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Migration and Mobility

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

CIDOB	Barcelona Center for International Affairs
CIS	Commonwealth of Independent States
CRIC	Child Rights Information Center
DIOC	Database on Immigrants in OECD Countries
ECA	Europe and Central Asia
ESS	European Social Survey
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
ICT	information and communications technology
IOM	International Organization for Migration
IPO	initial public offering
MERIT	Maastricht Economic and Social Research Institute on Innovation and Technology
MIPEX	Migrant Integration Policy Index
MOOC	massive open online course
MPG	Migration Policy Group
PICMME	Provisional Intergovernmental Committee for the Movement of Migrants from Europe
UNDESA	United Nations Department of Economic and Social Affairs
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNHCR	United Nations Higher Commissioner for Refugees
UNICEF	United Nations Children's Fund
UNRWA	United Nations Relief and Works Agency for Palestine Refugees in the Near East
VAR	vector autoregressive

Country Groups

TABLE E.1 Regional classification

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

Other country groups mentioned in this report:

EU-28: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxemburg, Malta, the Netherlands, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Sweden, United Kingdom

EU-13: Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovak Republic, Slovenia

EU-15: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxemburg, the Netherlands, Portugal, Spain, Sweden, United Kingdom

Executive Summary

Economic growth in Europe and Central Asia (ECA) is set to reach 2.2 percent in 2017, the strongest growth in six years and 0.3 percentage point faster than estimated in May 2017. Most ECA economies are showing more rapid growth than previously expected, reflecting a strengthening of growth in industrial production and exports in recent months. Export growth in the region continues to exceed that in the rest of the world. The relatively favorable growth outlook comes with a normalization of inflation; a decline in unemployment rates; and, in many countries, moderate fiscal deficits.

With the robust cyclical performance, countries are shifting their focus toward structural challenges that are part of the new normal after the financial crisis and the fall in commodity prices.

In the eastern part of the region, adjustment to the change in relative prices and the dramatic fall in income caused by the decline in oil prices is incomplete. Needed reforms could help boost exports. Several countries, especially Kazakhstan and Uzbekistan, have taken first steps toward such reforms.

In the western part of the region, platform networks and the sharing economy have grown rapidly since the global financial crisis, after which investors began looking for new investment opportunities, workers demonstrated a new willingness to engage in more flexible working arrangements, and individuals became eager to commercialize some of their underutilized assets. These changes have created many opportunities—but they have also increased uncertainty and anxiety. The challenge is to adjust the design of social security systems and the regulation of labor markets to this new reality.

Technological advancement, the globalization of production and work, and the challenges caused by lower commodity prices have contributed to a rise in public anxiety. It came to the surface as the number of asylum seekers and undocumented migrants in the region rose, leading to concerns about immigration in general. Often lost in the current debate is the fact that the number of refugees in ECA is not unprecedented, that surges tend to be temporary, that refugees represent just a small share of the total number of migrants—and that migration has long been vital to the region, with ECA economies reaping substantial benefits from cross-border labor mobility.

Migration patterns are likely to change with technological progress and further cross-border connectivity, and competition for high-quality jobs will become more intense. Reforms should help both migrants and nonmigrants cope with the inevitable increase in flexibility in labor markets—by, for example, ensuring the portability of benefits, increasing income security for workers, and better integrating migrants in host countries.

PART

Economic Outlook

1

Economic Developments and Prospects

Overview

GDP growth in Europe and Central Asia (ECA) is shaping up to reach 2.2 percent in 2017, the strongest growth in six years. The current estimate is 0.3 percentage points higher than forecast in ECA's May *Economic Update*.

Almost all parts of the region show stronger growth than earlier expected, reflecting a strengthening of industrial production and exports in recent months. ECA's export volume growth continues to exceed the global average. Central Europe and the Western Balkans continue to register solid GDP growth, while the Russian Federation and Belarus have come out of recession. Only Azerbaijan, the country that was hardest hit by the fall in oil prices and that responded with some delay, is expected to remain in recession this year.

The improved growth outlook comes with a normalization of inflation, lower unemployment rates, and in many countries moderate fiscal deficits. Average inflation in the European Union is approaching 2 percent this year, after close to zero inflation a year ago. Inflation in Kazakhstan and Russia has plummeted from the double-digit rates after the fall in oil prices—confirmation that the recent low inflation in oil-importing countries and high inflation in oil-exporting countries merely reflected one-time adjustments in relative import prices. In several countries, unemployment rates have fallen below pre-2008 levels and labor participation rates are above pre-crisis levels. The average fiscal deficit this year is 1.6 percent of GDP, down from 5 percent in 2009.

Despite this robust cyclical performance, daunting structural challenges have come to the surface:

- In many countries, the share of full-time permanent jobs in total employment has declined. The rising share of flexible contracts is driven by a wave of new technologies and the rapid growth of digital platforms for commercial activities. These new technologies will increase efficiency, but they will also change

the distributions of wealth and income.

- The banking sector remains fragile in many countries, and weaknesses have become more exposed in countries that directly or indirectly depend on commodity exports. Moreover, the financial sectors in ECA are struggling to absorb new technologies and meet new demand for risky capital.
- Regional economic and political cohesion is being tested, as exemplified by the Brexit vote. After the European banking crises, enthusiasm for deeper and broader integration has waned in the western part of the region. Meanwhile, the fall in oil prices has somewhat diminished the expected economic benefits of the Eurasian Economic Union.
- The eastern part of the region has still not fully adjusted to the change in relative prices and the dramatic fall in income triggered by the drop in oil prices. The unavoidable decline in private consumption has been steep. Over the last two years, consumption declined 16.4 percent in Tajikistan, 14.2 percent in Russia, 9.1 percent in Armenia, and 6.2 percent in Belarus. In other countries, where adjustment to new realities was slower, a sharp downward adjustment in income might still occur. Relative price changes have opened up the opportunity for sharply increased exports, but in most cases reform programs are needed to realize these opportunities. Several countries (Belarus, Kazakhstan, and Uzbekistan) have taken first steps toward such reforms.

GDP growth is strong throughout the region

GDP growth in ECA is shaping up to reach 2.2 percent in 2017, the strongest growth in six years and 0.3 percentage points higher than estimated in the May *Economic Update* (Table 1.1). Almost all parts of the region show higher growth than earlier expected, reflecting a strengthening of activity in recent months.

In the western part of the region, defined as the European Union (EU) and the Western Balkans, countries in Central Europe are expected to grow the most rapidly during this and coming years. GDP growth in these new EU member states is forecast to be almost twice the average growth in the European Union. This pattern represents a continuation of the historical convergence trend that earned the European Union the title of convergence machine (Gill and Raiser 2012). In the seven boom years before the global financial crisis (2001–07), GDP in Central Europe grew 4.7 percent a year—twice the 2.3 percent annual growth in the European Union. In the seven years after the crisis (2011–17), Central European economies continued to grow twice as rapidly (2.5 percent versus 1.3 percent). As growth is strengthening throughout the region, this relationship is likely to be sustained.

The Western Balkans are the only subregion in ECA for which growth rates have been reduced since April. The downgrading mainly indicates delayed acceleration of growth. As during the last two decades, GDP growth in the Western Balkans resembles growth in Central Europe much more than growth in the rest of the European Union.

TABLE 1.1 Upward revisions of GDP forecasts for Europe and Central Asia

	Annual GDP growth (percent)					Change in forecast since April 2017 (percentage points)		
Region/subregion	2015	2016	2017 (estimate)	2018 (forecast)	2019 (forecast)	2016	2017 (estimate)	2018 (forecast)
Europe and Central Asia	1.9	1.8	2.2	1.9	1.9	0.0	0.3	0.1
European Union and Western Balkans	2.2	1.9	2.1	1.8	1.7	0.0	0.3	0.2
Western Europe	2.2	1.8	2.0	1.6	1.5	0.0	0.3	0.2
Northern Europe	2.4	2.3	2.3	2.1	2.2	0.0	0.3	–0.1
Central Europe	3.7	2.9	3.7	3.4	3.3	–0.1	0.5	0.3
Southern Europe	1.6	1.7	1.9	1.5	1.4	–0.1	0.4	0.1
Western Balkans	2.3	2.9	2.8	3.2	3.5	0.1	–0.4	–0.3
Eastern Europe and Central Asia	0.1	1.1	2.6	2.5	2.8	0.1	0.4	0.0
South Caucasus	1.7	–2.1	0.3	1.9	2.4	0.0	0.2	0.3
Central Asia	2.9	2.8	4.4	3.5	3.8	0.1	0.6	–0.5
Russian Federation	–2.8	–0.2	1.7	1.7	1.8	0.0	0.4	0.3
Turkey	6.1	3.2	4.0	3.5	4.0	0.3	0.4	–0.4
Other Eastern Europe	–7.6	0.8	2.0	3.1	3.5	0.0	0.6	0.4

Source: World Bank.

High-frequency data for Southern Europe point at stronger growth than earlier expected. Still, the upgraded growth outlook for this part of Europe, which was hardest hit by the European banking crises, is still not strong enough to make up lost ground. Before the global financial crisis, growth in Southern Europe virtually equaled growth in the rest of the European Union. During the crisis years (2008–10), the cumulative contraction in Southern Europe was 4.2 percent, versus 1.8 percent for the European Union as a whole. Divergence continued during the seven years after the crisis, with the European Union growing at an average annual rate of 1.3 percent and Southern Europe experiencing no growth at all. The current outlook suggests that this trend will not soon be reversed.

The picture in the eastern part of ECA is mixed. Oil- and gas-exporting countries and some neighboring countries are coming out of a recession that was triggered by the fall in oil prices at the end of 2014. Only Azerbaijan, which is more dependent on the export of fossil fuels than other countries in the region and which responded with some delay, is still in recession. High and rising oil prices brought a decade of exceptionally strong growth, with a short interruption in 2009. The outlook is now more fragile for oil-dependent countries.

In an idiosyncratic crisis caused largely by geopolitical tension and a legacy of macroeconomic problems, Ukraine lost cumulatively more than 16 percent of its GDP in 2014 and 2015. It is registering positive growth again, but not nearly enough to undo the damage done during these two years.

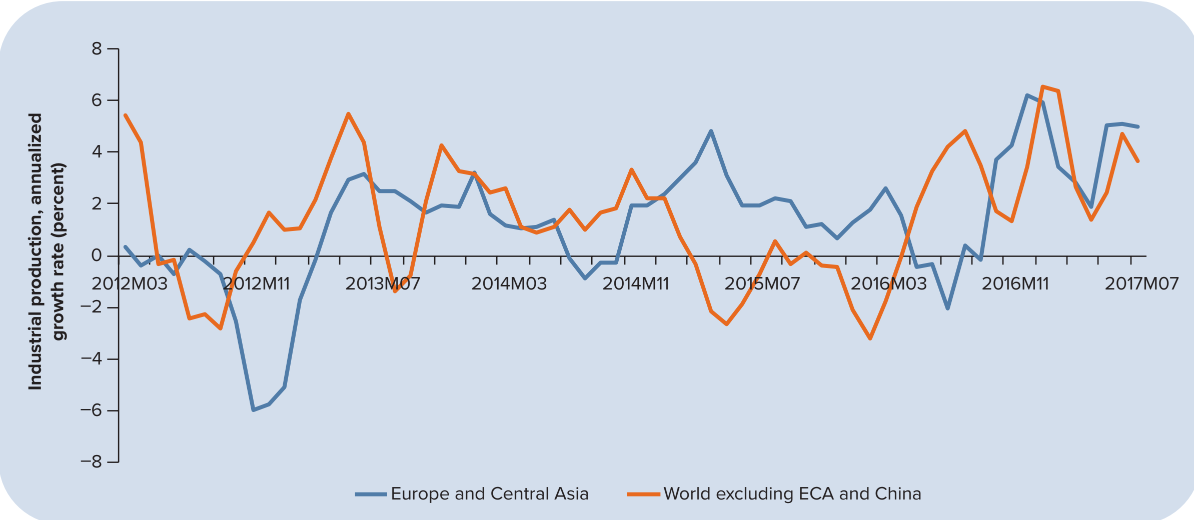
Turkey showed remarkably strong GDP growth after the global financial crisis, largely because of effective fiscal stimulus. Average annual GDP growth in 2011–16 was 6.4 percent. In 2016 growth declined to 3.2 percent, with rising inflation, rising long-term interest rates, and a depreciating lira. However, the first half of 2017 showed a strengthening of growth again, leading to higher expected growth than in other parts of the ECA region.

ECA is outperforming the rest of the world in exports

The upward revision of the growth forecasts follows data releases of high-frequency indicators that point at strong activity during the first half of 2017. In July the volume of industrial production in ECA was 4.2 percent above its level a year earlier (Figure 1.1). The increase constitutes a sharp acceleration from performance in recent years and is well above the annual average 1.5 percent growth since 2000. Stronger growth is broad-based within ECA. One of the few exceptions is the United Kingdom, where the approaching break with the European Union has depressed growth in industrial activity.

The recent acceleration of economic activity is part of a global trend. In the rest of the world excluding ECA and China, industrial production increased 3.2 percent during the 12 months ending in July 2017, a much faster rate than the long-term annual growth rate of 1.2 percent. Growth of industrial production in China is of a different order of magnitude (6.2 percent over the last 12 months).

FIGURE 1.1 Industrial production has strengthened, in the region and globally



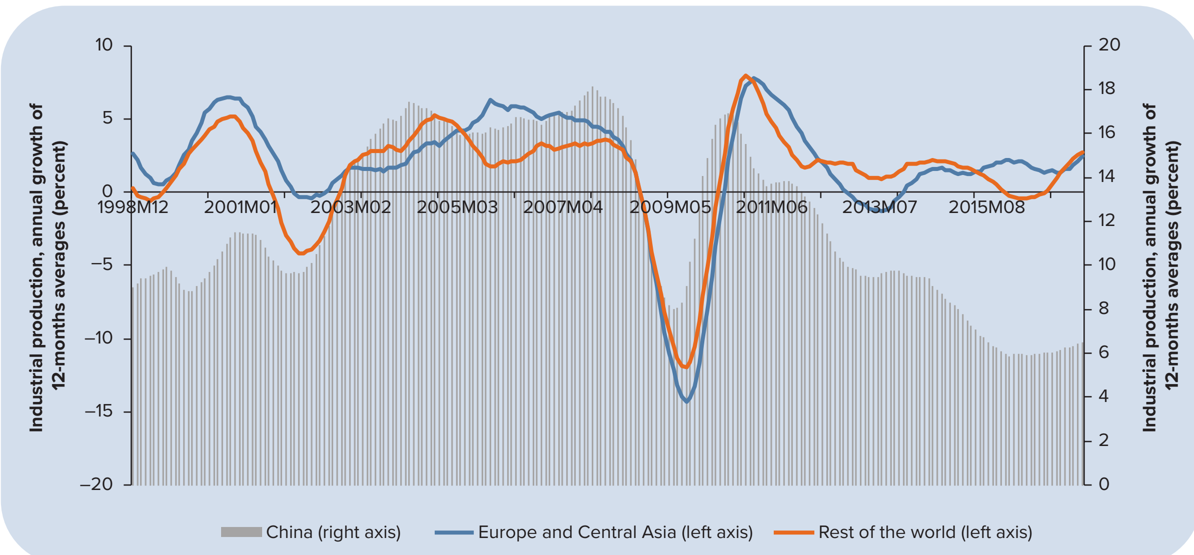
Source: World Bank.

High as that growth rate is, however, it is only half the average annual growth rate of 12 percent since 2000.

Slowdown in China does not necessarily lead to a slowdown in the rest of the world (Figure 1.2). On the contrary, as China's slowdown comes with rising costs, it improves the competitiveness of producers in other countries (World Bank 2016).

The acceleration of global growth is also evident in recent export data. The volume of global merchandise exports rose 7 percent in the 12 months ending in

FIGURE 1.2 Slowdown in China has not led to slowdown elsewhere

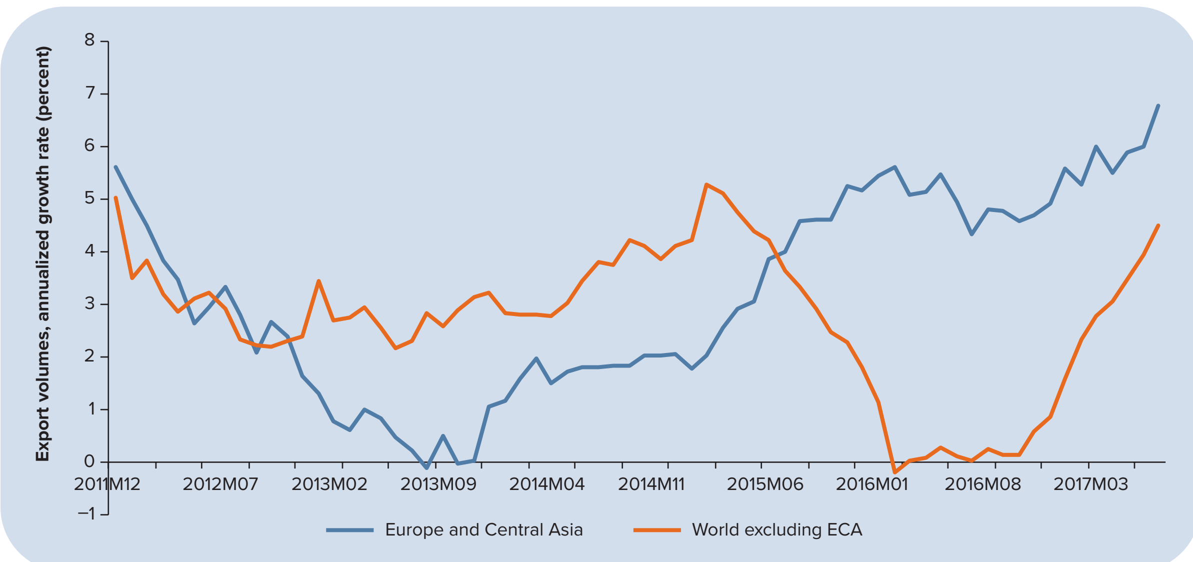


Source: World Bank.

