59.2 billion last year.

After an initial spike to 17.8 percent yoy in May, the rebound in the ruble and falling domestic demand led to a gradual but steady consumer price deflation to 14.3 percent yoy by August. With price pressure easing, the central bank more than unwound the monetary tightening (to 20 percent) it introduced in February, cutting the policy rate to 7.5 percent by mid-September.

FIGURE 1 **Russian Federation** / Real GDP growth and contributions to real GDP growth
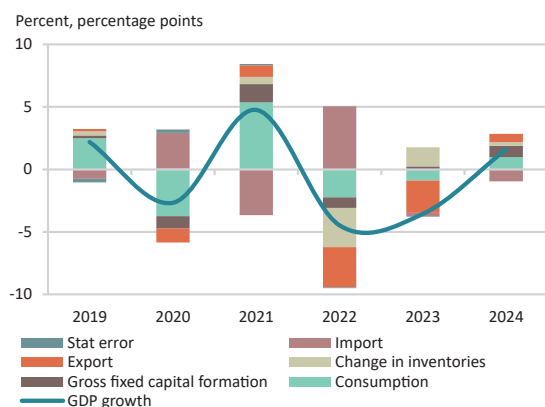
Sources: Rosstat and World Bank.

FIGURE 2 **Russian Federation** / Actual and projected poverty rate and real private consumption per capita
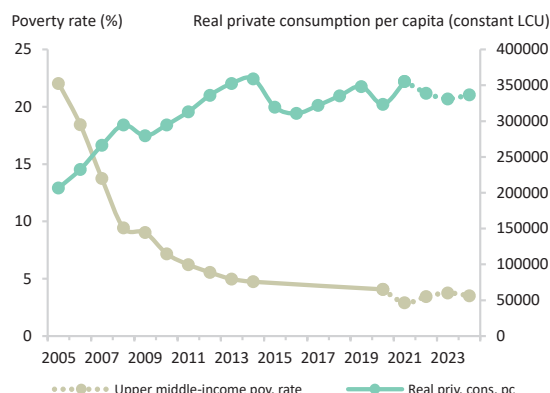
Source: World Bank. Notes: see Table 2.

The current account surplus reached US$183 billion over January to August 2022, triple its level the year before, as surging commodity prices and lower imports more than compensated for a fall in export volumes and discounts on Russian oil. Imports from some countries including Turkiye and India grew but did not offset the sharp drop in imports from sanctioning countries, resulting in an overall contraction of 22 percent in Q2, yoy. Oil export volumes fell slightly (by 0.4 mb/d in August - IEA) as exports to China, India, and Turkiye largely offset reductions to sanctioning countries. Gas export volumes to the EU, China, and Turkey fell 37 percent amidst Russia's unilateral changes in contract terms and pipeline shutdowns. The surplus was matched by substantial capital outflows by non-residents (US$62bn) and residents (US$68bn, which may include sales of official reserves), which have been registered as large financial inflows in several countries in the neighboring region.

Since a brief crash in February, the ruble more than recovered because of capital controls and current account strength and has been stable since. Russia's international reserves have fallen about 10 percent (US$65bn) since the start of the war. Official unemployment is near record lows at 3.9 percent (sa) and employment increased by 0.4 percent (yoy) but real wages have weakened by 3.2 percent to June (yoy), possibly reflecting increasing labor demand to substitute for lost capital and technology. The official poverty rate was 13.0 percent in H1 2022, similar to its level in the same period in previous years.

Outlook

The outlook is developed under assumptions that the war and sanctions will continue as in recent months. GDP is expected to decrease by 4.5 percent in 2022 and by a further 3.6 percent in 2023, as the economy continues to contract due to the impact of sanctions, including those coming into force at the end of this year (notably the EU partial oil ban and to a lesser extent the oil price cap). A declining economic base and higher expenditure are expected to turn the general government surplus into a 1.8 percent deficit in 2022. Consumption recovery will be weak this year as real wages remain subdued and further fiscal stimulus is limited as the authorities strive to limit the size of the deficit, including by increasing taxes. Looser monetary policy will have limited positive effect on credit growth as the banking sector faces large losses and uncertainty. The EU's ban on Russian oil will reduce exports in H2 2022 and 2023.

Agriculture is expected to expand 1.8 percent in 2022, industrial production to contract by 2.2 percent, and services to contract the most deeply.

Moderate growth is expected in 2024 as the economy stabilizes from the sanctions shock and sees a gradual recovery in domestic demand and exports. Potential growth is expected to be very low—if not negative—as Russia has lost access to key sources of productivity, which will increasingly hamper economic growth and poverty reduction.

Consumer price inflation will rise to 13.9 percent over 2022 and remain above the Central Bank's target of 4 percent until 2024. Russia's banking system experienced a significant loss of 1.5 trillion rubles during H1 2022, 13 percent of its aggregate capital, which, while not jeopardizing banking sector solvency, may hamper its ability to support the economy.

Poverty is expected to increase to nearly 4 percent (UMIC poverty rate) in 2023, while meager growth in 2024 will preclude poverty reduction.

Russia is vulnerable to lower demand for, and prices of, energy and extractives commodities, which may manifest through weaker global growth. Additional risks arise from the partial mobilization announced in September, which could dampen domestic demand, and increase labor market and financial sector pressures.

TABLE 2 **Russian Federation** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	2.2	-2.7	4.8	-4.5	-3.6	1.6
Private Consumption	3.8	-7.3	9.5	-4.7	-2.4	1.6
Government Consumption	2.4	1.9	1.5	2.1	1.6	1.0
Gross Fixed Capital Investment	1.0	-4.6	6.9	-3.9	-5.6	3.2
Exports, Goods and Services	0.7	-4.1	3.5	-12.3	-9.1	1.6
Imports, Goods and Services	3.1	-11.9	16.9	-20.8	3.3	5.0
Real GDP growth, at constant factor prices	2.2	-2.4	4.6	-4.4	-3.6	1.6
Agriculture	3.5	0.2	-1.3	1.8	1.4	1.4
Industry	1.6	-2.3	4.9	-2.2	-3.1	1.3
Services	2.4	-2.7	4.9	-5.9	-4.2	1.7
Inflation (Consumer Price Index)	4.5	3.4	6.7	13.9	5.9	4.5
Fiscal Balance (% of GDP)[a]	1.9	-4.0	0.8	-1.8	-2.1	-3.1
Debt (% of GDP)	14.3	20.0	17.9	15.0	15.7	17.0
Primary Balance (% of GDP)[a]	2.7	-3.2	1.7	-0.8	-1.0	-2.1
Upper middle-income poverty rate ($6.85 in 2017 PPP)[b,c]	0.0	4.1	2.9	3.5	3.8	3.5
GHG emissions growth (mtCO2e)	2.4	-4.1	0.8	-7.9	-3.2	0.6
Energy related GHG emissions (% of total)	91.6	91.5	90.6	91.2	90.2	89.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Fiscal and Primary Balance refer to general government balances.
b/ Calculations based on ECAPOV harmonization, using 2020-HBS. Actual data: 2020. Nowcast: 2021. Forecasts are from 2022 to 2024.
c/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on private consumption per capita in constant LCU.

