EUROPE and CENTRAL ASIA

Output in Europe and Central Asia (ECA) is estimated to have expanded by 5.8 percent in 2021, reflecting a rebound in domestic demand and positive spillovers from firming activity in the euro area. Growth is forecast to slow to 3 percent in 2022, as domestic demand stabilizes, and 2.9 percent in 2023, as external demand plateaus and commodity prices soften. The near-term outlook is weaker than previously projected, owing to recurrent COVID-19 flareups, a faster-than-expected withdrawal of macroeconomic policy support, and sharp increases in policy uncertainty and geopolitical tensions. The pace of growth over the forecast horizon will leave output slightly lower than its pre-pandemic trend by 2023, and the catch-up of per capita income growth with advanced economies will be slower during 2021-23 than in the decade before the pandemic. Key risks to the regional outlook include a further resurgence of the pandemic, financial stress, less supportive external conditions than expected, and an additional rise in policy uncertainty or escalation in geopolitical tensions.

Recent developments

The COVID-19 pandemic continues to shape the economic outlook for ECA. COVID-19 has infected about one-tenth of the regional population as of early 2022, making ECA the hardest hit emerging market and developing economy (EMDE) region in per capita terms. Cases and deaths have surged in recent months, where they remain elevated alongside the spread of COVID-19 variants—including Omicron, which has been detected in about three-quarters of ECA's economies (figure 2.2.1.A).

Output is estimated to have expanded by 5.8 percent in 2021—considerably stronger than previously projected, partly reflecting a release of pent-up demand, especially in the region's largest economies (figure 2.2.1.B). Robust incoming data contributed to upward revisions of estimates for 2021 growth in about 90 percent of ECA economies. Firming activity in the euro area and higher commodity prices lifted export growth and remittance inflows, further bolstering the regional recovery (figure 2.2.1.C; chapter 1).

Recent high-frequency data, however, suggest that the latest surge of the pandemic will be disruptive, including through tighter domestic mobility restrictions and international travel bans. New export orders have moderated, reflecting softening external demand and lingering supply chain bottlenecks. Services exports have continued to trail manufacturing exports, owing to subdued international tourism, especially after international travel bans were reimposed because of the Omicron variant. Consumer and business confidence is waning alongside rising COVID-19 cases, higher inflation, elevated policy uncertainty, and an escalation in geopolitical tensions.

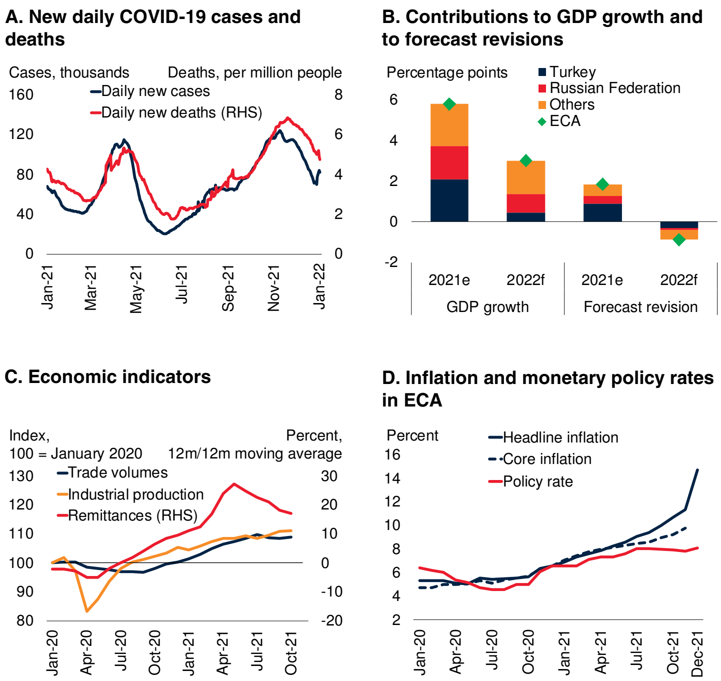
External financing conditions in ECA tightened more in 2021 than in the broader group of EMDEs. The region has experienced bouts of portfolio outflows amid weak investor sentiment, and sovereign bond spreads have widened in many ECA economies—particularly in those with elevated geopolitical tensions, policy uncertainty, or external financing pressures. Portfolio inflows to some large oil-exporting economies remain especially subdued, reflecting anemic investment in the extractives sector (UNCTAD 2021).