July 2017. Exports originating in ECA countries grew by 7.8 percent. These numbers are important for two reasons. First, global export growth is now faster than any year since 2010, when exports rebounded from the unprecedented collapse in 2009. Second, ECA's exports are outperforming exports from other parts of the world. ECA's export performance over the last three years is even more striking, with average annual growth of 5.2 percent, compared with 1.6 percent export growth in the rest of the world (Figure 1.3). The weakening of the euro in 2015—following the start of quantitative easing by the European Central Bank in January of that year and the real depreciation of currencies in the eastern part of ECA after oil prices fell in the final quarter of 2014—contributed to ECA's export success.

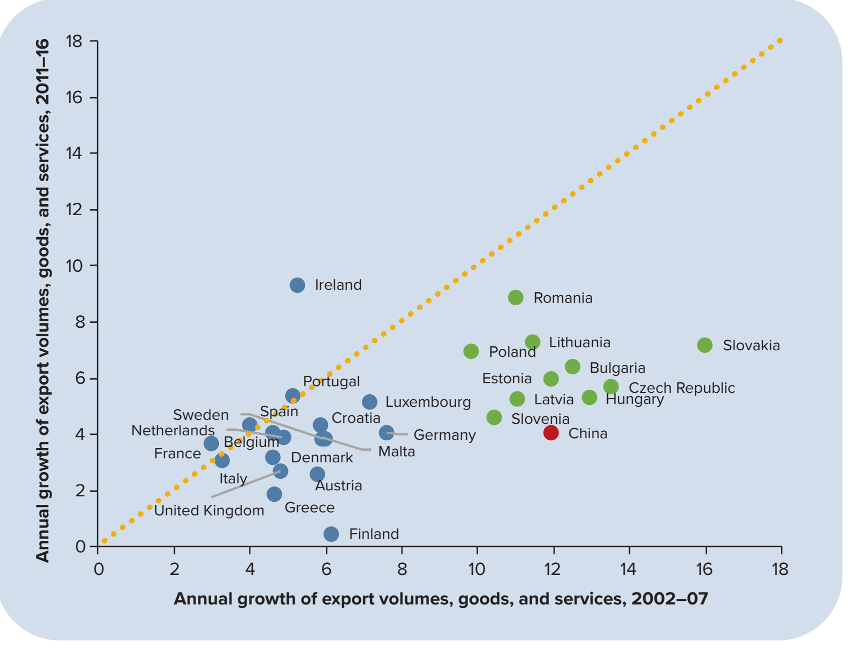
The export success of Central European countries has been remarkable over an even longer period. It compares favorably with export performance in China. The unweighted annual average of the growth of exports of goods and services (in volume terms) of EU accession countries was 11 percent in the six years before the global financial crisis, compared with 12 percent for China. Four countries—Bulgaria, the Czech Republic, Hungary, and the Slovak Republic—registered stronger growth than China. Only Croatia and Malta were clearly falling behind, with average growth rates of just under 6 percent. Export growth was an important vehicle for Central Europe's convergence toward EU levels during this period. During the six years after the crisis, export growth in China fell to just 4 percent. Annual export growth averaged 4 percent in Croatia and Malta; 7 percent in Lithuania, Poland, and the Slovak Republic; and 9 percent in Romania. Export growth of the older EU member states has fallen short of the performance of the new members, but the slowdown after the crisis has been much more moderate (Figure 1.4).

FIGURE 1.3 Europe and Central Asia outperforms the rest of the world in exports



Source: World Bank.

FIGURE 1.4 **EU accession countries outperformed China in export markets**



Source: World Bank.

Inflation has normalized and unemployment fallen

The improved growth outlook comes with a normalization of inflation, lower unemployment rates, and in many countries moderate fiscal deficits and close to balanced current accounts. In the European Union, average inflation is approaching 2 percent this year, up from about zero a year ago. In Kazakhstan and Russia, inflation declined significantly from the double-digit rates that prevailed after the fall in oil prices—confirmation that the recent low inflation in oil-importing countries and high inflation in oil-exporting countries reflected one-time adjustments in relative import prices.

The average unemployment rate in the 28 EU countries has fallen to 4.2 percentage points below the peak in the wake of the 2008 crisis; it is now just 0.7 percentage points above the 2007 low (Figure 1.5). In several countries, unemployment rates have fallen below pre-2008 lows and labor participation rates are in many cases above pre-2008 levels.

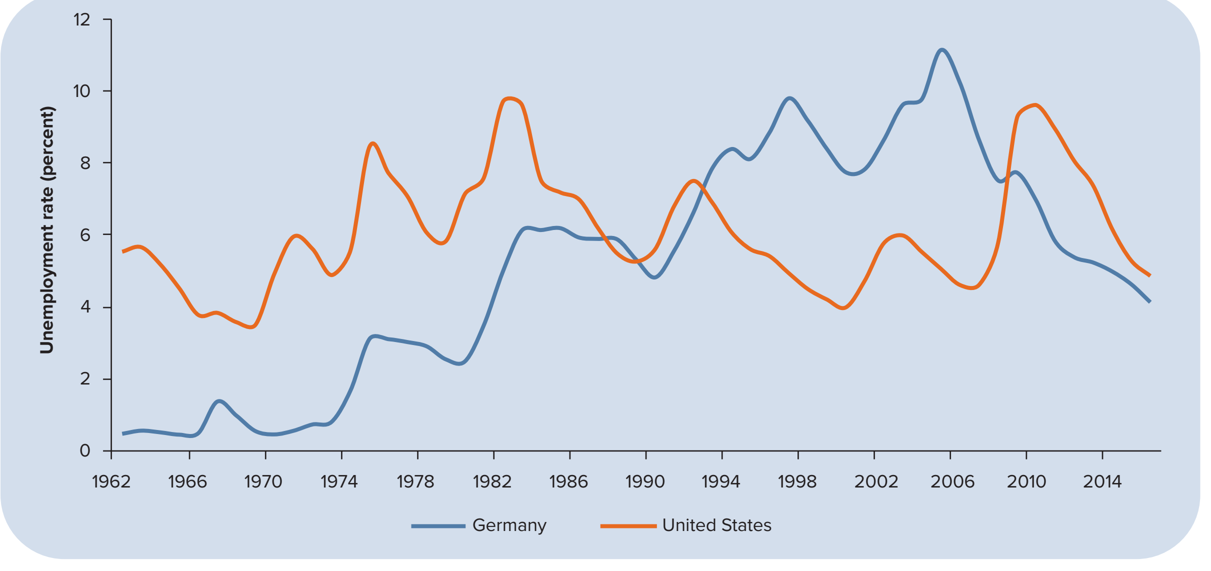
Germany provides a clear example of labor market improvements. For decades, its unemployment rate moved stepwise to ever higher levels: After every crisis—the oil crises of the 1970s, the recession of 1992—unemployment increased and then stayed at the elevated level.

As in the rest of Europe, the German labor market was a textbook example of hysteresis. Its experience has been very different from that of the United States, where unemployment rates fluctuated at about 4–5 percent during the last 50 years. The German hysteresis ended around the time of the 2008 crisis; since the crisis its unemployment rate has fallen by more than half (Figure 1.6). One contributing factor to this turnaround may have been the labor market reforms enacted in 2003, which increased support for job training and capped unemployment benefits.

FIGURE 1.5 The unemployment rate in the EU-28 has fallen back to pre-crisis levels

Source: Eurostat (http://ec.europa.eu/eurostat/data/database).

FIGURE 1.6 German unemployment has reversed the upward trend



Source: OECD (http://stats.oecd.org/).

Other European countries have implemented, or are in the process of implementing, similar labor market reforms. Some of the decline in unemployment rates can thus be interpreted as structural successes. However, the current rates should also be understood as signs that most of the cyclical obstacles to growth have disappeared. Other high-frequency indicators confirm this improvement in cyclical conditions. In September 2017, for example, the euro area economic sentiment indicator reached its highest level since June 2007.

Fiscal positions in the region are consistent with much improved cyclical conditions

Most ECA countries entered the global financial crisis with small fiscal deficits or comfortable surpluses. For the region as a whole, the fiscal deficit was 0.3 percent of GDP in 2007. In 2009 large deficits were built up, averaging 6.4 percent of GDP.

Throughout the region, fiscal balances have now returned to normal levels, with an average deficit of 1.6 percent of GDP. Countries in Central Asia, which are still struggling to absorb the impacts of lower oil prices, are among the few places in the region where deficits recently increased (Table 1.2).

Despite this robust cyclical performance, economic challenges of a structural nature have come to the surface. Among them are transformational changes in the character of employment caused by digital platforms for commercial activities, vulnerabilities in the banking sector and the emergence of new financial intermediation, fragility in regional economic and political cohesion, and dramatic changes in relative prices that force countries, especially in the eastern part of ECA, to adjust their production structures and consumption patterns. All these structural challenges are part of the new normal that tends to emerge after a major global crisis. Many of them are linked to disruptive technologies that find fertile ground in the wake of such crises.

New technologies have created daunting labor market challenges

In 2007 Netflix started streaming and the first iPhone came on the market. In 2008 the term MOOC (massive open online course) was first mentioned, the first pros-

TABLE 1.2 Divergence in fiscal balances in Europe and Central Asia

Fiscal balance as percent of GDP, by region/subregion	2007	2009	2017
Europe and Central Asia	**–0.3**	**–6.4**	**–1.6**
European Union and Western Balkans	–0.8	–6.5	–1.5
Western Europe	–1.3	–6.4	–2.2
Northern Europe	3.9	–2.3	–0.7
Central Europe	–1.2	–5.4	–1.2
Southern Europe	–0.7	–8.3	0.3
Western Balkans	–0.1	–4.2	–1.5
Eastern Europe and Central Asia	3.2	–5.2	–2.1
South Caucasus	–0.2	4.4	1.5
Central Asia	4.2	–3.5	–5.1
Russian Federation	5.6	–5.9	–1.9
Turkey	–0.2	–5.2	–2.1
Other Eastern Europe	–1.4	–4.7	–1.5

Source: World Bank.

thetic leg was created by a 3D printer, genome sequencing costs fell dramatically, bitcoin was invented, and Airbnb was created. Uber came on the scene in 2009.

The success of all these technologies and companies in the decade after the crisis may not be a coincidence. The major recession changed the behavior of investors, workers, and consumers. Investors had lost traditional investment opportunities and were looking for yields in a zero-interest-rate environment. Many workers had lost their jobs and were willing to experiment with more flexible contracts in the digital economy. Many consumers were looking for cheaper services and were open to sharing some of their underutilized assets in the sharing economy.

New disruptive technologies continue to emerge. The Internet of things will change the way products are produced, as illustrated by Internet 4.0, promoted by German industry. The commercial use of drones will change the way products are delivered. Personalized precision medicine will change the way people consume health services. Self-driving cars will revolutionize the automobile industry.

New technologies increase efficiency and improve services—but they are also disruptive. They will require changes in labor market policies and social security systems. Digital technologies create winners and losers and thus change the distribution of income and wealth. Firms that create successful digital networks can grow at an unprecedented rate with small initial investments, while traditional firms may experience sharp losses in valuation. Workers may face a new, digital divide between skill levels.

Flexible contracts have become the dominant employment arrangement for younger workers. In Poland the share of nonpermanent employment increased from less than 5 percent in 2000 to more than 15 percent in 2017. In the Netherlands the share of part-time workers and the self-employed is high and rising. Surveys show a similar rise of nontraditional employment contracts in Austria, Hungary, Italy, and Portugal. A forthcoming World Bank report—*Leveling the Playing Field: Rethinking the Social Contract in Europe and Central Asia*—shows that income inequality among young cohorts is greater today than it was in the past.

Many social security systems in ECA are based on a corporate model that serves people with long-term employment contracts and a government system that protects the poorest in society. Supporting large numbers of people with flexible contracts in an adequate way, while preserving incentives to take risks and innovate, represents a formidable challenge.

Low interest rates, vulnerable banking sectors, and new technologies pose financial risks

ECA's financial landscape changed dramatically during the decade after the crisis. Low and even negative real interest rates are a central feature of that new landscape. New vulnerabilities in the banking sector, the decline in foreign direct investment (FDI) flows to Central Europe and the Baltics, and an increased need for venture capital are other features. These new features can complicate the future role of financial intermediation in ECA.

There have been good reasons for the European Central Bank's zero interest rate policy and quantitative easing in response to the financial crisis. Loose monetary policy in the eastern part of the region is the proper response to the fall in oil prices and remittances. But low interest rates come with risks.

For one thing, they can create new bubbles. Corporate bond lending has surged in the region, which is likely to create distress once interest rates inevitably start rising. This risk is primarily a corporate sector risk in ECA, but some sovereigns could also find themselves in the danger zone, especially in Southern Europe, where government debt has increased to 120 percent of GDP.

Low interest rates while the real economy is no longer in a cyclical downturn also reduce the stock of monetary ammunition, which could be a problem if future stimulus is needed. Low interest rates in Europe also make it difficult for banks to earn profits.

Low interest rate policies have been partly a response to low GDP growth and low productivity growth. However, it is unclear how much of the low productivity growth after the crisis was a real phenomenon and how much simply reflected measurement problems. The surge in applications of new technologies has created formidable measurement challenges. It is virtually impossible to measure improvements in the quality of services; it is difficult to value services that are provided for free and financed by advertising; and it is challenging to measure production in the sharing economy when consumers use underutilized assets (Ahmad and Schreyer 2016). Moreover, the new technologies may have rendered some of the old capacity obsolete, accelerating the scrap rate of existing capital. If this phenomenon is significant, it can lead to an underestimation of the rate of technological progress. No conclusions have yet been reached about the causes of the observed productivity slowdown in the new normal, but the potential measurement problem argues for caution about adopting far-reaching policies to counteract the observed slowdown.

In the eastern part of the region, many banks find themselves in a very vulnerable situation. They have suffered significant losses as a result of unavoidable exchange rate depreciations, triggered by the decline in oil prices, and they cumulated losses on their investments in commodity production and real estate. In many cases, they entered this challenging period in a vulnerable position, having engaged in loss-making "connected" lending (lending in which the bank and the borrowing firm are connected to the same entity).

A big challenge for the financial sectors in the eastern part of the region is to provide funding for new companies in new sectors that use new technologies. It is an open question whether banks with entrenched ties to the nontradable sectors are flexible enough to finance new export sectors. Without new companies that are competitive in international markets, oil-exporting and surrounding countries will not be able to fully adjust to all the large changes in relative prices triggered by the decline in oil prices.

European banks shrunk after the crisis and are now well capitalized. But their profitability has declined, and some banks remain vulnerable. As in the rest of the region, it is unclear whether European financial sectors can provide the risky capital needed to develop new technologies. Globally, venture capital increased

70 percent in real terms over the last decade, while initial public offerings (IPOs) declined by half (Wright and Asimakopoulos 2017).

One of the manifestations of the decline in traditional financing could be the drop in FDI flowing into Central Europe and the Baltics (Table 1.3). These inflows are now less than half the level before the global financial crisis. The large inflow of FDI into the EU accession countries during the early 2000s may have been temporary; as these countries develop, the focus should naturally shift from inward FDI to outward FDI. Still, reduced FDI inflows have become part of the new normal for this part of the region. The big challenge for ECA's financial sectors is to accommodate these and other changes in funding activities.

Regional political and economic cohesion is being tested

Regional integration has long been a driving force for prosperity in ECA. With many small nations, there is no alternative to close cross-border cooperation. Without regional integration, it is impossible to achieve the economies of scale and the degree of competition required to increase prosperity.

New technologies have made it even more important to be connected to international markets that spark innovations. It is increasingly vital to be connected in multiple dimensions, as a forthcoming World Bank report—*Critical Connections: Why ECA's Regional and Global Network of Interconnections Matter for Inclusive Growth and Stability*—demonstrates. Trade, migration, financial flows, and information and communications technology (ICT) connectivity tend to reinforce one another; combined they are a conduit for essential knowledge spillovers. If connectivity falls behind in one dimension, the other dimensions become less effective.

TABLE 1.3 Foreign direct investment has declined in Central Europe and the Baltics

FDI flows as percent of GDP, by subregion/country	2000–07	2008–10	2011–16
Central Europe and the Baltics	6.4	4.4	2.5
Bulgaria	14.4	10.0	3.7
Czech Republic	6.9	3.7	3.0
Estonia	12.1	10.2	3.9
Hungary	13.8	9.8	1.8
Latvia	4.6	1.9	3.2
Lithuania	4.1	2.1	1.8
Poland	4.1	3.3	2.5
Romania	5.5	3.7	2.1
Slovak Republic	6.6	2.9	2.2
Slovenia	3.2	0.6	1.7

Source: World Bank.

Despite the growing economic importance of cross-border connectivity, the political trend seems to be moving in the opposite direction; the Brexit vote is the prime example of this phenomenon. In many small regions throughout ECA, voices are being raised for more autonomy, or even independence, as recent events in Catalonia illustrated. More generally, enthusiasm for deeper and broader integration seems to have waned in the new EU member states. Despite an impressive convergence process, keenness for the European Union has cooled after a series of European banking crises in recent years. Meanwhile, the fall in oil prices has somewhat diminished the expected economic benefits of the Eurasian Economic Union, and tensions between Russia and the European Union have strained ECA-wide economic cooperation.

The structural challenge is to rediscover a collective passion for regional cooperation with shared goals, in order to benefit from new technological opportunities while protecting local diversity and preventing new forms of inequality. The connectivity agenda is intertwined with the technology or growth agenda and the inclusion agenda. Separating one from the other is not productive and threatens to produce adverse consequences. Without connectivity, new technologies, or inclusion, social cohesion in ECA could erode and the region could fall behind in applying the new technologies that are reshaping the global economy.

