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Financial Inclusion

Europe and Central Asia Economic Update
Office of the Chief Economist
Spring 2019

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Abbreviations

BHAS	BIH Agency for Statistics
BYN	Belarusian Ruble
CAD	Current account deficit
CBA	Central Bank of Armenia
CIT	Corporate income tax
CPI	Consumer price inflation
CROSTAT	Croatian Bureau of Statistics
ECA	Europe and Central Asia
ECAPOV	ECAPOV (ECA Poverty) database of standardized household surveys
EEU	Euroasian Economic Union
EMDE	Emerging markets and developing economies
FDI	Foreign direct investment
FIFA	Fédération Internationale de Football Association
GDP	Gross domestic product
NBK	National Bank of Kazakhstan
HPP	Hydro-power plant
HUS	Hold utility subsidy
ICT	Information and communication technology
IFI	International financial institution
IMF	International Monetary Fund
IT	Information technology
LCU	Local currency unit
LMIC	Low and middle income countries
NBG	National Bank of Georgia
NBR	National Bank of Romania
NBS	National Bank of Serbia
NPL	Non-performing loans
OPEC	Organization of the Petroleum Exporting Countries
PIT	Personal income tax
PMI	Purchasing Managers' Index
PPA	Power purchasing agreements
PPG	Public and publicly guaranteed
PPP	Public-private partnership
SAR	Special administrative region
SBA	Stand-By Arrangement (IMF)

SOE	State-owned enterprise
TFP	Total factor productivity
TSA	Targeted social assistance
URKSTAT	Ukranian Bureau of Statistics
VAT	Value added tax
WB	World Bank
WDI	World Development Institute

Regional Classification Used in this Report

This report covers 47 countries referred to as Europe and Central Asia (ECA) countries. These are divided into 10 groups: Western Europe, Southern Europe, Central Europe and Baltic Countries, Northern Europe, Western Balkans, South Caucasus, Central Asia, Russia, Turkey, and Eastern Europe.

TABLE E.1 Regional classification used in this report

		European Union				Western Balkans
		Western Europe	**Southern Europe**	**Central Europe and Baltic Countries**	**Northern Europe**	
Europe and Central Asia	**European Union and Western Balkans**	Austria Belgium France Germany Ireland Luxemburg The Netherlands United Kingdom	Cyprus Greece Italy Malta Portugal Spain	Bulgaria Croatia Czech Republic Estonia Hungary Latvia Lithuania Poland Romania Slovak Republic Slovenia	Denmark Finland Sweden	Albania Bosnia and Herzegovina Kosovo Montenegro Republic of North Macedonia Serbia
	Eastern Europe and Central Asia	**South Caucasus**	**Central Asia**	**Russia**	**Turkey**	**Eastern Europe**
		Armenia Azerbaijan Georgia	Kazakhstan Kyrgyz Republic Tajikistan Turkmenistan Uzbekistan			Belarus Moldova Ukraine

Executive Summary

With slowing global growth and increasing uncertainty clouding the global economic prospects, the Europe and Central Asia region faces a more challenging context than previously envisioned. Growth in the emerging markets and developing economies in the region slowed to 3.1 percent in 2018 and is projected to decline to 2.1 percent in 2019. What challenges does the region face in the coming year? What are some of the risks to the macroeconomic outlook? In the long run, how should policy makers design policies that boost growth and help individuals and firms adjust to the interplay between globalization and technological change? In the global context, this update summarizes the recent developments and outlook for the region. It also focuses on financial inclusion, as one of the important policy areas that can promote long-term growth, reduce poverty, and enhance resilience to shocks.

The aggregate growth figures mask the diversity of performance across the region. Regional growth was hindered by marked weakness in Turkey amid substantial financial market stress despite strong growth in other parts of the region, such as Central Europe, the Western Balkans, the Russian Federation, and Central Asia. Regional growth is expected to pick up modestly in 2020–21, as a gradual recovery in Turkey offsets moderating activity in Central Europe. Key external risks to the region are spillovers from weaker-than-expected activity in the euro area, as well as the escalation of global policy uncertainty, particularly in trade. Renewal of financial pressures in Turkey, combined with possible contagion to the rest of the region, could also disrupt growth in the region. The possibility of sharp declines in energy prices presents a downside risk to the region's energy exporters, such as Azerbaijan, Kazakhstan, and Russia.

The region faces many long-run challenges to development, ranging from worsening demographics, to declining productivity and investment, to climate change. This update focuses on one policy – promoting inclusive financial sector development -as a way to promote growth and poverty alleviation. There is great variation in financial inclusion in the region. In the euro area, most adults already own an account. In the developing countries in the region, there has been significant improvement in account ownership, which has increased from 45 to 65 percent since 2011. Tajikistan, Armenia, Moldova, the Kyrgyz Republic, and Georgia are among the countries that have seen the greatest increases globally, despite starting from a very low base. These experiences underline the potential role of digital payments in driving financial inclusion. Nevertheless, almost 30 percent of unbanked adults report trust in banks as a barrier, which is nearly double the developing country average. And in some countries, gender gaps in account ownership remain significant. For example, the gap is close to 30 percentage points in Turkey, which is three times the average gap in developing countries. But there are many opportunities to increase account ownership. Over 80 percent of the unbanked have a mobile phone, and simply moving public sector pension payments into accounts would reduce the number of unbanked adults in the region by up to 20 million. Given the heterogeneity of experiences, there are ample opportunities for countries in the region to learn from each other, which lays out a rich research and operational agenda going forward.

PART

Economic Outlook

1

The Global Context

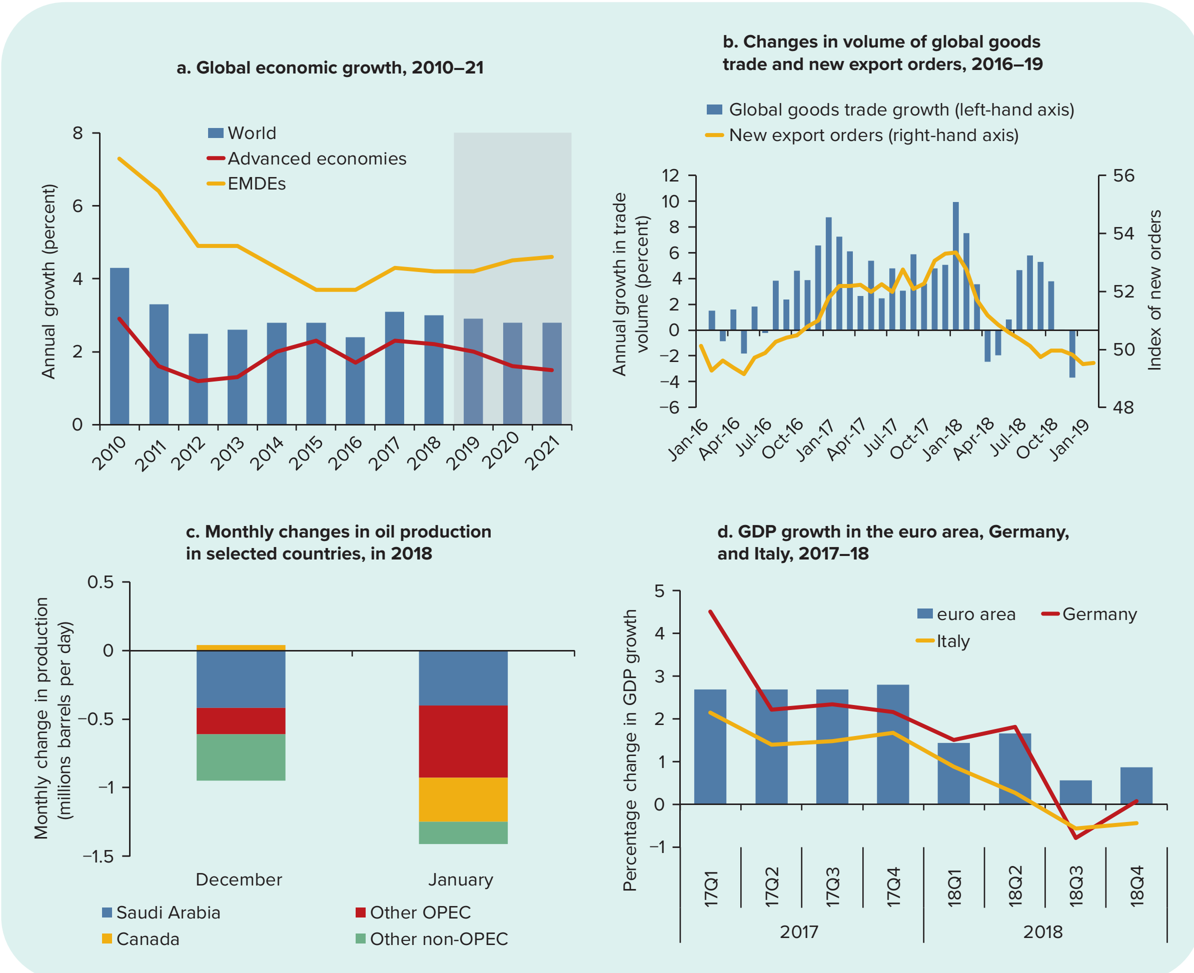
Softening growth and elevated uncertainty are clouding global economic prospects. Global activity and trade decelerated at the end of 2018, and data point to continued weakness into 2019. Growth in emerging markets and developing economies is projected to stall in 2019, with a weak recovery by commodity exporters accompanied by a deceleration in commodity importers. A recurrence of financial stress could disrupt activity and lead to contagion effects. Trade disputes could escalate or become more widespread, denting activity in the economies involved and leading to negative global spillovers. Slowing activity in the euro area and a sharper than expected deceleration in China could trigger a deeper slowdown in global activity. Policy uncertainty and geopolitical risks remain high and could negatively affect confidence and investment around the world.

Overall Trends

Global growth continues to moderate, amid soft trade and manufacturing activity, reflecting slowdowns in most major economies, as well as in emerging markets and developing economies (EMDEs) that experienced substantial financial market pressure, such as Argentina and Turkey. The ongoing weakness is consistent with the January 2019 *Global Economic Prospects* report, which estimated global growth at 3 percent for 2018 (figure 1.1, panel a). Global inflation trended up during most of 2018, peaking at 2.5 percent (year-over-year) in October before moderating.

Incoming data indicate that global growth may be softening further going into 2019. Global goods trade has been stagnating, with the euro area experiencing its largest contraction in export volumes since the 2009 global financial crisis (figure 1.1, panel b). Over the course of 2018, the pace of industrial production growth

FIGURE 1.1 Global economic outlook



Source: CPB Netherlands Bureau for Economic Policy Analysis; Haver Analytics; International Energy Agency; World Bank.
Note: In panel a, the shaded area indicates forecasts. Data for 2018 are estimates. Aggregate growth rates are calculated using constant 2010 U.S. dollar GDP weights. In panel b, new export orders are measured by the Purchasing Managers' Index (PMI). Readings above 50 indicate expansion; readings below 50 indicate contraction. The last observation is February 2019 for PMI and December 2018 for trade volumes. In panel d, figure shows quarter-on-quarter seasonally-adjusted annualized rates. Data in 2010 chained euro. The last observation is for fourth quarter 2018. EMDEs = emerging markets and developing economies; GDP = gross domestic product; OPEC = Organization of the Petroleum Exporting Countries.

declined by more than two-thirds. Several measures of global sentiment have fallen to their lowest level in years. Uncertainty remains elevated, notwithstanding recent optimism that ongoing trade disputes between major economies will be partially resolved.

After tightening throughout most of 2018, global financing conditions have eased somewhat as major central banks responded to deteriorating growth prospects with a more dovish stance, including the Federal Reserve, the European Central Bank, the Bank of England, the Reserve Bank of India, and the People's Bank of China. Reassessment of the future path of U.S. policy interest rates and inflation have contributed to U.S. long-term yields declining to 2.4 percent after a seven-year peak of 3.2 percent in November. Global equity markets have recovered after bottoming out in late December, despite continuing concerns about softening global growth.

Many EMDEs faced substantial financial market stress or deteriorating market sentiment in 2018. So far in 2019, however, external financing conditions have improved and capital inflows to EMDEs have recovered. After yields on EMDE debt issued on international bond markets rose about 150 basis points in 2018—the third-largest annual increase in the past two decades—sovereign bond spreads reversed and narrowed somewhat, although they remain elevated compared to 2017 levels.

Oil prices have been rising since the beginning of the year, with Brent crude climbing above $65 a barrel in mid-February, driven by a fall in the global oil supply of more than 2 million barrels a day, mainly as a result of planned production cuts by Saudi Arabia and other members of the Organization of the Petroleum Exporting Countries (OPEC) (figure 1.1, panel c). Oil prices are forecast to average $67 a barrel in 2019, slightly below the 2018 average.

The prices of metals and most agricultural commodities fell in the second half of 2018, following the imposition of new U.S. tariffs on imports from China; they have been slowly drifting back up in 2019. Negotiations between China and the United States may avert further increases or roll back existing tariffs between the two countries, but trade tensions are likely to persist.

TABLE 1.1 Real GDP

(Percent change from previous year)

	Real GDP (percent)					
Category	**2016**	**2017**	**2018[e]**	**2019[f]**	**2020[f]**	**2021[f]**
World	**2.5**	**3.1**	**2.9**	**2.9**	**2.8**	**2.8**
Advanced economies	1.7	2.3	2.1	2.0	1.6	1.5
United States	1.6	2.2	2.9	2.5	1.7	1.6
Euro Area	1.9	2.5	1.8	1.6	1.5	1.3
Japan	0.6	1.9	0.7	0.9	0.7	0.6
China	6.7	6.8	6.6	6.2	6.2	6.0
World trade volume[a]	2.6	5.4	3.8	3.6	3.5	3.4
Commodity prices[b]						
Oil price	–15.6	23.3	30.7	–2.9	0.0	0.0
Non-energy commodity price index	–2.8	5.3	1.7	1.0	1.2	1.2

Source: World Bank.
Note: Aggregate growth rates are calculated using constant 2010 U.S. dollar GDP weights. World Bank forecasts are frequently updated based on new information. Consequently, the projections presented here may differ from those in other World Bank documents, even if basic assessments of countries' prospects do not differ at any given moment. Country classifications and lists of emerging markets and developing economies are presented in table 1.2.
e = estimate; f = forecast.
a. World trade volume of goods and nonfactor services.
b. Oil is the simple average of Brent, Dubai, and West Texas Intermediate. The nonenergy index is made up of the weighted average of 39 commodities (7 metals, 5 fertilizers, and 27 agricultural commodities). For details, see http://www.worldbank.org/en/research/commodity-markets. For additional information, see www.worldbank.org/gep.

Major Economies

Growth in the U.S. economy increased to 2.9 percent in 2018, mostly reflecting strong domestic demand bolstered by procyclical fiscal stimulus and accommodative monetary policy. Wages and labor productivity are showing signs of picking up. In the coming years, growth is expected to decelerate toward long-term trends, as fiscal stimulus fades and the impact of higher tariffs is felt.

Euro area growth slowed in 2018, falling to 1.8 percent, down from 2.4 percent the year before. Exports softened, reflecting the earlier appreciation of the euro and slowing external demand. German activity decelerated especially rapidly at the end of 2018, and Italy entered a recession (figure 1.1, panel d). Incoming data do not point to recovery. Industrial production contracted to its lowest level since 2012, and the Manufacturing Purchasing Managers' Index (PMI) dipped to a six-year low.

The United Kingdom is scheduled to exit the European Union at the end of March, but no plans for an orderly withdrawal have yet been agreed upon as the British Parliament has rejected the draft withdrawal treaty negotiated with the European authorities. The exit deadline may be extended. A no-deal Brexit could

TABLE 1.2 Europe and Central Asia forecast summary

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

	Annual GDP growth (percent)						Percentage point differences from January 2019 projections		
Region/subregion	2016	2017	2018[e]	2019[f]	2020[f]	2021[f]	2019[f]	2020[f]	2021[f]
EMDE ECA, GDP[a]	**1.9**	**4.1**	**3.1**	**2.1**	**2.7**	**2.9**	**−0.2**	**0.0**	**0.0**
EMDE ECA, GDP excl. Turkey	1.5	3.0	3.3	2.5	2.6	2.6	−0.1	0.0	0.1
Commodity exporters[b]	0.7	2.1	2.7	1.9	2.2	2.3	−0.1	0.0	0.0
Commodity importers[c]	3.1	6.0	3.6	2.3	3.2	3.5	−0.3	0.0	−0.1
Central Europe and Baltic States[d]	3.3	4.9	4.6	3.6	3.3	3.0	0.0	0.0	0.0
Western Balkans[e]	3.3	2.6	3.8	3.5	3.8	3.8	0.0	0.0	0.0
Eastern Europe[f]	0.8	2.6	3.2	2.6	3.1	3.3	−0.3	0.0	−0.1
South Caucasus[g]	−1.6	2.0	2.6	3.7	4.0	4.2	−0.3	0.2	0.8
Central Asia[h]	2.9	4.5	4.7	4.2	4.0	4.1	0.0	0.0	0.0
Russian Federation	0.3	1.6	2.3	1.4	1.8	1.8	−0.1	0.0	0.0
Turkey	3.2	7.4	2.6	1.0	3.0	4.0	−0.6	0.0	−0.2
Poland	3.1	4.8	5.1	4.0	3.6	3.3	0.0	0.0	0.0

Source: World Bank.
Note: World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, the projections presented here may differ from those contained in other World Bank documents, even if basic assessments of countries' prospects do not differ at any given moment. For additional information, see www.worldbank.org/gep. e = estimate; ECA = Europe and Central Asia; EMDE = emerging market and developing economy; f = forecast; GDP = gross domestic product.
a. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars.
b. Includes Albania, Armenia, Azerbaijan, Kazakhstan, the Kyrgyz Republic, Kosovo, the Russian Federation, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.
c. Includes Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Hungary, the Republic of North Macedonia, Moldova, Montenegro, Poland, Romania, Serbia, and Turkey.
d. Includes Bulgaria, Croatia, Estonia, Hungary, Latvia, Lithuania, Poland, and Romania.
e. Includes Albania, Bosnia and Herzegovina, Kosovo, the Republic of North Macedonia, Montenegro, and Serbia.
f. Includes Belarus, Moldova, and Ukraine.
g. Includes Armenia, Azerbaijan, and Georgia.
h. Includes Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.

disrupt activity in the short term and exacerbate financial stability risks in the United Kingdom and abroad. Uncertainty remains high, likely hampering activity.

Growth in China slowed to 6.1 percent (quarter-over-quarter, seasonally adjusted annual rate) in the fourth quarter of 2018, bringing the rate for 2018 to 6.6 percent. Export growth decelerated, contributing to a shrinking current account surplus. Recent data point to further deceleration in 2019, amid ongoing rebalancing away from manufacturing and exports toward consumption and services. Growth is projected to decelerate to 6.2 percent in 2019 and 6.0 percent by 2021, broadly in line with its long-term pace. Supportive fiscal and monetary policies are expected to offset the negative impact of higher tariffs but may have the undesirable effect of slowing the deleveraging and derisking process.

Global Risks

The balance of risks to the global economy is tilted to the downside. The possibility of renewed disorderly financial market developments could further deteriorate growth prospects and spread through EMDEs. Elevated debt in many economies amplifies this risk. If all new tariffs currently under consideration were implemented, they would affect more than 5 percent of global goods trade. The dampening impact of trade tensions involving major economies could be multiplied through global value chains, such as those linking Central Europe to Germany. A sharper than expected deceleration in activity in the euro area and in China could trigger a deeper slowdown in global activity. Policy uncertainty and geopolitical risks remain high and could erode confidence and investment around the world. In the absence of an approved withdrawal agreement, the exit of the United Kingdom from the European Union could be accompanied by significant disruptions to domestic activity and become a source of financial stability risk in other economies.

Europe and Central Asia: Recent Developments and Outlook

Aggregate growth in EMDEs in Europe and Central Asia (ECA) slowed to an estimated 3.1 percent in 2018, with substantial subregional variations. It is projected to decelerate to 2.1 percent in 2019, mainly as a result of weakness in Turkey, as it experiences the consequences of earlier financial market stress. Regional growth is expected to pick up modestly in 2020–21, as a gradual recovery in Turkey offsets moderating activity in Central Europe. Uneven growth trends underline the regional numbers, reflecting divergence across subregions over the forecast horizon. Key external risks to the region include spillovers from weaker than expected activity in the euro area and an additional escalation of global policy uncertainty, particularly in trade. Renewed financial pressures in Turkey, combined with possible contagion to the rest of the region, could also disrupt growth in the region's EMDEs. The possibility of sharp declines in energy prices presents a downside risk to the region's energy exporters, such as Azerbaijan, Kazakhstan, and the Russian Federation.

Recent Developments

Growth in the EMDEs of ECA moderated to an average of 3.1 percent in 2018, with wide variation across countries. Upward revisions to gross domestic product (GDP) data for Russia, the largest economy in the region, contributed strongly to regional growth, alongside accelerating growth in Albania, Hungary, Poland, and Serbia. This was offset by weakness in Turkey due to financial market stress. The modest recovery in commodity exporters continued despite the volatility observed in commodity prices toward the end of the year; aggregate growth in commodity importers, excluding Turkey, eased slightly.

In line with general trends among EMDEs, inflation trended up for most of 2018, peaking at 3 percent (year-over-year) in August. It corresponded to the sharp decline in oil prices toward the end of the year. Growth is expected to slide to 2.1 percent in 2019, before recovering to 2.9 percent in 2021. Much of the growth profile reflects developments in Turkey, without which growth is expected to average just 2.6 percent during 2019–21.

Turkey entered a technical recession by the end of 2018, triggered by financial market and currency pressures. The contraction in activity represented a substantial reversal from the peak growth of 11.5 percent in the third quarter of 2017. Market sentiment deteriorated over concerns about rising private sector debt, much of it denominated in foreign currencies, accumulated through current account deficits financed through volatile portfolio capital flows. Accelerating inflation and a perceived delay in monetary tightening led to significant capital outflows from Turkey, with the lira undergoing a nearly 30 percent nominal depreciation against the U.S. dollar. To interrupt the cycle of a depreciating currency contributing to rising inflation and vice versa, the central bank hiked policy interest rates by 16 percentage points over the year to 24 percent by September. Turkish growth is expected to slow to 1.0 percent in 2019, weighed down by shrinking purchasing power, scarce and expensive credit, and low confidence. It is expected to begin to recover by 2020, through gradual improvement in domestic demand and continued strength in net exports, assuming that fiscal and monetary policy avert further sharp falls in the lira and corporate debt restructurings help prevent serious damage to the financial system.

In Russia growth accelerated to a six-year high of 2.3 percent in 2018, despite tightening economic sanctions and financial market pressure. It was supported by the rise in oil prices over most of the year, a solid contribution from net exports, as well as one-off factors, such as energy-related construction projects and the hosting of the World Cup. Throughout most of 2018, consumer price inflation accelerated as a result of the depreciation of the ruble, prompting the central bank to hike the policy interest rate twice toward the end of the year. Tighter monetary policy and a value-added tax hike at the beginning of the year are contributing to decelerating momentum in 2019.

Growth in Central Europe and the Baltics was 4.6 percent in 2018, supported by upwardly revised numbers for Hungary and Poland. Activity in Hungary accelerated to 4.9 percent in 2018, on the back of strong domestic demand from procyclical fiscal stimulus. In Poland, growth reached 5.1 percent in 2018, partly as a result of EU fund transfers and the strongest labor market since the 1990s. In contrast, investment in Romania was subdued, reflecting weak absorption of EU funds, which dampened growth. Central Europe, which is composed mainly of net oil importers, experienced rising inflation throughout 2018 that corresponded to increasing oil prices. The pace of inflation has since slowed, given the sharp decline in oil prices toward the end of the year. The deceleration over the forecast horizon is more pronounced in Central Europe and the Baltics than in other ECA subregions, as growth is expected to slow as a result of a shrinking working-age population, domestic capacity constraints (in Hungary, Poland, Romania, and the Baltics, for example) and tight connections with the slowing euro area economy. Private investment growth has been tepid and could diminish further in the absence of sustained progress on structural reforms.

TABLE 1.3 Europe and Central Asia country forecasts

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

	Annual GDP growth (percent)						Percentage point differences from January 2019 projections		
Country	2016	2017	2018[e]	2019[f]	2020[f]	2021[f]	2019[f]	2020[f]	2021[f]
Albania	3.4	3.8	4.2	3.8	3.6	3.6	0.2	0.1	0.1
Armenia	0.2	7.5	5.2	4.2	4.9	5.2	−0.1	0.3	0.6
Azerbaijan	−3.1	0.1	1.4	3.3	3.5	3.7	−0.3	0.2	1.0
Belarus	−2.5	2.5	3.0	2.2	2.4	2.1	−0.5	−0.1	−0.4
Bosnia and Herzegovina[a]	3.1	3.2	3.0	3.4	3.9	4.0	0.0	0.0	0.0
Bulgaria	3.9	3.8	3.1	3.0	2.8	2.8	−0.1	−0.2	0.0
Croatia	3.5	2.9	2.6	2.5	2.5	2.4	−0.3	−0.3	−0.2
Georgia	2.8	4.8	4.7	4.6	4.8	5.0	−0.4	−0.2	0.0
Hungary	2.3	4.1	4.9	3.5	2.8	2.6	0.3	0.0	0.2
Kazakhstan	1.1	4.0	4.1	3.5	3.2	3.2	0.0	0.0	0.0
Kosovo	4.1	4.2	4.2	4.4	4.5	4.5	−0.1	0.0	0.0
Kyrgyz Republic	4.3	4.7	3.5	4.3	4.0	4.1	0.9	0.1	0.1
Republic of North Macedonia	2.8	0.2	2.7	2.9	3.2	3.6	0.0	0.0	0.3
Moldova	4.4	4.7	3.8	3.6	3.5	3.8	−0.2	0.0	0.6
Montenegro	2.9	4.7	4.4	2.9	2.4	2.3	0.1	−0.1	−0.2
Poland	3.1	4.8	5.1	4.0	3.6	3.3	0.0	0.0	0.0
Romania	4.8	7.0	4.1	3.6	3.3	3.1	0.1	0.2	0.3
Russian Federation	0.3	1.6	2.3	1.4	1.8	1.8	−0.1	0.0	0.0
Serbia	3.3	2.0	4.2	3.5	4.0	4.0	0.0	0.0	0.0
Tajikistan	6.9	7.1	7.3	6.0	6.0	6.0	0.0	0.0	0.0
Turkey	3.2	7.4	2.6	1.0	3.0	4.0	−0.6	0.0	−0.2
Turkmenistan	6.2	6.5	6.2	5.6	5.1	4.9	0.0	0.0	0.0
Ukraine	2.3	2.5	3.3	2.7	3.4	3.8	−0.2	0.0	0.0
Uzbekistan	6.1	4.5	5.1	5.3	5.5	6.0	0.2	0.0	0.0

Source: World Bank.
Note: GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars, unless indicated otherwise. World Bank forecasts are frequently updated based new information and changing (global) circumstances. Consequently, the projections presented here may differ from those contained in other World Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time. For additional information, see www.worldbank.org/gep.
e = estimate; f = forecast.
a. GDP growth rate at constant prices is based on the factor costs approach.

Growth in the Western Balkans picked up to 3.8 percent in 2018, up from 2.6 percent the previous year. In Serbia, the economy rebounded from weather-related disruptions in 2018 and benefited from strong job creation. Activity in Albania and Montenegro was solid, thanks to robust industrial production growth, as well as a strong tourism season. Growth in the Western Balkans is envisaged to moderate to 3.5 percent in 2019 and grow to 3.8 percent by 2020-21, but the outlook is predicated on political stability and policy uncertainty remaining in check. Infrastructure projects and investment in the subregion will help deliver robust growth in some economies (for example, Kosovo and Serbia), while a deceleration in public and private investment will taper activity in others (for example, Albania and Montenegro).

In the South Caucasus subregion, growth in 2018 was 2.6 percent, backed by robust mining and manufacturing activity. In Armenia, growth expanded to 5.2 percent, slowing in the second half of the year after copper prices dropped. In Azerbaijan, the recovery in domestic demand was slower than previously anticipated, as systemic issues in the financial sector continue to weigh on credit, but a new natural gas pipeline coming on stream is expected to support growth in the coming years. Georgia continued to be characterized by robust domestic demand, although momentum in the third quarter slowed on the back of contracting industrial production growth. Growth in the South Caucasus subregion is projected to strengthen to 4.2 percent by 2021, conditional on continued implementation of domestic reforms.

Growth in Central Asia expanded at a robust 4.7 percent in 2018, the strongest subregional growth among the region's EMDEs. The recovery from the 2014–16 collapse in oil prices in Kazakhstan has been supported by higher than expected production in the Kashagan oil field and strong domestic demand. In the Kyrgyz Republic, growth eased from 4.7 percent in 2017 to 3.5 percent in 2018, partially as a result of slower gold production. Over the forecast period, growth is projected to moderate to a still robust 4.1 percent by 2020-21 in Central Asia, as the gradual slowdown in the euro area is expected to weigh on export growth in Kazakhstan.

Risks to the Regional Outlook

Although the global economy showed worsening signs of weakness throughout 2018, growth in the region (excluding Turkey) was largely insulated. There are risks that this divergence fades in the face of a sharper than expected deceleration in ECA's most important trading partner, the euro area. Europe remains the region's largest trading partner, purchasing the majority of all EMDE ECA exports in 2017. Recent developments point to the predominance of downside risks, with activity weakening sharply in the euro area, especially Germany and Italy, and multiple indicators pointing to continued deceleration going into 2019.

The experience of Turkey in 2018 is a stark reminder of the risk of sudden and widespread shifts in investor sentiment, in particular for countries with large current account deficits or reliance on volatile capital inflows, high external debt loads, or sizable foreign currency-denominated debt as a share of GDP.

Increases in policy uncertainty could undermine confidence in the region and slow growth. Policy disagreements between the European Union and some Central European countries could deter international investors and reduce fiscal transfers. An escalation of international trade restrictions could have a negative impact on the region, given its trade openness and capital linkages. A slowdown or reversal of ongoing structural reforms remains a risk in many countries, especially for Armenia, Azerbaijan, Belarus, Ukraine, and Turkey. Tensions over the Syrian Arab Republic or Ukraine could trigger new sanctions.

Long-Term Challenges

Over the next decade, promoting growth for the region's EMDEs is expected to become more challenging. Demographic trends are worsening rapidly, and productivity and investment growth remain subdued. Growth is expected to slow further in most ECA countries over the next decade (World Bank 2018a). Tighter financing conditions and diminishing economic prospects are expected to deter investment. Unless new technologies can help unleash a productivity revival, productivity growth is expected to remain lackluster. Meanwhile, climate change may impose significant economic costs, especially for countries that rely heavily on agriculture, such as those in Central Asia. Policymakers can adopt a wide range of policy options to mitigate slowing productivity growth and declining working-age populations. This update focuses on one policy - promoting inclusive financial sector development—as a way to promote growth and poverty alleviation.

Aging Populations

Working-age population growth among the region's EMDEs has long been well below the global average for EMDEs. In the late 2000s, it turned negative (figure 1.2, panel a). The shift is attributed to declining fertility rates in the 1990s in the aftermath of the collapse of the Soviet Union, exacerbated by migration to the European Union and Russia. A recent slowing of emigration and rising female labor force participation have only partially mitigated downward trends.

The region can be divided into two parts, based on countries' stage of demographic transition. Turkey and Central Asia have only recently entered the late stage, characterized by falling fertility and mortality at all ages. The higher-income parts of the ECA region have already reached an advanced stage of aging, with populations declining (Bussolo, Koettl, and Sinnott 2015).

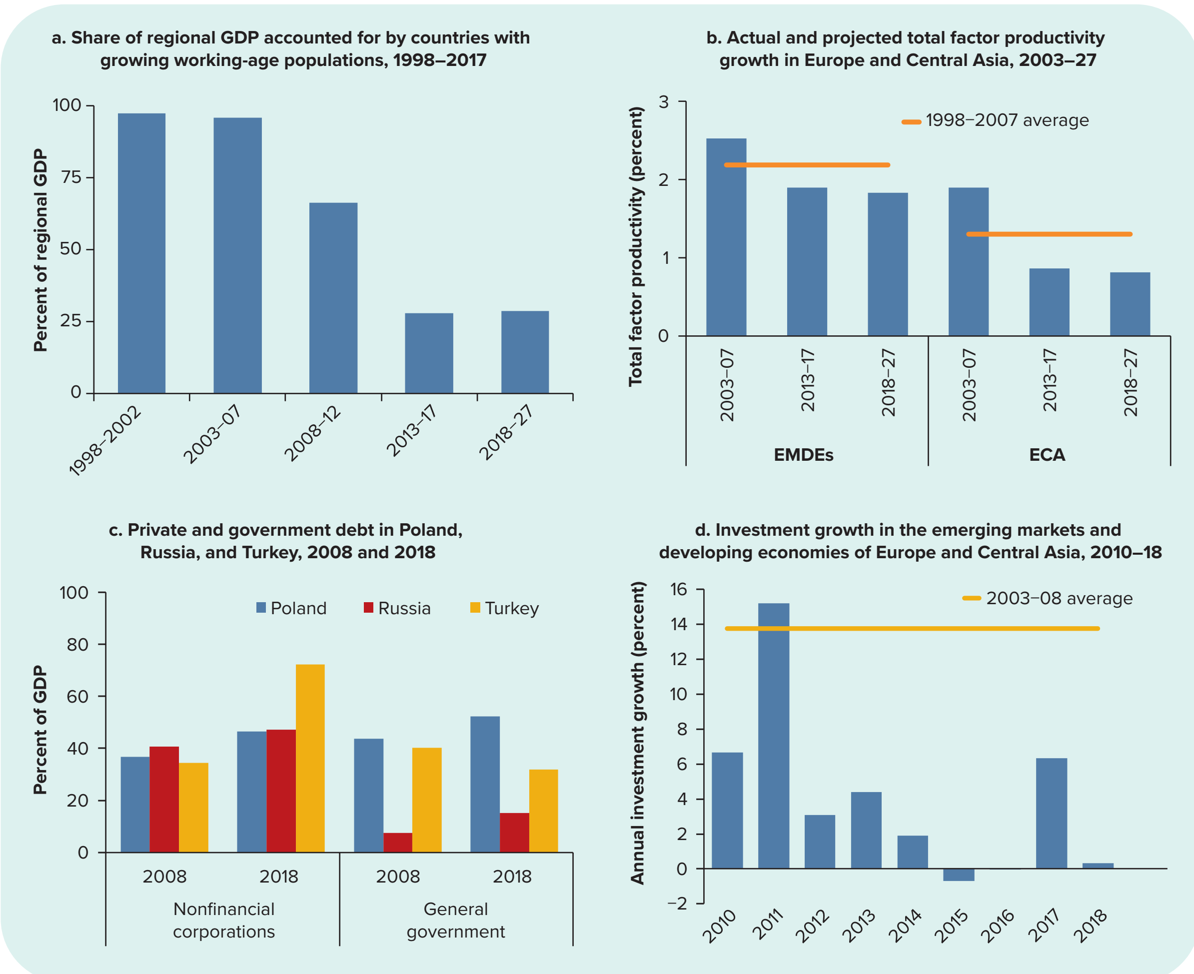
Declining Productivity

Annual trend total factor productivity (TFP) growth in ECA slowed to 0.8 percent in 2013–17, about 0.4 percentage point below the long-term average (figure 1.2, panel b) (World Bank 2018a). The deceleration largely reflected slowdowns in foreign direct investment (FDI) inflows, sectoral reallocation, and reform momentum, combined with aging population and declining business dynamism (World Bank 2018b). In the absence of a sudden productivity boost arising from new technologies, many of the drivers of the productivity slowdown in ECA appear likely to persist over the next decade.

FDI flows have fostered technology transfers and productivity gains among the region's EMDEs, particularly in Central Europe. However, growth in FDI flows to the region plummeted to 1 percent a year in 2013–16, down from 37 percent in 2005–07, likely adversely affecting TFP growth (EBRD 2015). The reallocation of labor from the agriculture sector to services and industry has been an important source of economywide productivity gains over the past two decades. In the western part of the region, however, the shift from agricultural to nonagricultural employment slowed after the global financial crisis.

Improvements in the business climate are associated with increasing productivity (World Bank 2018a). Over the past decade, EMDEs in ECA made strides in improving their business environments. As a result, in Central and Eastern Europe, the Western Balkans, and the South Caucasus, indexes of the business environment are approaching the levels in advanced EU countries. Reform momen-

FIGURE 1.2 Long-term economic challenges facing Europe and Central Asia



Sources: Institute of International Finance; Penn World Tables; World Bank.
Note: In panel a, the working-age population is defined as people 15–64. The sample includes 24 countries. In panel b, values are the GDP-weighted average of total factor productivity growth. In panel c, debt is defined as loans, debt securities, and currency and deposits. Data for 2018 are through the second quarter.

tum appears to have slowed in the mid-2000s, after Central European countries acceded to the European Union. Business climates in Central Asia continue to lag well behind those elsewhere in the region, notwithstanding improvements in Kazakhstan and Uzbekistan (World Bank 2019).

Weakening Investment

Investment growth has slowed sharply, from an average of more than 15 percent in the five years before the global financial crisis to an average of 1.6 percent in 2014–18, despite significant increases in debt (figure 1.2, panels c and d). The causes of investment weakness include declining commodity prices, lower FDI inflows, and lower long-term growth expectations. A sudden tightening of financial conditions could further weigh on investment, particularly for countries with high levels of debt that is denominated in foreign currency, short term, or at variable rates. In countries where the banking system is weak or has deteriorating asset quality (such as Belarus, Croatia, Kazakhstan, Russia, and Ukraine), a "sovereign-bank nexus" could amplify the impact of financial disruptions if bank holdings of government debt combine with government guarantees to the financial system to intertwine the health of banks and sovereigns (World Bank 2018c).

Climate Change

Climate change is contributing to droughts, floods, more intense and frequent natural disasters, and rising sea levels, with the poorest and most vulnerable people often hit hardest. Changes in rainfall patterns, rising temperatures, droughts, and floods have serious implications for countries with large agriculture sectors. Central Asia is especially vulnerable because of its aridity, previous underinvestment in infrastructure, high frequency of natural disasters, reliance on glaciers for water supply, and legacy of Soviet-era environmental mismanagement (UNDP 2018). Changes in sea level will affect many countries. Poland's heavily populated Baltic coast is vulnerable to rising sea levels. The Black Sea has seen a significant rise in sea level, which is threatening the many ports and towns along the coasts of Georgia, Russia, and Ukraine. As a result of increased surface evaporation, water levels in the Caspian Sea are projected to drop by approximately 6 meters by the end of the 21st century, imperiling fish stocks and coastal infrastructure (Fay, Block, and Ebinger 2010).

Policy Options for Responding to Long-Term Challenges

A wide range of policy options is available to help address the region's long-term challenges. Filling the region's investment gaps—estimated to be equivalent to 1.3 percent of GDP—could boost productivity (EBRD 2015). Public firms tend to be less efficient than private firms in ECA; privatization therefore presents an opportunity to raise economywide productivity, especially if it is accompanied by improved management and corporate governance.

Promoting FDI and other forms of connectivity could accelerate technology absorption and speed convergence with advanced economies (Gould 2018). Greater participation in global value chains is associated with faster productivity growth. Some countries have already integrated into the German supply chain. Countries in the South Caucasus and Central Asia could make similar progress through greater East-West connectivity. ECA countries could mitigate the impact of declining populations by increasing labor force participation—by providing better access to childcare services or attracting and retaining skilled labor, for example. Investments in human capital—both health and education—are also key in promoting productivity.

Financial Sector Development

Finance is central to development. Well-functioning financial systems contribute to growth and poverty alleviation by mobilizing and pooling resources, allocating capital to its most efficient uses, monitoring these investments after they have been made, and diversifying and managing risk. To be able to perform these functions, financial systems need to be deep, efficient and stable. For all segments of the society to benefit from these services, they also need to be inclusive.

Inclusive financial sector development can contribute to economic development by promoting individuals' investments in their health, education, and businesses. Greater financial inclusion can also help allocate the savings of an aging population and increase access to finance. But not all financial services are appropriate for everyone, and -especially for credit- there is a risk of overextension. Promoting financial inclusion is a responsible and sustainable way requires strong regulation and supervision to prevent potential crises that can accompany a rapidly-growing financial system (Gould and Melecky 2017; World Bank forthcoming). The feature chapter of this update examines recent trends and identifies many remaining challenges in promoting financial inclusion in ECA countries.

Annex: Data and Forecast Conventions

The macroeconomic forecasts presented in this report are the result of an iterative process involving World Bank staff from the Macroeconomics, Trade, and Investment Global Practice; regional and country offices; and the Europe and Central Asia Chief Economist's office. This process incorporates data, macroeconometric models, and judgment.

Data

The data used to prepare the country forecasts come from a variety of sources. National income accounts, balance of payments, and fiscal data are from Haver Analytics; the World Bank's World Development Indicators; and the IMF's World Economic Outlook, Balance of Payments Statistics, and International Financial Statistics. Population data and forecasts are from the United Nations World Population Prospects. Country and lending group classifications are from the World Bank. In-house databases include commodity prices, data on previous forecast vintages, and country classifications. Other internal databases include high-frequency indicators, such as industrial production, consumer price indexes, housing prices, exchange rates, exports, imports, and stock market indexes, based on data from Bloomberg, Haver Analytics, the Organisation for Economic Co-operation and Development analytical housing price indicators, the IMF's Balance of Payments Statistics, and the IMF's International Financial Statistics.

Aggregations

Aggregate growth for the world and all subgroups of countries (such as regions and income groups) is calculated as the GDP-weighted average (at 2010 prices) of country-specific growth rates. Income groups are defined as in the World Bank's classification of country groups.

