Regional Economic Prospects in EBRD Countries of Operations: January 2014[1]

EBRD Office of the Chief Economist

Overview

Slow recovery ahead

Since our forecast in November 2013, the recovery has gained further momentum in advanced economies, including the United States and the Eurozone. But capital outflows from emerging markets continued and for the first time since 2011 net private capital flows turned negative for the region as a whole in the third quarter. These outflows are likely to persist, as monetary conditions in the United States are expected to be gradually tightened.

On balance, the outlook for growth in the transition region has remained largely unchanged. The region is expected to grow at 2.7 per cent in 2014 compared with 2.0 per cent in 2013, broadly in line with our November forecast. For sustained recovery to take hold, countries in the region need to resume structural reforms and tackle the persistent legacies of the crisis, including high rates of non-performing loans and long-term unemployment. In the new global environment of greater differentiation among emerging markets, sound domestic policies will play a decisive role in supporting investor confidence and growth.

Regional overview

Growth across the transition region as a whole decelerated from 2.6 per cent in 2012 to 2 per cent in 2013, according to preliminary estimates. This primarily reflects a slowdown in Russia, Eastern Europe and Caucasus (EEC) and Southern and Eastern Mediterranean (SEMED).

At the same time, growth picked up in the countries with closest links to the Eurozone. Preliminary data suggest that output in the single currency area expanded in both the second and the third quarters of 2013, as recovery gained momentum in advanced countries more broadly, including in the United States and Japan.

Helped by the improving external environment and stronger demand for exports, growth accelerated further in the third quarter in Central Europe and the Baltics (CEB). Growth picked up to around 2 per cent in annualised terms in Poland and Hungary in the third quarter, and Latvia and Lithuania remained growth leaders among European Union countries. On 1 January 2014 Latvia also became the fourth country in the region to join the euro single currency area, having successfully

[1] This document is provided as a companion to the EBRD's growth forecasts for its countries of operations, which are released three times a year. For more comprehensive coverage of economic policies and structural changes, the reader is referred to the EBRD's Transition Report 2013 as well as country strategies and updates and statistical series on economic and structural reform variables, which are all available on the EBRD's website (www.ebrd.com).

met the qualification criteria. Overall, average growth in CEB in 2013 remained broadly unchanged from 2012 as the slowdown of late 2012 and early 2013 was offset by the acceleration in the second half of the year; however, Croatia and Slovenia remained in recession. The latest recovery has been driven mainly by stronger export performance, while domestic consumption and investment growth remains slow.

All south-eastern Europe (SEE) countries that were in recession in 2012 recorded positive growth in 2013. These include Bosnia and Herzegovina, FYR Macedonia, Montenegro and Serbia, while growth in Romania is estimated to have accelerated to 2.5 per cent. As a result, average growth in the region picked up markedly, from 0.4 per cent in 2012 to an estimated 2 per cent in 2013. Stronger export performance and a better harvest have been important drivers of recovery in these economies. However, unemployment remains high across the region.

Russia's growth remained low. Commodity prices no longer provide a boost to the economy and increasingly limit the fiscal policy room: the average annual price of Urals brand of oil declined in 2013, by about 3 per cent, after years of almost uninterrupted increases. Further, investment activity has remained subdued even though the economy works close to capacity, limiting current and future potential growth.

Weak external demand and low investment activity weighed on growth in Eastern Europe and Caucasus (EEC). Ukraine has been in recession since mid-2012, exacerbated by domestic policy uncertainty. Growth has slowed down considerably in Armenia, Belarus and Georgia but accelerated in Azerbaijan and Moldova, supported by stabilised oil output and fiscal stimulus measures in the former and a strong harvest in the latter.

Growth remained strong in Central Asian countries. Large new mining and hydrocarbon extraction projects contributed to growth in Kazakhstan, Mongolia and Turkmenistan. In the Kyrgyz Republic growth rebounded strongly following last year's disruption at the country's largest gold mine. Remittances from Russia to the Kyrgyz Republic, Tajikistan and Uzbekistan continued to grow, notwithstanding Russia's slowdown, providing an important source of external financing and consumer demand.

Growth in Turkey remained relatively strong, despite volatility in the financial markets. Government spending was the major driver of growth in the first half of the year. As it slowed down in the second half of the year, consumption and private investment picked up, the latter for the first time since the third quarter of 2011. They were boosted by monetary expansion with interbank rates averaging 5.7 per cent in the first half of 2013, 1.5 percentage points below inflation. At the same time, the Turkish lira depreciated by around 20 per cent against the US dollar over the course of 2013, first following US Fed's announcement of forthcoming tapering and then again in December, amidst heightened political uncertainty.

Recovery in the South-eastern Mediterranean (SEMED) has been slow, constrained by political and policy uncertainty in Tunisia and Egypt, the region's largest economy. Export receipts have declined across the region. At the same time growth in Morocco accelerated markedly in 2013 reflecting a strong harvest, and increased FDI thanks to a relatively more favourable policy environment.

In line with global trends, inflation rates continued declining in most countries (with the notable exception of Egypt). Lower inflation reflects weaker demand pressures against the background of economic slowdown with high unemployment as well as lower prices of agricultural and energy commodities. Administrative reductions in utility tariffs in a number of countries also contributed to lower inflation. They may, however, undermine the attractiveness of investments in the utilities sectors in the longer term. In many CEB and SEE countries the rates of inflation dropped to below one per cent, pointing to a possibility of deflation, which would exacerbate the burden of servicing corporate and consumer debt. Inflation has already turned negative in Bosnia and Herzegovina, Bulgaria and Latvia.

Boosting longer-term prospects

For a sustained recovery to take hold, the region needs to reignite structural reforms and deal with the persistent legacy of the crisis. Priority areas include deepening energy sector reforms, phasing out unsustainable subsidy schemes and cuts in administrative prices below long-term cost recovery levels, reducing barriers to trade, development of deeper local capital markets, ensuring long-term sustainability of pension systems and reinvigorating privatisations with a view to boost economies' long-term competitiveness.

The overhang of non-performing loans (NPLs) and entrenched long-term unemployment are key impediments to recovery. The estimate of NPLs in Slovenia has been revised upwards significantly following the recent bank asset quality review, to around 20 per cent of total loans. NPL ratios continued rising in Hungary, Kazakhstan and most SEE countries. All these countries and Ukraine now have NPL ratios close to 20 per cent, and over 30 per cent in the case of Kazakhstan (Chart 1).

Long-term unemployment rates are on average 3 to 4 percentage points higher than before the crisis in CEB and SEE countries (Chart 2). They now stand at 6 per cent on average in CEB and at 16 per cent in the SEE region. A particular concern is the widespread rise in the share of the long-term unemployed – those of work for more than 12 months – except in the Baltic States, where long-term unemployment has declined since 2011.

Capital flows

Total private capital flows for the transition region as a whole turned negative in the third quarter, for the first time in two years. Non-FDI (portfolio) capital outflows from the CEB and SEE regions turned negative and FDI inflows were not sufficient to compensate, as they did jointly in the past, for ongoing cross-border bank deleveraging. This resulted in net outflows from CEB and SEE regions of around one per cent of annual GDP in the third quarter of 2013 (Chart 3). Currencies and stock markets in the transition region continued experiencing downward pressures.

The outflows mirrored broader trends in the emerging markets brought about by increased expectations of monetary tightening in the United States. Emerging market currencies have been by and large under pressure since June 2013 when the U.S. Federal Reserve indicated that it would reduce its monthly purchases of assets from the level of US$ 85 billion, while long-term U.S. treasury yields have continued rising (Chart 4). The start of the tapering itself was announced more than half a year later, on 18 December 2013. As it was modest in size (US$ 10 billion) and largely anticipated, it did not have a major impact on market trends.

Deleveraging and de-dollarisation

Cross-border deleveraging in the transition region appears to have intensified again. In particular, the speed of withdrawal of funds by foreign banks increased in most CEB and SEE countries. Continued deleveraging is delaying the resumption of credit growth: as in previous quarters, real credit growth remained negative or near-zero across the CEB and SEE regions. In Turkey, EEC and Central Asia credit to the private sector continued expanding.

In countries with a positive credit growth, local-currency denominated loans have been the main driver (with a notable exception of Belarus). A number of CEB and SEE countries including Hungary, Poland, Bulgaria and FYR Macedonia also witnessed welcome growth in local currency lending, while deleveraging manifested itself primarily in a reduced volume of foreign currency credit (Chart 5). A number of factors contributed to this trend:

- Decreasing interest rate differentials due to lower inflation and increasing international risk appetite
- Stricter lending standards for foreign currency loans to unhedged borrowers (for example, in Poland)
- Greater reliance on domestic funding in the light of continued deleveraging
- Certain government-subsidised lending programmes (such as the Funding for Growth programme in Hungary which envisages zero-interest Central Bank funding to banks to on-lend to small and medium-sized enterprises). At the same time, such programmes may have distortive effects on allocation of capital in the economy.

Remittance flows

In contrast to capital flows, remittances flows into the region have been recovering strongly. Preliminary estimates for 2013 point towards a resumption of remittances growth into SEE countries, despite the weaknesses in the Eurozone (Chart 6). Notwithstanding a marked deceleration of the Russian economy, growth of remittances from Russia into EEC and Central Asian countries has also remained strong, in excess of 15 per cent, showing only a slight deceleration up to the third quarter of 2013. The growth of remittances may reflect a number of factors:

- Increased use of formal channels thanks to increased financial intermediation and lower cost of international transfers.
- Consumption smoothing motives and the tendency of remittances to rise when economic conditions in home countries worsen (irrespective of the situation in the source countries)

- Remittances sent through informal channels and saved entering official estimates with a delay, at the point when they are actually spent. An increase in official estimates in remittances may thus in part reflect drawing down of such savings during economic downturn.
- Comparative resilience of Russia's services and construction sectors, which are the main employers of migrants.

Outlook

Growth in the transition region is expected to recover modestly to 2.7 per cent in 2014 from 2.0 per cent in 2013. This is about the same as our November forecast for 2014, which stood at 2.8 per cent. The revision is largely driven by lower growth expectations for Turkey, mostly offset by expectations of a quicker recovery in the CEB region.

The external environment is expected to be improving slowly but will remain weak overall. The projections assume a slow and uneven recovery in the Eurozone and a deceleration in emerging markets, partly offset by a stronger outlook for the United States and Japan:

- Recent data point towards the return of growth in the single currency area, even though the headline number is likely to be negative for 2013 as a whole. Various policy decisions, including European Central Bank policies and steps towards the establishment of a banking union, have reduced the probability of a further substantial deterioration of the crisis.
- Growth has also picked up in the US, Japan and other advanced economies. Output in the US expanded at an annualised rate of over 4 per cent in the third quarter; employment has been steadily growing and is now only one per cent below the pre-crisis level, and consumer confidence is the highest since 2008. As the recovery takes hold and US monetary policy is gradually tightened, emerging markets are likely to continue receiving lower inflows of capital.
- Positive developments in the advanced economies are likely to be partially offset by the continued deceleration in major emerging markets. Growth in China slowed down to 7.7 per cent year-on-year in the first three quarters of 2013 and may decelerate further as the authorities put increased emphasis on rebalancing of the economy away from strong reliance on investment and net exports and towards domestic consumption.

Under the baseline scenario, the negative impact of the Eurozone crisis on the transition region should continue to decrease in magnitude, with stronger export demand, stronger remittances growth and milder contraction of cross-border lending. The global trade deal signed in Bali in December 2013, the first one since the establishment of the World Trade Organization in 1994, may over time give further boost to growth in the region and globally, provided the agreed trade facilitation measures are effectively implemented.

At the same time, growth in countries most closely integrated with the Euro area will remain modest. Given low domestic savings rates and underdeveloped local capital markets in CEB and SEE countries, the recent reduction in foreign funding is unlikely to be swiftly offset by funding from local sources. This constrains potential investment growth and hinders long-term growth prospects. In addition, cross-border bank deleveraging pressures may intensify further if the Eurozone-wide stress tests reveal significant recapitalisation needs of major banking groups operating in the CEB and SEE countries.

In the environment of greater differentiation among emerging markets, domestic policies will play a crucial role in supporting investor confidence and growth.

- Overall, the **CEB** region is expected to grow at 2.2 per cent this year. The rate of growth is thus expected to almost double compared with the rates seen in 2012 and 2013, as recovery finally takes hold in Croatia and gains momentum in Hungary, Poland and the Slovak Republic. At the same time, growth remains well below potential and Slovenia is expected to remain in recession under the burden of high indebtedness in the corporate sector and the additional need for bank recapitalisation.
- Recovery in **SEE** will continue but growth rates will remain modest overall. In Kosovo, the poorest economy in the region, growth is expected to reach 3.5 per cent.
- Economic growth in **Russia** will only partially recover in 2014, to 2.5 per cent. This assumes a moderate growth of government spending, including increased outlays on large public infrastructure projects. At the same time, structural reforms and improvements in the overall business environment are needed to boost investment and lift Russia's growth above 2.5 per cent per annum, the new official government estimate of the long-term potential growth rate.
- Growth in **EEC** is likely to accelerate. Ukraine is expected to exit recession after virtually no growth in 2012 and an output contraction in 2013. However, the economy's medium-term prospects remain highly uncertain given large external imbalances, which in the short term will be partly financed by the package agreed with Russia. Growth in other economies is expected at the level of 3 to 4 per cent with the exception of Belarus, where growth remains constrained by high external vulnerabilities.
- Growth in **Central Asia** will remain relatively strong owing to a number of large natural resource projects in Kazakhstan, Mongolia and Turkmenistan. Growth is expected to decelerate somewhat in the Kyrgyz Republic and Tajikistan on account of weaker demand and lower expected growth of remittances from Russia.
- Growth in **Turkey** is likely to moderate somewhat to 3.3 per cent in 2014. Recent and further monetary tightening and higher risk premia will increase the cost of finance and weigh on growth performance, while still high current account deficit (currently above 6 per cent of GDP) leaves the economy vulnerable to further shifts in global market sentiment. Nevertheless, domestic demand is still expected to grow, albeit at a slower pace, and net exports may benefit from the recent depreciation of the currency.
- The **SEMED** region is likely to grow somewhat faster in 2014. Growth is expected to accelerate to a still modest 3.0 per cent in 2014 but is subject to a high degree of uncertainty as all countries in the region remain vulnerable to external shocks.