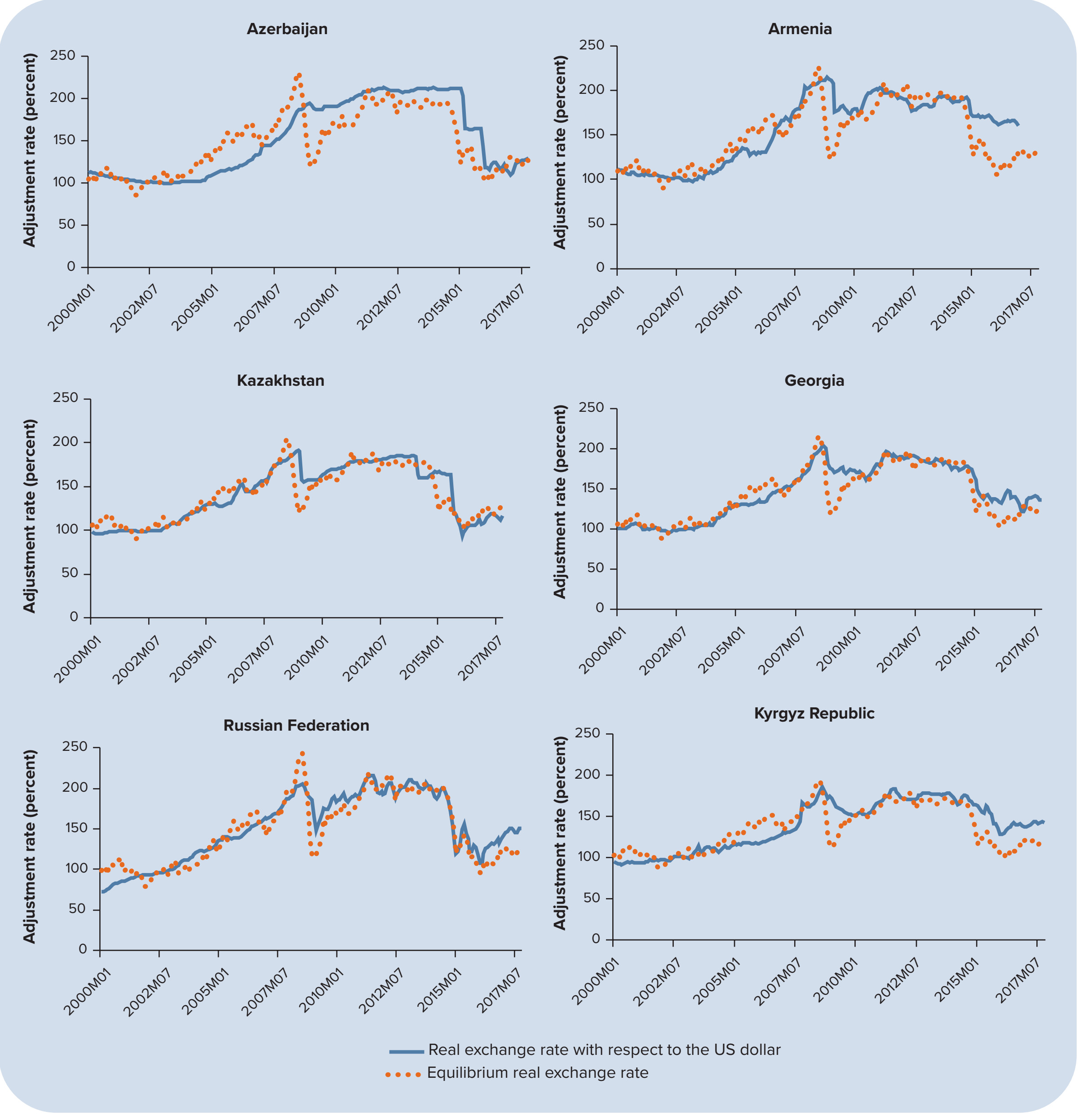
The greatest structural challenge is the sweeping change in relative prices in eastern ECA

The eastern part of the region has still not fully adjusted to the change in relative prices and the dramatic fall in income triggered by the plunge in oil prices and the subsequent drop in remittances. The unavoidable decline in private consumption has been steep: over the last two years, consumption declined 16.4 percent in Tajikistan, 14.2 percent in Russia, 9.1 percent in Armenia, and 6.2 percent in Belarus. In other countries, where adjustment to new realities was slower, a sharp downward adjustment in income might still come.

Countries can adjust successfully only if they seize the new export opportunities created by the relative price changes rather than merely defending against the negative impacts of these changes. In most cases reform programs are needed to realize the new export opportunities. Changes in exchange rate policies are needed, to smoothly achieve the unavoidable real depreciation. Extrapolations of a model that captures historical patterns of real exchange rates suggest that oil exporters have achieved the required real depreciation. Of the remittance-receiving countries that indirectly depend on the oil price, only Georgia seems to have reached the new equilibrium (Figure 1.7).

Realizing new export opportunities also requires reforms of the banking sector, in order to eliminate distortions that benefit banks that engage in connected lending in nontradable sectors and create new funding possibilities for start-ups. It requires mitigation of the artificial monopoly power that state-owned enterprises or enterprises controlled by oligarchs enjoy. It requires adjustments in fiscal policies, to avoid too much domestic stimulus, which can offset the newly

FIGURE 1.7 Oil-exporting and remittance-receiving countries experienced strong real depreciations



Source: World Bank.
Note: World Bank (2015) describes the model on which these figures are based. Because of data problems, it could not be applied to Tajikistan, Turkmenistan, or Uzbekistan.

regained international competitiveness. It requires improved cross-border connectivity, including reduced waiting times.

Many of these reforms have been advocated before, but with large commodity revenues and large incoming remittances they would not necessarily have resulted in strong competitiveness in international markets. Now that commodity revenues and remittances are down, reforms have become vital. They can lead to sharply increased exports and amplified opportunities to compete with imports, even in sectors where countries have not been competitive for a long time.

Uzbekistan recently initiated a bold reform program. As a first step, it depreciated the official exchange rate and lifted restrictions on currency convertibility, with the aim of eliminating the black market for currency exchange. This policy change should lead to improved export incentives in the formal sector and reduce distortions in the domestic economy that were created by the dual exchange rate system. It is an important step in a series of reforms that could make the Uzbek economy competitive in international markets. Kazakhstan has developed an ambitious reform strategy that aims to boost technology and unleash private sector initiatives. Belarus, a country with a large unfinished transition agenda, is also exploring reforms. If these initiatives are successful, the region could experience a second transition, after the opening up during the early 1990s—the right response to current structural challenges.

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2

Migration and Mobility in Europe and Central Asia

Overview

The sharp increase in asylum seekers and undocumented migrants has greatly exacerbated public concerns in Europe and Central Asia (ECA) over immigration in general. This response seems to reflect broader anxiety about reduced job security, caused by the technological developments and the internationalization of production and work discussed in Chapter 1 of this report.

The current debate often overlooks the fact that the number of forced migrants in ECA is not unprecedented, that an influx of refugees tends to be temporary in nature, and that there are stark differences between refugees and other types of migrants. Migration has been vital in ECA's social and economic history. For centuries, it has helped vulnerable households in the region escape poverty and political persecution. In recent decades, ECA economies have benefited from cross-border labor mobility.

Migration patterns in the region are likely to change, along with technological advancement and further cross-border connectivity. The competition for high-quality jobs will become more intense. The share of high-skilled and circular migration may increase, and the duration of skilled migration may decline.

Policy reforms should not focus on migration challenges in isolation. Rather, reforms should help both migrants and nonmigrants cope with increased and unavoidable flexibility in labor markets. Successful reforms will likely improve the portability of benefits, increase income security for workers with flexible contracts, and better integrate migrants in host countries. Programs in origin countries could improve the mixed effects on family members left behind, who benefit from increased resources but suffer from the prolonged absence of parents, spouses, and adult children.

The refugee crisis seems to have made it politically more difficult to fully benefit from cross-border mobility. However, the heightened attention the topic receives could also present an opportunity to establish a more coherent multilateral framework for migration while respecting country-specific idiosyncrasies.

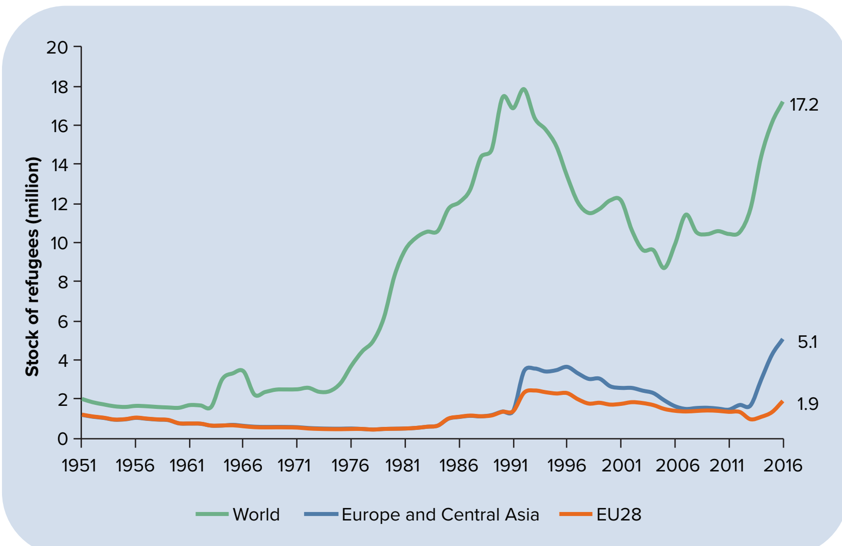
The refugee crisis is raising Europeans' concerns about migration

Refugee flows have increased sharply

The region is facing a steep increase in arrivals of refugees and undocumented migrants fleeing conflict or poverty in their home countries. The stock of refugees and asylum seekers in ECA rose about 75 percent between 2014 and 2016, from 3.7 million to 6.4 million. Turkey alone hosted 3.1 million refugees and asylum seekers in 2016, making it the top host country in the world, and several countries in the European Union (EU) experienced large increases over this period. The region accounted for the bulk of the 3.7 million increase in the global stock of refugees and asylum seekers between 2014 and 2016.

The public debate over immigration has blurred the distinction between refugees and other types of migrants (Box 2.1). First, refugees are forced to move, because of conflict or persecution, whereas economic migrants seek better employment opportunities in destination countries. Second, refugees are more concentrated in space and time and may lack the resources to become fully integrated in the labor markets in destination countries. They account for only a small share of total migration.

FIGURE 2.1 The stock of refugees has risen, globally and in Europe and Central Asia



Source: United Nations Higher Commissioner for Refugees (UNHCR).
Note: The data on asylum seekers and data from the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) are not included.

BOX 2.1 Glossary: Migrants, refugees, and asylum seekers

Asylum seeker: Person who has applied for asylum in a country and is in the process of having his or her refugee status determined. After an application has been processed, an asylum seeker may be granted refugee status or some other form of (often temporary) humanitarian or subsidiary protection status (if returning to the country of origin would put the individual's life or person at risk). The application may also be rejected, requiring the individual to leave the country.

International migrant: Person who changes his or her country of residence, irrespective of the reason. Most countries define migrants as people who were born in another country. A few countries use citizenship as the criterion. About 3 percent of the world's people are migrants. Refugees make up only a small share (7–8 percent) of the world's international migrants.

Irregular or undocumented migrant: Person who has entered, stayed, or worked in a country without a proper visa, residence, or work permit or in violation of laws for foreigners.

Refugee: According to the 1951 Geneva Convention, someone "who is outside his or her country of nationality or habitual residence; has a well-founded fear of being persecuted because of his or her race, religion, nationality, membership of a particular social group or political opinion; and is unable or unwilling to avail him- or herself of the protection of that country, or to return there, for fear of persecution." Regional refugee definitions (such as the 1969 Organization of African Unity Convention and the Cartagena Declaration) also include people displaced by armed conflict and violence. Recent guidelines from the United Nations High Commissioner on Refugees (UNHCR 2016a) also suggest that people displaced by armed conflict and violence fall under the 1951 Convention definition.

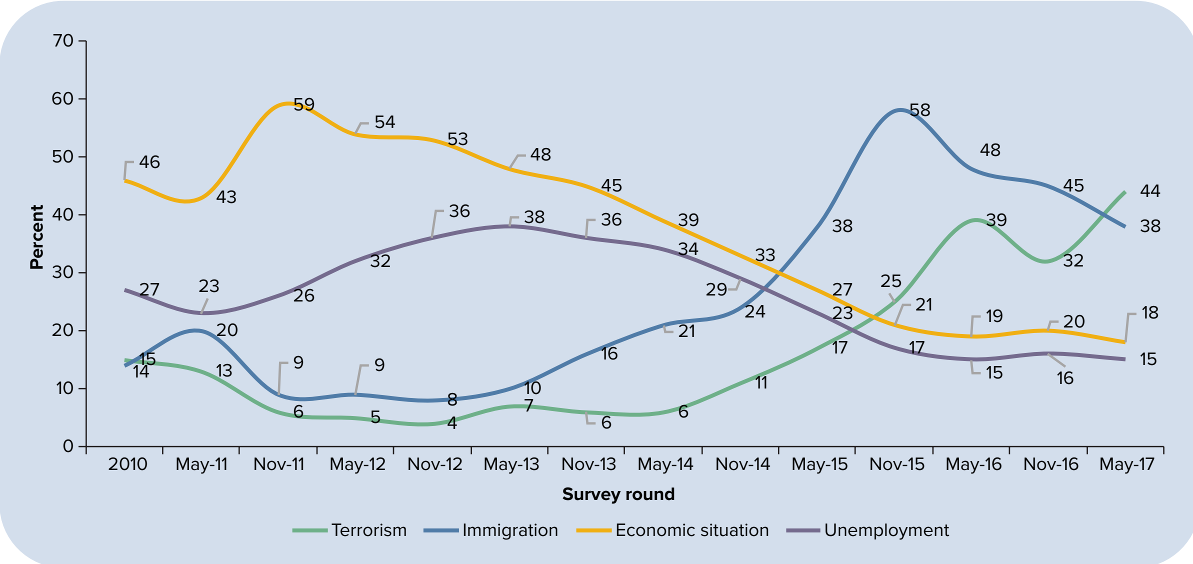
Sources: UNDESA 1998; UNHCR 2016b.

The increase in the number of refugees and undocumented migrants has contributed to public concerns over immigration

The share of survey respondents citing immigration as the most important issue facing the European Union rose from about 9–10 percent in 2011–12 to a peak of 58 percent in November 2015 (Figure 2.2). The increase coincided with a sharp rise in the number of refugees and asylum seekers. By May 2017 this share had fallen to 38 percent, with terrorism seen as a more important issue. Immigration continued to be the top issue in Estonia (62 percent), Hungary (60 percent), Denmark (56 percent), the Netherlands (51 percent), Sweden (45 percent), Germany (40 percent), and Austria (34 percent), however. In 20 other EU countries immigration was the second-most important concern; Portugal was the only EU country in which immigration was not among the three most important issues (European Commission 2017).

Even before the most recent rise in inflows, public attitudes in ECA largely opposed further increases in immigration. According to a survey conducted by the International Organization for Migration/Gallup in 2012–14, only 8 percent of respondents in Europe favored an increase in immigration; 52 percent favored a decrease and 30 percent wanted to maintain the current level. These attitudes differed widely across countries. For example, 70 percent of Russian and British respondents and 84 percent of Greeks wanted immigration to decrease, whereas only 45 percent of respondents in France favored a decrease. Results from the International Social Survey Program also show that only a small minority of people surveyed in all ECA countries think that the number of immigrants should be increased.

FIGURE 2.2 **Survey respondents have cited immigration and terrorism as the most important issues facing the European Union since November 2015**



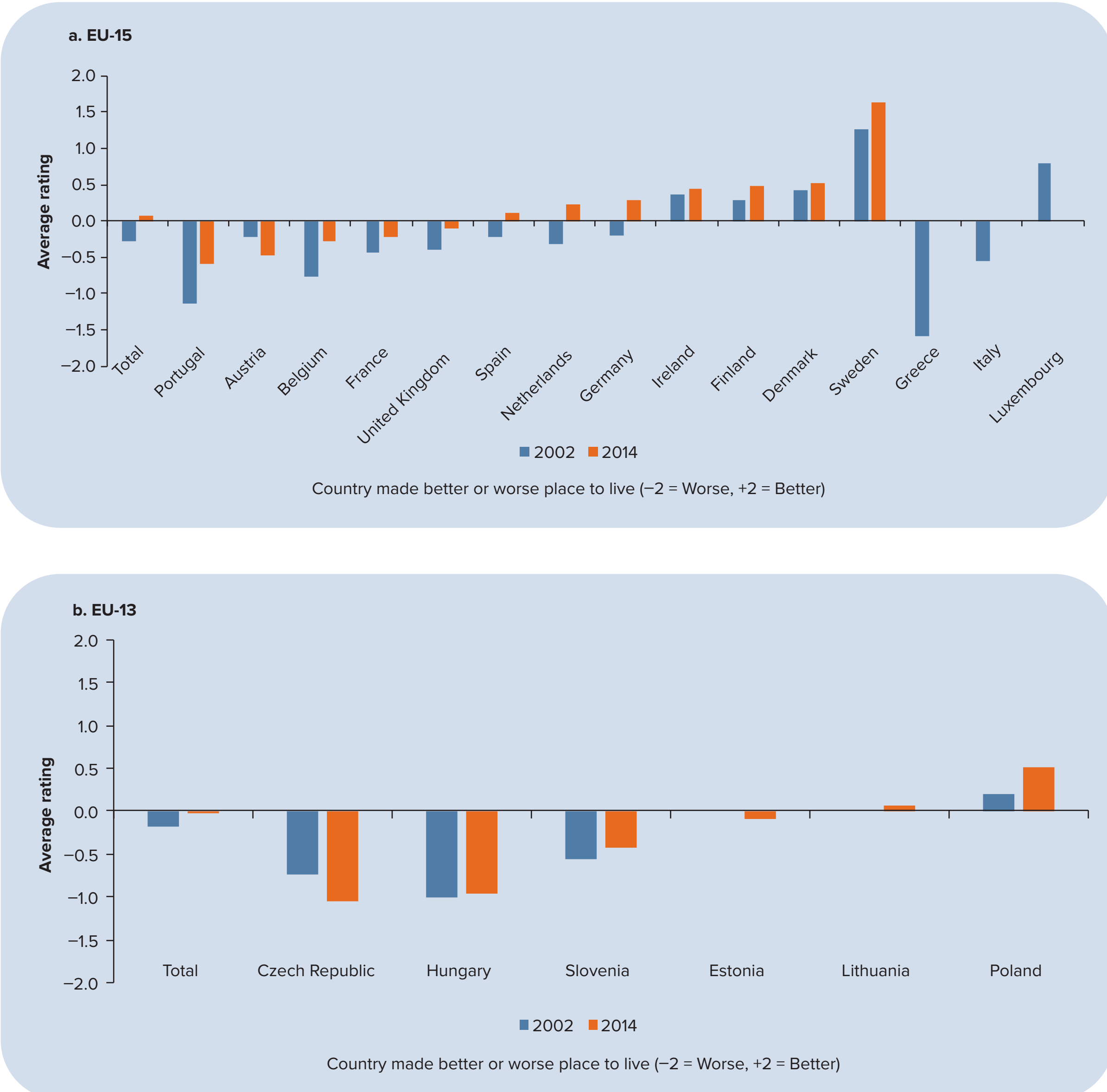
Source: Standard Eurobarometer 87, Spring 2017.
Note: Figure shows four most-mentioned items to the survey question "What do you think are the two most important issues facing the EU at the moment?" Each respondent provided a maximum of two answers.