SERBIA

Table 1	2021
Population, million	6.9
GDP, current US$ billion	63.0
GDP per capita, current US$	9180.9
Upper middle-income poverty rate ($6.85)[a]	12.1
Gini index[a]	34.5
School enrollment, primary (% gross)[b]	97.7
Life expectancy at birth, years[b]	74.2
Total GHG emissions (mtCO2e)	59.8

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ Most recent WDI value (2020).

The Serbian economy continued to grow in 2022 despite major challenges, domestic and from abroad. Poverty incidence declined to an estimated 10.5 percent. Growth is expected to decelerate in 2023 and the risks to the growth outlook are clearly tilted to the downside. Poverty reduction is expected to stagnate as well, as income gains are eroded by high inflation and rising food prices in particular.

Key conditions and challenges

After a strong recovery in 2021 several domestic and international factors caused an economic slowdown. Growth in 2022 is forecasted at 3.2 percent with risks tilted to the downside. The key challenge is the performance of the Serbian energy sector and availability of electricity and gas in the winter of 2022/23. Another challenge will be the availability of financing the fiscal deficit since interest rates increased significantly over recent months and subscription rates to auctions of T-bills remain low. Inflation is on the rise, eroding the incomes of the poor in particular.

Over the medium term, the Serbian economy is expected to slow down and return to the pre-pandemic growth levels only after 2024. However, Serbia still faces challenges that limit its potential growth both in the short and medium to long term. Most importantly, Serbia needs to further remove bottlenecks for private sector investment including toward greener growth. These include a deteriorating governance environment, a lack of infrastructure, and an unreformed education sector, which creates skills mismatches in the labor market. With limited space for future stimulus packages, structural reforms are needed to bring the economy back to sustained growth, boost jobs and incomes and strengthen resilience to shocks.

Recent developments

Solid GDP growth in Q1 and Q2 (4.3 and 3.9 percent, y/y) was driven by consumption and better-than-expected export performance. As a result, the employment rate increased and reached a record level of 50.9 percent, and unemployment declined, to 9.2 percent in Q2 2022. Wages increased by 13.5 percent in nominal terms in the first half of the year compared to the same period of 2021.

Poverty (defined as income under $6.85/day in 2017 PPP) is estimated to have declined slightly from 12.2 percent in 2020 to 10.5 percent in 2021. Wage subsidies and cash transfers to citizens helped to avert a spike in poverty in 2020. In 2021, poverty reduction resumed due to strong economic growth and improving labor market conditions, though it was partly countered by an output decline in agriculture, rising inflation at the end of the year, and the phasing out of government support programs.

Inflation has increased despite the introduction of price controls related to food and energy. It reached 12.8 percent in July 2022. In the same month, food prices were 20.3 percent higher than a year earlier. Rents for housing increased at a similar level (20.5 percent). Over the summer months, the government decided to increase the prices of electricity and gas which will push inflation even higher and increase the costs of living.

Budgetary revenues overperformed in 2022 thanks to higher than planned

FIGURE 1 **Serbia** / Value added by sector

Index 1=2010

Agriculture value added
Service value added
Industry value added
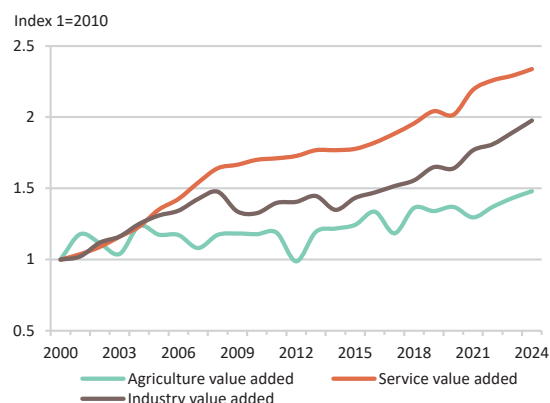
Source: World Bank staff calculations.

FIGURE 2 **Serbia** / Actual and projected poverty rates and real GDP per capita

Poverty rate (%)
Real GDP per capita (constant LCU)

Upper middle-income pov. rate
Real GDP pc
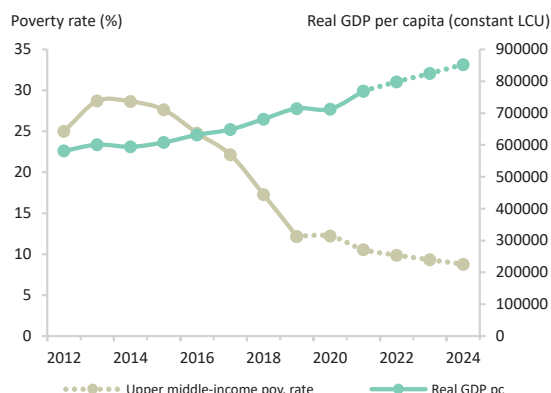
Source: World Bank. Note: see Table 2.

collection of VAT and CIT. In the first half of the year, total revenues were higher by 15.2 compared to the same period of 2021. Over the same period, expenditures increased by 13 percent. As a result, the consolidated fiscal deficit decreased significantly in 2022 reaching an estimated 0.2 percent of GDP in the first half of the year. Public debt remained broadly stable throughout 2022 and stood at around 57 percent of GDP.

The current account deficit (CAD) is widening in 2022 (increase by 370 percent in the first half of 2022 compared to the same period of 2021). The CAD reached EUR 2.7 billion in the first half of 2022 compared to EUR 0.6 billion in the same period of 2021 (or 4.4 percent of GDP in H1 2022 compared to 1.1 percent of GDP in H1 2021).This deterioration, by and large, was driven by a major increase in energy imports (of EUR 2.2 billion).

Outlook

The Serbian economy was expected to continue to grow at around 4-4.5 percent annually before the war in Ukraine and increases in international prices started. The growth was expected to be underpinned by broad-based growth in consumption, investment, and trade. However, the war in Ukraine, increase in international commodity prices, drought, and breakdowns in operations of EPS thermal power plants in 2021/2022 have brought projected growth downwards. Growth for 2022 is now expected to reach 3.2 percent, still driven primarily by consumption. Further downward revisions are possible depending on the performance of the energy sector and the impact of the poor agriculture season.

Over the medium term, the economy is expected to grow steadily at around 3 percent annually, supported by consumption and investment. Foreign direct investment is expected to continue playing a key financing role as Serbia continues to integrate into EU-centric manufacturing value chains. Inflation is expected to decline gradually as commodity prices normalize. The banking sector is expected to remain resilient, although NPLs (at 3.3 percent in June 2022) may face upward pressure if downside risks materialize.

