



Armenia

Highlights

- **Armenia's robust economic performance continues amid geopolitical and economic uncertainty.** The strong performance of the services industry, in particular, remains largely driven by the inflow of money transfers, but the first signs of a slowdown are already visible.
- **Connections with neighbours are improving slowly.** The past year has seen enhanced energy interconnections with Iran, which may yield economic benefits for Armenia.
- **Anti-corruption efforts will benefit from new measures to detect and prevent corruption.** The recent launch of the Electronic Platform for Declarations of Assets, Incomes, Expenditures and Interests, as well as the use of artificial intelligence, will make it easier for the Corruption Prevention Commission (CPC) to detect and prevent corruption.

Key priorities for 2024

- **Continued progress on implementing the digital agenda is necessary to maintain growth momentum.** The focus should be on advancing the digital transformation of the economy by improving the delivery of digital public services and supporting the development of digital skills.
- **Initial steps to facilitate green investments should continue.** An efficient and transparent regulatory environment and favourable natural conditions for renewable energy could help attract foreign direct investment in initiatives to green the economy and open up new growth potential.
- **Addressing the basic housing and social needs of displaced Karabakh Armenians is an utmost priority.** Their efficient inclusion in the labour market, health system, social security network and education would have a positive impact on their integration and on long-term economic growth.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	7.6	-7.2	5.8	12.6	6.5
Inflation (average)	1.4	1.2	7.2	8.6	3.5
Government balance/GDP	-1.0	-5.4	-4.6	-2.1	-2.7
Current account balance/GDP	-7.1	-4.0	-3.5	0.8	-1.4
Net FDI/GDP [neg. sign = inflows]	-1.7	-0.7	-2.5	-4.9	-1.6
External debt/GDP	90.9	102.1	99.8	78.2	n.a.
Gross reserves/GDP	20.9	20.7	23.3	21.1	n.a.
Credit to private sector/GDP	57.1	68.6	58.2	50.1	n.a.

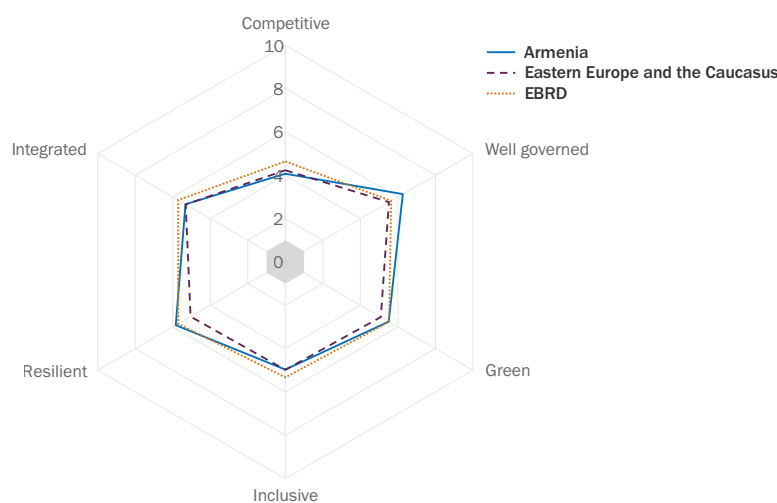
Macroeconomic developments and policy response

The economy continues to perform well in 2023. After exceptionally strong growth (12.6 per cent) in 2022, January to July 2023 saw further growth in gross domestic product (GDP) of 10.4 per cent year on year. Construction and services continue to drive GDP, posting double-digit rates of growth, although industrial production is almost flat. Money transfer inflows to individuals, which have been driving high demand for services, have remained robust, but there has been a noticeable rise in outflows in 2023 to date. While inflows from Russia have moderated slightly and outflows to Russia have edged up relative to the peak months of 2022, the main difference lies in the significant rebound in outflows to other countries. As a result, net money inflows in the first half of the year declined by 10 per cent from the same period in 2022 and by more than 40 per cent from their peak in the second half of 2022. At the same time, exports and imports increased by 72.8 and 73 per cent (year on year), respectively, in the first half of 2023, deepening the trade and current account deficits. Foreign reserves rose by almost one-third to US\$ 4.1 billion (around €3.8 billion, covering 3.8 months of imports) in 2022 and have remained around this level in 2023. Armenia's fiscal position has continued to improve in 2023 on the back of its prolonged, robust economic growth and improved public-finance management. Public debt has stabilised at around 50 per cent of GDP, after a sharp decline in the two preceding years, helped by low fiscal deficits, high GDP growth rates and the appreciation of the currency.

Annual inflation eased in the first half of 2023. Inflation peaked at 10.3 per cent in June 2022, but several factors have contributed to a significant decline since then. Timely monetary policy tightening, with a total increase in the policy rate of 650 basis points between December 2020 and December 2022, as well as falling global energy and food prices and significant appreciation of the Armenian dram in 2022, drove inflation to 0.1 per cent in September 2023. The Central Bank of Armenia (CBA) cut the policy rate three times beginning in June 2023, to 9.75 per cent in September, the first such reductions in almost three years. Nevertheless, the CBA is being cautious about easing monetary policy, as consumer demand remains strong. Successful disinflation and a stable nominal exchange rate since the beginning of 2023 have contributed to the eventual reversal of a two-and-a-half-year period of real currency appreciation.

Short-term growth is likely to slow down. The temporary factors that drove the exceptional economic activity of 2022 have been subsiding gradually in 2023. We expect GDP growth of 6.5 per cent in 2023 and 4.5 per cent in 2024. The exodus of more than 100,000 Karabakh Armenians will likely divert budget expenditures to address the immediate social needs, with an uncertain impact on short-term growth. The isolation of the Russian economy from Western markets could have negative long-term consequences for the Armenian economy, as Russia remains a major trading partner. On the positive side, progress on opening the border with Türkiye could have a positive impact on the medium-term growth outlook.

Assessment of transition qualities (1-10)



Structural reform developments

The government has committed to preventing Armenian companies from circumventing Western sanctions on Russia. In 2023 the authorities have made numerous decisions to help Armenian businesses comply with the sanctions. Notably, in the context of a fivefold increase in exports to Russia from 2022, the government has issued a list of goods prohibited from re-export to Russia and applied strict controls on “dual-use” goods that could ultimately be used by the Russian arms industry. The country acknowledges, however, that it will not be possible to prevent all exports of potential dual-use goods, given legitimate consumer demand for such products from Russia.