Risks to the outlook

The economic outlook in the region remains highly sensitive to the developments in the Eurozone. In the (unlikely) downside scenario, the crisis would engulf larger members of the single currency area, resulting in insolvencies of several major banks in Europe. In response to these events, parent banks would accelerate withdrawal of funding from the region, exacerbating the credit crunch and triggering recession in much of the emerging Europe. This downside external scenario has remained largely unchanged since October 2011, but its perceived likelihood has been diminishing.

At the same time, the risks of faster deceleration in large emerging markets, and in particular in China, have increased. China now accounts for between one third and one half of world-wide increase in value added. The growth rate of the Chinese economy decelerated from 8-10 per cent over the past decade to 7.7 per cent in the first three quarters of 2013 and concerns are growing about rapid expansion of bank and non-bank credit since 2009 and the underlying quality of assets of financial institutions. A hard landing in China, or a marked deterioration of the situation in the Eurozone, would likely lead to prolonged market turmoil, a drop in commodity prices and a lower growth in advanced and emerging economies.

Risks of a fiscal impasse in the United States have diminished significantly. Two months after the October government shutdown, which lasted for two and a half weeks, a deal on the extent and composition of fiscal adjustment has been reached. It foresees a moderate "fiscal squeeze" of around 0.5 per cent of GDP in 2014.

A realisation of downside risks would affect countries in Central and south-eastern Europe through trade, financial, and commodity price channels. Exports would be depressed and financial flows disrupted to a much higher extent than under the baseline assumptions. A sustained drop in commodity prices would hit the economies of Russia and commodity exporters in Eastern Europe and Central Asia, with a knock-on effect on other CIS economies via lower remittances and subdued demand for exports.

Growth in real GDP

(In per cent; EBRD forecasts as of 16 January 2014)

	Current forecast			EBRD Forecast in October 2013			
	2012	2013	2014	2013	Change October-January	2014	Change October-January
Central Europe and the Baltic states							
Croatia	-2.0	-0.7	10	-0.8	0.1	15	-0.5
Estonia	3.9	12	2.8	12	0.0	2.5	0.3
Hungary	-17	12	17	0.5	0.7	12	0.5
Latvia	5.2	4.4	4.1	4.2	0.2	3.2	0.9
Lithuania	3.7	2.8	3.3	3.0	-0.2	3.5	-0.2
Poland	19	13	2.7	12	0.1	2.3	0.4
Slovak Republic	18	0.9	2.0	0.9	0.0	2.0	0.0
Slovenia	-2.5	-17	-2.0	-2.4	0.7	-2.5	0.5
Average [1, 2]	**1.2**	**1.1**	**2.2**	**0.9**	**0.2**	**1.9**	**0.3**
South-eastern Europe							
Albania	16	15	17	12	0.3	2.0	-0.3
Bosnia and Herzegovina	-0.5	0.8	18	0.1	0.7	18	0.0
Bulgaria	0.8	0.7	18	0.4	0.3	2.0	-0.2
FYR Macedonia	-0.3	3.0	3.0	2.4	0.6	2.7	0.3
Kosovo	2.5	2.5	3.5	2.5	0.0	3.5	0.0
Montenegro	-0.5	15	2.0	15	0.0	2.0	0.0
Romania	0.7	2.5	2.4	2.2	0.3	2.4	0.0
Serbia	-17	2.2	13	14	0.8	17	-0.4
Average [1]	**0.4**	**2.0**	**2.1**	**1.6**	**0.4**	**2.2**	**-0.1**
Eastern Europe and the Caucasus							
Armenia	7.1	2.5	3.5	2.5	0.0	3.5	0.0
Azerbaijan	2.2	5.5	3.5	4.5	10	3.5	0.0
Belarus	17	0.9	10	0.5	0.4	10	0.0
Georgia	6.2	2.5	4.5	2.0	0.5	4.0	0.5
Moldova	-0.7	8.0	3.5	3.5	4.5	3.5	0.0
Ukraine	0.2	-0.8	15	-0.5	-0.3	15	0.0
Average [1]	**1.3**	**1.2**	**2.0**	**1.0**	**0.2**	**2.0**	**0.0**
Turkey	2.2	3.7	3.3	3.7	0.0	3.6	-0.3
Russia	3.4	13	2.5	13	0.0	2.5	0.0
Central Asia							
Kazakhstan	5.0	6.0	5.5	5.6	0.4	5.5	0.0
Kyrgyz Republic	-0.9	10.5	5.0	6.5	4.0	5.5	-0.5
Mongolia	12.3	13.0	14.0	13.0	0.0	14.0	0.0
Tajikistan	7.5	7.4	5.0	7.1	0.3	5.0	0.0
Turkmenistan	11.1	10.2	10.2	10.0	0.2	10.0	0.2
Uzbekistan	8.2	7.7	7.0	7.7	0.0	7.0	0.0
Average [1]	**6.4**	**7.1**	**6.5**	**6.7**	**0.4**	**6.5**	**0.0**
Average EBRD region (excluding SEMED) [1]	**2.6**	**2.1**	**2.8**	**2.0**	**0.1**	**2.8**	**0.0**
Southern and Eastern Mediterranean							
Egypt	2.2	2.1	2.5	2.1	0.0	2.5	0.0
Jordan	2.7	2.9	3.4	3.0	-0.1	3.4	0.0
Morocco	2.7	4.4	4.0	4.8	-0.4	4.0	0.0
Tunisia	3.7	2.9	3.8	3.2	-0.3	4.0	-0.2
Average [1, 3]	**2.5**	**2.7**	**3.0**	**2.8**	**-0.1**	**3.1**	**-0.1**
Average EBRD region (including SEMED) [1]	**2.6**	**2.0**	**2.7**	**2.0**	**0.0**	**2.8**	**-0.1**

[1] Weighted averages. The weights used for the growth rates are WEO estimates of nominal dollar-GDP for 2012.

[2] Weighted averages do not include the Czech Republic, for which EBRD no longer produces a forecast.

[3] As of January 2014, EBRD figures and forecasts for Egypt's real GDP reflect the fiscal year, which runs from July to June. For ease of comparison, the figures displayed reflect what the SEMED average would have been using fiscal-year rates in the October 2013 forecasts.

Chart 1. Non-performing loan ratio
(%)

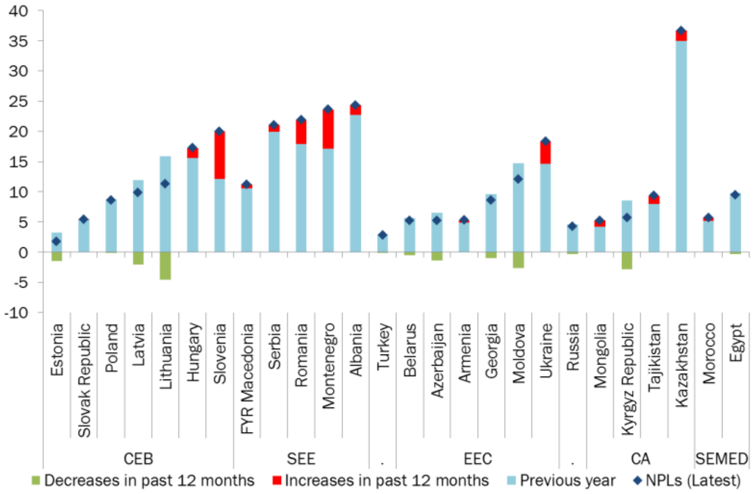


Chart 2: Long-term unemployment rates
(%)

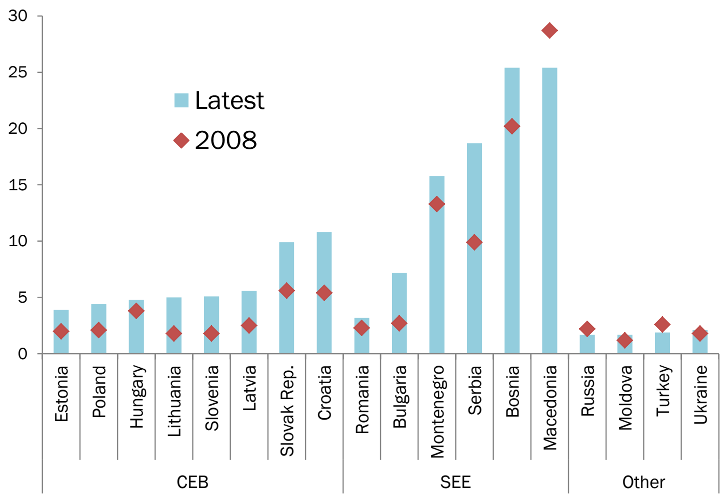


Chart 3. US treasury yields and EM currencies

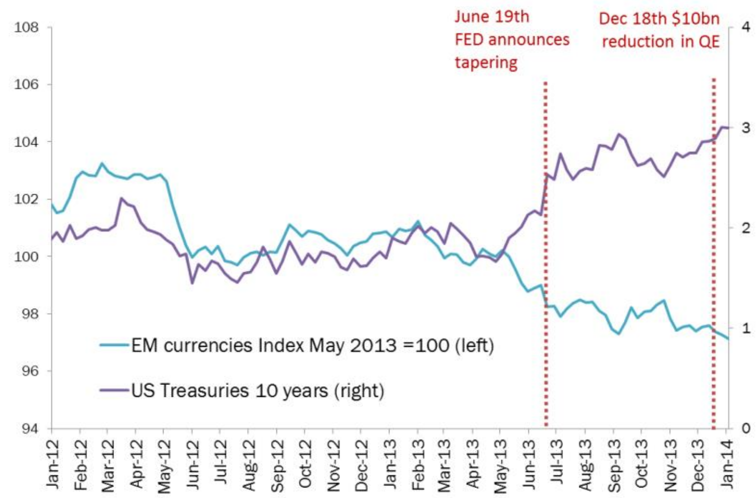


Chart 4. Private capital flows
(% of 2012 GDP)

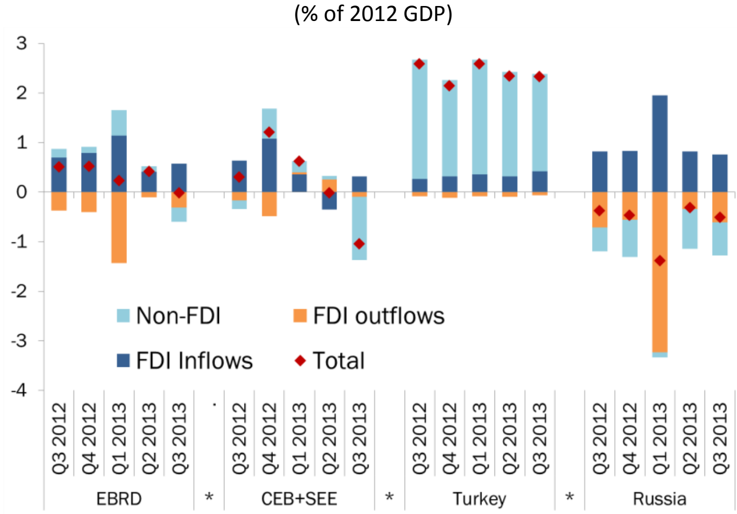


Chart 5. Real credit growth
(year-on-year, %)