Forecast Process

The process starts with initial assumptions about advanced economy growth and commodity price forecasts. These assumptions are used as conditions for the first set of growth forecasts for EMDEs, which are produced using macroeconometric models, accounting frameworks to ensure national account identities and global consistency, estimates of spillovers from major economies, and high-frequency indicators. These forecasts are then evaluated to ensure consistency of treatment across similar EMDEs. This process is followed by extensive discussions with World Bank country teams, which conduct continuous macroeconomic monitoring and dialogue with country authorities. Throughout the forecasting process, staff use macroeconometric models that allow the combination of judgment and consistency with model-based insights.

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2

Financial Inclusion in Europe and Central Asia

Well-functioning financial systems serve a vital purpose by offering savings, payment, credit, and risk management services and thereby contribute to economic development. Inclusive financial systems are those with a high share of individuals that have an access to and use financial services (World Bank, 2014; Demirgüç-Kunt, Klapper, and Singer 2017). Such systems provide individuals with greater access to resources to meet their financial needs, such as saving for retirement, investing in education, capitalizing on business opportunities, and confronting shocks. Inability to use these financial services can contribute to persistent income inequality and slow economic growth.

However, financial systems around the world are far from inclusive. Many poor people around the world lack the financial services that can serve these functions, such as bank accounts and digital payments. They rely on cash, which can be unsafe and difficult to manage. Without access to financial services that enable formal savings and borrowing, these “unbanked” people are also less likely to be able to come up with emergency funds to meet unexpected expenditure needs. This chapter focuses on financial inclusion of the individuals, provides an overview of how ECA countries fare in the global context, and identifies opportunities and challenges in promoting financial inclusion.

Why Does Financial Inclusion Matter?

Development theory provides important clues about the impact of financial inclusion on economic development. Available models illustrate how financial exclusion and, in particular, lack of access to finance can lead to poverty traps and inequality (Aghion and Bolton, 1997; Banerjee and Newman, 1993; Galor and Zeira 1993). For example, in the model of Galor and Zeira (1993), it is because of financial market frictions that poor people cannot invest in their education, despite their high marginal productivity of investment. In Banerjee and Newman's model (1993), the occupational choices of individuals (between becoming entrepreneurs or remaining wage earners) are limited by the initial endowments. These occupational choices determine how much individuals can save and what risks they can bear, with long-run implications for growth and income distribution. These models show that lack of access to finance can be critical for generating persistent income inequality or poverty traps, as well as lower growth.

There is also a growing body of empirical literature that documents the potential development benefits of financial inclusion, especially from the use of digital financial services, including mobile money services, payment cards, and other financial technology applications. Recent research shows financial inclusion yields a wide range of benefits. Mobile money services, which allow users to store and transfer funds through a mobile phone, can improve people's income-earning potential and reduce poverty. A study in Kenya finds that among households headed by women, access to mobile money services increased their savings by more than 20 percent and helped reduce extreme poverty by 22 percent (Suri and Jack 2016).

Digital financial services can also help people manage financial risks and smooth consumption. When times are tough, mobile money services can make it easier for families to receive money from friends and relatives living far away. Digital payment systems can lower the cost of remittances and save time and travel costs. Financial services also help people accumulate savings and increase spending on necessities. Women-headed households in Nepal, for example, spent 15 percent more on nutritious foods and 20 percent more on education after receiving free savings accounts (Prina 2015).

For governments, switching from cash to digital payments can reduce corruption and improve efficiency. In India the leakage of funds for pension payments declined by 47 percent when the payments were made through biometric smart cards rather than cash (Muralidharan, Niehaus, and Sukhtankar 2016). In Niger distributing social transfers through mobile phones rather than in cash reduced the variable cost of administering the benefits by 20 percent (Aker and others 2016).

Growth in Account Ownership Is Uneven in Europe and Central Asia

Account ownership serves as an entry point into the formal financial sector. A formal account makes it easier to transfer wages, remittances, and government payments. It can also encourage saving and open access to credit. Having an account is therefore often used as a marker of financial inclusion.

The Global Findex database—which provides systematic indicators of the use of different financial services (see Annex on Survey Methodology)—shows that 515 million adults across the world opened an account at a financial institution or through a mobile money provider between 2014 and 2017. The share of adults with an account increased from 51 percent in 2011 to 62 percent in 2014 and 69 percent in 2017. In developing economies, the share increased from 42 percent in 2011 to 55 percent in 2014 and 63 percent in 2017. Despite overall growth in account ownership around the world, however, wide variation remains across economies (map 2.1).

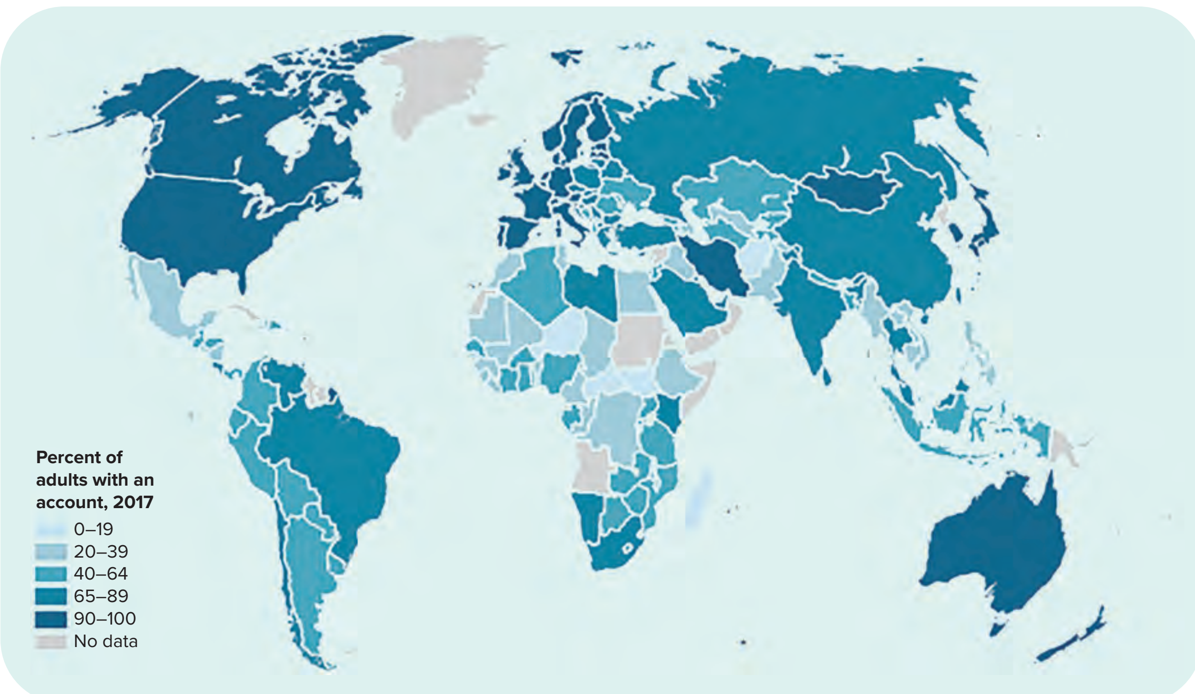
In developing economies in Europe and Central Asia (ECA), the share of adults with an account at a financial institution increased from 45 percent in 2011 to 65 percent in 2017. Compared with the rest of the world, developing economies in ECA had relatively high levels of account ownership as of 2011 and experienced moderate growth over time.

Within ECA there is considerable variation across countries in the growth of account ownership (figure 2.1). In the high-income euro area, 90 percent of adults already owned an account by 2011. The share increased marginally to 95 percent in 2017.

The pattern differs in the rest of the region. All three developing economies in Eastern Europe—Belarus, Moldova, and Ukraine—witnessed an increase in account ownership of more than 20 percentage points between 2011 and 2017 (table 2.1). The Baltic economies experienced an increase in account ownership from a high base level. In 2017 almost all adults in Estonia and Latvia had an account.

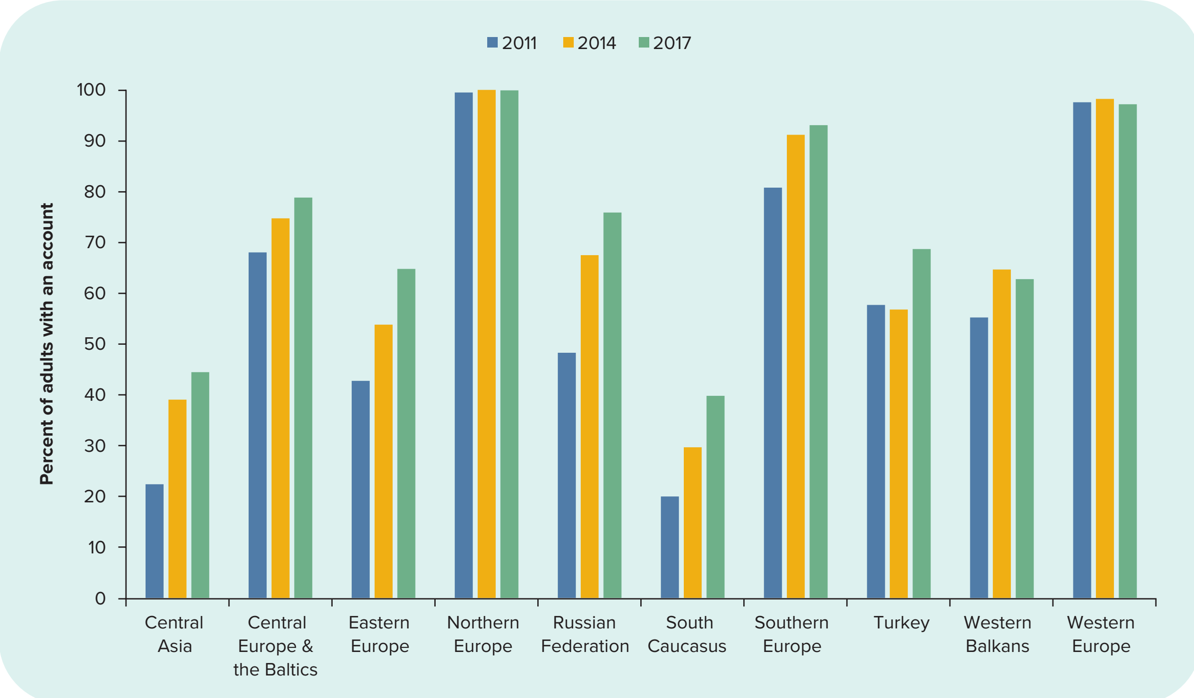
Financial inclusion levels are lower in Central Europe. A few Central European economies, such as Croatia and Czech Republic had stagnant levels of account ownership in the past decade. In Romania, account ownership grew from 45 percent in 2011 but re`mained at around 60 percent since 2014. Countries in the Western Balkans experienced moderate growth in account ownership, from 55

MAP 2.1 **Account ownership varies significantly across the world**



Source: Global Findex database.
Note: Data show percent of adults (aged 15 and above) with an account at a financial institution or a mobile money provider.

FIGURE 2.1 **Account ownership in Europe and Central Asia varies widely by subregion**



Source: Global Findex database.
Note: Data show percent of adults (aged 15 and above) with an account at a financial institution or a mobile money provider.

percent in 2011 to 63 percent in 2017. In Central Asia and the South Caucasus, account ownership doubled from about 20 percent in 2011 to roughly 40 percent in 2017. Armenia, Georgia, the Kyrgyz Republic, and Tajikistan saw significant increases in account ownership of 15 to more than 20 percentage points between 2014 and 2017.

Inequality in Account Ownership Is High in Parts of the Region

Globally, inequality in account ownership along gender, income, and other dimensions persists, despite continued growth in account ownership. Gender inequality is especially persistent. While 72 percent of men around the world have an account, just 65 percent of women do. The gender gap of 7 percentage points was also present in 2014 and 2011. In developing economies, the gender gap remained constant at 9 percentage points (figure 2.2).

The gap between richer and poorer households also failed to narrow. Among adults in the richest 60 percent of households within economies, 74 percent have an account. Among the poorest 40 percent, only 61 percent have an account. The global average gap between richer and poorer households stood at 13 percentage points in 2014 and 2017. Account ownership is also lower among young adults, the less educated, and people who are out of the labor force.

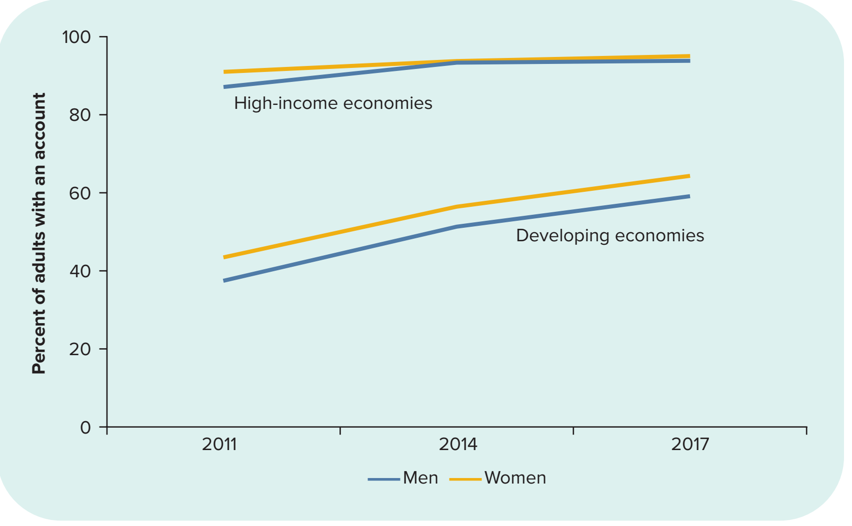
TABLE 2.1 Account ownership in Europe and Central Asia grew between 2011 and 2017

(Percent)

Subregion/country	2011	2014	2017
Central Asia	22	39	44
Kazakhstan	42	54	59
Kyrgyz Republic	04	18	40
Tajikistan	03	11	47
Turkmenistan	0	..	41
Uzbekistan	23	41	37
Central Europe and the Baltics	68	75	79
Bulgaria	53	63	72
Croatia	88	86	86
Czech Republic	81	82	81
Estonia	97	98	98
Hungary	73	72	75
Latvia	90	90	93
Lithuania	74	78	83
Poland	70	78	87
Romania	45	61	58
Slovak Republic	80	77	84
Slovenia	97	97	98
Eastern Europe	43	54	65
Belarus	59	72	81
Moldova	18	18	44
Ukraine	41	53	63
Northern Europe	99	100	100
Denmark	100	100	100
Finland	100	100	100
Sweden	99	100	100
Russian Federation	48	67	76
South Caucasus	20	30	40
Armenia	17	18	48
Azerbaijan	15	29	29
Georgia	33	40	61
Southern Europe	81	91	93
Cyprus	85	90	89
Greece	78	88	85
Italy	71	87	94
Malta	95	96	97
Portugal	81	87	92
Spain	93	98	94
Turkey	58	57	69
Western Balkans	55	65	63
Albania	28	38	40
Bosnia and Herzegovina	56	53	59
Kosovo	44	48	52
Republic of North Macedonia	74	72	77
Montenegro	50	60	68
Serbia	62	83	71
Western Europe	97	98	97
Austria	97	97	98
Belgium	96	98	99
France	97	97	94
Germany	98	99	99
Ireland	94	95	95
Luxembourg	95	96	99
Netherlands	99	99	100
United Kingdom	97	99	96
Total	**69**	**77**	**81**

Source: Global Findex database.
Note: Table shows percentage of adults 15 years and older who own an account at a financial institution or a mobile money provider.

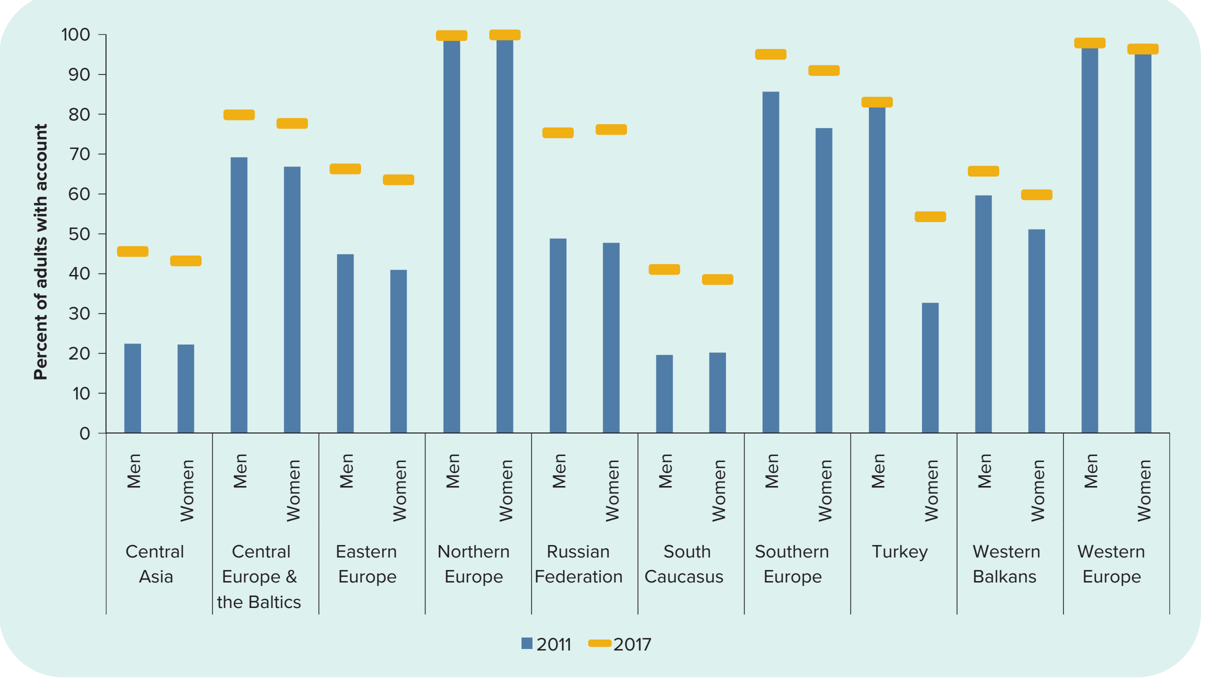
FIGURE 2.2 The gender gap in account ownership persists



Source: Global Findex database.
Note: Data show percent of adults (aged 15 and above) with an account at a financial institution or a mobile money provider.

In some ECA countries, the gender gap is much larger than the developing country average of 9 percentage points (table 2.2 and figure 2.3). The largest gap is in Turkey, where 83 percent of men but just 54 percent of women have accounts (figure 2.4). The gender gap is about three times as large as the average gap in developing countries. The income gap in account ownership is about 21

FIGURE 2.3 The gender gap in account ownership varies widely within Europe and Central Asia



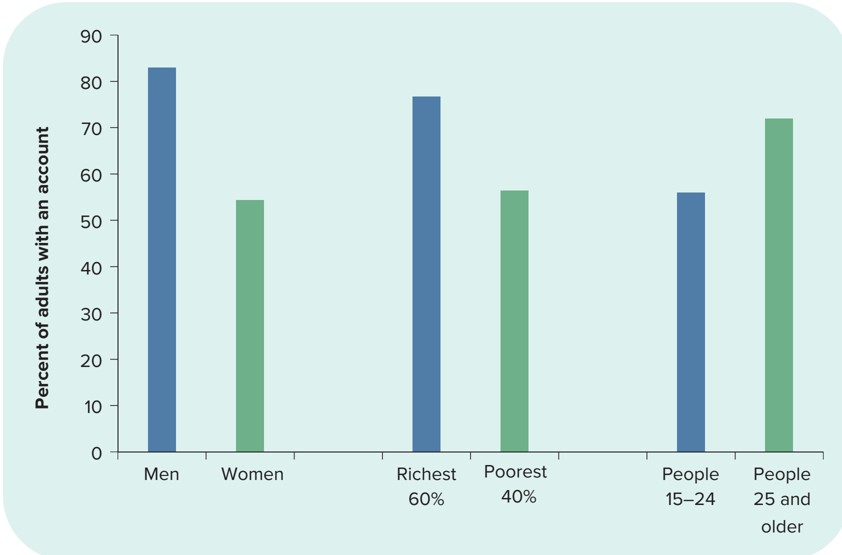
Source: Global Findex database.
Note: Figures show percent of population 15 years and older with an account at a financial institution or a mobile money provider.

TABLE 2.2 Gender gap in account ownership varies by country

Country	2011		2014		2017	
	Men	Women	Men	Women	Men	Women
Central Asia	22	22	39	39	46	43
Kazakhstan	40	44	52	56	57	60
Kyrgyz Republic	4	4	18	19	41	39
Tajikistan	3	2	14	09	52	42
Turkmenistan	0	1	..	..	46	36
Uzbekistan	24	21	42	39	38	36
Central Europe and the Baltics	69	67	77	72	80	78
Bulgaria	50	55	63	63	71	74
Croatia	90	87	84	88	90	83
Czech Republic	81	81	85	79	84	79
Estonia	96	97	98	97	98	98
Hungary	72	73	72	72	78	72
Latvia	87	92	90	90	94	93
Lithuania	71	76	78	78	85	81
Poland	72	68	83	73	85	88
Romania	49	41	65	57	62	54
Slovak Republic	80	79	74	80	85	83
Slovenia	96	98	98	97	98	97
Eastern Europe	45	41	55	53	66	64
Belarus	59	58	72	72	81	81
Moldova	19	17	16	19	43	45
Ukraine	44	39	54	52	65	61
Northern Europe	99	99	100	100	100	100
Denmark	100	99	100	100	100	100
Finland	99	100	100	100	100	100
Sweden	99	99	100	100	99	100
Russian Federation	49	48	64	70	75	76
South Caucasus	20	20	32	27	41	39
Armenia	17	18	21	15	56	41
Azerbaijan	16	14	33	26	29	28
Georgia	31	35	40	40	58	64
Southern Europe	86	77	93	89	95	91
Cyprus	88	83	90	90	87	90
Greece	80	76	88	87	86	85
Italy	79	64	92	83	96	92
Malta	97	94	97	96	98	97
Portugal	85	78	89	86	94	91
Spain	95	92	98	98	96	92
Turkey	*82*	*33*	*69*	*44*	*83*	*54*
Western Balkans	60	51	69	61	66	60
Albania	34	23	43	34	42	38
Bosnia and Herzegovina	67	48	59	47	63	55
Kosovo	57	31	59	36	61	44
Republic of North Macedonia	76	72	80	64	80	73
Montenegro	52	49	62	58	69	68
Serbia	62	62	83	83	73	70
Western Europe	97	98	98	98	98	96
Austria	98	97	96	97	98	98
Belgium	95	97	97	100	98	99
France	97	97	98	95	97	91
Germany	98	99	98	99	99	99
Ireland	96	92	95	95	95	95
Luxembourg	94	95	96	97	99	98
Netherlands	99	98	99	99	99	100
United Kingdom	97	98	99	99	97	96
Total	**72**	**66**	**79**	**76**	**83**	**79**

Source: Global Findex database.
Note: Figures show percent of male or female population aged 15 and older with an account at a financial institution or a mobile money provider.

FIGURE 2.4 Inequality in account ownership remains high in Turkey



Source: Global Findex database.
Note: The height of the bars shows the percentage of adults aged 15 and above with an account at a financial institution or a mobile money provider.

percentage points in Turkey, much higher than the global average. Younger adults are also less likely to own an account than older adults (see box 2.1). Such countries include Armenia (15 percentage points), Kosovo (17 percentage points), Tajikistan (10 percentage points), and Turkmenistan (10 percentage points).

Who Remains Unbanked in Europe and Central Asia?

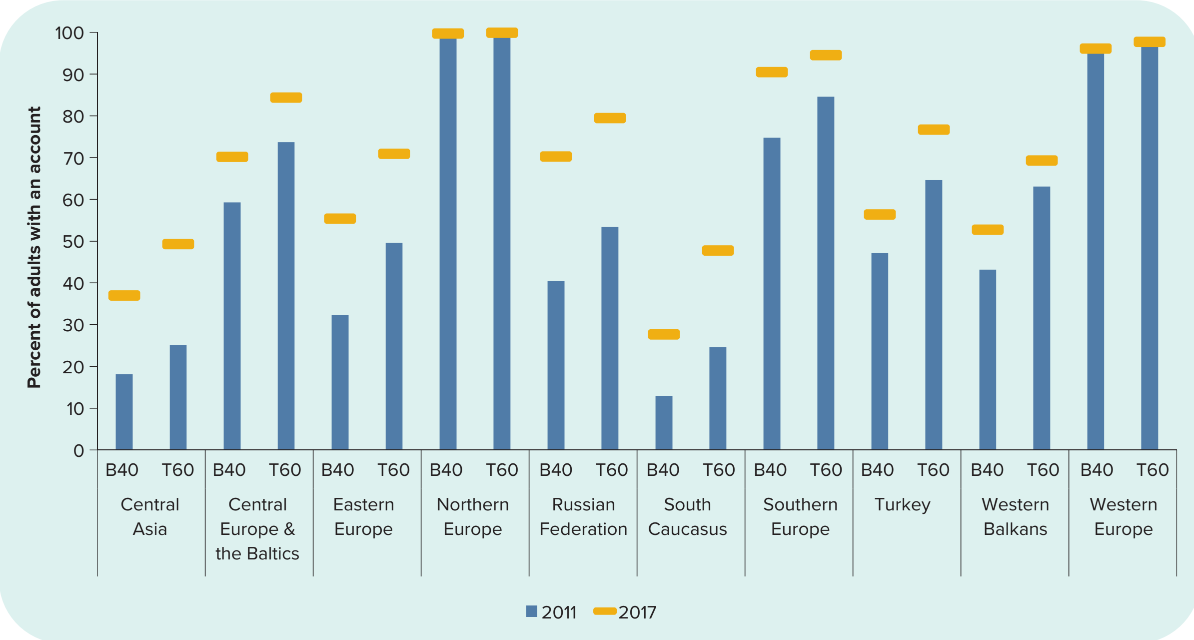
Globally, about 1.7 billion adults remain unbanked. Account ownership is almost universal in high-income economies; nearly all unbanked adults live in the developing world. Nearly half of them live in populous developing countries such as Bangladesh, China, India, Indonesia, Mexico, Nigeria, and Pakistan.

In 2017 there were 116 million unbanked adults in ECA. The majority live in Romania, the Russian Federation, Turkey, Uzbekistan, and Ukraine.

These people share various characteristics. First, women represent 58 percent of all unbanked adults in ECA. In some economies, such as Armenia, Kosovo, and Turkey, their share is even higher.

Second, poor people account for a disproportionate share of the unbanked in ECA (figure 2.5). Half of all unbanked adults are from the poorest 40 percent of households in the region. In Romania, for instance, nearly 60 percent of the unbanked are from the poorest 40 percent of households. Seventy-one percent of the richest 60 percent of adults in Romania have an account, while only 38 percent of the bottom 40 percent do. Such income gaps in account ownership are prevalent in ECA countries, with a handful of exceptions, including Croatia, the Kyrgyz Republic, Turkmenistan, and Russia, in all of which the gap is less than 10 percentage points.

FIGURE 2.5 The income gap in account ownership remains large in some countries in Europe and Central Asia



Source: Global Findex database.
Note: The gap is between adults (15 years and older) with an account at a financial institution or a mobile money provider living in the wealthiest 60 percent (T60) and poorest 40 percent of households (B40) within economies.

Unbanked adults are more likely than people with accounts to have low levels of education. In the developing world, about half of all adults have no more than a primary school education; among unbanked adults, the share is close to two-thirds. In developing economies in ECA, 34 percent of unbanked adults have no more than a primary school education. However, there is wide variation. In Albania and Kosovo, 67 percent of the unbanked have no more than a primary school education. By contrast, in Armenia this share was only 12 percent in 2017, thanks to the huge increase in account ownership among low-education adults, which rose from 7 percent in 2011 to 50 percent in 2017.

Being unbanked in ECA is also associated with lack of labor force participation. About 60 percent of unbanked adults in developing ECA are out of the labor force. The share of account ownership among people out of the labor force was 12–16 percentage points lower than the average for ECA in 2011, 2014, and 2017. There are a few exceptions. In Azerbaijan and Uzbekistan, where overall account ownership is low (30–40 percent), the share of unbanked adults who are out of the labor force was lower than the ECA average.

Lack of Trust in Banks Is a Major Barrier to Account Ownership

To help understand why people may remain unbanked, the 2017 Global Findex survey asked adults without a financial institution account why they did not have one. Globally, the most common reason offered was having too little money

BOX 2.1 Financial inclusion in Turkey: Insights from the 2017 Global Findex Survey

- 69 percent of adults in Turkey have an account, up from 57 percent in 2014.
- 83 percent of men but only 54 percent of women have an account, a gender gap that is roughly three times the average in developing economies.
- 64 percent of adults make or receive digital payments, up from 48 percent in 2014. Part of the increase may reflect the increased use of debit cards, which 39 percent of adults use, up from 24 percent in 2014.
- 23 percent of adults save at a formal financial institution, up from 9 percent in 2014. On average, men are 9 percentage points more likely than women to save.
- 19 percent of unbanked adults cite religious concerns as a reason for not having an account—the same percentage that cites high costs. Just 1 percent of adults report religious concerns as their sole reason for not having an account.
- 72 percent of unbanked women (and 51 percent of unbanked men) indicate that one reason they do not have an account is that one of their family members already has one. In the developing world overall, a quarter of the unbanked cite this reason, with no difference between men and women.
- 89 percent of unbanked women (and 65 percent of unbanked men) are out of the labor force.
- 5 percent of unbanked women are wage-employed and 6 percent are self-employed.
- Roughly 15 million unbanked adults in Turkey have mobile phones—including 88 percent of unbanked women—suggesting possible opportunities to increase financial inclusion by moving routine cash payments into accounts.
- About 1 in 10 unbanked women in Turkey—1.3 million women—send or receive domestic remittances in cash or through an over-the-counter service. Expanding the reach of mobile remittances could have benefits that go beyond convenience. Research shows that mobile transfers help people survive financial shocks by making it easier to collect money from faraway relatives when times are tough.
- Roughly one in six unbanked women in Turkey saves using semi-formal methods. If those savings were moved into accounts, up to 2 million unbanked women could join the formal financial system.
- 30 percent of women who have an account still pay utility bills in cash, including 5 million women who have mobile phones. Getting these financially included adults to use their accounts more often would help expand access to financial services.

to use an account. Two-thirds of unbanked adults across the world cited this as a reason for not having an account, and about one-fifth cited it as the only reason. About a quarter of respondents cited cost and distance; a similar share said that they did not have an account because a family member already had one. About 20 percent of respondents cited lack of documentation and trust in the financial system, and 6 percent cited religious concerns as the reason they did not have an account.

In ECA only 7 percent of unbanked adults reported insufficient funds as the sole reason for not having an account. Thirty percent cited lack of trust in financial institutions. These figures were particularly high in Azerbaijan (42 percent) and Ukraine (50 percent).

Other factors underlying the lack of account ownership include cost, lack of documentation, and distance. For the region as a whole, 27 percent of unbanked adults reported cost as a barrier. This figure was higher in Albania (40 percent), Azerbaijan (39 percent), Bulgaria (39 percent), Kosovo (42 percent), Moldova (35 percent), Russia (34 percent), and Ukraine (40 percent).

On average, only 14 percent of unbanked adults in ECA cited lack of documentation as a barrier. The figure was about 40 percent in Azerbaijan, Georgia, and Turkmenistan.

In the Republic of North Macedonia and Turkey, more than half of unbanked adults (54 and 65 percent, respectively) reported that they did not have an account because a member of the family already had one. This pattern may be associated with the fact that male household members are more likely to own an account than their spouses.

Use of Accounts for Payments Is Increasing in the Region's Developing Economies

Most people in ECA make or receive payments, pay bills, send money to relatives, or receive wages or government transfers. The 2017 Global Findex survey asked people what kinds of payments they made and received and whether they did so via an account or in cash.

Government Transfer Payments

Except in the poorest economies in the world, most people who get government payments receive them into an account. In the developing economies of ECA, more than 70 percent of government transfer recipients receive the payments into an account. This share remained stable in 2014 and 2017. It is larger than in developing countries in other regions. In the euro area, 86 percent of adults getting government transfers received the money via an account in 2014. This share declined to 75 percent in 2017.

Wage Payments

Globally, 28 percent of adults receive private sector wages—46 percent of adults in high-income economies and 24 percent in developing ones. In high-income economies, most people receive wage payments into an account. Only half of wage recipients do so in developing economies. In ECA more than 80 percent of private sector wage recipients and more than 90 percent of public sector wage recipients receive payments via an account. These shares increased moderately between 2014 and 2017.

Payments for Agricultural Product Sales

About 15 percent of adults in developing economies receive payments for agricultural product sales. Almost all receive them in cash. In some African countries, such as Ghana, Kenya, and Zambia, about 40 percent of people getting agricultural payments receive them into an account, in most cases a mobile money account.

In the developing economies of ECA, only about 10 percent of adults received payments for agricultural sales the year before the 2014 and 2017 Findex surveys. In 2014 only 5 percent of the agricultural product sellers reported having received payments via an account, and none reported receiving payment through a mobile phone. In 2017 these figures rose to 20 percent and 8 percent, respectively.

Domestic Remittance Payments

Domestic remittances play an important role in many developing economies. In the developing economies of ECA, the share of adults sending or receiving domestic remittances increased from 22 percent in 2014 to 29 percent in 2017. Forty-eight percent of these senders or recipients used a financial institution account in 2017, up from 33 percent in 2014. The share of senders or recipients using mobile phones increased from 4 percent in 2014 to 24 percent in 2017, and the share using cash or making transfers in person declined from 51 percent to 26 percent.

A few countries stood out in this trend. In Russia, for example, the share of domestic remittance senders or recipients using mobile phones soared from 8 percent in 2014 to 38 percent in 2017. The share using financial institution accounts increased by 10 percentage points, to 48 percent, over the same period. The proportion using cash fell from 36 percent to 14 percent.

In Turkey the increase in the use of accounts and mobile phones for remittances has been remarkable, rising from 35 percent in 2014 to 56 percent in 2017. Over the same period, the share of remittance senders or recipients using mobile phones skyrocketed, from 2 percent to 24 percent, and the share sending or receiving cash or in person dropped from 60 percent to 23 percent.

Use of Digitalized Accounts Is Also Rising

Account ownership is key to financial inclusion. But secure and convenient ways to use accounts are essential if users are to reap the full benefits of account ownership. The Global Findex database also sheds light on whether and how people use their accounts for payments.

Digital Payments

Globally, 52 percent of adults (more than three-quarters of account owners) reported having made or received at least one digital payment using their account the previous year. In high-income economies, the share of account owners using their accounts for digital payments was 97 percent. In the euro area the share of adults who made or received digital payments increased from 87 percent in 2014 to 92 percent in 2017, and the share making digital payments increased from 92 percent to 97 percent. In developing ECA economies, the share of adults making or receiving digital payments rose from 46 percent to 60 percent between 2014 and 2017, suggesting that the share of account owners doing so increased from 80 percent to 92 percent.

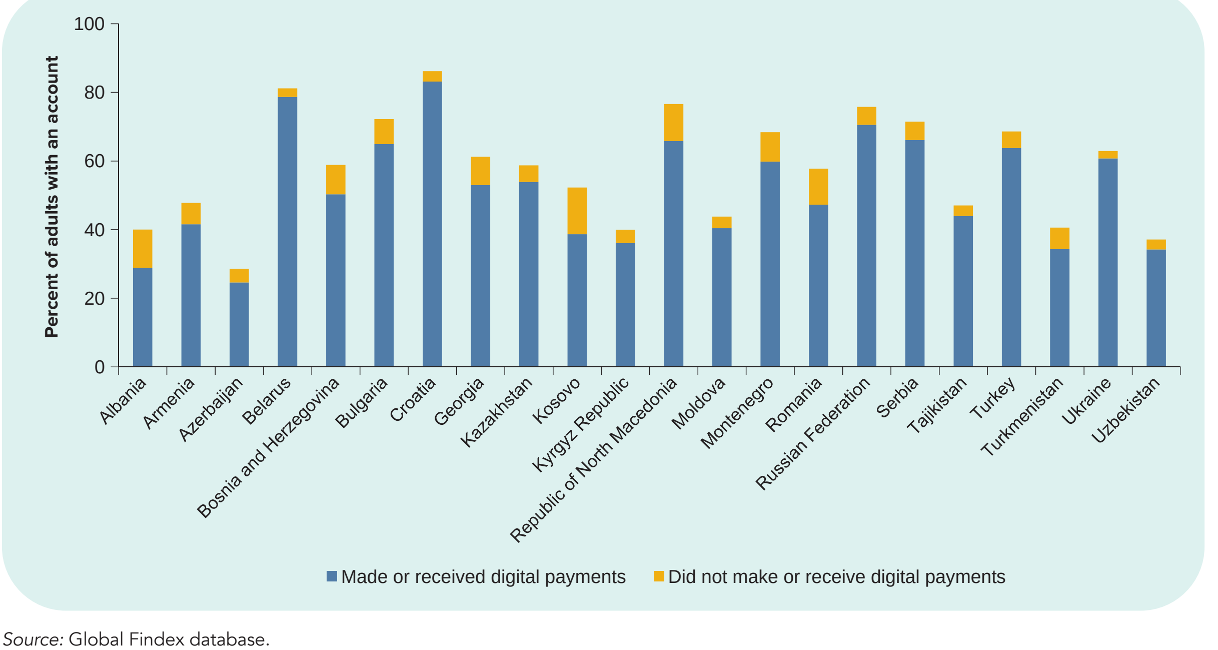
ECA countries with significant growth in the use digital payments include Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Kazakhstan, the Republic of North Macedonia, Montenegro, Russia, Turkey, and Ukraine (figure 2.6). Several countries witnessed an increase of more than 15 percentage points in the share of adults using digital payments during 2014–17. Uzbekistan, where fewer people used digital payments in 2017 than in 2014, seems to be an outlier (table 2.3).

Use of Mobile Phones or the Internet for Financial Services

Along with advancements in digital technologies, mobile phones and the Internet increasingly offer an alternative to debit and credit cards for making direct payments from an account. Globally, in high-income economies, 51 percent of adults (55 percent of account owners) reported making at least one financial transaction the previous year using a mobile phone or the Internet. In developing economies, the average share was much lower, at 19 percent of adults (30 percent of account owners).

There is wide variation among the developing economies in ECA in the use of mobile phones or the Internet to access accounts (figure 2.7). In the South Caucasus, more than 20 percent of adults in Armenia reported having used a mobile phone or the Internet to make payments; the share is much lower in Azerbaijan and Georgia. In Central Asia, more than 30 percent of adults reported doing so in

FIGURE 2.6 The share of adults making or receiving digital payments ranges from 25 to 83 percent in Europe and Central Asia



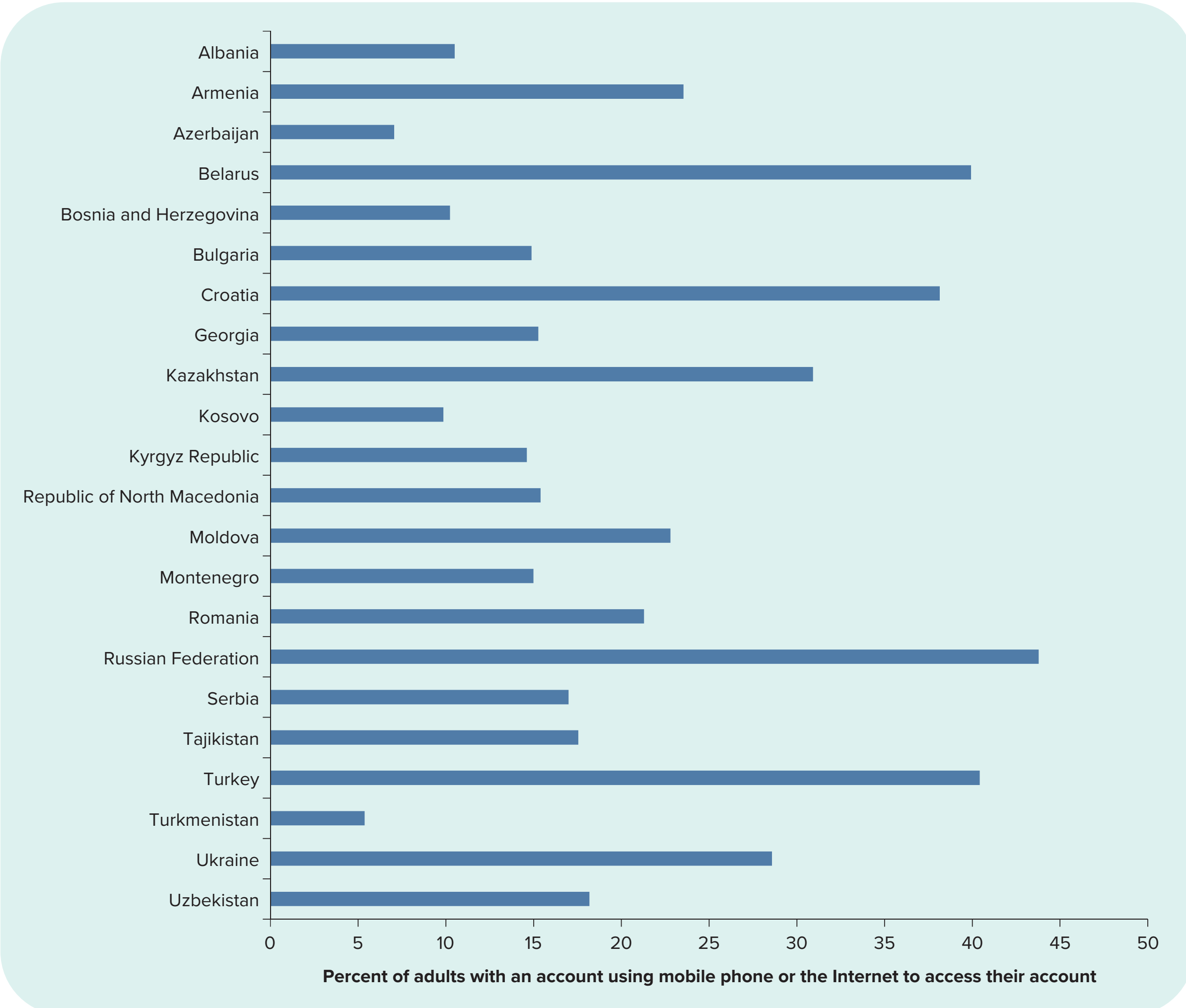
Source: Global Findex database.
Note: The height of the bars represents the share of adults (aged 15 and above) with an account at a financial institution or a mobile money provider.