Many of the region's central banks are rapidly withdrawing monetary policy accommodation,

Note: This section was prepared by Collette Mari Wheeler.

FIGURE 2.2.1 ECA: Recent developments

COVID-19 cases and deaths have surged in recent months, where they remain elevated alongside the spread of COVID-19 variants. Despite these pandemic disruptions, the recovery in ECA in 2021 was stronger than previously projected, reflecting the release of pent-up demand and a supportive external environment through most of the year. A surge in prices has pushed inflation above target in nearly all inflation-targeting economies in the region, prompting a withdrawal of monetary policy accommodation.



Sources: CPB Netherlands Bureau for Economic Policy Analysis; Haver Analytics; Our World in Data (database); World Bank.

Note: ECA = Europe and Central Asia.

A. Figure shows 7-day moving averages of daily new COVID-19 cases and deaths for 23 ECA countries. Last observation is January 2, 2022.

B. Forecast revision shows the percentage point change between the January 2022 and June 2021 projections. Aggregates are calculated using real U.S. dollar GDP weights at average 2010-19 prices and market exchange rates. Data for 2021e indicate estimates and 2022f indicate forecasts.

C. Trade is the average of goods export and import volumes. Last observation is October 2021.

D. Aggregate headline inflation, core inflation, and policy rate are calculated using 2019 real GDP weights at average 2010-19 prices and market exchange rates. Inflation measured as the year-on-year percent change in consumer price and core price indexes. The unbalanced sample includes 9 ECA economies for core inflation and 14 ECA economies for headline inflation (2 economies for December 2021 because of data availability) and policy rate. Last observation is November 2021 for core inflation and December 2021 for headline inflation and policy rate.

prompted by a surge in prices that has pushed inflation above targets in nearly all inflation-targeting economies in the region (figure 2.2.1.D). Inflationary pressures have risen alongside recoveries in domestic demand and labor markets. They have also reflected ongoing currency weakness, lingering supply chain bottlenecks, and an increase in commodity prices—the last of which has pushed up electricity costs, contributing to power outages and social unrest in some economies. Elevated energy prices are also likely to generate sizable fiscal costs in several countries, particularly those in Central Europe and Eastern Europe, as a result of remaining energy subsidies. In some cases, the acceleration in prices, particularly for food items, has weighed on private consumption and contributed to a de-anchoring of inflation expectations. Inflationary pressures are not anticipated to subside in the near term in some ECA countries, especially in those where external factors, such as rising energy prices, are likely to be compounded by growing wage pressures (CBR 2021; MNB 2021).

Fiscal support measures began to expire in 2021, with only a handful of countries providing additional support to confront continued disruptions from the pandemic (Bulgaria, Kazakhstan, North Macedonia, Russia). Average public debt in ECA is estimated to hover around 35 percent of GDP by end-2021—more than 5 percentage points higher than at end-2019, as a result of elevated expenditures and sustained weakness in revenues.

Outlook

Growth in ECA is forecast to slow to 3 percent in 2022—about half the pace of 2021—as tighter macroeconomic policy and recurrent COVID-19 outbreaks, including from Omicron, weigh on demand (figure 2.2.2.A; table 2.2.1). Regional growth is forecast to continue to ease in 2023, slowing to 2.9 percent, as fiscal support continues to be withdrawn. The boost from external demand is expected to fade in 2023, as global and euro area growth decelerate and commodity prices edge down. The outlook has been downgraded by an average of 0.8 percentage point over 2022-23, partly owing to a sharp rise in policy uncertainty or geopolitical tensions in some large economies, which is anticipated to dent investment. The weaker outlook in the near term also reflects a faster removal of monetary policy accommodation than envisioned because of inflationary pressures.

The strength of the recovery last year helped limit scarring from the pandemic in ECA relative to other EMDEs (figure 2.2.2.B). Nonetheless, per capita GDP in 2023 is projected to be about 1.5 percent below its pre-pandemic trend, and the pace of ECA's per capita income catch-up with advanced economies is expected to be significantly slower over 2021-23 than in the decade before the pandemic (figure 2.2.2.C).

