

Part 1: Regional Outlook

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Europe and Central Asia Economic Update
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Office of the Chief Economist ECA



Part 1. Economic developments, policies, and outlook

- **Recent Developments:** Growth in ECA slowed to **1.2% in 2022** from 7.1% in 2021
 - Caused by Russia's invasion, a surge in inflation, and disrupted international trade
- **Inflation:** surged in 2022 after increasing substantially in 2021
 - The rise in food and fuel prices accounted for two-thirds of the increase
- **Outlook:** ECA growth is projected to increase modestly to **1.4% in 2023**
 - **Excluding Russia, Türkiye, and Ukraine**, a slowdown to **1.8% in 2023** from 4.2%
- **Structural constraints:** Incomplete market transition will weigh on medium-term growth
 - Challenges include the role of the state, SOEs, competition, and aging population

Substantial slowdown in growth in 2022

Armenia and Kyrgyz Republic are the only ECA countries with stronger growth in 2022 than in 2021

TABLE 1.1 Europe and Central Asia Economic Growth Summary, 2020-25

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

							Percentage point differences from January 2023 projections		
	2020	2021	2022e	2023f	2024f	2025f	2022e	2023f	2024f
EMDE ECA^a	-1.7	7.1	1.2	1.4	2.7	2.7	1.0	1.3	-0.1
EMDE ECA excl. the Russian Federation and Ukraine	-1.0	8.3	4.7	2.4	3.6	3.7	0.5	0.3	0.2
EMDE ECA excl. the Russian Federation, Türkiye, and Ukraine	-2.7	6.4	4.2	1.8	3.2	3.4	0.3	0.1	0.1
Central Europe ^b	-2.9	6.7	4.7	1.1	2.9	3.3	0.2	0.0	0.2
Western Balkans ^c	-3.1	7.6	3.0	2.5	3.1	3.6	-0.1	0.0	0.0
Eastern Europe ^d	-3.1	3.6	-20.3	0.6	2.8	4.4	3.9	-0.5	-0.7
South Caucasus ^e	-5.3	6.7	7.0	3.0	3.4	3.6	0.5	-0.3	-0.1
Central Asia ^f	-1.3	5.3	4.1	4.0	4.3	4.2	0.2	0.1	0.0
Russian Federation	-2.7	5.6	-2.1	-0.2	1.2	0.8	1.4	3.1	-0.4
Türkiye	1.9	11.4	5.6	3.2	4.3	4.1	0.9	0.5	0.3
Poland	-2.0	6.8	4.9	0.7	2.6	3.2	0.5	0.0	0.4

Source: World Bank.

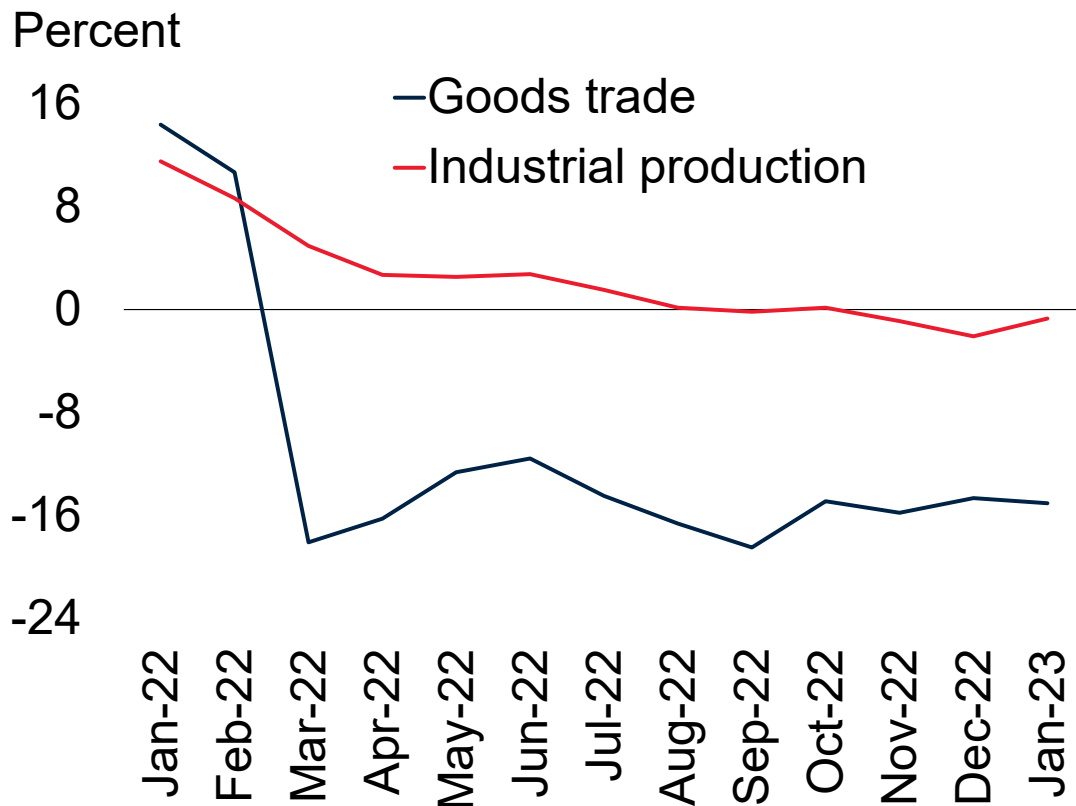
Russia's invasion of Ukraine ECA's growth slowdown