Some steps have been taken to enhance electricity market integration. Armenia is building a third interconnecting electricity transmission line to Iran, with a capacity of 400 kV, to add to the two existing ones, which have a capacity of up to 220 kV each. The new interconnection is expected to be operational by the end of 2023. In addition, Iran and Armenia have signed an extension to 2030 of the bilateral agreement under which Armenia exports electricity to Iran in exchange for natural gas.

Digital innovation in public administration is helping to prevent corruption. In February 2023 the CPC launched its Electronic Platform for Declarations of Assets, Incomes, Expenditures and Interests. By incorporating artificial intelligence and machine learning into the new asset declaration system, the CPC hopes to enhance its ability to scrutinise asset declarations filed by public servants, making it easier to detect and prevent corruption. Corruption watchdogs can now easily cross-check asset declarations with data in systems maintained by other state agencies. In addition, the requirement to submit declarations has been expanded significantly, with up to 35,000 declarations expected to be filed over the next year.

The authorities are striving to adopt international best practice on green investments. In February 2023 the Ministry of Economy launched its “Developing Green Taxonomy in Armenia” project, a year-long initiative aimed at creating a policy and legal basis for green investments in the country. The development of a green taxonomy in Armenia is another step in laying the foundations for a sustainable green finance ecosystem, by attempting to provide clear definitions and criteria for identifying and promoting environmentally sustainable investments, attracting capital and fostering the growth of green projects.




Azerbaijan

Highlights

- **Economic growth has subsided in 2023 and non-oil sector growth has moderated.** Lower energy prices, declining oil production and slow growth in the non-oil sector led to gross domestic product (GDP) growth of less than 1 per cent on the year in the first seven months of 2023.
- **There is growing support for information technology (IT) sector development and the digitalisation of the economy.** New tax legislation provides incentives for employees and companies in the IT industry. At the same time, capital market development is benefiting from a new digital platform that enables online securities issuance by market participants.
- **Important steps are being taken to develop the Middle Corridor trade route and promote renewable energy.** Azerbaijan is engaging with Kazakhstan and Georgia to coordinate the development of the Middle Corridor for cross-border energy transmission and non-oil goods, and the authorities are promoting major initiatives on the production and transmission of renewable energy.

Key priorities for 2024

- **Further investment in the non-oil sector is crucial to the sustainable diversification of the economy.** The authorities should encourage the diversification of the country's economic structure by strengthening the regulatory framework on competition and reducing the state's footprint across the economy.
- **The legislative and regulatory frameworks for the renewable energy market need improvement.** Recent reforms to reduce monopolies in the electricity market are welcome, but legal tools to control monopolistic entities in this market should be strengthened further. The authorities should also devise legislation for all types of renewable energy and improve the regulatory framework to attract foreign investors.
- **Enhancing the capacity of the Middle Corridor could play a crucial role in economic diversification.** The authorities should enhance the institutional capacity of domestic state-owned infrastructure companies along the Middle Corridor and step up collaboration with other countries along the corridor to unify tariffs and simplify customs procedures.

 Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.5	-4.2	5.6	4.6	1.5
Inflation (average)	2.6	2.8	6.7	13.9	10.3
Government balance/GDP	8.9	-6.4	4.1	6.0	1.0
Current account balance/GDP	9.1	-0.5	15.1	29.8	16.3
Net FDI/GDP [neg. sign = inflows]	2.9	1.8	3.8	6.0	4.8
External debt/GDP	47.2	55.7	43.6	31.5	n.a.
Gross reserves/GDP	13.0	14.9	12.9	11.4	n.a.
Credit to private sector/GDP	18.7	20.1	18.4	15.1	n.a.

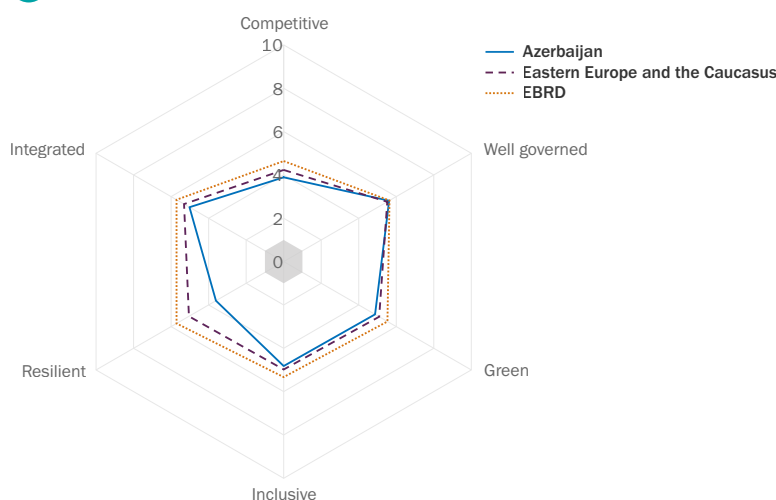
Macroeconomic developments and policy response

The strong economic growth of the past two years has started to slow. GDP grew 4.6 per cent in 2022, driven by strong growth in the non-oil and gas sector (9 per cent year on year), which benefited from large foreign-currency inflows as the high global prices of oil and gas boosted export revenues. However, the economy slowed in the second half of 2022 as global energy prices moderated and inflation reduced growth in real incomes. GDP growth decelerated sharply to 0.7 per cent year on year in January to July 2023. In a similar pattern to the previous year, output in the oil and gas sector fell 2.2 per cent, while non-oil sector output increased 3.4 per cent in the first seven months of the year, although the latter was well below the growth rate of 2022. Net money inflows increased almost sixfold in 2022, mostly from Russian citizens of Azerbaijani origin, but the pace of inflow growth has slowed markedly in 2023. Although oil and gas revenues declined 7.6 per cent in the first three months of 2023, the current-account balance maintained a large surplus on the back of rising gas exports and an oil price above pre-war levels.

Monetary policy tightening continues to curtail inflation, but domestic demand remains strong. Inflation has been easing in 2023, but was still relatively high, at 5.1 per cent year on year, in September 2023, after peaking at 15.6 per cent in October 2022. The authorities have reacted with significant monetary tightening. The Central Bank of Azerbaijan raised the policy rate to 9 per cent in May 2023, its tenth rate rise in the last two years. Robust nominal income growth of around 20 per cent in 2022 has added to the inflationary pressures, although this has slowed since the beginning of 2023. Lending to households has continued to rise, however, up 25.9 per cent year on year between January and July 2023, on top of a 30 per cent increase in 2022. Amid high domestic demand, in the middle of 2023 the government approved an increase in budgetary spending to boost public-sector wages, support the development of territories surrounding Karabakh, and strengthen the country's defence capabilities.