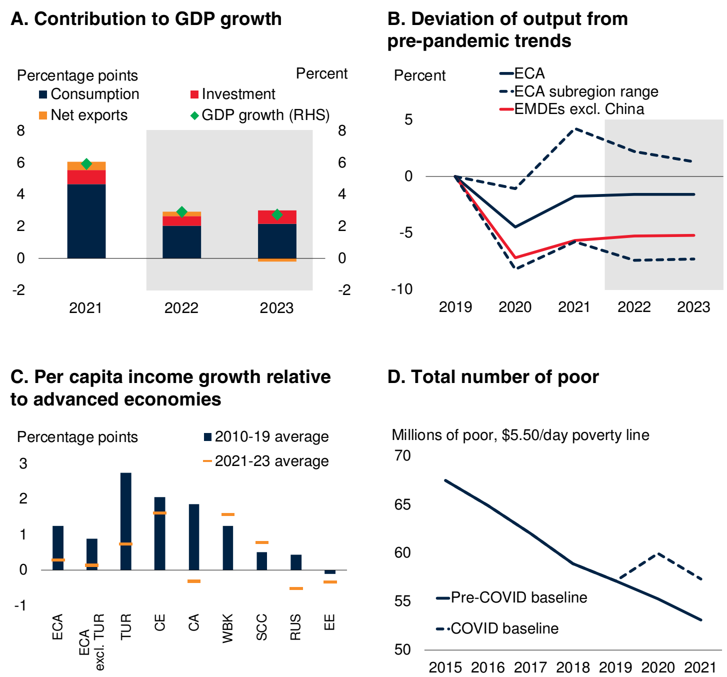
The pandemic has reversed earlier gains in poverty reduction. By the end of 2021, COVID-19 is likely to have pushed an additional 4.3 million people in ECA—about 1 percent of the region's population—under the $5.50 a day poverty line (figure 2.2.2.D; World Bank 2021c). Although this figure is smaller than in previous forecasts, it still indicates that the recovery is not inclusive. The incomes of many people in, or close to, poverty have been impacted by job losses, reductions in working hours, the removal of policy support, and higher inflation, particularly for energy and food items.

Growth in Russia is projected to moderate to 2.4 percent in 2022, as domestic demand wanes (table 2.2.2). Slowing growth also reflects a gradual return to adherence to the authorities' fiscal rule and a tighter monetary policy stance, which will offset an easing of oil production constraints among OPEC and its partners and a modest rise in oil prices. A further deceleration, to the trend growth rate of 1.8 percent, is projected for 2023, as industrial commodity prices soften. Forecasts for 2022 and 2023 have been downgraded by 0.8 and 0.5 percentage point, respectively, owing to ongoing pandemic disruptions and high inflation in the near term and a faster unwinding of macroeconomic policy support than previously envisioned over the next two years. The outlook is dampened by elevated geopolitical tensions, including additional U.S. sanctions imposed in 2021, and low vaccination rates, especially in the context of new variants. Absent policy reforms to address long-standing structural issues and the scarring effects of COVID-19, the pandemic is anticipated to exacerbate the slowdown in potential output growth over the next decade (World Bank 2021d).

In Turkey, the expansion is set to decelerate to 2 percent in 2022—less than half the pace previously projected, as the drag from high inflation on private consumption more than offsets a sustained boost from net exports. The marked deterioration in the near-term outlook

FIGURE 2.2.2 ECA: Outlook

Growth in ECA is forecast to slow to 3 percent in 2022 and 2.9 percent in 2023, as domestic demand stabilizes. Output is expected to be only slightly below pre-pandemic trends in 2023. Catch-up with advanced economies' per capita incomes is projected to be slower in the forecast period than before the pandemic, and more than 4 million additional people in the region are expected to fall into poverty.



Source: World Bank.

Note: CA = Central Asia; CE = Central Europe; ECA = Europe and Central Asia; EE = Eastern Europe; RUS = Russian Federation; SCC = South Caucasus; TUR = Turkey; WBK = Western Balkans.

A.B. Aggregates calculated using constant GDP weights at average 2010-19 prices and market exchange rates. Shaded area indicates forecasts.