Poverty reduction is expected to gradually decline or stagnate in 2022. The war in Ukraine continues to pose a significant downside risk for household welfare in Serbia. While Serbia's economy is expected to continue to grow, contributing to income growth for households, rising inflation will limit purchasing power. Particularly, rising energy prices would disproportionately affect the poor. Poverty in 2022 is projected at 9.9 percent, slightly lower than its 2021 level, though it could be revised upward depending on the length and severity of the war's economic impacts. The pace of labor market recovery remains critical for resumed poverty reduction.

The outlook also crucially depends on the domestic reform agenda and its implementation. In particular, the ongoing crisis in the domestic energy sector serves to highlight the importance of effective oversight and management of state-owned enterprises, as well as the risks to public finances associated with contingent liabilities.

TABLE 2 **Serbia** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	4.3	-0.9	7.4	3.2	2.7	2.8
Private Consumption	3.7	-1.9	7.6	4.6	4.1	3.7
Government Consumption	2.0	2.9	2.6	3.8	4.5	2.7
Gross Fixed Capital Investment	17.2	-1.9	12.5	5.0	2.8	4.4
Exports, Goods and Services	7.7	-4.2	19.4	8.0	5.0	5.0
Imports, Goods and Services	10.7	-3.6	19.3	9.0	6.2	5.8
Real GDP growth, at constant factor prices	4.4	-0.8	7.3	3.2	2.7	2.8
Agriculture	-1.7	2.2	-5.4	-5.5	4.5	3.4
Industry	5.9	-0.6	7.8	1.0	4.5	4.5
Services	4.4	-1.2	8.7	5.3	1.6	1.9
Inflation (Consumer Price Index)	1.9	1.6	4.0	11.5	9.2	3.7
Current Account Balance (% of GDP)	-6.9	-4.1	-4.4	-10.2	-9.4	-8.0
Net Foreign Direct Investment Inflow (% of GDP)	7.7	6.3	6.8	6.0	5.8	5.7
Fiscal Balance (% of GDP)	-0.2	-8.0	-4.1	-4.0	-2.7	-1.7
Debt (% of GDP)	52.8	57.8	57.2	58.1	58.2	56.5
Primary Balance (% of GDP)	1.8	-6.0	-2.4	-2.3	-0.7	0.3
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	12.1	12.2	10.5	9.9	9.3	8.8
GHG emissions growth (mtCO2e)	0.6	-3.3	0.0	-0.5	3.1	2.7
Energy related GHG emissions (% of total)	74.1	73.5	73.4	73.4	74.1	74.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2014-EU-SILC and 2019-EU-SILC. Actual data: 2019. Nowcast: 2020-2021. Forecasts are from 2022 to 2024.
b/ Projection using point-to-point elasticity (2014-2019) with pass-through = 0.6 based on GDP per capita in constant LCU.

TAJIKISTAN

Table 1	2021
Population, million	9.8
GDP, current US$ billion	8.7
GDP per capita, current US$	897.1
International poverty rate ($2.15)[a]	6.1
Lower middle-income poverty rate ($3.65)[a]	25.7
Upper middle-income poverty rate ($6.85)[a]	66.4
Gini index[a]	34.0
School enrollment, primary (% gross)[b]	100.9
Life expectancy at birth, years[b]	71.3
Total GHG emissions (mtCO2e)	19.7

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2015), 2017 PPPs.
b/ Most recent WDI value (2020).

Contrary to earlier expectations, the economy grew by 7.4 percent year-on-year (y/y) in the first half of 2022, despite the war in Ukraine. Full-year GDP growth is expected at 4.2 percent. This is expected to result in a reduction in poverty. Medium-term growth prospects will remain muted unless the government adopts substantive structural reforms.

Key conditions and challenges

Over the last decade (2011–21), Tajikistan experienced strong economic performance, with a growth rate averaging above 7 percent. Growth has translated into improved living standards, with the poverty rate falling from 32 percent in 2009 to an estimated 14.6 percent in 2021 (at the international poverty line of $3.65 a day; 2017 PPP). Yet, Tajikistan remains the poorest economy in the ECA region, with a GNI per capita of US$1,150 (Atlas method) in 2021.

With its young and fast-growing population, Tajikistan has enormous economic potential. To unlock key constraints, the government needs to expedite structural reforms to strengthen the rule of law, increase public sector efficiency and transparency, and promote private sector development through a better investment climate, trade connectivity, access to finance, and competition framework, especially in the telecom, aviation, and energy sectors. It will also be critical to enhance environmental resilience and ensure sufficient investment into human capital and better protection for poor households.

Recent developments

Tajikistan's economy grew 7.4 percent year-on-year (y/y) in the first half (H1) of 2022,

led by strong household consumption and private investment, whereas exports remained flat. Strong remittance inflows proved to be the main driver of robust domestic demand as a result of the increase in the number of labor migrants and a favorable exchange rate (as the appreciation of the Russian Ruble increased the value of remittances). Led by services and industry, the economy reported a broad-based expansion of output across sectors.

The trade deficit widened to 26.7 percent of GDP in H1 this year compared with 17.6 percent a year earlier. Strong demand for consumption and investment goods drove imports. In contrast, global price surges for minerals and strengthening Russian demand for agricultural products offset the 40 percent decline in export of precious metals (following substantial inventory sales over the past two years). Foreign private investment was about 25 percent higher y/y, albeit from a low base in 2021. External buffers remain adequate at about 8 months of import cover as of June 2022.

The sale of food reserves, the postponement of increases in utility tariffs, and the limited depreciation of the somoni contained headline inflation at 8.3 percent y/y ending in June. The somoni broadly followed the path of the ruble – i.e., initially depreciating at the onset of the war in Ukraine and later re-gaining value against major currencies.

The authorities balanced the government budget in the first half of the year. Vigorous domestic activity and import expansion led tax and non-tax receipts to exceed targets. The share of social sectors

FIGURE 1 Tajikistan / Fiscal balance and public debt
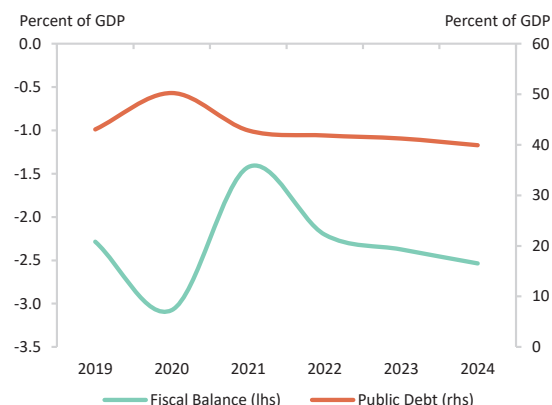
Source: World Bank staff estimates and projections.