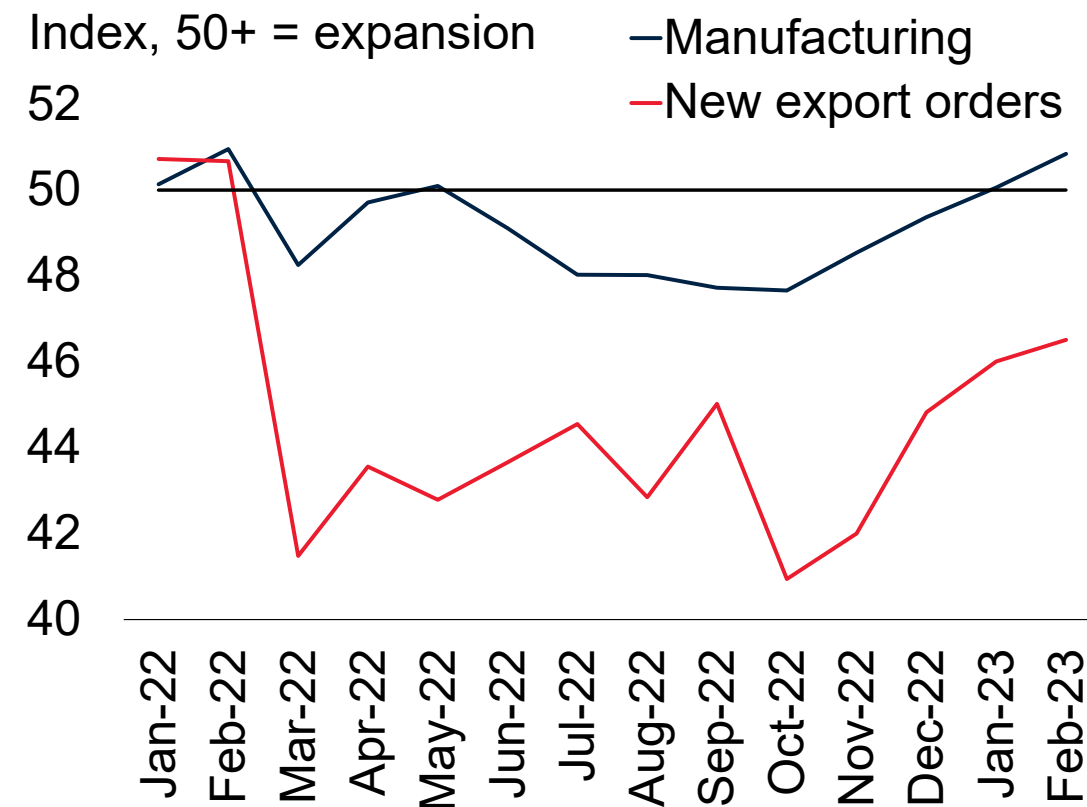
- Many killed, injured, and abducted
- Millions exposed to hunger and malnutrition
- 8 million refugees in Europe
- At least 5 million IDPs
- Huge damage to infrastructure, factories, and the housing stock
- Massive damage to the environment
- **GDP down an estimated 29% in 2022**

Trade and IP slumped in 2022; ongoing weakness into 2023

Goods trade volumes and industrial production



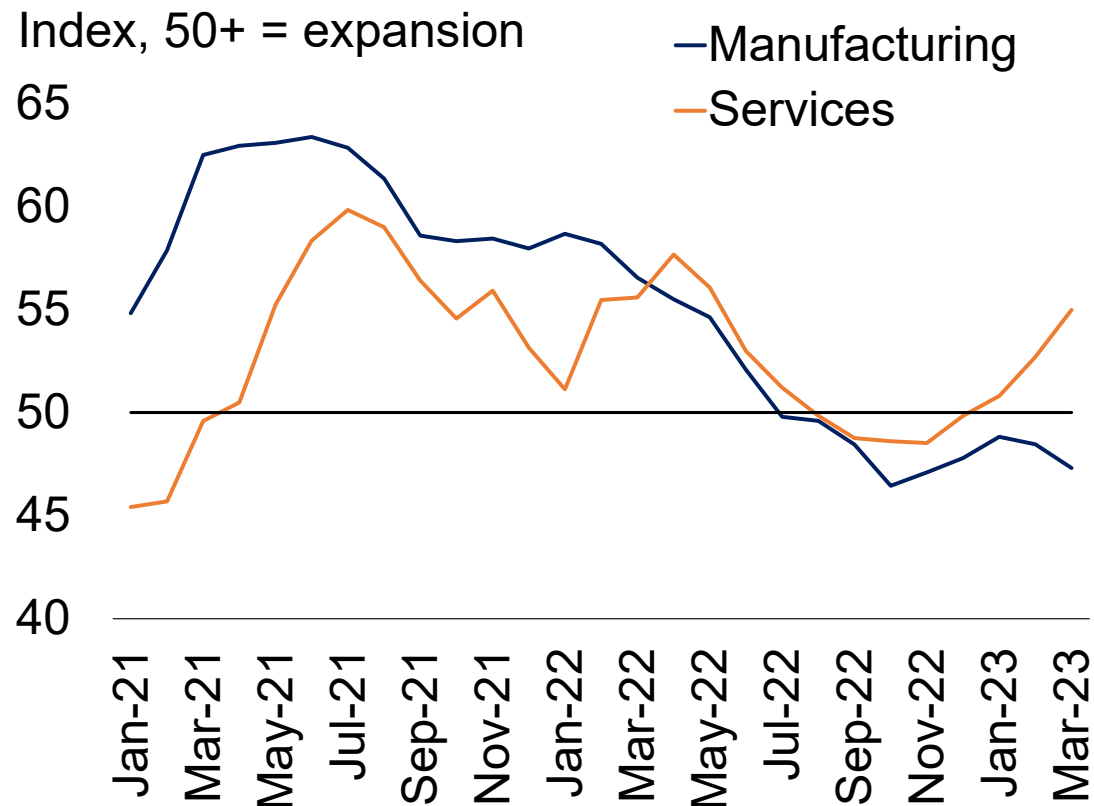
Manufacturing and new export orders PMIs



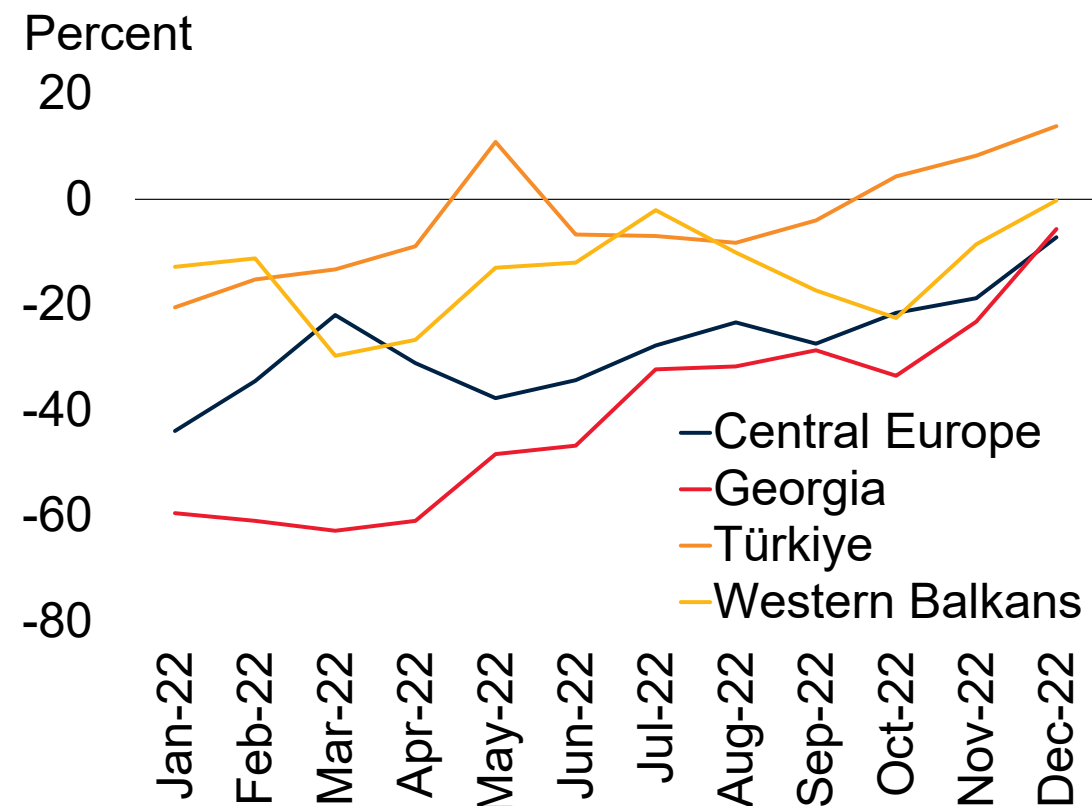
Sources: CPB World Trade Monitor; Haver Analytics; World Bank. Left Panel. Figure shows percent year-on-year. Goods trade is based on the Eastern Europe aggregate as defined by the CPB World Trade Monitor. IP sample includes 13 ECA economies. Right Panel. Purchasing Managers Index (PMI) readings above (below) 50 indicate expansion (contraction). Aggregates calculated as median of four ECA economies: Kazakhstan, Poland, Russia, and Türkiye.