A. The sample includes 14 ECA countries with available data for expenditure components of GDP; thus, aggregate GDP growth numbers presented in table 2.2.1 will differ from what is shown in figure.

B. Figure shows percent deviation between the levels of January 2020 and January 2022 baseline World Bank projections for 2020 to 2022. For 2023, the January 2020 baseline is extended using projected growth for 2022. The range includes the five ECA subregions and Russia and Turkey. The upper range line shows Turkey, which is expected to surpass its pre-pandemic trend. The lower range line over 2021-23 is Eastern Europe, which is anticipated to experience the largest output losses relative to its pre-pandemic trend.

C. Relative per capita income growth is computed as the difference in per capita GDP growth between respective groups and advanced economies.

D. Figure shows data from World Bank (2021c).

also reflects weaker-than-expected investment, owing to a sharp rise in policy uncertainty after multiple policy rate cuts triggered the lira to fall to new record lows against the U.S. dollar. Growth is then forecast to firm to only 3 percent in 2023, as the contribution from net exports fades and the recovery in domestic demand is held back by subdued investment. Additional monetary policy accommodation and accelerating inflation have heightened financial stability concerns, which could be exacerbated by a further erosion in confidence—possibly triggering financial turmoil (World Bank forthcoming).

In Central Europe, growth is forecast to moderate alongside the euro area, to 4.7 percent in 2022 and 3.7 percent in 2023. Although activity is likely to be disrupted in the near term from the spread of the Omicron variant, the subregional economy will benefit from firming domestic demand over the forecast horizon. In particular, investment and government revenues are expected to be bolstered by funding from the European Union (EU) Recovery and Resilience Facility—the largest component of the Next Generation EU funds. If fully implemented as planned by end-2026, these reforms and investments could help lift productivity by narrowing the digital divide and accelerating technological adoption (Hallward-Driemeier et al. 2020). Measures that improve administrative capacity and governance could help boost the absorption of these funds in Central Europe.

In the Western Balkans, growth is projected to moderate to 4.1 percent in 2022 and 3.8 percent in 2023. The recovery is expected to lose momentum as the external boost fades and confidence is dented by rising policy uncertainty, particularly in Bosnia and Herzegovina. Medium-term growth in Albania and North Macedonia should be boosted by accelerating structural reforms in preparation for EU membership, provided negotiations surrounding the accession process are not further delayed (Rovo 2020; World Bank 2021e). The subregion is also expected to benefit from 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 transition.

In the South Caucasus, growth is projected to moderate to 3.9 percent in 2022 and 3.6 percent in 2023. In Azerbaijan, growth is anticipated to decelerate over the forecast horizon but remain above its 2010-19 average rate, supported by an expansion in non-energy sectors, rising public investment, and stable energy sector growth in line with OPEC+ quotas and higher natural gas production. Georgia's economy is projected to ease toward its potential growth rate in 2022 and 2023 amid tighter fiscal policy. In Armenia, growth is expected to accelerate in 2023, as robust private consumption and a more stable investment climate support domestic demand and offset the drag from ongoing fiscal consolidation. The forecast is predicated on an easing of geopolitical tensions, limited pandemic-related disruptions supported by progress with vaccinations, and improving consumer and business confidence. Weighing on the outlook are legacy structural issues and weaker oil prices in Azerbaijan, as well as challenges with reform implementation in Armenia.

Growth in Eastern Europe is projected to be the weakest among the ECA subregions, halving from 3.1 percent in 2021 to 1.4 percent in 2022. The subdued outlook, particularly for private investment, reflects ongoing geopolitical tensions in Ukraine and the impact of economic sanctions on Belarus's economy, which is expected to contract in 2022. Assuming geopolitical tensions do not escalate further, improving domestic demand should help lift output in Eastern Europe to 3.2 percent in 2023. Longer-term growth prospects are constrained by sluggish reform momentum, which has hindered competition and private-sector development.