When it comes to the question of whether immigration makes their country a better or worse place to live, public perceptions remained stable or became slightly more positive between 2002 and 2014 (Figure 2.3). This finding suggests that the recent rise in public concerns over immigration might not reflect the long-term trend. There is also significant variation across countries in terms of public perceptions toward immigration in general. Figure 2.3 indicates that attitudes are more negative in Central Europe (EU-13) than in Western and Northern Europe (EU-15). In general, researchers find Nordic countries to be more positive toward immigration, particularly compared with Central and Eastern European countries (Heath and Richards 2016). Within the EU-13, Poland appears to have more favorable views toward immigration than other countries.

Attitudes toward immigration tend to be more negative in ECA than in other regions. Gallup created a Migrant Acceptance Index based on three questions.[1] Nine of the top 10 least-accepting countries in the 2016 poll were in ECA (the former Yugoslav Republic of Macedonia, Montenegro, Hungary, Serbia, the Slovak Republic, Latvia, the Czech Republic, Estonia, and Croatia). The 2012–14 International Organization for Migration/Gallup survey also shows that attitudes toward immigration are more negative in Europe than in other regions.[2]

Attitudes toward migrants at the country level are not uniform, however, and are influenced by various factors. Research suggests that although there is anxiety about overall immigration, there is strong support for intraregional mobility; younger generations see more benefits from inward migration than older generations; and economic hardship tends to fuel anti-immigrant sentiments (Box 2.2).

FIGURE 2.3 Public perceptions of immigration are more positive in Northern Europe than in the rest of the region



Source: European Social Survey.
Note: Ratings are based on responses to question "Has immigration made the country a better or worse place to live?" Responses from worse (0) to better (10) were rescaled from –5 to 5, multiplied by the shares of each response category, and then summed to arrive at each aggregate country score. Total refers to the weighted aggregate of countries with data for that year. Poststratification weights were applied in the aggregation at the country level; in addition, population weights were applied for the aggregated total. Data were unavailable for Greece, Italy, and Luxembourg in 2014 and for Estonia and Lithuania in 2002.

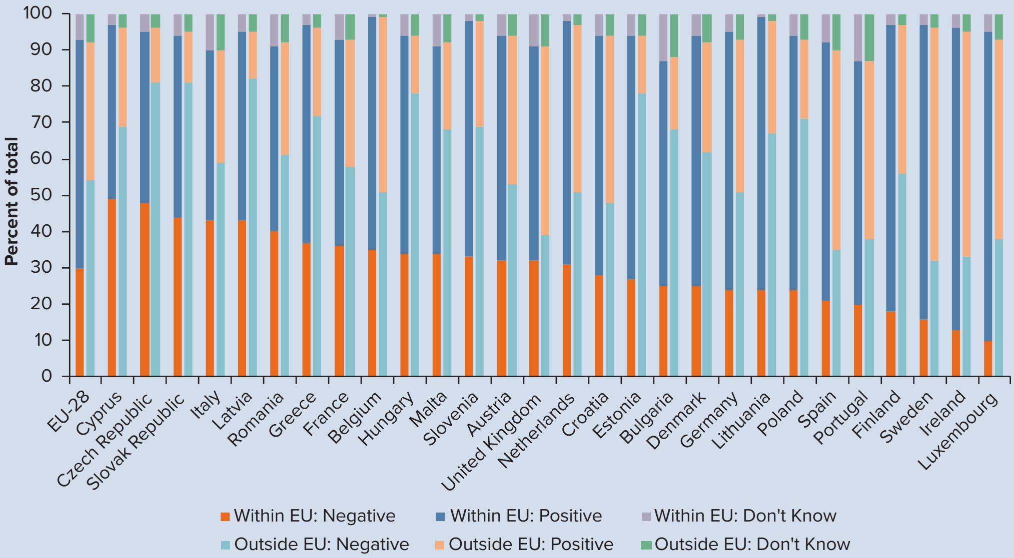
BOX 2.2 What affects public perceptions of immigration?

Polling evidence suggests that many factors seem to affect how people view immigrants.

There is more support for immigration by groups that are considered similar

Europeans are more worried about immigration from outside the European Union than about mobility within the European Union (Figure B2.2.1; German Marshall Fund 2014). According to the Spring 2017 Eurobarometer survey, more than 8 in 10 EU citizens favor the free movement of EU citizens within the European Union. The European Social Survey also shows more support for admitting immigrants of the same race/ethnic group as the majority. In the Russian Federation, attitudes toward migrants from Ukraine, Belarus, and other regions with predominantly Russian populations are more positive than attitudes toward immigrants from the South Caucasus or Central Asia (Levada Center 2017).

B2.2.1 People in the European Union are more accepting of immigration from other EU member states than from outside the European Union



Source: Standard Eurobarometer 87, Spring 2017.
Note: The survey question was: "Please tell me whether each of the following statements evokes a positive or negative feeling for you: 'Immigration of people from other EU member states' [the first bar for each country] and 'Immigration of people from outside the EU'" [the second bar for each country]. Countries are sorted based on the share of negative responses to immigration from other EU member states. Negative (positive) refers to total negative (total positive) as reported by the Eurobarometer—the sum of very negative (very positive) and fairly negative (fairly positive) responses to each question.

The economic situation affects public perceptions

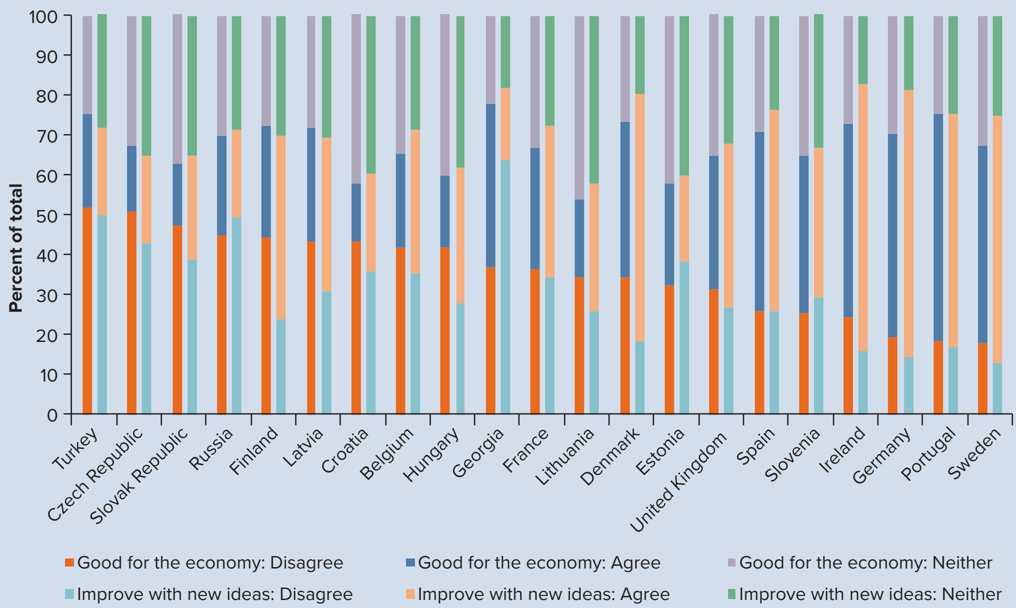
Opposition to immigration in ECA seems to be based more on economic than cultural issues. In the 2012–14 International Organization for Migration/Gallup survey, people's views about their personal and their countries' economic situations were strong predictors of their views of immigration, with the share of people favoring reducing migration highest in countries with the highest unemployment rates. In most ECA countries,

(Continued next page)

BOX 2.2 (continued)

more people disagreed that immigrants are good for the economy than disagreed that immigrants improve a society by bringing in new ideas and cultures (Figure B2.2.2). This result, from the International Social Survey Program, is corroborated by results from the European Social Survey.

B2.2.2 Opposition to migration is more economic than cultural



Source: International Social Survey Programme 2013.
Note: Figure shows percent of total responses; it does not take into account nonresponses. Data are weighted. For each country, the left bar shows the percent of responses to the statement "Immigrants are generally good for the economy." The right bar shows the percent of responses to the statement "Immigrants improve [country nationality] society by bringing in new ideas and cultures." Countries are sorted based on their disagreement with the statement "Immigrants are generally good for the economy."

Individual characteristics, such as education, also seem to matter

People with a higher level of education are more likely to favor migration. The role of other factors, such as age and gender, varies according to the context (OECD 2010). According to some surveys, such as the European Social Survey, people over 65 tend to have more negative attitudes toward immigration. This result could reflect generational differences rather than people becoming more anti-immigration as they get older (Bussolo, Koettl, and Sinnott 2015).

Information can change attitudes toward migration

The 2013 Transatlantic Trends Survey provides evidence that the public overestimates the number of immigrants by wide margins; the 2014 and 2015 IPSOS Mori surveys corroborate these results. The 2010 and 2014 Transatlantic Trends Surveys show that people who were given accurate immigration statistics beforehand were significantly less likely to say there were "too many" immigrants in the country (German Marshall Fund 2014). Besides information about migration, attitudes toward migration are shaped by emotions, individual values, and beliefs.

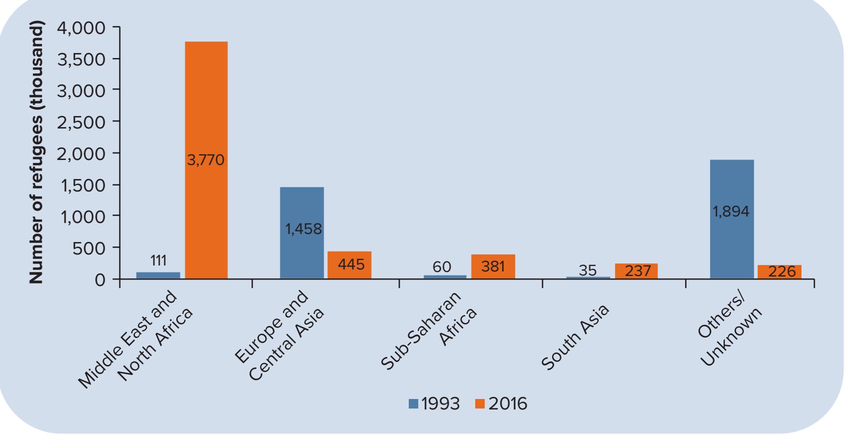
Perceptions of current migration policies are also negative. In most countries, the majority of survey respondents do not approve their government's handling of immigration (German Marshall Fund 2014). In all 12 ECA countries, a majority of people surveyed in 2007 thought that their country should restrict and control the entry of migrants more than it did (Pew Research Center 2007). In the spring of 2017, about 90 percent of respondents in the European Union thought that additional measures should be taken to fight irregular migration (European Commission 2017). In all ECA countries participating in the International Social Survey Program, a majority of respondents favored stronger measures to exclude illegal immigrants. In 2013 more than 40 percent of respondents in Russia agreed that all migrants—legal and illegal—and their children should be deported. Only 18 percent agreed that all migrants and their children should be granted residency rights where they want to live (Alexseev 2015).

Refugee flows are not unprecedented and represent a small share of total migration

The stock of refugees in ECA in 2016 was somewhat higher than in 1993, and the composition had changed significantly. In 1993 the top five origin countries of refugees in ECA were other ECA countries; in 2016 Syria, Afghanistan, and Iraq were the major origin countries of refugees and asylum seekers (Figure 2.4).

Refugees and asylum seekers account for only a small share of the total number of migrants in ECA, except in Turkey, where almost all migrants are refugees. Indeed, the share of refugees in the total stock of migrants fell sharply in most of the top 10 ECA country hosts between 1993 and 2016. For example, refugees made up 19 percent of the stock of migrants in Germany in 1993 and 10.5 percent in 2016 (with asylum seekers included only in the latter year). Overall, refugees

FIGURE 2.4 The vast majority of refugees and asylum seekers in Europe and Central Asia now come from the Middle East and North Africa



Source: United Nations High Commissioner on Refugees (UNHCR).
Note: Regional grouping follows the World Bank classification, with the following exceptions: (a) Europe and Central Asia (ECA) was adjusted to include the monitored countries of the World Bank's ECA regional office; (b) countries not included in the World Bank list were classified using the UN Population Division's regional grouping; and (c) countries not included in either list were assigned to a region on the basis of geographical location, using World Bank region names. Other/Unknown includes East Asia and Pacific, Latin American and Caribbean, North America, stateless, and various/unknown. The annex lists the countries in each grouping for which data were available in 1993 and 2016. Asylum seekers are included only in 2016; data for 1993 were not available.

and asylum seekers made up 7.8 percent of the total number of migrants in the ECA region in 2016.[3]

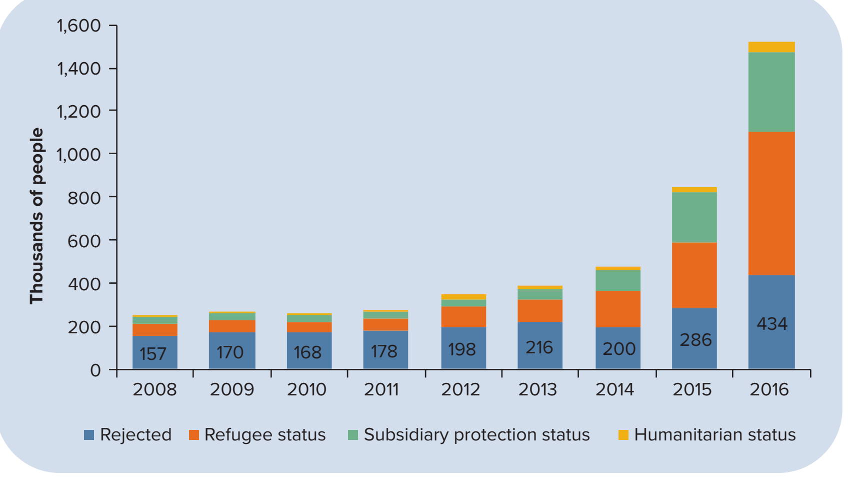
The sudden, large rise in the inflow of refugees and asylum seekers is likely to be temporary. Irregular border crossings into the European Union increased sharply in 2015 to 1.8 million but decreased to 511,000 in 2016 and seemed to decline further in 2017.[4] Many of these people will not be granted refugee status. Asylum rejection rates vary widely by country of origin but averaged about 40 percent in 2016 (Figure 2.5). Return rates of refugees vary greatly and tend to be lower than those of other migrants, but some of the people granted refugee or subsidiary protection status are likely to return home or move onward once the situation in their country of origin improves. The number of refugees in the ECA region from the former Yugoslavia (mainly Bosnia and Herzegovina and Croatia), for example, dropped from 1.3 million in 1996 (after the Dayton Peace Agreement was signed, in December 1995) to 932,000 in 1998 and 311,000 by 2006 (author's calculations based on UNHCR data).

Migration has long helped Europeans respond to economic and political challenges

Cross-border labor mobility in ECA is not unprecedented and has helped reduce poverty

During the last few decades, workers in ECA took advantage of employment opportunities across borders arising from regional economic integration. The common market provided the opportunity to connect workers in new EU member states with demand for services in Western Europe. High oil prices, and subsequently heavy domestic demand in Russia, created opportunities for workers in surrounding countries.

FIGURE 2.5 Asylum rejection rates in the European Union are high



Source: Eurostat.
Note: Figures are first-instance decisions on applications for asylum.

Movement of workers across borders is not a recent phenomenon. Emigration has long been a way to escape economic hardship, and immigration has been one of the mechanisms to fuel economic growth. The ECA region also has a history of relocation of large numbers of people before and after conflicts.

Emigration from ECA during the age of mass migration was a response to severe economic difficulties. More than 40 million people emigrated from Europe to the New World between 1850 and 1913, about two-thirds of them to the United States; Canada, Australia, Argentina, Brazil, and Cuba were also large recipients. Initially, famine, revolution and persecution in Europe drove emigration. Later waves of emigrants reflected rising fertility and declines in infant mortality, which created a large cohort of young, largely single potential emigrants, as well as large differences in workers' living standards between Europe and much of the New World. Technological progress, particularly the advent of the steamship, also facilitated emigration. The massive outflow of workers lifted the wages of workers who remained, resulting in a convergence between real wages in the New and Old Worlds, albeit at rates that varied across countries (Hatton and Williamson 1992; Chiswick and Hatton 2003).

Migration in Russia supported its overland expansion to the east and south. Russian peasants settled on lands formerly controlled by Turkic nomads in the mid-16th century (Brubaker 1995). Other ethnic groups allied with the Russian Empire, such as the Cossacks, also joined this process of migration, settling new lands. The process of out-migration of people from Russia from a core toward an expanding periphery continued into the post-war Soviet Union, which had ethno-demographic impacts in Estonia, Latvia, and Kazakhstan.