Energy exports will continue to drive short-term growth. The combination of stable energy prices and increasing demand for Azerbaijan's energy products is expected to support high levels of oil and gas revenues, despite declining oil output and rising gas production. This is likely to enable a continuation of current levels of public investment and government expenditure. However, persistent inflation is likely to dampen the real impact of fiscal stimulus and could lead to further appreciation of the real effective exchange rate. We therefore forecast GDP growth of 1.5 per cent in 2023, rising to 2.5 per cent in 2024. The forecast is highly sensitive to movements in global oil prices and to the effects of geopolitical developments on demand for Azerbaijan's gas exports.

Assessment of transition qualities (1-10)



Structural reform developments

The gradual transition to green energy continues. In December 2022 the government signed a memorandum of understanding (MoU) with Georgia, Romania and Hungary on the joint development and transmission of green energy through an electric cable under the Black Sea. The feasibility study on installing the electric cable should be finished by the end of 2023. The shift to green energy sources has been increasingly supported by the authorities through agreements and MoUs with international renewable investors. The Ministry of Energy has also signed an MoU with the European Bank for Reconstruction and Development to receive support for the development of a low-carbon and climate-resilient power sector in Azerbaijan, in line with the country's commitment to the Paris Agreement.

Reforms aimed at creating a competitive electricity market have accelerated. The adoption of a new law on electric power in May 2023 set in motion the gradual deregulation of the electricity sector and should enable the creation of a centralised electricity market. The law will enter into force at the beginning of 2024. The process of establishing an energy market regulator will begin by defining the role of the state and the regulator in 2024. Next steps include the legal separation of the generation, transmission and distribution of electricity, along with the creation of a market operator by July 2025. The final stage of the reform will be the establishment of retail and wholesale markets by the middle of 2028.

New tax legislation is facilitating the development of the IT sector. From January 2023 the new tax code widened the scope of tax exemptions to cover IT sector employees who reside outside the country's technology parks. The new law also exempts external activities conducted by enterprises located within the technology parks from corporate income tax, withholding tax on dividends and property tax.

The authorities have expanded cooperation with trading partners on developing the Middle Corridor. In June 2023 bilateral discussions with Kazakhstan resulted in the signing of an MoU that envisages investment of €5 billion over the next five years to develop infrastructure and enhance the efficiency of the Middle Corridor. At the same time, bilateral discussions with the Georgian authorities are focused on digitalisation as a way of overcoming customs and administrative bottlenecks along this part of the Middle Corridor.

Digitalisation is contributing to capital market development. In December 2022 the Central Bank of Azerbaijan launched an online securities issuance system. Under this system, issuers can avail of simpler online procedures for registering stocks and bonds, getting prospectus approval, safekeeping securities, and listing on the Baku Stock Exchange. Previously, issuers had to submit separate hard copies of the required documentation to the Central Bank of Azerbaijan, the National Depository Centre and the Baku Stock Exchange. This new digital platform is accessible to all market participants, enabling a simpler, faster securities issuance process.

Employment opportunities for women have been broadened. Until recently, women in Azerbaijan faced employment restrictions on around 700 jobs in various sectors, such as transport, energy and agriculture. However, the authorities repealed these restrictions in November 2022, as the jobs were no longer deemed hazardous to women's health. With the support of the World Bank, the authorities adopted a new rule for enhancing occupational safety and health across those jobs that were previously closed to women.



Belarus¹

Highlights

- **The economy is struggling under heavy sanctions.** After a deep recession in 2022, gross domestic product (GDP) growth turned slightly positive in the first half of 2023, while inflation decelerated to a level not seen in many years, mainly due to base effects and a stable exchange rate.
- **Economic uncertainty remains extremely high.** The impact of heavy sanctions on trade and logistical disruptions to links with European Union (EU) economies is constraining the export-oriented and high-tech sectors and undermining any hope of an economic recovery.
- **The EU and other advanced economies have imposed new rounds of sanctions.** As of August 2023, restrictive measures apply to a total of 233 individuals and 37 entities.

Key priorities for 2024

- **Essential first steps towards recovery must be for the country to halt prosecution of civil society, to release political prisoners, and to distance itself from Russia's invasion of Ukraine.** No sustainable growth is feasible unless sanctions are eased and ultimately removed, allowing renewed access to the international financial system and to the EU market and logistics.
- **Urgent steps are needed to improve the business climate and the quality of governance.** Legislation must be clear and unambiguous, and allow for the equal treatment of private and state enterprises. Private entrepreneurs should be relieved from undue pressure from the authorities.
- **The authorities should overhaul and restructure state-owned enterprises (SOEs), which dominate the economy but are plagued by inefficiencies and weak governance.** Commercialisation and the introduction of corporate governance standards in the large state-owned sector could improve growth prospects and asset valuations.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	1.4	-0.7	2.4	-4.7	2.0
Inflation (average)	5.6	5.5	9.5	15.2	4.7
Government balance/GDP	0.9	-2.9	-1.7	-3.9	-0.7
Current account balance/GDP	-1.9	-0.3	3.2	3.7	2.7
Net FDI/GDP [neg. sign = inflows]	-2.0	-2.1	-1.9	-2.0	-0.9
External debt/GDP	63.1	70.0	61.5	54.6	n.a.
Gross reserves/GDP	14.2	12.0	12.4	10.7	n.a.
Credit to private sector/GDP	21.9	23.7	23.0	n.a.	n.a.

¹ The EBRD announced on 4 April 2022 that, following the invasion of Ukraine, its Board of Governors had formally suspended Belarus's access to EBRD funding for projects or technical cooperation.