Rebound in services activity in late 2022 driven by tourism recovery

Euro area manufacturing and services PMI

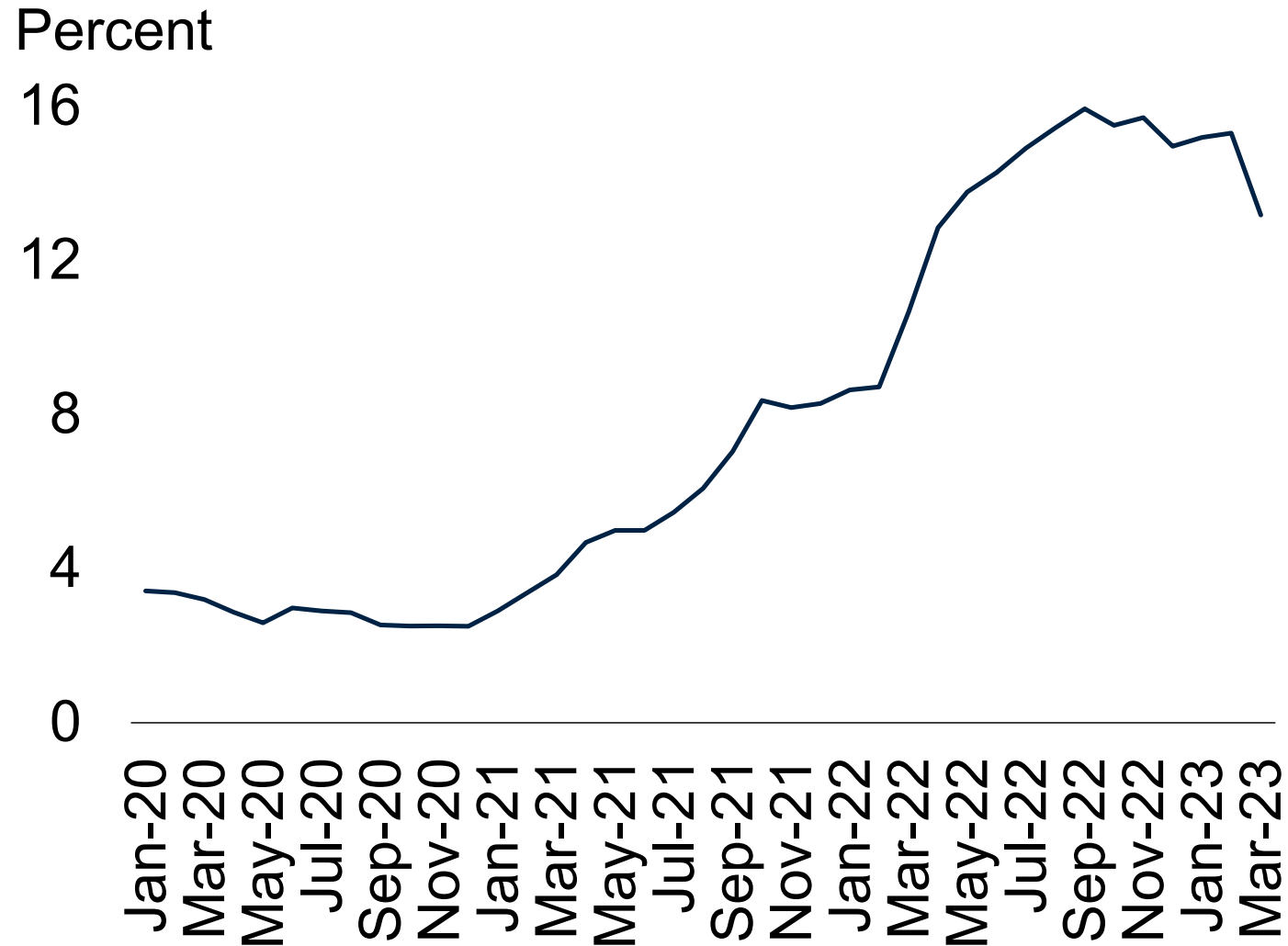


Tourist arrivals, 2022



Sources: Haver Analytics; World Bank. Left Panel. Purchasing Managers' Index (PMI) readings above (below) 50 indicate expansion (contraction) in economic activity. Right Panel. Figure shows percent change in tourist arrivals compared to the same month in 2019. Aggregates are calculated as medians.