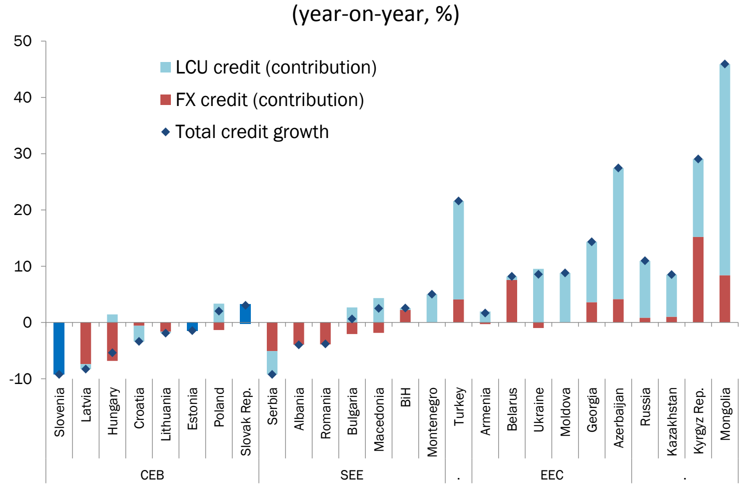
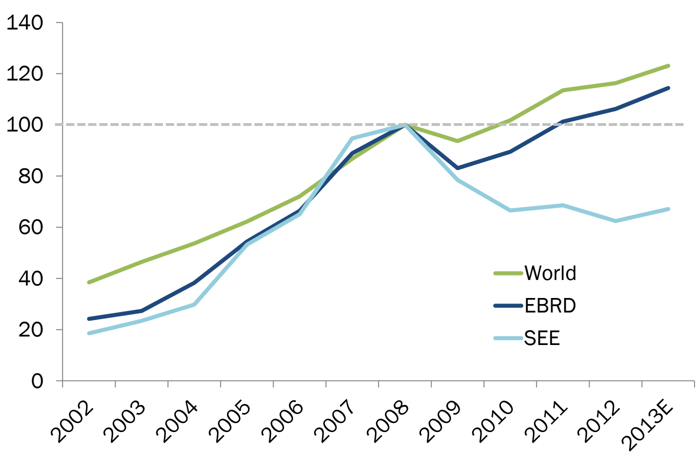


Chart 6. Migrant remittance inflows[2]
(index 2008=100)



2 World Bank estimates of migrant remittance inflows. 2013 figures are preliminary estimates.

Central Europe and the Baltic States (CEB)

Growth is picking up in the central European and Baltic states but remains generally modest, with projected growth rates of 1.1 per cent and 2.2 per cent in 2013 and this year respectively, well below potential. Key economies, Poland and Hungary, benefit from highly supportive monetary policies (in the case of Hungary augmented through a substantial central bank scheme of concessional lending to the corporate sector), and improving trends in labour market conditions and incomes. Growth remains predominantly export-driven and relies on participation in global production chains. As a result industrial production has shown notable strength, for instance in Poland (with likely over 5 per cent growth in 2013). Consumption has made a more significant contribution in recent quarters. In contrast, investment has continued to contract, though at a reduced rate.

- **Poland** appears to have overcome growth weakness of early 2013 and the third quarter of the year confirmed that growth had recovered to about 2 per cent in annual terms, with export volume growth and industrial production likely to record growth of 5 and slightly over 1 per cent, respectively. This has led to a recovery in private investment which made a substantial contribution to growth towards the end of the year. Short-term indicators of retail sales and consumer confidence point to a broader recovery supported by domestic consumption taking shape this year, underpinned by sustained real wage growth. The wide-ranging changes to Poland's pension system were adopted into law in January 2014 and will considerably lift debt and deficit constraints of the government, though the impact on local capital market development remains ambiguous. Nevertheless, public investment remains a drag on growth, as the government moves into the new phase of EU structural funds, and the government-sponsored growth fund is yet to make a noticeable impact.

- **Hungary** recorded a higher than expected annual growth rate of 1.8 per cent in annual terms in the third quarter of last year. This was driven by a surge in net exports and public investment. Much-improved conditions for agriculture last year provided a further boost. Further across-the-board cuts in utility tariffs should continue to underpin real disposable income and consumption ahead of the elections this spring, but the longer-term consequences for investment in the sector may well be negative. In light of the very substantial policy support to growth – in particular in the form of the central bank's scheme of subsidized credit to SMEs, and the rapid monetary easing - we upgrade our growth outlook for this year to 1.7 per cent. Over the medium term, we expect that the adverse legal, investment and financial environment have materially depressed trend growth.

- In **Slovenia** the recession moderated somewhat in the third quarter of 2013. Economic activity stagnated compared to a quarter earlier, and showed a less-than-expected decline of 0.6 per cent in annual terms as stronger export growth resumed. Results of a comprehensive bank asset quality review and stress tests were announced in mid-December, and revealed substantially higher NPLs and additional capital requirements of about 13 per cent of GDP in the key banks. While the government can meet the capital injections required for state-controlled banks from its liquid resources and the need to resort to outside financial assistance has been averted for the time being, adjustments in the banking sector will likely continue to weigh on private sector activity. Under EU state aid rules the two largest banks will need to engage in considerable deleveraging, and foreign bank subsidiaries are likely to continue to withdraw funding at a high pace. Comprehensive corporate debt restructuring is encouraged through a new legal framework, though given extensive cross-ownership linkages, this will further weigh on domestic investment sentiment. Domestic consumption remains similarly depressed and the repair of bank balance sheets will extend the recession well into 2014. Yet, the better than expected export performance leads us to moderate our expectation for contraction in both 2013 and this year.

- In the **Slovak Republic** growth expectations remain unchanged, with the 2 per cent growth forecast for 2014 remaining well below the more buoyant export-led growth seen in 2010-11. Gross investment continued to contract in 2013, falling by almost 8 per cent in the first three quarters compared to a year earlier. Investment in foreign-invested manufacturing firms will remain muted, though private and public infrastructure investment may recover somewhat. To date, private income growth and consumption have remained dampened by persistent high unemployment (which remained 14 per cent in August).
- All three **Baltic economies** witnessed a growth deceleration in 2013, though Latvia and Lithuania remained the top performers in the EU with estimated growth rates of 4.4 and 2.8 per cent, respectively. Estonia saw a sharper deceleration to only 1.2 per cent as a number of public investment projects came to an end, and the slowdown in key export markets such as Russia and Finland showed its impact. All three economies should be well poised to benefit from the slight recovery in European import demand and industrial production, and will further benefit from gains in export market shares. All will continue to see robust increases in incomes and private consumption, making growth reasonably well balanced. Latvia's adoption of the euro this month should further bolster sentiment of domestic and foreign investors, and modestly ease financing costs. There have been minor revisions to forecasts for Lithuania and Estonia, though a more marked upgrade to 4.1 for Latvia in 2014, given the performance evident late last year.
- The recession in **Croatia** that took hold in 2009 persisted throughout 2013, as the economy continues to struggle with long-standing problems of competitiveness, a large public sector and problems with the business environment. The rate of annual growth in the third quarter of 2013 was -0.6 per cent, a slight improvement on the previous two quarters (-1.5 and -0.7 per cent in the first and second quarters, respectively) but prospects for this year are still uncertain, with only a modest return to growth expected. However, EU membership should enable the country to benefit from full access to the single market and to substantial EU funds.

South-Eastern Europe (SEE)

The year 2013 saw a pickup in growth in SEE but growth for the region as a whole was just 2 per cent, as domestic demand remains subdued and foreign direct investment flows to the region continue to lag well behind levels seen in the pre-crisis years. Several countries in the region face big fiscal challenges, as the combination of weak growth and the failure to rein in public expenditure has led to rising fiscal deficits and public debt levels. In the financial sector, deleveraging pressures persist and the level of non-performing loans is close to, or has exceeded, 20 per cent of total loans in several cases. On the more positive side, exports are performing well in most cases, boosted by slightly improved economic performance in the Eurozone and increasing access to non-EU markets. Harvest was strong across the region. Inflation is low in all countries and has come down significantly in both Romania and Serbia to below-target range (in both countries it had been for some time above the central bank's target). A good agricultural season has contributed to lower food prices in the region. However, progress in deeper structural reforms remains hesitant throughout the region.

- Economic activity in **Albania** remained subdued throughout 2013. The anaemic growth performance reflects primarily the extent of difficulties in the eurozone and particularly in periphery countries that are Albania's major economic partners, but also home-grown problems related to weak corporate balance sheets and accumulation of government arrears have also played roles. Public debt is now above 60 per cent of GDP and still rising, and financial sector vulnerabilities are evident with NPLs of around 25 per cent of total loans. The new government has committed to tackle investment climate improvements, and an agreement has been reached with the IMF at staff level on a new programme, which should help anchor fiscal stability. Only a mild increase in growth is forecast for this year as expected fiscal tightening under a new IMF programme will dampen the positive growth contributions from the continued recovery in both domestic and external demand.

- **Bosnia and Herzegovina's** economy emerged from recession with GDP growth estimated at 0.8 per cent in 2013. The country's economic and political reform programme is stalled and relations with the EU are at a standstill, which jeopardises further EU funding. At the same time, the authorities have shown a commitment to targets agreed under the IMF Stand-By Arrangement, approved in September 2012, with four reviews completed so far. Economic recovery is expected to continue in 2014 on the back of strong export growth and a pick-up in domestic consumption. The EU's freeze on IPA funds for BiH, however, could have negative implications on investment this year. The highly challenging political environment presents further downside risks to the baseline growth scenario.

- The economy in **Bulgaria** showed few signs of a sustained recovery in 2013. Export performance continued to improve but weak internal demand means that growth in 2013 is likely to have been slightly lower than the 0.7 per cent growth recorded in 2012. On the positive side, the fiscal deficit is under control and public debt is among the lowest in the EU. Inflation remains low but this reflects to some extent the series of cuts in utility prices over the past year, which could have negative implications for future investment in the sector. Growth is expected to pick up this year to about 1.8 per cent driven by exports and some recovery in domestic private consumption.

- Economic performance has improved in **FYR Macedonia** in 2013. Output grew on average by 3.4 per cent year-on-year over the first three quarters of 2013 driven primarily by continued strong rise in investment as well as some recovery of exports. Consumption meanwhile continues to be a drag on growth. Inflation has fallen in 2013 and the country continues to make strong efforts to attract much-needed FDI. These efforts should help growth prospects in the coming years. Growth will remain strong at about 3 per cent in 2014 on the back of expected robust growth in exports as well as domestic consumption and investment.

- Economic growth in **Kosovo** in 2013 continued to be among the highest in the region at an estimated 2.5 per cent, but the country also remains the poorest in SEE, with unemployment and poverty at elevated levels. The macroeconomic environment is stable, assisted by an IMF Stand-By Arrangement. The economy is expected to grow at 3.5 per cent this year supported by strong remittance inflows and a pick-up in external demand.

- In **Montenegro**, economic activity picked up in the first half of 2013 especially on the back of recovering exports. However, the current account deficit at close to 20 per cent of GDP remains the highest in the region. The fiscal position has been weakened by payment of guarantees for the aluminium company, KAP, and public debt levels have risen sharply in recent years. Growth in 2014 is forecast to increase to 2.5 per cent in 2014 on account of improvements in both external and domestic demand.

- Economic activity in **Romania** has improved in 2013. GDP rose by 2.8 per cent year-on-year in the first nine months of the 2013, mainly on account of a strong export performance and the recovery in the agricultural sector. Inflation returned to the central bank's target range of 2-4 per cent, and fell further to 1.3 per cent year-on-year in November 2013. Fiscal performance has also been good and the country exited the European Commission's excessive deficit procedure in 2013. However, growth prospects in the short term continue to be constrained by a weak Eurozone. Growth is expected to remain strong at 2.4 per cent in 2014 driven by exports and a pick-up in domestic demand. However, the high level of NPLs (over 20 per cent of total loans) and ongoing cross-border deleveraging may weigh down on growth prospects in the near term by constraining the credit recovery.

- **Serbia**'s economy has recorded both positive and negative developments in 2013. Data from the first nine months of the year indicate that an export-led recovery was taking place, with GDP rising by over 2 per cent year-on-year in the first three quarters of 2013. Exports are growing strongly, boosted by the revival of the car industry, and the agriculture sector has also had a good harvest. Inflation has fallen significantly in recent months and is now below the central bank's target zone (1.3 per cent year-on-year as of November 2013, compared with a target range of 2.5 - 5.5 per cent). However, the country has major fiscal problems, with a government deficit estimated at between 7 and 8 per cent of GDP in 2013 and public debt having exceeded 60 per cent of GDP and still rising. NPLs are around 20 per cent of total loans and also constitute a significant vulnerability for the banking sector and the economy as a whole. Exports will continue to be the main growth driver in 2014. Meanwhile, consumption will remain subdued, in large part due to continued tightness in domestic credit markets (credit growth has been negative throughout H2 2013; NPLs are over 20 per cent of total loans), and the necessary fiscal retrenchment expected over the coming year. As a result growth this year at 1.3 per cent will be somewhat weaker than in 2013.

Turkey

Economic activity in Turkey picked up in 2013, following a sharp slowdown in 2012. Despite political uncertainty and global shifts in sentiment during the summer, the economy expanded at a steady pace in the third quarter of 2013. This was primarily driven by domestic demand, boosted by the expansionary monetary and fiscal position since late 2012. While government spending slowed sharply in the third quarter after having been an important driver of growth in the first half of the year, private-sector investment grew for the first time since the fourth quarter of 2011. However, growth prospects for the fourth quarter of 2013 have dimmed. While necessary to contain inflation pressures, the recent tightening by the central bank is expected to have moderated economic activity in the last quarter of 2013, as evidenced by leading indicators, and overall growth is expected to reach 3.7 per cent in 2013.

Recent elevated political uncertainty coupled with the Fed's decision to begin tapering off its quantitative easing programme in December, has renewed pressure on the currency and increased the risk premium facing the country. The Turkish lira depreciated about 6 per cent in the last two weeks of December, making it one of the worse performing currencies in a year that saw it lose about 20 per cent of its value against the dollar. Meanwhile, an increase in the risk premium has pushed the yield on Turkey's 10-year benchmark bond into the double digits, increasing the cost of finance.