Output growth in Central Asia is forecast to remain steady at 4.3 percent in 2022, with tighter monetary policies in some countries weighing on the recovery. Growth is expected to strengthen to 5.1 percent in 2023, supported by firming investment. In Uzbekistan, growth should continue to benefit from the implementation of its reform agenda, which progressed throughout the pandemic despite formidable headwinds. Weighing on the medium- to longer-term outlook for Central Asia are concerns about spillovers from political stability in neighboring countries, particularly Afghanistan, which has dampened Tajikistan's exports. The outlook is also subject to political uncertainty within the region following domestic political tensions, social unrest, and conflict over border disputes.

Risks

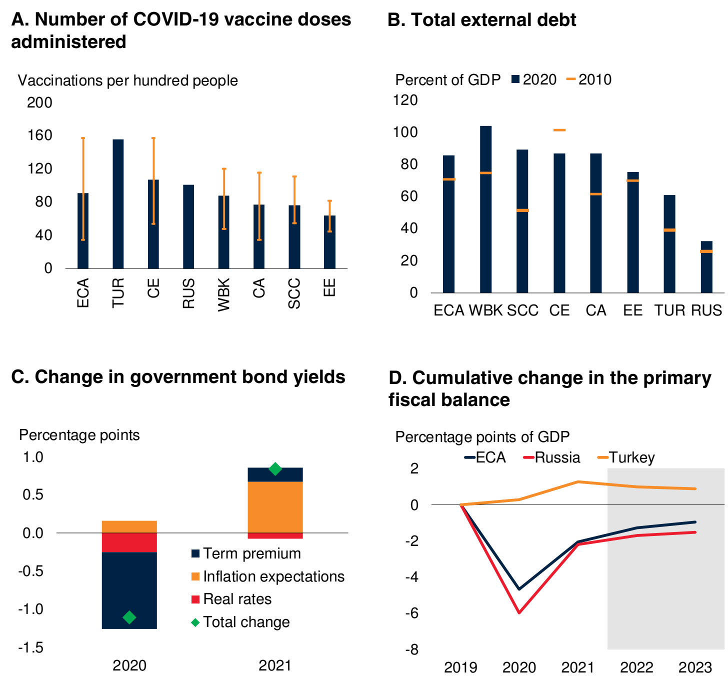
Risks to the baseline forecast for the region remain tilted to the downside. Further COVID-19 outbreaks may occur, especially in economies with low vaccination rates (figure 2.2.3.A). The spread of the Omicron variant could strain health systems in ECA, which could prompt additional restrictions. A prolonged pandemic could weigh further on the recovery in the euro area, generating negative spillovers in ECA economies with close trade and financial ties (Elekdag, Muir, and Wu 2015; World Bank 2016). Slower-than-projected growth in China could be propagated through trade and commodity price channels to industrial commodity exporters in the region, which have become increasingly reliant on China as an export destination. The region's energy exporters—Azerbaijan, Kazakhstan, and Russia—remain vulnerable to large swings in global commodity prices (chapter 3; van Eyden et al. 2019).

The possibility of financial stress also looms over the region's outlook, especially given the risk of inflation remaining above target in many ECA economies. As a result of its deep global financial linkages, particularly with the euro area, ECA is vulnerable to sudden stops of capital inflows and abrupt tightening of external financing conditions. In many of the region's economies, external financing pressures have remained elevated, reflecting heightened policy uncertainty and geopolitical risks. Inflationary pressures and sustained currency depreciation, combined with increasing term premiums and widening sovereign bond spreads, have started to put upward pressure on ECA government financing costs, increasing rollover risks in economies with high short-term external debt levels (figures 2.2.3.B and 2.2.3.C). Any further tightening in financing conditions that makes servicing public debt more costly could pose fiscal sustainability challenges, especially given that debt is anticipated to remain elevated throughout the forecast horizon despite fiscal policy support being withdrawn at a faster pace than previously envisioned (figure 2.2.3.D).

An intensification of geopolitical tensions, possibly accompanied by additional sanctions and leading to additional financial market pressures, remains a key downside risk in ECA. The region could be destabilized by an escalation of conflict in Ukraine or between the Kyrgyz Republic and Tajikistan; heightened political tensions in Bosnia and Herzegovina, armed conflict between Armenia and Azerbaijan, and the crossing of refugees at the Belarus-Poland border; or security challenges and associated refugee spillovers from neighboring Afghanistan.

