ARMENIA

Highlights

- **Strong economic growth and macroeconomic stability have been challenged by the shock of the Covid-19 pandemic.** GDP growth of 7.6 per cent in 2019 was followed by a slowdown to 3.7 per cent year-on-year in the first quarter of 2020 and to a 13.7 per cent year-on-year decline in the second quarter.
- **A crisis response package has been supported by external financing.** To cope with rising financing needs the authorities drew on the existing International Monetary Fund (IMF) programme and augmented the financial assistance envelope.
- **The authorities took steps to tackle longstanding governance and business environment deficiencies.** Measures adopted in the past year are helping to institutionalise the fight against corruption, address labour market shortcomings and advance business environment reforms.

Key priorities for 2021

- **The government should continue steps towards a new growth model.** The Covid-19 pandemic has shown the limitations and weaknesses of a growth model based on consumption driven by remittances. Good domestic policies, drawing on the support of the diaspora, could be helpful in exploiting new opportunities in the post-pandemic world.
- **Reforms in the key areas of governance and competition need to continue.** The institutional fight against corruption, a better rule of law and a good business environment are key components in building an economy more resilient to external shocks.
- **Fiscal prudence should be continued with a clear focus on needs and priorities.** Once the Covid-19 crisis subsides and the flare-up in Nagorno-Karabakh calms, the fiscal prudence characteristic of the last year can help to reduce the elevated public debt level. However, that should not be at the cost of much-needed infrastructure investments.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth[1]	0.2	7.5	5.2	7.6	-5.0
Inflation (average)	-1.4	1.0	2.5	1.4	0.9
Government balance/GDP	-5.6	-4.8	-1.8	-1.0	-5.8
Current account balance/GDP	-1.0	-1.5	-6.9	-7.2	-8.8
Net FDI/GDP [neg. sign = inflows]	-2.5	-1.9	-2.0	-2.9	n.a.
External debt/GDP	94.4	91.3	87.6	90.3	n.a.
Gross reserves/GDP	20.9	20.1	18.1	20.8	n.a.
Credit to private sector/GDP	52.2	53.0	57.1	62.3	n.a.

[1] The GDP forecast for 2020 was determined prior to the flare-up of the conflict over Nagorno-Karabakh.

CONTINUES

Covid-19: macroeconomic implications

Covid-19 containment measures are weighing on the economy in 2020. GDP growth of 3.9 per cent year-on-year in the first quarter of 2020, following 7.6 per cent growth in 2019, turned to a 13.7 per cent year-on-year decline in the second quarter as household consumption contracted by nearly 20 per cent, investments by nearly 30 per cent and trade by approximately 35 per cent year-on-year in real terms. Household consumption, the largest growth driver in Armenia, was affected by a severe drop in money transfers from abroad (close to 24 per cent year-on-year in the second quarter) and containment measures being put in place. The state of emergency, introduced in March 2020 and extended for five consecutive months until the first half of September, was replaced by a nationwide quarantine that will be in force until 11 January 2021. Measures of social containment and low mobility affect Armenia's tourism sector, which is largely dependent on visits from the diaspora. The decrease in remittances nearly levelled off in June to July and increased in August, driven by a strong increase in transfers from the United States of America, which were balanced against the continued shrinking of remittances from Russia. High-frequency indicators of economic activity point to a 6.6 per cent year-on-year decline in economic output in the period January to September 2020.

Despite the crisis, macroeconomic stability was preserved in the first three quarters of 2020. In the first six months of 2020, a contraction of goods and services imports balanced out the decline in export revenues, helping to contain currency pressures and supporting exchange rate stability following a short period of depreciation at the onset of the pandemic. International reserves assets, propped up by external financing, stood at US$ 2.4 billion in September 2020, covering 4.3 months of imports. In the absence of significant inflationary pressure, the refinancing rate was decreased four consecutive times in 2020, reaching 4.25 per cent in September.

The authorities' crisis response was supported by external financing. The initially announced package of measures to support the economy and the population amounted to 2.2 per cent of GDP. To satisfy rising financing needs the authorities asked for augmentation of the IMF programme, which, together with the authorities' intention to draw on the purchase rights accumulated under the Stand-By Arrangement, made around US$ 280 million available to the authorities. Because of Covid-19 disruption, the IMF projects government debt to exceed 60 per cent of GDP by the end of 2020. However, with the authorities' commitments to the medium-term fiscal goal of debt sustainability, it is expected that the ratio will gradually decline over the medium term.

The sharp decline of economic output in 2020 is likely to be followed by a gradual recovery. The Armenian economy is expected to shrink by 5.0 per cent in 2020, followed by growth of 4.0 per cent in 2021, but with considerable uncertainty depending on the future path of the pandemic. The flare-up of the conflict over Nagorno-Karabakh adds to the uncertainty and its impact on the economic performance of Armenia depends on the duration and human and material costs.

Policy response to Covid-19

Immediate relief measures adopted by the authorities aim to preserve jobs and protect the most vulnerable. Between the onset of the pandemic in March 2020 and August 2020, the authorities implemented 24 different measures amounting to 2 per cent of GDP (US$ 300 million) to support the economy. Measures include subsidised loans of two- or three- year terms to the most affected sectors and businesses, in particular in tourism and agriculture, grants to the private sector and direct wage subsidies to micro, small and medium-sized enterprises (MSMEs), under the condition that they keep their employees. The authorities also strengthened their social assistance programme with additional lump sum transfers to socially vulnerable groups. Enabled by low inflationary pressures, the central bank lowered the monetary policy rate to ensure liquidity in the banking sector and made limited interventions in the foreign exchange market to avoid excessive dram volatility. The regulator recommended banks to consider voluntary loan restructuring and limited payment holiday periods.

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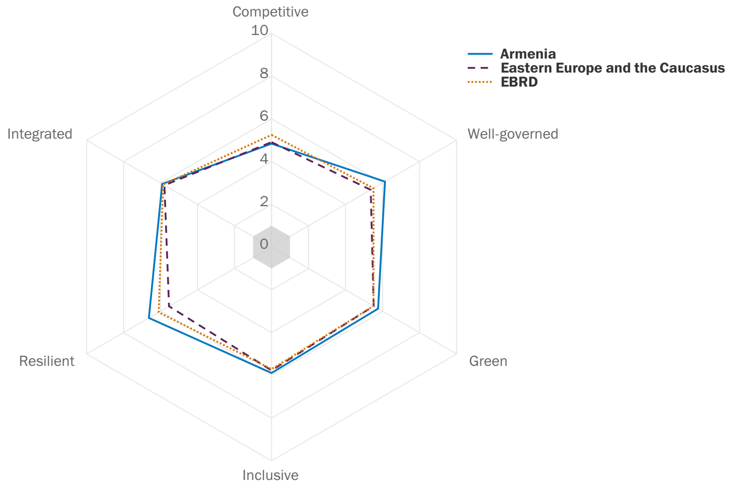
Assessment of transition qualities (1-10)



Structural reform developments

The authorities advanced their efforts to institutionalise the fight against corruption. An anti-corruption strategy for 2019-23, approved in October 2019, outlines the new institutional framework and proposes concrete actions. The strategy envisages setting up an Anti-corruption Committee, an independent entity in charge of detection and investigation of corruption offences, in 2021. Also in October 2019, the government approved the 2019-23 Strategy for Judicial and Legal Reforms aiming at enhancing the effectiveness of courts, the prosecutor's office and investigative bodies as they play a key role in the anti-corruption fight.