TABLE 2.3 The share of adults who made or received a digital payment the previous year rose in most countries in Europe and Central Asia

Subregion/country	2014	2017
Central Asia	33	41
Kazakhstan	40	54
Kyrgyz Republic	14	36
Tajikistan	8	44
Turkmenistan	..	34
Uzbekistan	38	34
Central Europe and the Baltics	61	73
Bulgaria	48	65
Croatia	72	83
Czech Republic	78	80
Estonia	95	97
Hungary	64	71
Latvia	84	91
Lithuania	66	78
Poland	63	82
Romania	41	47
Slovak Republic	72	82
Slovenia	86	96
Eastern Europe	45	62
Belarus	61	79
Moldova	15	40
Ukraine	44	61
Northern Europe	99	99
Denmark	99	99
Finland	98	98
Sweden	99	98
Russian Federation	53	71
South Caucasus	17	34
Armenia	12	42
Azerbaijan	18	25
Georgia	21	53
Southern Europe	77	88
Cyprus	67	80
Greece	39	74
Italy	73	90
Malta	74	89
Portugal	73	86
Spain	93	90
Turkey	48	64
Western Balkans	44	54
Albania	20	29
Bosnia and Herzegovina	32	50
Kosovo	28	39
Republic of North Macedonia	52	66
Montenegro	40	60
Serbia	60	66
Western Europe	95	96
Austria	92	96
Belgium	96	97
France	92	92
Germany	96	98
Ireland	87	94
Luxembourg	93	98
Netherlands	98	98
United Kingdom	97	96
Total	**68**	**78**

Source: Global Findex database.
Note: Data show percent of adults (aged 15 and above) with an account at a financial institution or a mobile money provider.

FIGURE 2.7 **Use of a mobile phone or the Internet to access an account varies widely within Europe and Central Asia**



Source: Global Findex database.
Note: Length of the bars represents percentage of adults (aged 15 and above) with an account who used mobile phone or Internet to access their account at a financial institution or a mobile money provider.

Kazakhstan; the share is much lower in other Central Asian countries. In Eastern Europe, 40 percent in Belarus of adults use mobile or online payments, a larger share than in Moldova or Ukraine. In Central Europe, Croatia stands out with 38 percent. The use of mobile and online payment is also high in Turkey (40 percent) and Russia (44 percent).

Use of mobile phones for financial services

In some regions of the world—such as Sub-Saharan Africa—use of mobile money is wide-spread and a significant share of adults have a mobile money account only rather than a financial institution account. In the ECA region, where ownership of financial institution accounts is higher than in other developing regions, using mobile phones only instead of bank accounts is not common. Account owners are more likely to use online payments from their bank accounts than mobile accounts only.

Mobile phones can be used for financial services in at least two ways (Demirgüç-Kunt and others 2018), for which China and Kenya serve as examples. In China mobile financial services are provided mainly through third-party payment service providers, such as Alipay and WeChat, using smartphone apps linked to a bank account or other type of financial institution account. By contrast, in some African countries, such as Kenya, mobile financial services are offered primarily by mobile network operators, and mobile money accounts do not need to be linked to an account at a financial institution. In ECA, despite the increasing use of mobile phones for financial services, the share of adults with mobile money accounts is very low, having risen from zero in 2014 to 3 percent in 2017.

Use of the Internet for financial services

Globally, 29 percent of adults use the Internet to pay bills or make purchases online. The share ranges from 68 percent of adults in high-income economies to 49 percent in China and an average of 11 percent in developing economies excluding China. In the developing economies of ECA, the share grew from 14 percent in 2014 to 31 percent in 2017. In the euro area, the percentage increased from 48 percent to 69 percent.

Buying something online does not necessarily mean making the payment online. In all developing economies except China, 53 percent of adults who made a purchase online paid for it in cash on delivery. In China, by contrast, 85 percent of adults who made a purchase on the Internet paid for it online.

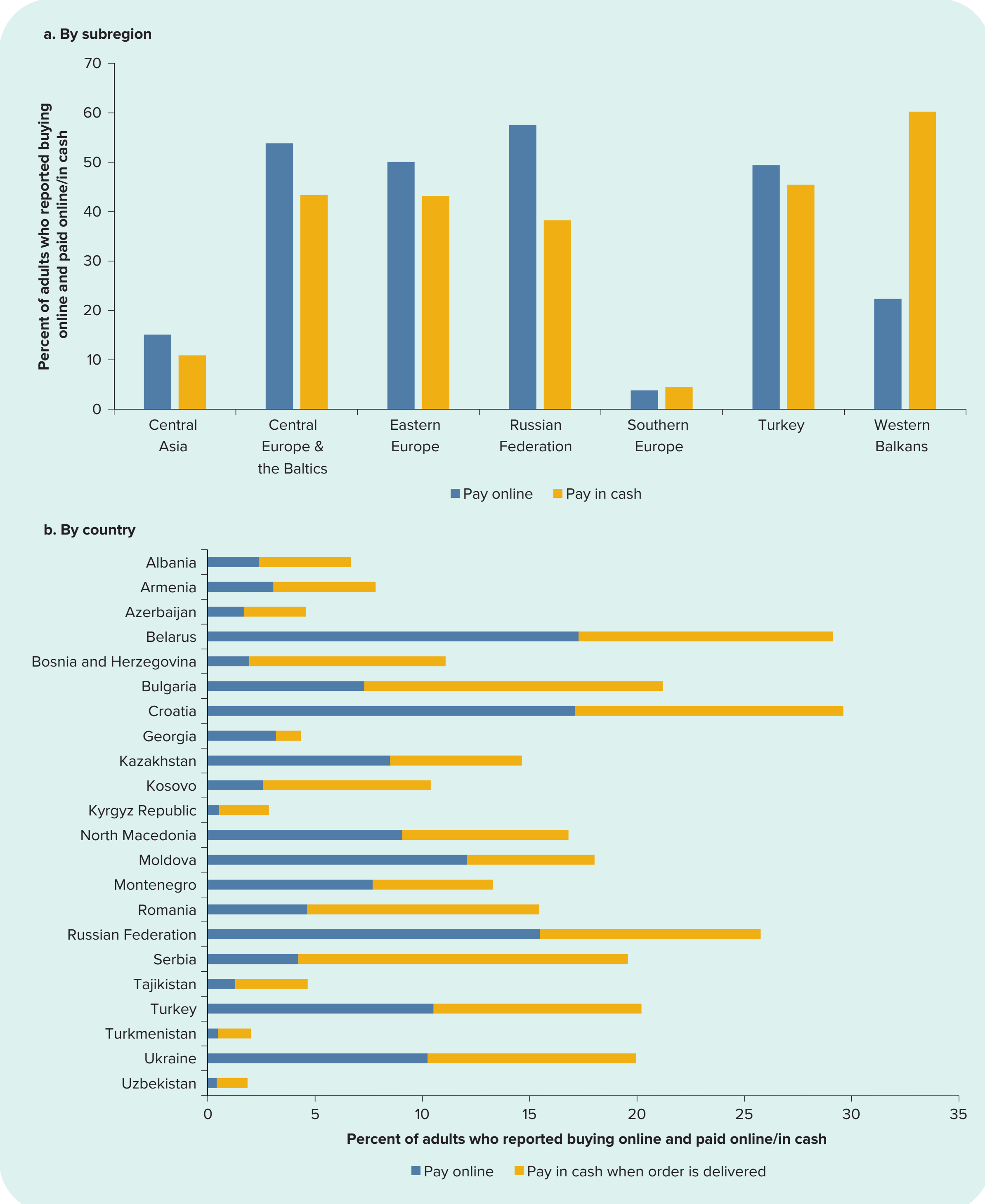
Within the ECA region, many people in Central Europe and the Baltic countries, Eastern Europe, Russia, Turkey, and the Western Balkans pay cash on delivery for online purchases (figure 2.8). For the region, 44 percent of Internet purchasers made their payment in cash on delivery in 2017. In some economies, such as Bosnia and Herzegovina, Bulgaria, Kosovo, and Serbia, more than two-thirds of online buyers paid in cash on delivery (figure 2.9). Countries in which relatively few people make their payment online when shopping on the Internet might learn from China's experience expanding the coverage of online payment services and benefit from greater efficiency and convenience.

Informal Saving and Borrowing Is Prevalent in Developing Economies of ECA

Formal Saving

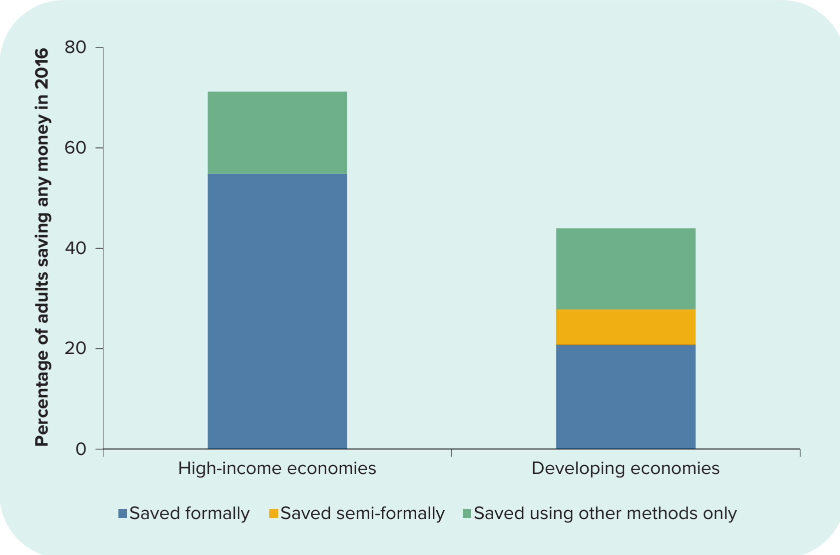
People save for future expenses and to be prepared to respond to uncertainties. They may save for a large purchase, investment in education or a business, financial needs in old age, or emergency expenses. To meet immediate expenses, they

FIGURE 2.8 Percent of online buyers paying in cash and online in total population



Source: Global Findex database.
Note: Panel (a): Data for Northern Europe, the South Caucasus, and Western Europe are not available.
Panel (b): The length of the bars represents the percentage of adults aged 15 and above who report buying online.

FIGURE 2.9 **Formal saving is more common in high-income economies than in developing economies**



Source: Global Findex database.
Note: People may save in multiple ways, but the categories here are constructed to be mutually exclusive. "Saved formally" includes all adults (aged 15 and above) who saved any money formally. "Saved semi-formally" includes all adults (aged 15 and above) who saved any money semi-formally but not formally. Data on semi-formal saving are not collected in most high-income economies. Semi-formal methods may include saving money with a savings club or a person outside the family.

may borrow. Global Findex data show how and why people save and borrow and shed light on their financial resilience to unexpected expenses.

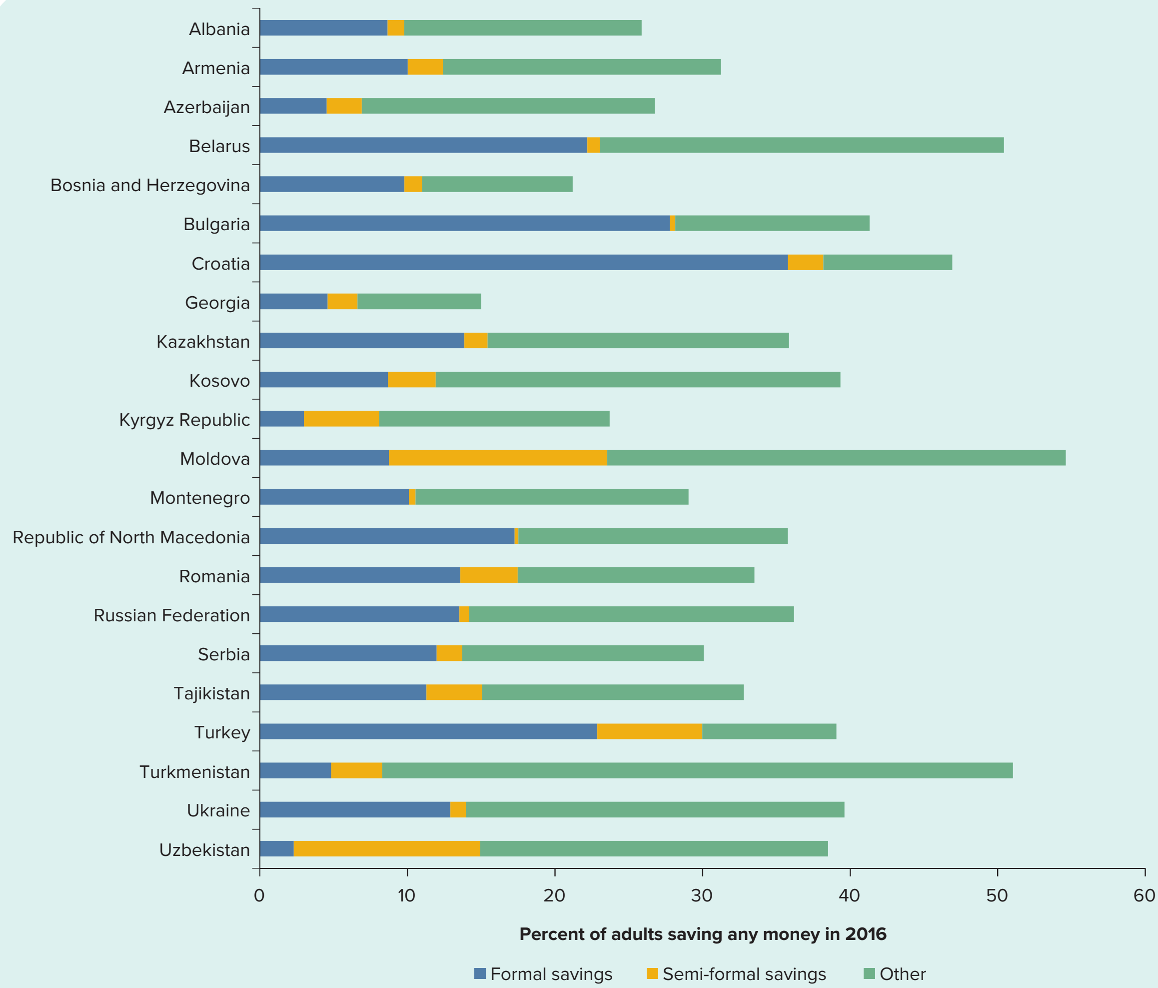
Formal saving is more common in high-income economies than in developing economies (figure 2.9). In 2017, 48 percent of the world's adults reported having saved or set aside money in the previous 12 months. The figure was 72 percent in high-income economies and 43 percent in developing economies. In high-income economies, more than 75 percent of savers (55 percent of all adults) save formally at a financial institution. In developing economies, slightly less than half of savers (21 percent of all adults) save formally. By contrast, in the developing economies of ECA, less than 40 percent of adults report having saved the previous year. Only 38 percent of savers (14 percent of all adults) saved formally at a financial institution. The share of adults who saved formally was only 7 percent in 2011 and 11 percent in 2014. Low rates of formal saving are prevalent in most developing economies in ECA. Exceptions include Bulgaria, Croatia, and Turkey, where most savers save formally (figure 2.10).

In the euro area, 67 percent of all adults reported having saved in the past year. Seventy-three percent of savers (about half of all adults) saved formally. These shares are slightly lower than in an average high-income economy.

Globally, saving patterns vary by gender and income level. In developing economies, men are more likely than women to save formally. The average gender gap in the share of adults who saved formally was 6 percentage points in 2017. In the developing economies of ECA, the gender gap widened slightly, from 2 percentage points in 2014 to 3 percentage points in 2017. In the euro area, it remained stable, at about 6–9 percentage points, between 2011 and 2017.

Wealthier adults are more likely than poorer adults to save formally. Globally, the income gap between the top 60 percent and the bottom 40 percent was 23

FIGURE 2.10 The share of adults who saved formally savings was low in most developing economies in Europe and Central Asia



Source: Global Findex database.
Note: The length of the bars represents the percentage of adults (aged 15 and above) who reported saving in any way in the previous 12 months.

percentage points in high-income economies and 15 percentage points in developing economies in 2017. In the developing economies of ECA, the income gap widened, from 7 percentage points in 2014 to 9 percentage points in 2017. In the euro area, the gap stayed at about 20 percentage points between 2011 and 2017.

People save for different purposes. Nearly half of adults in high-income economies report saving for old age. In 2017, 16 percent of adults in developing economies and 38 percent of adults in the euro area reported doing so. In developing ECA, only 15 percent of adults reported saving for old age.

In 2014 only 4 percent of adults in the developing economies of ECA reported saving to start, operate, or expand a farm or business. The share rose to 8 percent in 2017, still lower than the global average of 14 percent.

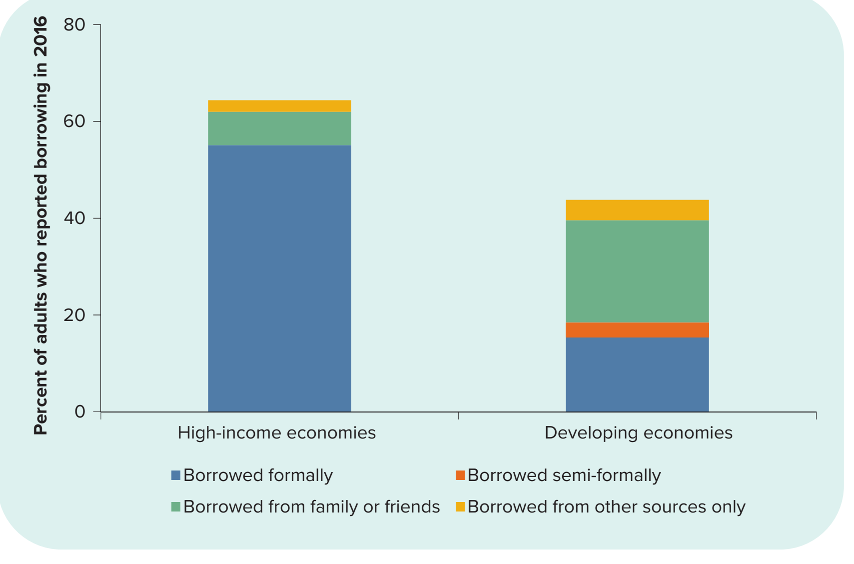
Informal Borrowing

In 2017 about half of the world's adults reported borrowing money the previous year. A larger share (64 percent) did so in high-income economies, where most borrowers rely on formal credit from financial institutions or credit cards. In developing economies, most borrowers rely on family and friends (figure 2.11).

The borrowing pattern in ECA looks different from that in the rest of the world. In 2017, 55 percent of adults in the euro area reported having borrowed money the previous year. Forty-six percent reported that they borrowed money from a financial institution or by using a credit card; only 12 percent reported borrowing from friends or family. In contrast, in the developing economies of ECA, 44 percent of adults reported borrowing the previous year, with 24 percent reporting borrowing from friends or family and about 24 percent reporting obtaining credit from a financial institution or using a credit card. The share of formal borrowing increased slightly (by 2 percentage points between 2014 and 2017), while the share of informal borrowing declined by 3 percentage points, though these changes are not statistically significant. Informal borrowing is common in the developing economies of ECA, except in Armenia, Croatia, and Turkey, where most borrowing is from a financial institution or credit card (figure 2.12).

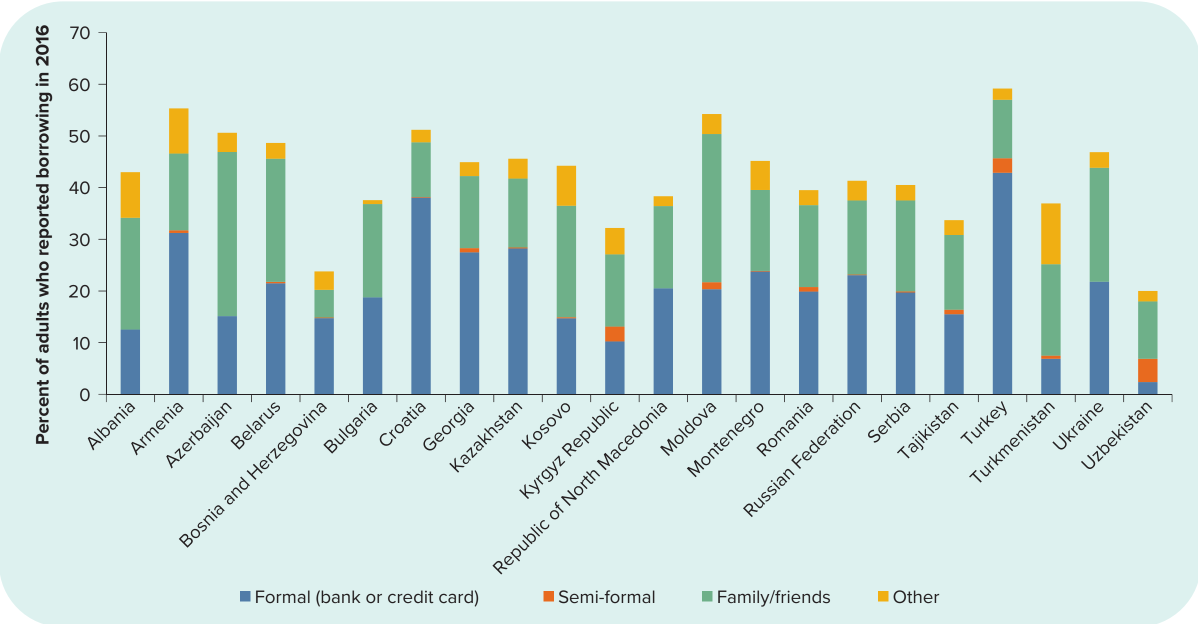
One common purpose of borrowing is to buy land or a home, the largest financial investment many people make. In 2017, 27 percent of adults in high-income economies reported having an outstanding housing loan from a bank or other type of financial institution. The share was less than 10 percent in developing economies. In the developing economies of ECA, the proportions were 13 percent in 2014 and 12 percent in 2017. In the euro area, the figures were 23 and 25 percent, respectively.

FIGURE 2.11 People in high-income countries rely on formal sources for borrowing, whereas people in developing countries tend to rely on family or friends



Source: Global Findex database.
Note: People may borrow from multiple sources, but the categories here are constructed to be mutually exclusive. "Borrowed formally" includes all adults (aged 15 and above) who borrowed any money from a financial institution or by using a credit card. "Borrowed semi-formally" includes all adults (aged 15 and above) who borrowed any money semi-formally (from a savings club) but not formally. "Borrowed from family or friends" excludes adults who borrowed formally or semi-formally.

FIGURE 2.12 Informal borrowing is prevalent in most developing economies in the region



Source: Global Findex database.
Note: The height of the bars represents the percentage of adults aged 15 and above who indicated borrowing in any way in the previous 12 months.

Financial Resilience

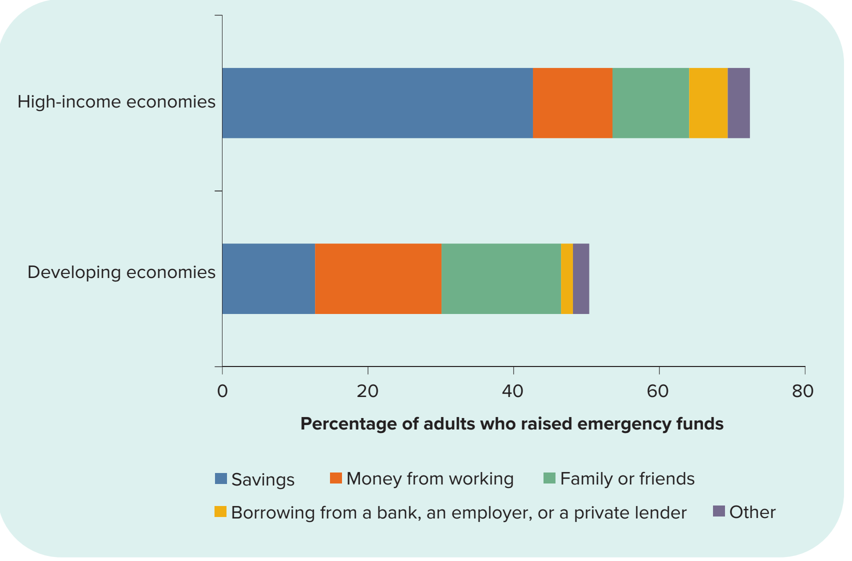
The 2017 Global Findex survey provides information on financial resilience by asking respondents whether they would be able to come up with an amount equal to 1/20th of gross national income per capita in local currency within the next month. It also asks what their main source of funding would be.

The results show that adults in high-income economies are far more likely (73 percent) to say that they could raise emergency funds than are adults in developing economies (50 percent) (figure 2.13). Most respondents in high-income economies who report that they could come up with the emergency funds say that they would rely on savings, whereas most respondents in developing economies say that they would turn to family or friends or use money from working.

About two-thirds of adults in ECA reported that they would be able to come up with emergency funds. In the euro area, the share rose from 70 percent in 2014 to 76 percent in 2017. In the developing economies of the region, the share declined from 64 percent to 61 percent, though the decline is not significant. The gender gap in the share is about 6 percentage points, with men more likely to report that they could come up with emergency funds than women. This gap remained constant between 2014 and 2017.

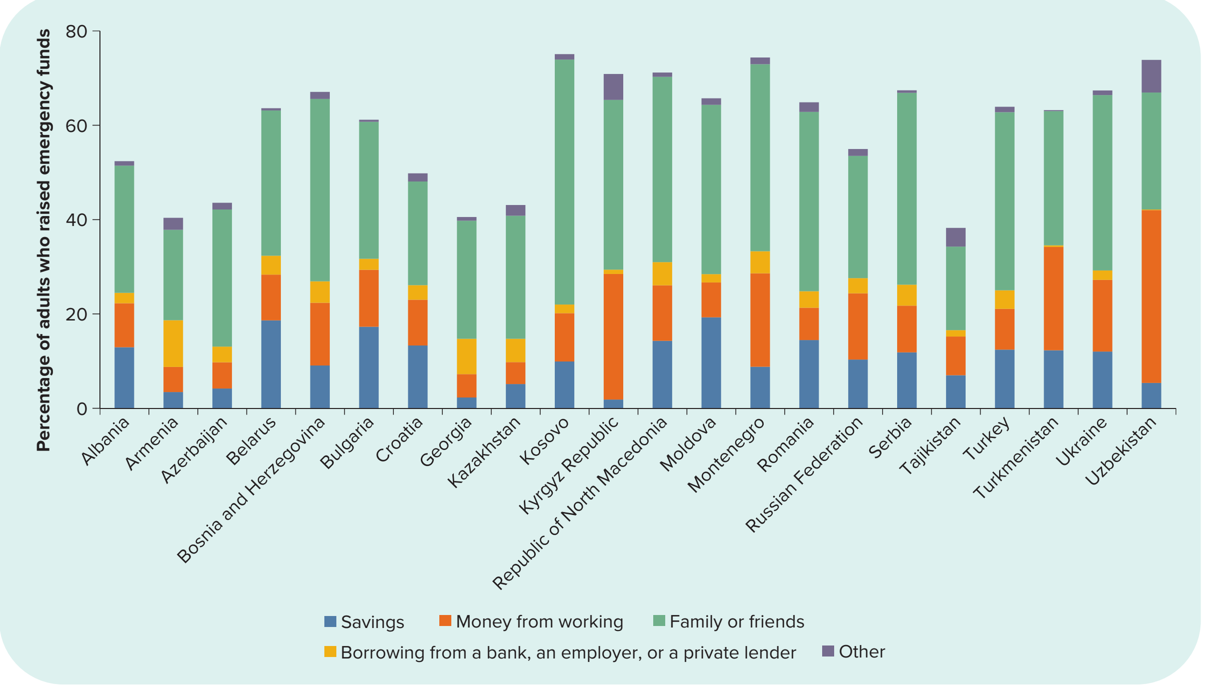
When asked about their source of emergency funds, 52 percent of respondents in the euro area who reported that they were able to come up with the funds stated that the main source was their savings. In the developing economies of the region, the share was 18 percent. More than half of the adults in developing ECA who said they could come up with the funds reported that the main source of funding would be family or friends (figure 2.14).

FIGURE 2.13 Financial resilience is much higher in high-income countries than in developing economies



Source: Global Findex database.
Note: "Other" includes all respondents who chose "selling assets," "other sources," "don't know," or "refuse" as their response. Data represent the percentage of adults aged 15 and above that report being able to come up with the equivalent of 5 percent of Gross National Income in a month.

FIGURE 2.14 People in developing economies of Europe and Central Asia tend to rely on family and friends for emergency funds



Source: Global Findex database.
Note: The height of the bars represents the percentage of adults aged 15 and above that report being able to come up with the equivalent of 5 percent of Gross National Income in a month.

Digital Technology Provides Opportunities to Enhance Financial Inclusion

Remarkable progress has been made in expanding financial inclusion in ECA. Account ownership has grown significantly in many countries, and the use of digital payments has picked up. There may be opportunities to enhance financial inclusion and encourage more account owners to use financial services (see box 2.2, on financial inclusion in the European Union). However, the behavior of account owners in ECA differs from that in other economies, because of issues related to culture, history, and trust.

BOX 2.2 Financial inclusion in the European Union: Insights from the 2017 Global Findex Survey

- Account ownership varies across EU member states. In Western European countries, such as France, Germany, and the Netherlands, account ownership is virtually universal. Account ownership is lower in some Eastern and Central European economies. The share is roughly 80 percent in the Czech Republic and the Slovak Republic and about 75 percent in Bulgaria and Hungary. In Romania just 58 percent of adults have an account, the lowest share in the European Union.
- Gender gaps are rare in the European Union. In the Czech Republic, Hungary, and Romania, men are roughly 6 percentage points more likely than women to have an account, a gap similar to the average global gender gap.
- Income gaps are evident in some EU countries with relatively low account ownership. Among adults in Bulgaria from the poorest 40 percent of households, 55 percent have an account; for adults in the richest 60 percent of households, the share is 84 percent. In Romania 71 percent of wealthier adults have an account—nearly twice the share among poorer adults.
- Use of digital payments varies widely within the European Union. In Denmark and the Netherlands, virtually all adults make or receive digital payments. The share is about 80 percent in Croatia, Cyprus, and the Czech Republic; about 70 percent in Greece and Hungary; about two-thirds in Bulgaria; and about half in Romania. Use of mobile phones and the Internet to make digital financial transactions is highest in Denmark, Finland, and Sweden (80 percent) and lowest in Greece (18 percent) and in Bulgaria and Romania (about 10 percent), among ECA countries with available data.
- With the European Union, the share of adults formally saving is highest in Sweden, at 75 percent. About 60 percent of adults formally save in Denmark, Luxembourg, and the Netherlands. In contrast, only about half of adults in France and Italy and a quarter of adults in Bulgaria and Hungary save formally, and the share in Romania is only 14 percent.
- Digitizing payments could increase account ownership. Many unbanked adults have mobile phones, making it easy to adopt digital financial products. In Romania roughly 1 million unbanked adults work in the private sector, get paid in cash, and have a mobile phone. Increasingly, these workers are employed by multinationals or in global value chains. In Bulgaria and Hungary, more than 40 percent of unbanked adults receive government payments—wages, social benefits, or pensions—in cash. In Romania about 3 million unbanked adults fall into this category.
- There is also room to increase the use of accounts among adults who are already financially included. In Italy about 9 million adults pay utility bills in cash despite having an account and owning a mobile phone. The number is about 3 million in Greece and in Germany.

In some ECA countries, such as Russia and Turkey, the application of digital technologies in financial services has increased. In other countries, such application remains limited. There may be room for growth in the use of digital financial services, such as electronic payments and services associated with e-commerce.

Digital technology alone is not sufficient to increase financial inclusion, however. A well-developed payment system, good physical infrastructure, appropriate regulations, and strong consumer protection safeguards must be in place. And financial services need to be tailored to the needs of disadvantaged groups, such as women, low-income families, and first-timer users of financial services, who may lack literacy and numeracy skills.

Lessons from advanced economies and other emerging and developing economies may be useful for ECA economies. In China, for example, third-party online payment systems, such as Alipay or WeChat, linked to bank accounts have enabled consumers to access their accounts efficiently using a mobile device. Mobile money accounts are widely used in Africa. Mobile phone carriers can provide financial services. Digital technologies may lower the cost of financial services and make them more affordable.

Globally, about 1.1 billion—or about two-thirds of all unbanked adults—have a mobile phone. In India and Mexico, more than half of the unbanked have one; in China 82 percent do. In the developing economies of ECA, 83 percent of the unbanked—some 95 million adults—have a mobile phone. Providing unbanked mobile phone users with Internet access and digital financial services could be key to expanding financial inclusion. In Central Asia and Albania, about half of mobile phone owners do not use the Internet (figure 2.15). Allowing them online access to financial services could significantly improve financial inclusion.

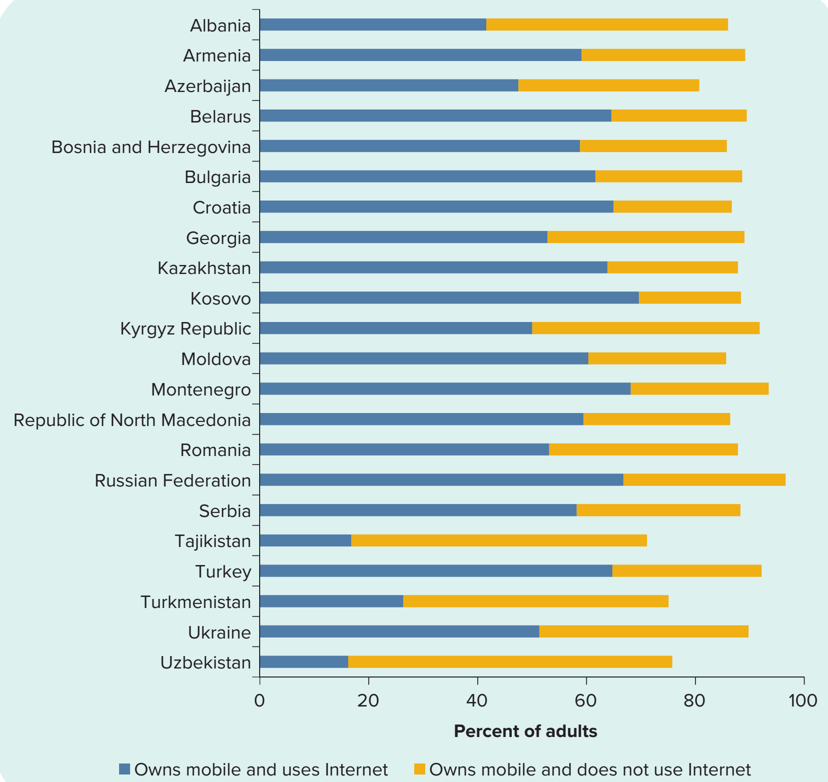
Policy Makers Can Increase Account Ownership and Use in Various Ways

Governments and businesses could help dramatically reduce the number of unbanked adults by moving routine cash payments into accounts. Such payments could include public sector wages, public pensions, and government transfers of social benefits. Globally, digitizing such payments could reduce the number of unbanked adults by up to 100 million (Demirgüç-Kunt and others 2018). Many unbanked adults have the basic technology to receive payments digitally. Of the 60 million unbanked adults worldwide who receive government transfers in cash, two-thirds have a mobile phone.

Digital payments have played an important role in boosting financial inclusion in ECA. About 1 in 6 account owners opened their first account with a financial institution to receive digital government payments. The share of adults in the region receiving government wages, pensions, or social benefits is twice the developing world average—and two-thirds of recipients receive their payments digitally.

More can be done. Nearly 25 million unbanked adults in ECA receive government payments in cash—and 75 percent of them have a mobile phone. Moving public sector pension payments into accounts would reduce the number of un-

FIGURE 2.15 More than 80 percent of the unbanked in Europe and Central Asia owned mobile phones in 2017, creating opportunities for financial inclusion



Source: Global Findex database.
Note: The length of the bars represents the percentage of adults aged 15 and above who report owning a personal mobile phone.

banked adults in the region by up to 20 million, including 8 million in Russia alone. In the private sector, about 19 million unbanked adults receive their wages in cash—and more than 90 percent of them have a mobile phone. About 15 million unbanked adults receive agricultural payments in cash—and more than 90 percent of them have a mobile phone.

Although financial inclusion starts with providing the unbanked with an account, the benefits come from actively using the account for saving, managing risk, borrowing, and making or receiving payments. The Global Findex database reveals many opportunities to help account owners make better use of their accounts. These benefits are considerable in ECA, given the ample room for promoting account use. For example, 80 million adults in ECA are banked but still pay utility bills in cash—and 95 percent of them own mobile phones. Digitizing these payments would improve usage.

Future Directions of Our Work

Our analysis of financial inclusion across the region reveals many interesting issues deserving of future research.

- First, how can the trust issue—which impedes financial inclusion and is associated with low levels of formal savings—be addressed?
- Second, what explains the differences across ECA countries in recent advances in financial inclusion? Why, for example, have Armenia, Georgia, the Kyrgyz Republic, Moldova, and Tajikistan shown significant increases in account ownership over the past three years while their neighbors, Azerbaijan and Uzbekistan, have not? What role do digitalization and technology play in explaining the different experiences?
- Third, how can we explain and address the observed disparities in financial inclusion across subregions within countries, such as Romania? Could credit unions and cooperative banks play a role in reaching remote rural areas? Again, what role can technology play?
- Fourth, how does financial inclusion and the spread of financial technology affect the development of entrepreneurship and the resilience of micro-, small, and medium-size enterprises to financial shocks? How do fintech regulations influence these developments?
- Fifth, what can be done to reduce the gender gaps in account ownerships in some of the region's countries, particularly Turkey, where the difference is 29 percentage points. How can we promote greater inclusion of Turkish women in the financial sector?
- Finally, what role do financial literacy and consumer protection play in addressing these issues? Can we generalize the lessons from our successful engagement in countries in the region, for example Russia?

This is an exciting agenda and we will continue to address these and other questions and more in the coming years in the Europe and Central Asia region.

Annex: Survey Methodology

In 2011 the World Bank—with funding from the Bill & Melinda Gates Foundation—launched the Global Findex database, the world's most comprehensive data set on how adults save, borrow, make payments, and manage risk. Drawing on survey data collected in collaboration with Gallup, Inc., the Global Findex database covers almost 150,000 people in 144 economies—representing more than 97 percent of the world's population.[1] The initial survey round was followed by a second one in 2014 and by a third in 2017.

The 2017 survey was carried out over the 2017 calendar year by Gallup, Inc., as part of its Gallup World Poll, which since 2005 has conducted annual surveys of approximately 1,000 people in each of more than 160 economies, in more than

1. For a list of the economies included, see table A.1 in the 2017 Global Findex Database, "Measuring Financial Inclusion and the Fintech Revolution" (Demirgüç-Kunt and others 2018). It shows the data collection period, the number of interviews, the approximate design effect, and the margin of error for each economy as well as sampling details, where relevant.

150 languages, using randomly selected, nationally representative samples. The target population is the entire civilian, noninstitutionalized population age 15 and older.

Interview Procedure

Surveys are conducted face to face in economies where telephone coverage represents less than 80 percent of the population or where doing so the customary methodology. In most economies, fieldwork is completed in two to four weeks.

In economies where face-to-face surveys are conducted, the first stage of sampling is the identification of the primary sampling units. These units are stratified by population size, geography, or both; clustering is achieved through one or more stages of sampling. Where population information is available, sample selection is based on probabilities proportional to population size; otherwise, simple random sampling is used.

Random route procedures are used to select sampled households. Unless an outright refusal occurs, interviewers make up to three attempts to survey the sampled household. To increase the probability of contact and completion, attempts are made at different times of the day and, where possible, on different days. If an interview cannot be obtained at the initial sampled household, a simple substitution method is used.

Respondents are randomly selected within the selected households. Each eligible household member is listed, and the handheld survey device randomly selects the household member to be interviewed. For paper surveys, the Kish grid method is used to select the respondent. [2] In economies where cultural restrictions dictate gender matching, respondents are randomly selected from among all eligible adults of the interviewer's gender.

In economies where telephone interviewing is employed, random digit dialing or a nationally representative list of phone numbers is used. In most economies where cell phone penetration is high, a dual sampling frame is used. Random selection of respondents is achieved by using either the latest birthday or household enumeration method. At least three attempts are made to reach a person in each household, spread over different days and times of day.

Data Preparation

Data weighting is used to ensure a nationally representative sample for each economy. Final weights consist of the base sampling weight, which corrects for the unequal probability of selection based on household size, and the poststratification weight, which corrects for sampling and nonresponse error. Poststratifi-

2. The Kish grid is a table of numbers used to select an interviewee. First, the interviewer lists the name, gender, and age of all permanent household members age 15 and older, whether or not they are present, in order by age. Second, the interviewer finds the column number of the Kish grid that corresponds to the last digit of the questionnaire and the row number for the number of eligible household members. The number in the cell where the column and row intersect is the person selected for the interview.

cation weights use economy-level population statistics on gender and age and, where reliable data are available, education or socioeconomic status.

Additional information about the Global Findex data, including the complete database, can be found at http://www.worldbank.org/globalfindex.

Additional information about the methodology used in the Gallup World Poll can be found at http://www.gallup.com/178667/gallup-world-poll-work.aspx.