Large population movements accompanied the reorganizations of states in ECA over the past century

The long decline of the Ottoman Empire led to the rise of several national states on its former territories, resulting in large-scale restructuring of populations. Millions of people were displaced from Bulgaria, Macedonia, Thrace, and western Anatolia (between about 1875 and 1924). The outmigration of Turks, especially from Bulgaria, continued for decades, up to the 1989 migration of 370,000 Bulgarian Turks to Turkey (Brubaker 1995).

Following World War II, about 4.7 million displaced persons and prisoners of wars were repatriated (sometimes against their will) from Germany to Eastern Europe and the Soviet Union. Under fear or duress, another 12 million ethnic Germans moved from eastern parts of the former Reich, German occupied areas, and countries previously allied with Germany. The new international boundaries decided at Yalta and Potsdam and other adjustments of territory resulted in further displacement. The sum of all these movements of 1945–50 is estimated at more than 20 million.

The period from 1950 to 1992 saw the movement of about 14 million people, largely out of the eastern parts of ECA, including continued ethnic migration (about 75 percent), refugees from repression under regimes behind the Iron Curtain (about 10 percent), and economically oriented migrants (less than 15 percent) (Fassmann and Munz 1994).

Migration helped accommodate the desire for ethnic reunification following the collapse of the Soviet Union

Besides the 25 million Russians in the successor states, people of other ethnic groups had social and economic links with states other than the one in which they found themselves after the divisions came into effect. (Net outflows of Russians from Armenia, Azerbaijan, Georgia, Kazakhstan, Moldova, and other Central Asian republics took place even before the demise of the Soviet Union [Brubaker 1995], but they would have been considered internal migration.) From 1959 to 1974, average annual out-migration from Russia to the other Soviet republics was about 1.1 per thousand. Between 1975 and 1992, there was in-migration of about the same rate to Russia; it increased to 5.5 per thousand in 1994. Return migration of ethnic Russians from former Soviet republics was responsible for about half the migrants entering Russia between 1993 and 1995, who settled in 17 southern border *oblasts* (Heleniak 1997). Despite the initial political realignments and ramifications of separate states, linguistic commonalities, family and cultural ties, and economic imperatives ensured that the Commonwealth of Independent States (CIS) continues to have strong migration interlinkages.

Migration helped support European economies in the postwar era. Convergence in wages and living standards reduced European emigration to North America and Oceania from about 400,000 a year in the early 1950s to less than 100,000 a year in the early 1990s. Europe became a net immigration region, as large numbers of workers came to Western Europe (particularly through the German guest worker program) to meet the increasing demand for labor in the region. Immigrant inflows into Europe from developing Asia, then Africa, and then from the rest of the world increased (Chiswick and Hatton 2003). There have been periodic ebbs in these flows, driven by economic changes, such as reduced labor absorption capacity in the mid-1970s following the oil price shock of 1973, and resulting policy changes (Fassmann and Munz 1992). But the overall trend of Europe as a migrant destination for migrants from poorer countries, accompanied by greater intra-European migration, persists.

Migration patterns in ECA are likely to change

Migration is likely to remain a critical element of an economically vibrant ECA

Differences in income and unemployment rates, as well as demand for skilled labor from the region's economic powerhouses, will remain key drivers of voluntary migration—and deep regional economic integration will intensify migration flows. Migration will thus continue to play an important role in the economic and social development of the region.

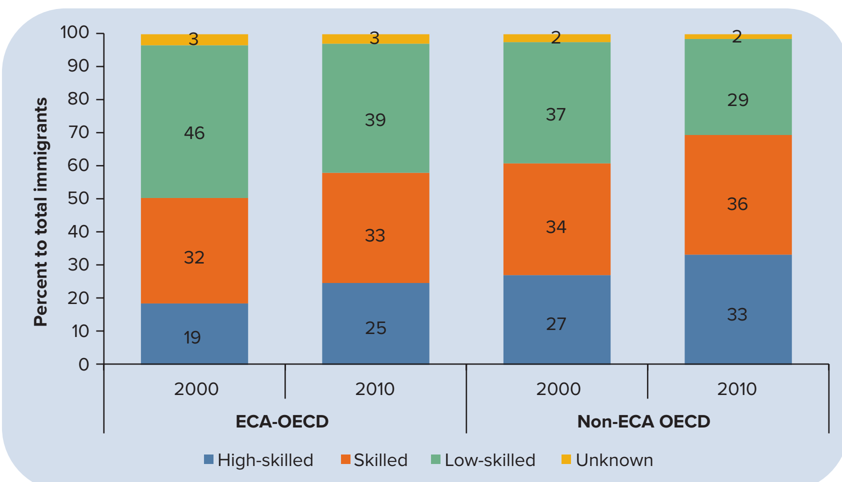
Technology has reshaped migration patterns

The nature and composition of international migration in the region is changing, as a result of technological advancement and the global integration of product and labor markets. Technology is boosting the integration of labor markets and increasing demand for high-skilled workers. Improvements in transport and communications have greatly increased the integration of labor markets, in part through the rise of global value chains, and general technological improvements have intensified competition for high-skilled workers. Workers everywhere are also increasingly in direct competition with workers from the rest of the world.

The Internet has lowered the cost of offshoring, as Internet-based platforms connect workers and employers across the world. ECA countries participate significantly in online digital labor platforms: Russia and Ukraine are the fifth- and sixth-largest suppliers, respectively, of contract labor to the U.S. market, and Ukraine had the third-largest cumulative online worker wage bill through 2014 (Horton, Kerr, and Stanton 2017). It is easier to facilitate trade in goods and services than to obtain labor inputs by attracting and hosting individuals near the location of work. Thus, labor market integration does not necessarily lead directly to more migration. It can first lead to more services trade.

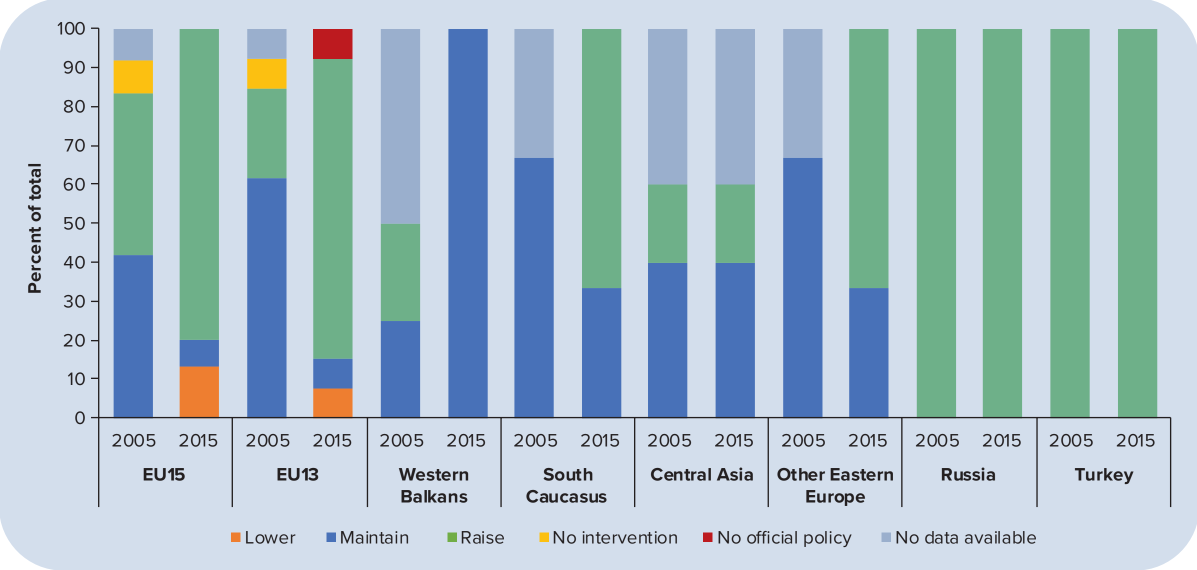
However, integration of labor markets and production chains will boost cross-border connectivity in many dimensions, which may indirectly lead to more migration. In general, technological advancement is complementary to global movements of skilled workers (Kerr et al. 2016). Indeed, the level of high-skilled migration to ECA/OECD countries increased more than that of less skilled types of migration during 2000–10 (Figure 2.6). ECA countries are trying to increase the number of high-skilled immigrants (Figure 2.7). It is the broader rise in connectivity, rather than direct migration, that intensifies competition for high-quality jobs. Competition occurs almost irrespective of where competing workers are located. Indeed, empirical evidence suggests that migration has only a small and temporary impact on average domestic workers' wages and employment (see, for instance, Longhi, Nijkamp, and Poot 2005; National Academies of Sciences, Engineering, and Medicine 2017), although close substitutes may lose, and complements win, especially in the short run. Both the positive and negative effects

FIGURE 2.6 The share of high-skilled immigrants in OECD countries increased between 2000 and 2010



Source: Database on Immigrants in OECD Countries (DIOC) 2000 and 2010.
Note: Low-skilled refers to people with no more than lower-secondary education. Skilled refers to people with upper-secondary to postsecondary nontertiary education. High-skilled refers to people with tertiary education. A list of countries for which data are available for both years is in the annex.

FIGURE 2.7 **ECA countries increasingly aim to attract high-skilled immigrants**



Source: World Population Policies Database, United Nations Department of Economic and Social Affairs (UNDESA) Population Division.
Note: Bars represent the share of country official responses to regional or country total that indicate the government's policy to lower, maintain, or raise the level of immigration of high-skilled workers into the country. Regions include all ECA countries (Table E.1) except Kosovo (part of the Western Balkans) for both years and Denmark, Finland, and Sweden (all part of EU-15) for 2005.

of increased connectivity depend on the flexibility of labor markets and the complementarity between the skills of native-born workers and migrants. Among the people who lose out are often migrants who arrived previously.

Greater labor mobility for high-skilled labor has occurred in tandem with the globalization of education

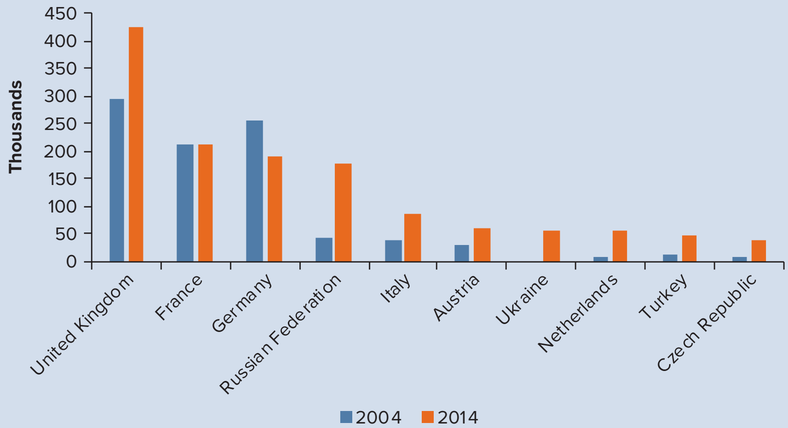
Globalization of education reflects the integration of labor markets for high-skilled workers across borders. Greater global integration and rising demand for skilled workers may reduce their ties to a location or national identity and increase their global perspectives and connections. The duration of skilled migration is therefore likely to decline, and circular migration (as opposed to one-way and long-term movement) is likely to increase. The increasing globalization of education is supportive of this trend (Box 2.3). Given these trends in global labor markets, individuals, employers, and countries may be more successful if they can find out how best to navigate these new, more integrated global labor markets, taking into account their own regulatory constraints (Kerr et al. 2016).

Technological change is increasing the share of alternative work arrangements, which may be affecting migration patterns. The share of temporary employment rose between 2002 and 2016 in most ECA subregions (Figure 2.8), more than two-thirds of OECD host countries for which migration data are available witnessed a rise in the share of temporary migration between 2000 and 2010 (Figure 2.9), and countries with larger shares of temporary employment tended to have larger shares of temporary immigration (Figure 2.10).[5] These trends are likely to contribute to the rise in the importance of temporary and circular migration.

BOX 2.3 The globalization of education

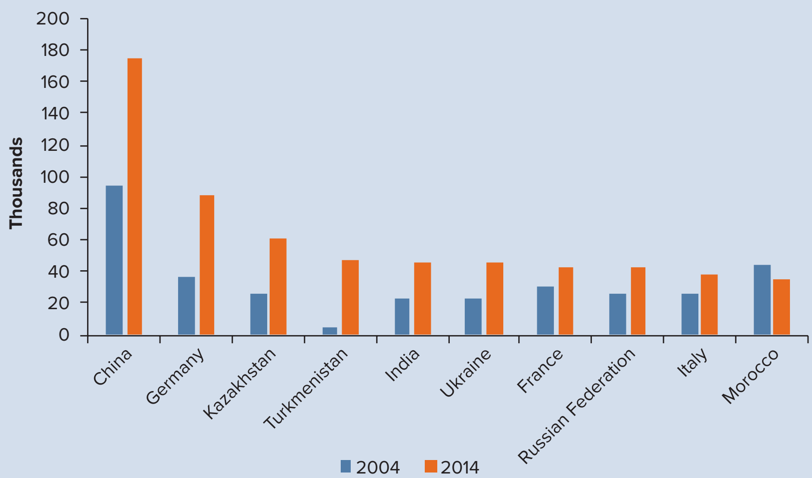
ECA experienced a rise in the number of international students over the past decade, facilitated by technological progress and rising incomes in source countries. The number of international students hosted by the top 10 ECA destination countries increased significantly between 2004 and 2014, except in Germany (figure B2.3.1). In 2014, apart from China and India, most of the top 10 sources of foreign students in ECA were other ECA countries (figure B2.3.2).

B2.3.1 Most top ECA destinations attracted more international tertiary students in 2014 than in 2004



Source: UNESCO Institute for Statistics.

B2.3.2 Most source countries of international tertiary students are in ECA



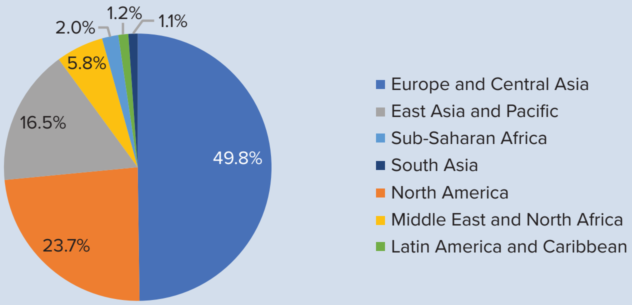
Source: UNESCO Institute for Statistics.
Note: Data for 2014 are not available for Georgia, Greece, and Spain. Data for 2004 are not available for Azerbaijan, Bosnia and Herzegovina, Croatia, Luxembourg, Serbia, Turkmenistan, Ukraine, and Uzbekistan.

(Continued next page)

BOX 2.3 (continued)

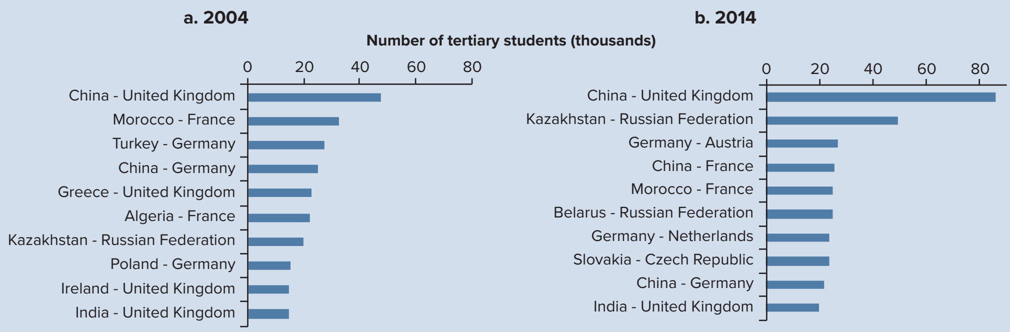
ECA countries hosted about half of all foreign students globally (figure B2.3.3). Among the top 10 corridors of international tertiary student flows, China–United Kingdom and Kazakhstan–Russian Federation witnessed remarkable increases in the number of international undergraduate and graduate students, of 80 percent and 145 percent, respectively (figure B2.3.4).

B2.3.3 ECA hosted half of the world's tertiary students in 2014



Source: UNESCO Institute for Statistics
Note: Regional grouping follows the World Bank classification, with the following exceptions: (a) Europe and Central Asia (ECA) was adjusted to include the monitored countries of the World Bank's ECA regional office; (b) countries not included in the World Bank list were classified using the UN Population Division's regional grouping; and (c) countries not included in either list were assigned to a region on the basis of geographical location, using World Bank region names. The annex lists the countries for which data were available.

B2.3.4 Top 10 corridors of international tertiary students with ECA hosts

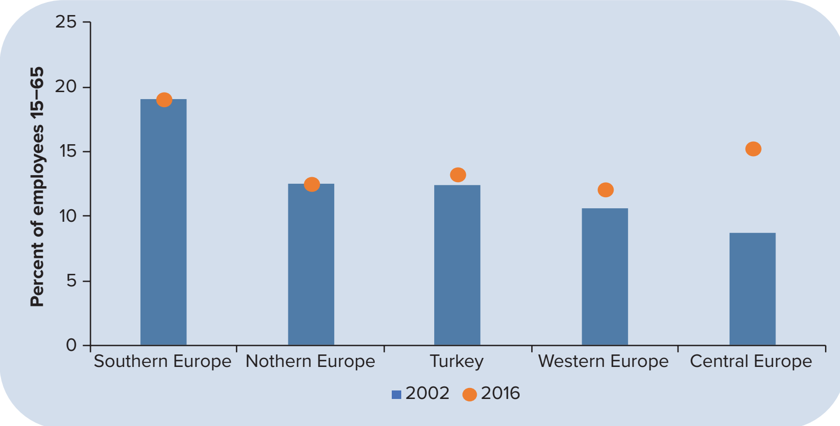


Source: UNESCO Institute for Statistics.

This process generates significant benefits: international students gain a wider access to education and employment opportunities abroad, while the receiving countries capture a broader range of skills (Tse 2012).