New labour market policies have been adopted. These include an employment strategy and an increase in the minimum wage. The employment strategy aims to address persistent labour market shortcomings. Armenia is facing skills mismatches despite rising educational attainment levels, and the private sector often has difficulty in finding skilled workers although the unemployment level is high. Adopted in December 2019, the employment strategy "Work, Armenia" proposes a set of active labour market policies in order to address labour market shortcomings and create sustainable and inclusive employment. At the same time, the government approved an increase in the minimum wage by 23 per cent to the equivalent of US$ 142 per month, effective from January 2020.

The authorities have adopted a new strategy for the development of capital markets. Implementation of the capital market development programme, adopted by the authorities in July 2020, would help better utilise domestic savings while increasing transparency in the corporate sector and enhancing the monetary transmission. The programme analyses the current state of the capital market in Armenia and proposes an action plan to strengthen the foundations, expand the market and achieve longer-term goals.

Improvements in the business environment have been made. At the end of 2019, the authorities created an Investment Support Office within the Ministry of Economy to promote domestic and foreign investments. The office acts as a one-stop-shop for investors, providing information on investment opportunities and the business environment, and supporting investors in accessing public services and in communicating with the state authorities. The government approved a set of measures for 2020-23 to address drawbacks in the business environment as identified in the World Bank *Doing Business 2020* report, while the strategy for the development of SMEs for 2020-24 and the associated action plan for 2020-22 aim to create a more favourable environment for smaller companies. Lastly, to strengthen state-owned enterprise (SOE) reporting requirements, audit and publication of financial reports of SOEs fulfilling certain criteria were made mandatory from January 2020.

AZERBAIJAN

Highlights

- **The economy has been hit by the twin shocks of the Covid-19 pandemic and a slump in oil prices in 2020.** GDP declined by 3.9 per cent year-on-year in the first nine months of the year. Amid soaring demand for foreign exchange, transfers by the sovereign wealth fund SOFAZ to local banks via central bank auctions kept the currency stable.
- **The authorities deployed a crisis response package of economic and social support.** The cost of the package exceeds 4 per cent of GDP and the widening budget deficit is expected to be financed by the sovereign fund rather than by external financing.
- **The crisis prompted the authorities to rethink their approach to the governance of state-owned enterprises (SOEs).** The establishment of a public holding company to centrally manage SOEs aims to increase the efficiency and transparency of the state sector.

Key priorities for 2021

- **Pursuing further governance reforms in the state sector would bring significant efficiency gains.** The creation of a public company to manage SOEs is an opportunity to introduce best international corporate governance and management practices across the SOE sector.
- **The shift in financial sector regulation back to the central bank is an opportunity to reinvigorate reforms.** The current economic downturn will further accentuate weaknesses in the banking sector, including the regulatory framework and its supervision. Promptly addressing these drawbacks would support a faster economic recovery.
- **Continued implementation of energy sector reforms is needed.** The development of a sustainable and competitive energy market with a sound regulatory framework and institutions will strengthen the economy's resilience to future shocks.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth[1]	-3.1	0.1	1.4	2.2	-3.0
Inflation (average)	12.4	12.9	2.3	2.7	3.0
Government balance[2]/GDP	-1.1	-1.4	5.5	8.1	-6.3
Current account balance/GDP	-3.6	4.1	12.8	9.1	-3.6
Net FDI/GDP [neg. sign = inflows]	-5.1	-0.7	1.7	2.9	-1.0
External debt[3]/GDP	20.4	22.8	19.0	18.9	n.a.
Gross reserves[4]/GDP	10.5	13.1	11.9	13.0	n.a.
Credit to private sector/GDP	27.2	16.7	16.3	18.7	n.a.

[1] The GDP forecast for 2020 was determined prior to the flare-up of the conflict over Nagorno-Karabakh.
[2] Includes central government and main extrabudgetary funds, including operations of the oil fund and the social protection fund.
[3] Public and publicly guaranteed external debt outstanding.
[4] Excluding assets of the State Oil Fund (SOFAZ).

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Covid-19: macroeconomic implications

The economy was hit by twin shocks: the Covid-19 pandemic and a slump in oil prices. After the robust growth at the beginning of 2020, output in the non-oil sector turned negative following the introduction in March 2020 of measures to protect public health. Containment measures were extended a few times since then and limitations on regular business activities maintained, particularly in the service sector, although they have been loosened. Output in the non-oil and gas sector reached a trough in June 2020 before slowly recovering. The slump in global demand hit Azerbaijan's export sector, which is dominated by hydrocarbons. With more than one-third of GDP, roughly two-thirds of government revenue and 90 per cent of exports generated by the hydrocarbon sector, the slump in oil prices on top of the Covid-19-induced crisis is taking a significant toll on the economy. Preliminary figures show GDP declined by 3.9 per cent year-on-year in the first nine months of 2020, with the non-oil and gas sector falling by 2.4 per cent. Capital investments were down by 3.8 per cent year-on-year and nominal income of the population remained flat (after many years of continued growth).

Macroeconomic stability is being preserved. Amid soaring demand for foreign exchange, SOFAZ sold US$ 6.2 billion until October 2020 to local banks, keeping the currency stable. The *de facto* currency peg is supporting low inflation, at 2.6 per cent in September 2020. Low inflationary pressures allowed the central bank to continue cutting the refinancing rate, which declined by 100 basis points to 6.5 per cent in September 2020. However, external and fiscal surpluses are turning negative on the back of significantly lower oil revenues.

Crisis response and the budget financing gap have been financed by reserves from SOFAZ. The authorities responded with a package of economic and social support measures amounting to 4.3 per cent of GDP. Higher expenditures and lower tax revenues are expected to widen the budget deficit to 6.3 per cent of GDP. However, the country prefers to rely on the sovereign fund for financing rather than on external financing. In the first half of 2020, the combined assets of SOFAZ and the central bank amounted to nearly US$ 50 billion, more than the country's projected GDP.