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PART II

Selected Country Pages

ALBANIA

Table 1	2018
Population, million	2.9
GDP, current US$ billion	15.3
GDP per capita, current US$	5319
International poverty rate ($1.9)[a]	1.1
Lower middle-income poverty rate ($3.2)[a]	7.7
Upper middle-income poverty rate ($5.5)[a]	39.1
Gini index[a]	29.0
School enrollment, primary (% gross)[b]	109.8
Life expectancy at birth, years[b]	78.3

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2012), 2011 PPPs.
(b) Most recent WDI value (2016).

Economic growth accelerated to 4.2 percent as favorable hydrological conditions supported energy production. Higher growth translated to job creation and a steady decline in unemployment. Contained spending and currency appreciation helped bring down the public debt, but off-balance risks including from PPPs are mounting. Growth is forecasted to moderate to 3.7 percent in 2019-2021. Growth will depend on the pace of reform implementation, including in the area of business environment, infrastructure and closing the labor force skills gap.

Recent developments

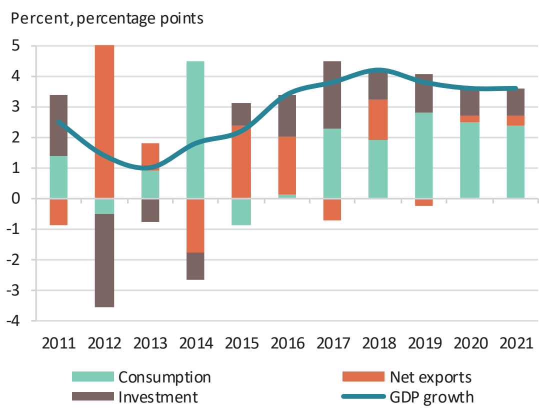
Growth sped up in 2018 and is estimated to have reached 4.2 percent. Favorable hydrological conditions more than doubled energy production in the first nine months of the year, making energy account for nearly half of GDP growth during the period. Meanwhile, a broad-based economic recovery supported job creation in all sectors. On the expenditure side, household consumption accounted for 1.9 percentage points of GDP growth, while strong exports of energy and services boosted the contribution of net exports to 1.3 percentage points of GDP growth. Public infrastructure investment increased, contributing 1 percentage point to GDP growth.

Economic growth was accompanied by job creation and increased labor force participation. Employment growth was stronger in industry (by 3.9 percent y-o-y) and services (2.5 percent). The average unemployment rate declined by 1.5 p.p.to 12.3 percent in 2018. Similarly, youth unemployment dropped by 2.8 percentage points in 2018 with respect to the same period in 2017. A stronger job market encouraged job search and labor force participation in the context of shrinking working-age population. Overall, labor force participation reached 59.4 percent, but a large gap between male and female participation remains. Despite the recovering labor market, poverty remains high, as about 35 percent of Albanians still live with under 5.5 dollars per day per capita (in 2011 PPP).

While fiscal consolidation alleviated debt-financing risks, risks from public off-balance and contingent liabilities still need attention. Fiscal consolidation continued in 2018 in the form of contained spending. Revenues declined to 27.2 percent of GDP from 27.7 in 2017, partially due to the clearance of VAT refund arrears and the currency-appreciation effect on the VAT of imported goods. Current spending declined from 25.3 percent of GDP in 2017 to 24.3 percent of GDP in 2018, as wage bill and social benefit growth were contained. Meanwhile, capital spending increased to 4.7 percent of GDP with new infrastructure projects implemented through rapid increase in PPPs. Though they alleviate short-term funding constrains, PPPs increase contingent liabilities and restrain the fiscal space for new policies. While the stock of public debt and arrears declined to 68.6 percent of GDP (mostly due to exchange rate appreciation), budgetary arrears totaled around 1.5 percent of GDP in 2018. The government successfully placed a 7-year, €500 million Eurobond at 3.50 percent in October 2018, which was used to buy back a portion of higher-priced debt due in 2020.

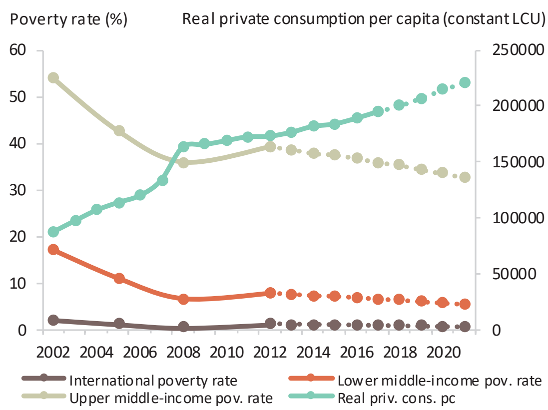
Weak inflationary pressure prompted an easing of the monetary policy stance, in line with the price stability framework. Headline inflation remains below the central bank's target of 3 percent and reached 2 percent at the end of 2018. Inflation dynamics during the year reflect the food price dynamics, with additional pass-through effects of the appreciation towards the second part of the year. The policy rate was lowered to a new low of

FIGURE 1 Albania / Real GDP growth and contributions to real GDP growth



Sources: Instat and World Bank.

FIGURE 2 Albania / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

1 percent. While the currency appreciated by 6 percent against the euro over 2018, temporary forex interventions were used to prevent excessive fluctuations in the exchange market, caused by large one-off conversions. Despite monetary easing and a reduction in non-performing loans, private sector credit contracted by 2 percent (y-o-y) as of end-December 2018.

Strong export performance and lower import growth improved external balances. The current account deficit narrowed to 6.3 percent of GDP in 2018, from 7.5 percent in 2017. Foreign Direct Investment (FDI) grew by 6.4 percent and now fully covers the current account deficit. Foreign reserves' coverage stood at 6½ months of imports at the end of 2018, mitigating risks posed by high foreign debt at 62.1 percent of GDP.

Outlook

Albanian economic growth is expected to fall to 3.8 percent in 2019, and to level off around 3.6 percent on average over the medium term, as energy production returns to normal levels. Growth will continue to be led by domestic demand, with consumption expected to grow at around 3.4 percent annually, followed by fixed capital formation growth (3 percent per year). Net exports are also expected to support growth, albeit to a lesser extent, as imports expand in line with domestic consumption. As in the past, poverty is expected to react weakly to economic growth, falling steadily but slowly to reach about one-third of the population by 2020.

The fiscal deficit is likely to increase over 2019-2021 as the government speeds up the clearance of arrears and implements several fiscal incentives including VAT exemptions, a reduction in the income tax and an increase of the high-income tax bracket for the personal income tax. On the expenditure side, current expenditures including public sector wages, social transfers and operations and maintenance are expected to remain stable, while the government capital spending is projected to increase to 4.8-4.9 percent of GDP. Additional projects are expected to be financed by PPPs, some of them already signed in 2018 or in the pipeline; these will increase contingent liabilities.

The medium-term growth projections crucially depend on the pace of structural reforms and progress with EU accession. Albania needs to continue its path towards fiscal consolidation and mitigate risks from off-balance activities. Reform in the energy sector is needed to safeguard the economy and the budget from unexpected financing needs. Improving business climate addressing infrastructure gaps and labor force skill gaps is necessary to reap the early benefits of EU accession and make Albania attractive for FDI.

Risks and challenges

Over the medium-term, risks are significant. Albania is vulnerable to a slowdown in Europe, particularly among its main trading partners. A slowdown in these countries could spill over through lower exports, remittances, and FDI. In addition, the expected tightening of monetary policy in external markets will increase financing costs for Albania in the context of a high public debt, which is increasingly being refinanced through foreign sources.

TABLE 2 Albania / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	3.4	3.8	4.2	3.8	3.6	3.6
Private Consumption	2.6	3.1	2.6	3.6	3.6	3.2
Government Consumption	4.7	2.5	1.1	6.3	-0.7	4.1
Gross Fixed Capital Investment	3.2	6.8	3.3	4.1	3.0	3.1
Exports, Goods and Services	11.4	8.5	5.3	5.8	5.8	5.9
Imports, Goods and Services	6.9	8.2	2.5	5.3	4.8	4.7
Real GDP growth, at constant factor prices	3.2	3.8	4.3	3.8	3.6	3.6
Agriculture	1.7	0.6	1.4	2.1	2.2	2.2
Industry	2.1	6.8	8.3	4.2	4.4	4.4
Services	4.8	4.2	3.9	4.6	3.9	4.0
Inflation (Consumer Price Index)	1.3	2.0	2.1	2.5	2.9	3.0
Current Account Balance (% of GDP)	-7.6	-7.5	-6.3	-6.4	-6.1	-5.7
Net Foreign Direct Investment (% of GDP)	8.7	8.6	7.8	6.8	6.8	6.9
Fiscal Balance (% of GDP)	-2.3	-2.0	-1.8	-2.1	-2.0	-2.1
Debt (% of GDP)	73.2	71.8	68.6	65.8	64.7	62.4
Primary Balance (% of GDP)	0.2	0.0	0.4	0.0	0.1	0.0
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.9	0.8	0.8	0.7	0.7	0.6
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	6.8	6.5	6.2	5.9	5.6	5.4
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	36.7	35.9	35.2	34.4	33.5	32.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2002-LSMS, 2008-LSMS, and 2012-LSMS. Actual data: 2012. Nowcast: 2013-2018. Forecast are from 2019 to 2021
(b) Projection using average elasticity (2002-2008) with pass-through = 1 based on private consumption per capita in constant LCU.

ARMENIA

Table 1	2018
Population, million	3.0
GDP, current US$ billion	12.4
GDP per capita, current US$	4095
International poverty rate ($19)[a]	14
Lower middle-income poverty rate ($3.2)[a]	12.3
Upper middle-income poverty rate ($5.5)[a]	50.0
Gini index[a]	33.6
School enrollment, primary (% gross)[b]	94.3
Life expectancy at birth, years[b]	74.6

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2017), 2011 PPPs.
(b) Most recent WDI value (2016).

Armenia's economy slowed in late-2018 but still grew by 5.2 percent for the year, reflecting higher private investment and consumption. Two years of pro-poor growth lowered the poverty rate ($3.2/day at 2011PPP) to 12.3 percent in 2017, its lowest level since the 2008–09 crisis. GDP growth is expected to moderate slightly in 2019 and accelerate in the medium term, subject to reforms. An increasingly uncertain external environment and the ability to push through reforms are significant challenges.

Recent developments

After growing by 7.5 percent in 2017 and 8.3 percent in the first half of 2018, real GDP moderated in the rest of 2018 reflecting weakening exports and remittances, lower-than-planned public capital spending, and slowing investment. Still, the economy expanded at a robust 5.2 percent rate for the year due to higher private consumption and a strong build-up of inventories.

On the supply side, services were once again the main driver of growth, rising by 9 percent. Industry grew by 3.4 percent, below the rate recorded in 2017 and with a significant shift from mining to manufacturing. Mining output contracted by 14 percent, mostly due to the suspension of operations at one large copper mine since February 2018. Manufacturing output, dominated by food and tobacco products, expanded by 10 percent. For the third year in a row, output from the agriculture sector (particularly horticulture) contracted, declining by 8.5 percent.

With demand pressures moderating in the second half of the year and external inflationary pressures low, average annual inflation was 2.5 percent in 2018, just at the lower band of the Central Bank of Armenia's (CBA) inflation target range (4 percent +/- 1.5 percent). In response, in late-January 2019 the CBA cut the refinancing rate by 25 basis point to 5.75 percent, its first correction in two years.

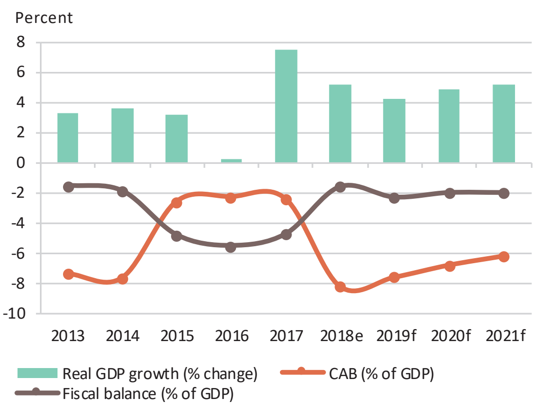
The fiscal deficit was 1.6 percent of GDP in 2018, well below the budget deficit target of 2.6 percent, reflecting an 8 percent increase in revenue collection, sound control over current spending as well as significant underperformance on capital expenditures. As a result, the public debt to GDP ratio fell from 58.9 percent of GDP in 2017 to 55.8 percent of GDP (51.4 percent excluding the CBA), the first reduction since 2013.

The current account deficit is estimated to have widened to above 8 percent of GDP as goods imports grew almost three times faster than goods exports. Half of the growth in imports was due to imports of machinery and transport means. On the other hand, the main driver of the 8 percent export growth in 2018 were textile exports, which rose by 65 percent year on year reflecting also new investment in the sector. The recovery in remittances stalled in the second half of the year, mainly due to volatility in the Russian ruble. Tourism and IT services exports increased markedly but were insufficient to offset the larger goods trade deficit. Foreign direct investment (FDI), mostly in the mining and energy sectors, remained low (2.3 percent of GDP).

The exchange rate of the dram against the U.S. dollar remained broadly stable, but modest inflation caused an appreciation of the real effective exchange rate in 2018. Pressures on the dram increased slightly in early 2019. Foreign exchange reserves stood at $2.2 billion in December 2018, providing a cover of around 3.8 months of next year imports.

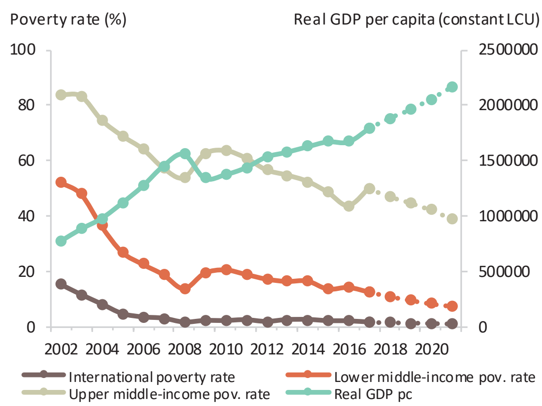
The banking sector remains liquid and broadly sound with a capital adequacy ratio of 17.4 percent in November 2018.

FIGURE 1 Armenia / GDP growth, fiscal and current account balances



Sources: National Statistics Service of Armenia; Central Bank of Armenia; World Bank staff projections.

FIGURE 2 Armenia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

Still, profitability is low. Non-performing loans remain below levels registered during 2015–16 but have edged up in recent months. Also, while declining, dollarization is high (56 percent of lending and 60 percent of deposits at end-2018).
Two consecutive years of solid growth and low inflation have contributed to an improvement in living conditions. The unemployment rate declined from 17.8 percent in 2017 to 15.3 percent in the third quarter of 2018. The absolute poverty rate, measured at the $3.2/day PPP 2011 lower-middle-income poverty line fell to 12.3 percent in 2017 and is estimated to have continued to decline in 2018. In 2017, economic growth translated into higher consumption levels for those at the bottom 40 percent of the distribution, breaking the pattern observed in 2011–16, when growth benefited more the upper deciles.

Outlook

The baseline scenario for Armenia's outlook envisages slower, but still robust, growth, amid a supportive macroeconomic environment of low inflation and sustainable public finances. The macroeconomic foundations are expected to be strengthened further through structural reforms to create a fairer and more competitive business environment. Growth is projected to reach 4.2 percent in 2019, and gradually accelerate to around 5 percent in medium term. Private consumption will continue to drive growth, followed by further expansion in exports of goods and services. In line with the fiscal rule, the budget deficit is projected to stay at around 2 percent of GDP over the medium term, further lowering the public debt-to-GDP ratio to below 55 percent in 2021. Meantime, government capital spending is projected to rebound and support efforts to improve the productivity of the Armenian economy and push up its potential growth. The current account deficit is envisaged to decline gradually, subject to structural reforms which will stimulate further exports of goods and tourism.
The absolute poverty rate (at $3.2 PPP 2011) is expected to fall below the 10 percent mark in 2019, assuming the economy continues to grow, incomes from labor markets rise, and social transfers are sustained.

Risks and challenges

The uncertainties for Armenia's outlook are increasing, taking into account Armenia's limited market and product diversification and moderating global and regional economic activity. Regional currencies could come under renewed pressure; intensification of trade restrictions remains possible, while geopolitical risks could further escalate. The realization of these risks will put the external accounts under pressure and lower Armenia's economic growth prospects. On the other hand, the resumption of copper mine operations could push exports and growth rates higher.
Domestically, the new government has an opportunity to push key governance and business environment reforms to facilitate job creation, better address social issues and attract investment. While some of these reforms will be challenging, they can also help produce the results needed to mitigate social and political tensions and thereby lower economic uncertainty.

TABLE 2 Armenia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	0.2	7.5	5.2	4.2	4.9	5.2
Private Consumption	-1.0	9.4	5.3	5.4	5.5	5.8
Government Consumption	-2.4	13.1	-6.4	6.0	6.2	4.5
Gross Fixed Capital Investment	-11.4	7.7	5.0	6.5	6.2	6.5
Exports, Goods and Services	19.1	18.7	5.2	6.8	9.6	10.2
Imports, Goods and Services	7.6	24.6	10.9	6.6	9.7	10.0
Real GDP growth, at constant factor prices	0.6	7.2	4.8	4.2	4.9	5.2
Agriculture	-5.0	-5.3	-8.5	2.9	2.7	2.5
Industry	-0.3	5.4	3.4	5.1	5.2	5.5
Services	3.3	12.5	9.3	4.0	5.3	5.7
Inflation (Consumer Price Index)	-1.4	1.0	2.5	4.0	4.0	4.0
Current Account Balance (% of GDP)	-2.3	-2.4	-8.2	-7.6	-6.8	-6.2
Net Foreign Direct Investment (% of GDP)	2.6	2.0	2.3	2.6	2.9	3.3
Fiscal Balance (% of GDP)	-5.5	-4.8	-1.6	-2.3	-2.0	-2.0
Debt (% of GDP)	56.7	58.9	55.8	56.0	55.3	54.3
Primary Balance (% of GDP)	-3.6	-2.6	0.5	0.1	-0.1	-0.1
International poverty rate ($1.9 in 2011 PPP)[a,b]	1.8	1.4	1.2	1.1	0.9	0.7
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	14.1	12.3	10.8	9.5	8.3	7.5
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	43.5	50.0	47.1	44.8	42.2	39.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2017-ILCS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021
(b) Projection using neutral distribution (2017) with pass-through = 0.7 based on GDP per capita in constant LCU.

AZERBAIJAN

Table 1	2018
Population, million	9.9
GDP, current US$ billion	46.9
GDP per capita, current US$	4717
School enrollment, primary (% gross)[a]	106.4
Life expectancy at birth, years[a]	72.0

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2016).

Azerbaijan's economy expanded at a moderate pace in 2018 aided by stable oil production and a modest pick-up in domestic demand, as higher oil earnings boosted fiscal spending and real wages rose. As natural gas exports rise, economic growth is forecast to accelerate over the medium-term. The uncertain external environment represents the main risk to Azerbaijan's growth prospects, while a sporadic approach to structural reform and the absence of policies targeting the vulnerable could further hinder poverty eradication efforts.

Recent developments

Supported by stable oil production and a modest acceleration in domestic demand, real GDP expanded by 1.4 percent in 2018. While oil production plateaued, the hydrocarbons sector overall posted growth of 1.1 percent thanks to higher exports of natural gas. The non-energy economy expanded by 1.8 percent, reflecting greater dynamism in most economic sectors. The notable exception was construction, which posted a contraction year on year following the completion of a major gas field project. On the demand side, the expansion was mainly driven by consumption, as higher oil and gas prices supported an increase in public spending and real wages. A modest recovery in credit also supported demand. Total investment continued to contract in 2018, though at a more moderate pace, while non-energy sector investment jumped by 22 percent year on year.

Higher oil prices propelled the current account surplus to 15 percent of GDP (a non-energy deficit of 10 percent of GDP) in the third quarter of 2018. Oil exports rose by 44 percent year on year, while non -oil sector exports increased by 12 percent. Imports also rebounded, rising by 25 percent, buoyed by increased government consumption and stronger domestic demand. Foreign direct investment dropped substantially owing to the completion of the gas field project. Moderate capital outflows (mostly from deposits and cash) kept the financial account deficit stable. International reserves rose to $5.6 billion, the assets of the State Oil Fund of Azerbaijan reached $38.5 billion (82 percent of GDP), and the manat remained stable against the U.S. dollar. In contrast, the real effective exchange rate appreciated by 5.5 percent.

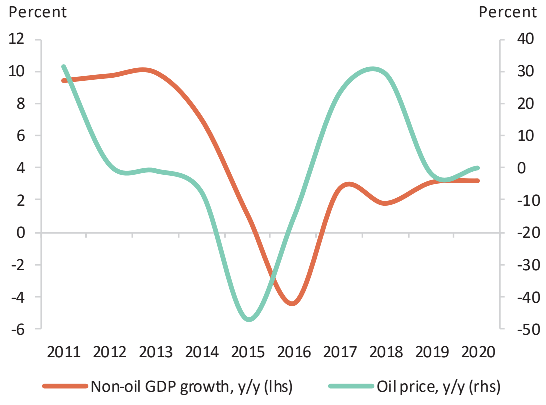
Consumer price inflation decelerated sharply in 2018, falling to 1.6 percent from 7.9 percent in 2017, reflecting modest domestic demand, low external inflationary pressures. In response, the Central Bank of Azerbaijan (CBA) gradually lowered its policy rate to 9.25 percent by February 2019 (from 15 percent in December 2017).

Higher oil revenues helped boost fiscal spending in 2018 (up by 29 percent year on year), mainly through higher public investment. The consolidated budget recorded a surplus of 5.9 percent of GDP (compared to a deficit of 1.5 percent of GDP in 2017), while the non-energy deficit widened to 33 percent of non-energy GDP.

The financial sector showed signs of a fragile recovery. Even though credit growth turned positive in 2018, non-performing loans remain high, profitability is low (with several banks making losses), and many banks are still vulnerable to foreign exchange risk.

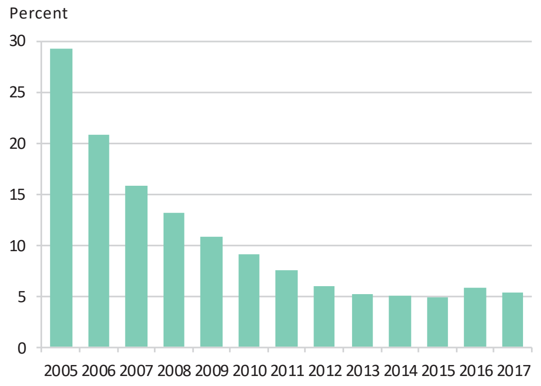
The State Statistical Committee estimates that the national poverty rate fell from 5.9 percent in 2016 to 5.4 percent in 2017. The poverty rate is estimated to have fallen further in 2018 in response to continued economic expansion, low unemployment, rising real wages, and modest inflation.

FIGURE 1 Azerbaijan / Non-oil sectors influenced by oil price



Sources: The State Statistical Committee of the Republic of Azerbaijan and World Bank staff estimates.

FIGURE 2 Azerbaijan / Poverty headcount rate at the national poverty line



Source: The State Statistical Committee of the Republic of Azerbaijan.
Note: The World Bank has not reviewed the official national poverty rates for 2013-17.

Outlook

Primarily owing to rising natural gas exports, economic growth in the medium term is forecasted to average 3.5 percent annually. Non-energy output is projected to expand at around 3 percent annually, supported by domestic demand, as real wages and credit to the economy continue to improve. In 2019, private consumption will receive a temporary boost from increases in the minimum wage and minimum pension. Meanwhile, recent tax reforms and ongoing efforts to reform the customs system—building on Azerbaijan's strong business reform performance in 2018—could reduce informality and translate into greater economic activity.

The gradual recovery in domestic demand is expected to lift inflation slightly and CPI inflation will hover at about 3 percent through 2022. Monetary policy may be further loosened in the medium term.

With no major decline in oil prices and a boost in gas exports, the current account surplus is likely to remain above 12 percent of GDP over the medium term. Imports will continue to recover reflecting trends in domestic demand. Capital outflows are expected to remain low.

Implementation of a relatively stringent fiscal rule (which caps spending increases to 3 percent per annum) will further bolster the fiscal accounts. The surplus on the consolidated budget is forecasted to rise to 7 percent of GDP; the non-energy fiscal deficit should decline over the medium-term.

Sustained GDP growth, additional social transfers, and low unemployment levels will translate into further reductions in the poverty rate. However, more significant poverty reduction may require policies tailored to the specific segments of the population where the poverty incidence remains highest.

Risks and challenges

Azerbaijan's economy faces both external and domestic uncertainties. A global economic slowdown or rising geopolitical risks in major oil suppliers could impact oil prices and hurt Azerbaijan's growth prospects. Tensions surrounding Azerbaijan's major trade partners (the Russian Federation and Turkey) could have a contagion effect, spurring renewed capital outflows. Strengthened macroeconomic buffers, as well as a more flexible exchange rate regime, will help limit the impact of the external shocks on the economy.

The main risks to Azerbaijan's economic prospects are domestic. Because it will rely almost entirely on rising gas exports, the projected acceleration in growth in the medium term will be temporary. Growth in the non-energy economy will remain lackluster without reforms to boost private sector investment, reduce the state footprint, tackle issues of competitiveness, and develop human capital. The notable increases in the 2019 budget allocations for education (up by 13 percent) and health care (by 44.5 percent) are important in terms of improving human capital. But further efforts are needed to align budget spending with development needs, including through strengthening medium-term budgeting and the Public Investment Management system.

TABLE 2 Azerbaijan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	-3.1	0.1	1.4	3.3	3.5	3.7
Private Consumption	-2.8	2.7	2.8	3.2	3.4	3.7
Government Consumption	-8.1	1.8	3.3	3.1	3.2	3.2
Gross Fixed Capital Investment	-20.0	-5.2	-0.2	1.1	2.6	3.9
Exports, Goods and Services	-2.0	-1.0	1.0	3.6	3.4	3.2
Imports, Goods and Services	-10.0	0.2	2.5	2.7	2.9	2.9
Real GDP growth, at constant factor prices	-3.0	0.1	1.4	3.4	3.5	3.7
Agriculture	2.6	4.7	4.6	4.6	4.6	4.6
Industry	-4.2	-3.7	-1.4	2.3	2.4	2.6
Services	-1.9	6.6	5.5	5.1	5.0	5.2
Inflation (Consumer Price Index)	15.6	7.9	1.6	2.8	3.2	3.3
Current Account Balance (% of GDP)	-3.6	4.1	12.4	12.5	13.1	13.4
Net Foreign Direct Investment (% of GDP)	3.2	2.8	2.4	2.2	2.1	1.9
Fiscal Balance (% of GDP)	0.3	-1.5	5.9	6.5	6.9	7.3
Primary Balance (% of GDP)	1.0	-0.4	7.1	7.5	7.6	7.9

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.

BELARUS

Table 1	2018
Population, million	9.4
GDP, current US$ billion	52.2
GDP per capita, current US$	5549
Upper middle-income poverty rate ($5.5)[a]	0.8
Gini index[a]	25.4
School enrollment, primary (% gross)[b]	101.9
Life expectancy at birth, years[b]	73.8

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2017), 2011 PPPs.
(b) Most recent WDI value (2016).

The recovery continued in 2018, driven by favorable external conditions and domestic demand. The inflation targeting framework kept consumer price inflation low, while lower real interest rates stimulated credit growth, especially to households. Despite accelerated income growth, low income households remain vulnerable. Concerns about external sustainability and growth come from uncertainty surrounding the terms of economic cooperation with Russia. The growth outlook is undermined by structural rigidities in the economy, the projected slowdown in traditional markets, and tightening global liquidity.

Recent developments

The recovery of the Belarusian economy continues, with real GDP growth reaching 3 percent in 2018. Merchandise exports (in dollar terms) grew by almost 16 percent y/y on the back of higher prices for oil products and potash fertilizers and selected agricultural commodities. Domestic demand was driven by still robust growth in public investments and household consumption, supported by growth of real wages (11.6 percent y/y, above productivity growth of 3.4 percent) and household incomes (8.6 percent y/y). On the supply side, the recovery remains broad based—all main sectors, apart from agriculture, recorded output growth. At the same time, the pace of GDP growth has been decelerating from February 2018 onwards, reaching just 0.4 percent y/y in January 2019, as the base effect has dissipated.

The current account deficit has remained mostly flat at 0.4 percent of GDP in January-November 2018, but vulnerabilities remain significant. Exchange rate flexibility has been retained, while the foreign exchange market has been further liberalized by abolishing surrender requirements. In the second half of 2018, adjustment of the Russian ruble led to a slight weakening of the Belarusian currency vis-à-vis US dollar, resulting in 8.7 percent annual nominal depreciation of the BYN. Gross international reserves amounted to US$7.2 billion at the beginning of 2019, covering approximately two months of goods and services imports.

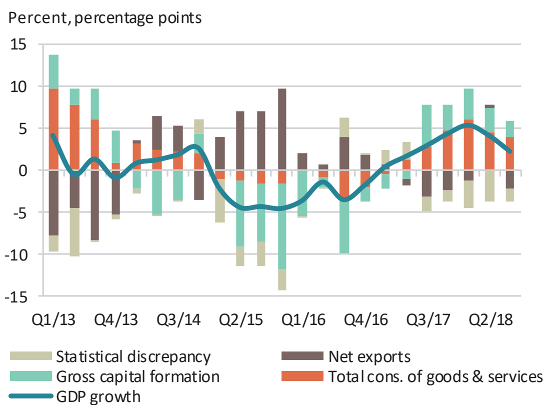
Quantitative targeting framework is keeping inflation at historically low levels—5.6 percent y/y in December 2018, against the target not higher than 6 percent. As the policy rate remained virtually unchanged throughout 2018, real interest rates fell, stimulating nominal credit growth—mainly in national currency—to corporates (by 7.6 percent) and especially to households (by 28.4 percent).

The national poverty rate, having peaked at 5.9 percent in 2017, started improving in 2018 (5.6 percent in Q3, compared to 5.9 percent in Q3 of 2017) on account of higher real wages and incomes, lower inflation, and continued economic recovery. However, significant vulnerabilities remain: the share of population below the Minimum Consumption Budget—a national measure of welfare—increased from 18.9 percent in 2014 to 33.9 percent in 2017. The poverty headcount at PPP US$5.5/day remains at below 1 percent.

Outlook

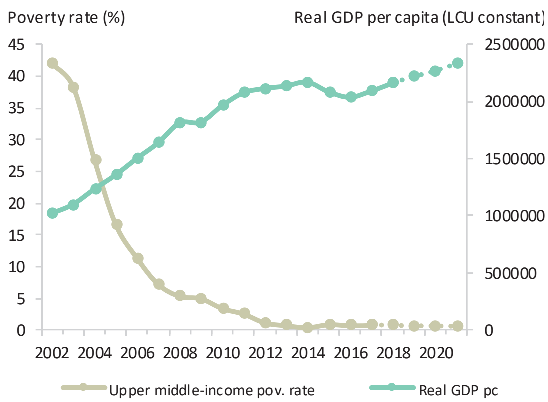
The growth outlook in 2019 and in the medium-term remains weak at about 2 percent p.a. due to a combination of structural rigidities in the economy and softening terms of trade, as the economies of main trading partners are stagnating. This modest outlook is conditional on partial – at least one half of the full amount – compensation for the so-called 'tax maneuver' in Russia, or abolishing export duty on oil and raising mineral extraction tax. With no compensation,

FIGURE 1 Belarus / Real GDP growth and contributions to real GDP growth



Sources: World Bank staff calculations based on Belstat data.

FIGURE 2 Belarus / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

growth would decelerate to below 2 percent, the current account deficit could increase, and additional fiscal consolidation would be required. Under the worst-case scenario of no compensation from Russia, the economy could slide into recession as the petrochemical sector would adjust its output, along with the deterioration of fiscal accounts and the external position.

Growth prospects are also undermined by structural rigidities and major pending reforms. On the positive side, recent measures to liberalize economic activity, reflected in the improved 2019 'Doing Business' rakings and growing exports of ICT services, should contribute to a trade surplus. However, inefficiency and contingent liabilities in State Owned Enterprises continue to undermine economic activity. SOEs continue to crowd out more productive use of capital and remain a key source of fiscal risks—total public sector debt remains high at 56.5 percent in 2018, as compared to 44.1 percent in 2011.

In 2019, household utility tariffs—except for heating—are expected to achieve full cost recovery. This may lead to inflationary pressures. Nevertheless, if current prudent monetary policy is continued, the 6-percent inflation target goal remains reachable. Low inflation is also instrumental to strengthen confidence in national currency and reducing high dollarization. Over the 2019-2020 period, PPP US$5.5/day poverty headcount is projected to continue falling slowly from the peak of 2015-16, on account of positive, yet somewhat weaker economic growth, and small increases in real wages. Yet, continued increases in utility tariffs highlight a need to ensure affordability of basic services for low-income households.

Risks and challenges

Rapidly rising public debt, largely denominated in foreign currency, high dollarization, and the uncertainty about negative spillovers from Russia's new energy taxation pose significant risks to macroeconomic stability. The room for policy flexibility is limited, as monetary policy efficiency is compromised by high dollarization and weak monetary transmission mechanism, while exchange rate adjustment remains risky due to high share of foreign currency-denominated public debt. Fiscal policy, as a remaining policy tool, has a limited scope due to high levels of contingent liabilities and quasi-fiscal operations related to SOEs and state-owned commercial banks, and high tax expenditures against weak net borrowing capacity.

The main challenge is to take advantage of the recovery in growth to start implementing far-reaching economic changes, including restructuring the state-owned enterprise sector. SOEs produce about a half of Belarus's GDP, and their productivity and financial performance directly shapes Belarus's growth prospects. According to National Bank's estimates, liabilities with risks of repayment delays held by the largest SOEs account for 15 percent of GDP in 2018, a 1 percentage point higher than in 2017. Hence, advancing in this crucial area of reform will help to reduce vulnerabilities and raise growth potential over the medium to the long-run. An actionable plan to guide SOE restructuring should consider risks-based assessment of SOEs' viability and fiscal risks.

To cushion the impact of restructuring on vulnerable groups, social safety net needs to be enhanced by introducing unemployment assistance mechanisms and inclusively improving the design of the Household Utility Subsidy (HUS) program.

TABLE 2 Belarus / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	-2.5	2.5	3.0	2.2	2.4	2.1
Private Consumption	-3.2	4.7	4.8	2.5	2.8	1.9
Government Consumption	-6.9	1.7	-0.9	0.6	0.4	0.5
Gross Fixed Capital Investment	-14.5	9.4	1.2	1.8	4.1	2.9
Exports, Goods and Services	2.6	7.5	2.5	2.8	2.7	3.0
Imports, Goods and Services	-1.4	11.1	3.9	3.1	3.9	3.2
Real GDP growth, at constant factor prices	-2.5	2.5	3.0	2.2	2.4	2.1
Agriculture	3.9	4.4	-3.4	4.6	3.5	3.8
Industry	-4.7	3.6	6.1	4.2	5.2	5.8
Services	-1.7	0.8	1.4	-0.8	-1.3	-3.2
Inflation (Consumer Price Index)	11.8	6.0	5.6	5.8	5.0	5.0
Current Account Balance (% of GDP)	-3.4	-1.7	-1.0	-1.6	-2.6	-2.4
Net Foreign Direct Investment (% of GDP)	2.7	2.6	2.6	2.5	2.3	2.2
Fiscal Balance (% of GDP)	1.5	3.1	3.4	1.4	1.1	1.0
Debt (% of GDP)	44.4	50.3	52.1	55.2	58.3	54.2
Primary Balance (% of GDP)	3.1	5.6	6.2	3.5	3.9	3.6
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	0.7	0.8	0.7	0.7	0.7	0.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2017-HHS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2017) with pass-through = 0.7 based on GDP per capita in constant LCU.

BOSNIA AND HERZEGOVINA

Table 1	2018
Population, million	3.5
GDP, current US$ billion	19.2
GDP per capita, current US$	5476
Life expectancy at birth, years[a]	76.9

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2016).

Economic growth in Bosnia and Herzegovina (BiH) remained stable at 3 percent in 2018 and is expected to pick-up starting in 2019 with the implementation of infrastructure investment. Translating this growth into improvements in labor markets will be important for continuing reducing poverty, which was last recorded at 16 percent in 2015 and is expected to have declined in more recent years on account of the decline in unemployment. Delays in Governments formation after the general elections is a downside risk to the growth outlook.

Recent developments

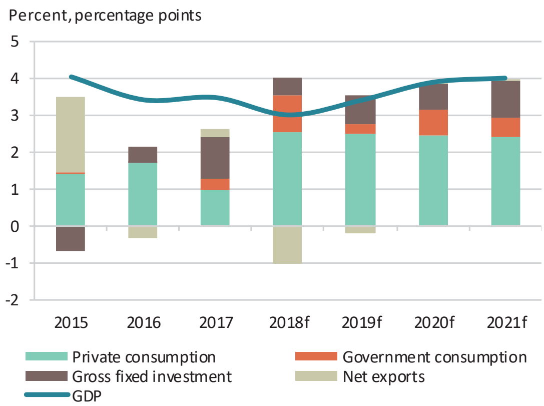
Growth reached an estimated 3 percent in 2018. Domestic demand remains the dominant driver of growth, with consumption adding 3.5pp, investment 0.5 pp and net exports subtracting 1pp. Improved external demand has supported exports growth, but higher growth of imports in 2018 is offsetting this momentum. Unemployment remains high, although some improvements are observed in the labor market. The unemployment rate fell from 20.5 percent in 2017 to 18.4 in 2018, driven by a reduction in activity rate and a slight rise in employment (mainly in manufacturing and construction). The 15-24 years-old benefited particularly from this increase in employment in industry sectors, which drove a substantial decline in youth unemployment, from 46 to 39 percent. Long-term unemployment, however, remains stubbornly high, as 4 of every 5 unemployed workers have been looking for employment for more than a year.

Prices continued to rise in 2018. The consumer price index increased by 1.8 percent year-on-year (y-o-y) in December 2018. The biggest driver of the increase were transport, tobacco and rental housing. Given that growth in nominal salaries was 4.9 percent y-o-y, the effect on real incomes was positive.

In 2018, fiscal deficit is expected to be at a 0.5 percent of GDP, down from a surplus of 2.6 percent in 2017. In 2018, revenues rose mainly due to stronger collection of indirect taxes, while expenditures rose mainly as a result of higher spending on public wages and social benefits. At the same time, while sluggish capital spending in 2017 reflected implementation delays, a pick-up of 2.5 pp is estimated in 2018 mainly due to investments in construction and roads infrastructure. The current account deficit (CAD) is forecast to rise slightly in 2018 as imports experience higher growth rate than exports. FDI remained at low levels covering 2 percent of GDP. Total public debt in 2018 is estimated at 37.1 percent of GDP, consisting largely of concessional borrowing from international financial institutions, while the total external debt is estimated at 70.5 percent of GDP.

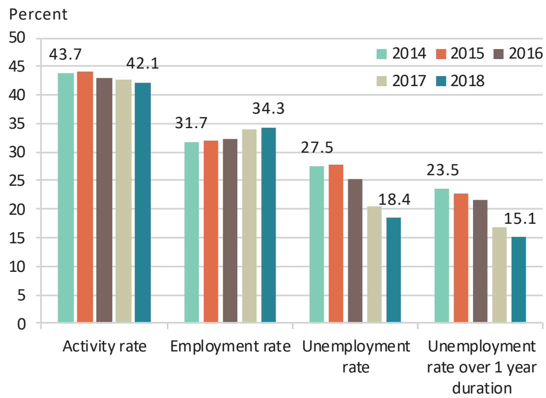
The latest available poverty data using the national poverty line is for 2015 and was estimated at 16 percent, very close to the 15 percent poverty rate estimated for 2011. Rural poverty (19 percent) was higher than urban poverty (12 percent). The implementation of new labor laws in both BiH entities, and continuation of support schemes for first-time job seekers are expected to improve labor market outcomes in the coming years, hence also supporting poverty reduction. The improvement in labor market indicators recorded between 2015 and 2018 (after the most recent microdata was collected) suggest that poverty may have receded more recently. Simulations that replicate the fall in unemployment captured by the Labor Force Survey show that this impact could account for a decrease of two percentage points in poverty. Inequality has remained constant in BiH between 2011 and 2015, with a Gini ratio of 33.

FIGURE 1 Bosnia and Herzegovina / Real GDP growth and contributions to real GDP growth



Sources: BIH Agency for Statistics (BHAS), World Bank staff estimate.

FIGURE 2 Bosnia and Herzegovina / Labor market indicators, 2014-2018



Sources: LFS 2014-2018 report, World Bank staff calculations. LFS 2018 preliminary results.

Outlook

Supported primarily by consumption and to some extent by public investment, economic growth is projected to gradually strengthen to about 4 percent by 2021. As the reform agenda deepens, a moderate rise in exports is expected, but strong demand for imported goods implies that consumption will continue to drive growth. Remittances are likely to remain high and stable at 8.3percent of GDP, and, together with progress on reforms, will underpin a gradual pickup in consumption. Investments in energy, infrastructure, and tourism will also support job creation in those sectors. A stronger push on the capital investment program and streamlining of current spending, including better targeting of social assistance programs, remains a high priority for the authorities' medium-term economic programs.

As poverty is strongly associated with unemployment and inactivity, economic growth and improvements in labor market participation and employment will remain key, especially in sectors that employ the low-skilled. Much of the unemployed have secondary education or less. With high unemployment and expectations of flat real wages, poverty is projected to decline slowly over the next several years. Improvements in agricultural productivity will also be critical, as close to 16 percent of employment depends on this sector.

In the medium run, with improved progress on ongoing structural reforms and higher demand for foreign goods, the CAD is expected to widen further from 5.6 percent of GDP in 2018 to 6.4 percent of GDP by 2021. Overall, in the medium term both fiscal and external deficits are expected to persist.