Growth is expected to moderately slow in 2014. While net exports may benefit from the renewed depreciation, the recent and further tightening by the central bank and the introduction of legislation curtailing credit card spending are expected to constrain consumption and investment activity in 2014. The higher cost of finance stemming from elevated risk premia and necessary policy tightening will weigh on growth in 2014, which is expected at 3.3 per cent. Meanwhile, average annual inflation reached 7.4 per cent in 2013, above the central bank's target of 5.5 per cent, and is expected to remain elevated above the target in 2014 at 7.3 per cent, driven by the recent tax hikes and currency depreciation passing through to inflation, and less favourable base effects of food and energy prices.

Large external imbalances remain the key vulnerability, with the current account deficit still above 6 per cent of GDP, leaving Turkey exposed to further shifts in global market sentiment. Turkey continues to have persistently large external financing requirements and is heavily reliant on short-term foreign borrowing and volatile portfolio inflows to meet those requirements. A further weakening or a reversal of capital flows would bring additional challenge for the Turkish economy. Another downward risk to the outlook stems from a continuation of political uncertainty at the high levels seen recently throughout the long election cycle over the next year. On the other side, a quick political stabilisation would help consolidate financial condition and confidence and boost domestic demand.

Eastern Europe and the Caucasus (EEC)

Growth trends in the region have diverged in the past year. Growth in Moldova and Azerbaijan accelerated in 2013 benefiting, respectively, from a good harvest and from policy-induced stimulus. Ukraine remained in recession. The economies of Armenia, Belarus and Georgia slowed down significantly due to subdued investment activity and weakening consumer spending growth. External demand improved for Moldova and the three countries of the South Caucasus whereas Ukraine and Belarus saw their export markets weakening. We expect growth rates across the region to somewhat converge in 2014 as last year's laggards will demonstrate modest recovery while growth leaders will slow down to a lower path.

- **Armenia's** economy slowed down considerably in 2013 hit by the contraction of private and public investments and a halt in real consumer spending growth, which was affected by the hike in energy tariffs. Remittances, which had been growing fast in the first nine months of 2013, started to slow down by the end of the year, likely reflecting a certain cooling of construction activity in Russia. These late-2013 developments impacted upon the annual 2013 growth rate, which we estimate at approximately 2.5 per cent. At the same time, closer ties with Russia, progress on structural reforms and planned capital and social spending increases may spur growth to 3-4 per cent in 2014.

- **Azerbaijan's** economy accelerated in 2013, boosted by the pre-election fiscal and monetary stimulus. Oil output stabilized in 2013 after two years of decline, while the non-oil sector expanded at near double-digit rates, benefiting from increased public spending and expansion of credit. The government's plans to curb stimulus by shrinking the non-oil consolidated fiscal deficit in 2014 could potentially lead to growth in 2014 in the range of 3-4 per cent.

- Growth in **Belarus** remained lackluster in 2013 reflecting a fall in exports, volatile economic policies and a lack of structural reforms, which is hindering competitiveness. Although the export outlook may improve in 2014 on the account of the trade relations with Russia and of the moderate devaluation of the currency in 2013, domestic demand will likely slow down as and when the authorities tighten macroeconomic policies to reduce vulnerabilities. External risks, which had been rising throughout the last year, eased somewhat after Russia's pledge to provide to Belarus a loan which could cover a major portion of the public external debt repayment in 2014. Our 2014 growth outlook for Belarus remains at 1 per cent.

- In **Georgia**, after a significant growth slowdown in the first nine months of 2013, early signs of the rebound emerged towards the year-end. Weak domestic demand was countered by an acceleration of exports growth as demand from the EU strengthened and Russia continued to reopen access of Georgian foodstuffs to its market, resulting in a sizable drop in the current account deficit. Lower political uncertainty following October's elections, coupled with prospects of the Association Agreement with the EU and of the improvement of trade relations with Russia, have paved the way to recovery in domestic demand, already evident in some pick-up in credit growth. Our outlook for Georgia is thus moderately upgraded to 4.5 per cent in 2014.

- **Moldova's** economic growth increased in the third quarter of 2013, supported by a rebound in harvest and continued expansion in manufacturing and trade. Investment activity, however, remained subdued, aggravated by a weak business environment and poor corporate governance in banks. Remittances were growing steadily in the first nine months of the year, although some signs of a slowdown emerged by year-end. Given the one-off nature of the positive growth shock in 2013 and volatility in growth rates, short-term prospects are uncertain. The evolution of remittances and external demand for Moldovan products will be crucial in 2014. Investor confidence will depend on the completion of reforms related to the signing of the Association Agreement with the EU.

- In **Ukraine**, the economy has been in a shallow recession since the second half of 2012, due to the decline in traditional exports, the contraction of private and public investments, and weakening growth in consumer spending. Lower external demand, some temporary trade restrictions by the main trading partner country, and subdued steel and other commodity prices have led to a broad contraction in the industrial sector. Investment activity and construction remain subdued, affected by tight monetary conditions, an unfriendly business environment and more recently social unrest and political uncertainty. Short-term external pressures have been relieved for the time being by Russia's pledge to cut gas prices for Ukraine by one-third and to provide loans of US$ 15 billion, amounting to a total package of about U$20 billion. The announced cuts in domestic gas tariffs and possible fiscal and monetary loosening in the run-up to the March 2015 presidential elections may provide a short-lived boost to the economy. In the absence of comprehensive structural fiscal transformation such policies could exacerbate the vulnerability of the stretched public finances and lead to greater macroeconomic volatility over the medium term. Any boost to growth from the deal with Russia would likely be offset by the deterioration of private investment. In light of these uncertainties, we leave our 2014 growth forecast for Ukraine unchanged at 1.5 per cent.

Russia

Economic growth remained subdued in 2013. After growing at the rate of 3 to 5 per cent in 2010-12, the economy slowed down in the first quarter of 2013, growing at 1.6 per cent year-on-year. In the second and third quarters output increased by only 1.2 per cent year-on-year.

A number of factors contributed to the deceleration. The external environment remains difficult, as growth in the Eurozone, Russia's key trading partner, is estimated to have been negative in 2013 as a whole and the price of oil, Russia's dominant export, has declined in year-on-year terms for the first time since the 2008-09 crisis (Urals brand oil was around three per cent cheaper on average in 2013 compared with 2012). Further, the post-crisis recovery effect has subsided over time while investment activity has remained subdued, resulting in capacity constraints becoming binding on the supply side. Against this background, the Ministry of Economic Development revised the official forecast for the average long-term economic growth rate from 4 per cent to 2.5 per cent per annum.

Net private capital outflows persisted. They fell somewhat from US$ 81 billion in 2011 to US$ 54 billion in 2012 (around 3 per cent of GDP), but the rate of outflow picked up again in the first nine months of 2013 (to US$ 48 billion). The outflows and a relatively subdued investment activity may in part reflect concerns about the quality of the overall business environment and effective cost of investment. Against the background of higher capital outflows from emerging markets more generally and lower current account surpluses, the rouble has weakened somewhat against the basket of the euro and the US dollar. Inflation has remained relatively high, at around 6.5 per cent year-on-year.

The slowdown led to mounting pressures to increase government spending. A new fiscal rule, which came into force in 2013, was designed to make fiscal policy more conservative by linking budget expenditure to the average historical oil price calculated over a number of years. The rule might now be relaxed, and part of the savings in the National Welfare Fund has been earmarked to finance selected infrastructure projects in the run-up to the 2018 FIFA World Cup as well as to purchase Ukraine's Eurobonds.

GDP growth is expected to pick up to only 2.5 per cent in 2014. Russia's medium-term outlook remains dependent on commodity prices, particularly oil and gas, while the growth potential has declined due to low investment and productivity in a generally weak business environment.

Central Asia

In most of Central Asia, economic growth remained relatively strong, albeit weaker than in recent years. The deceleration reflects a more difficult external environment, particularly weaker growth in Russia, and flattening of commodity prices. The slowdown in Russia may have a further negative impact on growth in this region, mainly through the impact on remittance flows, which have so far continued growing. At the same time, certain delays notwithstanding, large natural resource exploration projects remain broadly on track throughout the region, and are expected to make a sizable contribution to growth over the medium term.

- In **Kazakhstan,** GDP growth slowed from 7.5 per cent in 2011 to around 5 per cent in 2012 owing to the more difficult external environment. Growth then picked up to an estimated 6 per cent in 2013 on the back of strong investment growth. It is expected to remain around this level in 2014, supported by an expansion of oil output. The banking sector remains weak, suffering from overhang of non-performing loans (in excess of 30 per cent of total loans). Inflation has slowed down somewhat, to 4.8 per cent in December 2013, and remains broadly within the targeted range.

- In the **Kyrgyz Republic,** growth rebounded strongly after a disruption at the Kumtor gold mine in early 2012. It is estimated to have reached 10.5 per cent in 2013, reflecting the base effect, and is expected to moderate to 5 per cent in 2014. Inflation picked up from around 2 per cent in August 2012 to 8 per cent in summer 2013 but has now moderated to 4.8 per cent due to the slowdown in food prices.

- In **Tajikistan**, GDP growth remained strong at 7.5 per cent in 2012 and an estimated 7.4 per cent in 2013. It is expected to moderate somewhat to 5 per cent in 2014 on account of slowing remittances, which come mainly from

Russia. Moreover, the growth outlook in Tajikistan is particularly uncertain given weaknesses in the banking system. Inflation declined from 7 per cent in the beginning of the year to 3.4 per cent in November 2013 due to almost flat food prices.

- **Turkmenistan** continues to experience a strong economic expansion with GDP growth of 11.1 per cent in 2012 and an estimated 10.2 per cent in 2013, driven by large public construction projects and increased gas exports to China. GDP growth is expected to reach 10 per in 2014, as a new gas field comes on stream, and remain strong over the medium term, supported by exploration of Turkmenistan's abundant gas reserves and further diversification of gas export routes.

- **Uzbekistan's** GDP growth remained strong at 8.2 per cent in 2012 and 8.1 per cent in the first nine months of 2013. It was driven by a combination of increases in public spending, diversification of gas export routes and accommodating monetary conditions. Growth is expected to slow down somewhat to around 7 per cent in 2014.

- **Mongolia** continued to benefit from a mining boom, and in July 2013 the first commercial shipments of copper concentrate departed from Oyu Tolgoi, expected to become one of the world's largest copper mines. The economy grew at the rate of 11.5 per cent year-on-year in the first nine months of 2013, notwithstanding weaker external demand, decreases in prices of key commodities and delays at key mining projects. Growth is projected to reach 14 per cent in 2014, as the first phase of Oyu Tolgoi comes fully on stream. Inflation remained relatively high, at around 12 per cent at end-November 2013 reflecting expansionary fiscal policy and higher import prices.

Southern and Eastern Mediterranean (SEMED)

The SEMED economies continue to face adverse conditions, amid regional turmoil, a weak external environment, and a heightened political uncertainty in a number of countries. The increased government spending on social benefits and subsidies in response to rising social pressures since 2011 has exacerbated fiscal deficits, which remain high across the board. However, SEMED countries have taken some positive steps towards reforming expensive subsidy schemes, in particular by raising some energy prices. In the meantime, pressures on the balance of payments continue to persist. IMF programmes in place in Jordan, Morocco, and Tunisia continue to provide buffers against any further deterioration of external conditions while in Egypt the GCC financial support has eased immediate financing concerns. Meanwhile, implementing comprehensive reform programmes to restore macroeconomic stability remains challenging in the SEMED countries, as this requires a broad buy-in from key stakeholders, which has proved difficult to secure during complex political transitions. Growth for the region as a whole has been muted in 2013, and expected to pick up modestly in 2014. In Egypt and Tunisia, economic performance is primarily dependent on the unravelling domestic and political situation. In Jordan and Morocco, the external environment will be a key factor in economic recovery.

- The recent financial assistance from the Gulf countries has eased immediate financing concerns in **Egypt**. The receipt of the financial assistance package of US$15 billion by the Saudi Arabia, UAE and Kuwait, following the ousting of

President Morsi in July, has provided the government some breathing space, helping to shore up reserves, ease pressure on the currency, and finance parts of the fiscal deficit. This has prompted S&P to raise Egypt's sovereign credit rating by one notch to B-, with a stable outlook. The financial support has also allowed the government to announce a stimulus plan of US$4.3 billion (1.6 per cent of GDP), mostly directed to infrastructure projects. Meanwhile, macroeconomic fundamentals remain weak, and key structural reforms are still needed to boost growth prospects. Output grew by just 2.1 per cent in fiscal year 2012-13 (which runs from July to June), and forecasted to increase by 2.5 per cent in fiscal year 2013-14. Risks to the outlook remain tilted to the downside and are mostly associated with the domestic political situation.

- Economic developments in **Jordan** remain weak amid continued regional turmoil. The conflict in Syria has disrupted trade and resulted in an influx of over half a million refugees (estimates including nonregistered refugees are higher), and continues to strain public services and labour market conditions. In addition, natural gas inflows from Egypt have been severely disrupted since 2011, resulting in imports of expensive fuels, and leading to a significant deterioration of Jordan's fiscal and current accounts. Leading indicators continue to reflect weak economic activity as indicated by the subdued dynamics of industrial production and tourism. GDP is expected to gradually recover in the near-term, with output growth projected at 2.9 per cent in 2013 and 3.4 per cent in 2014.