Economic contraction is expected to be followed by a mild recovery. We expect the economy to contract by 3.0 per cent in 2020, recovering by 2.5 per cent in 2021. Key risks to the near-term developments are related to a possible resurgence of the pandemic, continued weaknesses in the oil market and the ongoing conflict over Nagorno-Karabakh. Large liquidity buffers anchor the country's resilience to shocks, but the prolonged duration of the conflict could test the country's macroeconomic stability and have significant economic costs.

Policy response to Covid-19

The authorities prepared a large programme to support the non-oil and gas sector and vulnerable social groups. Support to businesses includes wage subsidies, various tax benefits, financial support to micro entrepreneurs, issuance of state guarantees on new loans with a subsidised interest rate to businesses in the most affected sectors, and subsidising interest rates on existing loan portfolios of companies operating in pandemic-affected areas. The transport sector is receiving significant support from the authorities as well. The Central Bank of the Republic of Azerbaijan adopted a package of measures to relax the regulatory burden and support the banking and insurance sectors as well as capital market participants. It reduced capital requirements, introduced a loan loss provisions holiday and restricted dividend payments until September 2020. To support vulnerable individuals, the state expanded unemployment benefits and introduced a scheme providing preferential mortgage loans, and it expanded the pool of households benefiting from consuming electricity under preferential prices.

The blanket deposit guarantee insurance was extended. The scheme was first adopted in 2016 to safeguard financial stability and boost confidence amid times of macro-financial volatility and an economic downturn. In March 2020, the authorities decided to extend the blanket guarantee for an additional nine months to strengthen confidence in the banks during the pandemic. The scheme covers all depositors' funds irrespective of the amount and currency denomination.

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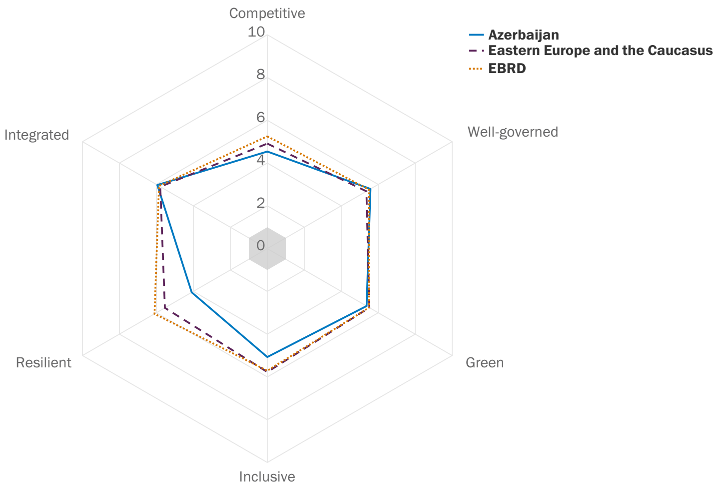
Assessment of transition qualities (1-10)



Structural reform developments

Regional support infrastructure for small and medium-sized enterprises (SMEs) was strengthened. The recently established Agency for the Development of SMEs in Azerbaijan opened the first House of SMEs in early 2020. Based in the Khachmaz region in the north of the country, this platform offers and coordinates services provided by the government and by private entities in a single space. Its offer includes support in launching start-ups via the development of business and marketing plans, improvement of business knowledge, and help in obtaining registration and various licences to access financial resources, logistics and infrastructure networks, internal and external markets and export promotion.

The authorities have partly liberalised the foreign currency operations regime. In February 2020, the central bank extended the period for submission of customs declarations and other documents confirming imports of goods and services from 270 days to two years. Under the new rules, imports with a total cost below US$ 10,000 are exempt from notifying the currency control authorities.

The central bank has regained its financial sector supervision function. The Financial Market Supervision Authority (FIMSA) was established in early 2016 with the onset of the banking sector crisis and tasked with the licensing, regulation and supervision of banks, the securities market, investment funds, insurance firms, credit organisations and payment systems. During its term, FIMSA implemented a number of reforms including initiating the cleaning up of the banking sector (11 banks closed in 2016), strengthening the monitoring and regulatory framework for the financial system, and setting up a credit bureau. At the end of 2019, the authorities closed FIMSA and transferred all of its functions back to the central bank. Following the transfer of power and following inspection of the banks, the central bank initially appointed temporary administrators in four banks in April 2020 and revoked their licences shortly thereafter.

The authorities initiated reforms to improve management of the SOEs. Recognising the cost of inefficient management, particularly with the budget tightening as the pandemic unfolds, in August 2020 the authorities established the Azerbaijani Investment Holding public company to manage SOEs. The establishment of the company aims to increase the efficiency and transparency of the SOEs to be placed under its umbrella. The governance and management structure of the holding as well as the list of public companies are yet to be determined.

Development of a major gas project advanced. In November 2019, the European segment of the Southern Gas Corridor, Trans Adriatic Pipeline (TAP) was linked to the Trans-Anatolian Natural Gas Pipeline (TANAP) at the Turkish-Greek border. With TANAP becoming operational in 2018, the first gas deliveries from Azerbaijan's Shah Deniz gasfield to Europe via TAP are expected by the end of 2020. The project almost triples Azerbaijan's annual gas production capacity.

BELARUS

Highlights

- **After a slowdown in 2019, economic growth turned negative in 2020.** GDP growth was just 1.2 per cent in 2019 and the decline of 0.2 per cent year-on-year in the first quarter of 2020 was largely driven by a supply shock in the petrochemical sector.
- **The Covid-19 pandemic has deepened the recession.** Support to the economy mainly came from limited tax measures and monetary and prudential counter-cyclical measures in the banking sector. Events following the presidential elections in August 2020 have created additional disruption and uncertainty in the economy.
- **The dire economic performance has been paired with limited progress in structural reforms.** The business environment has suffered from a near absence of reforms in the past year, hampering an economy overwhelmed by structural weaknesses in the face of the pandemic.

Key priorities for 2021

- **Corporate governance improvements and commercialisation of the state-owned sector are urgently required.** Inefficiencies and a lack of corporate governance of state-owned enterprises (SOEs) are negatively affecting valuations and seriously undermining the growth potential of the economy.
- **A regulatory level playing field would help unleash the full potential of companies in private ownership.** Private companies still face regulatory discrimination in many sectors of the economy. Liberalisation of economic governance and the introduction of appropriate market regulation are critical measures for restarting the stalled economy.
- **The authorities should start preparing the economy to benefit from long-term post-pandemic shifts in global supply chains.** A strong and diversified industrial base and a highly skilled labour force in near proximity to major European multinational companies can drive future growth provided they are complemented by a sound business environment and a free market economy.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	-2.5	2.5	3.1	1.2	-3.5
Inflation (average)	11.8	6.0	4.9	5.6	5.1
Government balance[1]/GDP	-1.7	-0.3	1.8	0.6	-4.7
Current account balance/GDP	-3.3	-1.7	0.0	-2.0	-3.3
Net FDI/GDP [neg. sign = inflows]	-2.3	-2.2	-2.3	-2.0	-1.4
External debt/GDP	78.0	72.8	65.5	64.4	n.a.
Gross reserves/GDP	10.2	13.4	11.9	14.9	n.a.
Credit to private sector/GDP	20.4	20.9	21.3	22.4	n.a.