Risks and challenges

Addressing persistent unemployment and boosting growth while maintaining macro-fiscal stability, remain central to the BiH reform agenda. To this end, promoting private sector employment creation and improving job-preparedness among new entrants to the labor force and the currently unemployed will be necessary. Otherwise, poverty will see only modest improvement, continuing the trend in recent years.

Pressures on current spending from frequent elections and slow implementation of the reform agenda weigh heavily on the government's ability to speed-up future growth. Although external deficits continue to be moderate, on the fiscal side the tax burden is high, and public spending is inefficient, as evidenced by poorly-targeted benefits. Planned fiscal reforms aim to strengthen the social contribution system and introduce a progressive income tax system. These reforms are a step forward and, in combination with other reforms, will help build a fairer and more growth-enhancing tax system. Provision of an effective safety net will not be effective if structural rigidities in spending are not addressed—especially the high public wage bill. However, support from the international partners can help the authorities to deliver on the challenging reform agenda.

There are notable risks, both domestic and external. The main domestic risk is the challenging political environment, which makes structural reforms difficult especially in such areas as infrastructure, telecommunications, energy, and transport. It also raises risks to the economic outlook. The main external risk for BiH remains slow growth in the EU and rising in developed countries interest rates.

TABLE 2 Bosnia and Herzegovina / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	3.4	3.5	3.0	3.4	3.9	4.0
Private Consumption	2.2	1.2	3.4	3.3	3.3	3.2
Government Consumption	0.0	1.5	5.0	1.5	3.6	2.6
Gross Fixed Capital Investment	2.5	6.3	2.7	4.3	3.7	5.5
Exports, Goods and Services	9.3	10.1	4.5	4.6	3.5	3.5
Imports, Goods and Services	6.7	6.3	5.0	3.5	2.4	2.4
Real GDP growth, at constant factor prices	3.1	3.2	3.0	3.4	3.9	4.0
Agriculture	7.6	-4.4	0.5	2.9	2.9	2.9
Industry	4.7	3.0	1.5	1.9	2.5	2.5
Services	2.0	4.2	3.9	4.0	4.5	4.7
Inflation (Consumer Price Index)	-1.1	1.2	2.5	3.4	4.2	2.0
Current Account Balance (% of GDP)	-4.5	-4.6	-5.6	-5.8	-6.3	-6.4
Net Foreign Direct Investment (% of GDP)	-1.6	-2.0	2.3	2.7	2.9	2.7
Fiscal Balance (% of GDP)	1.2	0.9	-0.5	0.3	1.2	1.1
Debt (% of GDP)	39.1	38.4	37.1	34.8	36.2	35.9
Primary Balance (% of GDP)	2.0	2.2	0.9	1.2	2.4	2.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.

BULGARIA

Table 1	2018
Population, million	7.0
GDP, current US$ billion	617
GDP per capita, current US$	8792
International poverty rate ($1.9)[a]	1.5
Lower middle-income poverty rate ($3.2)[a]	3.8
Upper middle-income poverty rate ($5.5)[a]	8.7
Gini index[a]	37.4
School enrollment, primary (% gross)[b]	94.8
Life expectancy at birth, years[b]	74.6

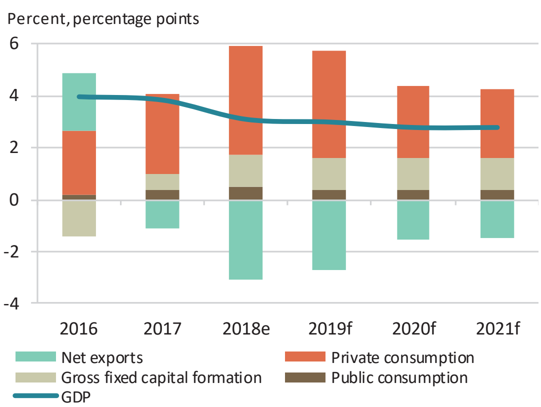
Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2014), 2011 PPPs.
(b) Most recent WDI value (2016)

Bulgaria's economy grew by 3.1 percent in 2018 driven by private consumption and investment. Labor capacity constraints led to rising wages and pushed down the unemployment rate to a post-crisis low. Output and employment growth contributed to a reduction in poverty. Further gains in growth, poverty reduction and shared prosperity hinge on the implementation of policies to boost productivity. Renewed attention should be given to strengthening institutions to support planned ERM2 accession, enhancing the skills of the labor force, and improving the effectiveness and efficiency of public spending.

Recent developments

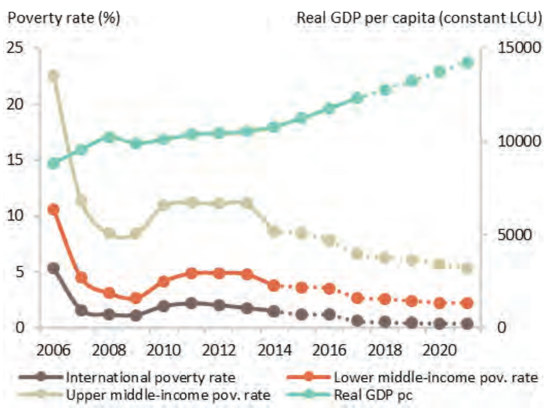
Economic growth remained strong in 2018, projected at 3.1 percent yoy, albeit expanding at a slower pace compared to 2017. Growth was driven mainly by private consumption (up 5.7 percent yoy) supported by rising wages and cheap credit and invigorating investment (up 6.5 percent yoy) which benefited from the recovery in the EU investment funding. On the production side, the greatest contribution came from real estate (up 9.3 percent yoy); finance (up 6.7 percent yoy), construction (up 4.0 percent yoy). Industry grew by 0.8 percent yoy, reflecting a weaker external demand from non-EU countries, including neighboring Turkey. Strong domestic demand and weaker external demand in the major export markets contributed to the widening of the trade deficit. However, the current account balance remained positive at 4.6 percent on the back of strong performance of services and higher inflows of EU grants. Headline inflation accelerated to 2.8 percent in 2018 due to higher energy prices, robust domestic demand and higher unprocessed food prices reflecting a disappointing agriculture year. Fiscal performance remained positive on the back of improved revenue collection. Fiscal revenues grew by 18.1 percent yoy in the first nine months of 2018 thanks to strong economic activity, better compliance, and higher minimum wages. Despite higher public wages resulting in a 12.4 percent increase in the public wage bill and additional budget resources allocated to police and municipalities, the fiscal accounts remained in surplus at 0.8 percent of annual GDP. Robust economic growth and a tighter labor market led to a decline in the unemployment rate to 5.2 percent, as of end 2018, a post-crisis low. At 73.5 percent as of Q3 2018, the employment rate (20-64) also improved. However, the working age population continued to shrink constraining expansion of potential growth. Labor and skill shortages as well as a rising minimum wage pushed real wages up, albeit at a slower pace than in 2017. Improvements in labor market conditions, including low unemployment and wage and income growth, supported a return in 2015 of poverty rates to pre-crisis levels. Poverty measured using the Upper Middle-Income Class line of $5.5 per day (in 2011 PPP terms) is projected to have declined from 8.5 percent in 2015 to 7.1 percent in 2018. Bulgaria has the most unequal distribution of disposable income in the EU, and inequality has been increasing since 2013. The high level of inequality reflects the relatively low redistributive impact of Bulgaria's fiscal system. When inequality is seen through the lens of market income, before taxes and transfers are paid, Bulgaria's inequality is close to EU averages. However, Bulgaria's system of taxes and transfers is relatively less redistributive than in other countries, contributing to Bulgaria's Gini coefficient of disposable income being 40 percent higher than the average in the EU-28 in 2016. Unemployment has declined significantly but regional variations and long-term

FIGURE 1 Bulgaria / Real GDP growth and contributions to real GDP growth



Sources: NSI, World Bank

FIGURE 2 Bulgaria / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

and youth unemployment remain high. Inactivity among certain groups of the population persists and many citizens – including the elderly, those living in rural areas, and the Roma – are excluded from economic opportunities.

Outlook

Growth is expected to remain robust over the medium-term. GDP will likely expand by around 3 percent in 2019. Domestic demand will continue to be the main driver of growth supported by labor market tightening and additional public-sector wage increases. Investment sentiment might be affected by increasing uncertainty in external markets, but private and public investment should remain strong supported by low interest rates and EU funding. Strong domestic demand coupled with weaker external demand will put pressure on the trade balance. The current account balance is likely to remain positive, but the surplus will narrow significantly. The fiscal balance is expected to remain positive in 2019 and beyond through a moderate rise in spending on non-wage items and robust revenue collection. This will further push down public debt from 25.6 percent of GDP in 2017 to 21.1 percent in 2021. However, the lack of improvement in spending efficiency in health, public order, and infrastructure could undermine fiscal consolidation and limit the potential of public spending to enhance growth. Poverty reduction is expected to continue at a modest pace in the near term. Sustained improvements in employment and wages, as well as recent increases in the minimum pension, should support real incomes and therefore further reductions in poverty. Poverty is projected to fall to 6.9 percent in 2019, as measured at $5.5 a day in 2011 PPP, to 6.5 percent in 2020, and further to 6 percent by 2021.

Risks and challenges

Risks to the outlook remain broadly balanced. Weaker growth momentum in Bulgaria's main EU trading partners and further slowdown in Turkey, mainly acting through the trade channel, could undermine export growth, while tightening global financial market conditions could increase the cost of lending to the private sector with negative implications for investment. Continued wage growth at a faster pace than productivity could translate into increasing unit labor costs and therefore undermine competitiveness. Further acceleration of real estate prices in large cities could negatively affect the quality of bank portfolios. Upside factors likely to lead to higher-than expected growth are an enhanced economic sentiment in Europe and stronger global economic activity. The key challenges for Bulgaria are to accelerate convergence with the rest of the EU and to build a more inclusive society. Accelerating convergence requires improvements in productivity and labor force participation as the demographic transition is weighing on the size of the working age population. Employment rates of those aged 20-64 remain in the bottom third of those seen in the EU-28, suggesting substantial potential to increase participation. Inclusion can be supported through reducing inequality of opportunities across groups and regions and ensuring that the fiscal system plays its role in alleviating rather than deepening poverty. Enhancing productivity growth requires addressing governance challenges, critical also for planned ERM2 accession. Boosting the skills and employability of all Bulgarians, more effective and efficient public spending on health, pensions and long-term care are also needed to ensure inclusiveness and sustainability of growth in the face of demographic changes.

TABLE 2 Bulgaria / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	3.9	3.8	3.1	3.0	2.8	2.8
Private Consumption	3.4	4.3	5.7	5.5	3.6	3.5
Government Consumption	2.5	4.4	6.3	4.8	4.2	4.1
Gross Fixed Capital Investment	-6.6	3.2	6.5	6.3	6.1	6.1
Exports, Goods and Services	8.1	5.8	-0.8	0.6	2.4	2.5
Imports, Goods and Services	4.5	7.5	3.7	4.5	4.4	4.3
Real GDP growth, at constant factor prices	3.4	4.2	3.0	3.0	2.8	2.8
Agriculture	5.3	8.9	-1.1	1.0	1.0	1.0
Industry	5.9	4.0	0.8	1.4	1.8	2.1
Services	2.2	3.9	4.2	3.8	3.3	3.2
Inflation (Consumer Price Index)	-0.8	2.1	2.8	2.9	3.0	3.0
Current Account Balance (% of GDP)	2.6	6.5	4.6	3.7	2.8	2.1
Net Foreign Direct Investment (% of GDP)	2.1	2.7	2.8	3.0	3.0	3.0
Fiscal Balance (% of GDP)	0.2	1.1	0.2	0.0	0.4	0.4
Debt (% of GDP)	29.6	25.6	24.0	22.7	21.9	21.1
Primary Balance (% of GDP)	1.0	1.9	1.0	0.8	1.1	1.1
International poverty rate ($1.9 in 2011 PPP)[a,b]	1.2	1.0	0.8	0.7	0.6	0.6
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	3.6	3.3	3.2	2.9	2.8	2.7
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	7.9	7.5	7.1	6.9	6.5	6.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2014-EU-SILC. Actual data: 2014. Nowcast: 2015-2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2014) with pass-through = 0.87 based on GDP per capita in constant LCU.

CROATIA

Table 1	2018
Population, million	4.1
GDP, current US$ billion	60.8
GDP per capita, current US$	14878
Lower middle-income poverty rate ($3.2)[a]	13
Upper middle-income poverty rate ($5.5)[a]	5.5
Gini index[a]	311
School enrollment, primary (% gross)[b]	95.4
Life expectancy at birth, years[b]	78.1

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2016).

Growth continued to moderate in 2018 to 2.6 percent mainly as exports of goods and services decelerated. Yet, economic recovery supported by the solid domestic demand increased employment and real net wages reducing poverty rate to 4.2 percent (at $5.5/day PPP). General government recorded a balanced budget with further decline of public debt. However, weak potential growth and low labor inclusiveness with accelerated outmigration call for a broader structural reform agenda to reinitiate real convergence with the EU.

Recent developments

Croatian economy continued its growth in 2018 at 2.6 percent in 2018, although growth lost some of the momentum compared to the 2.9 percent growth in the 2017, mainly as exports of goods and services decelerated. In terms of growth composition, the strongest contribution came from private consumption at 2 percentage points (pp) supported by the rise of disposable income as favorable labor market developments continued. On the other hand, investment recovery is still subdued despite solid private investment growth, as government investment plunged due to the weak absorption of EU funds. Finally, both exports and imports of goods and services slowed down, resulting in a negative net contribution of 1.2 pp to the 2018 growth. From the supply side, market services were the main drivers of growth during 2018 with highest contribution coming from retail sales, tourism and construction. On the other hand, manufacturing had a neutral impact on growth.

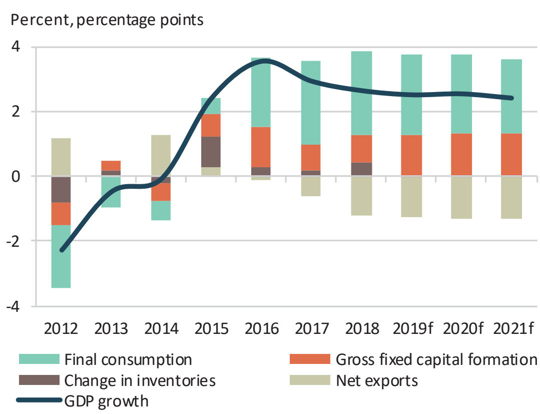
Current account surplus declined to 2.9 percent of GDP in 2018 (estimate), after reaching 4.0 percent of GDP in 2017, mainly due to the deterioration of the trade balance with exports of goods slowing down and imports increasing. Despite solid reinvested earnings as banks' profits fully recovered following conclusion of settlement agreement of Agrokor Group, net FDI moderated to 2.1 percent of GDP in 2018 (estimate) from 2.5 percent of GDP in 2017 as new direct investments remained weak, mainly directed in real estate and trade. External debt declined to 75.7 percent of GDP in 2018 (estimate), 6.1 percentage points below the end of 2017 level and 31.1 percentage points below record-high level in 2014.

Economic recovery has led to new employment, resulting in an increase in the employment rate by 3 percent in 2018. Together with a significant negative migration flow this resulted in further decline in unemployment below 10 percent in 2018 (estimate) from 12.4 percent in 2017. The economic recovery and shortages of labor that are appearing in some sectors increased real net wages by 2.8 percent in 2018. After international oil and food prices recovery in 2017, prices accelerated to 1.5 percent in 2018 mainly due to the further rise of international oil prices.

Real per capita disposable income has increased and has finally reached its level from 2009. Additionally, after suffering one of the worst recessions in the EU, real GDP per capita is now above its pre-crisis level. Furthermore, inequality has decreased and micro-data for 2016 shows that it is at its lowest level since 2009. The country's annualized growth of disposable per capita incomes among the bottom 40, between 2010 and 2015, has been close to half percent and above the growth rate of the top 60 (-0.26).

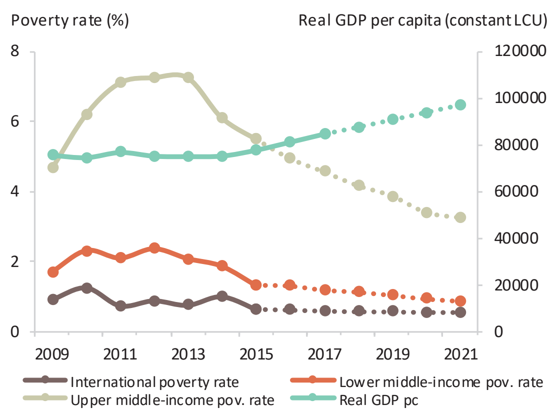
General government recorded a balanced budget in 2018 (estimate) after surplus of 0.9 percent of GDP in 2017. Revenues continued to increase as tax collection remained buoyant, especially for VAT,

FIGURE 1 Croatia / Real GDP growth and contributions to real GDP growth



Sources: CROSTAT, World Bank.

FIGURE 2 Croatia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

while expenditures increased faster as current expenditures including wage bill and current transfers are on the rise. In addition, there was one-off increase in expenditures due to the materialization of contingent liabilities for the guarantees issued for Uljanik shipyard (0.7 percent of GDP) which points to the persistent risk of activation of guarantees, which stood above 3 percent of GDP in 2018. Mainly as a result of high primary surplus, public debt continued to decline to 74 percent of GDP in 2018 (estimate). The Government has also introduced tax reform package in the amount of 0.7 percent of GDP to reduce the overall tax burden. The most significant changes in 2019 include reducing the VAT rate for some food products and medicines, reducing CIT for the highest income bracket and a decrease in social contributions. For 2020, the Government is planning to reduce the general VAT rate by 1 percentage point, to 24 percent, which amounts around 0.5 percent of GDP.

Outlook

Growth is expected to remain moderate at an average of 2.5 percent in 2019-2021 period due to the slowdown of exports of trade and services, while private consumption is expected to remain robust as real wages continue growing and the government reduces some of the tax burden. The trade balance could further deteriorate as foreign demand from main trading partners decelerates and imports remain solid, while better absorption of EU funds will give a boost to investment spending. The general government finance is expected to be in average surplus of 0.4 percent of GDP in 2019-2021 period, leading to a further decline of public debt below 64 percent of GDP by the end of 2021. Continued positive labor market developments are expected to support growth of disposable income for all segments of the welfare distribution. The continued recovery of the economy, including a decline of the share of long-term unemployed and NEETs, is expected to contribute to the further decline in the absolute poverty rate measured at the US$5.5 at PPP 2011 to 3.2 percent by 2021.

Risks and challenges

Risks are slightly skewed to the downside. Exports of goods is exposed to the risk of faster slowdown in external demand from the EU as Italy, one of Croatia's main trading partners, is expecting a slowdown of its economy. In addition, exports of tourist services are expected to slow in the projection period, due to the capacity constraints. On the other hand, government debt is still high and subject to interest rate risk. Also, cyclical upturn and a sounder fiscal position have resulted in a slight fiscal expansion and reduced reform momentum that will have an adverse effect on growth over the medium term.

As such, Croatia's current medium-term growth outlook is insufficient to accelerate the convergence with the EU. Tackling weak potential would include a broad reform agenda with aim to address low productivity through raising quality and mobility of human and physical capital. Then it would require undertaking the cumbersome business environment related to an inefficient public sector and low labor market inclusiveness. This would lead to higher and more inclusive growth, which would further reduce poverty rates in Croatia.

TABLE 2 Croatia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	3.5	2.9	2.6	2.5	2.5	2.4
Private Consumption	3.5	3.6	3.5	3.6	3.4	3.2
Government Consumption	0.7	2.7	2.9	2.2	2.2	2.0
Gross Fixed Capital Investment	6.5	3.8	4.1	6.3	6.4	6.1
Exports, Goods and Services	5.6	6.4	2.8	2.1	1.9	1.7
Imports, Goods and Services	6.2	8.1	5.5	4.7	4.5	4.2
Real GDP growth, at constant factor prices	3.5	2.1	2.6	2.5	2.5	2.4
Agriculture	7.3	-2.1	2.1	2.0	2.0	2.0
Industry	5.0	0.9	0.5	2.4	2.4	2.4
Services	2.8	2.8	3.4	2.5	2.6	2.4
Inflation (Consumer Price Index)	-1.0	1.0	1.5	0.9	1.4	1.4
Current Account Balance (% of GDP)	2.7	4.5	2.9	2.1	1.3	0.9
Net Foreign Direct Investment (% of GDP)	4.2	2.5	2.1	2.2	2.2	2.4
Fiscal Balance (% of GDP)	-0.9	0.9	0.0	0.3	0.4	0.5
Debt (% of GDP)	80.2	77.5	74.0	70.7	67.3	63.9
Primary Balance (% of GDP)	2.1	3.5	2.4	2.5	2.4	2.6
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	1.3	1.2	1.1	1.0	0.9	0.9
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	4.9	4.6	4.2	3.9	3.5	3.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2015-EU-SILC. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021
(b) Projection using neutral distribution (2015) with pass-through = 0.87 based on GDP per capita in constant LCU.

GEORGIA

Table 1	2018
Population, million	3.7
GDP, current US$ billion	16.2
GDP per capita, current US$	4352
International poverty rate ($1.9)[a]	5.0
Lower middle-income poverty rate ($3.2)[a]	16.3
Upper middle-income poverty rate ($5.5)[a]	43.6
Gini index[a]	37.9
School enrollment, primary (% gross)[b]	102.6
Life expectancy at birth, years[b]	73.3

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2017), 2011 PPPs.
(b) Most recent WDI value (2016).

Georgia's economy expanded by 4.7 percent in 2018, driven by strong exports of goods and tourism services and robust private consumption and investment. Supported by rising investment and prudent economic management, the economy is projected to grow by 4.6 percent in 2019. The national poverty rate, at 21.9 percent in 2017, will return to a declining trend as economic growth remains robust and translates into higher incomes.

Recent developments

The Georgian economy grew by 4.7 percent in 2018, though economic activity moderated towards the end of the year. Financial and tourism-related sectors grew at above 10 percent, compensating for weak performances in agriculture and construction. On the demand side, strong credit growth and external transfers, and improvement in labor markets, supported domestic demand, while a recovery in the region supported exports. The contributions of public consumption and investment remained subdued.

Strong export earnings and easing demand in late-2018 narrowed the external gap to around 8 percent of GDP in 2018. Goods exports grew by 23 percent but remain concentrated. Imports of goods rose by 15 percent. The goods trade deficit widened by 11 percent year on year but was offset by a 15 percent increase in foreign transfers and improvement in the services account as tourism receipts increased by 18 percent. Transfers from Russia accounted for 29 percent of total transfers, while most tourists arrived from Armenia, Azerbaijan, Russia and Turkey. Foreign direct investment (at about 9 percent of GDP in 2018) more than offset the external financing needs.

The exchange rate remained flexible in 2018, with lari fluctuations driven by seasonal factors. The lower current account deficit in late-2018 allowed the National Bank of Georgia to boost reserves to $3.3 billion, the equivalent of four months of imports. With the currencies of key trading partners (Russia and Turkey) coming under pressure in 2018, the nominal and real effective exchange rates appreciated by 8 percent and 3.4 percent, respectively.

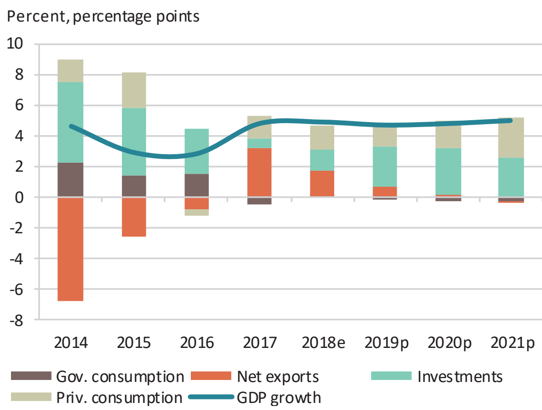
Annual inflation dropped to 1.5 percent in December 2018 as prices of apparel and communication services declined, overcoming slight upward pressure from higher food, alcohol, and fuel prices. In response to softer aggregate demand and the improved external balance, the NBG loosened monetary policy slightly in January 2019, cutting its refinancing rate by 25 basis points to 6.75 percent.

Credit expanded by 19 percent in 2018 with mortgage lending accounting for almost 40 percent of the increase. More stringent loan approval conditions introduced by the NBG have contained growth elsewhere in the lending portfolio. Prudential indicators remain healthy; in December 2018, the banking system's return on assets stood at 2.5 percent and return on equity at 19.4 percent. Non-performing loans were modest at 2.7 percent of loans.

While the budget was balanced until November 2018, a surge in spending in December brought the annual fiscal deficit to 2.9 percent of GDP (compared to a target deficit of 3.2 percent). The spike in expenditure was driven by public investment to compensate for spending delays earlier in the year. Current expenses declined slightly, while tax revenue performance was strong. Public debt was at 43.5 percent of GDP.

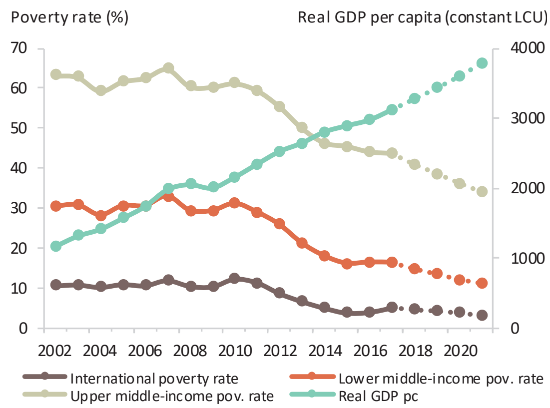
Due to slow employment growth and a pick-up in inflation, the national poverty rate, stagnated at 21.9 percent in 2017.

FIGURE 1 Georgia / Real GDP growth and contributions to real GDP growth



Sources: Geostat; World Bank staff estimates.

FIGURE 2 Georgia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.
Note: Calculations based on ECAPOV harmonization using 2015-HIS.

While pensions contributed positively to poverty reduction, the impact of Targeted Social Assistance and other social programs was negligible. Poverty was estimated at 16.3 percent using the lower-middle-income poverty line ($3.20/day, 2011PPP). With the unemployment rate declining in 2018 from 13.9 to 12.7 percent, external transfers increasing, and weak inflationary pressures, the poverty rate is estimated to have declined in 2018.

Outlook

Georgia's positive medium-term growth outlook is supported by higher investment (public investment in particular) and stable external demand thanks to improving economic prospects in its main trading partners (Azerbaijan, Russia and Turkey). Real GDP growth is projected to slow to 4.6 percent in 2019 as external demand weakens and the NBG tightens measures to encourage responsible lending. Growth will rebound to 5 percent by 2021. The external gap is expected to narrow, as private consumption growth slows and exports (including tourism services) remain robust. While newly introduced measures in the banking sector are expected to slow credit growth and private consumption, they will strengthen the resilience of the sector and its ability to sustainably support the economy. Inflation will remain low, anchored by credible monetary policy.

Fiscal operations will continue to shift from current to capital expenditures in the medium-term, while efficiency improvements will create some additional fiscal space for higher capital spending. Public debt is projected to stabilize around 43 percent of GDP by 2020.

Economic expansion will lead to more employment and income-generating opportunities for those at the bottom of the income distribution. Increases in pensions and social assistance in 2019 (also planned for future years) will help reduce poverty further.

Risks and challenges

Substantial quasi-fiscal risks emanate from the state-owned enterprises (SOEs). The liabilities of the 57 SOEs classified as high and medium-risk, total 16.2 percent of GDP and additional risks stem from contingent liabilities generated by the 181 power purchasing agreements (PPAs), which provide state guarantees for the purchase of excess electricity from power generators. While PPAs present a fiscal risk, consumption growth trends suggest the need for additional power capacity. The government will review PPA decisions going forward to ensure compliance with the 2018 Law on Public-Private Partnerships (PPPs). The inclusion of liabilities from PPPs in public debt is also an important step.

Georgia will remain vulnerable to regional developments and the risks associated with a sharp decline in export demand or a reduction in remittance inflows. While the Russian economy has withstood external shocks and the Turkish economy has begun to stabilize, a fresh round of disturbances in either economy could undermine Georgia's prospects for tourism and investment, complicate access to financial markets, and negatively impact economic growth. At the same time, with its stable business environment, Georgia is well placed to attract investors from neighboring countries due to stable operating environment.

Rural poverty will remain a challenge. Providing new job opportunities to workers now employed in low-productive agriculture—and supporting productivity increases in agricultural production—will be critical to reducing rural poverty from current 26.4 percent.

TABLE 2 Georgia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	2.8	4.8	4.7	4.6	4.8	5.0
Private Consumption	-0.6	2.4	2.2	2.2	3.1	4.3
Government Consumption	6.8	-2.1	0.2	-0.6	-1.6	-1.5
Gross Fixed Capital Investment	10.0	1.8	4.3	8.8	9.5	8.0
Exports, Goods and Services	7.7	21.8	9.0	7.5	7.0	7.0
Imports, Goods and Services	6.3	10.4	4.5	5.0	5.4	5.7
Real GDP growth, at constant factor prices	2.9	4.7	4.7	4.6	4.7	4.9
Agriculture	0.3	-2.7	2.5	3.0	3.0	3.0
Industry	6.2	5.7	3.4	3.5	3.3	3.3
Services	2.1	5.2	5.5	5.1	5.4	5.6
Inflation (Consumer Price Index)	2.1	6.0	3.0	3.0	3.0	3.0
Current Account Balance (% of GDP)	-13.1	-8.8	-8.1	-7.9	-7.7	-7.0
Net Foreign Direct Investment (% of GDP)	9.8	10.8	8.6	9.8	10.5	10.5
Fiscal Balance (% of GDP)	-4.2	-3.7	-2.9	-2.8	-2.5	-2.0
Debt (% of GDP)	44.4	44.1	43.6	44.7	43.2	43.1
Primary Balance (% of GDP)	-3.0	-2.4	-1.5	-1.4	-1.1	-0.9
International poverty rate ($1.9 in 2011 PPP)[a,b]	3.9	5.0	4.5	4.2	3.7	3.2
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	16.4	16.3	14.8	13.4	12.1	11.1
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	44.0	43.6	40.9	38.6	36.2	33.9

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2017-HIS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021
(b) Projection using neutral distribution (2017) with pass-through = 0.87 based on GDP per capita in constant LCU.

KAZAKHSTAN

Table 1	2018
Population, million	18.2
GDP, current US$ billion	164.3
GDP per capita, current US$	9036
International poverty rate ($1.9)[a]	0.0
Lower middle-income poverty rate ($3.2)[a]	0.4
Upper middle-income poverty rate ($5.5)[a]	8.6
Gini index[a]	27.5
School enrollment, primary (% gross)[b]	109.0
Life expectancy at birth, years[b]	72.3

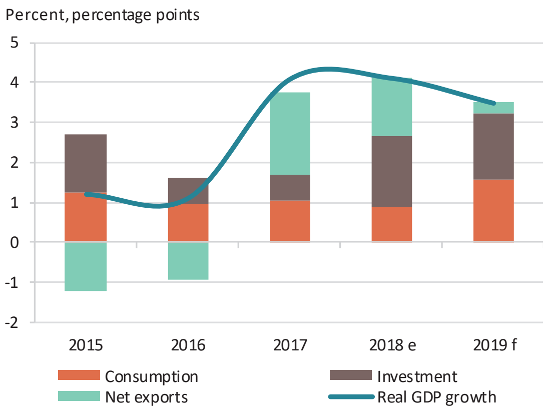
Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2017), 2011 PPPs.
(b) Most recent WDI value (2016).

The economy grew by 4.1 percent in 2018 benefiting from higher oil exports and strong private consumption. Poverty is estimated to have fallen to 7.4 percent. Economic growth is projected to decelerate going forward as oil production levels off. Private consumption, fueled by income tax cuts and a minimum wage increase, is expected to drive growth and support modest poverty reduction. The challenges to faster growth, however, are significant given Kazakhstan's overreliance on oil and structural bottlenecks that constrain private sector development.

Recent developments

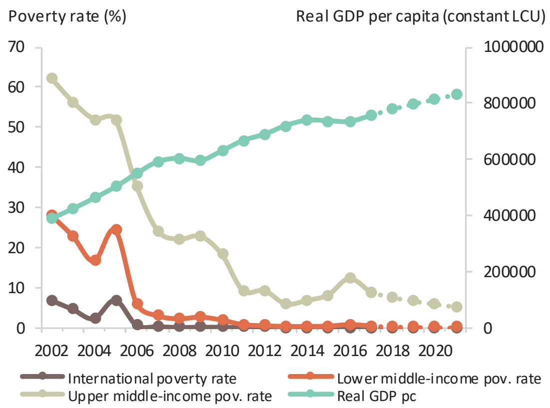
Real GDP expanded by 4.1 percent in 2018 on the back of stronger exports and recovering domestic demand. Net exports continued to contribute substantially to GDP due to stronger-than-expected production from the ashagan oil field. But the impetus appears to be diminishing as production flattens. Private consumption rose by an estimated 4.5 percent, benefiting from rising incomes and moderating inflation. Higher oil prices supported a rise in profits in the extractive industries, which contributed to a 3 percent increase in overall investment. On the supply side, the domestic, non-export manufacturing and services sectors continued to be the main engines of growth; the contribution of mining was slightly lower compared to previous years.
Higher oil prices and robust foreign demand have made a sizeable dent in the current account, which turned to a surplus of 0.5 percent of GDP in 2018 (from a deficit of 3.3 percent of GDP in 2017). On the capital account, net outflows of portfolio investment offset higher inflows of foreign direct investment (up by 9.8 percent) and Eurobond proceeds. Net international reserves stood at $30.9 billion (18.1 percent of GDP) in 2018.
Budget spending growth was moderate in nominal terms and slightly negative adjusted for inflation, in line with the government's consolidation and deficit reduction commitment. The completion of major infrastructure projects in 2018, and the removal of one-off large banking sector bail-out packages in 2017, contributed to the moderation in spending. On the revenue side, corporate income tax and value added tax—which account for two-thirds of fiscal tax revenue— increased by a combined 16.2 percent in 2018. The overall fiscal deficit is estimated at 0.6 percent of GDP (down from 4.6 percent in 2017), while the non-oil fiscal deficit is estimated to have narrowed to 6.8 percent of GDP in 2018 (from 12.8 percent a year earlier). Public debt inched up to an estimated 21.1 percent of GDP (from 20.1 in 2017).
The banking sector remains fragile. There is considerable uncertainty over the actual scale of nonperforming loans in the absence of an asset quality review of banks. Although retail credit bounced back recently, corporate lending shows no sign of recovery. The National Bank of Kazakhstan's (NBK) effectiveness as an independent regulator may have been further compromised by becoming a shareholder in a state-owned company and the sole bondholder of the Problem Loan Fund.
Annual inflation fell to 5.3 percent in December 2018 from 7.1 percent at end-2017. In response to a depreciation of the tenge, the NBK raised the policy interest rate in mid-October; together with stagnant credit to the economy, this dampened inflationary expectations.
Against the backdrop of buoyant economic activity and labor market improvements, the poverty rate (using the $5.5/day international poverty line) is estimated to have declined to 7.4 percent in 2018 from 8.6 percent in 2017, marking the second consecutive year in which poverty has fallen since its peak in 2016.

FIGURE 1 Kazakhstan / Real GDP growth and contributions to real GDP growth



Sources: Statistical Office of Kazakhstan; World Bank staff estimates.

FIGURE 2 Kazakhstan / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

Economic growth has contributed positively to labor market outcomes. The reported increase in real wages in 2018 is expected to continue in 2019 following a significant increase in the national minimum wage in early January. The headline unemployment rate hovers at about 5 percent.

The President replaced his cabinet on February 25 in response to complaints by certain segments of the population over the lack of inclusive growth.

Outlook

GDP growth is projected to decelerate slightly in 2019–20 and flatten thereafter. The outlook reflects slow productivity growth and the underlying structural weaknesses of the economy, including market dominance by SOEs, unequal regulatory treatment of enterprises, and a low level of competition. Decelerating economic growth in Kazakhstan's main trading partners—particularly China, the European Union, and the Russian Federation—is also forecast to dampen growth in 2019.

Boosted by rising real wages, consumer spending will continue to drive economic activity, though to a lesser extent than in previous years. Government initiatives to provide subsidized mortgage and car purchase loans will also support private consumption. A weaker

The non-oil fiscal deficit is expected to decline further in line with the government's medium-term fiscal consolidation strategy. Assuming that prices, oil demand, and oil and mining profit repatriation remain stable, the current account will be roughly balanced in the forecast period.

The NBK is expected to raise the key policy rate to counter inflationary pressures from real wage growth, thereby keeping inflation within the 2019 target range.

The tax cut for low income earners and the 50 percent increase in the minimum wage in January 2019, along with a tight labor market, are expected to stabilize the poverty rate at around 5 percent by 2021. However, a significant share of the population is close to the poverty line and therefore will remain vulnerable to economic shocks.

The government's concerted efforts to combat corruption, modernize the judiciary, and reduce the share of state activity in the economy need to be executed more decisively. These efforts will be even more critical as the country approaches a period of political transition that could be disruptive to the economy.

Risks and challenges

As a commodity exporter, Kazakhstan faces many risks. The forecast could come under pressure if external conditions deteriorate beyond the baseline scenario. Three main risks face the Kazakh economy. First, new sanctions on Russia (by the European Union or the United States) could negatively impact Kazakhstan through Russian trade and investment channels and place downward pressure on the value of the tenge. Coupled with rising domestic price pressures—spurred by higher real wages following the minimum wage increase—this would require a more aggressive tightening of monetary policy.

Second, greater trade protectionism and a deeper-than-expected slowdown in Kazakhstan's trading partners would adversely affect demand for exports, slowing GDP growth.

Third, rising uncertainty surrounding a possible political transition in the coming years may slow the progress of planned economic reforms, adversely impacting private investment, both domestic and foreign.

TABLE 2 Kazakhstan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	1.1	4.0	4.1	3.5	3.2	3.2
Private Consumption	1.2	1.5	4.5	4.0	3.7	3.4
Government Consumption	2.4	-2.5	-3.1	1.3	-0.4	1.4
Gross Fixed Capital Investment	3.0	6.2	3.0	3.2	3.4	3.3
Exports, Goods and Services	-4.4	1.5	6.8	3.4	2.1	2.6
Imports, Goods and Services	-2.2	-6.0	3.1	3.6	3.0	3.2
Real GDP growth, at constant factor prices	1.2	3.8	4.1	3.5	3.2	3.2
Agriculture	5.4	2.8	3.0	3.1	3.3	3.0
Industry	1.2	6.0	4.9	3.2	3.1	3.3
Services	0.9	2.7	3.8	3.7	3.2	3.1
Inflation (Consumer Price Index)	14.6	7.4	5.6	6.1	5.8	5.7
Current Account Balance (% of GDP)	-6.5	-3.3	0.5	0.2	0.2	0.3
Net Foreign Direct Investment (% of GDP)	10.5	6.0	4.0	6.9	6.7	6.5
Fiscal Balance (% of GDP)	-6.4	-4.6	2.0	0.5	0.0	-0.3
Debt (% of GDP)	19.6	20.1	21.1	18.8	17.3	16.5
Primary Balance (% of GDP)	-5.3	-3.7	2.7	1.4	1.0	0.6
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.0	0.0	0.0	0.0	0.0	0.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.7	0.4	0.4	0.3	0.3	0.3
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	12.2	8.6	7.4	6.6	5.8	5.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2017-HBS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2017) with pass-through = 1 based on GDP per capita in constant LCU.

KOSOVO

Table 1	2018
Population, million	1.8
GDP, current US$ billion	7.6
GDP per capita, current US$	4108
Life expectancy at birth, years[a]	71.6

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2016).

Economic growth remained high at 4.2 percent in 2018, propelled by strong public investment and services exports. Overall fiscal deficit was at 2.7 percent of GDP in 2018, driven by higher infrastructure spending, but in line with fiscal rules. The macroeconomic outlook is positive, with a projected growth rate of 4.5 percent for 2019-2021. Fiscal risks are on the rise due to further increases in untargeted social benefits and the recently adopted law on public salaries.

Recent developments

Growth registered at 3.9 percent in Q3 2018 and is estimated to have reached 4.2 percent by end-2018, driven by higher public investment, a recovery in consumption, and strong services exports. Higher wages and social spending, remittance growth, albeit slower than expected, and increasing credit to households, promoted private consumption and added 2 percentage points (pp) to growth. Public investment registered a strong growth and reached 8.1 percent of GDP in 2018, up from 7.3 percent of GDP. Private investment also increased thanks to higher investment in the retail sector, residential investment fueled by continued demand from the Kosovar diaspora, and higher corporate lending. Overall, investment added 5.7 pp to growth. Net exports subtracted 3.5 pp from real GDP growth as higher imports met increasing demand for capital goods. On the production side, services were the main engine of growth, followed by industry. Whereas agriculture contributed a mere 0.1 pp to growth.

Consumer price inflation (CPI) was 1.1 percent at end 2018, down from 1.5 percent in 2017, but accelerated in December. In December y-o-y inflation was 2.9 percent due to price increases for fuel, food, tobacco, alcohol, and transportation. The tariffs imposed on goods imports from Serbia and Bosnia and Herzegovina might have contributed to this increase.

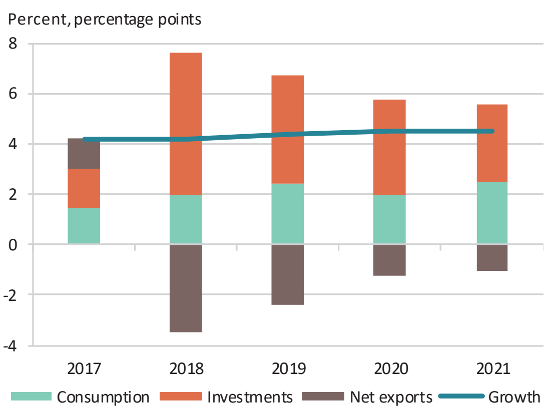
The fiscal deficit doubled from 1.2 percent in 2017 to 2.7 percent at end 2018. This increase was driven by higher capital investment (financed through privatization proceeds) and growing untargeted social protection benefit spending. The sharp increase in the social benefits is driven by proliferation of untargeted social benefits and new pension schemes, threatening fiscal stability. The changes to the law to cap the spending on war veteran's benefits at 0.7 percent of GDP were not implemented in 2018. The overall fiscal balance per fiscal rule was in line with legal requirements and below 1.4 percent of GDP, as it excludes capital spending financed by privatization proceeds. Public and publicly guaranteed debt was at 17.7 percent of GDP by end-2018 and is growing fast, driven by higher primary budget deficits.