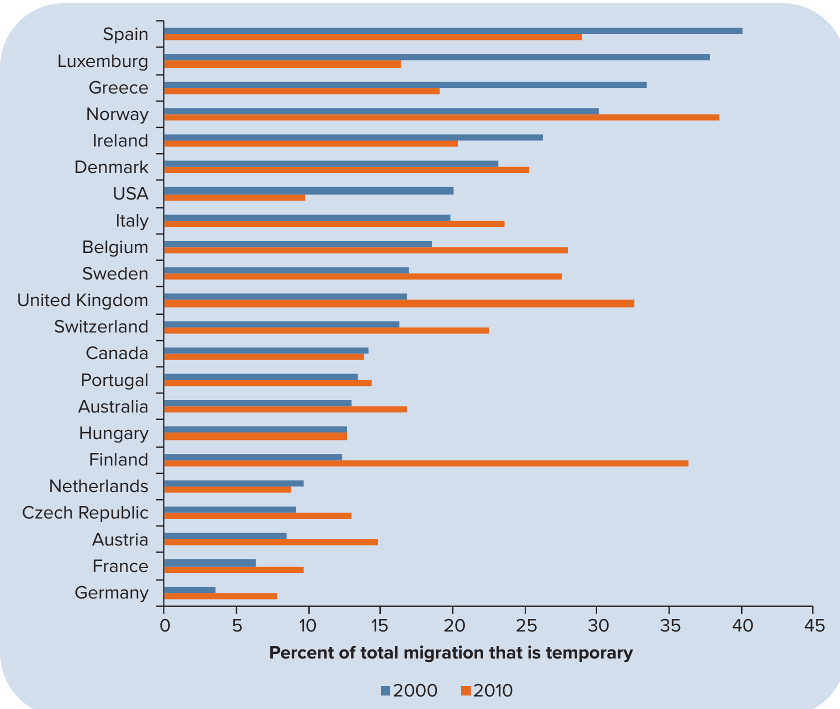
During a meeting in Bologna in 1999, European officials proposed harmonizing their postsecondary educational systems and offering programs in English, with the aim of facilitating more interest and increasing recognition of their degrees globally. This harmonization has resulted in a common three-cycle system for tertiary education (the bachelor's, master's, and doctorate degrees). The European Higher Education Area and Bologna Process has 48 full members. The Commonwealth of Independent States (CIS) signed an agreement on the mutual recognition of education credentials for secondary and vocational education in 2004, effective from September 2005. Russia also has bilateral agreements on mutual recognition with other CIS countries, including Azerbaijan, Moldova, Turkmenistan, and Ukraine.

FIGURE 2.8 The share of temporary employment increased in Europe and Central Asia between 2002 and 2016



Source: World Bank 2016.
Note: Shares for Turkey are based on 2006 and 2016 data.

FIGURE 2.9 The share of temporary migration in total migration increased in most countries in Europe and Central Asia between 2000 and 2010

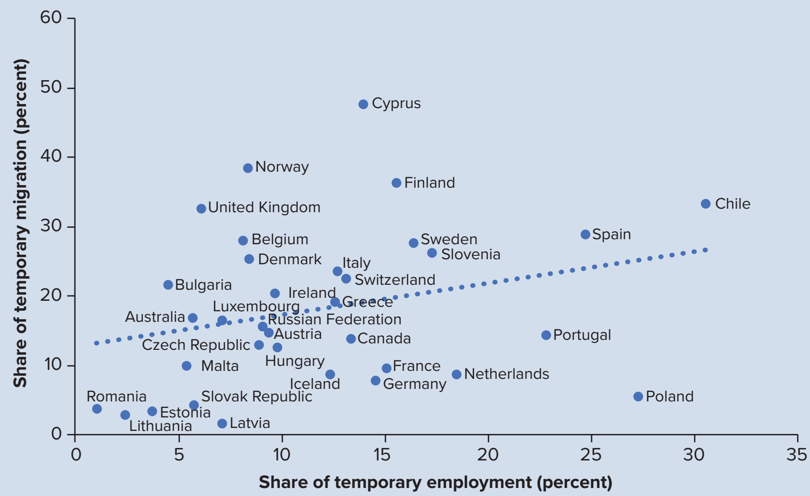


Source: OECD database on immigrants in OECD and non-OECD countries (DIOC) and OECD database on employment.
Note: Temporary migration is defined as migration with a duration of less than five years.

Policies should remain supportive of migration

A return to higher growth rates requires embracing cross-border connectivity across multiple dimensions (see Box 2.4). Support for migration should be an integral part of a growth agenda that seizes the opportunities of new technologies in increasingly integrated markets. Countries should help people, migrants and nonmigrants alike, navigate new competitive forces and try to prevent growing inequalities.

FIGURE 2.10 The share of temporary migration is positively related to the share of temporary employment



Source: OECD data for 2010.

BOX 2.4 How do migration and connectivity affect growth?

Globalization yields long-term growth benefits, by facilitating the transfer of technology and knowledge. Economic connections between countries—through international trade, foreign investment, migration, and infrastructure connectivity—play important roles in furthering economic growth and innovation. Foreign direct investment (FDI), for example, facilitates the exchange of ideas and technology. Countries with better connections often enjoy higher income growth and shared prosperity.

Migration can play an important role in supporting trade and FDI. Gould (1994) first identified the link between migration and subsequent growth in international trade between the home and host countries of migrants. Subsequent studies find evidence of a strong link between migration and FDI flows (Onodera 2008). In fact, migration appears to be one of the most important networks in the global economy: migrants not only transfer knowledge between the host and home countries, they also facilitate the transmission of knowledge embodied in other connections (trade, FDI, and so forth).

Studying the impact of connectivity on growth requires a framework that captures the state of the entire network. It is not enough to focus only on the size of the immediate bilateral connections of each country in the network. Countries that are connected to more "central" countries will experience greater benefits because of their greater exposure to flows of information and ideas. For example, $1 of trade between Kazakhstan and Germany may provide greater knowledge spillovers than $1 of trade between Kazakhstan and Morocco, because Germany is much more connected to the global economy and is likely to be a conduit for technology and knowledge from other countries it is connected to.

Methods used to analyze complex networks can be used to capture these higher-order effects from connectivity. A centrality measure (similar to Google's PageRank) can be constructed for each country that assigns greater weight to connections

(Continued next page)

BOX 2.4 (continued)

with countries with higher technology as well as to countries that are themselves connected to more central countries. The centrality of each country is a function of the centrality of its connections, which in turn are a function of the centralities of their connections and so on:

$$\Theta_i = \lambda \sum_k A_{ki} \Theta_k + G_i,$$

where Θ_i is the connectivity of a country i, A_{ki} is a function of the bilateral links, and G_i is a proxy for innovation capacity. Countries have higher centrality not only if they connect to well-connected countries but also if they connect to countries with higher propensity to innovate (*G*).

Table B2.4.1 shows the impact on annual economic growth rate of a one standard deviation increase in various types of connectivity. Trade and FDI connections have the greatest impact on long-term overall growth, followed by migration and airline connectivity (after controlling for other important growth determinants, such as education, investment, institutional quality, and others).

TABLE B2.4.1 Impact of connectivity on annual growth of income per capita (percent)

Type of connectivity	Economic growth of economy as a whole	Economic growth of bottom 40 percent
Multidimensional	0.67***	1.48***
Trade	0.61***	1.48**
Foreign direct investment (FDI)	0.60***	0.8*
Migration	0.34*	0.18
Airline	0.19*	0.11
Portfolio flows	0.17	–0.13
Information and communications technology (ICT)	0.12	0.21

Note: * significant at the 10 percent level; ** significant at the 5 percent level; *** significant at the 1 percent level.

Migration is an important component of the multidimensional connectivity index. In fact, there is evidence of complementarity between various network layers. Countries with more diversified connections tend to have higher growth than countries that focus on one or two types of connection. For example, if two countries have deep trade links, they can improve their overall connectivity more by stimulating migration and FDI than by continuing to intensify trade links.

Between 2000 and 2010, countries in the ECA region increased their migration connectivity index by 1.9 percent and their overall connectivity index by 11.6 percent. Parts of the region still trails behind, however (table B2.4.2).

In addition to improving overall connectivity and stimulating growth through innovation, migration linkages have strong impacts on other connections. The results of a vector autoregressive (VAR) model indicate that a 1 percent increase in migration (the sum of emigrant and immigrant stock) for a given country is associated with a 0.25 percent increase in future trade and a 0.2 percent increase in ICT connectivity.

(Continued next page)

BOX 2.4 (continued)

TABLE B2.4.2 Countries in Europe and Central Asia with highest and lowest connectivity

Country	Combined connectivity	Trade	FDI	Migration	ICT	Airline	Portfolio flows
Countries with highest overall connectivity							
Luxemburg	1	2	1	1	1	3	32
Ireland	2	3	5	5	3	5	27
Netherlands	4	5	3	18	14	12	9
Belgium	5	4	4	7	5	18	78
Switzerland	6	6	6	2	2	6	7
Countries with lowest overall connectivity							
Belarus	95	75	103	42	98	106	99
Georgia	102	105	101	62	104	104	93
Armenia	104	91	102	64	103	98	86
Azerbaijan	105	104	108	110	109	107	107
Tajikistan	107	109	106	109	110	110	106

Source: World Bank forthcoming a.
Note: The values indicate the rankings of each country according to their connectivity index (1- best, 130-worst). Figures are adjusted for population.

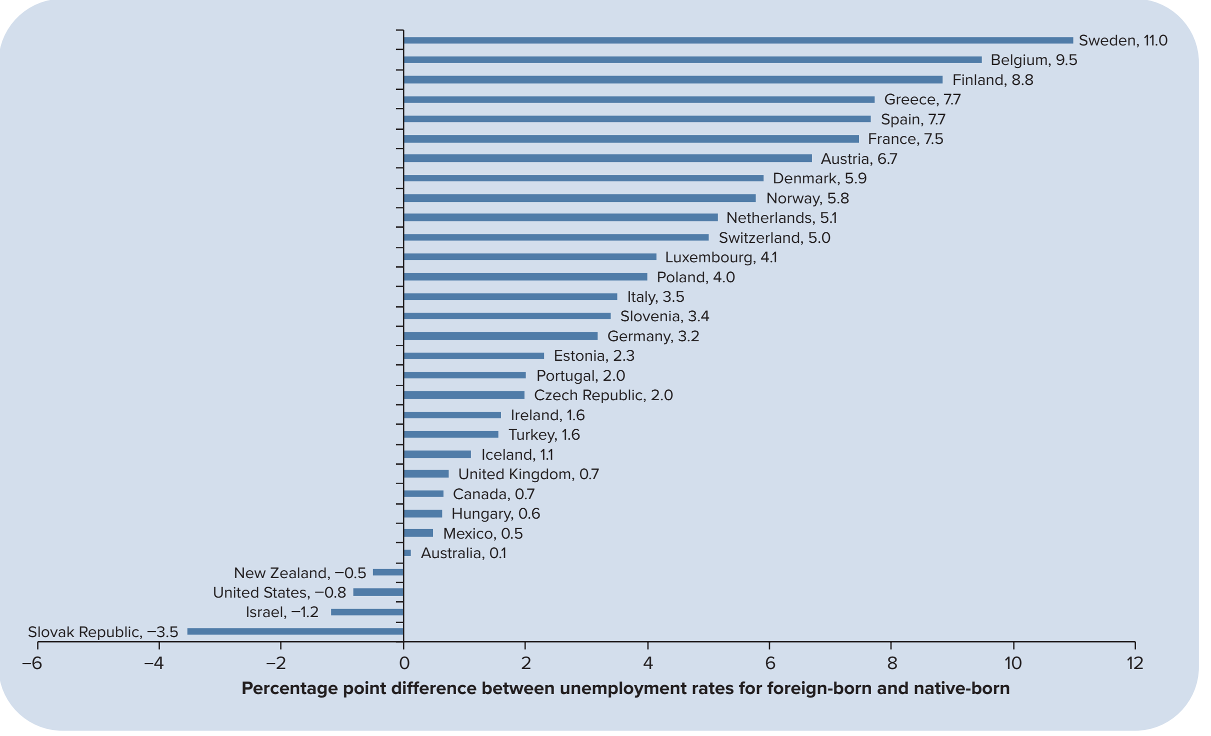
New developments are a challenge for immigration countries, emigration countries, and migrant families. But successful adjustment toward more integrated labor markets will unlock new growth potential. This adjustment will also ultimately result in circular migration, as it becomes increasingly feasible and attractive to return or stay connected to the country of origin.

Migrants have higher unemployment and poverty rates and lower rates of tertiary education than the native-born population

The integration of migrants into the society of the host country is key to maximizing the gains from international migration for both origin and host countries (Eurostat 2017). Lack of economic integration can increase tension between immigrants and the native population in destination countries.

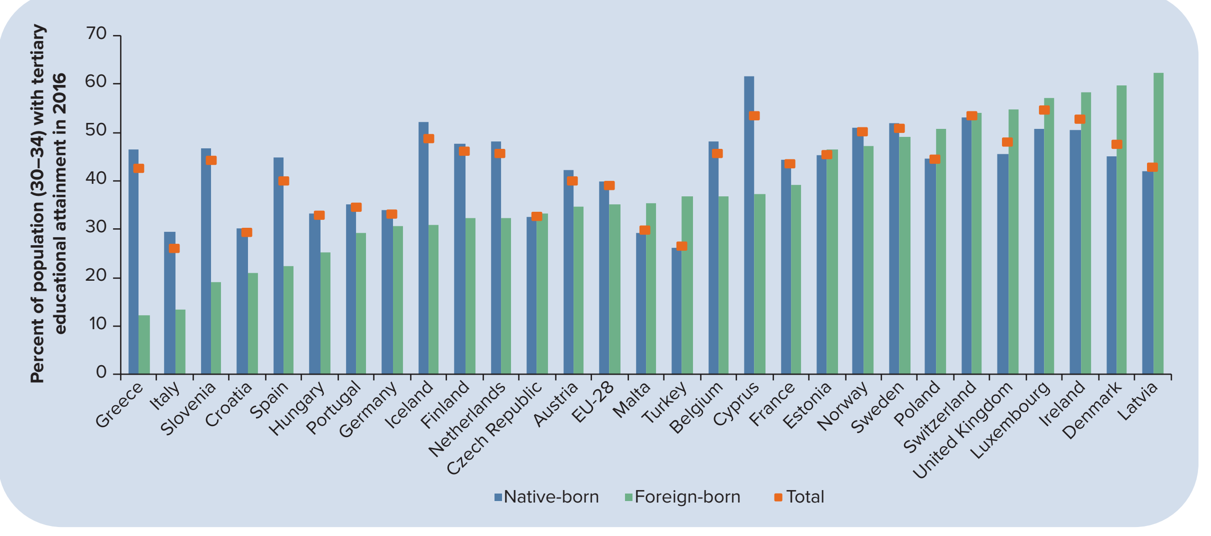
In most countries in ECA, unemployment rates are higher among the foreign-born than the native-born population (Figure 2.11); youth unemployment in some countries is particularly high among immigrants. Tertiary education rates are much lower among immigrants in most countries (Figure 2.12). On average in the EU-28, unemployment rates are higher, employment rates are lower, hous-

FIGURE 2.11 Unemployment rates are higher for foreign-born than for native-born workers in most countries in Europe and Central Asia



Source: OECD (http://www.oecd.org/els/mig/keystat.htm).
Note: Data are for 2016.

FIGURE 2.12 Tertiary education rates in Europe and Central Asia are lower among the foreign-born than the native-born population



Source: Eurostat.
Note: Data are for 2016.

ing overcrowding is greater, housing costs represent a larger share of income, mean income is lower, the severe material deprivation rate is greater, and the risk of poverty is higher among immigrants from non-EU countries than among natives (Table 2.1).

The polarization between immigrants and the native population is consistent with the finding that skills of migrants are often complementary to existing skills in rich host countries. Bussolo, Koettl, and Sinnott (2015) show that people who immigrated to Western Europe between 1990 and 2000 had complementary skills to natives and contributed to increasing wages and reducing inequality among natives. The effect of immigration also depends on the responses of natives. Cattaneo, Fiorio and Peri (2015) find that native workers in Europe are more likely to move to occupations associated with higher skills and status when they are faced with a large inflow of migrants into the labor market. Foged and Peri (2015) find that in Denmark the presence of low-skilled migrants was associated with upward wage and skill mobility of low-skilled native workers.

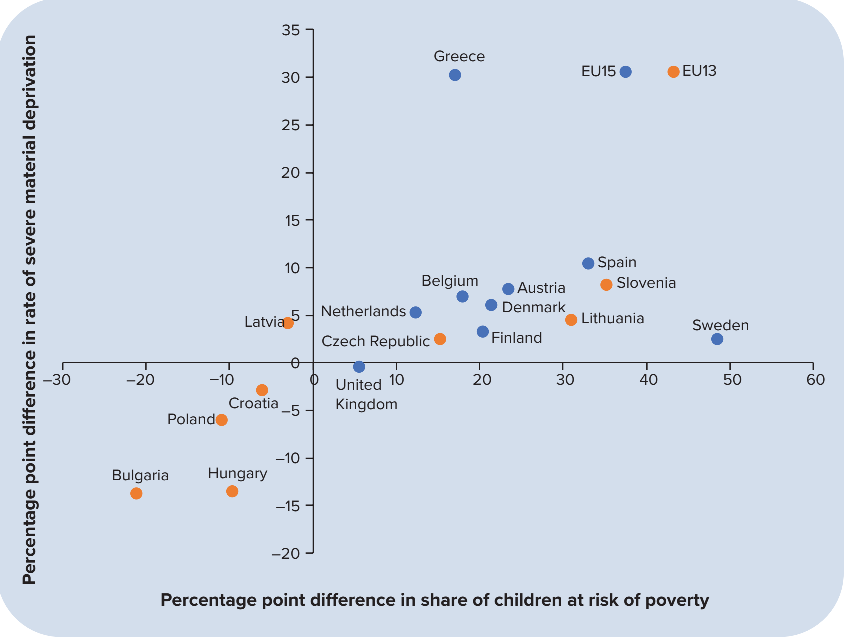
The gap between the foreign-born and native-born population in terms of material deprivation and the risk of poverty for children ranges widely across EU countries (Figure 2.13). In most EU-15 countries, the foreign-born population has higher rates of severe material deprivation and children at risk of poverty than the native-born population. Elsewhere—in Bulgaria, Croatia, Hungary, and Poland—the foreign-born population seems to do better than the native-born population. This pattern is atypical. In Hungary, Lithuania, Poland, and Portugal, the at-risk-of-poverty rates of both EU and non-EU migrants are lower than the rates of the local population. This apparent anomaly may reflect the fact that these countries have relatively small migrant groups (Lelkes and Eszter 2010).[6]

TABLE 2.1 Selected social statistics for people born in the European Union and elsewhere

Item	Born outside the European Union	Born in the European Union	Gap
Unemployment rate among people 15–74	16.4	8.0	8.4
Housing overcrowding rate Percent of population 20–64 living in household with insufficient number of rooms	24.6	16.5	8.1
Housing cost overburden rate Percent of population 20–64 living in households in which total housing costs exceed 40 percent of disposable income	29.6	10.8	18.8
Mean annual income of people over 18 (thousands of euros)	15.4	19.0	3.6
Severe material deprivation rate Percent of population over 18 with inability to afford four of nine necessary items for leading an adequate life	17.9	7.5	10.4
Children at risk of poverty rate by birth place of parents (percent of population below 18)	37.6	19.0	18.6

Source: Eurostat.
Note: Calculations are based on 2015 data, except for the unemployment rate, for which the latest available year is 2016.