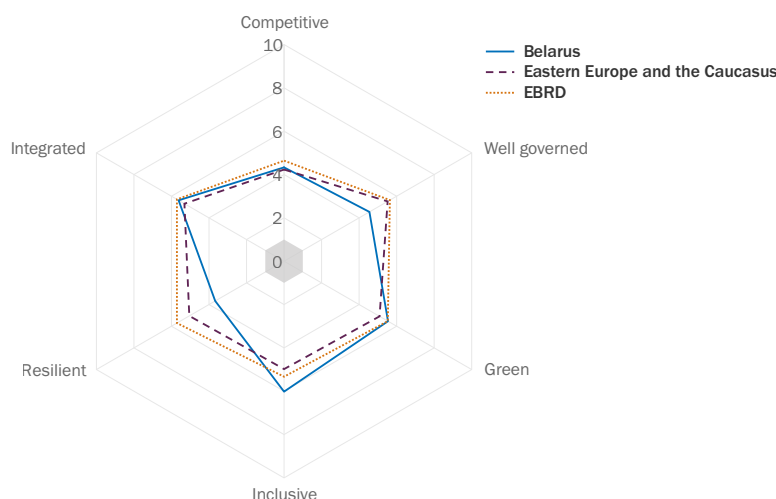
Macroeconomic developments and policy response

Some growth has returned in 2023 after a deep recession in 2022. After contracting 4.7 per cent in 2022, annual GDP increased 2 per cent year on year in the first half of 2023. The economy is nevertheless struggling to adapt to the heavy sanctions imposed by the EU and other trading partners as a result of the country's support for Russia's war on Ukraine. The moderate upturn so far in 2023 is being driven by a rebound in manufacturing, construction and retail trade, which increased 7.6 per cent, 6.1 per cent and 5.5 per cent on the year, respectively, in January to June. In contrast, the information and communications technology sector and the transport sector continued to decline in the first half of 2023, bringing output in both sectors to around 80 per cent of the level of 2021. Exports rose 12.4 per cent and imports 22.6 per cent year on year in January to June, with the direction of exports shifting significantly away from Western countries towards those in the Commonwealth of Independent States. During the first half of 2023 the authorities provided more than US\$ 70 million (€64.7 million) of financial support to over 600 small and medium-sized enterprises (SMEs) in the form of subsidies, soft loans and liquidity. Almost two-thirds of the firms receiving this support were in the manufacturing sector, with the remainder mainly in the agriculture and transport sectors.

Inflation decelerated sharply and the exchange rate remained broadly stable. The inflation rate eased to 2.7 per cent in July 2023, its lowest level in the last 15 years. Base effects from high prices in 2022 were the main reason for the fall; other factors included tight monetary policy, a stable exchange rate and disinflation in Russia, the country's main trading partner. Foreign reserves stabilised at US\$ 8 billion (€7.2 billion) in July 2023, covering 2.3 months of imports. Responding to the falling inflation rate, the National Bank of Belarus reduced its policy rate by a cumulative 250 basis points to 9.5 per cent between January and June 2023. Notwithstanding the positive trends, food inflation edged up slightly in July, the first increase since the middle of 2022.

The short-term outlook remains gloomy. Although the first half of 2023 saw some growth return, the uncertain geopolitical outlook and the possibility of a new wave of sanctions mean that the economy is unlikely to improve significantly in the short term. As a result, the economic growth attained in the first half of the year is likely to be short lived and to moderate to an overall rate of 2 per cent in 2023. We expect this to be followed by a growth rate of 1.3 per cent in 2024.

Assessment of transition qualities (1-10)



Structural reform developments

Structural reforms have stalled amid widespread and expanding sanctions. Although sanctions have been in place in some form since 2004, several rounds imposed by the EU and others since the contested presidential elections in August 2020 and, later, in response to Belarus's role in Russia's military invasion of Ukraine, have been far-reaching. Following the latest round of sanctions adopted by the EU in August 2023, restrictive measures now apply to a total of 233 individuals and 37 entities. Further measures, including the closure of remaining border crossings for vehicles and the suspension of cross-border railway transport links, cannot be ruled out.



Georgia

Highlights

- **Growth remained robust, at 7.6 per cent year on year in the first half of 2023.** The extraordinary growth factors that have prevailed over the past year are gradually receding, and inflation has fallen below the central bank's target.
- **The European Commission (EC) has acknowledged progress on fulfilling the 12 requirements for European Union (EU) accession status.** In November 2023 the EC recommended to the European Council that Georgia be granted the status of candidate country once the 12 priorities are fully addressed.
- **There is increased focus on improving connectivity in the changing geopolitical environment.** Georgia is working with Azerbaijan, Hungary and Romania to connect the Caucasus to Europe through an electric cable under the Black Sea and to take action to increase the attractiveness of the Middle Corridor trade route between Asia and Europe.

Key priorities for 2024

- **The authorities should focus on implementing reforms that address the remaining priorities highlighted by the EC.** Progress on establishing independent anti-corruption institutions, an impartial judicial system and other priorities are crucial not only to progress on EU candidacy, but also to making another leap forward in improving the business environment.
- **Reform of state-owned enterprises (SOEs) should be speeded up.** It is necessary to have a clear governance framework in place for all SOEs and to adhere to best international corporate governance standards. SOEs should operate on commercial principles and be subject to the same regulatory requirements as private enterprises.
- **Reforms in the energy sector need to advance.** The authorities should avoid further delay in the development of competitive and organised domestic electricity and gas markets.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	5.0	-6.8	10.5	10.1	6.0
Inflation (average)	4.9	5.2	9.6	11.9	2.4
Government balance/GDP	-2.7	-9.3	-6.3	-2.5	-3.0
Current account balance/GDP	-5.9	-12.5	-10.4	-4.6	-6.1
Net FDI/GDP [neg. sign = inflows]	-6.1	-3.6	-5.0	-7.2	-4.6
External debt/GDP	107.9	131.7	118.4	95.5	n.a.
Gross reserves/GDP	20.1	24.7	22.9	19.9	n.a.
Credit to private sector/GDP	61.7	74.6	69.2	60.0	n.a.

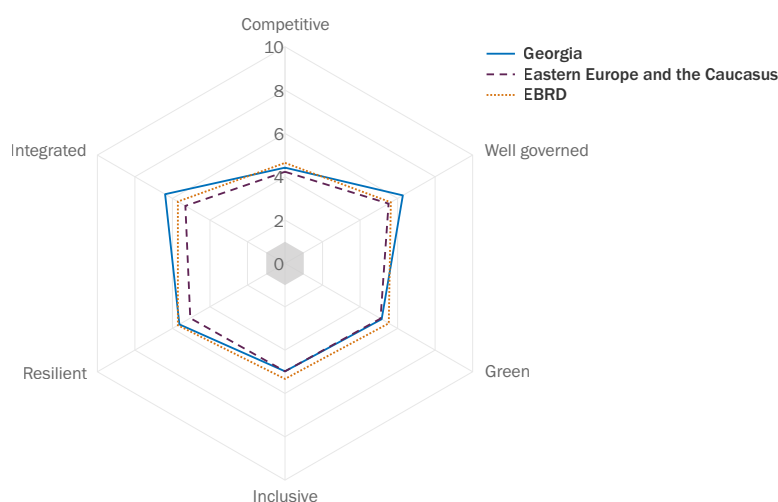
Macroeconomic developments and policy response