The current account deficit (CAD) deteriorated in 2018 as higher services exports could not compensate for the investment-driven imports. The CAD increased to 8.7 percent of GDP in 2018, up from 6 percent of GDP in 2017.

Higher growth did not translate into job creation, unemployment rose in 2018 despite the reduction in labor force participation. In the third quarter of 2018, employment rate dropped by 0.3 pp yoy, mostly driven by a decline in employment in the manufacturing and construction sectors. Unemployment increased by 0.5 pp despite the 1.5 pp decline in labor force participation in the third quarter of 2018, compared to the same period last year. Youth unemployment increased by 1.7 pp y-o-y, in the same period.

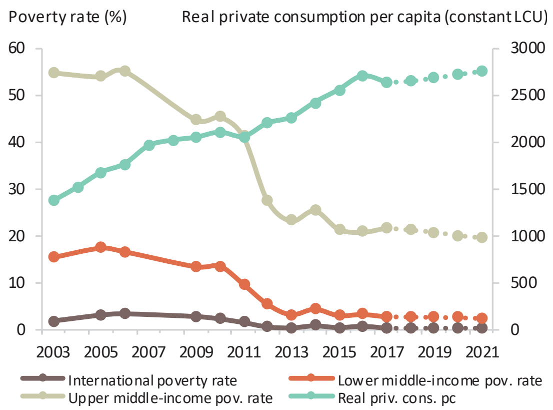
The poverty rate (measured at US$ 3.2/day, 2011 PPP) decreased slightly from

FIGURE 1 Kosovo / Real GDP growth and contributions to real GDP growth



Sources: Kosovo statistics agency and World Bank staff projections.

FIGURE 2 Kosovo / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

3.1 percent in 2016 to 2.67 percent in 2017, driven by welfare improvements in rural areas. Poverty in urban areas has been stagnant, and extreme poverty increased in urban areas. Poverty reduction in rural areas has been driven by rising labor earnings among those at the bottom of the income distribution, and pensions. Labor income has been the main driver of poverty reduction. Despite weak employment gains and persistently high unemployment, net job creation was concentrated among sectors that are characterized by low productivity/low wages, benefitting more those at the bottom of the income distribution. While growth has been pro-poor in rural areas, in urban areas the distribution of growth benefitted the rich. This explains rising inequality, particularly in urban areas.

Outlook

Kosovo's economic growth is projected at 4.5 percent in the medium-term, driven mainly by public investment, supported by services exports and consumption. Public investment will continue to be financed through privatization proceeds and IFI-financed infrastructure projects. Private investment is also expected to pick up because of the increase in credit from the partial credit guarantee fund for SMEs. CAD is expected to widen because of larger trade deficits driven by domestic demand for investment goods. Despite the projected increase in exports and domestic production, the increased demand for investment goods is expected to lead to a widening of the CAD. FDI inflows, including in the energy sector, and remittances are expected to continue to finance CAD.

Given the negative developments in labor market indicators and expected cost of living pressures due to rising food prices and upward trend in urban inequality, poverty, measured at the lower middle-income poverty line (U$ 3.2/day, 2011 PPP), is expected to remain stagnant.

Risks and challenges

The positive outlook is vulnerable due to political uncertainty, lower than projected IFI investment,. Moreover, the expansion of public investment as a driver of growth in 2019–2021 may suffer from capacity constraints.

Fiscal risks are on the rise. The recently approved law on public salaries, if not regulated through prudent secondary legislation to control employment and allowances, could pose risks for macro fiscal sustainability through higher fiscal deficits or lead to a deterioration in the composition of the public spending. As the law will only come into force at end 2019, the full impact will be felt in 2020. Higher wages in the public sector can also place a pressure on the private sector wages impacting export competitiveness of Kosovar exporters. There are additional fiscal risks that might arise from further increases in untargeted social protection spending. Even if the current fiscal deficit ceiling is respected, public and publicly guaranteed debt has the potential to exceed 30 percent of GDP by 2025, if recurrent spending growth continues to exceed revenue growth. This ratio could expand further if the fiscal risks materialize risking medium-term macro fiscal sustainability.

The slower pace of poverty reduction, high incidence and long duration of unemployment is a challenges. The level of unemployment is particularly worrisome among the young (54 percent) and those with no schooling (48.4 percent), groups that tend to be over overrepresented among the poor.

TABLE 2 Kosovo / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	4.1	4.2	4.2	4.4	4.5	4.5
Private Consumption	6.6	1.8	2.2	2.1	2.2	2.8
Government Consumption	-6.3	-0.6	1.6	5.2	0.6	0.0
Gross Fixed Capital Investment	7.3	5.5	14.9	14.0	11.4	10.9
Exports, Goods and Services	2.4	16.8	9.0	7.4	8.5	7.4
Imports, Goods and Services	6.4	5.4	8.0	7.0	5.6	6.0
Real GDP growth, at constant factor prices	2.4	5.6	4.0	4.4	4.5	4.5
Agriculture	3.1	3.7	3.0	3.1	3.2	3.2
Industry	1.6	6.5	0.4	3.5	3.9	3.9
Services	2.8	5.5	6.4	5.1	5.0	5.1
Inflation (Consumer Price Index)	0.3	1.5	1.1	2.6	1.9	1.8
Current Account Balance (% of GDP)	-7.9	-6.0	-8.7	-8.9	-10.3	-10.7
Net Foreign Direct Investment (% of GDP)	2.9	3.3	2.7	4.0	4.5	3.5
Fiscal Balance (% of GDP)	-1.4	-1.2	-2.7	-3.9	-3.6	-3.0
Debt (% of GDP)	14.0	15.5	16.9	18.5	20.0	21.0
Primary Balance (% of GDP)	-1.0	-0.9	-2.5	-3.5	-3.2	-2.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.

KYRGYZ REPUBLIC

Table 1	2018
Population, million	6.3
GDP, current US$ billion	8.0
GDP per capita, current US$	1277
International poverty rate ($1.9)[a]	1.5
Lower middle-income poverty rate ($3.2)[a]	19.6
Upper middle-income poverty rate ($5.5)[a]	66.4
Gini index[a]	27.3
School enrollment, primary (% gross)[b]	106.4
Life expectancy at birth, years[b]	71.0

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2017), 2011 PPPs.
(b) Most recent WDI value (2016).

Real GDP growth slowed in 2018 reflecting a deceleration in most economic sectors. On the demand side, growth was driven by private consumption fueled by remittances and supported by monetary easing. Growth is projected to accelerate in 2019 before stabilizing in 2020–21 in line with gold output projections. Risks to the outlook include a slowdown in regional growth, fluctuations in global commodity prices, and failure to implement fiscal consolidation measures.

Recent developments

Real GDP growth slowed to 3.5 percent in 2018 (from 4.7 percent in 2017). Excluding gold production, output growth slowed to 3.5 percent from 5.1 percent a year earlier. On the demand side, growth was supported by consumption (fueled by remittance inflows and a relatively relaxed monetary policy) and investment, with a negative contribution from net exports. On the supply side, while slowing (only agriculture grew at a faster rate than in 2017), a positive expansion was recorded in all sectors.

Following an improvement in 2017, the external position deteriorated in the first nine months of 2018. The current account deficit widened to 12.2 percent of GDP (from 6.6 percent a year earlier), reflecting a larger trade deficit (which rose to 40.9 percent of GDP in January-September). The current account deficit was financed by foreign direct investment (FDI), a debt write-off of $240 million by the Russian Federation, and a drawdown on foreign exchange reserves.

The fiscal accounts strengthened significantly in 2018. Strong tax collections, coupled with the underperformance of capital investment, reduced the deficit to 1.6 percent of GDP in 2018 (from 4.6 percent in 2017). Tax revenue rose to 25.4 percent of GDP in 2018 from 23.9 percent in 2017, driven mainly by higher collections of import taxes. However, non-tax revenue and grant support declined and, as a result, total revenues fell to 31.8 percent of GDP (from 32.6 percent in 2017). Total spending was reduced to 33.4 percent of GDP (from 37.2 percent a year earlier) due to under-execution of the investment program. Excluding on-lending, the fiscal deficit fell to 1 percent of GDP, a decline from the 3.1 percent of GDP deficit recorded in 2017.

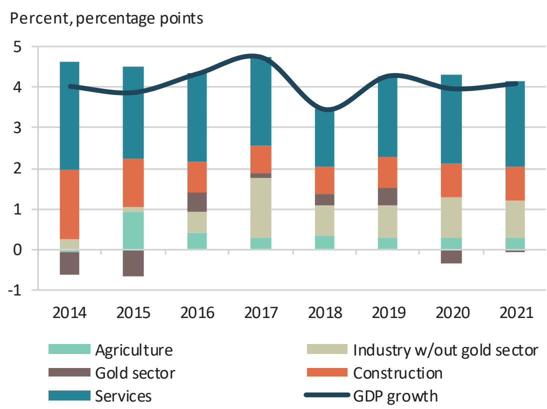
Annual inflation eased markedly in 2018, falling to 0.5 percent by end-2018 from 3.7 percent at end-2017. Food prices dropped by 2.6 percentage points as food supply exceeded demand. A broadly stable exchange rate also helped to contain inflationary pressures.

With inflation well below the target range of 5-7 percent, monetary policy was loosened slightly in 2018. The National Bank cut its policy interest rate by 25 basis points to 4.75 percent in May 2018. The som experienced some fluctuations against the U.S. dollar in 2018, mainly owing to seasonal factors. The National Bank intervened in the foreign exchange market both as a buyer and seller with net sales of $134 million during the year. Gross international reserves declined by 3.2 percent in 2018 but remained adequate at four months of goods and services import cover.

Banking sector performance remains robust with the key indicators well above the required levels. However, the sector is vulnerable to interest rate and concentration risks.

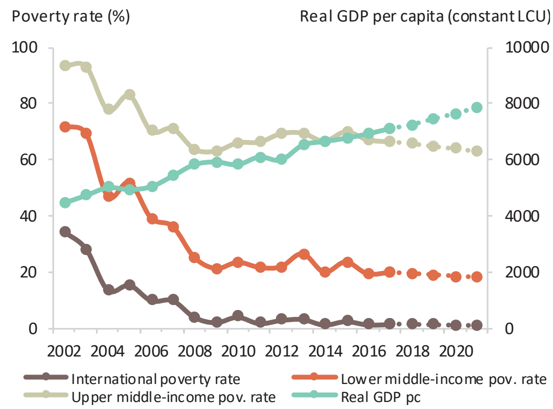
The poverty rate (measured at $3.20 per day, in 2011 PPP terms) was estimated at 19.3 percent in 2018. Higher remittance inflows supported household consumption while falling food prices supported

FIGURE 1 Kyrgyz Republic / Real GDP growth and contributions to real GDP growth



Sources: Kyrgyz authorities; World Bank staff calculations.

FIGURE 2 Kyrgyz Republic / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

the purchasing power of poor households. Moderate growth in construction and agriculture—sectors that employ more than one-half of the of the bottom 40 percent —constrained an increase in real labor incomes and the number of jobs for the poor.

Outlook

Real GDP growth is projected to accelerate to 4.3 percent in 2019 and stabilize at around 4 percent thereafter. This scenario reflects the gold production forecast and assumes moderate economic growth in Kazakhstan and Russia, which will benefit the Kyrgyz economy through the traditional channels of remittances and trade. Export earnings are expected to provide an additional boost to growth as access to the Eurasian Economic Union market expands.

Average annual consumption growth is projected at around 3 percent in 2019–21, mainly reflecting rising remittance inflows. Investment is expected to grow at about 12 percent per year.

More buoyant economic activity will stoke inflationary pressures in 2019. However, assuming exchange rate stability and no significant adverse shocks to global food prices, inflation will remain below the central bank's target range over the medium term.

The current account deficit is projected to remain elevated at about 10 percent of GDP, reflecting structural constraints, the significant import content of public investment, and an indirect feed-through effect via imports. Borrowing and FDI will finance the deficit.

To rebuild fiscal buffers, the authorities are committed to reducing the deficit to 3 percent of GDP by 2020 and maintaining it below this level thereafter in line with the fiscal rule. In 2019–21, tax revenues as a share of GDP are projected to rise on account of the government's commitment to implement policy measures to expand the tax base and reduce tax exemptions. Meanwhile, recurrent expenditures are forecast to decline following efforts to streamline non-priority purchases and reduce the wage bill as a share of GDP. Public investment spending is forecast to decelerate slightly.

Further increases in remittances, together with modest growth in the agriculture and construction sectors, will support household consumption and rural poverty reduction. Social transfers and pensions (which contribute 16.3 percent of income among the poor) will continue to support poor households. The poverty rate is projected to decline slightly to 18.8 percent in 2019 and 17.9 percent by 2021.

Risks and challenges

The Kyrgyz Republic's economic performance will remain vulnerable to developments in its major regional trading partners. Specifically, an unexpected slowdown in Russia or Kazakhstan could negatively impact the baseline scenario through decreased remittances and trade. A continuous real appreciation of the som against trading partner currencies would undermine the competitiveness of Kyrgyz goods and services. Export earnings could fall considerably in the event of a slowdown in gold output or a decline in gold prices. The inability to successfully implement the fiscal consolidation plan could jeopardize macroeconomic stability and sustainability.

A central challenge for Kyrgyz producers will continue to be meeting EEU standards. In addition, improving the business environment and addressing issues related to energy pricing will be critical to boost exports and support overall growth in the medium term.

TABLE 2 Kyrgyz Republic / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	4.3	4.7	3.5	4.3	4.0	4.1
Private Consumption	-0.6	6.3	3.2	3.4	3.3	3.4
Government Consumption	1.5	1.3	-0.9	-1.2	2.1	2.0
Gross Fixed Capital Investment	7.8	9.2	2.1	16.8	9.7	10.8
Exports, Goods and Services	-3.8	6.1	4.8	5.6	6.4	7.0
Imports, Goods and Services	-1.1	7.4	8.5	11.5	8.1	9.3
Real GDP growth, at constant factor prices	4.3	4.7	3.5	4.3	4.0	4.1
Agriculture	2.9	2.2	2.7	2.5	2.5	2.5
Industry	7.1	8.6	6.2	7.2	5.3	6.0
Services	4.5	5.3	3.1	4.5	4.6	4.6
Inflation (Consumer Price Index)	0.4	3.2	1.5	4.1	4.5	5.0
Current Account Balance (% of GDP)	-11.6	-6.4	-10.9	-9.7	-10.3	-9.4
Net Foreign Direct Investment (% of GDP)	8.5	-1.0	5.7	5.6	5.8	5.7
Fiscal Balance (% of GDP)	-6.3	-4.6	-1.6	-3.7	-3.0	-3.0
Debt (% of GDP)	59.1	58.8	56.0	56.5	56.6	56.5
Primary Balance (% of GDP)	-4.5	-2.8	-0.4	-2.6	-1.7	-1.3
International poverty rate ($1.9 in 2011 PPP)[a,b]	1.4	1.5	1.4	1.2	1.1	1.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	19.1	19.6	19.3	18.8	18.4	17.9
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	67.2	66.4	65.8	64.9	64.1	63.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2011-KIHS and 2017-KIHS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021
(b) Projection using average elasticity (2011-2017) with pass-through = 0.7 based on GDP per capita in constant LCU.

MOLDOVA

Table 1	2018
Population, million	3.5
GDP, current US$ billion	114
GDP per capita, current US$	3226
Lower middle-income poverty rate ($3.2)[a]	11
Upper middle-income poverty rate ($5.5)[a]	16.3
Gini index[a]	25.9
School enrollment, primary (% gross)[b]	918
Life expectancy at birth, years[b]	716

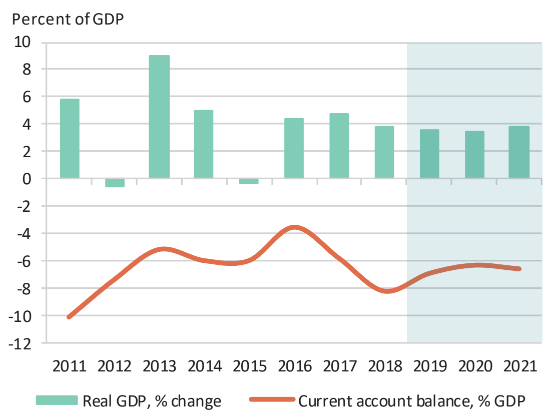
Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2017), 2011 PPPs.
(b) Most recent WDI value (2016).

Real GDP growth is expected to increase by 3.8 percent in 2018 compared to the 4.6 percent average growth in the last decade. The pace of growth will remain subdued in the coming years in the face of weaker foreign and domestic demand. Adverse demographic trends, low productivity and vulnerability to external shocks constitute the main challenges to long-term growth. US$5.5/day poverty, roughly constant at 16.3 percent during 2015-2017, is projected to decrease slowly over the forecast period.

Recent developments

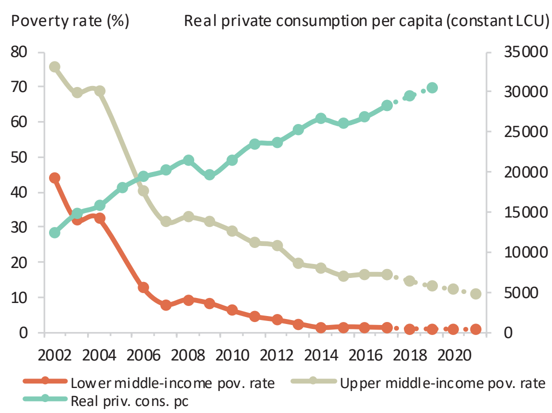
Against the background of strengthening fundamentals and financial situation, in 2018, growth remained solid. Real GDP increased by 4.0 percent during the first three quarters in 2018, compared to 4.5 percent in 2016 and 4.7 percent in 2017. Tax cuts, strong wage increases, and remittances supported real growth of disposable income, resulting in a 2.7 percentage points contribution of private consumption to growth. On the back of lower inflation, favorable interest rates underpinned investment growth, resulting in a 4-percentage points contribution from capital formation. With strong domestic demand and stronger Leu, imports expanded quicker (+8.9 percent), resulting in a negative contribution to growth (-2.6 percentage points) from net exports. On the production side, favorable financial conditions and government programs in the sector, expanded the construction sector adding 1.2 percentage points to growth. The growth in disposable income supported the wholesale and retail trade, which combined with industry added another 2 percentage points to growth. After two years of good yields, the agricultural sector subtracted 0.3 percentage points.
Consumer inflation has been below the lower target of the corridor of 5 percent (+/- 1.5 percent) since April 2018. A high base effect, lower administrative prices, relatively weaker demand, agricultural supply and lower imported inflation contributed to the observed decline. In addition, excess liquidity resulting from low financial intermediation persists in the system. As a response, authorities maintained the reserve requirement to a record high of 40 percent, while keeping the base rate at 6.5 percent since end-2017. The Leu strengthened against USD during 2018, supported by remittances and export growth.
Due to robust imports, in the first three quarters the current account deficit increased to 10.3 percent of GDP, from 8.3 percent in 2017. With FDI inflows accounting for only 2.1 percent of GDP, external debt remained the main source of current account deficit financing. Against this background, by end-February 2019 foreign reserves amounted to 2.9 billion, after reaching a record high of 3.05 billion USD in November 2018, still covering more than 5 months of imports.
Despite recovery in growth, labor markets improved slowly, with key indicators largely stable during 2016-2017, and improving throughout 2018, with falling unemployment rate, and increasing activity and employment rates. Real wages increased by almost 10 percent y/y in Q4 of 2018, benefiting from lower inflation that protected purchasing power. Consistent with these developments, the PPP US$5.5/day poverty rate remained roughly constant during 2015-2017, as the effects of the recession lingered, although a downward poverty trend is projected to have resumed in 2018. Overall inequality continues to decline, but spatial disparities remain and poverty is overwhelmingly rural (80 percent of total poor population).
Despite of Parliamentary elections, fiscal position remained solid. Since mid-2017, public revenue growth has been strong as growth expanded. On back of buoyant trade and economic activity, total revenues increased by 8.6 percent, while expenditures

FIGURE 1 Moldova / Actual and projected real GDP growth and current account balance



Source: World Bank.

FIGURE 2 Moldova / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

increased by 9.3 percent. The fiscal deficit totaled 0.8 percent of GDP, considerably lower than the planned levels (-2.5 percent of GDP). As some capital expenditure were shifted closer to the 2019 parliament elections, the execution of the capital spending was 27 percent lower than the planned levels. Mainly due to stronger revenues, the public and publicly guaranteed debt decreased to 27 percent from 29.2 percent of GDP in 2017.

Outlook

Against the background of lower remittances, the projected weaker foreign and domestic demand, will decelerate economic growth below historical values. Initially, the expansionary fiscal policy measures adopted in 2018—tax cuts, increase in wages and public transfers—and lower interest rates will underpin growth. As fiscal stimuli fade away after elections, consumer and business confidence, together with the normalization of financial conditions, will continue to support private consumption and investment, resulting in an average growth of around 3.7 percent in the medium term. On the supply side, industry and non-tradable sectors will be the most dynamic, while contribution from agriculture is expected to be marginal provided favorable climatic conditions. Albeit relatively robust exports mainly due to expansion of activities in free economic zones, given slower projected economic activity, the current account balance is projected to decrease till 2020. With the reignition of economic activity it will increase thereafter, however still remaining below historical values. The expansionary fiscal policy introduced before the elections combined with more dynamic agricultural and regulated prices, will build up inflationary pressures pushing the inflation out of the corridor in the second half of 2019. Nonetheless, in medium term, the monetary stance is projected to remain adequate and consumer inflation is envisaged to variate in the target corridor.

Poverty is projected to decline, on account of improving economic and labor market conditions, but at a slower pace than in the past, on account of slower projected private consumption growth. Compared to the most recent survey estimate of 16.3 percent in 2017, the US$ 5.5/day poverty is projected to decline to 11 percent by 2021.

Risks and challenges

Moldova remains highly vulnerable to external shocks. Additionally, political uncertainty and vested interests undermine the reform agenda and the investment process. Extreme weather may affect agricultural output, impacting overall growth and poverty. The large share of the state in the economy, coupled with weak institutions and governance challenges, including in the financial sector, may pose additional risks. In the medium term, the fiscal position may deteriorate due to inefficient public spending, declining economic activity and increasing burden from the wage and social transfers bills. Deficit financing also constitutes a risk as it heavily relies on external financial sources, which may not materialize in the post-election period. With higher projected inflation, the government may find it costlier to finance the planned spending on the local market, with the risk of crowding-out the credit activity. Long-term challenges to economic growth include population ageing, large net migration, and the unsustainable growth model, characterized by remittances-driven consumption and low levels of productivity. Despite past poverty reduction, there is little visible convergence in recent years between bottom 40 and top 60 groups on some key dimensions such as educational attainment, or access to key services.

TABLE 2 Moldova / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	4.4	4.7	3.8	3.6	3.5	3.8
Private Consumption	2.9	5.3	3.6	3.2	3.1	3.7
Government Consumption	0.8	1.5	0.1	0.9	-0.1	0.3
Gross Fixed Capital Investment	-0.9	8.0	10.7	9.8	6.8	8.1
Exports, Goods and Services	9.8	10.9	7.5	5.5	6.3	7.5
Imports, Goods and Services	2.8	11.0	8.3	5.8	5.2	6.7
Real GDP growth, at constant factor prices	4.5	4.2	4.1	3.6	3.5	4.0
Agriculture	18.1	8.9	0.2	1.2	1.4	2.4
Industry	0.4	3.9	5.1	4.5	4.1	5.3
Services	3.7	3.4	4.5	3.8	3.6	3.8
Inflation (Consumer Price Index)	6.4	6.6	3.8	4.7	4.5	5.0
Current Account Balance (% of GDP)	-3.5	-5.8	-8.2	-6.9	-6.3	-6.6
Net Foreign Direct Investment (% of GDP)	1.0	1.5	1.8	1.7	1.6	1.4
Fiscal Balance (% of GDP)	-1.6	-0.6	-0.8	-2.7	-2.2	-2.0
Debt (% of GDP)	36.9	32.7	30.0	30.3	31.0	29.9
Primary Balance (% of GDP)	-0.4	0.5	0.0	-1.7	-1.2	-1.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	1.3	1.1	0.9	0.7	0.7	0.5
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	16.4	16.3	14.7	13.2	12.3	11.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2017-HBS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021
(b) Projection using neutral distribution (2017) with pass-through = 0.7 based on private consumption per capita in constant LCU.

MONTENEGRO

Table 1	2018
Population, million	0.6
GDP, current US$ billion	5.2
GDP per capita, current US$	8365
Upper middle-income poverty rate ($5.5)[a]	4.8
Gini index[a]	319
School enrollment, primary (% gross)[b]	96.0
Life expectancy at birth, years[b]	77.1

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2014), 2011 PPPs.
(b) Most recent WDI value (2016)

Strong investment activity, another record-high tourism season, and increased industrial production drove GDP growth to an estimated 4.4 percent in 2018. Solid growth is reflected in improved labor market dynamics as the unemployment rate reached a historic low. Poverty is estimated to have declined since 2012. External imbalances remain high due to import-dependent investments. Gradual fiscal consolidation led to a reduced fiscal deficit, but higher than planned expenditures delayed reaching a balanced budget until next year.

Recent developments

Montenegro's economic growth remains robust. In the first three quarters of 2018, the economy expanded by 4.9 percent, bringing the estimated annual GDP growth to 4.4 percent. Both private and public investments accelerated, and the tourism season recorded another strong year. Investment grew by an estimated 15 percent in 2018 led by investments in tourism and energy and supported by the motorway construction. Private consumption grew by an estimated 3 percent, supported by solid employment and credit growth. Given the high import-dependence of the investment projects, net exports were negative. On the production side, industrial production growth was led by energy production, supporting stronger electricity exports. By year-end, manufacturing strengthened, while the mining sector contracted. Construction growth of 25 percent and retail trade growth of 3.4 percent supported strong economic activity.

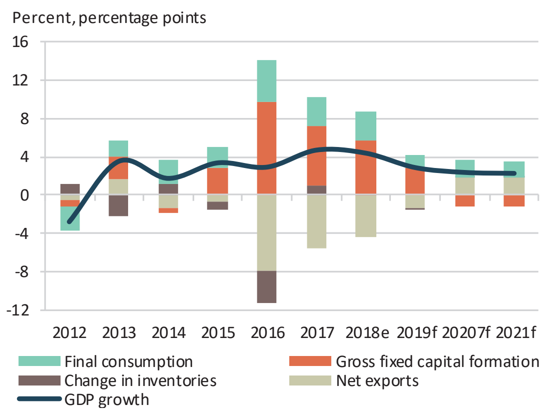
The strong economic performance is reflected in recent labor market dynamics. Employment grew by 4.3 percent in 2018, mostly in construction, tourism, services, and the public sector. The administrative employment data show that the total number of unemployed declined by 13.7 percent in 2018, resulting in a registered unemployment rate of 17.8 percent in December 2018 from 22.4 percent in December 2017. The survey-based unemployment rate, which better captures informal employment, declined to a historic low of 15.2 percent. At the same time, the survey-based participation and employment rates reached their record highs of 56 percent and 47.5 percent, respectively. Due to strong economic activity, the youth employment rate went up in 2018.

The external deficit further widened in 2018 to an estimated 17.1 percent of GDP. Solid growth of exports of goods and services was led by rising tourism, transport, electricity, and chemical products. Export growth, however, was outpaced by real import growth, largely driven by import-dependent investments. Specifically, the imports of machinery and equipment, oil, steel, iron, minerals, and furniture further increased in 2018. The primary income account surplus declined due to higher dividend and interest payments. In 2018, net FDI inflows declined to 7.1 percent of GDP, because of repayment of intercompany debt and government repurchases of shares of the power utility company. External debt is estimated at 168 percent of GDP in 2018.

In 2018, average annual CPI inflation stood at 2.6 percent, driven by increased prices of transport, alcohol, and tobacco With nominal wages flat, inflation caused real gross wages to decline by more than 2 percent.

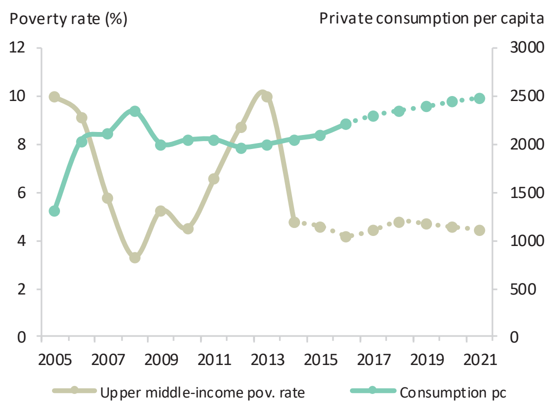
Solid growth and labor market improvements reduced poverty (measured as consumption below the standardized middle-income-country poverty line of $5.5/day 2011PPP) from 8.7 percent in 2012 to an estimated 4.8 percent in 2018. In 2018, poverty reduction slowed down due to the mother's benefit withdrawal, real gross wages decline, and the rise in indirect taxes.

FIGURE 1 Montenegro / Real GDP growth and contributions to real GDP growth



Sources: MONSTAT, World Bank.

FIGURE 2 Montenegro / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

The financial sector has remained stable during the ongoing resolution of two smaller, non-systemic banks, one of which is in bankruptcy. But a rapid resolution focusing on the overall strength of the sector in observance of regulations is critical to maintain financial sector stability. The financial sector capital adequacy ratio of 16.5 percent as of October 2018 is above the 10 percent regulatory minimum. Overall credit grew by 8.5 percent y-o-y by December 2018, driven by household and general government lending. The loan-to-deposit ratio of 85 percent indicates plenty of liquidity in the system. Deposits grew by 5.9 percent y-o-y with both corporate and households deposits up. A recovery in credit growth helped to reduce non-performing loans to 6.9 percent of total loans.

The gradual fiscal consolidation program has reduced the fiscal deficit, but higher-than-planned public spending is delaying the Fiscal Strategy goal of balancing the budget. After reaching 5.6 percent in 2017, the fiscal deficit is estimated to have fallen to 3.8 percent of GDP in 2018. Revenue growth of 10.1 percent was supported by higher VAT, income tax, and non-tax revenues. Public spending went up by 5.5 percent due to higher capital spending and spending on wages and good and services. Public debt is projected to have peaked at 70.8 percent of GDP, and public and publicly guaranteed debt at 75.4 percent in 2018.

Outlook

The economy is expected to grow by an average of 2.5 percent in 2019-21. GDP growth is expected to slow down as private investment levels off after the strong increase in 2018 and the large public infrastructure investment projects gradually phase out. After a moderation in 2019, due to the fiscal consolidation and the implementation of the public administration staff reduction plan, private consumption and employment growth are expected to rebound in 2020. Increasing political and overall uncertainty will likely weigh on private consumption and investments.

Inflation is projected at 1.9 percent over the medium term due to increasing excises and the announced electricity prices increase.

Current imbalances are expected to slowly moderate as investment-dependent infrastructure projects phase out.

Due to higher capital expenditures, the fiscal deficit will reach 3.0 percent in 2019 but is projected to turn into a surplus in 2020-2021 as the first phase of the motorway construction is completed.

The still large financing needs, which are estimated to average EUR 460 million over 2019-2021, again highlight the importance to fully commit to the implementation of planned fiscal consolidation.

Subject to improvements in private sector employment and earnings, poverty is expected to decline to an estimated 4.7 percent in 2019 as the fiscal consolidation phases out.

Risks and challenges

Notwithstanding the positive outlook, there are significant downside risks. Apart from external factors, domestic risks are increasing due to increasing political uncertainty ahead of the elections in 2020, further cost overruns of the motorway project, and the vulnerability of some smaller banks. Mitigating these risks requires a firm commitment to the fiscal consolidation plan and an acceleration in implementing critical structural reforms in the labor market, social sectors, and the public administration. And it requires strengthening public institutions that enforce fair market competition to ensure that nobody benefits from special treatment and entrepreneurs are encouraged to compete by innovating.

TABLE 2 Montenegro / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	2.9	4.7	4.4	2.9	2.4	2.3
Private Consumption	5.4	3.9	3.0	2.1	2.4	2.0
Government Consumption	0.8	-1.4	2.9	-1.2	-0.3	-0.3
Gross Fixed Capital Investment	38.4	18.7	15.0	6.5	-2.8	-2.8
Exports, Goods and Services	5.9	1.8	6.6	3.7	4.6	4.8
Imports, Goods and Services	15.3	8.4	9.0	3.5	0.1	0.1
Real GDP growth, at constant factor prices	2.9	4.7	4.4	2.9	2.4	2.3
Agriculture	3.9	-3.1	0.0	0.1	0.5	1.0
Industry	22.7	18.9	5.0	3.4	2.9	2.5
Services	-22.9	-21.4	4.7	2.8	1.7	2.4
Inflation (Consumer Price Index)	-0.3	2.4	2.6	2.0	1.9	1.9
Current Account Balance (% of GDP)	-16.2	-16.1	-17.1	-17.1	-14.9	-11.4
Net Foreign Direct Investment (% of GDP)	9.4	11.3	7.1	8.7	8.4	7.9
Fiscal Balance (% of GDP)	-2.8	-5.6	-3.8	-3.0	0.2	2.2
Debt (% of GDP)	64.4	64.2	70.8	67.2	64.3	60.2
Primary Balance (% of GDP)	-0.7	-3.2	-1.8	-0.9	2.0	3.9
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	4.2	4.4	4.8	4.7	4.6	4.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2009-HBS and 2014-HBS. Actual data: 2014. Nowcast: 2015-2018. Forecast are from 2019 to 2021.
(b) Projection using point-to-point elasticity (2009-2014) with pass-through = 0.4 based on private consumption per capita in constant LCU, with estimated impact of fiscal conso

NORTH MACEDONIA

Table 1	2018
Population, million	2.1
GDP, current US$ billion	12.7
GDP per capita, current US$	6100
International poverty rate ($1.9)[a]	5.3
Lower middle-income poverty rate ($3.2)[a]	9.8
Upper middle-income poverty rate ($5.5)[a]	23.2
Gini index[a]	35.6
Life expectancy at birth, years[b]	75.7

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2016), 2011 PPPs.
(b) Most recent WDI value (2016)

Economic growth rebounded to 2.7 percent in 2018, driven by consumption and net exports, while investment started recovering. Unemployment fell to a historical low, while wage pressure continues. Poverty decreased further, following the trend set in 2009. The fiscal deficit declined in 2018 amid revenue growth and a significant under-execution of capital spending. Nevertheless, public debt increased further. As the political outlook improved, the emphasis should be on economic reforms to reignite EU convergence process and stabilize public finances.

Recent developments

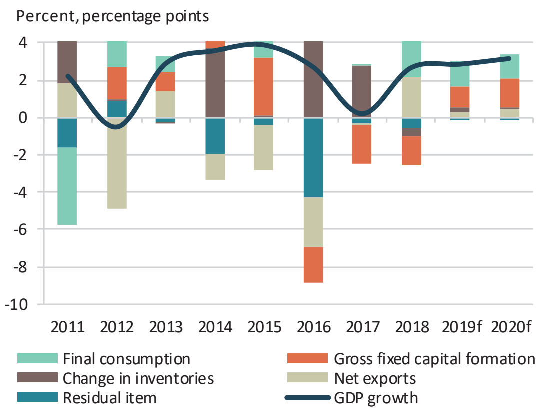
In 2018 the economy grew by 2.7 percent. Supported by consumption and net exports, economic activity picked up in 2018 after stagnating in 2017. Private consumption was the main driver of growth, contributing 2.4 percentage points (pp) because of rises in employment, wages, and lending to households. Net exports, mainly FDI-related, contributed 1.7 pp. The remaining 0.8 pp came from government consumption as investments reduced growth by 2.2 pp. On the production side, wholesale and retail trade and information and transportation services were the main drivers of growth, contributing 2.3 pp. The manufacturing contribution of 0.6 pp was driven by higher production of busses, electric machinery, food and beverages, pharmaceuticals, and basic and fabricated metal products. Construction rebounded from October thanks to higher public investment and a continued recovery of private investment.

Labor market continued improving in 2018. The employment rate increased by one percentage point to 45.1 percent, while the activity rate increased only slightly to 56.9 percent. The employment expansion was broad-based, with significant gains for young men and prime-age women. Unemployment rate declined to 20.7 percent in 2018, compared to 22.7 percent a year earlier. Most of the new jobs were created in manufacturing, wholesale and retail trade, and industries closely related to tourism. Led by agriculture, manufacturing, trade and public-sector, wage growth was 5.8 percent in 2018, compared to 2.6 percent in 2017. Using the US$5.5/day (2011 PPP) poverty line, poverty is projected to have fallen to below 21 percent in 2018, continuing a decreasing trend present since 2009. Employment growth and increases in salaries, partly led by the minimum wage increase, are expected to have driven most of the poverty reduction in recent years. The additional income-generation opportunities at the bottom of the income distribution also contributed to a decline in inequality, with the Gini index falling from 43 in 2009 to 35.6 in 2015.

Consumer price inflation remained moderate in 2018, at 1.5 percent, led by rise in transport prices (up by 7.5 percent) and non-tradables. Annual growth of broad money accelerated further to 11.8 percent, reflecting accommodative monetary policy stance and rise in deposits. In December, the central bank reduced further the key policy rate by 25bp to a historically low 2.5 percent. Loans and deposits growth accelerated. The bulk of the overall credit increase of 7.3 percent, continued to be accounted for by households (growth of 10 percent). The banking sector remained stable and well capitalized--the NPL ratio stood at 5.1 percent at end-2018 and capital to risk-weighted assets stood at 16.3 percent.

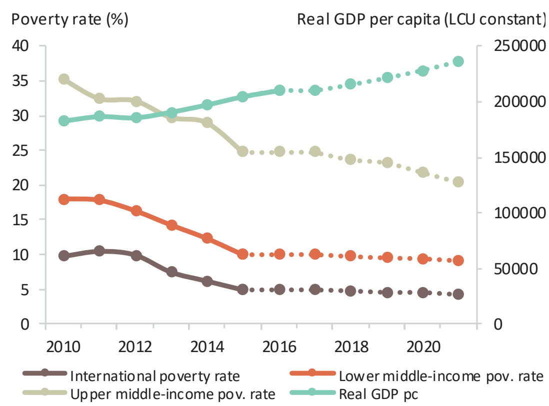
Revenue growth and under-execution of capital investments brought the fiscal deficit down in 2018. General government revenues rose 4.2 percent, tracking rises in social contributions, excises, and corporate and personal income tax revenues. Net VAT revenues also increased, despite

FIGURE 1 North Macedonia / Real GDP growth and contributions to real GDP growth



Source: North Macedonian Statistical Office.

FIGURE 2 North Macedonia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

a surge in refunds to clear arrears to businesses. Spending went up only 1.1 percent because the historically largest drop in capital spending made up for higher current spending by 6.3 percent caused by a surge in social transfers and higher subsidies to firms. The general government deficit declined from 2.8 percent in 2017 to 1.8 percent (adding in the Public Enterprise for State Roads raises the deficit to an estimated 2.3 percent of GDP).

The current account deficit (CAD) declined to 0.3 percent of GDP in 2018, compared to 1 percent in 2017. The continued solid export performance of FDI-related industries like automobiles and electrical machinery was supplemented by growth of exports in such traditional products as iron and steel, furniture, and apparel. This helped to bring down the goods trade deficit to 16.2 percent of GDP. Net services exports surplus remained solid at 3.3 percent of GDP, driven by transport and services for processing manufactured goods. Net private transfer inflows continued increasing and were more than sufficient to cover the entire goods and services deficit. Net FDI inflows surged to 5.8 percent of GDP in 2018, due to significant investments coming from UK. Gross external debt, excluding central bank transactions, increased by September to 77.6 percent of GDP (up 3.4 pp y-o-y), reflecting the January 2018 issuance of Eurobonds.

Outlook

The economic outlook is positive, with growth expected at average 3.1 percent during 2019-2020. Construction activity spurred by investments is expected to recover, as technical difficulties that interrupted the construction of one of the highways are resolved. The manufacturing sector should benefit from the renewed FDIs cycle, propelled by higher exports, and still stable demand along the supply chain to Germany. Private consumption is projected to rise supported by higher wages, employment, and rising credit to households.

Poverty is expected to continue trending downwards. Real wage growth and continuous improvement in labor markets, especially with expansions of employment in construction, manufacturing and the tourism-related industries, will provide more income earning opportunities at the bottom of the distribution, where unemployment is still high. Public investment in infrastructure should sustain employment creation. The social assistance reform currently under implementation should reduce poverty, as the reorientation of benefits envisioned should favor poorer households.

Risks and challenges

Lower growth prospects in Europe could affect exports and thus growth in North Macedonia. The successful resolution of agreement with Greece on the country's name dispute and deblocking of the EU membership processes provide a stimulus for growth and reforms. Strengthening public spending efficiency and broadening the tax base would help stabilize public debt and rebuild fiscal buffers against future shocks. In the baseline scenario of gradual consolidation, the PPG debt-to-GDP ratio is expected to rise to 55 percent by 2021, to decline thereafter, which underscores the need for strong and frontloaded structural reforms to stabilize debt in the medium term. Increasing overall levels of productivity in the economy remains one of the most important challenges for local firms to be able to compete globally and sustain increases in salaries. As poverty continues declining, tailored policies will be needed to support human capital accumulation and job preparedness for specific groups where poverty could remain entrenched.