FIGURE 2.13 The gap between measures of deprivation and poverty of the foreign-born and native-born populations is larger in the EU15 than in the rest of the European Union



Source: Eurostat.

Policies have not been very supportive of efforts to integrate migrants

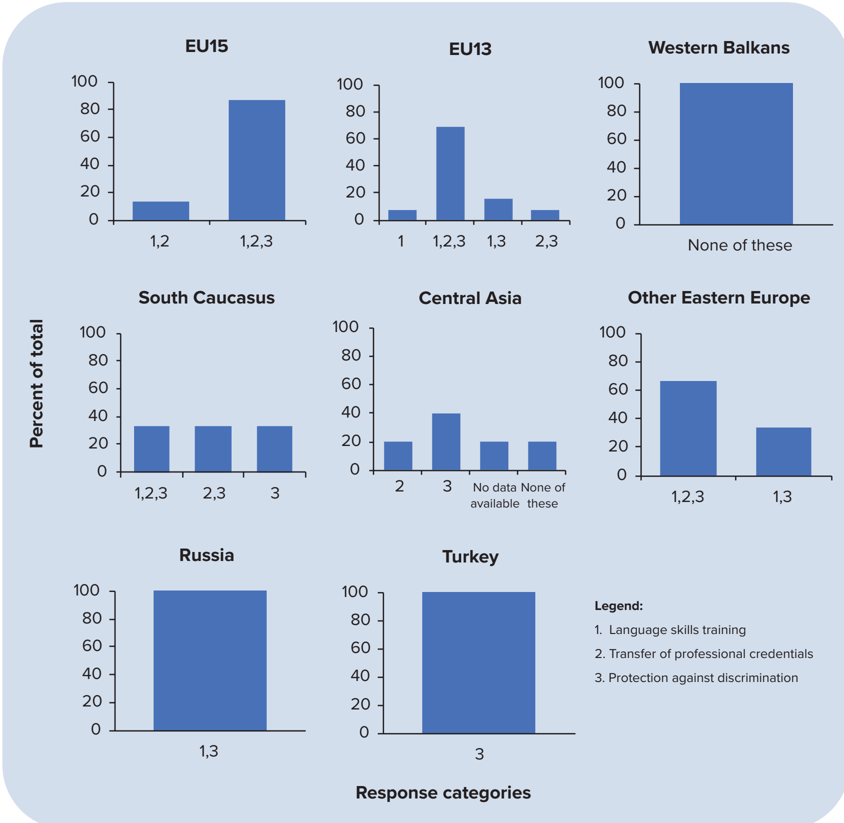
The Migrant Integration Policy Index (MIPEX) indicates that the average ECA country has a lower degree of migrant integration for labor market mobility than other regions (Huddleston and others 2015).[7] There has been little policy progress toward higher integration over time, and the trend in the political participation dimension is negative.

Policy efforts to support the integration of migrants vary considerably across countries. More comprehensive programs are more common in the EU-15 countries than in the rest of the region (Figure 2.14).

According to the 2014 MIPEX index, policies were weak in Turkey and Central Europe. Western, Southern, and Northern Europe performed almost as well as the best performers outside ECA. Since 2015 the government of Turkey started implementing new migration legislation and is currently working on a national integration strategy. Progress is also apparent in Northern and Central Europe.

Support for integration is even more important for refugees than for other migrants. Refugees typically must leave their homes with little notice; they have little time to prepare or choose their destination. As a result, they are less likely to find jobs that match their qualifications or have access to documents certifying their skills. Many refugees are also traumatized. Evidence from the 2008 EU Labour Force Survey shows that refugees take 6 years to achieve the labor force participation rates of migrants who moved for family reasons and more than 15 years to catch up with migrants who came for work or education (OECD 2016). The recent influx of refugees accentuates the need for strong integration programs.

FIGURE 2.14 There is variation across countries in the availability of policy measures that aim to integrate migrants, 2015



Source: World Population Policies Database, United Nations Department of Economic and Social Affairs (UNDESA) Population Division.
Note: Regions include all ECA countries (Table E.1) except Kosovo (part of the Western Balkans), for which data are not available. The bars represent the share of country official responses to regional or country total that indicate the existence of policy or combination of policies aimed at integrating immigrants into the host society. For instance, bar "1,3" in EU-13 means that two countries out of 13 (i.e., 15%) indicated that they provide migrants with language skills training and protection against discrimination as measures for integration of immigrants in their community. Russia also indicated having both of these programs for migrants.

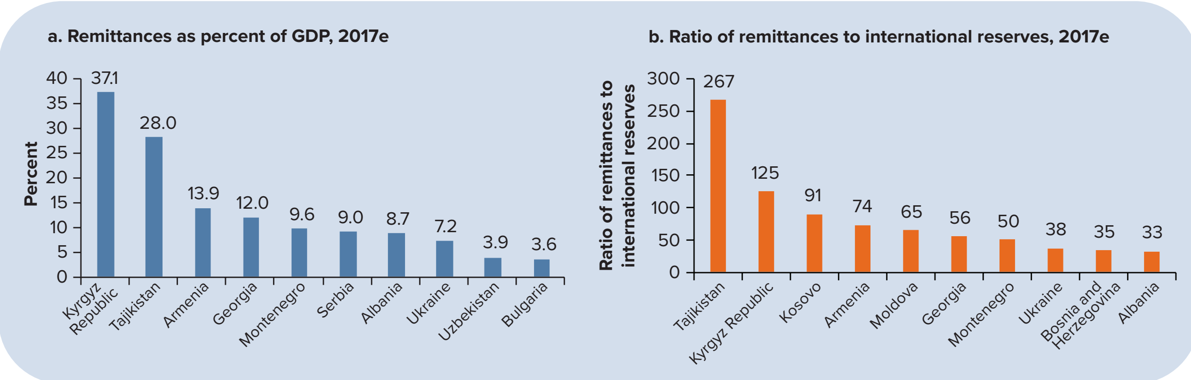
Emigration has generated substantial benefits in ECA origin countries

Massive emigration seems to have had positive effects on the average wages of nonemigrants in ECA countries. Workers who are close substitutes were more likely to have benefitted; people with complementary skills may not have benefited or may even have lost (see Elsner 2013 for Lithuania; Bouton, Paul, and Tiongson 2011 for Moldova; and Dustmann, Frattini and Rosso 2015 for Poland).

Remittances are large relative to GDP and an important source of foreign exchange in the region (Figure 2.15). They have a mildly positive impact on long-term economic growth in emigration countries in ECA and a positive impact on poverty reduction for the poorest households (Mansoor and Quillin 2006). They can also improve access to international capital markets.

There is considerable anecdotal evidence on diaspora investments and the promotion of trade and knowledge transfer. The return of migrants to their home country can support economic development, particularly when they bring capital and knowledge with them and the origin country provides the framework conditions to help them make use of their skills and investments. The return of

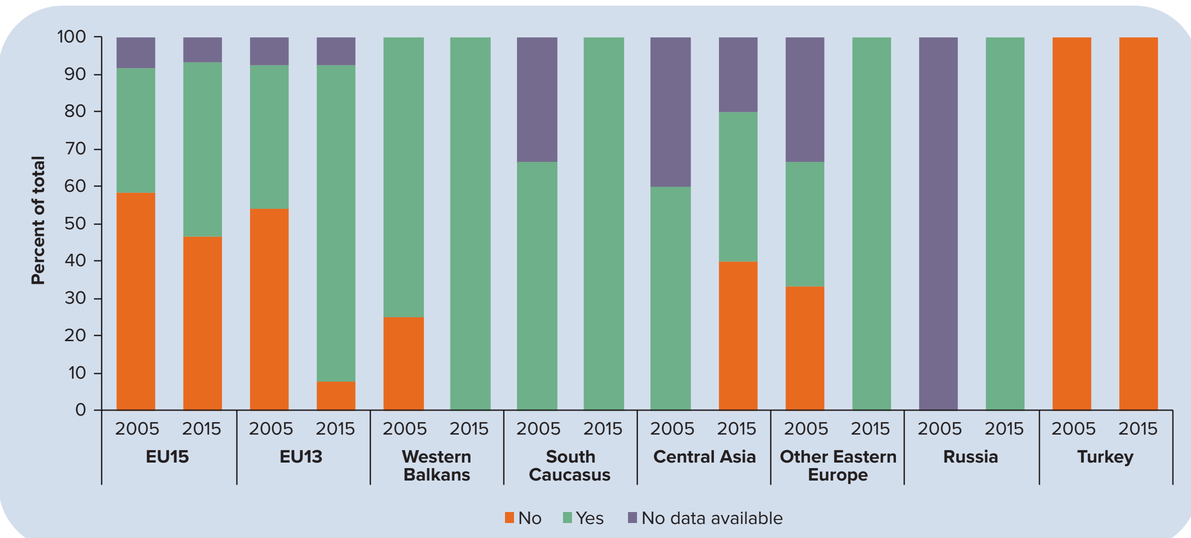
FIGURE 2.15 Many countries in Europe and Central Asia depend on remittances



Sources: World Economic Outlook and International Financial Statistics databases (International Monetary Fund), World Development Indicators (World Bank) database. World Bank 2017b.
Note: Estimates of remittances and GDP are for 2017. International reserves data are as of the second quarter of 2017.

Albanian migrants as a result of the Greek crisis, for example—which increased Albania's labor force by 5 percent between 2011 and 2014 alone—had positive effects on the wages of low-skilled nonmigrants and overall positive effects on employment of those who stayed (Hausmann and Nedelkoska 2017). Return migrants are also more often self-employed than workers who never left, potentially contributing to employment generation and economic growth. The majority of ECA countries have developed policies to encourage the return of their nationals. Between 2000 and 2015, the number of EU-13 countries with return policies increased significantly (Figure 2.16).

FIGURE 2.16 Nearly all EU-13 countries have developed policies to encourage the return of their citizens



Source: World Population Policies Database, United Nations Department of Economic and Social Affairs (UNDESA) Population Division.
Note: Bars represent the share of country official responses to regional or country total that indicate whether the government has adopted any policies or programs to encourage the return of its citizens living abroad. Regions include all ECA countries (Table E.1) except Kosovo (part of the Western Balkans) for both years and Denmark, Finland, and Sweden (all part of EU-15) for 2005, for which data were not available.

Emigration can also create challenges

These benefits notwithstanding, over the medium to long term, reliance on remittances may reduce the macroeconomic stability and competitiveness of ECA origin countries. Remittance inflows have a positive income effect on the consumption of tradable and nontradable goods. For small open economies, the prices of tradable goods are given, whereas growing aggregate demand may lead to higher relative prices for nontradable goods and higher wages. Such effects may discourage investment and labor movements into export-oriented or import-competing sectors. As a result, the external sector of economies relying on remittances may lose competitiveness. In addition, large remittance inflows may result in real exchange rate appreciation, as well as higher reservation wages and lower incentive to work. These effects may further exacerbate the decline in competitiveness of the exporting sectors. In response to these challenges, authorities in origin economies such as Tajikistan and the Kyrgyz Republic—the world's top remittance-dependent countries—could implement reforms that reduce the rigidities in factor and output markets, such as financial sector deepening and deregulation in labor and product markets (World Bank forthcoming b).

High emigration rates in some ECA countries have exacerbated population decline and aging and may have reduced the supply of skilled workers. After EU enlargement, mainly young and skilled people left Central European countries, most of them for Western Europe. Their emigration accelerated population declines in some ECA countries (Bussolo, Koettl, and Sinnott 2015) and may have slowed growth (IMF 2016). Emigration of high-skilled workers, particularly workers specializing in critical public services that are predominantly supplied domestically (health, education), may lower productivity and welfare. However, the opportunity to emigrate can also increase incentives for human capital acquisition in the country of origin. Ambrosini et al. (2015), for example, find a positive effect of emigration on average schooling in Romania.

International migration of parents can have both positive and negative effects on the children they leave behind. Remittances can allow children to attend school for longer, fund healthcare and better housing, and increase consumption. The positive economic impact of migration and remittances, however, can be outweighed by the negative effects of parental absence, which can be detrimental to the social and psychological development of the children left behind (Antman 2013). Children may also need to spend more time helping in the household after a family member leaves. Negative effects seem to be greater when both parents leave and children are raised by their grandparents or other relatives. The effect may also depend on the age and gender of the child. Antman (2011) finds that families in Mexico spend more on girls than on boys when the (male) head of the household migrates.

Results on the educational impact in ECA countries are mixed. Giannelli and Mangiavacchi (2010) find a negative impact of parental migration on long-term school attendance of the children left behind in Albania. Griogrian and Melkonyan (2011) find that remittance-receiving households spend less on the education of their children than households that do not receive remittances. Studies conducted by UNICEF in Moldova (UNICEF 2008; UNICEF-CRIC 2008) reveal negative emotional and social impacts but no clear evidence of negative impacts on health, nutrition, and education. Gassmann and others (2013) find that migration of a household member does not play a significant role in the well-being of the children in the household. Research on Romania indicates that the net impact of emigration on the education of children left behind is positive (Saurav 2017a). Allowing migrants to move freely back and forth would help them cater to the demands of their children left behind and improve their educational outcomes.

Migration and remittances affect the employment of spouses left behind. Most research finds a negative impact on paid labor supply outside the home, because remittances raise the reservation wage of household members left behind and the emigration of a spouse increases the need for more unpaid work in the household (Antman 2013). Remittance-receiving households in Armenia reduce their hours of work (Grigorian and Melkonyan 2011). Estimates for Albania show that having a migrant abroad decreases the wife's paid labor supply and increases unpaid work (Mendola and Carletto 2012). Remittances and migrant savings can also provide capital for starting a business. Women whose husbands returned are significantly more likely to engage in self-employment and less likely to supply unpaid work (Mendola and Carletto 2012). Results for Romania indicate that left-behind spouses whose husbands were absent for a year or more were six times more likely to engage in entrepreneurial activity than women in nonmigrant households (Saurav 2017b). Norms in the migrants' countries of destination can affect gender norms at home, creating more or less gender equality and autonomy of the women left behind, depending on the destination (Fleury 2016).

Migration also affects elderly parents left behind. Parents may benefit from more financial support through remittances. Migrant children will not be able to personally help and care for them, however, and may not be able to visit them. This aspect of the impact of migration on families left behind is often overlooked; more research on the topic is needed, especially in ECA, given its aging population (Antman 2013). Governments in ECA need to build up social safety systems that take account of the fact that not all parents will be able to rely on their children for support in old-age.

The refugee crisis presents opportunities for crafting a multilateral approach to migration

Adverse public reaction to the influx of refugees and undocumented migrants may result in tightening restrictions on immigration, uncoordinated approaches, and increased social tensions between immigrant and native communities. The refugee crisis has led to the reintroduction of border controls in the European Union, which could impose economic costs of up to €58 billion a year (Auf dem Brinke 2016).[8] The Dublin system, which defines which member state is responsible for the examination of an asylum application, has come under strain. The crisis may provide an opportunity for a needed overhaul of European asylum and migration policies. About 70 percent of the population in EU member states support a common European policy on migration (Eurobarometer 2017), with support more limited in some EU-13 countries. However, further integration is challenged by national interests. One example is the opposition of a number of Central European countries to mandatory relocation quotas for refugees within the European Union, even after the European Court of Justice confirmed the scheme. Right-wing parties in ECA may benefit from the political polarization the refugee crisis has helped foment (see the ECA Economic Update from November 2016).

The refugee crisis is, however, an opportunity to adopt a more coordinated, multilateral approach to migration. Global institutions and norms to assist refugees were established in response to the vast number of displaced persons at the end of World War II, which uprooted an estimated 11 million Europeans.[9] By contrast, migration has been dealt with largely on a bilateral basis, with receiving countries playing the leading role. Multilateral agreements have been partial (the multilateral Mode 4 of the General Agreement on Trade in Services [GATS], for example, affects a very small subgroup of migrants) or ratified by only a small number of states (an example is the 1990 International Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families, which has been ratified by only 49 states, mainly countries of origin of migrants).

The crisis has heightened awareness of the need for a comprehensive and cooperative approach to migration. The UN General Assembly's Summit on Large Movements of Refugees and Migrants adopted the New York Declaration in September 2016. It calls for the development of two global compacts, which are expected to be adopted in 2018: a global compact for safe, orderly, and regular migration and a global compact on refugees. The global compact on migration would be the first intergovernmental agreement, prepared under the auspices of the United Nations, to cover all dimensions of international migration in a comprehensive manner. Agreement still needs to be reached on several issues in the ongoing negotiations.