- Output in **Morocco** continued to improve in 2013, with real GDP growth reaching 4 percent in Q3. This mainly comes on the back of the continued rebound in the agricultural sector (which accounts for around 13 per cent of GDP and 40 per cent of employment) while growth in non-agricultural production slowed. Economic growth is expected to reach 4.4 per cent in 2013, but is expected to slow to 4.0 per cent in 2014 as agriculture growth normalizes. Meanwhile, inflation remains under control, and Morocco enjoys the lowest rate in SEMED. Downside risks to the outlook mainly emanate from external factors related to the recovery of the Eurozone. A period of prolonged stagnation in the euro area would depress growth prospects, mostly through their impact on exports, tourism, and remittances.

- In **Tunisia**, recent political and security turmoil has impacted economic performance. Real GDP slowed to 2.7 per cent in the third quarter of 2013, down from 3.2 per cent in the second quarter. The slowdown reflects weaker domestic and external demand, and the adverse impact of continuing social unrest on production, especially in the mining and energy sectors. Heightened political uncertainty has dampened business confidence and further weakened domestic private investment. Renewed protests and labour strikes have disrupted activity in tourism and manufacturing which were key growth drivers in the second quarter. As a result, overall growth is expected to reach only 2.9 per cent in 2013. The balance of payments remains under pressure, on the back of weak export earnings from the mining and energy sectors as well as depressed tourist receipts. The recent resolution of the political crisis could instil some stability which would help the growth rate reach 3.8 per cent in 2014.

Table 1. Transition Region: Vulnerability Indicators 1/

	Public and External Debt /2 (% of GDP) Government (end 2012)	External: Total (end 2012)	External: Private (end 2012)	External: Short term (remaining maturity)	Gross reserves /2: billions US$ (latest)	Gross reserves /2: in percent of GDP	Gross reserves /2: in percent of Short term debt	Gross reserves /2: month of prosp. Imports	Bank dep. (latest): % of GDP	Loans/dep. (latest): Private sector, in %	Country risk: 16-Jan-14 (CDS spread, bps)	Country risk: Latest S&P sovereign country ratings	Country risk: Latest Fitch sovereign country ratings	Domestic FX loan stocks (latest) (% GDP): Total pvt sector	Domestic FX loan stocks: of which Corp.	Domestic FX loan stocks: of which HH	% FX credit in total loan stock	Nonperforming loans /3: latest	Unem-ployment: % (latest avail.)
Central Europe and Baltics																			
Croatia	53.7	104.5	79.9	33.4	17.5	31.0	92.7	8.5	68.1	110.4	326.1	BB+	BB+	54.2	25.1	29.2	74.7	14.4	18.0
Estonia*	10.1	90.8	83.5	51.4	…	…	…	…	51.8	150.4	…	AA-	A+	1.0	1.0	0.0	1.3	1.8	9.0
Hungary	79.8	130.3	73.6	29.4	47.2	37.5	127.7	5.0	41.3	118.7	226.5	BB	BB+	25.6	12.3	13.3	51.9	17.3	9.5
Latvia	40.6	139.8	106.7	60.2	7.5	26.6	44.2	4.7	35.4	169.8	113.8	BBB+	BBB+	49.0	24.3	24.7	86.5	9.9	12.0
Lithuania	40.5	73.3	36.5	33.0	7.9	18.8	56.8	2.5	37.8	120.1	…	BBB	BBB+	33.4	17.5	15.9	72.2	11.3	11.3
Poland	55.6	74.4	43.7	20.6	102.9	21.0	101.9	5.4	46.3	110.1	76.0	A-	A-	15.1	3.8	11.3	29.8	8.6	10.2
Slovak Republic*	52.4	77.2	34.8	30.6	…	…	…	…	49.3	97.4	78.9	A	A+	0.2	0.2	0.0	0.4	5.4	14.0
Slovenia*	54.4	115.6	59.6	29.4	…	…	…	…	53.2	141.9	…	A-	BBB+	3.0	0.5	2.5	4.1	14.6	9.9
South-Eastern Europe																			
Albania	61.4	38.3	10.7	3.2	2.7	21.4	660.6	6.3	69.5	57.0	…	B+	…	24.2	18.5	5.7	61.6	24.3	12.8
Bosnia and Herzegovina	44.3	52.6	24.3	13.7	4.7	27.2	197.7	5.0	44.4	132.1	…	B	…	39.0	21.4	17.6	67.4	14.9	28.0
Bulgaria	18.5	97.2	88.5	35.3	17.8	35.0	99.1	5.8	67.5	105.6	123.7	BBB	BBB-	42.0	32.7	9.3	60.9	17.2	12.9
FYR Macedonia	34.0	70.7	48.6	27.8	2.5	25.7	92.7	3.7	52.6	93.8	…	BB-	BB+	25.7	16.2	9.5	…	11.2	28.7
Kosovo	17.0	15.6	…	…	1.3	19.8	…	4.2	42.2	82.2	…	…	…	…	…	…	0.8	7.5	30.9
Montenegro	51.9	108.4	68.9	…	0.5	11.9	…	2.1	56.1	100.4	…	BB-	…	…	…	…	…	23.6	15.0
Romania	38.2	77.3	50.1	28.6	44.1	26.0	91.0	6.8	33.1	115.6	180.1	BB+	BBB-	22.6	10.9	11.7	61.2	22.0	7.3
Serbia	61.8	88.1	46.3	13.8	13.4	34.8	252.1	6.7	43.4	125.4	…	BB-	BB-	38.5	26.2	12.4	72.6	21.1	20.1
Eastern Europe and the Caucasus																			
Armenia	38.9	77.0	38.8	5.4	2.0	20.4	375.8	4.7	24.5	163.9	…	…	BB-	24.8	19.4	5.4	62.8	5.3	5.9
Azerbaijan	11.6	17.0	7.8	…	14.2	20.6	…	8.7	17.0	148.1	…	BBB-	BBB-	7.2	4.0	3.2	28.6	5.2	5.4
Belarus	41.9	55.1	31.9	29.2	4.7	7.4	25.5	1.2	28.4	160.6	…	B-	…	23.5	23.4	0.0	49.6	5.2	0.5
Georgia	32.3	85.2	36.0	17.6	3.0	19.1	109.0	4.0	35.3	109.4	…	BB-	BB-	22.9	12.1	10.8	62.9	8.6	15.0
Moldova	23.9	84.6	61.1	33.7	2.8	38.7	114.9	5.0	48.9	85.2	…	…	…	17.6	17.3	0.4	40.4	12.1	3.9
Ukraine	37.4	76.6	58.4	35.2	17.1	9.7	27.6	2.1	44.0	129.0	712.8	B-	B-	20.4	15.4	4.9	35.6	18.4	6.2
Turkey	36.2	42.8	29.7	18.7	114.3	14.5	77.4	5.1	46.2	106.0	236.1	BB+	BBB-	19.4	19.4	0.0	27.7	2.8	9.7
Russia	12.5	28.6	25.9	7.8	474.9	23.4	298.6	12.4	43.8	126.4	157.7	BBB	BBB	7.0	6.6	0.4	13.1	4.3	5.5
Central Asia																			
Kazakhstan	12.4	67.6	64.9	7.0	17.7	8.7	124.2	3.4	32.9	109.1	170.7	BBB+	BBB+	11.0	9.3	1.7	29.5	36.7	5.2
Kyrgyz Republic	48.9	75.6	29.8	8.5	2.0	30.9	364.3	3.7	…	…	…	…	…	8.5	6.6	1.8	52.8	5.7	2.4
Mongolia	…	131.9	86.3	…	2.3	22.6	…	3.8	…	…	…	BB-	B+	15.3	14.1	1.2	…	5.3	7.6
Tajikistan	32.3	46.2	19.1	1.3	0.4	4.8	364.6	0.8	…	…	…	…	…	…	…	…	…	9.3	2.5
Turkmenistan	18.1	18.1	0.0	0.3	…	…	…	…	…	…	…	…	…	…	…	…	…	...	…
Uzbekistan	8.6	13.0	4.8	0.8	…	…	…	…	…	…	…	…	…	…	…	…	…	...	…
Southern and Eastern Mediterranean														…	…	…			
Egypt	80.6	13.4	0.8	2.0	17.0	6.6	326.4	3.6	70.4	46.3	678.0	B-	B-	8.6	8.4	0.2	…	9.5	13.4
Jordan	79.6	23.4	0.0	2.2	13.1	38.3	1759.9	6.8	115.6	70.9	…	BB-	…	11.4	…	…	…	7.3	11.0
Morocco	60.5	29.8	3.5	2.0	16.9	0.0	0.0	4.0	67.7	103.6	…	BBB-	BBB-	…	…	…	…	5.3	9.1
Tunisia	44.0	51.4	15.1	15.1	7.0	16.0	106.3	3.0	54.2	…	…	…	BB-	…	…	…	…	13.0	15.7

1/ National sources based on CEIC and IFS, unless stated otherwise.
2/ WEO October 2013 estimates. CEB figures from Eurostat.
3/ Slovenia NPLs: EBRD estimate
* Euro area members

Table 2. Transition Region: Annual indicators and projections 1/

	GDP Growth (year over year percent change)			GDP Growth (end year) (Q4 over Q4 percent change)			Inflation (average) (year over year percent change)		Fiscal Balance /4 (Gen. gov; % of GDP)	Primary fiscal balance to GDP /4	GG Debt/revenues (%)	Current Account (% of GDP)	Net FDI (% of GDP)
		Forecast 2/				Forecast 2/	Estimate	Forecast 2/	3/	3/	3/	3/	3/
	2012	2013	2014	2011	2012	2013	2013	2014	2012	2012	2012	2012	2012
Central Europe and Baltics													
Croatia	-2.0	-0.7	1.0	-0.3	-2.3	-0.1	2.2	2.0	-3.8	-1.2	140.6	-0.2	2.6
Estonia	3.9	1.2	2.8	5.2	4.9	1.7	3.2	2.8	-0.2	0.0	22.2	-1.8	2.5
Hungary	-1.7	1.2	1.7	1.3	-2.7	2.9	1.7	2.0	-2.0	2.2	171.2	1.0	2.1
Latvia	5.2	4.4	4.1	5.1	4.6	4.5	0.0	2.0	-1.3	0.0	98.4	-2.5	2.7
Lithuania	3.7	2.8	3.3	5.7	4.0	1.7	1.2	1.8	-3.2	-1.4	126.9	-0.2	0.7
Poland	1.9	1.3	2.7	4.9	0.8	1.3	0.8	2.0	-3.9	-1.1	144.8	-3.7	1.1
Slovak Republic	1.8	0.9	2.0	3.5	0.4	1.2	1.5	1.6	-4.5	-2.7	157.5	2.2	3.2
Slovenia	-2.5	-1.7	-2.0	-2.0	-3.3	0.0	1.9	1.5	-3.8	-1.7	123.1	3.3	0.5
South-Eastern Europe													
Albania	1.6	1.5	1.7	2.2	1.7	2.7	1.9	2.2	-3.2	-0.1	251.1	-10.5	7.5
Bosnia and Herzegovina	-0.5	0.8	1.8	…	…	…	0.3	0.3	-2.8	-2.0	96.9	-9.4	2.0
Bulgaria	0.8	0.7	1.8	0.6	0.3	0.6	0.5	1.4	-0.8	0.1	53.1	-1.4	3.0
FYR Macedonia	-0.3	3.0	3.0	0.9	0.4	1.9	2.8	2.1	-3.9	-2.9	113.9	-3.1	1.0
Kosovo	2.5	2.5	3.5	…	…	…	2.1	2.0	-2.6	-2.4	61.1	-7.6	4.3
Montenegro	-0.5	1.5	2.0	…	…	…	3.0	2.9	-4.3	-2.5	134.9	-18.3	14.0
Romania	0.7	2.5	2.4	2.1	0.9	2.0	3.4	2.5	-2.5	-0.7	116.1	-4.4	1.7
Serbia	-1.7	2.2	1.3	0.7	-2.1	2.6	7.9	5.0	-7.1	-5.1	148.3	-10.6	0.8
Eastern Europe and the Caucasus													
Armenia	7.1	2.5	3.5	5.2	6.2	2.4	5.8	3.9	-1.6	-0.6	187.7	-11.3	4.8
Azerbaijan	2.2	5.5	3.5	-3.8	4.3	5.6	2.5	3.8	3.0	3.2	29.0	21.8	1.2
Belarus	1.7	0.9	1.0	0.6	0.0	0.4	18.3	14.5	0.6	2.0	102.7	-2.7	2.1
Georgia	6.2	2.5	4.5	8.5	3.0	4.5	-0.5	4.1	-2.3	0.2	112.5	-11.7	3.9
Moldova	-0.7	8.0	3.5	5.8	-2.5	6.7	4.4	4.7	-2.1	-1.3	62.7	-6.8	2.1
Ukraine	0.2	-0.8	1.5	5.0	-2.5	0.3	-0.3	2.6	-4.5	-1.1	84.0	-8.1	3.8
Turkey	2.2	3.7	3.3	5.3	1.4	3.0	7.5	7.3	-1.6	1.9	104.0	-6.2	1.1
Russia	3.4	1.3	2.5	5.1	2.1	1.2	6.8	5.6	-0.2	1.0	33.3	3.5	0.1
Central Asia													
Kazakhstan	5.0	6.0	5.5	8.7	4.5	6.7	5.9	5.9	4.5	5.0	46.0	0.3	6.1
Kyrgyz Republic	-0.9	10.5	5.0	4.6	8.1	13.1	6.7	5.4	-5.8	-4.8	141.8	-21.8	4.5
Mongolia	12.3	13.0	14.0	20.2	10.6	16.8	10.4	10.6	-7.7	-6.8	159.2	-32.8	43.0
Tajikistan	7.5	7.4	5.0	7.2	7.5	7.4	5.2	4.4	0.5	1.1	128.7	-3.3	2.6
Turkmenistan	11.1	10.2	10.2	…	…	…	5.7	5.7	6.4	...	85.9	0.0	8.9
Uzbekistan	8.2	7.7	7.0	8.5	8.2	7.3	11.0	11.0	8.5	8.6	20.8	0.7	1.3
Southern and Eastern Mediterranean													
Egypt	2.2	2.1	2.5	3.3	1.5	1.1	6.9	10.4	-10.7	-4.7	356.0	-2.7	1.0
Jordan	2.7	2.9	3.4	3.1	2.2	3.0	5.5	4.0	-8.8	-6.2	251.0	-17.2	4.8
Morocco	2.7	4.4	4.0	4.6	2.3	4.6	2.0	2.5	-7.5	-5.2	215.1	-10.0	2.6
Tunisia	3.7	2.9	3.8	-1.6	4.0	2.6	6.1	5.0	-4.9	-3.1	143.7	-8.0	3.5

1/ EBRD data and projections unless otherwise stated.