[1] Includes central government, local government and social security funds.

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Covid-19: macroeconomic implications

The economy entered the Covid-19 pandemic in a weakened state, partly as a result of the delay in reaching a new oil agreement with Russia. GDP contracted by 0.2 per cent year-on-year in the first quarter of 2020 on the back of manufacturing and export declines, due to disrupted production at the oil refineries at the beginning of the year. The Covid-19 pandemic deepened the recession to 1.8 per cent year-on-year in the period January to May, before it moderated to a 1.3 per cent decline in the nine-month period from January to September. In the absence of a full lockdown, the negative impact on non-tradeable services was less severe than in other countries, with the heaviest decline being in transport (9.5 per cent). Agriculture, construction and information and communication technology services all enjoyed strong year-on-year growth. The large export sector was hit hard by reduced global demand, falling almost 18 per cent year-on-year in the period January to August 2020. The events following presidential elections in August caused additional disruptions in economic activity, and the currency came under renewed pressure. The Belarusian rouble depreciated by 8 per cent against the US dollar between the election and the end of August, adding to the currency weakening at the beginning of the year, with the total depreciation standing at 20 per cent in 2020 as of the end of October. Foreign reserves declined from an historical high of US$ 9.4 billion at the end of 2019 to US$ 7.3 billion in September 2020.

Fiscal constraints impeded a comprehensive financial response to the crisis. The combination of a lack of available foreign financing, substantial debt service obligations and the absence of rapid financing from the International Monetary Fund (IMF) has left policymakers with little room for manoeuvre. Support to the economy was limited to the use of prudential counter-cyclical measures in the banking sector, providing additional loan support to SOEs and temporary fiscal benefits for small and medium-sized enterprises. Eventually, benefiting from the liquidity that flooded financial markets, Belarus issued Eurobonds amounting to US$ 1.25 billion in June 2020, helping to ease the near-term financing obligations. In September 2020 a preliminary agreement was reached with Russia for an additional US$ 1.5 billion to ease the foreign currency liquidity constraints.

The post-election worsening of the business environment threatens the pace of recovery from the Covid-19 recession. The rapid deterioration of the macroeconomic environment during 2020 is visible in the scarcity of foreign currency liquidity and banking deposits withdrawals. An environment of uncertainty and intimidation threatens the vibrant export-oriented digital sector, one of the rare bright spots during the pandemic. Output is forecast to decline by 3.5 per cent in 2020 and then increase by a mere 1.0 per cent in 2021. Prolonged political instability remains the main risk for this scenario.

Policy response to Covid-19

Crisis-response measures have been limited and skewed towards recommendations instead of regulation. In April 2020 the authorities announced a package of fiscal measures, which include additional resources for the healthcare sector, and tax relief and tax deferral measures for companies in the sectors most affected by the pandemic. Tax measures are largely left to be designed and implemented at the local government level. The growth of prices and tariffs for socially important goods was capped in the initial period of the pandemic, and later extended until the end of 2020. Rent payment holidays and a moratorium on raising the base rent amount or the actual amount of rent were introduced for state property. In the state sector, the authorities delinked wages from productivity growth to avoid a strong decline in real wages. Public sector organisations are being subsidised in case their production was disrupted. During 2020, the amount of new directed loans to SOEs increased significantly, reversing the trend in recent years of phasing them out. Meanwhile, the National Bank of Belarus has decided to apply counter-cyclical measures related to the mitigation of a number of prudential requirements, and it issued guidance to the banks to offer loan holidays to targeted customers. It also partially released the capital buffers and extended the maturity of its refinancing loans.

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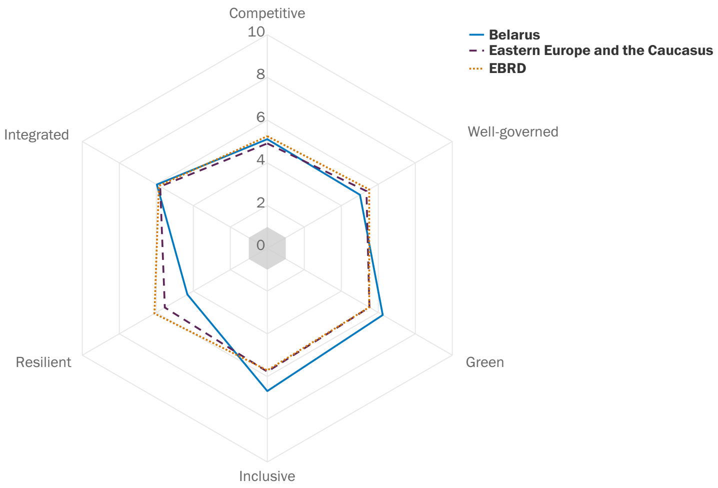
Assessment of transition qualities (1-10)



Structural reform developments

The halt of crude oil supply from Russia is forcing oil refineries to adapt. The oil and gas agreement with Russia expired in 2019. Delays in reaching a new agreement resulted in a temporary cessation of oil supplies from Russia to Belarus on 1 January 2020. This forced the oil refineries in Belarus to run their refineries at minimum load and to suspend exports. As a consequence, Belarus started exploring other oil suppliers. An agreement was reached in the second quarter of 2020, leading to a partial resumption of oil imports from Russia.

The government introduced an environmental tax on oil transit. Introduced by presidential decree in January 2020, the tax of 50 per cent will be applied on profits of companies providing transit for crude oil and petroleum products via Belarus. The proceeds will be used to create resources in case of environmental damage from potential future oil pipeline damage. The new tax comes less than a year after the contamination of the Druzhba pipeline, which caused disruptions in oil delivery and a strong negative impact on the Belarusian economy.

GEORGIA

Highlights

- **Economic growth remained strong in 2019, but is contracting in 2020.** The hospitality sector, the main driver of robust economic growth in recent years, has become a key source of vulnerability during the Covid-19 pandemic.
- **The policy response to Covid-19 went hand in hand with securing support from international partners.** Total funding pledged by official creditors, including under the augmented International Monetary Fund (IMF) programme, is expected to cover the external and budget gaps in the near term.
- **The adoption of key energy laws marks a new stage in the sector's development.** The laws outline the upcoming energy market reform, establish a renewable energy framework and support energy efficiency in construction.