FIGURE 2 Tajikistan / Actual and projected poverty rates and real GDP per capita
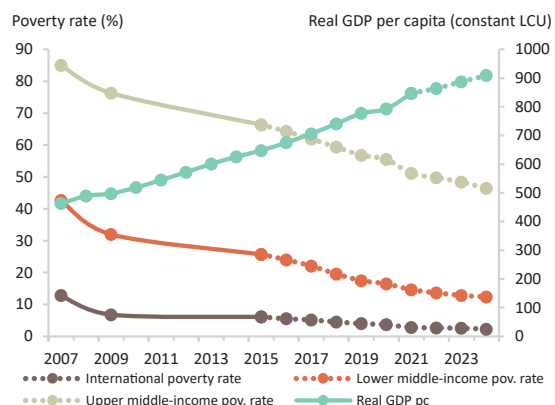
Source: World Bank staff estimates.

(education, healthcare, and social protection) in total budgetary spending remained at 40 percent. Aided by development partners, the authorities plan to increase social allocations sustainably to assist vulnerable households. In line with the long-term development strategy, public investment was focused on energy and transport. At about 40 percent of GDP, and in light of its low export earnings, Tajikistan's risk of external and overall public debt distress remains high.

The liquidation of problem banks, Tajiksodirotbank and Agroinvestbank, has improved the banking sector indicators. By June 2022, the share of non-performing loans in total loans declined from 13.4 percent to 11.4 percent a year ago, and the ratio of capital to risk-weighted assets, at 25.1 percent, was more than double the minimum requirement of 12 percent. During the first 7 months of 2022, household wages and self-employment income declined, with the share of households receiving income declining from about 14 to 10 percent and those receiving self-employment and agricultural income declining from 12 to 7 percent, respectively. However, this decline in income was mitigated

by resilient remittances. After a slight decline in March, the share of households receiving remittance income rebounded sharply and stood at 16 percent by July. In July, the share of respondents to the "Listening-to-Tajikistan" (L2T) survey who self-classified themselves as "poor" stood at around 42 percent (up from 39 percent in June), and the share of respondents assessing local economic conditions as "good" stood at 82 percent (nearly unchanged over the same period in 2021). Although L2T reported an overall improvement in food security in H1 2022, most food insecurity (going a whole day without eating; being hungry but not eating; running out of food; and eating less) remained concentrated among low-income respondents.

Outlook

Economic performance is expected to be stronger than initially anticipated in 2022. Full-year GDP growth is expected to be 4.2 percent. Inflation is expected to remain in single digit for the year as a whole.

The 2022 fiscal deficit is expected at 2.2 percent of GDP, subject to lower remittances, weaker growth, and a ramp-up in countercyclical expenditures in the year's second half. To ensure the sustainability of public finances, the authorities plan to keep the medium-term fiscal deficit at around 2.5 percent of GDP.

External and domestic risks weigh on the economic growth prospects. Geopolitical risks are elevated due to the ongoing war in Ukraine, the unresolved border dispute with the Kyrgyz Republic, and the uncertain political situation in neighboring Afghanistan. While intensifying sanctions on Russia could hamper inward remittances, on the positive side Tajikistan may be able to further increase the export of agricultural products to Russia, and textiles, precious metals, and minerals to other countries.

Domestic risks primarily relate to political challenges in advancing private sector reforms, promoting public sector transparency and accountability, and addressing vulnerabilities in the social and environmental sectors.

Poverty is expected to fall from an estimated 14.6 percent in 2021 to 13.6 percent in 2022.

TABLE 2 Tajikistan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	7.4	4.4	9.2	4.2	4.8	4.5
Private Consumption	5.0	3.4	8.0	3.6	6.1	5.6
Government Consumption	0.7	2.3	7.1	2.0	3.3	4.4
Gross Fixed Capital Investment	8.9	-4.6	15.0	9.6	5.7	8.3
Exports, Goods and Services	21.5	21.8	35.0	-17.5	4.8	3.5
Imports, Goods and Services	6.4	-0.4	25.0	-9.0	6.0	4.5
Real GDP growth, at constant factor prices	8.7	4.3	9.0	4.2	4.8	4.5
Agriculture	7.1	8.8	6.6	3.5	3.0	3.0
Industry	13.6	9.7	22.0	4.5	4.0	4.0
Services	4.9	-4.0	-5.2	4.2	7.4	6.3
Inflation (Consumer Price Index)	8.0	8.6	9.0	8.5	8.2	7.8
Current Account Balance (% of GDP)	-2.2	4.3	8.4	4.2	3.9	3.2
Net Foreign Direct Investment Inflow (% of GDP)	-2.3	-0.4	-0.4	-1.0	-1.7	-2.3
Fiscal Balance (% of GDP)	-2.3	-3.1	-1.4	-2.2	-2.3	-2.4
Debt (% of GDP)	43.1	50.3	42.9	41.9	41.3	39.9
Primary Balance (% of GDP)	-1.4	-2.3	-0.5	-1.0	-1.1	-1.2
International poverty rate ($2.15 in 2017 PPP)[a,b]	4.0	3.7	2.8	2.7	2.5	2.3
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	17.5	16.4	14.6	13.6	12.8	12.4
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	56.8	55.5	51.1	49.8	48.4	46.5
GHG emissions growth (mtCO2e)	5.3	2.4	10.8	6.6	6.8	6.9
Energy related GHG emissions (% of total)	44.2	44.9	47.0	48.3	49.8	51.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2015-HSITAFIEN. Actual data: 2015. Nowcast: 2016-2021. Forecasts are from 2022 to 2024.
b/ Projection using neutral distribution (2015) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

TÜRKIYE

Table 1	2021
Population, million	84.1
GDP, current US$ billion	814.5
GDP per capita, current US$	9679.1
International poverty rate ($2.15)[a]	0.4
Lower middle-income poverty rate ($3.65)[a]	2.2
Upper middle-income poverty rate ($6.85)[a]	12.6
Gini index[a]	41.9
School enrollment, primary (% gross)[b]	97.1
Life expectancy at birth, years[b]	77.9
Total GHG emissions (mtCO2e)	499.2

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ Most recent WDI value (2020).

Robust economic activity in the first half of 2022 was driven by strong private-sector and export performance and loose monetary policy despite soaring inflation, a weakening currency, and a widening current account deficit. GDP growth is expected to moderate to 4.7 percent in 2022, with a risk investor confidence may falter, intensifying pressure on the Lira and corporate and bank balance sheets. Despite a strong jobs recovery, post-Covid poverty rates are receding slowly as lower-income households' budgets are hit by rising energy and food prices.

Key conditions and challenges

The authorities continue to loosen monetary policy to stimulate the economy, cutting interest rates six times since September 2021, while intervening in currency markets and introducing regulatory measures to tackle macroeconomic instability. While the economy grew 7.5 percent yoy in real terms in 2022H1, inflation climbed to a 24-year high, the lira depreciated further, the current account deficit widened, banks' capital buffers declined, and realized and contingent fiscal liabilities are mounting from policy measures seeking to dampen the impact of macroeconomic developments on firms and households. The impact of the Russia-Ukraine war has been modest and largely felt through higher food and energy import costs that added inflationary pressure and widened the current account deficit, while financial inflows from Russia have reportedly increased.

Recent developments

Stronger than anticipated private consumption drove rapid growth in the first half of the year as rising inflation expectations fueled purchases of durables despite inflation eroding real incomes. Merchandise export growth and tourism revenues remained robust, supported by a weaker currency and resilient external demand.