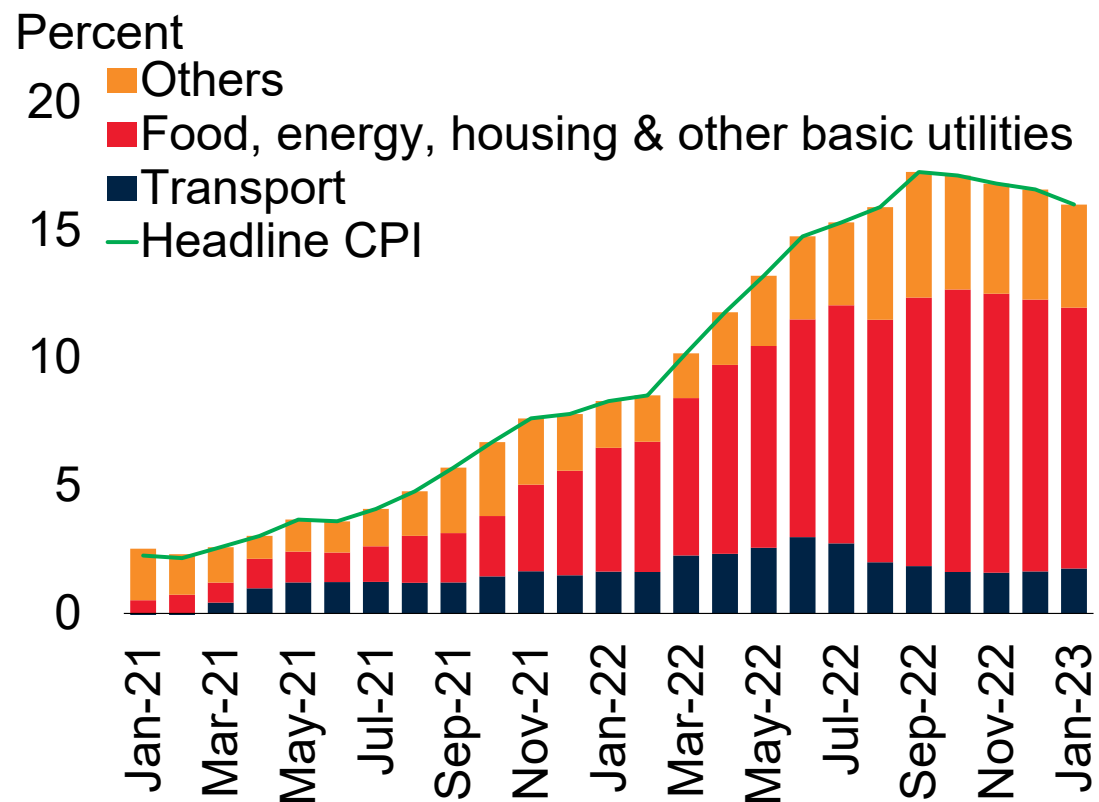
EMDE ECA inflation started rising in 2021 and surged in 2022



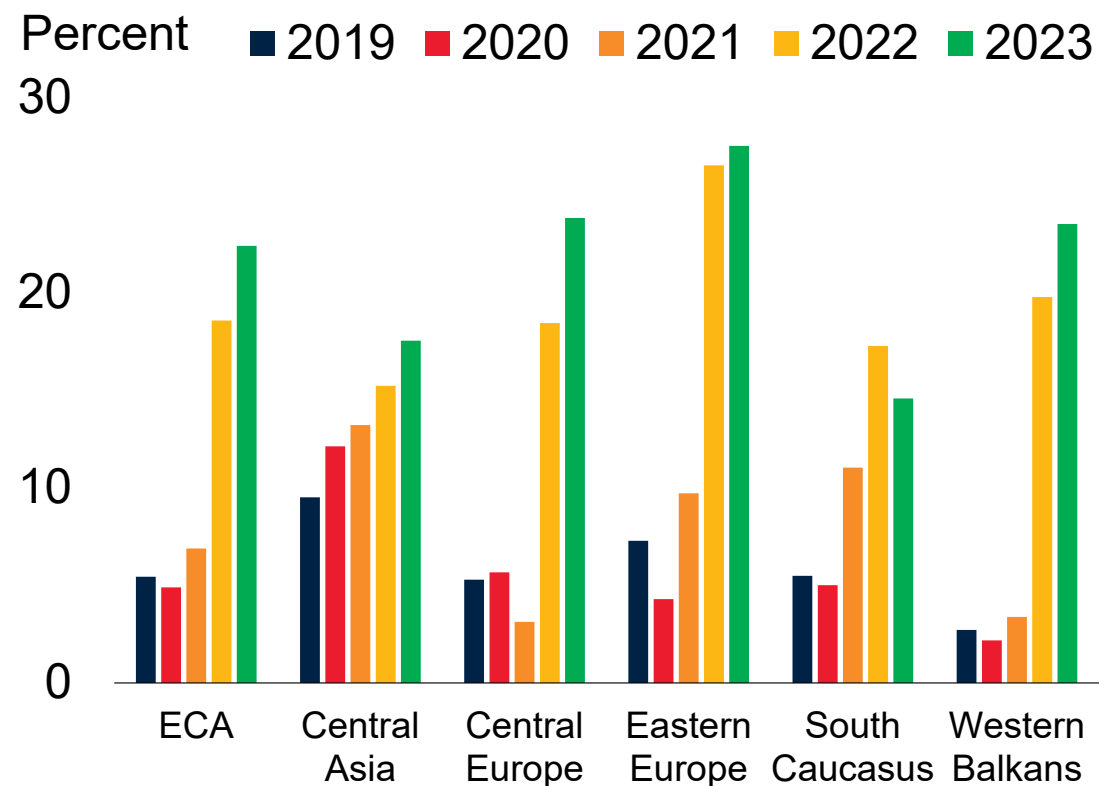
Sources: Haver Analytics; World Bank. Figure shows median headline inflation. Sample includes 22 ECA economies. Data are non-seasonally adjusted, except for Kazakhstan.