Key priorities for 2021

- **The authorities should strengthen the resilience of the economy through diversification.** Policies to support the export of information technologies services and to benefit from the expected post-Covid-19 shifts in global supply chains could enhance the growth potential of the economy and its resilience.
- **Governance standards need to remain high on the reform agenda.** Strong institutions, an impartial judicial system and independent market regulatory bodies are key for attracting investments in higher value-added sectors and speeding up the convergence process.
- **Human capital development through investments in education would help improve the overall productivity of the economy.** Digital technologies capabilities and vocational skills will become important factors in directing post-Covid-19 investments.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.9	4.8	4.8	5.1	-5.0
Inflation (average)	2.1	6.0	2.6	4.9	5.3
Government balance[1]/GDP	-1.3	-0.9	-0.7	-2.7	-8.1
Current account balance/GDP	-12.5	-8.0	-6.8	-5.4	-10.8
Net FDI/GDP [neg. sign = inflows]	-8.2	-10.5	-5.5	-5.8	-5.2
External debt/GDP	105.3	106.6	101.3	105.0	n.a.
Gross reserves/GDP	18.2	18.7	18.7	19.8	n.a.
Credit to private sector/GDP	51.7	53.4	58.1	62.2	n.a.

[1] According to the definition by the Ministry of Finance (GFS-2001).

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Covid-19: macroeconomic implications

The Covid-19 pandemic is particularly disruptive for the small and open Georgian economy. The impact of the external pandemic shock was wide-ranging, hitting export of goods, tourism and remittances, all very important pillars of the Georgian economy. Strict virus containment measures, imposed in March 2020, hit domestic demand and many small service providers. Growth slowed from 5.1 per cent in 2019 to 2.2 per cent year-on-year in the first quarter of 2020, and GDP fell by 12.3 per cent year-on-year in the second quarter, with the trough of the cycle reached in April. Preliminary indicators show that economic output contracted by 5.0 per cent year-on-year in the first nine months of 2020. Tourism, which brought foreign exchange inflows close to one-fifth of GDP in 2019, recorded a 78 per cent year-on-year fall of foreign visitors in the period January to September 2020, as international borders remained largely closed. An increase in domestic tourism helped to somewhat soften the blow to the sector. After growing by four consecutive years, money transfers fell by more than 40 per cent year-on-year in April 2020, before returning to growth in June. Depreciation pressures prevailing throughout 2019 resumed in March 2020 on the back of looming uncertainty. This added to the inflationary pressures and the consumer price level remained above the 3 per cent level targeted by the National Bank of Georgia (NBG). However, on the back of significantly subdued demand, the NBG cautiously lowered the policy rate three consecutive times, from 9.0 to 8.0 per cent, between March and August 2020.

The authorities secured substantial foreign financing to help fund the crisis response. An increase in government expenditures combined with weaker economic activity led to a sharp rise in the budget deficit, and the loss of tourism revenues has resulted in a widening of the current account deficit. To help stabilise internal and external imbalances and provide an additional liquidity buffer, the authorities asked for augmentation of the Extended Fund Facility programme with the IMF, thus securing finances of more than US$ 400 million for 2020-21. This is expected to more than cover the external and budget gaps in the near term.

Economic recovery depends on the rebound of tourism. We project a GDP contraction of 5.0 per cent in 2020 followed by a recovery of 3.5 per cent in 2021. The speed of recovery and overall economic health in 2021 will be dictated by the developments in the hospitality sector and the inflow of foreign visitors, both of which are highly uncertain at present. The crisis emphasises the need for advancing structural reforms that would attract stronger efficiency-enhancing foreign investments, and lead to productivity increases and economic diversification.

Policy response to Covid-19

The government prepared a comprehensive package of measures to support the economy. The measures first adopted in March and then extended in May 2020 include increased health sector funding, postponement of certain tax payments, doubling of value-added tax refunds by the end of 2020, a scaling up of the credit guarantee scheme and the state programme 'Produce in Georgia', and exemption from income tax for low-paid jobs. Social assistance measures include coverage of utility fees for smaller household users, deferred loan repayments for household loans and support for those affected by the pandemic, the self-employed and vulnerable groups. The NBG lowered capital and liquidity requirements, relaxed regulatory requirements to support loan restructuring and loosened monetary policy in light of lower inflationary pressures.

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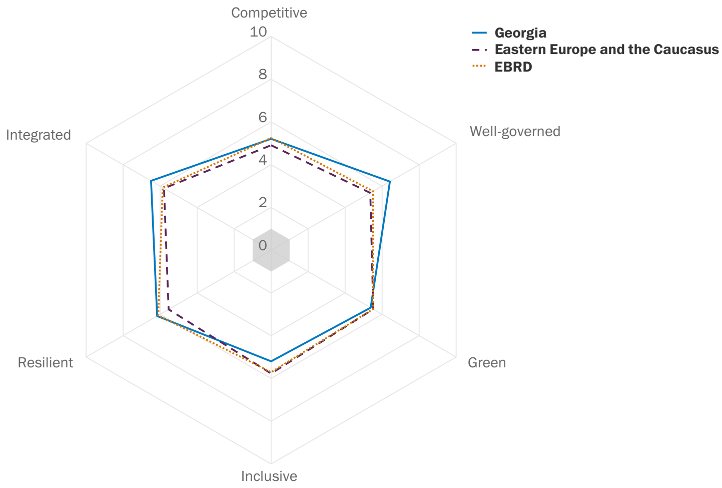
Assessment of transition qualities (1-10)



Structural reform developments

A number of key energy laws and regulations were adopted. The Law on Energy and Water Supply outlines the overarching energy sector reform while the Renewable Energy Law sets renewable energy targets. Both were adopted at the end of 2019 and define the general framework for the upcoming markets, set deadlines and determine the government bodies responsible for their implementation. Secondary legislation setting out the details of the new market organisation and implementation action plans is being developed. Following the adoption of the National Energy Efficiency Action Plan, also at the end of 2019, the authorities adopted the Law on Energy Efficiency and the Law on Energy Performance of Buildings in May 2020. The regulation will help improve the energy performance standards for new constructions and building retrofits, in line with European Union (EU) standards. All these laws are important milestones in meeting requirements under the EU-Georgian Association Agreement as well as Georgia's membership of the Energy Community.