2/ As of January 16, 2014. Figures for Egypt reflect the fiscal year, which runs from July to June.

3/ WEO October 2013. CEB figures from Eurostat.

4/ Ukraine: Augmented general government balance: overall government balance includes Naftogaz and other debt-creating flows.

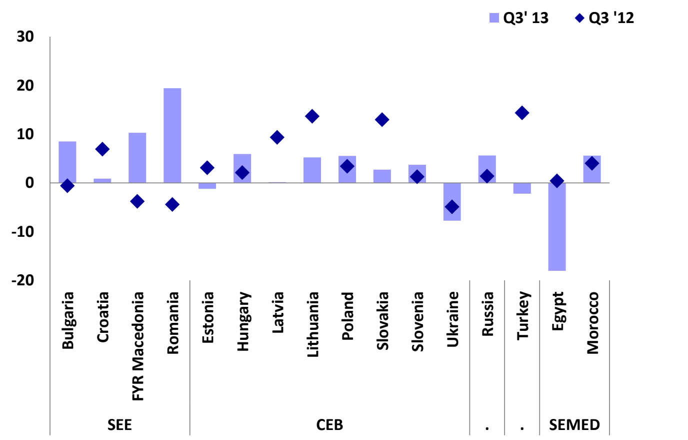
Table 3. Transition Region: Quarterly GDP actuals and projections, Q1 2011- Q3 2013 1/

	Quarterly GDP Growth (seasonally adjusted, quarter-on-quarter percent change)								Quarterly GDP Growth (year-on-year percent change)								GDP Growth (year over year percent change)		
					Estimates 1/								Estimates 1/						
	2012				2013				2012				2013					Forecast 1/	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2012	2013	2014
Central Europe and Baltics																			
Croatia	-11	-0.8	0.1	-0.5	0.0	-0.1	-0.1	0.7	-11	-2.5	-19	-2.3	-15	-0.7	-0.6	-0.1	-2.0	-0.7	10
Estonia	2.3	-0.1	13	0.5	-0.1	-0.2	0.6	0.6	5.0	2.5	3.4	4.9	13	10	0.7	17	3.9	12	2.8
Hungary	-14	-0.4	-0.3	-0.5	0.9	0.4	0.9	0.4	-0.6	-16	-17	-2.7	-0.8	0.8	18	2.9	-17	12	17
Latvia	0.7	2.2	16	0.9	18	0.1	13	0.5	7.1	4.9	4.6	4.6	3.8	4.5	4.5	4.5	5.2	4.4	4.1
Lithuania	0.4	0.6	17	0.7	0.8	0.6	0.2	10	3.8	18	5.0	4.0	3.5	3.8	2.2	17	3.7	2.8	3.3
Poland	0.4	0.0	0.2	0.2	0.3	0.5	0.6	0.3	3.6	2.0	16	0.8	0.5	12	2.0	13	19	13	2.7
Slovak Republic	0.3	0.2	0.2	0.0	0.2	0.3	0.2	0.7	2.7	2.3	19	0.4	0.5	0.8	0.9	12	18	0.9	2.0
Slovenia	-0.4	-13	-0.6	-0.8	-0.3	-0.1	0.0	-0.8	-0.2	-3.5	-3.0	-3.3	-4.6	-15	-0.6	0.0	-2.5	-17	-2.0
South-Eastern Europe																			
Albania	-0.1	13	0.7	-0.3	0.1	0.8	0.9	0.4	-0.4	2.1	2.9	17	17	11	0.7	2.7	16	15	17
Bosnia and Herzegovina	…	…	…	…	…	…	…	…	…	…	…	…	…	…	…	…	-0.5	0.8	18
Bulgaria	0.2	0.2	0.1	0.1	0.2	-0.1	0.4	-0.5	10	11	0.8	0.3	0.8	-0.2	15	0.6	0.8	0.7	18
FYR Macedonia	-13	0.6	0.6	0.4	2.4	-0.6	11	-0.6	-13	-0.8	0.3	0.4	2.9	3.9	3.3	19	-0.3	3.0	3.0
Kosovo	…	…	…	…	…	…	…	…	…	…	…	…	…	…	…	…	2.5	2.5	3.5
Montenegro	…	…	…	…	…	…	…	…	…	…	…	…	…	…	…	…	-0.5	15	2.0
Romania	-0.9	15	-0.8	11	0.6	0.8	16	-0.5	-0.1	19	-11	0.9	2.2	15	4.1	2.0	0.7	2.5	2.4
Serbia	-2.5	2.7	-2.4	0.3	2.1	0.1	0.7	-0.8	-2.7	-0.1	-2.1	-2.1	2.7	0.2	3.2	2.6	-17	2.2	13
Eastern Europe and the Caucasus																			
Armenia	10	4.1	18	-0.7	13	-12	18	0.5	5.4	7.1	9.1	6.2	7.5	0.6	14	2.4	7.1	2.5	3.5
Azerbaijan	0.3	0.8	2.0	0.5	0.6	3.2	18	18	19	0.0	17	4.3	3.1	6.7	6.0	5.6	2.2	5.5	3.5
Belarus	2.9	12	-3.4	-0.2	6.0	-3.3	-11	-18	3.7	3.1	2.0	0.0	4.0	-0.5	0.8	0.4	17	0.9	10
Georgia	0.8	2.6	10	-14	0.3	14	0.9	18	6.6	8.2	7.5	3.0	2.4	15	14	4.5	6.2	2.5	4.5
Moldova	-3.3	0.8	-12	13	2.7	3.5	4.7	-3.7	10	0.6	-17	-2.5	3.5	6.1	12.9	6.7	-0.7	8.0	3.5
Ukraine	-0.8	0.2	-10	-0.8	0.5	-0.2	-0.8	0.5	2.2	3.0	-13	-2.5	-11	-13	-13	0.3	0.2	-0.8	15
Turkey	-0.4	14	0.3	0.2	15	2.0	0.9	-13	3.1	2.8	15	14	3.0	4.5	4.4	3.0	2.2	3.7	3.3
Russia	0.6	0.6	0.5	0.3	0.3	0.3	0.4	18	4.8	4.3	3.0	2.1	16	12	12	12	3.4	13	2.5
Central Asia																			
Kazakhstan	-0.3	2.1	0.9	15	0.5	2.4	2.1	15	5.6	5.6	4.6	4.5	4.7	5.4	6.6	6.7	5.0	6.0	5.5
Kyrgyz Republic	-3.2	2.7	19	4.7	-0.6	2.7	3.9	5.5	-7.1	-4.8	-3.9	8.1	7.6	8.2	10.5	13.1	-0.9	10.5	5.0
Mongolia	7.7	0.7	3.6	-0.8	3.6	7.3	0.7	3.1	14.6	14.4	10.5	10.6	7.2	14.3	11.6	16.8	12.3	13.0	14.0
Tajikistan	19	2.2	2.0	12	18	2.4	16	14	7.2	7.5	7.6	7.5	7.3	7.6	7.3	7.4	7.5	7.4	5.0
Turkmenistan	…	…	…	…	…	…	…	…	…	…	…	…	…	…	…	…	11.1	10.2	10.2
Uzbekistan	17	2.7	2.0	14	16	3.1	15	15	7.5	8.5	8.3	8.2	7.5	8.4	7.8	7.3	8.2	7.7	7.0
Southern and Eastern Mediterranean																			
Egypt	0.7	0.2	-0.3	0.7	-0.3	0.7	0.4	0.8	2.6	2.2	2.2	15	2.2	15	10	11	2.2	2.1	2.5
Jordan	0.3	0.5	0.7	0.6	0.8	0.8	0.5	0.9	3.0	2.9	2.6	2.2	2.6	3.1	2.8	3.0	2.7	2.9	3.4
Morocco	-0.3	0.2	17	0.6	12	16	0.5	16	2.8	2.7	2.9	2.3	4.5	5.0	4.0	4.6	2.7	4.4	4.0
Tunisia	13	0.3	0.6	0.1	0.3	12	0.4	13	4.9	2.2	3.7	4.0	2.7	3.4	2.7	2.6	3.7	2.9	3.8

1/ As of January 16, 2014.

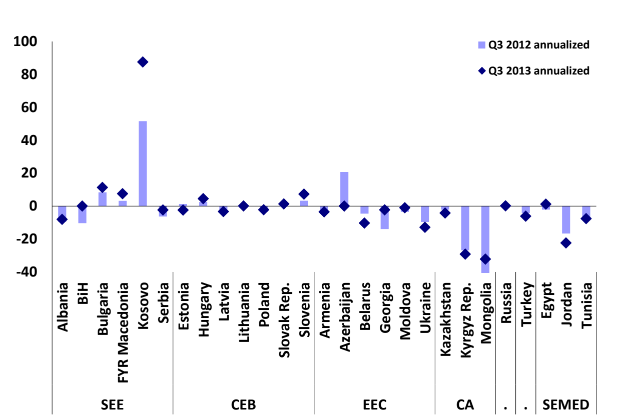
Figure 1. External environment

Export volumes, y-o-y, %



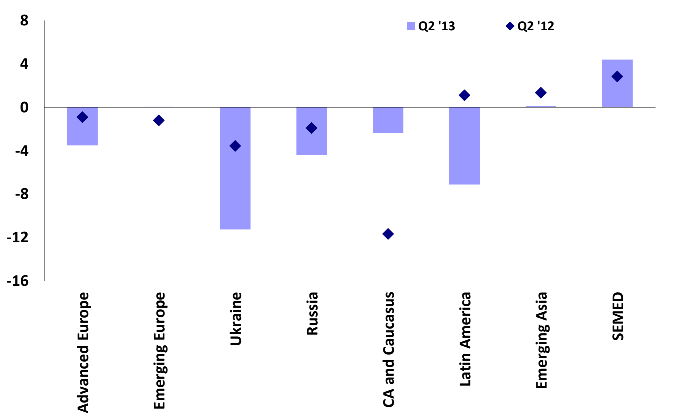
Source: National authorities via CEIC data service.

Current account, % of previous year GDP



Source: National authorities via CEIC data service.

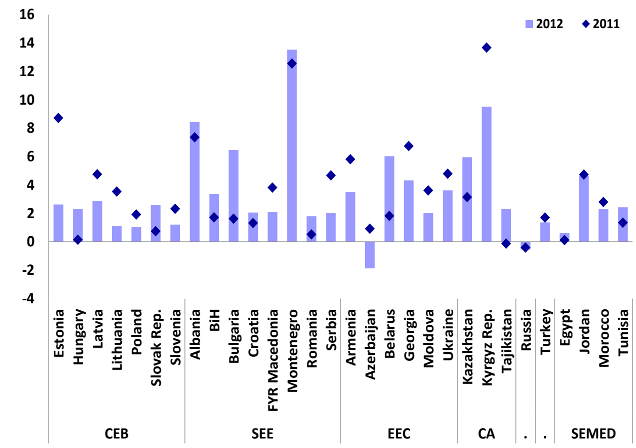
Net lending from BIS-reporting banks, exch. rate adjusted, q-o-q



1/ Emerging Europe excludes Russia and Ukraine.
2/ Emerging Asia excludes China, Central Asia and Caucasus.

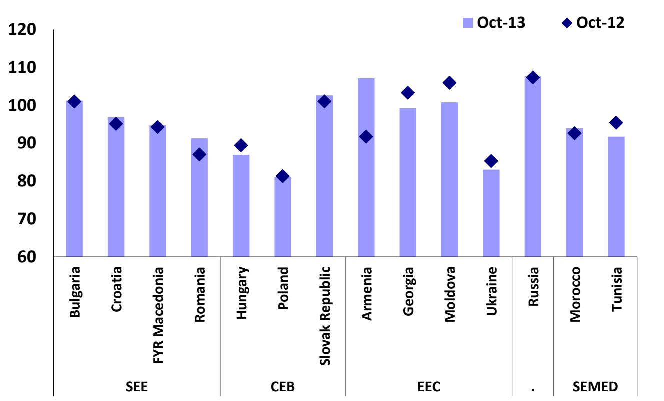
Source: BIS via CEIC data service.