Economic growth has started to moderate from very high levels. After two years of double-digit growth, gross domestic product (GDP) grew by 7.6 per cent year on year in the first half of 2023, largely driven by the construction, trade, tourism and financial sectors. Transportation and energy supply, however, registered declines over the same period. Exports and imports of goods increased 19.4 and 24.3 per cent year on year, respectively, moderating after the extraordinary growth achieved last year. Income generated by foreign travellers continued to soar, up 57.9 per cent on the year in the first half of 2023, exceeding levels in the pre-pandemic period. The growth in tourism has included many visitors from the EU, Israel and neighbouring countries, suggesting the full recovery of this important industry. Growth in net money inflows continued, at 34.7 per cent year on year in the first half of 2023, helping to cover a significant part of the trade deficit and bring down the current-account gap. These trends lifted foreign reserves to US\$ 5.4 billion (around €4.9 billion) in July 2023, covering 4.2 months of imports, and enabled the Georgian lari to remain broadly stable after strong appreciation in 2022.

Inflation has fallen below target. After two years of being well over the central bank's target of 3 per cent, annual inflation slowed to 0.7 per cent in September 2023 on the back of tight monetary policy, lower commodity prices and a stronger domestic currency. Fiscal policy also contributed, with a budget surplus in the first half of the year as a result of buoyant revenues. The National Bank of Georgia responded to the disinflation with a 50 basis-point cut in its policy rate in May 2023 and further 25 basis-point cuts in August and September to 10 per cent. The central bank remains cautious amid strong domestic demand and the persistently high level of cash inflows from migrants.

Robust growth is likely to continue in the short term. GDP growth is forecast to moderate to 6 per cent in 2023 and 4.5 per cent in 2024. Geopolitical uncertainty in the region remains the main downward risk to the forecast. The possibility of obtaining EU candidate status, in contrast, could give new impetus to growth-conducive reforms and promote economic stability.

Assessment of transition qualities (1-10)



Structural reform developments

Efforts have been made to implement the requirements for gaining EU candidate status. In the past year, the authorities achieved progress on the 12 priorities set out by the EC in 2022 as conditions for granting Georgia candidate status for EU membership. As a result, in November 2023 the EC recommended that the European Council grant Georgia the status of candidate country once these 12 priorities are fully addressed.

Parliament has rejected the draft law on de-oligarchisation, acknowledging the need for a systemic approach. Parliament halted the legislative process to regulate de-oligarchisation with a specific law, accepting the opinion requested from the Venice Commission, the Council of Europe's body of constitutional experts. Instead, Georgia's EU Integration Commission, led by the prime minister, adopted an action plan for eliminating the excessive influence of vested interests in economic, political and public life, which follows the Venice Commission's proposal for a holistic set of measures. The action plan includes amendments to the legislation in all areas identified by the Venice Commission. Although this is a move in the right direction, the action plan has not yet been implemented.

Measures promoting the fight against corruption progressed, but fell short of fully meeting the EC's recommendations. The Anti-Corruption Bureau of Georgia was established as a legal entity following a vote in parliament in November 2022. The entity has a mandate to promote the fight against corruption and develop relevant proposals for the prevention, detection and suppression of conflicts of interest in public institutions. However, the law does not grant the Anti-Corruption Bureau investigative powers. In an additional setback, the government recently decided to withdraw from the monitoring of the Organization for Economic Co-operation and Development Anti-Corruption Network for Eastern Europe and Central Asia (OECD/ACN), raising concerns about the country's commitment to anti-corruption reforms.

Energy links with neighbouring countries are being developed. In December 2022 the authorities signed a memorandum of understanding for new energy interconnections with European countries through an electric cable under the Black Sea, which will improve connectivity and energy security. The agreement on a feasibility study for a 500 kV Black Sea electric cable project connecting with Georgia and Azerbaijan with Romania and Hungary is an important step forward in transforming Georgia into an electricity hub and integrating the country into the EU's internal electricity market. A parallel digital data cable connecting Georgia with European countries is part of the same project.

Georgia has delayed the opening of its electricity market. In June 2023 the Georgian government decided to postpone the opening of the electricity market, originally scheduled for 1 July, by one year. The last-minute postponement raised uncertainty among market participants and investors. Establishing a fully functioning and liquid domestic electricity market remains a key prerequisite to Georgia's continuing integration with the European energy sector.

Some progress has been made in the field of environment and climate change regulation. The central bank has published a Sustainable Finance Taxonomy that establishes a system for classifying economic activities in accordance with their social, green and sustainable status. This forms the basis for banks' loan classification, and reporting and measuring their impact against climate and social goals. The government has also approved a new plan for ambient air quality management of central Georgia (which includes two of the country's regions) for 2023-25 that aims to reduce air pollution, assess the impact of air pollution on human health and raise public awareness of its importance. Georgian State Electrosystem has started to issue certificates of origin for electricity produced from renewable energy sources, allowing consumers to choose the origin of their energy.

Digital upskilling has advanced. In July 2023 Georgia's Innovation and Technology Agency, supported by the EU, launched an information technology (IT) ecosystem, which aims to provide training to more than 1,300 Georgian citizens in high-demand digital professions, with a special emphasis on women's participation in the IT industry.

The authorities are taking concrete steps to improve connectivity. In August 2023 the government approved the National Transport and Logistics Strategy 2023-30 and associated Action Plan for 2023-24. The main goal of the strategy is to establish the country as a transportation and logistics hub by implementing EU directives in this area, digitalising the transport and logistics sectors, and attracting investments in road infrastructure and high-speed railway connections with neighbouring countries.



Moldova

Highlights

- **The economy continues to struggle.** Output fell further in the first half of 2023 after a steep decline in 2022, and inflation decelerated to 8.6 per cent in September 2023.
- **Digital transformation is advancing.** A new government digital strategy aims to develop the information technology (IT) sector, improve the efficiency of government services, enable remote identification and simplify online business registration for foreign investors.
- **Structural reforms have accelerated.** Having been granted European Union (EU) candidate country status in June 2022, the authorities have made important progress in addressing the nine priorities identified in the European Commission's opinion on the application for membership. As a result, in November 2023 the European Commission recommended that the European Council open accession negotiations with Moldova once all priorities have been fully addressed.