The NBG has strengthened its regulatory power. In a series of moves in the past year the NBG amended regulations on consumer lending to give more discretionary power to the banks and enhanced its transparency and communication. The framework for the recovery of banks and resolution, approved in December 2019, strengthens Georgia's financial resilience. The resolution framework is an alternative to bank liquidation, to be used in cases where liquidation would lead to significant risks to financial system stability. The framework will become effective by the end of 2020. The regulation on consumer lending, adopted at the end of 2018, was adjusted with the aim to move from a rules-based to a principle-based approach, giving banks more freedom to manage risks. The amendments include deregulating the way the borrower's income is determined while keeping the obligation of income verification, introducing risk management requirements for consumer lending in banks and microfinance institutions, reducing the number of income brackets for payment-to-income limits, and increasing the maturity for mortgages in local currency. Publication of the Financial Stability Report, an annual assessment of risks and vulnerabilities in the financial system, resumed in September 2019 after eight years. In the same month, the NBG published a macro-prudential policy strategy, which identifies intermediate objectives to promote financial stability. The Supervisory Strategy 2020-22 sets the strategic priorities for the regulator and lays out specific activities for the execution of those priorities.

MOLDOVA

Highlights

- **The Covid-19 crisis hit a stable but already decelerating economy.** Economic activity plummeted in the second quarter of 2020 by 14 per cent year-on-year. However, the relatively good macroeconomic position before the crisis, and access to external financing, helped the economy to cope with the shock.
- **The authorities adopted a package of measures to safeguard the economy.** These include tax deferrals, an increase in social benefits, monetary policy easing and measures to support liquidity in the banking sector.
- **Finalisation of the new gas pipeline increases Moldova's energy security.** The inauguration of the Ungheni-Chisinau gas transmission pipeline, connecting the Moldovan gas network to the European Union via Romania, is an important step towards geographical diversification of energy supplies.

Key priorities for 2021

- **Moldova should start preparing for opportunities from the expected post-Covid-19 shift in global value chains.** One of the long-term consequences of the pandemic is expected to be the restructuring of global supply chains, and Moldova, with its geographical proximity to western Europe, should strengthen its position by pursuing long overdue structural reforms to improve the business environment.
- **The authorities should advance institutional reforms and improve governance.** The success achieved in recent years in financial sector reform would not be sustainable without improvements in the rule of law and the fight against corruption. The creation of a level playing field, guaranteed by strong regulatory institutions, will be critical for investments.
- **The independence of the National Bank of Moldova (NBM) should be preserved.** The continued strengthening of professional capacities of the NBM and respect for its institutional independence are the best guarantees of financial system stability.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	4.4	4.7	4.3	3.6	-5.5
Inflation (average)	6.4	6.6	3.1	3.8	2.8
Government balance/GDP	-1.5	-0.6	-0.8	-1.4	-8.0
Current account balance/GDP	-3.5	-5.7	-10.4	-9.3	-8.3
Net FDI/GDP [neg. sign = inflows]	-0.9	-1.4	-2.2	-3.9	-1.0
External debt/GDP	75.0	70.6	63.9	62.0	n.a.
Gross reserves/GDP	27.3	29.0	26.1	25.6	n.a.
Credit to private sector/GDP	21.6	18.7	18.4	19.2	n.a.

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Covid-19: macroeconomic implications

The Covid-19 crisis hit an already-decelerating economy. Due to a near-standstill in the last quarter of the year, economic growth decelerated to 3.6 per cent year-on-year in 2019. This declining trend in growth continued in the first quarter of 2020 when GDP growth slowed further to 0.9 per cent year-on-year, driven by a fall in exports and stagnating private consumption. Investments in fixed assets remained strong, helped by construction activity picking up again on the back of an increase in the state subsidy for the First House programme. GDP plummeted in the second quarter of 2020 by 14 per cent year-on-year, on the back of a 17 per cent year-on-year drop in private consumption and a 15.6 per cent year-on-year fall in investments. However, net exports had a positive contribution to GDP due to a deeper drop in imports than exports. The exchange rate remained broadly stable and the inflation rate decelerated to 2.3 per cent in September 2020, below the target rate of 5.0 per cent, prompting the central bank to set a new historical low policy rate at 2.75 per cent.

Fiscal prudence and access to external financing have helped the economy cope with the shock. Public debt is estimated at around 28 per cent of GDP in 2019, leaving ample fiscal space for policy response. Multi-year efforts to clean up the financial system succeeded in putting it on a significantly better footing, with tightened regulatory and governance frameworks, a stronger regulator, and foreign strategic investors in the banking sector. At nearly US$ 3.5 billion in September 2020 and covering over six months of imports, international reserves held by the NBM are at comfortable levels. To help cover the widening external and fiscal gaps and anchor macroeconomic stability, the government secured US$ 235 million rapid financing from the International Monetary Fund (IMF) in April 2020.

Economic recovery is likely to be gradual and dependent on the recovery of global demand. Subdued demand for new cars is likely to weigh down demand for the automotive components industry, which is well integrated into global supply chains. On the other hand, a strong increase of remittances since May 2020 will most likely support the recovery of private consumption. After reaching a trough in the second quarter of 2020, the economy will likely remain in negative growth territory until early 2021. Taking all factors into account, we expect GDP to decline by 5.5 per cent in 2020 followed by a moderate recovery of 3.5 per cent in 2021, but downside risks to the forecast remain significant.

Policy response to Covid-19

The authorities have introduced significant mitigation measures to combat Covid-19. The initial emergency policy response of 2 per cent of GDP in April 2020 focused on tax deferrals, a temporary increase in social benefits, monetary policy easing and liquidity provision. The government reduced the value-added tax (VAT) rate for the hospitality sector from 20 per cent to 15 per cent, announced faster VAT reimbursements and provided subsidised lending to small and medium-sized enterprises. Tax payment deadlines were delayed to mid-2020 and tax audits and other controls were temporarily suspended. Firms that ceased operations during the state of emergency had their payrolls (personal income tax and social contributions) fully compensated by the state, and those that continued operating received up to 60 per cent. Social assistance to vulnerable groups includes expanding unemployment benefits and targeted social help. The NBM cut the policy rate in the face of shrinking aggregate demand and lowering inflationary pressures. It also allowed banks to defer loan payments and decreased the Moldovan leu reserve requirements to support liquidity in the banking sector.