TABLE 2 North Macedonia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	2.8	0.2	2.7	2.9	3.2	3.6
Private Consumption	3.9	0.6	3.3	2.4	2.1	2.3
Government Consumption	-4.9	-2.5	6.2	1.0	0.8	0.5
Gross Fixed Capital Investment	-6.2	-8.7	-7.2	5.0	6.0	6.5
Exports, Goods and Services	9.1	8.1	15.3	7.5	8.1	8.2
Imports, Goods and Services	11.1	6.4	9.1	5.8	6.1	6.1
Real GDP growth, at constant factor prices	2.0	0.1	2.8	2.9	3.2	3.6
Agriculture	-0.4	-13.5	-5.0	1.8	1.5	1.5
Industry	-2.9	-1.0	2.2	5.5	5.9	6.4
Services	4.5	2.3	3.9	2.0	2.3	2.6
Inflation (Consumer Price Index)	-0.2	1.3	1.5	1.8	1.9	2.2
Current Account Balance (% of GDP)	-2.9	-0.8	-0.3	-1.7	-2.1	-1.8
Net Foreign Direct Investment (% of GDP)	3.3	1.8	5.8	4.4	4.6	4.8
Fiscal Balance (% of GDP)	-3.8	-3.5	-2.3	-3.5	-2.9	-2.5
Debt (% of GDP)	48.7	47.7	48.4	53.4	54.4	55.0
Primary Balance (% of GDP)	-2.6	-2.1	-1.1	-2.1	-1.5	-1.1
International poverty rate ($1.9 in 2011 PPP)[a,b]	4.9	4.9	4.8	4.5	4.5	4.2
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	10.0	10.0	9.7	9.5	9.4	9.0
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	24.8	24.7	23.7	23.2	21.8	20.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2015-SILC-C. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2015) with pass-through = 0.87 based on GDP per capita in constant LCU.

POLAND

Table 1	2018
Population, million	37.9
GDP, current US$ billion	580.6
GDP per capita, current US$	15310
International poverty rate ($1.9)[a]	0.4
Lower middle-income poverty rate ($3.2)[a]	0.8
Upper middle-income poverty rate ($5.5)[a]	2.6
Gini index[a]	31.8
School enrollment, primary (% gross)[b]	110.1
Life expectancy at birth, years[b]	77.5

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2015)

Poland's economy continued to perform strongly in 2018. Real GDP growth is estimated to reach 5.1 percent in 2018, driven by domestic consumption and higher investments. The pace of growth is expected to subside in the coming years in the face of a tightening labor market and slowing growth in the rest of the EU. Labor shortages, procyclical government policies and global factors are the main challenges to sustained growth in the medium term.

Recent developments

Poland's GDP grew by 5.1 percent in 2018, driven primarily by slightly decelerating domestic consumption (4.3 percent growth in 2018 compared to 4.5 percent in 2017) and stronger investments (7.3 percent growth). Private consumption grew by 4.5 percent, fueled by a strong labor market, increased average salaries (by 7.1 percent) and social programs such as "Family 500+". Despite the lower FDI inflow (net FDI increased due to falling outward FDI), investments continued to recover (7.3 percent increase in 2018) after a major decline in 2016 caused by a cyclical fall in EU-funded projects. Increased government investments strongly influenced by local elections held in Autumn and higher absorption of EU funding have contributed to the rebound of total investments. On the production side, industry (up by 5.5 percent), transportation (9.2 percent increase), and construction (up by 17 percent) were the key drivers of growth.

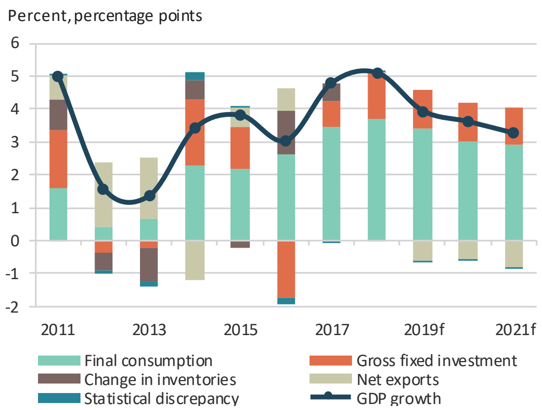
Despite growing public expenditures, the general government deficit for 2018 is estimated to amount to 0.5 percent of GDP, safely below the 3 percent EU threshold. Poland's debt-to-GDP ratio is set to decrease to approximately 49.2 percent, as budget revenues exceeded budget projections. Despite increased energy prices and strong consumption, consumer prices rose by a modest 1.6 percent in 2018, due to low core inflation of 0.7 percent.

Strong domestic demand caused imports to grow by 6.3 percent in the first three quarters of 2018. As Poland's key trade partners experience economic slowdown, growth of exports almost halved to 5.3 percent compared to 9.1 percent growth in the first three quarters of 2017, resulting in neutral net exports. The current-account balance returned to a deficit in 2018 as robust household consumption, higher investments, and depreciated Polish currency pushed up the volume and cost of imports.

The labor market has further tightened despite rising employment rates, partly due to lowering the retirement age while introducing a child benefit that contributed to workers withdrawing from the labor market during a period of growing demand. Labor shortages have started to affect business activity, as the job vacancy ratio increased in quarter three of 2018 by 0.1 pp to 1.2 percent compared to the previous year.

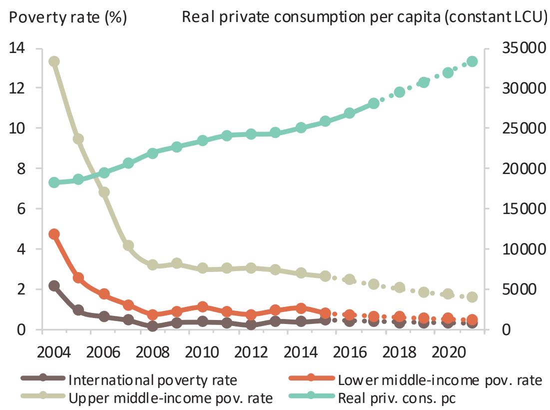
With strong growth, a tight labor market and higher social spending, the poverty rate using the Upper Middle-Income Class line of $5.50 per day (2011 PPP) is estimated to decline from 2.7 percent in 2015 to 2.0 percent in 2018. The Gini coefficient of inequality has progressively declined since 2004, reflecting strong income growth for bottom 40 households as a result of employment and wage growth and an increase in the progressivity of the tax and benefit system following the introduction of Family 500+.

FIGURE 1 Poland / Real GDP growth and contributions to real GDP growth



Source: World Bank.

FIGURE 2 Poland / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

Outlook

After three consecutive years of accelerating growth, the pace of Poland's economic expansion is expected to decline. Amid the economic slowdown in the EU, Poland's GDP growth may reach 4.0 percent in 2019, driven by both private and government consumption, as well as investments. The previous projection of 2019 real GDP growth has been revised upward by 0.1 pp due to persistently strong domestic consumption and expanding investments. Household consumption expenditures are set to continue growing, fueled by government spending on social benefits and labor market conditions. However, as the positive effects of the Family 500+ program fade and are not fully compensated for by increased salaries, the contribution of private consumption to GDP is expected to fall in coming years. A stable banking sector, low interest rates and availability of EU funds are expected to support private investments and offset an anticipated post-election decline in growth of local government investments. A trade deficit is predicted to emerge on the back of a slowing German economy, which accounts for roughly a quarter of Polish exports, and it is expected to widen the current account deficit. In the medium term, economic growth is forecast to decelerate to 3.6 percent in 2020 and 3.3 percent in 2021. Nonetheless, rising real incomes are expected to lead to further declines in poverty. The $5.50/day 2011 PPP poverty rate is projected to decline to 1.9 percent in 2019 and further to 1.6 percent by 2021.

Fiscal performance remains a challenge despite the sound budget position so far. In the short-term public expenditure is likely to increase significantly due to recently announced policies that are expected to enter into force prior to the general elections in October 2019. Subsidized energy prices, the extended "Family 500+" program, lower PIT rates and the 13th month pension payment are expected to elevate the general government deficit in 2019 and will become a fiscal burden in the medium term. Thanks to the economic expansion, general government gross debt is expected to stabilize at around 49 percent of GDP in 2019-20.

Risks and challenges

The three main challenges ahead for Poland are a shortage of labor in the economy, procyclical government policies encouraged by the political calendar and adverse global factors.

The shortage of labor will eventually weigh heavily on potential GDP growth, and will be exacerbated by the early retirement of an increasing share of the workforce. Too few workers could negatively affect production capacity and investment. The problem may be amplified by the possibility that other EU countries open their labor markets to workers from Ukraine, who have so far helped Poland mitigate the shortfall in labor supply.

A dense political calendar, with EU, presidential, and general elections all coming up within a year, inspired a range of procyclical policies. Proposed measures increasing social benefits, lowering tax rates and inflating the cost of pension payments are expected to put pressure on public finances in the short and medium term. Due to their irreversible nature, such policies would weigh on Poland's fiscal position in the coming years and may push the deficit towards the EU threshold.

Poland's economy is likely to feel the negative impact of global factors. A slowing German economy will affect Polish exports. In addition, given that the UK is the third biggest market for Polish exports, Poland's economic growth could be further weakened, should a no-deal Brexit scenario materialize

TABLE 2 Poland / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	3.1	4.8	5.1	4.0	3.6	3.3
Private Consumption	3.9	4.9	4.5	4.1	3.9	3.7
Government Consumption	1.9	3.5	5.9	5.7	4.0	4.2
Gross Fixed Capital Investment	-8.2	3.9	7.3	6.0	5.9	5.6
Exports, Goods and Services	8.8	9.5	6.4	4.5	4.2	3.8
Imports, Goods and Services	7.6	10.0	6.7	5.9	5.4	5.4
Real GDP growth, at constant factor prices	3.0	4.7	5.0	3.8	3.5	3.2
Agriculture	3.0	5.2	4.0	3.0	2.3	1.8
Industry	3.9	5.2	5.5	4.8	4.0	3.4
Services	2.4	4.4	4.8	3.4	3.2	3.1
Inflation (Consumer Price Index)	-0.6	2.0	1.6	3.0	2.7	2.5
Current Account Balance (% of GDP)	-0.5	0.1	-0.1	-0.2	-0.2	-0.5
Net Foreign Direct Investment (% of GDP)	0.9	1.2	2.0	1.7	1.5	1.0
Fiscal Balance (% of GDP)	-2.2	-1.2	-0.5	-1.4	-1.6	-1.8
Debt (% of GDP)	54.1	50.6	49.2	49.0	48.7	48.6
Primary Balance (% of GDP)	-0.5	0.3	0.9	0.0	-0.1	-0.2
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.4	0.4	0.3	0.3	0.3	0.3
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.7	0.6	0.6	0.5	0.5	0.5
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	2.4	2.2	2.0	1.9	1.7	1.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2004-EU-SILC and 2015-EU-SILC. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021
(b) Projection using point-to-point elasticity (2004-2015) with pass-through = 1 based on private consumption per capita in constant LCU.

ROMANIA

Table 1	2018
Population, million	19.5
GDP, current US$ billion	228.7
GDP per capita, current US$	11745
International poverty rate ($1.9)[a]	5.7
Lower middle-income poverty rate ($3.2)[a]	13.3
Upper middle-income poverty rate ($5.5)[a]	25.6
Gini index[a]	35.9
School enrollment, primary (% gross)[b]	89.4
Life expectancy at birth, years[b]	75.0

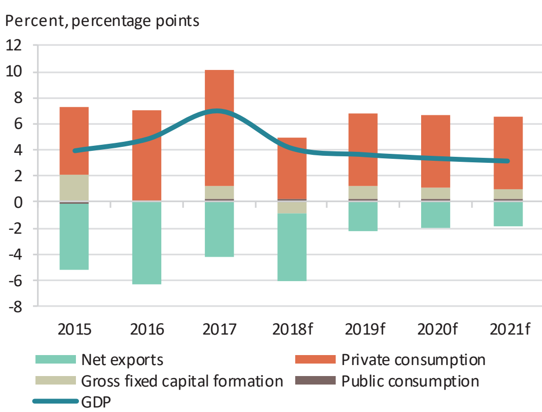
Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2016)

Economic growth remained strong at 4.1 percent in 2018, largely in line with the country's long-term potential. Growth was driven by private consumption, supported by expansionary fiscal policy, while investment was subdued. Improved labor market outcomes, including historically low unemployment, have contributed to the further reduction of poverty. Risks to the growth outlook have increased, stemming mainly from weaker demand from the major export markets, a tightening labor market and fiscal policy uncertainties.

Recent developments

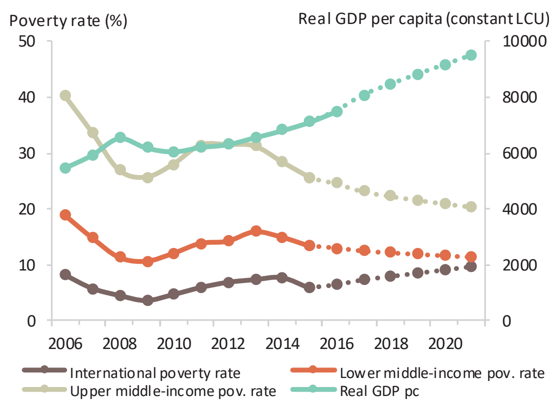
The economy grew by 4.1 percent in 2018, in line with potential but down from a post-crisis high of 7 percent in 2017. Growth was driven by private consumption (up 4.7 percent yoy) supported by increases in the minimum and public-sector wages and pensions. Investment underperformed, contracting by 3.2 percent yoy, owing to weak performance in construction and a slowdown in industry. Exports grew by 4.7 percent yoy reflecting weaker demand from the major export markets, while imports remained strong (up 8.6 percent). On the production side, ICT (up 7 percent yoy) and industry (up 4.1 percent yoy) were the main drivers. The fiscal deficit was 2.9 percent of GDP in 2018, but fiscal policy continued to be pro-cyclical. Increases in public wages and pensions led to a 23.7 percent hike in the public sector wage bill and a 16.5 percent increase in current budget spending. Social contribution revenues were strong (up 36.8 percent yoy) reflecting the legal transfer of the social contributions from employers to employees and improved collection. The impact was partially offset by the 24.8 percent contraction in personal income tax revenues from the reduction of the income tax rate from 16 to 10 percent in January 2018. The boost in consumption led to a widening of the current account deficit to 4.7 percent of GDP mainly on the back of an increase in the goods trade deficit. FDI inflows amounted to 2.4 percent of GDP in 2018. The domestic demand pressures contributed to a temporary hike in inflation to 5.4 percent in May 2018, prompting the NBR to increase its policy rate by 75 ppts cumulatively (to 2.5 percent) in three rounds in 2018. Slowing consumption growth in H2 2018 eventually brought inflation down to 3.3 in December. The labor market benefited from economic growth, with unemployment falling to 4.2 percent in December 2018, a 27-year low, and real wages increasing by 8.9 percent yoy. Nonetheless, the low employment rate (66.2 percent, below the EU average of 69.1 percent) and high youth unemployment (16.4 percent in Q3 2018) reflect persistent rigidities in the labor market. A key driver of low employment is low female participation - 55.8 percent in 2017, the fifth lowest rate in the EU - and one of the highest participation gender gaps. In line with robust economic growth, boost in private consumption and labor market improvements, the poverty rate corresponding to upper middle-income countries (using the $5.50/day 2011 PPP poverty line) is forecast to have declined to 22.3 percent in 2018, from 25.6 percent in 2015, after peaking at nearly 32 percent in 2012. The incomes of the bottom 40 were boosted by employment gains in sectors with a large share of low-skilled workers. The impact has been stronger for those in the bottom 80 percent of the income distribution, who have seen an increasing share of total incomes over this period. Tightening labor markets and minimum wage increases have contributed to a

FIGURE 1 Romania / Real GDP growth and contributions to real GDP growth



Sources: World Bank, Romanian National Statistical Institute.

FIGURE 2 Romania / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

reduction in inequality, reversing a rise in the Gini index seen between 2010 and 2014, although Romania's inequality indicators remain high in the EU context. Since 2014 poverty has declined in both rural and urban areas, but in 2016 estimated poverty rates in rural areas remained 6 times higher than in cities and just over twice as high as in towns and suburbs.

Outlook

The economy is projected to grow at a slower pace over the medium term, reflecting the closing output gap, labor market tightening and fiscal policy uncertainties. Fiscal measures promoted at end-December 2018 risk slowing the economy further in 2019 and beyond. These measures include the introduction of a tax on bank assets, a turnover tax for companies in energy and telecoms; and measures to increase the capitalization of the second pension pillar funds. The government has committed to maintaining the budget deficit within 3 percent of GDP in 2019. However, the fiscal measures passed in 2017 and 2018 have put pressure on the consolidated budget deficit and reduced the available fiscal space for investment. Further planned increases in pensions and public wages will exacerbate these pressures. Widening of the fiscal deficit to 3 percent of GDP, coupled with an increase in borrowing costs and a slowdown in growth would push public debt from 43 percent of GDP in 2017 to 43.3 percent at end-2021, still among the lowest ratios in the EU. After peaking in the spring of 2018, inflation is expected to stabilize at current levels of around 3.5 percent, reflecting slowing growth in domestic demand. The expected slowdown in Romania's traditional export markets, coupled with persistently high international commodity prices, would contribute to a further widening of the current account deficit to 5.2 percent in 2019 from 4.7 percent in 2018. Strong private consumption aided by the expansionary fiscal policy and continued growth in real wages, partly supported by minimum wage increases, should boost real incomes and lead to further declines in poverty incidence. However, these gains will be eroded by Romania's fiscal system, which deepens rather than alleviates poverty due to the large regressive impact of indirect taxation. The $5.50/day 2011 PPP poverty rate is projected to decline to 21.6 percent in 2019, 21.0 per-cent in 2020, and 20.4 per-cent in 2021.

Risks and challenges

The slowdown in Romania's export markets in the EU, mainly Germany and Italy, could adversely affect growth and investment. Negative effects could be exacerbated by fiscal policy uncertainties, coupled with a tightening labor market. The partial decoupling of real wage growth and productivity could also affect Romania's competitiveness, putting supplementary upward pressures on the current account deficit. Renewed efforts are needed to improve labor participation, in particular to address labor market barriers for women, and to tackle higher unemployment among the youth and those with secondary education or less, helping to ease labor supply constraints and improve the sustainability of growth. Over the medium term, fiscal policy should be re-balanced from boosting consumption to mobilizing investment, primarily from EU funds, with the aim of supporting a sustainable EU convergence path and social inclusion. Reforms in public administration and SOEs, increased regulatory predictability, reduction in of social and spatial discrepancies should be key government priorities.

TABLE 2 Romania / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	4.8	7.0	4.1	3.6	3.3	3.1
Private Consumption	7.4	9.2	4.7	5.6	5.5	5.4
Government Consumption	1.8	5.2	6.4	5.2	5.0	4.6
Gross Fixed Capital Investment	-0.2	3.5	-3.2	4.1	3.5	2.9
Exports, Goods and Services	16.0	10.0	4.7	6.7	6.6	6.5
Imports, Goods and Services	16.5	11.3	8.6	7.1	7.0	6.9
Real GDP growth, at constant factor prices	4.9	7.1	4.1	3.6	3.3	3.1
Agriculture	4.2	14.6	9.9	2.1	2.1	2.1
Industry	5.1	8.3	4.1	4.0	3.9	3.8
Services	4.9	5.5	3.4	3.5	3.1	2.8
Inflation (Consumer Price Index)	-1.5	1.3	4.6	3.5	3.4	2.9
Current Account Balance (% of GDP)	-2.1	-3.2	-4.7	-5.2	-5.3	-5.2
Net Foreign Direct Investment (% of GDP)	2.7	2.6	2.4	2.0	2.2	2.4
Fiscal Balance (% of GDP)	-2.4	-2.8	-2.9	-3.0	-3.0	-3.0
Debt (% of GDP)	44.3	43.0	42.5	43.0	43.2	43.3
Primary Balance (% of GDP)	-0.9	-1.7	-1.6	-1.7	-1.7	-1.7
International poverty rate ($1.9 in 2011 PPP)[a,b]	6.3	7.2	7.8	8.5	9.1	9.7
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	12.9	12.4	12.1	11.9	11.6	11.4
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	24.6	23.2	22.3	21.6	21.0	20.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2007-EU-SILC, 2012-EU-SILC, and 2015-EU-SILC. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 202
(b) Projection using annualized elasticity (2007-2012) with pass-through = 0.7 based on GDP per capita in constant LCU.

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RUSSIAN FEDERATION

Table 1	2018
Population, million	144.3
GDP, current US$ billion	1657.0
GNI per capita, US$ (Atlas method)[a]	9230
International poverty rate ($1.9)[b]	0.0
Lower middle-income poverty rate ($3.2)[b]	0.3
Upper middle-income poverty rate ($5.5)[b]	2.7
Gini index[b]	37.7
School enrollment, primary (% gross)[c]	102.1
Life expectancy at birth, years[c]	71.6

WDI, MPO, Rosstat, and Bank of Russia.
Notes:
(a) Most recent WDI value (2017).
(b) Most recent value (2015), 2011 PPPs.
(c) Most recent WDI value (2016).

Real GDP growth in the Russian Federation surpassed expectations in 2018, reaching 2.3 percent. However, this was mostly due to one-off effects in non-housing construction. A downgraded forecast for GDP growth in 2019 reflects lower oil prices; the medium-term outlook remains modest. Poverty rates eased in 2018, but the government's goal of halving the poverty rate in six years will require the mobilization of additional resources and better targeting of social spending.

Recent developments

Supported by robust global growth, higher oil prices, one-off construction projects, and Russia's hosting of the FIFA World Cup, GDP growth accelerated to 2.3 percent in 2018 from 1.6 percent in 2017. In the first half of the year, manufacturing drove growth in the tradable sectors. The relaxation of the OPEC+ agreement in June 2018 provided a growth boost to mineral resource extraction and related non-tradable sectors (transportation and storage) in the second half of the year. The construction sector grew by 4.7 percent (compared with a contraction of 1.2 percent in 2017), driven by the completion of energy sector construction projects.

The current account surplus widened to about 7 percent of GDP in 2018 (from 2.1 percent of GDP in 2017), supported by higher commodity prices and robust export volume growth. Difficult external financial conditions for emerging markets and elevated geopolitical tensions boosted net capital outflows to $72.1 billion (about 4.8 percent of GDP) in 2018 and led to a depreciation of the real effective exchange rate of 7.7 percent. At $468.5 billion at end-2018, international reserves were $33.7 billion higher for the year (compared to an increase of $15.4 billion in 2017), due mainly to foreign currency purchases under the fiscal rule framework.

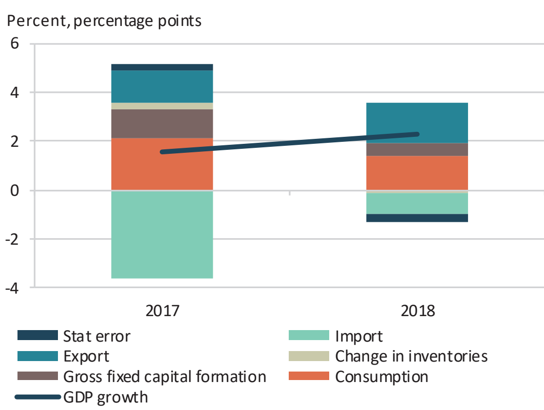
Average annual consumer price inflation decreased to 2.9 percent in 2018 (from 3.7 percent in 2017). However, consumer price inflation has been on the rise since July 2018 reflecting ruble depreciation, a weaker harvest, higher gasoline prices, an upcoming value added tax (VAT) rate increase, and a narrowing of the output gap. In December 2018, the Central Bank increased the key policy rate by 25 basis points to 7.75 percent citing elevated inflationary risks.

Higher oil prices, combined with a weaker ruble, a better tax administration, and a conservative fiscal policy further improved fiscal balances at all levels of the budget system in 2018. In 2018, the general government posted a surplus of 2.9 percent of GDP, compared to a deficit of 1.5 percent of GDP in 2017.

New development goals announced by the President in May 2018 ordered increased government spending on education, health, and infrastructure starting in 2019. Revenue will be boosted through a VAT rate hike and tax maneuver in the oil sector. The fiscal rule has been temporarily relaxed to accommodate higher spending. While these measures will raise fiscal risks, these will remain modest thanks to Russia's low public debt.

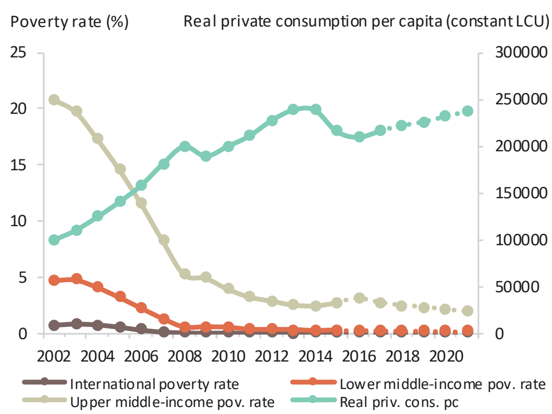
Despite recent bailouts, Russia's banking sector remains relatively weak with a lower capital adequacy ratio (12.3% in December 2018) and a higher ratio of non-performing loans (10.4%) than other emerging markets, leaving the sector vulnerable to macroeconomic shocks. However, the situation is stabilizing, and lending activity is recovering. In 2018, household credit grew at double-digit rates, prompting the Central Bank to tighten prudential requirements to slow unsecured consumer lending.

FIGURE 1 Russian Federation / Real GDP growth and contributions to real GDP growth



Sources: Russian Statistical Authorities and World Bank staff calculations.

FIGURE 2 Russian Federation / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

The unemployment rate fell to 4.8 percent in 2018 from 5.2 percent in 2017. Rising real wages in 2018 reflected low average inflation and higher public sector wage growth. Real disposable incomes, however, remained unchanged compared to 2017, suggesting a contraction in real terms of some unobserved components (informal earnings, for example). Nevertheless, incomes at the bottom of the distribution grew slightly faster than at the top, possibly driven by the higher minimum wage and new family benefits.

The poverty rate under the national definition (population share with income below 10,088 rubles/month in 2017) fell by 0.5 percentage points (from 13.8 to 13.3 percent) in the first nine months of 2018, as the poverty line grew below the rate of inflation and incomes rebounded at the bottom of the distribution. Poverty also declined under the World Bank's upper-middle-income country poverty measure (population share with per capita consumption under $5.5/day in 2011 PPP, equivalent to 4,351 rubles/month in 2017), falling from 2.6 percent in 2017 to 2.4 percent in 2018. Income inequality remained broadly unchanged.

In May 2018, the President announced a target of halving the official poverty rate over the next six years. The current forecast of average annual GDP growth of about 1.7 percent does not support the achievement of this goal. Additional budget funding and improved targeting of social protection programs will be needed to supplement the poverty reduction impact of GDP growth. Failing to introduce these reforms will jeopardize the achievement of the government's poverty reduction target.

Outlook

Russia's overall growth prospects for 2019–21 are modest given low growth potential. Supported by relatively high oil prices, the general government budget is expected to remain in surplus in 2019–21. Inflation is forecast to accelerate in 2019 on the back of the VAT rate increase and ruble depreciation pass-through, but return to the Central Bank's target of 4 percent in 2020–21. The forecast of a narrower external surplus reflects lower oil prices and a pick-up in import spending. Stable economic growth, wage growth in the private sector, and the indexation of pensions to inflation should support disposable incomes and contribute to a gradual decline in the poverty rate in 2019–21. However, many Russians lack formal employment, and many households will remain close to the poverty line.

Risks and challenges

Downside risks to Russia's growth outlook stem from the potential expansion of sanctions, a deterioration in financial market sentiment, and a dramatic drop in oil prices. Investment growth is subject to the successful and efficient implementation of government infrastructure investment initiatives. The recent expansion in household credit may pose a risk to financial stability in the case of a deterioration in the macroeconomic environment.

In addition to expanding the labor force by raising the retirement age, lifting Russia's potential growth rate will require the implementation of reforms that support total factor productivity growth. The continuing presence of high price-cost margins and lower-than-average market entry rates point to the limits to competition, which is essential for improving productivity.

TABLE 2 Russian Federation / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	0.3	1.6	2.3	1.4	1.8	1.8
Private Consumption	-1.9	3.2	2.2	1.1	1.7	2.0
Government Consumption	1.4	2.5	0.9	1.0	1.0	1.0
Gross Fixed Capital Investment	0.7	5.5	2.3	2.8	3.9	3.9
Exports, Goods and Services	3.2	5.0	6.3	3.9	4.0	4.0
Imports, Goods and Services	-3.6	17.4	3.8	4.2	5.3	5.8
Real GDP growth, at constant factor prices	0.4	1.6	2.2	1.4	1.8	1.8
Agriculture	2.2	1.4	-2.0	1.7	1.7	1.7
Industry	2.2	0.8	2.8	1.4	2.0	2.0
Services	-0.7	2.0	2.3	1.4	1.7	1.7
Inflation (Consumer Price Index)	7.1	3.7	2.9	5.2	4.0	4.0
Current Account Balance (% of GDP)	1.9	2.1	6.9	6.2	5.4	4.6
Net Foreign Direct Investment (% of GDP)	0.8	-0.5	-0.5	-0.5	-0.5	-0.5
Fiscal Balance (% of GDP)[a]	-3.7	-1.5	2.9	1.7	1.6	1.5
Debt (% of GDP)	15.7	15.1	14.3	14.8	15.6	16.5
Primary Balance (% of GDP)[a]	-2.8	-0.6	3.8	2.4	2.3	2.2
International poverty rate ($1.9 in 2011 PPP)[b,c]	0.0	0.0	0.0	0.0	0.0	0.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[b,c]	0.3	0.3	0.2	0.2	0.2	0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[b,c]	2.9	2.6	2.4	2.3	2.2	2.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Fiscal and Primary Balance refer to general government balances.
(b) Calculations based on ECAPOV harmonization, using 2015-HBS. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021
(c) Projection using neutral distribution (2015) with pass-through = 0.87 based on private consumption per capita in constant LCU.

SERBIA

Table 1	2018
Population, million	7.0
GDP, current US$ billion	49.9
GDP per capita, current US$	7134
International poverty rate ($1.9)[a]	5.6
Lower middle-income poverty rate ($3.2)[a]	11.1
Upper middle-income poverty rate ($5.5)[a]	23.6
Gini index[a]	39.7
School enrollment, primary (% gross)[b]	100.6
Life expectancy at birth, years[b]	75.2

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2016)

Growth in 2018 is estimated at 4.2 percent. Growth is broad-based and driven by both investment and consumption. Growth has translated into steady improvement in the labor market outcomes, bringing unemployment to 12.9 percent in Q4 2018. Poverty is estimated to have declined from 23.8 percent in 2014 to 21.3 percent in 2018. Over the medium-term, growth is expected to reach 3-4 percent, although risks remain, including from policy reversals as well as from delays in structural reforms.

Recent developments

The strong 4.8 percent y/y growth in the first half of 2018 was mainly related to a rebound from the low base in the same period of 2017. In the second half of the year growth moderated to 3.7 percent (y/y) thus leading to a new estimate for the annual growth of 4.2 percent. Growth in 2018 was primarily driven by investment which increased by 16.4 percent in real terms. As public sector wages and pensions were increased, consumption was up 3.3 percent, y/y. Higher consumption to some extent influenced an increase in imports (up 12.6 percent, in euro terms) which led to a negative contribution of net exports to growth of 2 percentage points. Looking at sectoral composition, growth in 2018 was broad-based, with all sectors increasing value added compared to the same period last year.

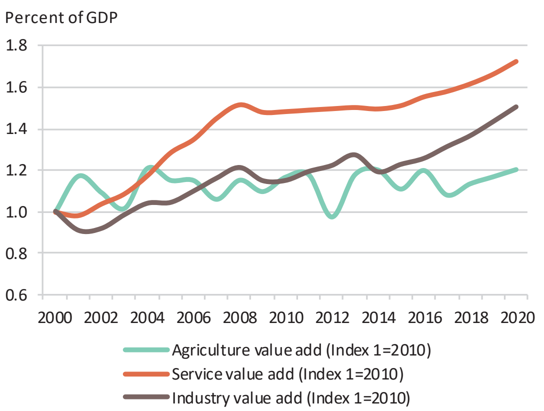
Recent economic growth contributed to steady labor market performance in 2018. The activity rate (within the working age cohort) increased to 67.8 percent in 2018, while the employment rate stood at 58.8 percent. Unemployment also declined from 14.1 percent in 2017 to 13.2 percent in 2018 (annual average). Female employment rate still remains significantly lower, at 41.7 percent in Q3 2018 compared to 57.3 percent for males. Average salaries increased by 6 percent in nominal terms (or 3.9 percent in real terms) in 2018.

Thanks to improvements in the labor market outcomes and to higher salaries and pensions, poverty (living on income under $5.5/day in 2011PPP terms, the standardized middle-income-country poverty line) is estimated to have declined from 23.8 percent in 2014, to estimated 21.3 percent in 2018.

The budget remained in surplus (of an estimated 0.6 percent of GDP) in 2018, thus helping to continue lowering the public debt burden. Strong revenue collection helped to offset an increase in expenditures in 2018. Revenues increased by 6.7 percent while expenditures increased by 7.9 percent compared to 2017. Revenues were up primarily because of higher proceeds from social insurance contributions (up by 9.4 percent) and the VAT (up 11.8 percent), but practically all other sources of revenues increased as well. The fiscal surplus, as well as a favorable dollar/euro and dinar/euro exchange rate dynamic (in particular appreciation of dinar against euro) have helped to reduce public debt as a share of GDP from 62.5 percent at the end of 2017, to an estimated 54.3 percent at the end of 2018.

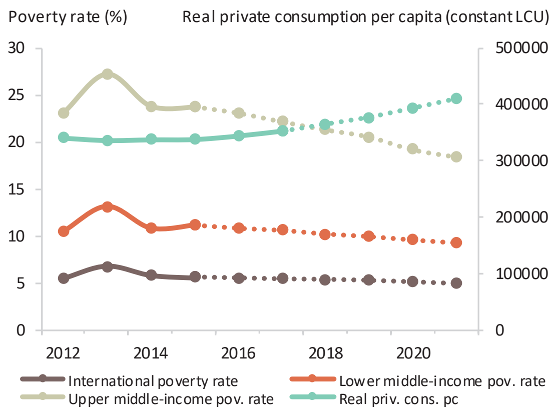
Inflation averaged 2 percent in 2018, after reaching a peak level of 2.6 percent (y/y) in August. As food price inflation reached a peak in August at 2.7 percent y/y, it drove the CPI. The NBS lowered the key policy rate to 3.25 percent in March 2018, it lowered it again to 3.0 percent in April 2018, and kept it unchanged since. After a significant appreciation of the dinar in the last quarter of 2017 the exchange rate against the euro remained stable in 2018. The NBS intervened regularly on the foreign exchange market to prevent more significant volatility of the exchange rate. In 2018, the

FIGURE 1 Serbia / Value added index: 2000=1



Source: Statistics Office.

FIGURE 2 Serbia / Actual and projected rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

NBS was a net-purchaser of foreign currency, in the amount of EUR 1.6 billion. Credit activity recovered in 2018 (up 7.6 percent, by December, y/y), but its structure remains somewhat unfavorable. Most of the increase in lending comes from the household sector (up 12.5 percent), while loans to private businesses were up by 6.9 percent, y/y. Loans to households increased primarily because of the high increase in short-term loans (so called cash-loans) to individuals. The stock of those loans is 18.7 percent higher than a year ago (in euro terms).

Outlook

The Serbian economy is expected to continue with the solid growth of around 3-4 percent over the medium-term, although growth in 2019 is expected to slow down to 3.5 percent, as effects from the increase in consumption and investment were to a large extent exhausted in 2018. Investment and exports will be the main drivers of growth. Exports are projected to grow by around 9.5 percent annually in real terms, while investment are projected to increase by about 6.5 percent in real terms annually, over the next three years. On the other hand, consumption will increase as well, driven by wages and employment growth. Increase in consumption has already impacted imports (up by 12.6 percent in 2018, compared to 2017, in euro terms) and resulted in higher CAD in 2018 by 8.4 percent (in euro terms).

The medium-term growth projections crucially depend on the pace of structural reforms and progress with EU accession. Most importantly, Serbia needs to deal with its large and unsustainable state-owned enterprises (SOEs) sector. It was encouraging to see recent renewed attempt to deal with some of the main loss-makers (like for instance RTB Bor, PKB) and this should remain at the center of government's efforts. Similarly, it is expected that privatization of state-owned financial institutions speeds up. Slower growth in some parts of EU (most importantly Italy, which is one of the most important trading partners for Serbia) are a downside risk. Acceleration of the EU accession process is important not only from the point of view of strengthening of institutions but also as a signaling device to attract investment. In addition, the work on regional projects (mainly on investment in infrastructure which connects – roads, railways etc.), would help Serbian exporters and growth of the economy overall.

With economic growth and improvements in the labor market, poverty is expected to continue its gradual decline. Poverty, measured as income below the standardized $5.5/day 2011PPP line is estimated to fall to around 20.5 percent by 2019.

Risks and challenges

Risks are mainly associated with internal political developments. Regional disputes, slow progress with the EU accession process and constant threat of early elections cause a caution among both local and foreign investors. This in turn delays realization of some of important projects both related to infrastructure and to the real sector. Despite recent labor market improvements, employment rates remain low and limit the scope for robust welfare improvements.

TABLE 2 Serbia / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	3.3	2.0	4.2	3.5	4.0	4.0
Private Consumption	1.3	1.9	3.1	3.0	3.8	3.8
Government Consumption	1.3	3.3	4.6	2.1	1.5	2.3
Gross Fixed Capital Investment	5.4	7.3	12.4	7.5	6.2	5.8
Exports, Goods and Services	11.9	8.2	10.5	9.0	8.7	8.7
Imports, Goods and Services	6.7	11.1	10.8	8.4	8.1	8.0
Real GDP growth, at constant factor prices	3.8	2.1	3.4	3.5	4.0	4.0
Agriculture	8.3	-11.2	10.0	3.8	3.0	3.0
Industry	4.3	3.4	1.5	4.6	3.5	3.5
Services	3.0	3.3	3.6	3.0	4.3	4.4
Inflation (Consumer Price Index)	1.1	3.1	2.0	2.6	3.0	3.0
Current Account Balance (% of GDP)	-3.3	-6.3	-5.4	-5.1	-5.0	-4.7
Net Foreign Direct Investment (% of GDP)	3.5	4.4	5.8	5.6	5.6	5.2
Fiscal Balance (% of GDP)	-1.2	1.1	0.5	-0.6	-0.6	-0.7
Debt (% of GDP)	68.9	58.7	56.2	55.4	53.7	51.9
Primary Balance (% of GDP)	1.7	3.6	2.6	1.4	1.6	1.6
International poverty rate ($1.9 in 2011 PPP)[a,b]	5.5	5.4	5.3	5.2	5.1	4.9
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	10.8	10.6	10.2	9.9	9.5	9.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	23.0	22.1	21.2	20.5	19.2	18.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2015-EU-SILC. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2015) with pass-through = 0.87 based on private consumption per capita in constant LCU.

TAJIKISTAN

Table 1	2018
Population, million	9.1
GDP, current US$ billion	7.5
GDP per capita, current US$	822
International poverty rate ($19)[a]	4.8
Lower middle-income poverty rate ($3.2)[a]	20.3
Upper middle-income poverty rate ($5.5)[a]	54.2
Gini index[a]	34.0
School enrollment, primary (% gross)[b]	95.7
Life expectancy at birth, years[b]	711

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2016)

Tajikistan's economy registered strong growth in 2018 driven by private consumption and public investment in the energy sector. The poverty rate fell below 29 percent thanks to sustained remittance inflows. Growth is expected to remain at around 6 percent over the medium-term drawing on favorable commodity prices, substantial public investment, and a gradual recovery of domestic lending. Rising debt service obligations, heightened state-owned enterprise (SOE) contingent liabilities, and costly energy projects with uncertain revenue prospects pose significant downside risks.

Recent developments

Real GDP growth accelerated slightly to 7.3 percent in 2018 (from 7.1 percent in 2017). Robust private consumption and public investment in energy, which offset a decline in net exports, supported the expansion. Sustained remittance inflows propped up activity in the services sector, and new capacity in energy, food processing, and metallurgy bolstered industrial output. Migrant transfers and rising wages helped to reduce the national poverty rate from 34.3 percent in 2013 to 29.5 percent in 2017.

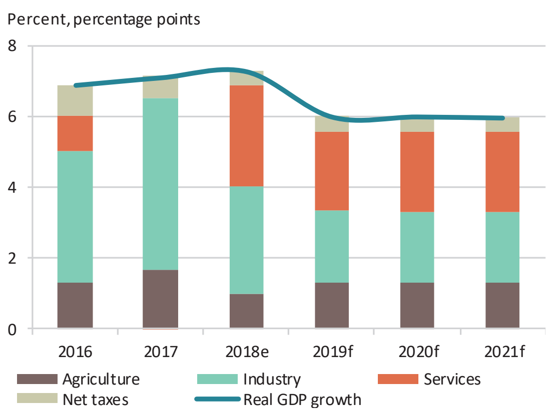
The external position deteriorated in 2018 as public investment in energy capacity boosted imports of machinery and construction materials. The current account posted a deficit of 5.6 percent of GDP in January-September 2018 (a reversal from the surplus of 2.5 percent of GDP recorded in the same period of 2017). Given the concentration of metallic minerals, particularly gold, in Tajikistan's export basket, the substantial fall in international prices for minerals severely affected export proceeds and could not be offset by the increased export of cotton and electricity. Although Chinese mining sector investments helped lift foreign direct investment (FDI) to 2.6 percent of GDP, the country's investment needs are such that FDI needs to rise further.