Key priorities for 2024

- **Administrative and institutional capacities need strengthening in advance of EU accession negotiations.** The authorities should ramp up ongoing public administration and judicial-system reform efforts to further reduce corruption and eliminate the influence of oligarchs in the political system.
- **The authorities should continue to undertake legislative reform to support the digitalisation of public services.** Building on the success of new platforms to promote e-government, the necessary legislative and regulatory framework should be put in place to enable systemic digitalisation across all layers of government.
- **Energy-sector reform should continue, to further integrate the domestic energy market into the EU single market.** Enhancing energy security remains a priority given the country's location. The authorities should advance policy action with the EU to enable competitive energy trading with European partners and reduce the country's dependency on a single source of energy supply.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.6	-8.3	13.9	-5.0	0.0
Inflation (average)	4.8	3.8	5.1	28.7	13.3
Government balance/GDP	-1.5	-5.3	-2.6	-3.2	-6.0
Current account balance/GDP	-9.4	-7.7	-12.4	-17.1	-12.1
Net FDI/GDP [neg. sign = inflows]	-4.1	-1.3	-2.7	-3.7	-1.5
External debt/GDP	61.2	70.1	63.8	65.9	n.a.
Gross reserves/GDP	26.1	32.8	28.5	30.8	n.a.
Credit to private sector/GDP	19.6	22.9	23.3	22.5	n.a.

Macroeconomic developments and policy response

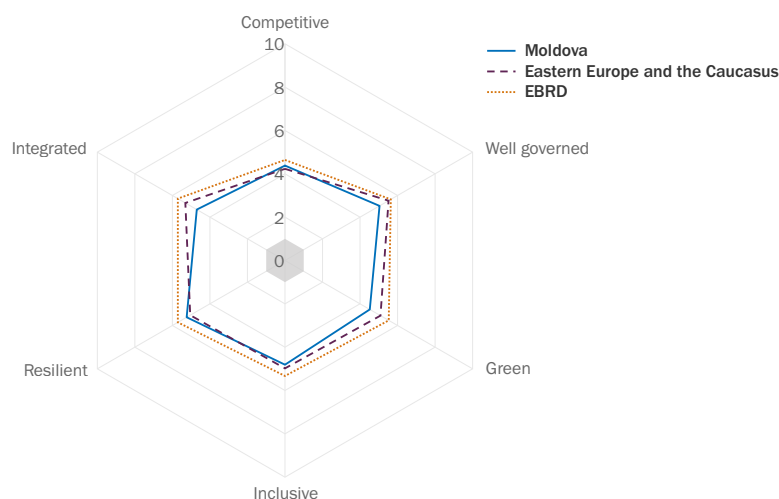
The economy is struggling to exit from a negative spiral. Moldova is one of the economies hardest hit by the war on Ukraine, with gross domestic product (GDP) falling by 5 per cent in 2022. Soaring inflation (peaking at 34.6 per cent in October 2022) and tight monetary policy stifled domestic demand, while a severe drought led to a steep decline in agricultural production. These negative trends continued in the first half of 2023, when GDP contracted by 2.3 per cent year on year, mainly due to a further 5.6 per cent fall in private consumption. Industrial output dropped 7.6 per cent year on year during the same period and exports of goods declined 10.9 per cent. With imports remaining flat, the current account deficit-to-GDP ratio remained at double-digit levels. On a more positive note, the combination of more stable energy prices and tight monetary policy contributed to a sharp deceleration in the annual inflation rate, to 8.6 per cent in September 2023, allowing the National Bank of Moldova to cut the policy rate to 6 per cent.

Fiscal pressures have increased as a result of the Ukraine war. In December 2022 parliament approved a 12.5 per cent increase in government expenditure in 2023, targeting higher public-sector wages and pensions and expanding standard-of-living support for the most vulnerable. In the past year, the Moldovan authorities have provided social assistance, public education, emergency healthcare services and temporary accommodation to 117,000 Ukrainian refugees. They have also introduced energy subsidies for vulnerable Moldovan households through the Energy Vulnerability Reduction Fund. Financial support for agricultural producers in rural areas increased 17 per cent year on year between January and July 2023. Since November 2022 micro, small and medium-sized agricultural producers can apply for a 100 per cent subsidy for diesel used, while large agricultural enterprises can receive a 30 per cent subsidy for energy used. All of these measures led to a fiscal deficit of 3.2 per cent of GDP in 2022 and 2.8 per cent of GDP in the first half of 2023.

Official creditors' external financing is helping to cover the twin deficits. In April 2023 the International Monetary Fund (IMF) approved the disbursement of US\$ 96 million (€87.5 million) for immediate budgetary support out of a total US\$ 795 million (€750 million) from the Extended Credit Facility (ECF)/Extended Fund Facility (EFF). In addition, the EU increased its macro-financial assistance (MFA) by €145 million in January 2023, while the World Bank paid out additional grant funding of US\$ 43 million (€40.6 million) in May 2023 through its emergency response. On the back of significant capital inflows, the domestic currency appreciated 8 per cent from the beginning of 2023 and foreign reserves reached US\$ 5 billion (€4.5 billion) at the end of July 2023, covering six months of imports. Public debt is moderate, at 33.7 per cent of GDP at the end of 2022, though is likely to have edged up by a few percentage points as a result of the new loans.

Geopolitical uncertainties are weighing on the short-term economic outlook. The government's expansionary fiscal policy in 2023 and the drop in inflation have not yet resulted in clear signs of an economic rebound. Nevertheless, the progress achieved on energy resilience and the expected rise in real incomes are likely to improve growth prospects in 2024. We, therefore, forecast GDP growth of 0 per cent in 2023, followed by growth of 3.5 per cent in 2024. The prospects for EU accession and associated reforms could drive a stronger recovery in the medium and long term.

Assessment of transition qualities (1-10)



Structural reform developments

The authorities are focusing reform efforts on nine priorities identified by the European Commission when granting Moldova EU candidate country status. In November 2023 the European Commission noted that Moldova has made important progress on the nine priorities and has taken additional measures to complement and sustain these achievements. Therefore, the Commission recommended that the European Council open accession negotiations with Moldova once it complies in all nine areas.

Progress is under way on reducing the influence of oligarchs. The authorities have accepted the advice of the Venice Commission on implementing a systemic approach to removing the political influence of oligarchs. This approach covers the adoption, strengthening and integration of legal tools across different fields of law to prevent the influence and growth of oligarchs in the long term. The authorities have also submitted an action plan to the Venice Commission, outlining institutional and legal progress, as well as a plan to revise it every six months. The Venice Commission made recommendations on the implementation of the action plan, including measures on the consistent reform of the judicial system, conducting impact assessments and introducing additional or complementary legislation.