FIGURE 2.2.3 ECA: Risks

Although ECA has higher COVID-19 vaccination rates than several other EMDE regions, progress has been hindered by vaccine hesitancy in some countries. Risks of financial stress remain elevated. An abrupt tightening in global financing conditions could increase risks relating to public debt rollovers and currency mismatches, especially given record-high debt in some countries.



Sources: Andrle et al. 2015; Botha et al. 2017; International Monetary Fund; Kose et al. 2017; Our World in Data (database); Ruch 2021; World Bank.

Note: CA = Central Asia; CE = Central Europe; ECA = Europe and Central Asia; EE = Eastern Europe; RUS = Russian Federation; SCC = South Caucasus; TUR = Turkey; WBK = Western Balkans.

A. Aggregates calculated using simple averages. Orange whiskers are the minimum-maximum range. Data as of January 2, 2022.

B. The figure shows average external debt as a percent of GDP. Aggregates calculated using simple averages. The sample includes 22 ECA countries.

C. Based on estimates from a multivariate filter model of Ruch (2021) extended using the expectations hypothesis as in Andrle et al. (2015) and Botha et al. (2017). Actual data through 2021Q4, as featured in World Bank (2021c). The sample excludes Turkey.

D. Figure shows the GDP-weighted cumulative change in the primary fiscal balance since 2019, based on IMF (2021b) data. The sample includes 23 ECA countries.

TABLE 2.2.1 Europe and Central Asia forecast summary

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

	2019	2020	2021e	2022f	2023f	Percentage point differences from June 2021 projections: 2021e	2022f	2023f
EMDE ECA, GDP [1]	**2.7**	**-2.0**	**5.8**	**3.0**	**2.9**	**1.9**	**-0.9**	**-0.6**
GDP per capita (U.S. dollars)	2.3	-2.4	5.5	2.8	2.8	1.8	-0.9	-0.6
EMDE ECA, GDP excl. Turkey	3.2	-3.1	4.8	3.3	2.9	1.1	-0.4	-0.3
(Average including countries that report expenditure components in national accounts) [2]								
EMDE ECA, GDP [2]	2.5	-2.0	5.9	2.9	2.7	1.9	-1.0	-0.7
PPP GDP	2.4	-2.0	5.9	2.8	2.7	2.0	-1.0	-0.6
Private consumption	3.5	-3.7	7.7	3.1	3.1	4.0	-0.8	-0.5
Public consumption	3.0	3.4	1.7	1.5	2.1	0.9	0.8	0.5
Fixed investment	-0.5	-2.2	4.1	2.8	4.0	-0.8	-3.8	-1.0
Exports, GNFS [3]	3.6	-6.7	10.5	5.7	4.9	4.9	0.2	-0.5
Imports, GNFS [3]	2.9	-4.6	10.0	5.5	6.1	4.9	-1.5	0.5
Net exports, contribution to growth	0.4	-1.0	0.5	0.3	-0.2	0.2	0.6	-0.3
Memo items: GDP								
Commodity exporters [4]	2.5	-2.9	4.3	2.7	2.4	1.0	-0.7	-0.4
Commodity importers [5]	2.8	-1.2	7.3	3.3	3.4	2.7	-1.1	-0.8
Central Europe [6]	4.5	-3.5	5.7	4.7	3.7	1.1	0.1	-0.3
Western Balkans [7]	3.7	-3.3	5.9	4.1	3.8	1.5	0.4	0.0
Eastern Europe [8]	2.7	-3.2	3.1	1.4	3.2	1.2	-1.4	0.6
South Caucasus [9]	3.8	-5.3	6.3	3.9	3.6	2.7	-0.3	-0.4
Central Asia [10]	4.9	-1.4	4.3	4.3	5.1	0.6	0.0	0.0
Russian Federation	2.0	-3.0	4.3	2.4	1.8	1.1	-0.8	-0.5
Turkey	0.9	1.8	9.5	2.0	3.0	4.5	-2.5	-1.5
Poland	4.7	-2.5	5.1	4.7	3.4	1.3	0.2	-0.5

Source: World Bank.