The services sector led production side contributions to GDP growth. Although real interest rates remain deeply negative, private investment growth slowed due to price and exchange rate uncertainty and a deteriorating outlook. The manufacturing PMI has remained below the 50.0 threshold since March, and economic confidence has deteriorated in the manufacturing, service, and retail sectors. Despite annual CPI inflation rising for the 15th consecutive month to 80.2 percent in August, with food and non-alcoholic beverage prices rising even faster at 90.3 percent, the central bank lowered the benchmark interest rate to 13 percent in August and 12 percent in September after keeping it at 14 percent since December. According to the September Survey of Market Participants, expected CPI in 12 and 24 months' time remains high at 36.7 and 21.2 percent, respectively.

External pressures are mounting and external buffers remain low. The lira lost a third of its value this year after a sharp decline in 2021, and the nominal current account deficit was 13 times higher in July 2022 than in July 2021 on the back of high energy prices, putting further pressure on the currency. Gross foreign exchange reserves remain low at US$113.7 billion (about 4 months of import coverage) in early September and net reserves excluding swaps between the central bank and other banks remain deeply negative. Credit risk premia, reflected in CDS spreads, surged to a 19-year high in July.

Deteriorating conditions have elevated corporate and financial sector vulnerabilities. While financial regulatory measures helped

FIGURE 1 Türkiye / Real GDP growth and contributions to real GDP growth
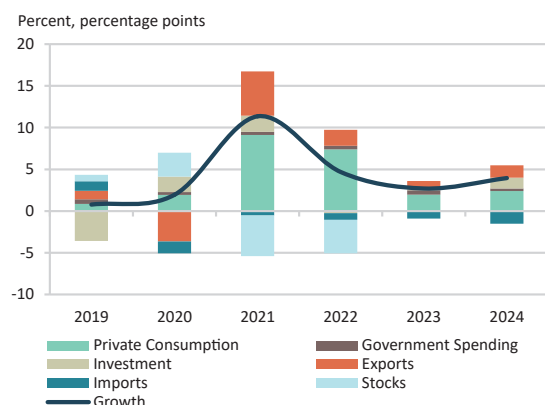
Sources: Turkstat and World Bank staff calculations.

FIGURE 2 Türkiye / Actual and projected poverty rates and real GDP per capita
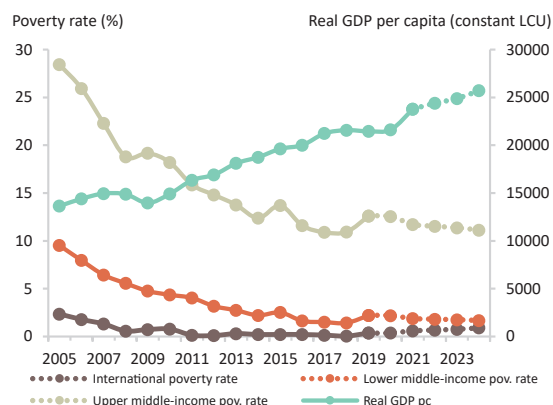
Source: World Bank. Notes: see Table 2.

curb credit growth, and real credit growth is negative, nominal credit growth remains high at 70.2 percent yoy in August. High market risk premia are keeping consumer and commercial lending rates elevated, but measures introduced to penalize banks that lend at high rates brought down commercial lending rates to 21.0 percent (weighted average) by early September. High-interest margins and required holdings of inflation-indexed government securities supported commercial bank profits, which grew over 500 percent yoy in August. However, official numbers show a gradual erosion of banks' capital buffers to 18 percent in July, especially at state banks (16.1 percent in July), despite forbearance measures introduced during the Covid pandemic, due to FX depreciation. Banks increased holdings of government securities to comply with recent regulatory requirements, which, in addition to reserve holdings and currency swaps with the central bank, raise spillover risks between the financial and fiscal sectors. Corporations have deleveraged, but the magnitude of currency depreciation puts pressure on their balance sheets.

Labor market recovery continued into 2022. Employment increased by 1.5 million (or 5.2 percent) between July 2021 and July 2022, with female and youth (ages 15-24) employment expanding faster than average. The labor force participation rate

recorded its highest level in nearly three years, reaching 53.1 percent in July. The gross wages/salaries index for formal employees in the industry, construction, trade and service sectors increased in line with CPI inflation in 2022Q2.

Exchange rate depreciation and policies to mitigate the impact of inflation—including public wage increases, VAT cuts on food and energy, and a deposit scheme that compensates holders for lira depreciation—have cost the government significant fiscal resources. However, the central government fiscal deficit narrowed to 1.6 percent of GDP in 2022H1 as high inflation boosted nominal government revenues. Although debt levels remain moderate, the share of FX-denominated central government debt has risen to 68 percent, increasing vulnerability to FX shocks.

Outlook

After expanding 11.4 percent in 2021, the economy is expected to grow 4.7 percent in 2022 and 2.7 percent in 2023. Economic activity is expected to weaken in the second half of 2022 as macroeconomic volatility intensifies, inflation erodes the purchasing power of households that can no longer frontload consumption,

and external demand weakens, at the same time as government policies to stimulate the economy ahead of the June 2023 elections continue.

Despite the labor market and economic recovery in 2021, the poverty rate is projected to remain above pre-2019 levels due to persistently high inflation. Inflation affects the lowest income households the most as they spend a higher share of income on items like food that face higher than average inflation. Projections using an updated upper-middle-income country poverty line of $6.85 per person per day (2017 PPP terms) estimate the poverty rate falling from 11.7 percent in 2021 to 11.4 percent in 2022 and 11.1 percent by 2024.

External risks remain elevated given the growing current account deficit, high FX-share of public debt, low FX reserves, high external financing requirements, and continued loosening amid tightening global liquidity. There is a risk investor confidence may falter, intensifying pressure on the Lira, external balances, and corporate and bank balance sheets. Any additional monetary policy loosening could exacerbate external and domestic imbalances and financial stability concerns. Uncertainty around the duration of the Russia-Ukraine war, the Covid pandemic, and the path of rising interest rates in advanced economies further clouds the outlook.