Anti-corruption measures have progressed, but there is parliamentary opposition to their scope. A new legislative process began in March 2023, setting out a clear division between the National Anti-corruption Centre and the Anti-corruption Prosecutor's Office to optimise coordination between the two main anti-corruption agencies. To simplify corruption case proceedings, the authorities partially amended the Criminal Procedure Code at the end of December 2022. However, in July 2023 parliament proposed amendments to limit the role of the Anti-corruption Prosecutor's Office to taking on only large-scale corruption cases (over €15,000 for bribery and €150,000 for damages).

Reforms to the judicial system continued, but judicial independence remains vulnerable. In August 2023 parliament passed a law on the Supreme Court of Justice under which it will become a court of cassation rather than an appeals court. Recent amendments to the judiciary's roles and responsibilities include changes to the status of judges, the code of criminal procedure and the code of civil procedure. However, vested interests and slow progress on passing these legal and regulatory amendments are hindering transparent judicial staff appointments and the budgetary independence of the anti-corruption agencies.

A new strategy for digital transformation is boosting digital technology applications in the public sector. In January 2023 the authorities launched the 2023-27 Strategy for Digital Transformation of the Republic of Moldova. Its main goals are to enhance IT sector competitiveness, expand access to digital services for the wider population and improve e-government services. In March 2023 parliament voted to discard legal constraints on foreign investors who want to open an online business in Moldova without a physical presence. Legislative amendments were made to allow remote identification of clients in the financial sector from July 2023. The authorities are also developing a digital platform to enable remote identification for e-government services.

Moldova's domestic energy sector is being integrated into the European market. Reducing dependence on energy imports from Russia has been a key target of energy-sector reform since the start of the war on Ukraine. Electricity trade capacity from continental Europe to Moldova increased to 1,050 MW in May 2023 through a new agreement with the European Network of Transmission System Operators for Electricity (ENTSO-E). The Moldovan authorities and the EU agreed in May 2023 that energy infrastructure projects in Moldova would be eligible to apply for EU grants under the bloc's energy infrastructure rules. Financial support from the European Bank for Reconstruction and Development (EBRD) also enabled the authorities to accumulate gas reserves for the coming winter.

Governance reforms of state-owned enterprises (SOEs) have advanced. In December 2022 the authorities adopted an ownership strategy identifying all SOEs at central government level that should be subject to reorganisation, privatisation or liquidation. It also published a plan to strengthen corporate governance. Later, amendments to the law were passed, enabling the Public Property Agency to monitor implementation by SOEs of corporate governance regulations, evaluate the performance of SOE board members and monitor the potential fiscal risks of SOEs. The authorities are also finalising an SOE privatisation plan.



Ukraine

Highlights

- **The economy has stabilised in 2023, but economic conditions remain very difficult.** After an economic collapse in 2022, the situation has improved slightly in 2023 as businesses adapt to wartime conditions. Gross domestic product (GDP) growth is slightly positive once again, and inflation has declined to single-digit levels.
- **Timely external financing and the new International Monetary Fund (IMF) programme have helped to restore macroeconomic stability.** Foreign reserves have increased to a historical high, while surpluses on the foreign-exchange market have brought down the market exchange rate close to the official level and prompted a shift from a pegged to a managed flexible exchange rate.
- **The prospect of European Union (EU) accession and the IMF programme are powerful drivers of reform.** The authorities are coordinating a reform agenda with international partners and, despite the exceptionally difficult circumstances, are making steady progress, including on seven priority areas identified by the European Commission on Ukraine's application for membership. As a result, in November 2023 the Commission recommended that the European Council open accession negotiations with Ukraine once all priorities have been completed.

Key priorities for 2024

- **Reforms to strengthen governance and transparency and tackle corruption need to proceed without delay.** Progress in these areas is essential, not only to build a fair and prosperous society, but also to convince foreign investors that there is a level playing field in Ukraine and to assure donors that their resources will be well spent. These reforms are also critical to progress towards EU accession.
- **An asset quality review of systemically important banks is needed.** This exercise should reveal if banks' assets are valued appropriately and whether banks have adequate capital to absorb current and future losses on delinquent assets. Meanwhile, ongoing bank profits need to be fully added to capital reserves.
- **Fiscal policy should focus on systemic measures rather than short-term fixes.** Proposals for short-term tax breaks and, in the medium term, tax havens should be avoided. Budget needs will remain high long after the war ends, and long-term, quality investors will be attracted by a sound business environment rather than by tax incentives.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.2	-3.8	3.4	-29.1	1.0
Inflation (average)	7.9	2.7	9.4	20.2	17.7
Government balance/GDP	-2.2	-5.3	-3.4	-16.3	-19.1
Current account balance/GDP	-2.7	3.4	-1.6	5.0	-5.7
Net FDI/GDP [neg. sign = inflows]	-3.4	0.0	-3.8	-0.1	-0.4
External debt/GDP	79.1	80.3	64.9	81.6	n.a.
Gross reserves/GDP	16.4	18.6	15.5	17.8	n.a.
Credit to private sector/GDP	24.3	22.2	18.7	18.9	n.a.