FDI net inflows, % of GDP



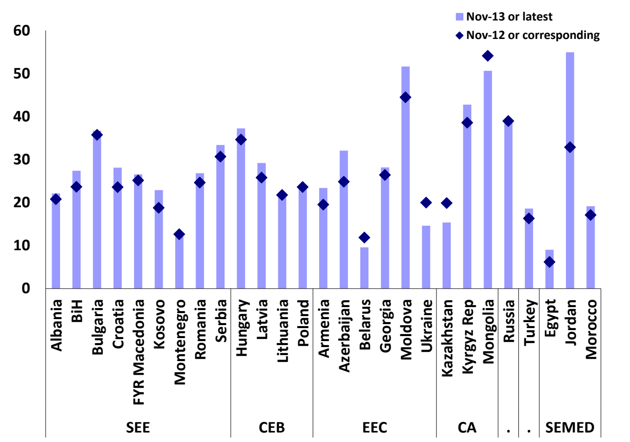
Source: National authorities via CEIC data service.

Real effective exchange rate, July 2008=100



Source: IMF International Financial Statistics.

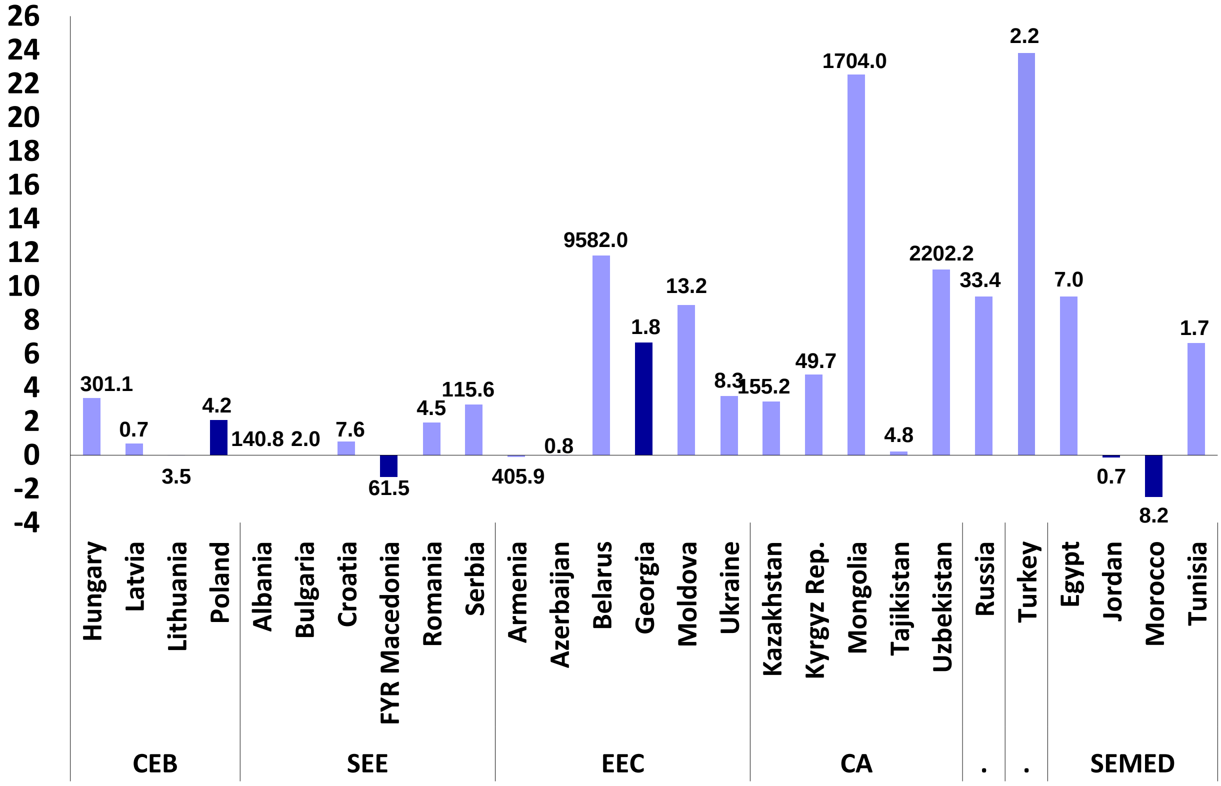
Reserves, end of period, % of previous year GDP



Source: IMF International Financial Statistics.

Figure 2. Currencies and financial market indicators (daily frequency)

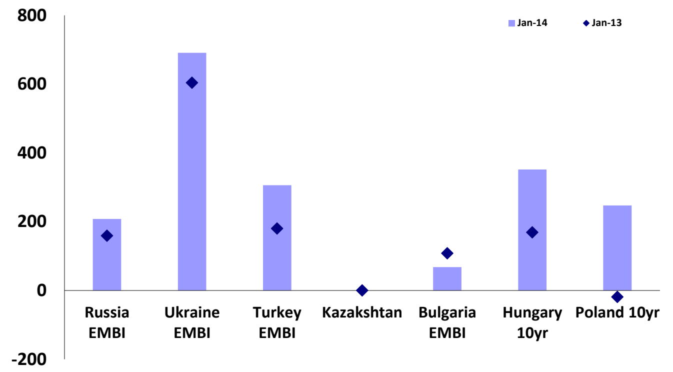
Currencies (change since 01/01/2013)



Source: Bloomberg.

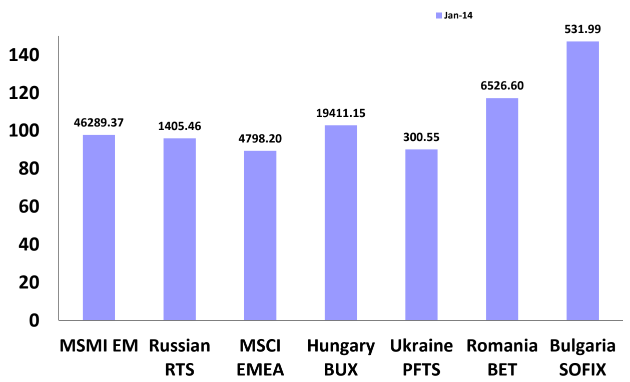
For EEC, CA, SEMED, Turkey and Russia the reference currency is U.S. dollar; For CEB and SEE the reference currency is Euro. A decrease represents an appreciation. Numbers on bars represent actual exchange rate values

Sovereign risk (bond spreads, bp)



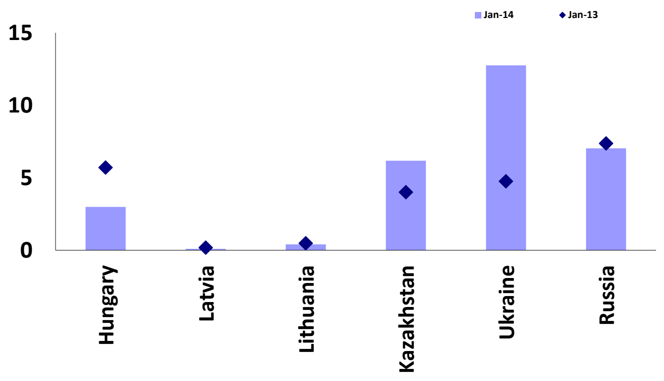
Source: Bloomberg.

Stock markets (January 2011=100)

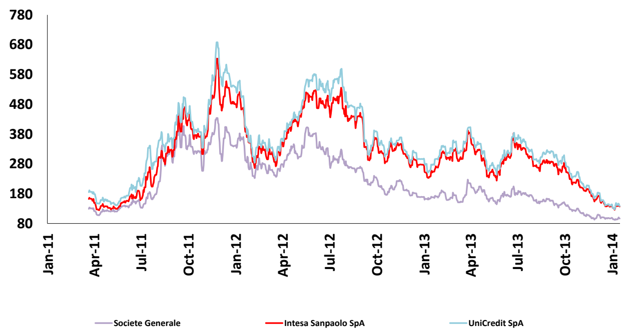


Numbers on bars represent actual values of stock indices.

Interbank rates (%)



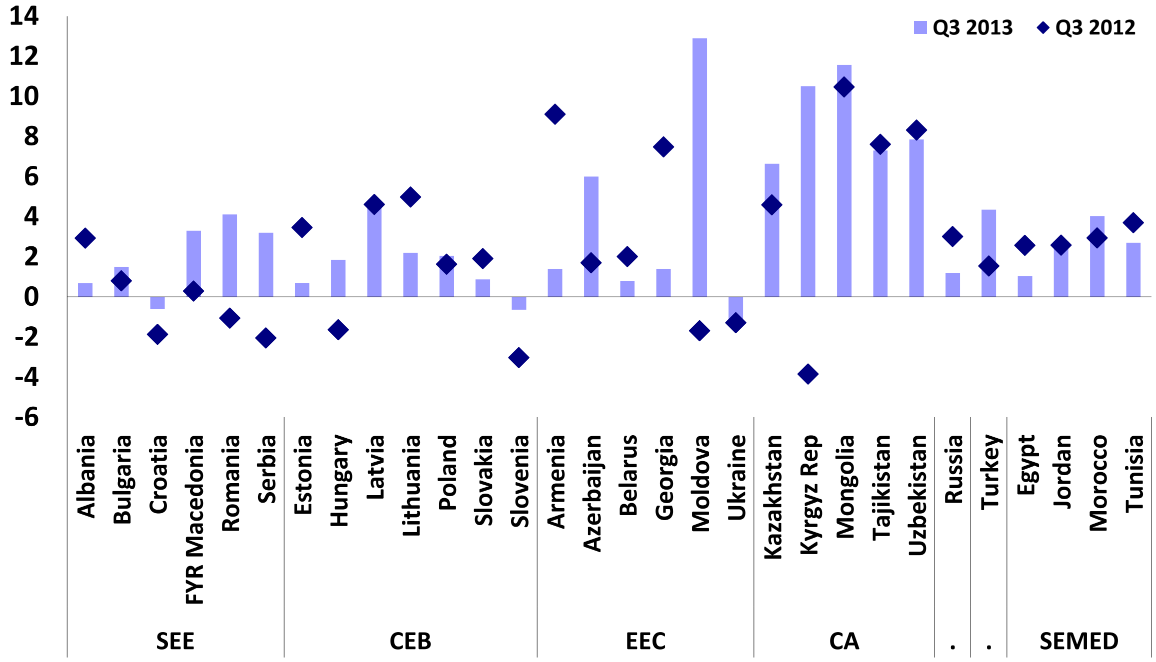
Parent banks CDS spreads (bp)



Source: Bloomberg.

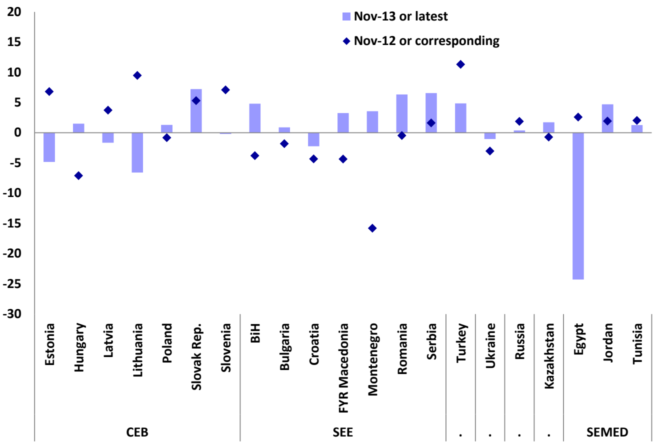
Figure 3. Indicators of real activity

Real GDP, y-o-y change, %

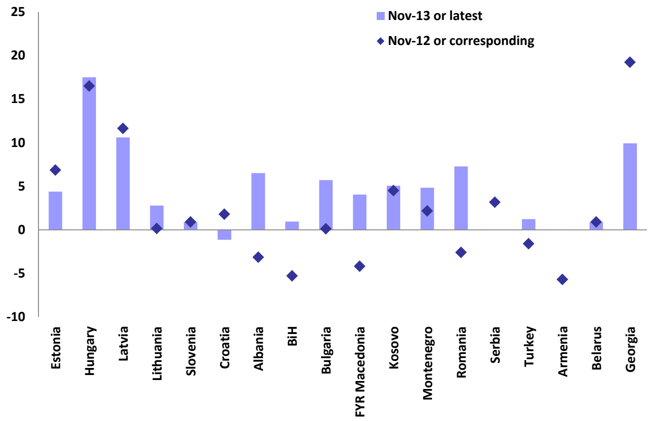


Source: National authorities via CEIC data service.