TABLE 2 **Türkiye** / Macro poverty outlook indicators   (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	0.8	1.9	11.4	4.7	2.7	4.0
Private Consumption	1.5	3.3	15.3	12.0	3.0	3.6
Government Consumption	3.8	2.5	2.6	3.2	4.0	2.4
Gross Fixed Capital Investment	-12.5	7.4	7.4	-1.0	1.0	5.5
Exports, Goods and Services	4.2	-14.4	24.9	8.0	3.5	6.0
Imports, Goods and Services	-5.0	6.7	2.4	4.0	4.5	7.5
Real GDP growth, at constant factor prices	0.9	1.2	11.9	4.7	2.7	4.0
Agriculture	3.3	5.7	-2.9	0.5	1.0	1.5
Industry	-3.0	1.1	13.0	3.5	2.5	4.5
Services	2.5	0.8	13.1	5.7	3.0	4.0
Inflation (Consumer Price Index)	15.2	12.3	19.6	75.0	45.0	32.0
Current Account Balance (% of GDP)	0.7	-4.9	-1.7	-6.3	-4.9	-3.7
Net Foreign Direct Investment Inflow (% of GDP)	0.9	0.6	0.9	0.7	0.7	1.0
Fiscal Balance (% of GDP)	-3.0	-3.9	-2.6	-3.8	-4.4	-3.0
Debt (% of GDP)	32.6	39.7	41.8	36.8	36.1	35.2
Primary Balance (% of GDP)	-0.5	-1.1	0.0	-0.9	-0.5	0.7
International poverty rate ($2.15 in 2017 PPP)[a,b]	0.4	0.4	0.6	0.7	0.8	0.9
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a,b]	2.2	2.2	1.9	1.8	1.7	1.7
Upper middle-income poverty rate ($6.85 in 2017 PPP)[a,b]	12.6	12.5	11.7	11.5	11.4	11.1
GHG emissions growth (mtCO2e)	-2.3	-0.8	9.4	2.6	-0.5	1.5
Energy related GHG emissions (% of total)	80.5	79.4	80.0	79.6	79.1	78.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on ECAPOV harmonization, using 2011-HICES and 2019-HICES. Actual data: 2019. Nowcast: 2020-2021. Forecasts are from 2022 to 2024.
b/ Projection using point-to-point elasticity (2011-2019) with pass-through = 1 based on GDP per capita in constant LCU.

UKRAINE

Table 1	2021
GDP, current US$ billion	201.9
Upper middle-income poverty rate ($6.85)[a]	7.1
Gini index[a]	25.6
School enrollment, primary (% gross)[b]	99.0
Life expectancy at birth, years[b]	71.2
Total GHG emissions (mtCO2e)	192.8

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2020), 2017 PPPs.
b/ WDI for School enrollment (2014); Life expectancy (2020).

The ongoing Russian invasion in Ukraine continues to inflict substantial economic and social losses due to extensive damages to productive assets and infrastructure, limited market access, and labor force dislocations. Since April, economic activity has started to gradually improve. Nevertheless, in the baseline scenario, Ukraine's GDP is expected to contract by 35 percent in 2022 if the status quo continues until the end of the year without additional economic shocks.

Key conditions and challenges

After Ukraine regained control of Kyivska oblast in April, the active combat is localized mainly in the southern and eastern parts. The war, however, still affects about 20 percent of Ukraine's territory. As of August, the government lost control over two oblasts (2.5 percent share in GDP), while active fighting continued within three other oblasts (15 percent in GDP). 7mn people have become refugees, and another 7mn displaced internally.

With the war continuing, Ukraine is facing three key macro-critical challenges: high fiscal financing needs amidst the inability to mobilize domestic revenues and increasing reliance on monetary financing; deteriorating asset quality in the financial sector; and a weaker external position.

Despite significant efforts to reduce fiscal needs, their size remains large over the medium term. Expenditures have been trimmed to the level of critical public services. Ukraine reached an agreement with external creditors (commercial and majority of bilateral) for a debt payments deferral for two years. However, fiscal financing needs – consisting of the deficit (excluding grants) and debt repayments - are expected to grow from US$4bn per month in 1H22 to US$4.5bn per month in 2H22 (US$2bn excluding military expenditures). In addition, the government could also face the costs of gas purchases by Naftogaz for the heating season

(US$2.2 bn) and the most critical reconstruction needs (US$3.4bn).

Over the medium run, prospects for attracting additional external funding are uncertain. Donors have committed US$16.7bn of support to Ukraine for 2H2022. These funds, if fully disbursed, are sufficient to cover non-military fiscal needs only, with other expenditures to be covered by monetization, which since the war started reached US$9.7bn in September. In case disbursements are delayed, Ukraine faces a trade-off between continuing monetization or cutting social expenditures further. Both scenarios have negative social impacts.

Recent developments

In Q2 2022, Ukraine's GDP shrank by 37.2 percent YoY, following an estimated 45 percent contraction in March. After the localization of the active combat in April, economic activity has shown signs of improvement, even though it remains much below the prewar level. Consumer price inflation has accelerated rapidly, reaching 23.8 percent YoY in August, with high food price inflation hurting families, particularly the poor.

The government has continued providing essential public and social services amidst a significant drop in revenues. Real tax revenues fell by 30 percent YoY during March-June. Although non-essential public spending has been reduced to the minimum, total expenditures have been growing sharply by about 40 percent per month

FIGURE 1 **Ukraine** / State budget general fund revenue, expenditure, and debt amortization in 2022
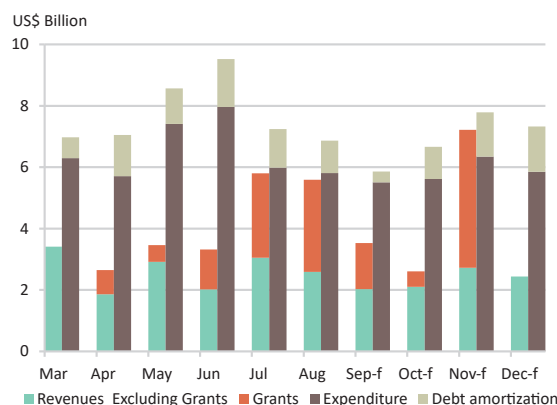
Sources: MoF and World Bank estimates. Note: f = forecast

FIGURE 2 **Ukraine** / Actual and projected poverty rate and real GDP per capita
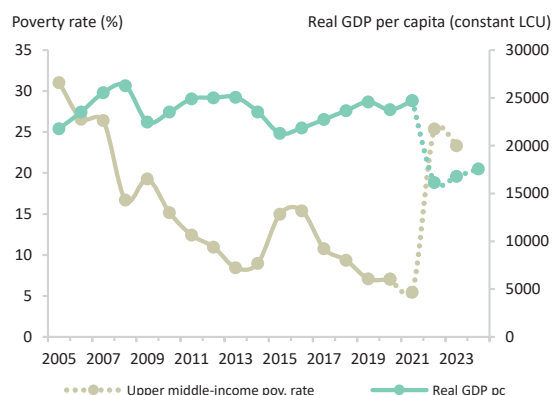
Source: World Bank. Notes: see Table 2.

in real terms. The resulting fiscal deficit has been met by a combination of external funding and monetization.

The war generated immediate balance of payments pressures. Exports fell precipitously as the Black Sea ports have been completely closed until July. Despite resumption of agricultural exports via Black Sea ports under the UN-brokered deal, their capacity is rather limited, while imports have recovered fast starting in May. On the capital account, pressures have emerged from the withdrawal of foreign exchange by Ukrainian refugees. Since the beginning of the war, the NBU has spent around US$12bn on currency interventions. This has eroded international reserves, which declined to US$ 22.4bn at the end of July from a prewar level of US$ 29bn. In August reserves improved to US$25.4bn thanks to donor support.