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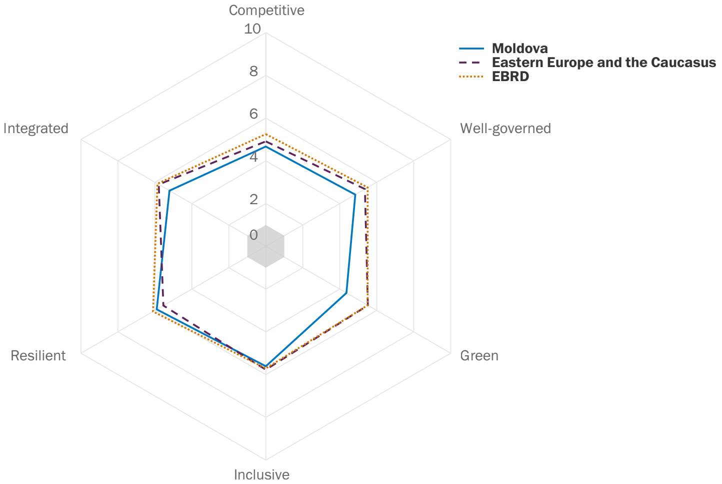
Assessment of transition qualities (1-10)



Structural reform developments

Reforms in the financial sector to ensure its stability continued. To prevent migration of risks from the banking to the non-bank financial sector, the authorities have been improving the regulatory and supervisory framework for the sector. According to new regulations introduced in February 2020, the non-banking sector is not allowed to accept deposits from the general public, all entities in the sector need to report the new credit activity to the credit bureaus, and the minimum share capital is increased to MDL 1 million (around US$ 60,000) from January 2021. Prudential requirements have been enhanced and a sanctioning regime introduced. The banking sector also saw the adoption and implementation of the enhanced Emergency Liquidity Assistance to solvent and viable banks from December 2019. On the NBM's approval of the new supervisory and management boards, a systemic bank exited temporary administration in February 2020.

Continued engagement with the IMF supports Moldova's reform agenda. The authorities finalised the sixth and final review under the three-year Extended Credit Facility and Extended Fund Facility arrangement with the IMF in March 2020. Negotiations for a new economic reform programme resulted in a staff-level agreement in July 2020 for a US$ 558 million three-year arrangement. When approved by the IMF Board, the new programme will support the Moldovan authorities in advancing institutional reforms aimed at tackling vulnerabilities in fiscal governance, non-bank financial sector oversight, market regulation, anti-corruption and the rule of law.

Finalisation of the Ungheni-Chisinau gas pipeline increases Moldova's energy security. The inauguration of the 120-kilometre-long Ungheni-Chisinau gas transmission pipeline in August 2020 marks the completion of the second stage of the Ungheni-Chisinau strategic infrastructure project, connecting the Moldovan gas network to the European Union via Romania. Construction of the interconnector between the Romanian city of Iasi and the Moldovan town of Ungheni was the first stage of the project. The Ungheni-Chisinau pipeline will add up to 1.5 bcm/year of gas supplies and support the geographical diversification of natural gas supply routes to Moldova. This project increases Moldova's energy security, because up until now the country has been nearly fully dependant on Russia for the import of gas.

A new customs code was adopted. The new code merges three laws into a single legal act in an effort to systematise and streamline the previous customs legislation. It also aims to liberalise and simplify certain customs procedures as well as promote the use of electronic documentation. Adopted in July 2020, the code will take effect in January 2022 with a transitional period provided for some of the articles.

UKRAINE

Highlights

- **Structural weaknesses weighed on economic growth even before Covid-19.** GDP declined by 1.3 per cent year-on-year in the first quarter of 2020 before plunging by 11.4 per cent year-on-year in the second quarter, as the pandemic took its toll on the economy.
- **A new International Monetary Fund (IMF) programme has been approved.** Approval of the 18-month, US$ 5.0 billion Stand-By Arrangement in June 2020 helped ease immediate funding pressures, and the implementation of certain prior conditions unleashed the necessary external financing.
- **Progress in energy sector reform has been mixed.** The long-awaited Naftogaz unbundling will improve Ukraine's energy resilience, but a forced retroactive reduction in feed-in tariffs for renewables could damage investor confidence.

Key priorities for 2021

- **Preserving the independence of the National Bank of Ukraine (NBU) is vital for macroeconomic stability and maintaining access to external funding.** Strategic and operational decisions undertaken by the NBU, as regulator of the financial system, need to be governed exclusively by sound principles of macroeconomic policymaking and supervisory prudence.
- **Progress is needed in key areas of governance.** While the authorities have successfully implemented legal changes in many areas over the past years, they should push forward with privatisation, judicial reform, public administration reform and digitalisation of public sector services.
- **The lack of meaningful progress in the fight against corruption needs to be addressed.** More than five years after the Revolution of Dignity, widespread corruption continues to be among the main impediments to doing business in Ukraine.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.4	2.5	3.4	3.2	-5.5
Inflation (average)	13.9	14.4	10.9	7.9	3.2
Government balance/GDP	-2.2	-2.2	-2.2	-2.0	-7.8
Current account balance/GDP	-2.0	-3.1	-4.9	-2.7	4.3
Net FDI/GDP [neg. sign = inflows]	-4.1	-3.3	-3.4	-3.4	1.2
External debt/GDP	120.5	102.9	87.6	79.2	n.a.
Gross reserves/GDP	16.6	16.8	15.9	16.5	n.a.
Credit to private sector/GDP	41.9	34.1	30.1	24.5	n.a.

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Covid-19: macroeconomic implications

The economy was already slowing before Covid-19 induced a recession. In 2019 GDP growth moderated to 3.2 per cent, due mainly to a disappointing fourth quarter as consumption and construction-led investments, the main drivers of the economy, slowed down. Since March 2020 the pandemic has been taking its full toll on the economy through a combination of reduced foreign demand and a drop in domestic demand because of the lockdown. These developments have further damaged the already-declining manufacturing sector and reversed the fortunes of most services sectors. GDP declined by 1.3 per cent year-on-year in the first quarter of 2020 and plummeted by 11.4 per cent year-on-year in the second. The decline in the second quarter was broad-based across all sectors of the economy, especially affecting hotels and restaurants (value added was down almost 60 per cent year-on-year), while in a number of services value added fell by more than 20 per cent. Investments also declined by more than 20 per cent year-on-year in the second quarter. Despite the challenging environment, a credible monetary policy has preserved macroeconomic stability. In June 2020 the central bank reduced the policy rate to a historical low at 6 per cent amid subdued inflationary pressures. The current account deficit turned into a huge surplus in the period January to September 2020, supported by a huge fall in the trade deficit and an increase in the primary income surplus.

A new IMF Stand-By Arrangement is helping to close the financing gap. Following the December 2019 staff-level agreement on a US$ 5.5 billion, three-year IMF Extended Fund Facility (EFF) programme, the Ukrainian parliament was dragging its feet in terms of fulfilling the main conditions for IMF Board approval, namely, the adoption of a new land law and a set of laws that would prevent the return of closed and nationalised banks to their previous owners. In the meantime, the Covid-19 crisis shifted the priorities and focus of the authorities towards mitigation measures for the economy. In this new environment, the government and the IMF agreed on an 18-month US$ 5.0 billion Stand-By Arrangement (SBA) as a better fit for the country's immediate needs. The IMF Board approved the SBA in June 2020 following adoption of the prior actions agreed during the negotiations on the previous arrangement. A tranche of US$ 2.1 billion was immediately disbursed, unlocking additional support from the World Bank and European Union, and enabling a successful Eurobond issuance. Total financing attracted in June to July 2020 amounted to nearly US$ 6.0 billion.