Higher food and fuel prices accounted for two-thirds of the price increases

Composition of median headline inflation



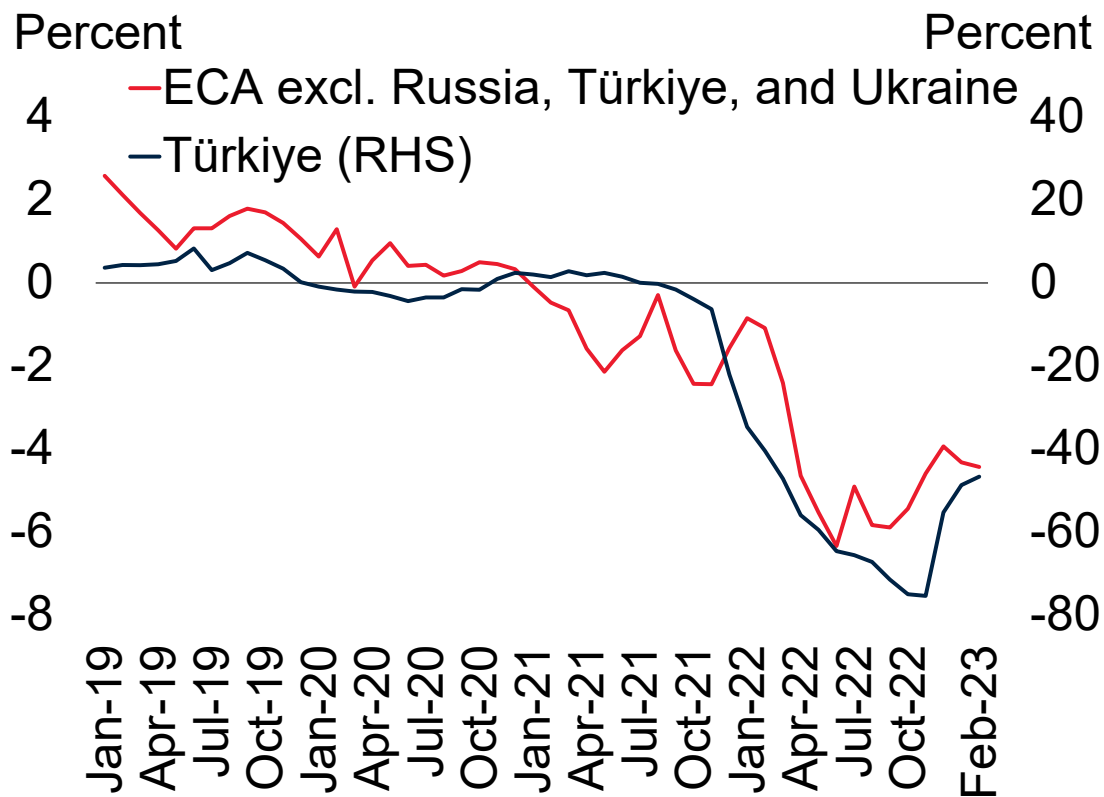
Food inflation, 2019-23



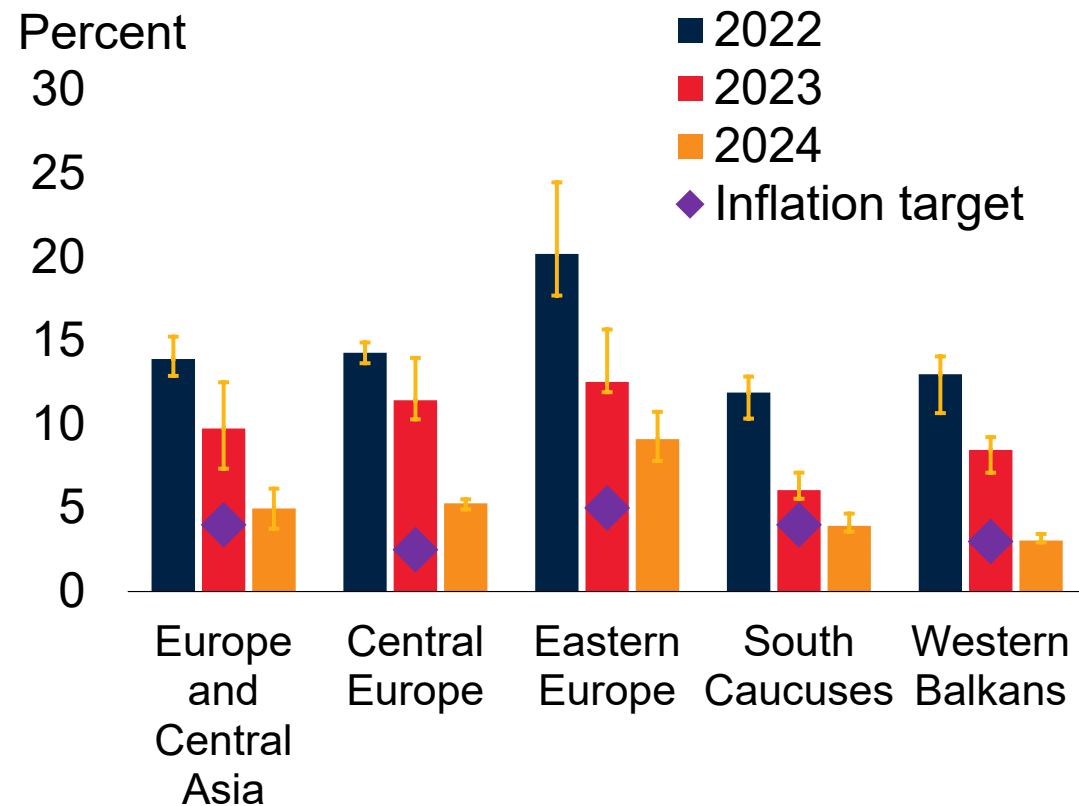
Sources: Haver Analytics; IMF; World Bank. Left Panel. Figure shows year-on-year headline CPI inflation and contributions to inflation for categories indicates. Aggregates are calculated as median. Sample includes 14 ECA economies. Right Panel. Figure shows annual averages of food consumer price inflation. Samples includes 22 ECA economies. Data are through February 2023.