Industrial production, monthly y-o-y change, %

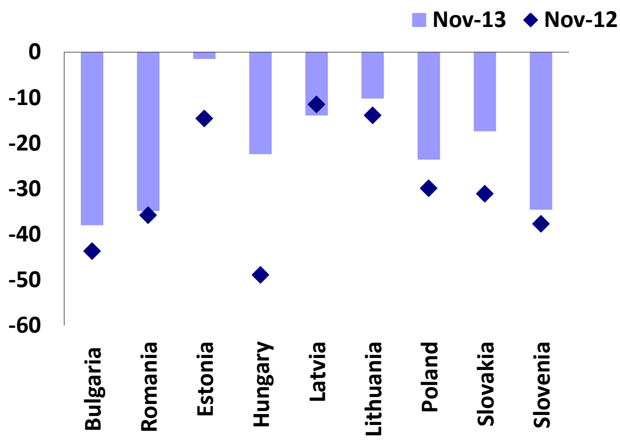


Retail sales, monthly y-o-y change, %



Source: National authorities via CEIC data service.

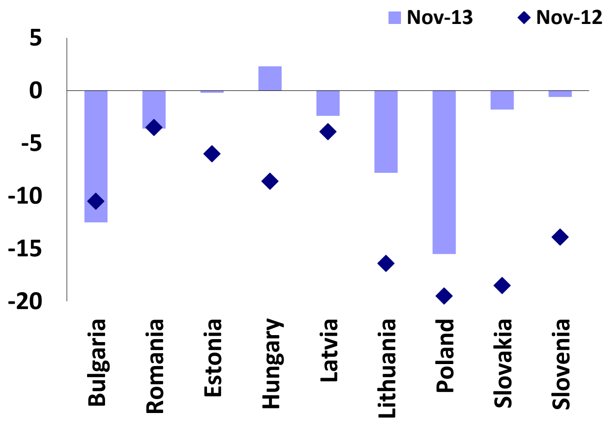
Consumer confidence



defined as the difference (in percentage points of total answers) between positive and negative answers

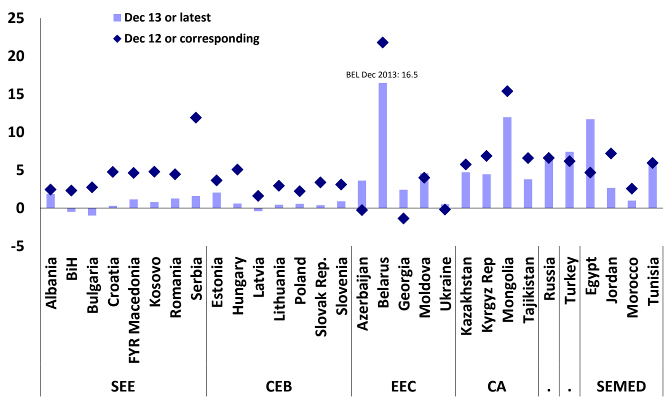
Source: Eurostat

Industrial confidence

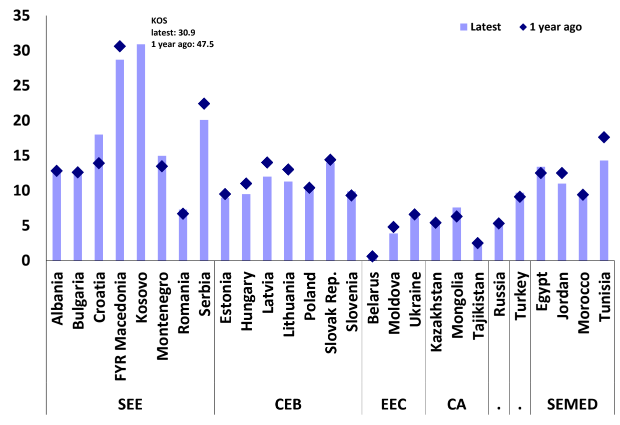


defined as the difference (in percentage points of total answers) between positive and negative answers

CPI, y-o-y change, %



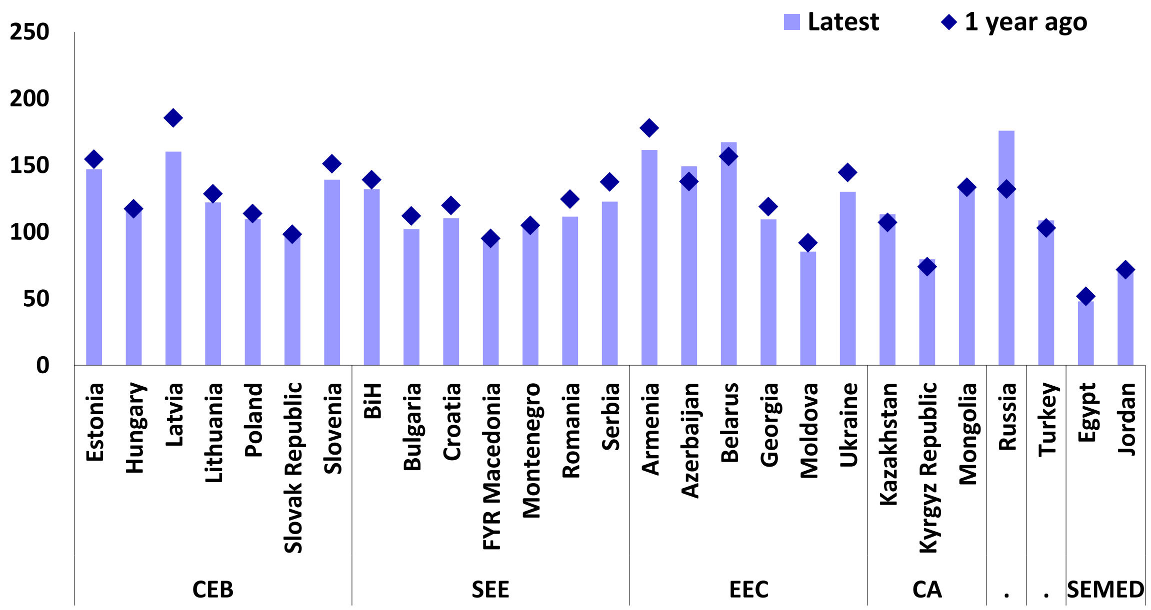
Unemployment rate, %



Source: National authorities via CEIC data service, Eurostat

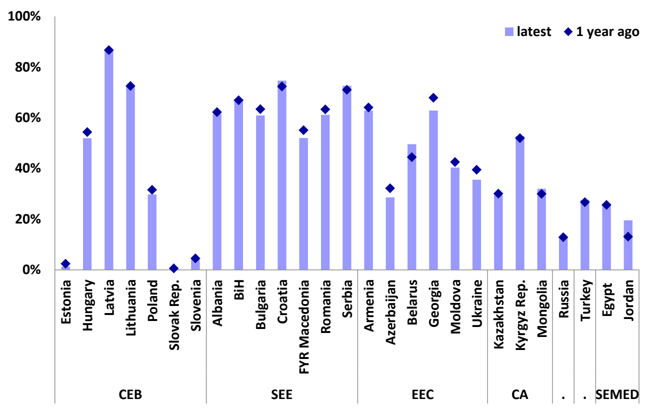
Figure 4: Financial sector indicators: loans and deposits

Loan to deposit ratio, (%)

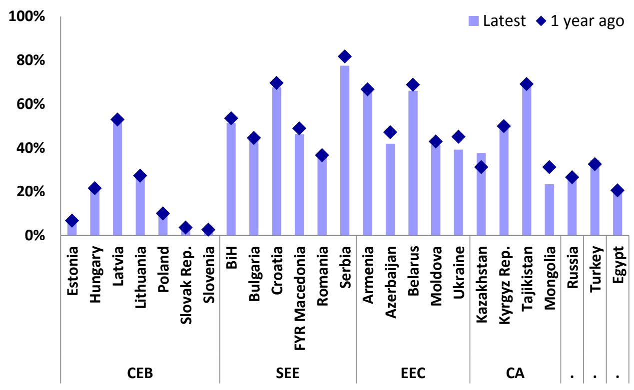


Source: National authorities via CEIC data service.

Foreign currency loans to total loans ratio, (%)



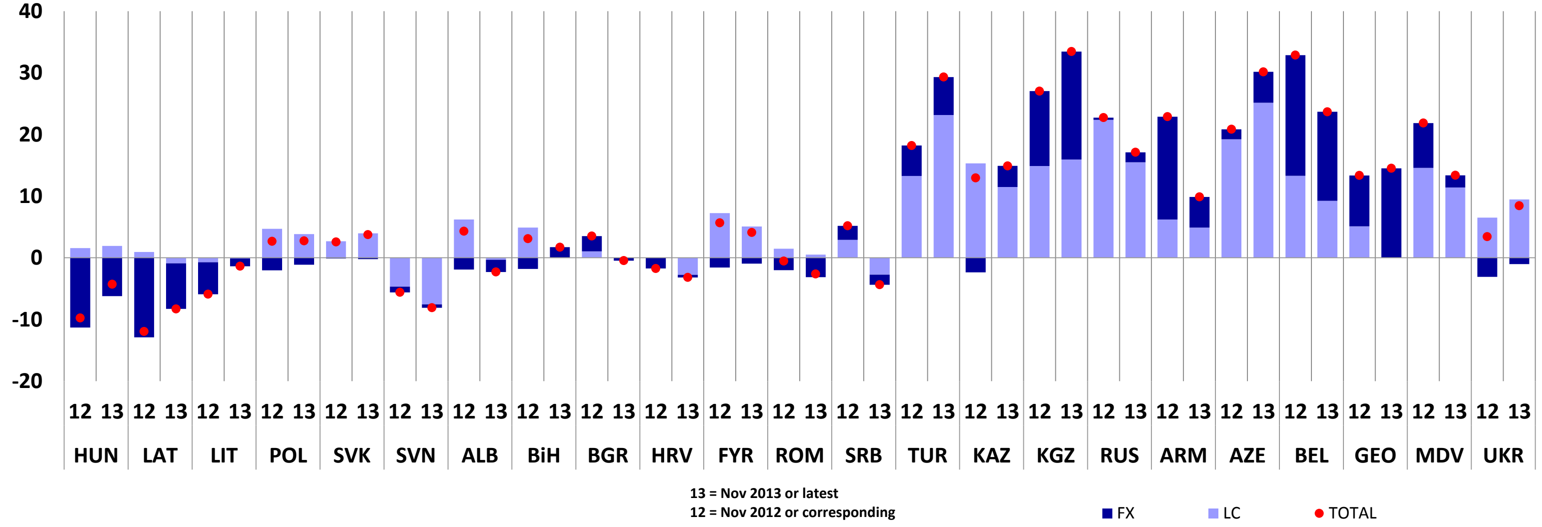
Foreign currency deposits to total deposits ratio, (%)



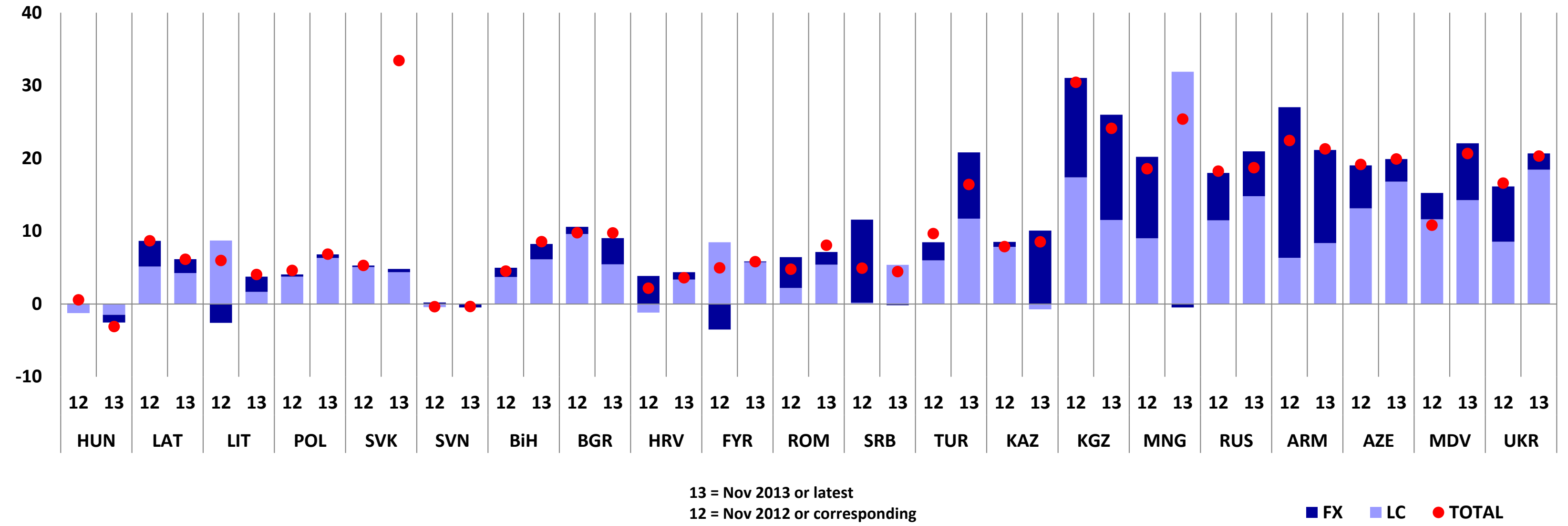
Source: National authorities via CEIC data service

Figure 5. Financial sector indicators: foreign and local currency lending and deposits

Contribution to private sector credit growth (year-on-year, in %)



Contribution to private sector deposits growth (year-on-year, in %)



Source: National authorities via CEIC data service