A moderate recovery in 2021 is likely but uncertainty remains high. We forecast that the economy would contract by 5.5 per cent in 2020, followed by a partial recovery of 3.0 per cent in 2021. Risks to the downside remain considerable, not only because of a possible resurgence of the pandemic but also because of uncertainty about policy and structural reform commitments. Achieving a stronger recovery and sustainable medium-term growth would require a reinvigorated reform agenda, particularly in the judiciary, implementation of the anti-corruption programme, fair competition and improvements in governance.

Policy response to Covid-19

The authorities have put in place a range of crisis-response measures. The size of the authorities' initial crisis package, introduced in April 2020, is estimated at 3.1 per cent of GDP. Fiscal and regulatory support to businesses is focused on temporary tax breaks, tax audit holidays, abolishment of penalties for certain tax wrongdoings, extension of deadlines and an increased threshold for the simplified taxation regime. The subsidised loan programme, credit guarantee scheme and social support programmes were expanded to make them more generous and accessible. The authorities boosted pensions for certain categories, and introduced a moratorium on penalties and disconnection of households who are behind in their utility payments. Temporary price controls and export bans on particular food products, medicine and other medical equipment were introduced at the onset of the pandemic. Additional support for households and businesses has been offered to counteract the direct consequences of the lockdown, such as forgiveness of penalties related to delays in loan repayments. To support banks and ensure liquidity in the system, the NBU introduced a long-term refinancing facility, relaxed liquidity and reserves requirements and expanded the list of collateral for emergency lending.

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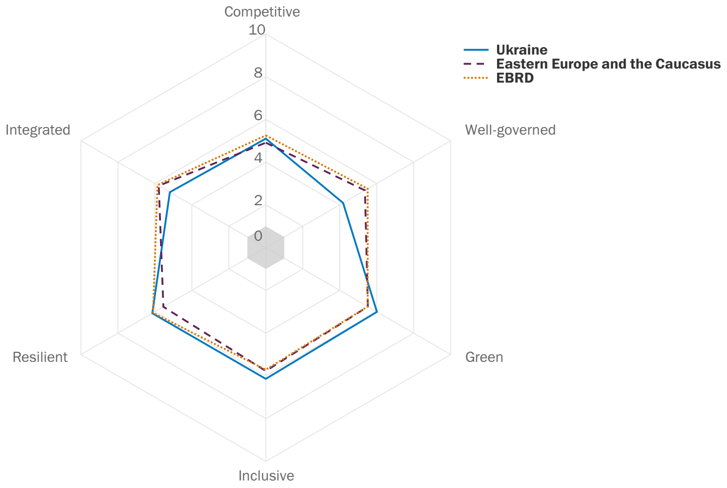
Assessment of transition qualities (1-10)



Structural reform developments

The bank resolution mechanism was significantly strengthened. A number of legal amendments, adopted by parliament in May 2020, aim to address regulatory gaps found during the banking sector clean-up in recent years and to ring-fence the decisions taken by the regulator. The law guarantees irreversibility of bank resolution as decided by the NBU by preventing the court from challenging the liquidation procedure, sale of assets and settlements with the bank's creditors. Further, it changes the procedure for courts to contest decisions by the regulators, namely the NBU, the cabinet of ministers and the Deposit Guarantee Fund, as it restricts the possibility of questioning their technical expertise and judgements. In cases where compensation to the previous owners is warranted, the law stipulates the exact conditions, processes and type of compensation, with the key role given to internationally acknowledged audit firms as unbiased experts. The reform also strengthens the early intervention framework and entry into resolution, and sets clear guidelines for potential nationalisation.

Reforms in the gas sector have advanced, but there were reform reversals in the renewables sector. At the end of 2019 gas production operations of the national oil and gas company, Naftogaz, were separated from gas transmission. The latter was moved to a new state-owned independent pipeline operator. The creation of an independent gas transmission system operator enabled the signing of a new five-year transit contract with Gazprom Russia at the end of 2019. The legislation pertaining to Naftogaz's unbundling was reviewed by the Energy Community and is deemed in line with Ukraine's obligations under the European Third Energy Package. After household gas prices were liberalised in January 2019 and the Public Service Obligation Order for the supply of gas to households was terminated in July 2020, household gas prices are now fully market-determined. However, long negotiations between the government, private sector and international development partners on restructuring the feed-in tariff mechanism for renewables in Ukraine did not lead to a consensus. In July 2020 parliament approved the reduction in the feed-in tariffs, thus changing the framework conditions for investing in renewables. While the main motivation was to decrease the burden on the state's finances, the forced retroactive changes will impair the investors' legitimate interests and may lead to litigation, with potentially serious future fiscal implications.

The longstanding moratorium on the sale of agricultural land was lifted, albeit with limitations. In March 2020 parliament adopted a new law on the market circulation of agricultural land, which comes into effect in July 2021. A large number of limitations in the legislation put a tight cap on the productivity gains expected to be realised. In particular, the embargo on the participation of foreign persons and entities remains in place and can be lifted only on approval by a national

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referendum. The sale of state land also continues to be banned. Among other notable limitations, the law imposes an upper limit on the amount of agricultural land that can be owned by a citizen or legal entity, with the latter being able to make purchases from 2024.

Parliament re-criminalised illicit enrichment. The law on the prevention and punishment of revenues embezzled by public servants was originally approved in 2015 before it was overturned by a controversial Constitutional Court ruling in February 2019. Approved in November 2019, the current bill envisages filing criminal charges if public officials' assets, as stated in the asset declaration, exceed their official income by a certain amount. However, in October 2020 the Constitutional Court undermined the fundamentals of the anti-corruption reform by overturning the system of electronic declaration of assets and income of state officials and decriminalising the act of knowingly submitting fraudulent declarations.

A new law on concessions sets up a clear legal framework for this form of public-private partnership. Adopted and effective in the last quarter of 2019, the law replaces previous outdated regulations. A clear regulatory framework for concession activities is conducive to attracting investment and upgrading infrastructure. In June and August 2020, the new framework was successfully implemented in the selection and contraction of concessioners of two Black Sea ports.

New wage caps in state-owned institutions may hinder future governance improvements. In April 2020 the authorities introduced a cap on salaries of all public employees as well as top management and supervisory board members of state-owned enterprises (SOEs) and state-owned banks (SOBs) to match more closely average salaries in the country. The cap was introduced as a temporary emergency measure and it was removed for judges, prosecutors, members of parliament and members of the board of the National Bank of Ukraine in August 2020, and for the managers of state banks in September 2020. However, it stays in place for the board members of SOEs and SOBs, thus risking having a long-term detrimental effect on the ability to attract and retain leaders of appropriate quality and experience at institutions of systemic importance for the country.