Monetary tightening has yet to deliver positive real policy rates

Real policy rates were negative in 2022

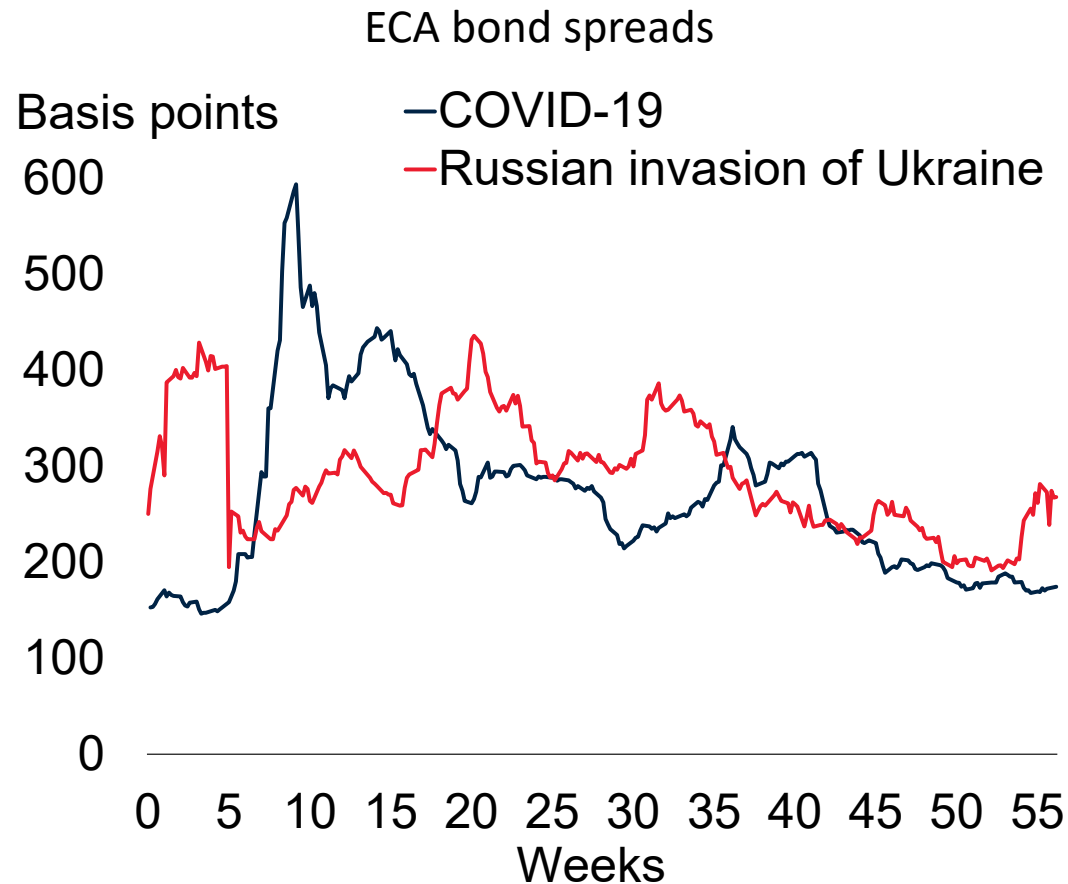


ECA inflation, inflation expectations and inflation targets



Sources: Consensus Economics; Haver Analytics; IMF; World Bank. Aggregates calculated as median. Left Panel. Figure shows year-on-year percent change. Sample includes 18 ECA economies for policy rates and 20 ECA economies for inflation. Right Panel. Inflation data reflect actuals for 2022, and Consensus Economics forecasts for headline CPI inflation based on the March 2023 survey for 2023-24. Sample includes 16 ECA economies. Whiskers indicate interquartile ranges. Diamonds indicate inflation targets as of March 24, 2023.

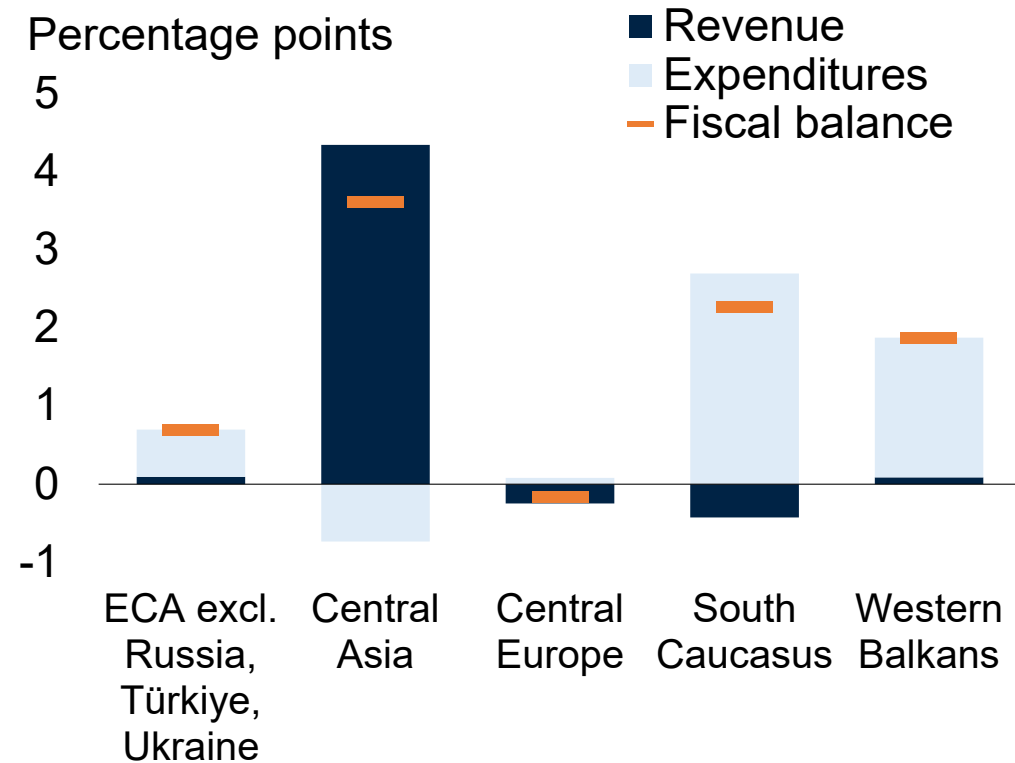
Financial conditions have tightened, weighing on investment



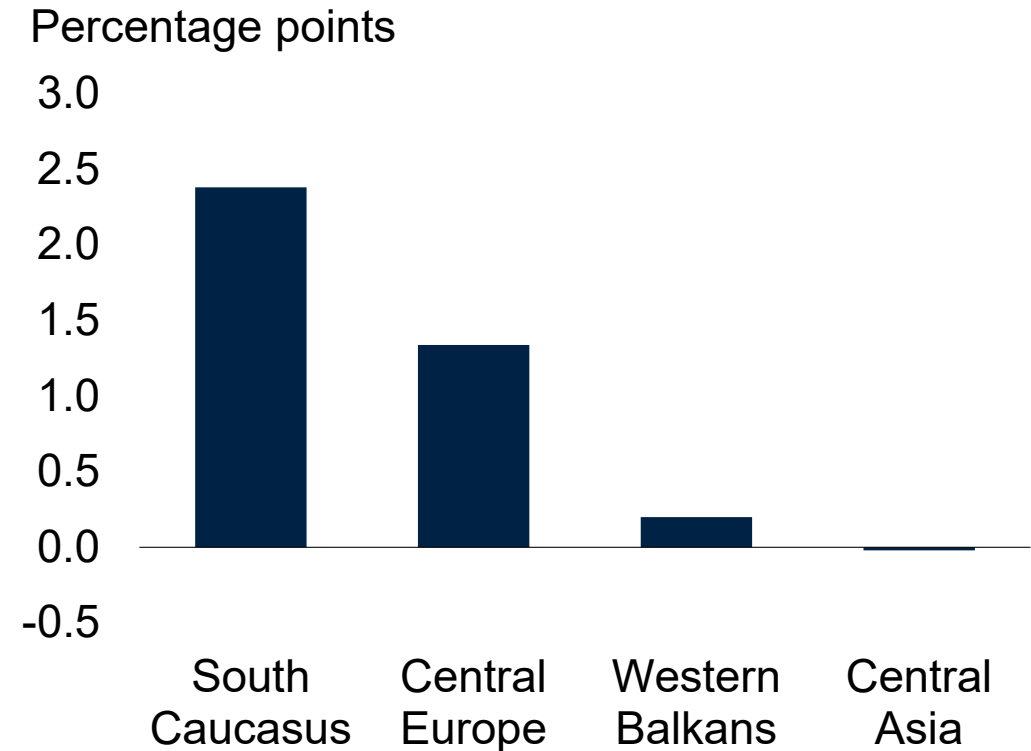
Sources: Haver Analytics; J.P. Morgan; World Bank. Left Panel. Figure shows the Emerging Market Bond Index (EMBI) for the weeks since the onset of the COVID-19 pandemic and Russia's invasion of Ukraine. The date of onset is January 20, 2020, for COVID-19 and February 24, 2022, for Russia's invasion of Ukraine. Aggregates are calculated as medians of daily data. Bond index calculated using subindices of the EMBI Global Index, which includes dollar denominated government debt. Last observation is March 24, 2023. Sample includes 10 ECA economies.