As a result of the war, banks face heightened operational, liquidity, credit, profitability and solvency risks. The recent financial stability report issued by the NBU estimates at least 20 percent losses of the loan portfolio with significant impacts on banks' capital position. The war may also impact the solvency position of nonbanking financial institutions.

Outlook

Even though the active combat is currently localized, the duration of the war is uncertain, and downside risks are high. Our status quo scenario extrapolates estimated economic activity in 3Q22 into the medium term. Thus, assuming the military and economic situation does not change substantially, GDP is expected to contract 35 percent in 2022 with a gradual rebound of 3-4 percent in the medium term. This scenario does not include any potential upside effects of a large reconstruction activity as well as possible downside risks related to a deterioration of the security situation and/or energy shortage during the winter season. Inflation is expected to accelerate to 30 percent by the year-end, and real wages to drop by 10 percent YoY.

The current account is expected to turn negative in 2022 at 0.5 percent of GDP despite large grants accounted as a secondary income. Exports are estimated to decline around 30 percent YoY in 2022 in nominal terms and around 60 percent in real terms with tepid recovery in the medium term. Imports are to recover much faster than exports as restrictions on imports have been lifted since July, while there is a need to purchase gas and other energy resources. In this status quo scenario, the CAD will broaden gradually in the medium term due to an acceleration of imports and only a modest recovery of exports.

The poverty and social impacts of the war will be massive. Under the baseline scenario, the population share with income below the national poverty line may reach nearly 60 percent in 2022, up from 18 percent in 2021. Based on the global line of US$6.85 a day (2017PPP), poverty is projected to increase from 5.5 percent in 2021 to 25 percent in 2022, with high downside risks if the war and energy security situations worsen.

TABLE 2 **Ukraine** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	3.2	-3.8	3.4	-35.0	3.3	4.1
Private Consumption	10.9	1.7	7.7	-28.0	10.0	10.0
Government Consumption	-13.6	-0.7	1.8	16.7	5.0	3.0
Gross Fixed Capital Investment	11.7	-21.3	7.6	-80.0	20.0	30.0
Exports, Goods and Services	7.3	-5.8	-10.4	-60.0	40.0	35.0
Imports, Goods and Services	5.7	-6.4	12.7	-40.0	34.0	28.5
Inflation (Consumer Price Index)	4.1	5.0	10.0	30.0	20.0	15.0
Current Account Balance (% of GDP)	-2.7	3.4	-1.1	-0.5	-4.3	-4.5
Fiscal Balance (% of GDP)[a]	-2.1	-5.6	-4.0	-22.8	-18.6	-11.5
Debt (% of GDP)	50.2	60.4	50.7	66.8		
Primary Balance (% of GDP)[a]	1.0	-2.7	-0.5	-19.9	-15.1	-10.3
Upper middle-income poverty rate ($6.85 in 2017 PPP)[b,c]	7.1	7.1	5.5	25.4	23.3	
GHG emissions growth (mtCO2e)	-4.9	-10.2	-2.9	-35.1	-3.3	-1.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.
a/ Fiscal Balance and Primary Balance are excluding grants in 2022-2024.
b/ Calculations based on ECAPOV harmonization, using 2020-HLCS.
c/ Projection using neutral distribution (2020) with pass-through = 1 (High (1)) for 2022 and 0.7 for 2023 based on GDP per capita in constant LCU. Actual data: 2020. Nowcast: 2021. Forecasts are from 2022 to 2024.

UZBEKISTAN

Table 1	2021
Population, million	35.0
GDP, current US$ billion	69.2
GDP per capita, current US$	1980.2
School enrollment, primary (% gross)[a]	100.1
Life expectancy at birth, years[a]	71.8
Total GHG emissions (mtCO2e)	168.0

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent WDI value (2020).

Despite the fallout from the war in Ukraine, Uzbekistan is expected to grow by 5.3 percent in 2022. Fiscal consolidation is continuing albeit on a more gradual trajectory given the need to cushion the impact of new shocks this year. The medium-term outlook remains positive provided that the ambitious ongoing economic reforms will continue to invigorate private sector-led growth.

Key conditions and challenges

Uzbekistan has pursued an ambitious initial set of trade and price liberalization reforms in recent years. However further reforms are needed to continue to spur productivity, private-sector-led growth, and job creation. The focus should shift to addressing weak factor markets, high trade and transit costs, dominant state-owned enterprises, the weak regulatory environment, and further strengthening market incentives and sustainability in agriculture and across the economy.

The government recognizes the need for a more inclusive transition. According to the new national poverty line, about 17 percent of the population was in poverty in 2021. The recent reform efforts to expand the coverage and strengthen the targeting of social assistance will be key to supporting those that may otherwise fall behind.

Recent developments

Despite the uncertain regional outlook, GDP grew by 5.4 percent in the first half (H1) of 2022, led by strong remittances, exports, and investments. Real wages increased by more than 6 percent yoy in the second quarter.On the supply side, stronger growth in construction and agriculture partly offset slower growth in industry and services. Investment (mostly in energy production, fertilizers, and infrastructure) grew by 9.4 percent. The value of exports (in US$) grew by 40.5 percent yoy, led by a more than doubling of gold exports. Non-gold exports were 22.5 percent higher, driven by natural gas, textiles, food, machinery, transport, and tourism. Imports expanded by 27.4 percent as prices of imported food and energy rose, as did domestic demand. Food exports were 41 percent higher, machinery and equipment 29 percent, and service imports 65 percent, yoy. Contrary to earlier expectations, remittance inflows doubled as a share of GDP in H1 to 16.7 percent, due to favorable exchange rate movements with the Russian Ruble, and more labor migrants going abroad, mostly to Russia. These drivers narrowed the current account deficit to just 1.4 percent of GDP in H1 2022, compared to 4.8 percent in H1 2021.

The fiscal deficit declined from 5 percent of GDP in H1 2021 to 4.2 percent in H1 2022, supported by higher revenues from gold exports. International reserves increased by $1.5 billion in the year to July to $35.6 billion and remain ample, equivalent to 11 months of imports.