In light of the exhausted fiscal space and the need to improve the country's high risk of debt distress, Tajik authorities sought fiscal consolidation in 2018. Preliminary estimates indicate that fiscal deficit narrowed to 5 percent of GDP in 2018 (from 6.9 percent in 2017) facilitated by cuts to capital spending. While public spending cuts and delays targeted non-priority capital expenditures, the government safeguarded energy sector investment and core social obligations and raised civil servant wages, pensions, and other social transfers on September 1, 2018. Investments into the Rogun Hydropower Plant (HPP) accounted for 14 percent of total budget spending in 2018, only slightly less than total education spending at 16 percent. In 2018, the government received a budget support grant from the European Union in the amount of €9.4 million.

Subsiding consumer price inflation in 2018 reflected prudent monetary policy and benign food-import prices, especially for agriculture products from Uzbekistan. At 5.2 percent, annual inflation fell within the central bank's medium-term target band of 5-9 percent. Despite increases in water and electricity tariffs, continued administrative measures and withdrawal of liquidity by the monetary authorities ensured limited exchange rate depreciation.

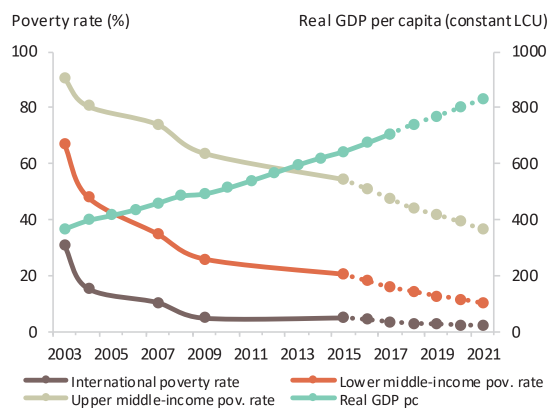
Except for two problem banks, the financial sector was generally healthy in 2018. Adopted amendments in the legal framework in mid-2018 are expected to strengthen the regulator's supervisory powers. However, the banking system remains non-transparent, particularly regarding related-party lending; the overdue resolution of two toxic banks will require additional efforts by the authorities.

FIGURE 1 Tajikistan / GDP growth decomposition



Sources: TajStat; World Bank staff estimates.

FIGURE 2 Tajikistan / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

The decline in remittance inflows to households slowed the pace of poverty reduction between 2014 and the first half of 2016. The poverty rate returned to a downward trend in the second half of 2016 and accelerated throughout 2017. Poverty was relatively stagnant in urban areas during 2015 - 16 at 24 percent before falling to 22 percent in 2017. By contrast, rural poverty fell significantly from 36.1 percent in 2014 to 33.1 percent in 2017. The official unemployment rate stood at 2 percent in December 2018.

Outlook

Tajikistan's positive medium-term outlook assumes that external environment will remain favorable and publicly-driven investment programs will be sustained. Prospects of positive (albeit modest) growth in the Russian Federation, elevated prices for major export commodities (cotton and aluminum), and deepening regional cooperation should sustain high rates of GDP growth in Tajikistan. Remittance inflows will continue to support private consumption, while long-awaited resolution of problem banks, once completed, would restore trust in the banking system and lead to a gradual pickup in private credit and investment. The central bank's expected move to an inflation targeting regime and the accompanying administrative measures will dampen inflationary and exchange rate pressures.

The country's current account is expected to remain in deficit owing to continued strong demand for capital-intensive imports for the construction of Rogun HPP and a remittance-propelled expansion of private consumption. FDI inflows are forecast to suffer from weaknesses in the general business climate and slowing growth in China.

Although the government is expected to pursue fiscal consolidation, in the medium term, Tajikistan will continue to face fiscal stress. The primary sources of this stress will be the tight schedule for Rogun HPP construction and high public debt service obligations. The targeted social assistance (TSA) program is expected to be rolled out nationwide in 2019.

Risks and challenges

Domestic and external risk factors weigh down Tajikistan's economic growth prospects. Governance challenges at public enterprises - particularly in the energy and transport sectors - present high quasi-fiscal risks and threaten sustainability of public finances. Delays in much-needed structural reforms to improve the business environment will further dampen private sector development. Limited fiscal space and low policy buffers leave Tajikistan vulnerable to potential shocks. An escalation of global trade tensions, or economic slowdown in the region's large economies, would negatively impact inflows of FDI and remittances.

The construction of the Rogun HPP could present a serious risk to debt sustainability and crowd-out social spending if the authorities are unable to secure alternative financing for the project from private sources or improve revenue collection while sufficiently reducing spending inefficiencies.

A potential three-year program with the IMF suggests an upside risk if the government successfully meets the pre-program conditions. An IMF arrangement is expected to have a positive impact on Tajikistan's image in international capital market and the pricing of Eurobonds.

Although extreme poverty is expected to benefit from the national rollout of TSA program, the budget will need to be increased to adequately compensate for utility tariff increases, especially for electricity and water, in the coming years. The TSA methodology also needs to be revised to account for household size and the frequency of disbursements.

TABLE 2 Tajikistan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	6.9	7.1	7.3	6.0	6.0	6.0
Private Consumption	6.4	0.0	3.2	3.5	4.0	4.2
Government Consumption	3.9	2.5	2.1	2.0	1.7	1.8
Gross Fixed Capital Investment	20.3	20.1	20.7	21.1	20.0	19.8
Exports, Goods and Services	0.0	0.0	2.5	2.9	3.2	3.2
Imports, Goods and Services	0.0	0.0	3.0	2.8	2.5	2.5
Real GDP growth, at constant factor prices	6.6	7.5	7.1	6.0	6.0	6.1
Agriculture	5.2	6.8	4.0	5.3	5.0	5.1
Industry	18.1	21.3	11.8	10.2	10.0	10.2
Services	2.2	0.7	6.0	3.7	3.9	3.7
Inflation (Consumer Price Index)	6.0	7.3	3.9	6.0	6.5	6.5
Current Account Balance (% of GDP)	-5.2	2.2	-5.1	-3.6	-3.0	-3.0
Net Foreign Direct Investment (% of GDP)	3.4	0.2	2.5	2.5	2.4	2.3
Fiscal Balance (% of GDP)	-9.8	-6.9	-5.0	-3.8	-3.0	-2.4
Debt (% of GDP)	42.0	52.3	49.3	46.5	51.7	49.9
Primary Balance (% of GDP)	-8.3	-6.4	-4.1	-2.4	-1.6	-1.0
International poverty rate ($1.9 in 2011 PPP)[a,b]	4.2	3.4	2.8	2.5	2.3	2.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	18.0	15.6	14.1	12.6	11.4	9.9
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	51.0	47.6	44.1	42.0	39.5	36.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2015-HSITAFIEN. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021
(b) Projection using neutral distribution (2015) with pass-through = 1 based on GDP per capita in constant LCU.

TURKEY

Table 1	2018
Population, million	814
GDP, current US$ billion	768.9
GDP per capita, current US$	9445
International poverty rate ($19)[a]	0.2
Upper middle-income poverty rate ($5.5)[a]	9.9
Gini index[a]	419
School enrollment, primary (% gross)[b]	1013
Life expectancy at birth, years[b]	75.8

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2016), 2011 PPPs.
(b) Most recent WDI value (2016)

The sharp external adjustment that Turkey experienced in mid-2018 is now feeding through to the real sector. The economy is contracting, and unemployment is rising. The livelihoods of low-income households and the incidence of poverty are at risk of deterioration. The downturn has so far been tempered by a strong, positive contribution of net exports. The outlook hinges on how early a recovery takes root, with well-targeted policy responses and clear communication of macroeconomic risks likely to be key.

Recent developments

Growth in 2018 fell to 2.6 percent, with the last two quarters seeing a contraction in economic activity. A slowdown in the real sector began in the second half of 2018. Private consumption declined by 1.6 and 2.4 percent in Q3 and Q4 respectively, while investment fell by 6.7 and 3.6 percent in the same quarters (seasonally-adjusted, quarter on quarter). Over the last year, Turkey has experienced intense market turbulence, ending 2018 with its nominal effective exchange rate 25 percent lower, consumer inflation above 20 percent, and policy interest rates tripling to 24 percent. Since the end of September, the exchange rate has become more stable, and gross international reserves have risen nearly 20 percent to $99 billion although market risk perception remains elevated.

The impact on growth would have been more severe were it not for a strong external adjustment, with import volumes contracting sharply and exports rising during the year. The current account moved from a deficit of $3.4 billion per month in the first three quarters of 2018 to a surplus of $900 million per month in the fourth quarter.

With a large proportion of domestic credit extended in foreign currency or FX-indexed loans and weakening domestic demand, part of the corporate sector is under stress. While the nonperforming loan ratio has only risen to 4.1 percent so far, a much larger fraction of domestic credit may be unable to be collected soon. Banks are undergoing a process of balance sheet repair, with their liabilities to foreign banks falling by 16 percent from their peak in August, and domestic credit has contracted since end-September.

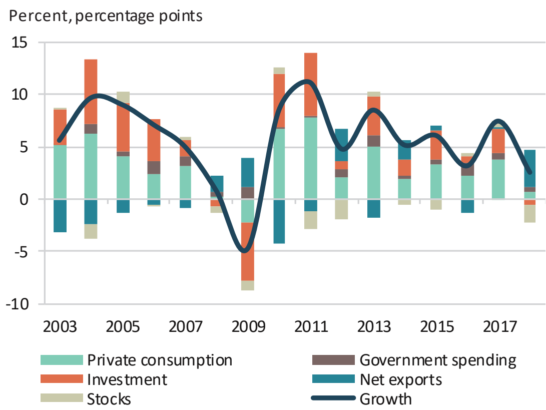
Unemployment is steadily rising, and food price inflation has spiked, adding further to economic difficulties for low-income households. The sharp fall in demand has begun to feed through into business cut-backs: The economy experienced a net loss of 200,000 jobs in 2018 and unemployment rose from 10 to 13 percent in the last year. Meanwhile, the youth unemployment rate peaked at 22.2 percent, having risen by three percentage points in a year. Annual inflation accelerated to 19.7 percent in February 2019; the rate of food price inflation rose even faster at 29.3 percent. While poverty had been declining until 2016, the latest available data point, recent inflation, and unemployment evolution put poverty trends at risk of stagnation and reversal.

The government raised the minimum wage by 26 percent in January to stem low-income households' eroding purchasing power. In addition, benefit levels of certain government transfers increased since they are indexed to the minimum wage, but the target population of those transfers is limited and composed mainly of the elderly and disabled.

Outlook

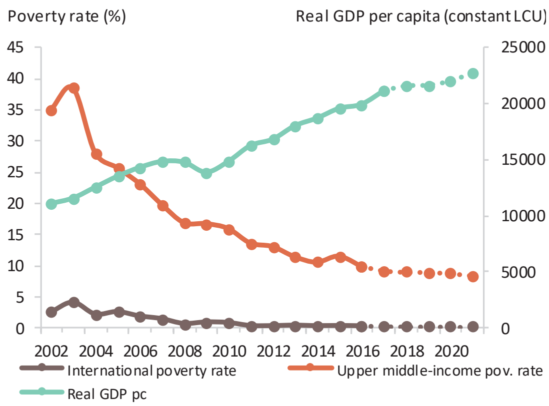
Growth in 2019 is projected to decelerate to 1 percent, reflecting three consecutive quarters of contraction from the fourth

FIGURE 1 Turkey / Real GDP growth and contributions to real GDP growth



Sources: Turkstat and World Bank staff calculations.

FIGURE 2 Turkey / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see table 2.

quarter of 2018 to the second quarter of 2019. This marks a downward revision, as a deeper-than-expected fall in consumption in the last quarter of 2018 is expected to continue in the first half of 2019. Private consumption growth is expected to resume in the third quarter aided by the substantial minimum wage hike in January and recently-announced employment support programs. A larger primary deficit and higher interest costs are forecast to drive a widening of the overall fiscal deficit in 2019. Robust government consumption growth is also expected to contribute to growth in 2019 while investment—both public and private—is projected to contract substantially. Import volumes are forecast to fall slightly, reflecting slowing consumption growth and declining investment. Despite lower growth expectations in Europe, improved price competitiveness is expected to boost exports in 2019.

In 2020, growth is expected to recover momentum to 3 percent, led by recovering private consumption and investment, and further to 4 percent in 2021.

Inflation is forecasted to decline steadily beginning in mid-2019; aided by a continued tight monetary stance, inflation should fall to 15 percent by year-end. However, with inflation beginning the year high, average annual inflation for the year is expected to peak at around 18 percent. In later years, inflation is expected to fall towards the high single digits.

Credit markets will remain muted as banks go through a process of deleveraging in 2019. Many firms will be effectively under bankruptcy protection in 2019, so the full extent of balance sheet losses is unlikely to be realized until 2020.

Despite the increased minimum wage, higher social assistance transfers will be needed to protect unemployed people and informal workers from potential shocks. Poverty is projected to stagnate around 9 percent from 2018 to 2020, measured with the upper-middle-income country poverty line of $5.5/day in 2011 PPP. The total number of poor is forecasted to rise from 7.37 million people in 2018 to 7.42 million in 2020.

Risks and challenges

The outlook for 2019 hinges on how early a recovery takes root. At present, the authorities are in a position to support a recovery, by providing more transparent information to the market about the health of the banking sector and measures to support a recovery, such as a corporate debt restructuring program and well-targeted counter-cyclical fiscal policy. However, market actors are increasingly concerned about poorly planned, interventionist policies targeted to artificially lower market prices and boost credit growth in the short run, and in the absence of an adequate policy response, the economy may experience a prolonged period of recession.

A recovery in mid-2019 will depend on an improving environment for both consumption and investment. Further shocks from the external sector, domestic supply shocks, or materialized risks in the financial system could lead to a delayed, or weaker, recovery.

The most significant known risk is the rising level of uncollectable debts in the private sector (especially in the non-tradeable sectors) which, if not well managed, could lead to severe problems in the financial sector.

High inflation and unemployment stand out as the major risks to Turkey's prospects for poverty reduction in 2019. Rising food prices should be monitored carefully and addressed with adequate policies to ensure continued poverty reduction. Poor households are particularly vulnerable to high food price inflation since food comprises a larger share of their budgets. The continuation of adverse trends in 2019 would put the poverty reduction gains of the last decade at risk.

TABLE 2 Turkey / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	3.2	7.4	2.6	1.0	3.0	4.0
Private Consumption	3.7	6.1	1.1	0.6	2.2	2.7
Government Consumption	9.5	5.0	3.6	5.4	2.0	2.6
Gross Fixed Capital Investment	2.2	7.8	-1.7	-5.9	4.8	9.0
Exports, Goods and Services	-1.9	11.9	7.5	5.5	5.7	4.8
Imports, Goods and Services	3.7	10.3	-7.9	-1.5	6.0	7.5
Real GDP growth, at constant factor prices	3.1	7.9	2.9	1.0	3.0	4.0
Agriculture	-2.6	4.9	1.3	0.9	2.0	2.0
Industry	4.6	9.1	0.2	1.0	3.3	3.8
Services	3.2	7.6	4.4	1.1	2.9	4.2
Inflation (Consumer Price Index)	7.8	11.1	16.3	18.0	11.0	9.5
Current Account Balance (% of GDP)	-3.8	-5.6	-3.6	-2.7	-4.0	-4.5
Net Foreign Direct Investment (% of GDP)	1.3	1.0	1.2	1.0	1.1	1.1
Fiscal Balance (% of GDP)	-1.4	-1.8	-2.7	-3.8	-2.7	-2.0
Debt (% of GDP)	28.3	28.3	32.7	33.6	33.9	32.8
Primary Balance (% of GDP)	0.6	0.1	-0.4	-1.2	0.3	0.5
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.2	0.2	0.2	0.2	0.2	0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	9.9	9.2	9.1	9.1	8.9	8.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2011-HICES, 2017-, and 2016-HICES. Actual data: 2016. Nowcast: 2017-2018. Forecast are from 2019 to 2021
(b) Projection using point-to-point elasticity (2011-2017) with pass-through = 1 based on GDP per capita in constant LCU.

TURKMENISTAN

Table 1	2018
Population, million[a]	5.8
GDP, current US$ billion[a]	42.4
GDP per capita, current US$[a]	7356
School enrollment, primary (% gross)[b]	88.4
Life expectancy at birth, years[c]	67.8

Source: IMF, WDI, Macro Poverty Outlook, and official data.
Notes:
(a) estimations.
(b) Most recent WDI value (2014).
(c) Most recent WDI value (2016).

Even as favorable external environment supported export expansion, Turkmenistan's economic growth eased slightly in 2018 on weaker domestic demand. Trade and fiscal balances improved, benefitting from higher hydrocarbon prices. However, rising inflation - driven by prices for imported consumer goods - and continued cutbacks in welfare subsidies negatively affected living conditions. Higher global demand for energy and emerging regional cooperation opportunities suggest favorable GDP growth prospects, although the slow pace of structural reforms presents downside risks.

Recent developments

Real GDP growth slowed to 6.2 percent in 2018 (from 6.5 percent in 2017), according to official estimates. Improved terms of trade and continued strong Chinese demand for natural gas helped to sustain the strong rate of economic growth. On the other hand, public and private investment fell sharply (by 26 percent) in the context of fiscal consolidation, lower inflows of foreign direct investment and weaker credit expansion.

Officially-reported inflation subsided to 7.2 percent in 2018 (from 10.4 percent in 2017). While limited access to hard currency drove inflationary pressures for imported non-food items, administrative measures and the state-led import of consumer staples (to ease food supply constraints) contained food prices. The upward adjustment of gasoline prices (by 50 percent) and public salaries, pensions, and other social transfers (by 10 percent) in early 2018 also contributed to the accumulation of inflationary pressures.

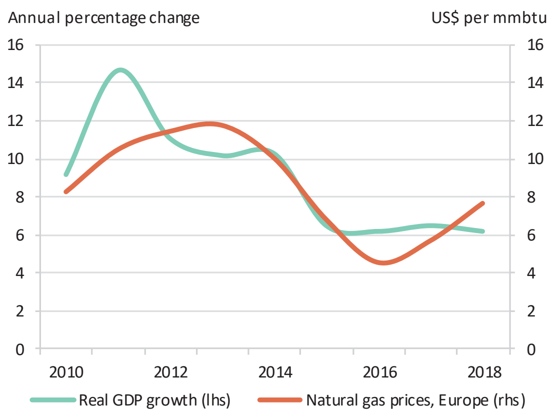
Turkmenistan's external position improved in 2018 on account of improved terms of trade and lower demand for imports of capital and consumer goods. Strong Chinese demand, coupled with surging natural gas prices (up by over 30 percent in 2018 year on year), boosted export earnings by almost 50 percent. Meanwhile, reduced capital investment, limited access to foreign exchange, and broadening domestic production (supported by import substitution programs), resulted in a 47.8 percent reduction in import spending. Foreign investment continued to drop owing to challenges in the foreign exchange market and the economy's weaker growth prospects. As a result, the current account deficit is estimated to have narrowed to about 2.9 percent of GDP, a sharp decline from double-digit levels in recent years.

Throughout 2018, the authorities continued to impose tight foreign exchange controls on international trade and access to hard currency reduced in early 2018. Although strong export earnings served to ease pressure on the exchange rate in mid-2018, pressures remained elevated. Market trends suggest overvaluation of the official manat rate.

The government continued fiscal consolidation efforts in 2018 in line with its medium-term objective of a balanced budget. Revenue collection slightly over - performed budget projections, bolstered by higher hydrocarbon proceeds, while expenditure was reduced by 17.6 percent following cuts to non-priority capital investment and a reduction of welfare transfers.

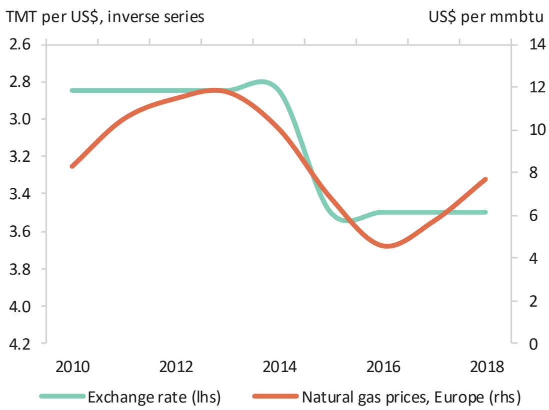
Turkmenistan does not release official statistics on living standards, and little is known about the country's labor market. Data constraints prevent a thorough analysis of the social impact of slower economic growth. Nonetheless, the gradual reduction of welfare subsidies—which the population has enjoyed since shortly after independence—has negatively affected living standards.

FIGURE 1 Turkmenistan / GDP growth and natural gas prices, 2010-18



Source: Statistical Committee of Turkmenistan.

FIGURE 2 Turkmenistan / Official exchange rate and natural gas prices, 2010-18



Source: Central Bank of Turkmenistan.

Outlook

Turkmenistan's positive economic outlook assumes that global energy demand remains strong and that China's economy does not falter; both assumptions carry significant uncertainties. Ongoing high-level talks with the Russian Federation may result in the resumption of natural gas sales to Russia. Policies aimed at fostering private sector development and economic diversification could gradually promote non-hydrocarbon sectors and contribute to inclusive growth.

Inflationary and exchange rate pressures are expected to ease, supported by ample hydrocarbons earnings. The authorities are likely to adhere to the exchange rate peg and considerations to adjust the national currency will largely depend on the evolution of public sector foreign liabilities. Turkmenistan's external position will continue to benefit from elevated prices for natural gas and controlled access to foreign exchange, accompanied by expanded industrial output supported by export promotion and import-substitution policies. However, ongoing challenges associated with expatriating profits will discourage strong FDI inflows.

The government will seek consolidation of the state budget in the medium term as it attempts to rebuild depleted policy buffers. However, the expansion of public investment in strategic infrastructure using off-budgetary funds cannot be ruled out.

While ending free access to water, gas, and electricity in 2019 may result in deteriorated living standards for the poor, such measures underscore the government's firm commitment to reforming the country's utilities and improving their finances. The agriculture sector—which employs most of the labor force—is expected to benefit from increased government procurement prices for wheat and cotton, which were raised by 100 percent and 50 percent, respectively, in January 2019.

Risks and challenges

External and domestic risks to the economy will remain elevated. A sudden drop in hydrocarbons prices would significantly reduce economic growth prospects. Other external risks include the escalation of trade tensions or the tightening of global liquidity, which could result in a sudden deceleration in economic growth in Turkmenistan's trade partners.

Domestically, risks include slow progress on the implementation of policies that support economic diversification and private sector development. Liberalizing business regulations and easing foreign exchange controls will be necessary to improve investor confidence. Long-term socio-economic sustainability will require a shift toward investment in human capital.

In a push to improve the fiscal accounts and, more broadly, adopt market economy principles, Turkmenistan recently reversed a long-standing policy of providing free water, electricity, natural gas, and housing. While full information on the depth and breadth of the tariff increases is not yet officially available, such measures undoubtedly will impact the welfare of households. The social consequences of the reform should be considered, and a distributional analysis performed, together with mitigating measures to protect vulnerable households through a well-targeted social protection mechanism. Although the social protection system in Turkmenistan consists of a set of social policies (both cash and non-cash), a performance assessment of the system in terms of coverage, targeting accuracy, and impact on the Sustainable Development Goals - in particular, goal 1 (no poverty) and goal 10 (reduced inequality) - is needed.

TABLE 2 Turkmenistan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	6.2	6.5	6.2	5.6	..	..
Inflation (consumer price index, end of period)	6.2	10.4	7.2	6.0	..	..
Current account balance (% of GDP)	-19.9	-11.5	-2.9	-2.4	..	..
Financial and capital account (% of GDP)	5.9	7.3	5.8	7.2	..	..
of which: net foreign direct investment (% of GDP)	5.4	5.1	3.4	4.3	..	..
Fiscal balance (% of GDP)	-2.4	-2.8	0.4	0.0	..	..
Public debt (% of GDP)	24.1	28.8	29.9	31.2	..	..

Sources: World Bank, International Monetary Fund.
Notes: e = estimate, f = forecast.

UKRAINE

Table 1	2018
Population, million	44.5
GDP, current US$ billion	124.6
GDP per capita, current US$	2799
International poverty rate ($1.9)[a]	0.1
Lower middle-income poverty rate ($3.2)[a]	0.5
Upper middle-income poverty rate ($5.5)[a]	6.4
Gini index[a]	25.0
Life expectancy at birth, years[b]	715

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2016), 2011 PPPs.
(b) Most recent WDI value (2016)

In 2018 GDP growth accelerated to 3.3 percent, but macroeconomic vulnerabilities remain. Growth was supported by a record harvest, services, and favorable domestic demand conditions. Consumption continued to grow due to higher public spending, real wages, and remittances. Investment is held back by uneven reform progress, election related uncertainties, and low domestic savings. The growth outlook depends on accelerating reforms and mobilizing adequate financing as Ukraine faces formidable financing needs to repay its public debt in 2019-2021.

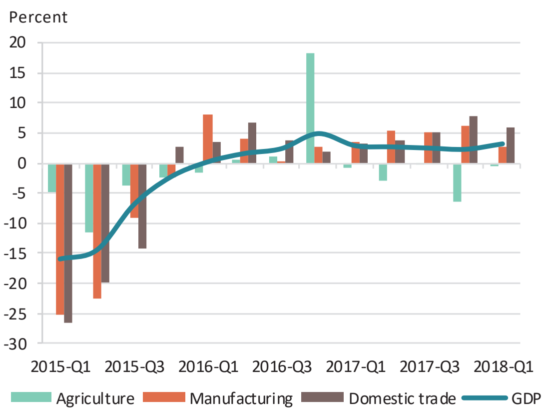
Recent developments

In 2018, GDP grew by 3.3 percent (after 2.3 and 2.5 percent in 2016 and 2017 respectively). The pickup in growth was driven by a good agricultural harvest, and sectors dependent on domestic demand—domestic trade and construction (which both grew by over 5 percent). Household consumption continued to grow rapidly in 2018 on the back of (i) significant hikes in public sector wages and pensions; (ii) sizable remittance inflows due to labor migration to EU countries; and (iii) resumption of consumer lending. At the same time, investment growth decelerated to around 9 percent (vs 18 percent in 2017) due to reform delays, election and conflict-related uncertainties, and continued low domestic savings. Structural weaknesses remain in the banking system and the real sector. The debt overhang and legacy non-performing loans in the corporate sector still remain high. FDI inflows remained low (just 2 percent of GDP) for the third consecutive year.

Higher consumption helped reduce poverty but pressures on the current account have intensified. Real wages continued to grow in 2018 due to further increases in minimum wages and pressures from outward labor migration. After four consecutive years of decline, pensions increased by 22.2 percent in real terms in 2018. As a result, poverty (consumption per capita below 5.5 USD/day in 2011 PPP) declined to 4.0 percent in 2018 from 4.9 percent in 2017 and 6.4 percent in 2016. Strong domestic demand, together with real exchange rate appreciation, contributed to a pick-up in imports and a widening of the current account deficit to 3.7 percent of GDP in 2018 (vs 1.9 percent in 2017). Remittances reached 9 percent of GDP in 2018, but they were not sufficient to cover the growing trade deficit.

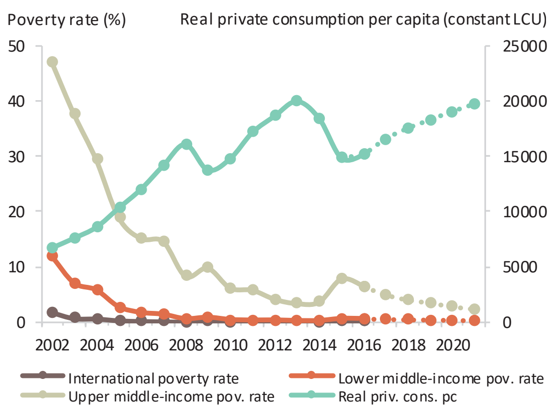
Monetary policy helped to maintain a macroeconomic stability. Fiscal deficit amounted to 2.1 percent of GDP (vs 2.3 percent in 2017) that helped to reduce PPG to 63 percent of GDP in 2018. At the same time, significant hikes in minimum wages and additional sectoral top-ups resulted in the wage bill to grow up to 11 percent of GDP (vs 9 percent in 2016). Social assistance spending remained high at 4 percent of GDP. To deal with the outcomes of higher current expenditures the National bank increased the policy rate sharply over 2018 to 18.5 percent, although this has raised the cost of funds and dampened investment. With limited access to external funds, domestic public borrowings have increased in 2018 crowding out the private sector investment. This limited the supply responses to the growing demand pressures. As a result, the external trade deficit has widened significantly in 2018. Ukraine's renewed cooperation with the IMF, EU and WB helped to cover the current account deficit and to rebuild international reserves that reached $20.8bn (or equivalent of 3.5 month of import cover).

FIGURE 1 Ukraine / GDP growth by sectors



Sources: UKRSTAT, World Bank.

FIGURE 2 Ukraine / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

Outlook

The growth outlook depends critically on sustaining the reform momentum to support investment and mobilizing adequate financing. In 2019, growth is projected at 2.7 percent as investment remains constrained by difficult external conditions, election-related uncertainties, and the resulting high cost of external borrowing. In addition, Ukraine's terms of trade are projected to soften and limit traditional exports. Growth in 2019 will thus continue to be supported by the services sectors and consumption. The continued growth of consumption is expected to help continue to mildly reduce poverty.

Going forward, if the reform momentum is sustained, growth can recover to 4 percent in the medium term after election related uncertainties abate. This will require progress in the following areas: (i) attracting private investment into tradable sectors by improving the business environment and privatizing large state-owned enterprises, developing a market for agricultural land, and tackling corruption; (ii) ensuring fiscal sustainability through affordable implementation of the health and education reform, rationalizing social assistance, and a more equitable and growth-friendly tax system; (iii) further reducing inflation and rebuilding reserves; and (iv) reviving sound bank lending to the enterprise sector. If reforms do not progress and adequate financing is not mobilized, growth could fall below 2 percent as investor confidence deteriorates, macroeconomic vulnerabilities intensify, and financing difficulties force a compression in domestic demand.

Risks and challenges

Ukraine faces formidable financing needs in the next three years, which will require mobilizing sizable international financing and meeting the fiscal target of a deficit of 2.5 percent of GDP to maintain macroeconomic stability. Ukraine needs about $11 billion per year (8 percent of GDP per year) to repay public debt and finance the fiscal deficit in 2019, 2020, and 2021. To raise the necessary financing, it is critical to maintain the reform momentum and stay on track with completion of IMF reviews. Ukraine will continue to need an IMF program after the SBA runs out in March 2020.

Ukraine remain highly vulnerable to external shocks and commodity price cycles due unfinished structural transformation of the economy. To increase resilience to external shocks Ukraine will need higher and more sustainable economic growth, supported by tradable and higher value-added sectors. This will require significant capital investments and deeper integration into global value chains. To facilitate investments, it is critical to maintain the reform momentum, reduce macroeconomic risks and insure repayment of public external obligations.

TABLE 2 Ukraine / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	2.3	2.5	3.3	2.7	3.4	3.7
Private Consumption	1.8	8.4	8.9	3.8	3.5	3.0
Government Consumption	0.0	3.3	0.1	0.5	1.0	1.5
Gross Fixed Capital Investment	20.1	18.4	14.3	6.6	9.3	9.6
Exports, Goods and Services	-1.6	3.6	-1.6	0.5	2.0	4.5
Imports, Goods and Services	8.4	12.8	3.2	3.8	4.2	5.0
Real GDP growth, at constant factor prices	2.4	2.6	3.3	2.5	3.4	3.7
Agriculture	6.0	-2.5	7.8	1.5	2.5	4.5
Industry	3.3	2.1	2.0	3.0	4.5	6.0
Services	1.4	3.7	3.0	2.4	3.2	2.7
Inflation (Consumer Price Index)	13.9	13.7	9.5	6.8	6.0	5.4
Current Account Balance (% of GDP)	-3.7	-2.1	-2.9	-3.0	-3.5	-3.7
Net Foreign Direct Investment (% of GDP)	0.2	2.1	1.9	2.2	2.4	2.5
Fiscal Balance (% of GDP)	-2.3	-2.3	-2.0	-2.1	-2.2	-2.4
Debt (% of GDP)	81.2	72.3	63.2	60.1	57.9	55.7
Primary Balance (% of GDP)	2.0	1.5	1.9	2.3	1.9	2.3
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.1	..	..	..	..	..
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.5	0.4	0.3	0.3	0.2	0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	6.4	4.9	4.0	3.4	2.8	2.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2016-HLCS. Actual data: 2016. Nowcast: 2017-2018. Forecast are from 2019 to 2021
(b) Projection using neutral distribution (2016) with pass-through = 0.87 based on private consumption per capita in constant LCU.

UZBEKISTAN

Table 1	2018
Population, million	32.3
GDP, current US$ billion	49.7
GDP per capita, current US$	1535
School enrollment, primary (% gross)[a]	101.0
Life expectancy at birth, years[a]	71.3

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent WDI value (2016)

Economic growth was 5.1 percent in 2018 due to strong investment growth in industry and infrastructure . Despite a projected external weakening, Uzbekistan's medium-term outlook remains favorable as market reforms address production bottlenecks and liberalize high-potential growth sectors of the economy.

Recent developments

Economic growth in 2018 accelerated reflecting the high growth in industry and construction. Agricultural production was disappointing due to unfavorable weather and water shortages. Domestic demand remained robust in 2018 due to strong domestic investment growth (18.1 percent), supported by large increases in government lending to fund capital investments of state-owned enterprises (SOEs). Annual inflation averaged 17.9 percent in 2018 mainly due to the effects of the 2017 exchange rate unification, wage increases, and the removal of administrative price controls.

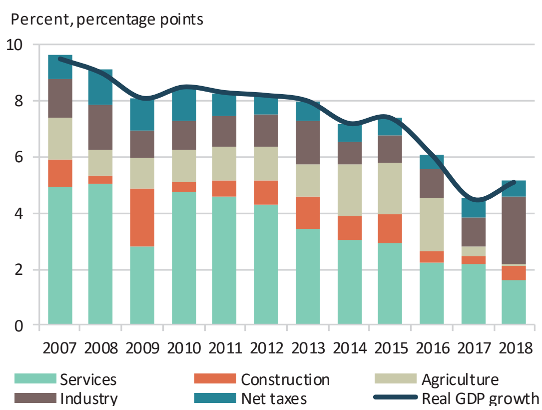
Import spending rose sharply in 2018 (up 25.8 percent year on year) due to large capital imports by SOEs. Export growth was weaker at 10.7 percent. A more competitive real exchange rate and removal of export controls helped textile and food exports, which grew by 41.4 and 25.3 percent, respectively. Car exports declined by 39.7 percent due to weaker demand and supply bottlenecks. Commodity exports of gas and metals grew by 65.8 percent and 27.6 percent, respectively. Gold exports, however, declined by 10.8 percent due to lower global prices in 2018. As a result, the current account moved from years of surplus to a deficit of 8.1 percent of GDP in 2018, financed by a drawdown in reserves and from external creditors. The real effective exchange rate depreciated by about 10 percent in 2018 due to the exchange rate unification in late 2017, and since then a depreciation of the som against major currencies.

In response to inflationary pressures, authorities raised the policy (refinancing) rate by 2 percentage points (from 14 to 16 percent) in September 2018. The effects of this increase were dampened by the increase in government-directed lending, which drove annual domestic credit growth of 50.8 percent in 2018.

Total government expenditure as a share of GDP, including directed lending, rose to 35.7 percent of GDP in 2018 (from 31.5 percent of GDP in 2017). Central government expenditures grew by 3.7 percent of GDP due to an expansion in public investment and reform-related social spending initiatives. A surge in extra-budgetary government lending to SOEs of 5.1 percent of GDP compounded this increase. A push to improve tax collection and administration helped to partially offset these expansions, leading to an overall fiscal deficit of 2.5 percent of GDP in 2018 (compared to a deficit of 2.1 percent of GDP in 2017).

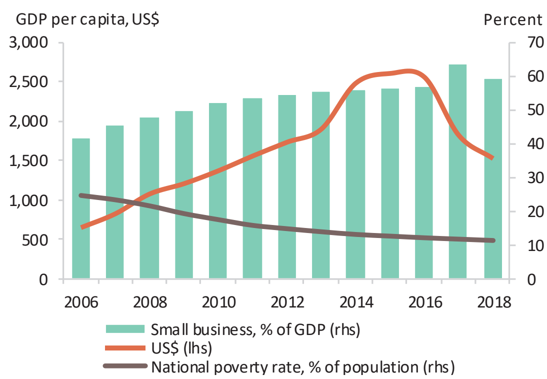
The banking sector remains well-capitalized and stable. Large capital injections by the Uzbekistan Fund for Reconstruction and Development in 2017 and 2018 have helped banks remain well capitalized after the foreign exchange unification in late 2017, despite rapid credit growth in 2018. At end-2018 the capital adequacy ratio stood at about 16 percent. Non-performing loans were low at 1.3 percent of gross loans, mainly due to the recent restructuring of debts from energy SOEs to state-owned banks.

FIGURE 1 Uzbekistan / Real GDP growth and contributions to real GDP growth



Source: Uzbekistan official statistics.

FIGURE 2 Uzbekistan / Poverty, GDP per capita, and small business development



Sources: Uzbekistan official statistics. Due to the lack of data access, the World Bank cannot validate the official figures.
Note: Poverty line is national data based on minimum food consumption at 2,100 calories per person per day and excludes non-food items.

The official poverty rate, which stood at 11.9 percent in 2017, is estimated to have declined to 11.5 percent in 2018. Estimates of PPP adjusted poverty rate at the LMIC line was 9.6 percent in 2018. The official unemployment rate was 9.3 percent in the last quarter of 2018. Unemployment was 17 percent among youth (16-25 years old) and 12.9 percent among women in 2018. According to official statistics, 59.3 percent of the total employed in the economy were employed in the informal sector in 2018. Since September 2018, income growth among the B40 has been driven by increased remittances and a 30 percent nominal increase in social protection payments in 2018. Poor and B40 households consistently cite local labor market conditions as their most pressing economic concern. Government public works and employment programs were expanded in 2018.

Outlook

Despite a slowdown relative to historical averages, Uzbekistan's economic outlook remains positive, with growth projected at 5.3 in 2019 and converging to around 6 percent by 2021. Market reforms are expected to address production bottlenecks and liberalize high-potential growth sectors of the economy, such as horticulture, tourism, food processing, textile, and chemicals. These will be supported by a significant reduction in 2019 of the business tax burden. Inflationary pressures will persist in 2019–20 due to further price reforms and wage increases, but the effects are expected to moderate by 2021. The current account is expected to moderate from its 2018 level but remain in deficit as the economy continues increasing imports of capital and machinery to modernize production. This is expected to be financed by increased donor support and a gradual increase in FDI. External buffers are expected to remain comfortable over the medium-term, with forex reserves at over 13 months of import cover. Gross external debt is expected to slightly decline by 2020 to about 39 percent of GDP, while total public debt is expected to increase to about 29 percent of GDP.

Central government budget (excluding policy-based lending) is expected to shift from a surplus to a small deficit of about 1 percent of GDP over the medium-term due to the significant reductions in excise, income and payroll tax rates, and increased spending to maintain public investments, pensions, and low-income allowances. The government is expected to curtail directed lending in the economy to maintain fiscal discipline. Steady economic growth and remittance income are expected to contribute to a modest pace of poverty reduction. Changes in government policies may further expand support programs to the poor and vulnerable households and reduce poverty. For 2019 the government has increased the budget allocation for social protection by 50 percent.

Risks and challenges

Uzbekistan's economy remains reliant on a state dominated economic model and on traditional trading partners that face heightened external risks over the medium term (for example, the Russian Federation). While market reforms have begun to address these issues, the next phase of reforms aims to tackle more complex issues such as SOEs and the financial sector, agricultural reforms, and the privatization of non-agricultural land. These reforms are critical to economic transformation and to sustaining growth and job creation. They also carry significant economic and social risks that will need to be carefully monitored and managed.

TABLE 2 Uzbekistan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	6.1	4.5	5.1	5.3	5.5	6.0
Private Consumption	1.4	1.3	3.5	3.6	3.8	4.0
Government Consumption	3.8	6.6	1.5	1.4	2.3	2.6
Gross Fixed Capital Investment	4.1	19.4	18.1	15.3	10.2	10.1
Exports, Goods and Services	7.9	1.3	10.7	8.2	2.2	2.5
Imports, Goods and Services	-2.2	18.7	25.8	18.4	7.1	6.8
Real GDP growth, at constant factor prices	6.1	4.5	5.1	5.3	5.5	6.0
Agriculture	6.2	1.2	0.3	2.9	3.2	3.4
Industry	5.9	5.4	10.4	6.4	6.3	6.7
Services	6.2	6.0	4.7	5.9	6.3	7.0
Inflation (Private Consumption Deflator)	8.0	12.5	17.9	14.8	14.1	11.0
Current Account Balance (% of GDP)	0.3	1.4	-8.1	-7.8	-6.3	-5.7
Fiscal Balance (% of GDP)	-0.6	-2.1	-2.5	-2.0	-2.1	-2.1
Debt (% of GDP)	10.5	24.1	24.4	28.1	29.0	28.5
Primary Balance (% of GDP)	-0.6	-2.0	-2.1	-1.5	-1.6	-1.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.

WORLD BANK **ECA ECONOMIC UPDATE** SPRING 2019

Financial Inclusion

Financial services can help drive development by facilitating people's investments in their health, education, and businesses, and making it easier for people to manage emergencies. There is great variation in financial inclusion in the Europe and Central Asia region. Some countries have seen significant growth in account ownership, despite starting from a low base. These experiences underline the potential role of digital payments in driving financial inclusion. But nearly 30 percent of unbanked adults report trust in banks as a barrier, which is nearly double the developing country average. And in some countries, gender gaps in account ownership remain significant. Given the heterogeneity of experiences, there are ample opportunities for countries in the region to learn from each other and contribute to the rich research and operational agenda going forward.

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