Fiscal adjustment is a priority after delays in some countries in 2022

Change in fiscal balances in ECA, 2022



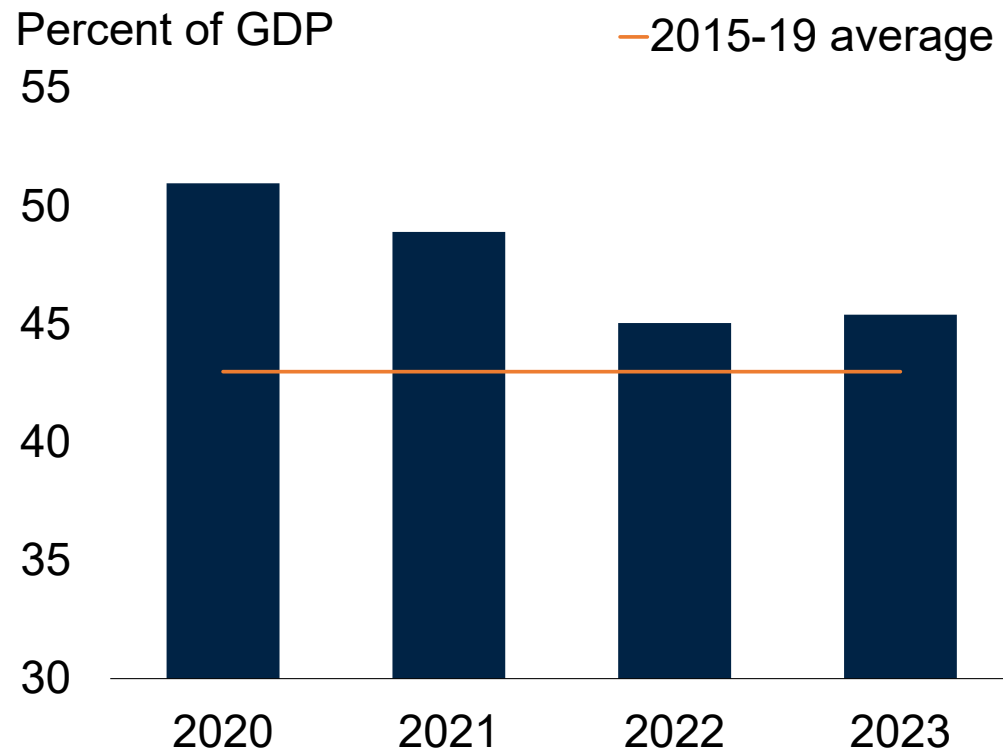
Fiscal consolidation in ECA, 2021-24



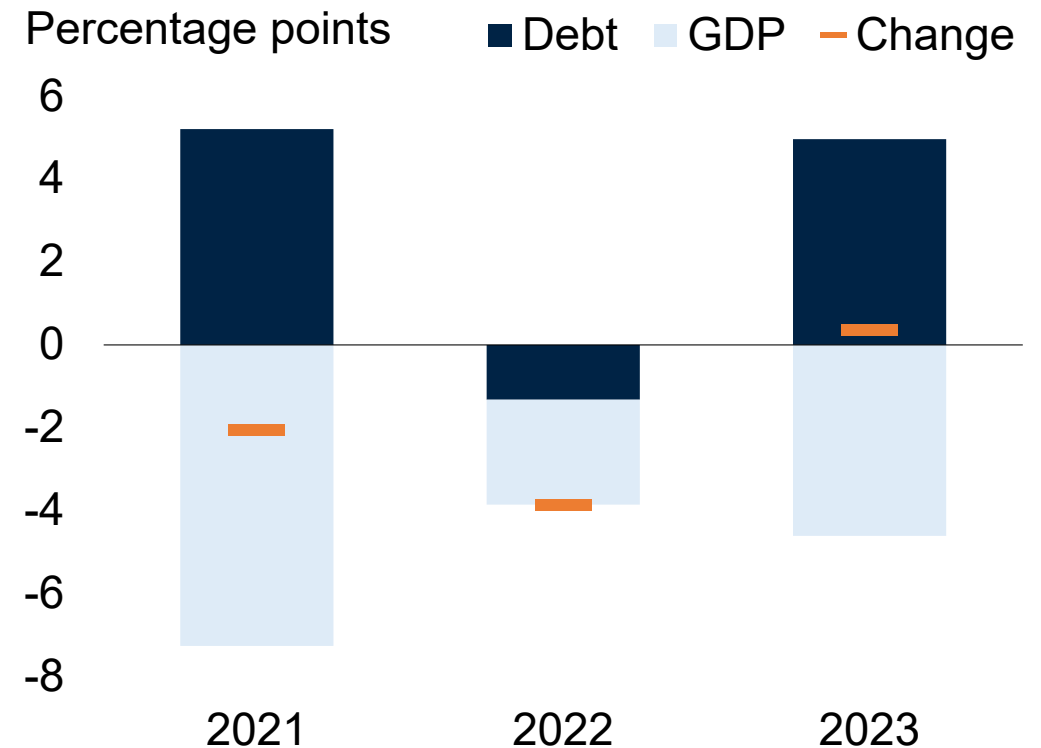
Sources: IMF, World Bank. Data for 2022-25 are projections as calculated by the April 2023 edition of the IMF *Fiscal Monitor*. Sample includes 19 ECA economies. Right Panel. Aggregates are period averages over 2021-24 of medians.