Higher costs of food, fuel, and logistics drove CPI inflation up to 12.3 percent in June 2022 (against 10.9 percent in June 2021). In March-May 2022 the Som depreciated by 7 percent against the US$. In response to exchange rate pressures and an uncertain inflation outlook, the Central Bank (CBU) initially hiked the policy rate by 300 bps to 17 percent. In June and July, the stabilization of the exchange rate, the
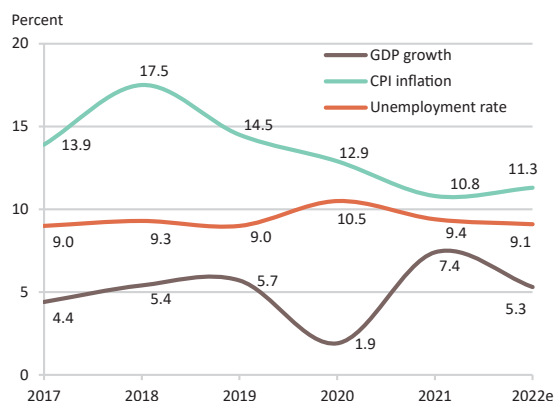
Percent

Source: Uzbekistan official statistics.
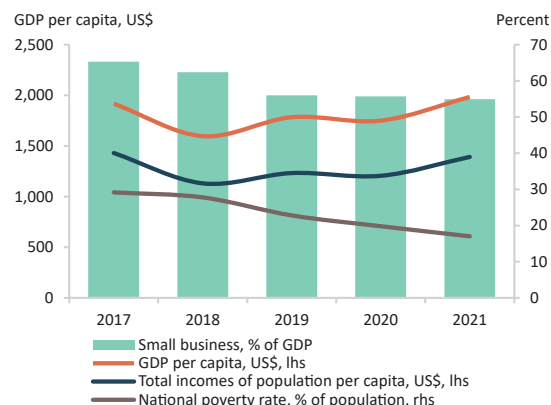
Source: Uzbekistan official statistics. Note: The national poverty line is more ambitious (67 percent higher) than LMIC poverty line.

recovery of foreign exchange inflows, and the growth of domestic deposits enabled the CBU to cut the policy rate to 15 percent. Decreasing capital buffers and more cautious lending policies of banks following the war in Ukraine slowed credit growth to 14 percent in end-June 2022 yoy from 23 percent the year earlier. Stricter capital adequacy regulations and increased loan loss provisions enacted in 2021, partly mitigated by stronger profits and recapitalization of a few state-owned banks, reduced the banking sector's total capital adequacy ratio (CAR) slightly, from 17.7 percent at the end-H1 2021 to 17.0 percent at the end-H1 2022, relative to a required CAR of 13 percent. While the banking system remains resilient overall, a few banks are in vulnerable positions, and several are in need of additional loan loss provisions for non-performing loans (NPLs). NPLs spiked from 2 percent in end-2020 to 6.2 percent in August 2021, but gradually decreased since then to 4.9 percent in H1 2022.

Higher remittances contributed to an expected decline in the poverty rate of 1.25 percentage points, to 15.7 percent in 2022. The unemployment rate fell to 8.8 percent in H1 2022, though still elevated among youth and women, and in lagging regions.

Outlook

Growth is expected to slow to 5.3 percent in 2022. Increased logistical challenges linked to sanctions on Russia are expected to dent private consumption growth. Private investment and exports are expected to grow strongly, and the current account balance improve, as Uzbekistan benefits from strong global commodity prices (gold, copper, natural gas) and increasing remittances. FDI is not expected to pick up in 2022, with the trade deficit financed largely by official borrowing.

Higher revenues from commodity exports and slower public investment spending will see the fiscal deficit decline from 6.2 percent of GDP in 2021 to 4.4 percent in 2022, nevertheless higher than the 2022 budget target of 3 percent due to higher social protection, health, education, and infrastructure spending. An anticipated fiscal consolidation by 2023 is now expected to be delayed as targeted social protection increases in response to pressure from rising food price priorities and the impacts of the war in Ukraine. Continued growth and expanded social protection programs are expected to sustain poverty reduction, with the national poverty rate projected to fall to 14.5 percent in 2023, and 12.2 percent in 2024.

Nonetheless, expenditure consolidation is expected to resume in future years, supported by both revenue mobilization and spending efficiency. The government is expected to continue adhering to its overall debt limits, with public debt and total external debt gradually falling to 32 and 55 percent of GDP, respectively, by end-2024.

The risks to the outlook are tilted to the downside, including a prolonged war and further sanctions on Russia, and tighter-than-expected global financial conditions. There is a risk from reform inertia in this more complex phase of economic reforms, that is compounded by the difficult international environment. Potential positive surprises include higher global gold, natural gas, and copper prices and stronger productivity growth arising from ongoing structural reforms.

TABLE 2 Uzbekistan / Macro poverty outlook indicators   (annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	5.7	1.9	7.4	5.3	4.9	5.1
Private Consumption	5.3	0.1	11.6	4.8	4.6	5.3
Government Consumption	5.7	1.4	3.4	8.1	1.6	6.6
Gross Fixed Capital Investment	38.1	-4.4	5.2	9.4	9.0	9.2
Exports, Goods and Services	16.2	-20.0	12.7	18.6	16.1	14.8
Imports, Goods and Services	13.3	-15.0	23.1	18.3	15.6	16.2
Real GDP growth, at constant factor prices	5.7	1.9	7.4	5.3	4.9	5.1
Agriculture	3.1	2.9	4.0	3.7	3.6	3.9
Industry	8.3	2.5	7.9	3.8	4.8	5.1
Services	5.6	0.9	9.2	7.3	5.7	5.8
Inflation (Consumer Price Index)	14.5	12.9	10.8	11.3	10.9	9.6
Current Account Balance (% of GDP)	-5.8	-5.0	-7.0	-3.2	-3.9	-4.0
Net Foreign Direct Investment Inflow (% of GDP)	3.9	2.9	3.0	1.4	2.0	3.1
Fiscal Balance (% of GDP)	-3.9	-4.4	-6.2	-4.4	-3.5	-3.0
Debt (% of GDP)	29.7	37.6	35.8	34.4	33.4	32.1
Primary Balance (% of GDP)	-3.4	-3.3	-5.1	-3.4	-2.5	-2.0
National poverty rate[a,b]	22.8		17.0	15.7	14.5	13.4
GHG emissions growth (mtCO2e)	2.7	-6.2	-3.4	-1.1	-0.6	0.4
Energy related GHG emissions (% of total)	60.8	58.8	57.4	56.5	55.8	55.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.
a/ Calculations based on the Household Budget Survey of UzbeksitanActual data: 2018, 2019, 2021. Nowcast: 2022. Forecasts are from 2023 to 2024.
b/ Projection using point to point elasticity at regional level with pass-through = 0.87 based on GDP per capita in constant LCU.

WORLD BANK **ECA ECONOMIC UPDATE** Fall 2022

Social Protection for Recovery

Globalization, demographic trends, the green transition, and technological innovations are transforming labor markets in Europe and Central Asia, altering their institutional and contractual arrangements, and creating disparities and vulnerabilities in the labor force. Systemic risks—economic, health, or climate-related—are also playing an increased role in driving poverty and vulnerability. Social protection systems in Europe and Central Asia will need to be reformed to address these challenges and provide adequate protection to workers and families.

Countries in the region responded to the COVID-19 pandemic by implementing social protection packages with a substantial contribution of job protection policies. Analysis of the impact of these policies suggests that while job protection policies may have preserved employment in the short run, this may have come at the expense of efficiency and growth. In the long run, income protection policies may be better at addressing the needs of vulnerable groups as labor markets continue evolving. A policy package that combines a guaranteed minimum income with labor market policies that facilitate job transitions can best help countries address long-term challenges.

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