Macroeconomic developments and policy response

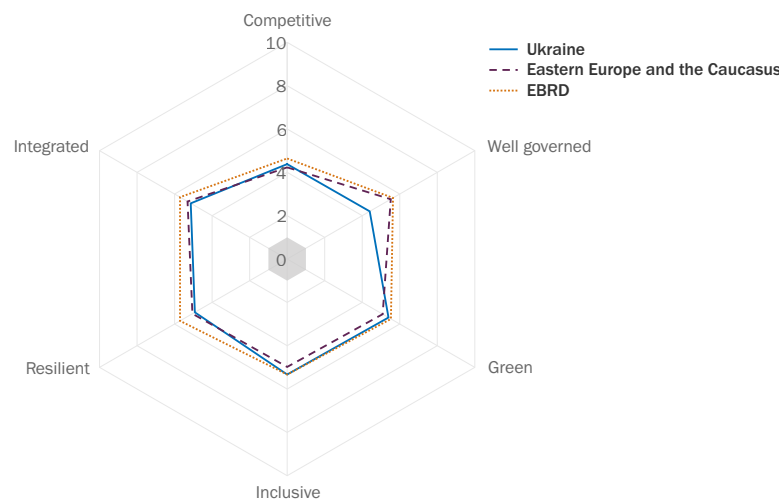
The economy has stabilised at around 70 per cent of pre-war real output levels. GDP collapsed by around 30 per cent in 2022 following Russia's invasion of the country. Signs of a modest recovery are now apparent, but domestic demand remains depressed due to the displacement of more than 8 million people abroad and the weak purchasing power of those remaining in Ukraine. According to a Transparency International survey, the war negatively affected the finances of 83 per cent of businesses, with 20 per cent suffering very significant losses. Encouragingly, businesses have adapted to the difficult conditions, and many have cited an optimistic outlook since the beginning of 2023. In the first half of the year, annual GDP increased by around 4.5 per cent, with the second quarter recording growth of 19.5 per cent compared to the second quarter of 2022, the first upturn since the start of the war. The grain and oilseed harvest in 2023 is forecast to be almost 10 per cent higher than last year, helped by favourable weather conditions. However, grain and oilseed exports are expected to fall to 49 million tonnes in the 2023-24 season (July to June) from 58 million tonnes in 2022-23.

External financing is supporting the recovery. In March 2023 the IMF approved a 48-month extended arrangement under the Extended Fund Facility (EFF) for an amount of SDR 11.6 billion (US\$ 15.6 billion [€14.6 billion], and 577 per cent of the quota). The main goal of the programme is to sustain macroeconomic and financial stability under extreme uncertainty and promote reforms that support Ukraine's recovery on the post-war path to EU accession. The authorities met all applicable quantitative performance criteria and structural benchmarks in the first review in May 2023. Probably the most difficult measure was restoring pre-war tax rates on fuel and on the self-employed and small businesses, which were reduced or abolished in March 2022. This move will strengthen budget revenues in the second half of 2023. Meanwhile, external financing has become more timely, stable and predictable. As of 20 October 2023, Ukraine had received US\$ 33.8 billion (€31.3 billion) from donors and international organisations out of the expected US\$ 42.2 billion (€39 billion) for the whole year. This lifted official foreign reserves to US\$ 39.7 billion (€37.3 billion) as at the end of September 2023, close to the highest level since Ukraine's independence. It also narrowed the exchange-rate spread between the cash market and the official exchange rate to less than 2 per cent (as of late August 2023) compared with 17 per cent in September 2022. These developments enabled a policy shift from a pegged to a managed flexible exchange rate at the beginning of October 2023.

Monetary policy is being eased amid falling inflation. The inflation rate peaked at 26.6 per cent in December 2022, but dropped thereafter to 7.1 per cent in September 2023. On the back of this positive development, the National Bank of Ukraine started easing monetary policy in July 2023 by reducing the policy rate from 25 per cent to 22 per cent, followed by a further cut to 20 per cent in September 2023. Increased foreign debt financing has lifted public debt by one-third since the start of the war, to US\$ 133.9 billion (€122.7 billion) as of August 2023, or more than 80 per cent of GDP. Bilateral creditors from the G7+ group of countries have extended the grace period for debt repayments to March 2027. Meanwhile, the Ukrainian authorities are trying to reach an agreement with bond holders on a debt operation under comparable terms to bilateral creditors, with the aim of finalising it by the end of August 2024.

With the ongoing war, uncertainty remains high. Despite the optimism and mild recovery so far in 2023, the recent non-extension of the grain export corridor and the wave of destruction on grain port infrastructure add to the uncertainty surrounding the short-term outlook. On the assumption that the war continues at its current level of intensity, we forecast GDP growth of 1 per cent in 2023 and 3 per cent in 2024.

Assessment of transition qualities (1-10)



Structural reform developments

Reforms are moving ahead, despite the war, guided by the EU accession process and the IMF programme. The current environment is obviously not conducive to structural reforms, but the authorities are still taking important steps to implement reforms in line with the seven priority areas set out in the European Commission's opinion on Ukraine's membership application and with commitments under the IMF programme. In November 2023 the Commission noted Ukraine's progress on addressing the seven priorities and recommended that the European Council open negotiations on membership once all priorities have been completed.

Judicial reform has advanced. In December 2022 the parliament amended the procedure for selecting constitutional court judges in a competitive process. Under the new rules, an advisory group, comprising an equal number of Ukrainian and international experts, will check the integrity and professional competence of candidates. To address concerns about potential impasses in the decision-making process, the Venice Commission suggested adding one more international expert to the advisory group. The European Commission expects the Venice Commission's recommendations to be implemented in full in order to avoid political interference in the selection of Constitutional Court judges. In addition, the High Council of Justice resumed its work in early 2023 and in June 2023 appointed all 16 members of the High Qualification Commission of Judges, a judicial body that vets and nominates candidates for judicial jobs. This is a significant milestone in fundamental judicial reform. The two judicial governing bodies will have to appoint more than 2,000 judges and complete the process of building a professional and independent judicial system.

Anti-corruption reforms are continuing. The authorities have moved ahead with the appointment of heads of the High Anti-Corruption Court (HACC) and National Anti-Corruption Bureau (NABU). The new head of the HACC was named in February 2023 and in March the government appointed a new director of the NABU from the three candidates shortlisted by a selection commission consisting of three Ukrainians and three international experts. These steps complete the triad of a fully formed and functioning anti-corruption infrastructure. Progress on anti-corruption was acknowledged by the Council of Europe Group of States against Corruption (GRECO), which concluded in March 2023 that Ukraine had implemented or satisfactorily dealt with 15 out of 31 recommendations contained in the previous report, and partly implemented nine other recommendations. As a result, Ukraine is no longer deemed to be "globally unsatisfactory", and the special reporting procedure was discontinued.

Significant progress was achieved in regulating the media in accordance with EU standards.

The new media law, adopted in December 2022, harmonises media-sector regulation with the EU audiovisual media services directive. It also gives the independent media regulator the power to ensure the smooth functioning of the media market. In May 2023 the parliament adopted the provisions of the EU acquis in the field of audiovisual advertising.

A law on de-oligarchisation was adopted, but further refinements may be necessary. The Venice Commission classifies the new law as a “personal approach”, which seeks to identify persons as oligarchs through specific criteria, such as wealth, ownership of a business monopoly, media ownership and political engagement, and subjects them to a series of limitations. Contrary to this, the common approach in most countries is to prevent undue influence through the concentration of economic and political power by pursuing a multi-sectoral and systemic approach.