Government debt ratios improved in 2022, but remain higher than pre-COVID trend

Government debt in ECA excl. Russia, Türkiye, and Ukraine



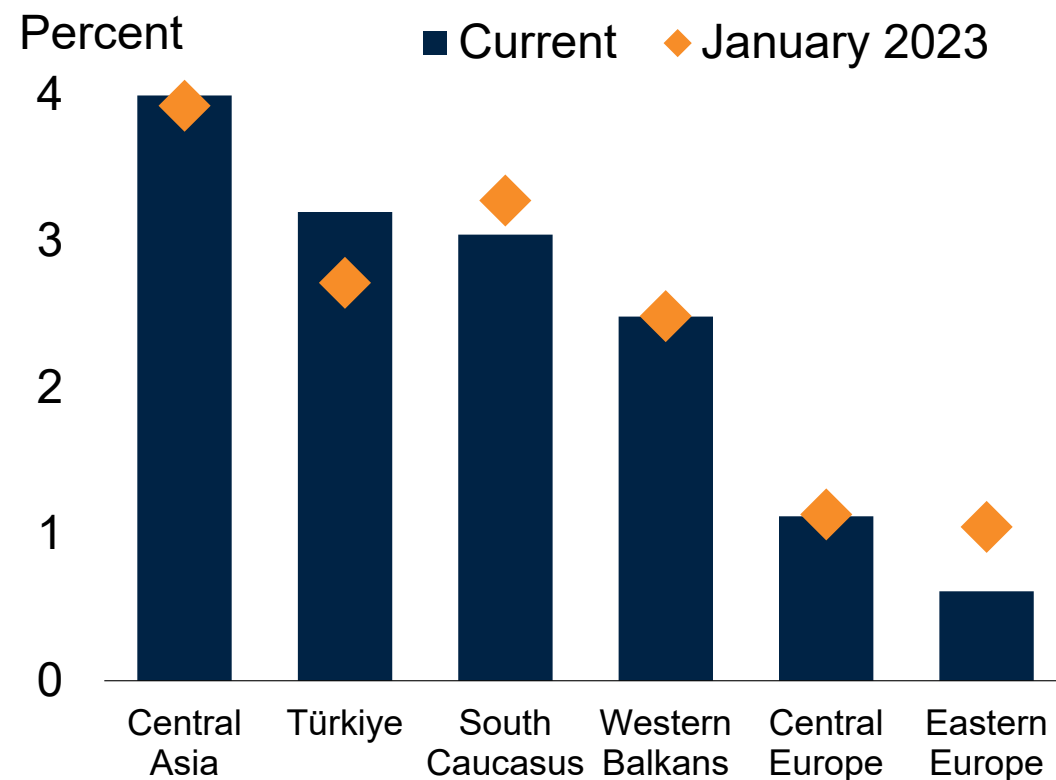
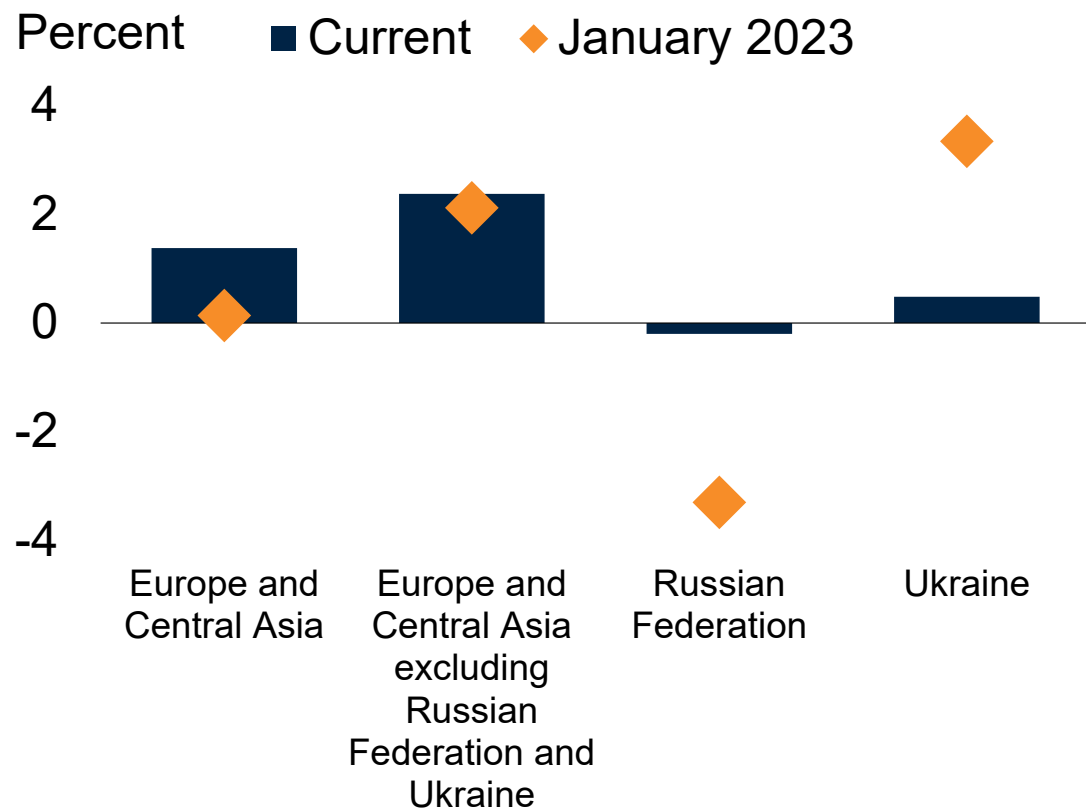
Change in government debt in ECA excl. Russia, Türkiye, and Ukraine



Sources: IMF, World Bank. Sample includes 19 ECA economies. Data for 2022-23 are projections, as calculated in the April 2023 edition of the IMF *Fiscal Monitor*. Aggregates are calculated using nominal U.S. dollar GDP weights. Right Panel. Figure shows contribution of the change in debt levels and change in GDP levels to the percentage point change in debt-to-GDP ratios.

Growth projected to remain lackluster 2023

Kazakhstan, Kosovo, Moldova, North Macedonia, and Ukraine will achieve higher growth in 2023 than in 2022



Source: World Bank. Aggregates are calculated using real GDP weights at average 2010-19 prices and market exchange rates. "January 2023" refers to projections released in the January 2023 edition of the *Global Economic Prospects* report.

Part 1. Conclusions

- Weak growth remains the greatest challenge for ECA
 - Growth projected at **1.4% for 2023** and **2.7% for 2024-25**
- High inflation will hurt households, especially among low-income persons
 - The longer inflation stays high, the more damage it generates
 - Reducing poverty to pre-COVID levels will be challenging
- Structural constraints will continue to weigh on growth prospects
 - Larger government presence in ECA
 - SOEs, state-connected enterprises, and lack of competition
 - Aging population
 - Climate vulnerabilities