Note: e = estimate; f = forecast; PPP = purchasing power parity; EMDE = emerging market and developing economy. 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 Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time. The World Bank is currently not publishing economic output, income, or growth data for Turkmenistan owing to a lack of reliable data of adequate quality. Turkmenistan is excluded from cross-country macroeconomic aggregates.

1. GDP and expenditure components are measured in average 2010-19 prices and market exchange rates.
2. Aggregates presented here exclude Azerbaijan, Bosnia and Herzegovina, Kazakhstan, Kosovo, the Kyrgyz Republic, Montenegro, Serbia, Tajikistan, Turkmenistan, and Uzbekistan, for which data limitations prevent the forecasting of GDP components.
3. Exports and imports of goods and nonfactor services (GNFS).
4. Includes Armenia, Azerbaijan, Kazakhstan, the Kyrgyz Republic, Kosovo, the Russian Federation, Tajikistan, Ukraine, and Uzbekistan.
5. Includes Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Hungary, Moldova, Montenegro, North Macedonia, Poland, Romania, Serbia, and Turkey.
6. Includes Bulgaria, Croatia, Hungary, Poland, and Romania.
7. Includes Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia.
8. Includes Belarus, Moldova, and Ukraine.
9. Includes Armenia, Azerbaijan, and Georgia.
10. Includes Kazakhstan, the Kyrgyz Republic, Tajikistan, and Uzbekistan.

TABLE 2.2.2 Europe and Central Asia country forecasts [1]

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

						Percentage point differences from June 2021 projections		
	2019	2020	2021e	2022f	2023f	2021e	2022f	2023f
Albania	2.1	-4.0	7.2	3.8	3.7	2.8	0.1	0.0
Armenia	7.6	-7.4	6.1	4.8	5.4	2.7	0.5	0.1
Azerbaijan	2.5	-4.3	5.0	3.1	2.7	2.2	-0.8	-0.7
Belarus	1.4	-0.9	1.9	-2.8	2.3	4.1	-4.7	1.1
Bosnia and Herzegovina [2]	2.8	-3.2	4.0	3.0	3.2	1.2	-0.5	-0.5
Bulgaria	3.7	-4.2	3.3	3.8	3.6	0.7	0.5	0.2
Croatia	3.5	-8.1	9.4	5.4	4.4	3.9	-0.8	-1.3
Georgia	5.0	-6.8	10.5	5.5	5.0	4.5	0.5	0.0
Hungary	4.6	-4.7	6.8	5.0	4.3	0.8	0.3	0.0
Kazakhstan	4.5	-2.5	3.5	3.7	4.8	0.3	0.0	0.0
Kosovo	4.8	-5.3	7.1	4.1	4.4	3.1	-0.4	0.3
Kyrgyz Republic	4.6	-8.6	2.3	4.7	4.3	-1.5	0.4	-0.2
Moldova	3.7	-7.0	6.8	3.9	4.4	3.0	0.2	0.6
Montenegro	4.1	-15.3	10.8	5.6	4.8	3.7	1.1	1.3
North Macedonia	3.9	-6.1	4.0	3.7	3.4	0.4	0.2	0.0
Poland	4.7	-2.5	5.1	4.7	3.4	1.3	0.2	-0.5
Romania	4.2	-3.7	6.3	4.3	3.8	0.3	-0.2	-0.1
Russian Federation	2.0	-3.0	4.3	2.4	1.8	1.1	-0.8	-0.5
Serbia	4.3	-0.9	6.0	4.5	4.0	1.0	0.8	0.1
Tajikistan	7.4	4.5	7.0	5.5	4.5	1.7	-0.1	-1.5
Turkey	0.9	1.8	9.5	2.0	3.0	4.5	-2.5	-1.5
Ukraine	3.2	-4.0	3.4	3.2	3.5	-0.4	0.1	0.4
Uzbekistan	5.7	1.7	6.2	5.6	5.8	1.4	0.1	0.0

Source: World Bank.

Note: e = estimate; f = forecast. 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 Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time. The World Bank is currently not publishing economic output, income, or growth data for Turkmenistan owing to a lack of reliable data of adequate quality. Turkmenistan is excluded from cross-country macroeconomic aggregates.

1. Data are based on GDP measured in average 2010-19 prices and market exchange rates, unless indicated otherwise.

2. GDP growth rate at constant prices is based on production approach.

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