The goal of the compact should be to resolve the current policy challenges and intergovernmental impasses. Although there is no clarity yet on the definition of a global compact for migration, a working definition could be "an internationally negotiated framework for governments and international organizations to harness the benefits of migration while navigating its challenges" (World Bank 2017a). Both host and origin countries have several concerns, including the need to (a) support safe, orderly, and regular migration that relieves pressures for undocumented migration; (b) tackle the issue of job competition for native-born workers in host countries; (c) address concerns about national identity while facilitating the integration of migrants in the host community; and (d) retain critical skills in origin countries and address the needs of family left behind in origin countries. Ahead of the UN international conference in 2018, the global community needs to (a) identify the thematic priorities; (b) suggest an institutional architecture to support the compact by mapping the current institutional arrangements, clarifying the missions of key organizations and how their work programs and budget allocations are aligned with those missions; and (c) develop a normative framework or guidelines for governments and international organizations building on existing global conventions, and regional and bilateral agreements that address migration.[10]

Conclusion

Migration has played a key role in resolving economic and political problems in the ECA region for centuries. Maintaining supportive policies toward migration would make a critical contribution to prosperity in the region. Although dealing with the refugee crisis is understandably a central focus of national policy makers, a broader, longer-term perspective is critical to reaping the gains from migration. Measures to increase the integration of migrants in destination countries and greater support for families left behind in origin countries would improve equity and productivity. Increasing the flexibility of labor market institutions and improving skills would help promote employment; increasing the portability of benefits and improving income security could reduce fears over the economic impact of immigrants on native workers. Reaching international agreement on a multilateral framework for migration could enhance the benefits of migration for origin countries, destination countries, and migrants.

Annex. List of Countries for Which Data Are Available

This annex clarifies data availability for selected graphs in the Chapter II.

TABLE A.1 Economies included in figure 2.4

Region	Data available for 1993 and 2016	Data available for 1993 only	Data available for 2016 only
Europe and Central Asia	Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Germany, Greece, Hungary, Italy, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Poland, Moldova, Romania, Russian Federation, Serbia and, Kosovo, Slovenia, Tajikistan, the former Yugoslav Republic of Macedonia, Turkey, Ukraine, the United Kingdom, Uzbekistan		Belgium, France, Montenegro, Netherlands, Slovak Republic, Spain, Turkmenistan
Middle East and North Africa	Algeria; Bahrain; Djibouti; Egypt; Iran, Islamic Rep. Iraq; Israel; Jordan; Kuwait; Lebanon; Libya; Morocco; West Bank and Gaza; Saudi Arabia; Syrian Arab Republic; Tunisia; Yemen		Oman, United Arab Emirates, Western Sahara
South Asia	Afghanistan, Bangladesh, India, Nepal, Pakistan, Sri Lanka		Bhutan, Maldives
Sub-Saharan Africa	Angola, Benin, Botswana, Burkina Faso, Burundi, Cabo Verde, Cameroon, Chad, Comoros, Congo, Dem. Rep. of the Congo, Equatorial Guinea, Eritrea, Ethiopia, Gabon, The Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Liberia, Madagascar, Mali, Mauritania, Mozambique, Namibia, Niger, Nigeria, Rwanda, , Senegal, Seychelles, Sierra Leone, Somalia, South Africa, Sudan, Togo, Uganda, Tanzania, Zimbabwe	Côte d'Ivoire and Sao Tome and Principe.	Central African Republic, Lesotho, Malawi, Mauritius, South Sudan, Swaziland, Zambia
Other/ Unknown	Argentina; Barbados; Bolivia; Brazil; Cambodia; Canada; Chile; China; Colombia; Costa Rica; Cuba; Dominica; Dominican Republic; Ecuador; El Salvador; Guatemala; Guyana; Haiti; Hong Kong SAR, China; Honduras; Indonesia; Lao PDR; Malaysia; Mongolia; Myanmar; Nicaragua; Panama; Paraguay; Peru; Philippines; Korea Rep.; Singapore; Stateless; Suriname; Thailand; Trinidad and Tobago; United States; Uruguay; Venezuela, RB; Vietnam	French Guiana	Fiji, Grenada, Jamaica, Japan, Democratic People's Rep. of Korea, Mexico, New Zealand, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines

TABLE A.2 Economies included in figure 2.6

Grouping	Countries
ECA-OECD	Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Poland, Portugal, Slovak Republic, Spain, Sweden, Turkey, United Kingdom
Other	Australia, Canada, Japan, Mexico, New Zealand, Norway, Switzerland, United States

TABLE A.3 Economies included in figure B2.3.1

Years	Host Countries
2004 and 2014	Liechtenstein, Switzerland (both non-ECA European countries), Albania, Armenia, Austria, Belarus, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Malta, Netherlands, Norway, Poland, Portugal, Republic of Moldova, Romania, Russian Federation, Slovak Republic, Slovenia, Sweden, Tajikistan, former Yugoslav Republic of Macedonia, Turkey, and United Kingdom.
2004 only	Iceland (a non-ECA European country), Georgia, Greece, and Spain
2014 only	Azerbaijan, Bosnia and Herzegovina, Croatia, Luxembourg, Serbia, Turkmenistan, Ukraine, and Uzbekistan.

TABLE A.4 Economies included in figure B2.3.2

Years	Source Countries
2004 and 2014	Afghanistan; Albania; Algeria; Andorra; Angola; Anguilla; Antigua and Barbuda; Argentina; Armenia; Aruba; Australia; Austria; Azerbaijan; Bahamas; Bahrain; Bangladesh; Barbados; Belarus; Belgium; Belize; Benin; Bermuda; Bhutan; Bolivia; Bosnia and Herzegovina; Botswana; Brazil; British Virgin Islands; Brunei Darussalam; Bulgaria; Burkina Faso; Burundi; Cambodia; Cameroon; Canada; Cabo Verde; Cayman Islands; Central African Republic; Chad; Chile; China; Hong Kong SAR, China; Colombia; Comoros; Congo, Dem. Rep; Congo, Rep.; Costa Rica; Côte d'Ivoire; Croatia; Cuba; Cyprus; Czech Republic; Denmark; Djibouti; Dominica; Dominican Republic; Ecuador; Egypt, Arab Rep.; El Salvador; Equatorial Guinea; Eritrea; Estonia; Ethiopia; Fiji; Finland; France; Gabon; The Gambia; Georgia; Germany; Ghana; Gibraltar; Greece; Grenada; Guatemala; Guinea; Guinea-Bissau; Guyana; Haiti; Holy See; Honduras; Hungary; Iceland; India; Indonesia; Iraq; Ireland; Iran, Islamic Rep; Israel; Italy; Jamaica; Japan; Jordan; Kazakhstan; Kenya; Kiribati; Korea, Dem. People's Rep.; Korea, Rep.; Kuwait; Kyrgyz Republic; Lao PDR; Latvia; Lebanon; Lesotho; Liberia; Libya; Liechtenstein; Lithuania; Luxembourg; Macao SAR, China; Macedonia, FYR; Madagascar; Malawi; Malaysia; Maldives; Mali; Malta; Mauritania; Mauritius; Mexico; Micronesia, Fed. Sts.; Monaco; Mongolia; Montserrat; Morocco; Mozambique; Myanmar; Namibia; Nauru; Nepal; Netherlands; New Zealand; Nicaragua; Niger; Nigeria; Norway; Oman; Pakistan; West Bank and Gaza; Panama; Papua New Guinea; Paraguay; Peru; Philippines; Poland; Portugal; Qatar; Republic of Moldova; Romania; Russian Federation; Rwanda; St. Kitts and Nevis; St. Lucia; St. Vincent and the Grenadines; Samoa; San Marino; Sao Tome and Principe; Saudi Arabia; Senegal; Serbia; Seychelles; Sierra Leone; Slovak Republic; Slovenia; Solomon Islands; Somalia; South Africa; Spain; Sri Lanka; Sudan; Suriname; Swaziland; Sweden; Switzerland; Syrian Arab Republic; Tajikistan; Tanzania; Thailand; Timor-Leste; Togo; Tonga; Trinidad and Tobago; Tunisia; Turkey; Turkmenistan; Turks and Caicos Islands; Tuvalu; Uganda; Ukraine; United Arab Emirates; United Kingdom; United States; Uruguay; Uzbekistan; Vanuatu; Venezuela, RB; Vietnam; Yemen; Zambia; and Zimbabwe.
2004 only	Marshall Islands; Netherlands Antilles; Cook Islands; Montenegro; Niue; Palau; and South Sudan.

TABLE A.5 Economies included in figure B2.3.3

Region	Economies
East Asia and Pacific	Australia; Brunei Darussalam; China; Hong Kong SAR, China; Japan; Korea, Rep.; Lao PDR; Macao SAR, China; Malaysia; Mongolia; New Zealand; Thailand; Vietnam
Europe and Central Asia	Albania, Armenia, Austria, Azerbaijan, Belarus, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Kazakhstan, Kyrgyz Republic, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Moldova, Romania, Russian Federation, Serbia, Slovak Republic, Slovenia, Sweden, Switzerland, Tajikistan, former Yugoslav Republic of Macedonia
Latin America and the Caribbean	Aruba, Brazil, Chile, Colombia, Dominican Republic, Ecuador, El Salvador, Honduras, St. Kitts and Nevis, St. Lucia, Sint Maarten (Dutch part)
Middle East and North Africa	Bahrain; Egypt, Arab Rep.; Iran, Islamic Rep.; Israel; Morocco; Oman; Qatar; Saudi Arabia; United Arab Emirates
North America	Bermuda, United States
Sub-Saharan Africa	Botswana, Burundi, Cape Verde, Côte d'Ivoire, Ghana, Lesotho, Madagascar, Mauritius, Mozambique, Namibia, Rwanda, South Africa
South Asia	India, Sri Lanka

Notes

1. Respondents were asked to indicate whether each of the following was a "good thing," a "bad thing," or "it depends": (a) immigrants living in this country, (b) an immigrant becoming your neighbor, and (c) an immigrant marrying one of your close relatives. See http://www.gallup.com/poll/216377/new-index-shows-least-accepting-countries-migrants.aspx?g_source=mn2-us.
2. The survey defined Europe as the European Union, the Western Balkans, Russia, Belarus, Moldova, Ukraine, Norway, and Switzerland.
3. This estimate was calculated by dividing the refugee and asylum seeker stock in 2016 by the migrant stock in 2015, except for Turkey, for which the migrant stock for 2016 was estimated using the following formula: migrant stock 2015 plus refugee flow in 2016 minus number of returnees in 2016. Data on asylum seekers are not available for years before 2000. Migrant stock data are available only for 1995 (not 1993) and 2015 (not 2016). Data on refugees and asylum seekers is from UNHCR, data on migrant stocks is from UNDESA.
4. The number of "illegal border crossings" recorded by Frontex (the European Border and Coast Guard Agency) may differ from the number of people crossing the border, because some people cross several times. The number of border crossings also differs from the number of asylum applicants. Not everyone who enters illegally is recorded, not everyone who enters illegally requests asylum, and not everyone who requests asylum enters illegally (for example, Serbs do not require a visa to enter the European Union).
5. Temporary migrants are defined as foreign-born residents who have been in the host country for less than five years. They could stay longer.
6. If these countries have more stringent policies for low-skilled immigrants than the traditional destination countries, the relatively strong position of foreign-born workers may reflect their higher qualifications. For instance, in 2016 Bulgaria relaxed work-permit rules for high-skilled non-EU workers; it maintains strict work permit requirements for other workers.
7. For the definitions for MIPEX indicators, see http://www.mipex.eu/sites/default/files/downloads/Definitions_of_Who_Benefits_Outcome_and_Beneficiaries_Indicators.pdf.
8. This figure includes costs related to trade and commuters (as a result of longer waiting times at the border) and actual border controls.
9. The early 1950s saw the adoption of the 1951 Geneva Convention Relating to the Status of Refugees, a creation of the office of the United Nations High Commissioner for Refugees (UNHCR) to provide humanitarian protection for refugees, and the founding of the International Organization for Migration (IOM), with a mandate to identify resettlement countries and arrange transport. (The IOM was established in 1951 as the Provisional Intergovernmental Committee for the Movement of Migrants from Europe [PICMME]. Its name went through a succession of changes.)
10. Analysis of the World Bank Group's activities and consultations with partners and stakeholders suggest that it and other international financial institutions could contribute to the global migration agenda in four areas: (a) financing migration programs, (b) addressing fundamental drivers of migration, (c) maximizing the benefits and managing the risks of migration in sending and receiving countries, and (d) providing knowledge for informed policy making and improving public perceptions (World Bank 2016).

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PART II

Selected Country Pages

ALBANIA

Table 1	2016
Population, million	2.9
GDP, current US$ billion	11.9
GDP per capita, current US$	4078
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 coefficient[a]	29.0
School enrollment, primary (% gross)[b]	112.5
Life expectancy at birth, years[b]	77.8

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2012), 2011 PPPs.
(b) Most recent WDI value (2014)

Growth strengthened to 3.4 percent in 2016 and is projected to average 3.5 percent during 2017-19. Private investments in FDI-financed energy projects and consumption drove the recent economic expansion. Growth improved labor market outcomes, gradually leading to more inclusive access to jobs and poverty reduction. The fiscal position remained strong in 2016 and in the first half of 2017 despite elections. Continued growth, and job creation are expected to sustain poverty reduction in the forecasting period.

Recent developments

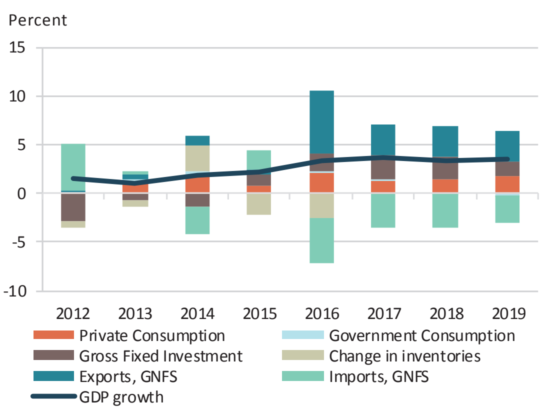
Albania's economy expanded 3.4 percent in 2016, supported by robust domestic demand. Private investment in two large FDI-financed energy projects—the Trans -Adriatic Pipeline and a hydropower plant—and a recovery in private consumption drove growth, contributing 1.8 and 2.1 percentage points respectively. Private consumption was helped by improvements in employment and credit growth. Net exports contributed 2.1 percentage points, driven by services exports, especially tourism. With extractive industry affected by unfavorable commodity prices, services were the main driver of growth, followed by construction and agriculture. Recent data confirms stronger growth in early 2017; business confidence strengthened, especially in services.

Prudent fiscal and monetary policies sustained macroeconomic stability through the election cycle. The fiscal deficit declined to 1.8 percent of GDP in 2016 (compared to 4.9 percent in 2015) in line with the country's fiscal consolidation efforts. Revenues increased by 1 pp of GDP, helped by all tax categories. Public spending (excluding arrears repayments) fell by 0.8 pp as consolidation efforts continued. The primary surplus of 0.7 percent of GDP helped lower the debt to GDP ratio for the first time since the global crisis, reaching 72.4 percent of GDP in 2016. Despite the parliamentary elections, revenues and expenditure remained within budgeted targets in the first half of 2017, consistent with constrains in the new organic budget law. Average annual inflation fell from 1.9 percent in 2015 to 1.3 percent in 2016, below the Bank of Albania's target of 3±1 percent. However, higher food prices lifted inflation to 2.2 percent in the first half of 2017. Monetary easing stimulated the recovery of credit to households, although the high stock of nonperforming loans continues to deter lending to corporations.

Despite the increase in investment related imports, the current account deficit (CAD) narrowed from 10.8 percent in 2015 to 9.6 percent in 2016. Lower electricity imports and higher services exports more than compensated for the increase in investment related imports. Remittances remained broadly stable despite weak growth in source countries (Greece and Italy). Net FDIs increased to 8.9 percent of GDP from 8 percent in 2015, helped by inflows associated with energy projects, and financed 93 percent of the CAD. At end-2016, the stock of foreign exchange reserves was 2.9 billion euros, covering 5.7 months of imports.

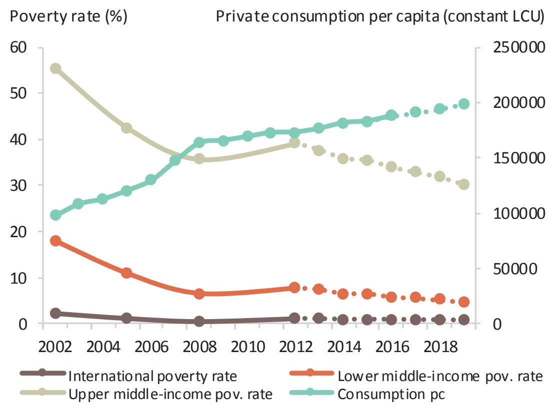
Stronger growth stimulated job creation in 2016. In 2016 employment grew by 2.5 percentage points, reaching 48.7 percent, driven by industry (3 percent) and services (8.2 percent). Labor force participation increased to 57.5 percent, 1.8 percentage points higher than in 2015. The official unemployment rate declined by 1.9 percentage points to an average of 15.2 percent in 2016, with

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



Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.

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



Source: World Bank. Notes: see table 2.

more than half of the unemployment still being long-term. Labor market recovery continued in the first half of 2017, with improvements in the employment rate (1.5 pp y-o-y) driven mostly by declining unemployment (2.3 pp y-o-y). Average nominal wages have been declining since the end of 2013, and might recover in 2017 helped by the end of the public wages freeze.

Poverty is estimated to have declined as growth and employment continued to pick up. The poverty rate (measured as US$ 5.5/day, 2011 PPP) is estimated to have decreased in 2016 to 33.9 percent, compared to 35.4 percent in 2015. For some households, the decline in nominal wages likely muted some of the progress taking place on employment outcomes, while the stabilization of remittances provides positive prospects for recipients. While labor force participation declined for women and youth in early 2017, this change was more than compensated by reductions in unemployment for these groups, resulting in slightly higher employment.

Outlook

Albania's economic outlook is positive, supporting further poverty reduction. Growth is projected at 3.6 percent in 2017 and 3.5 percent in 2018 and 2019. The two large energy projects will continue to support growth, aided by private consumption supported by labor market improvements, and net exports supported by demand from the EU. Sustained reform in the energy and social protection sectors will create additional savings creating room for further fiscal consolidation. The CAD will remain elevated, driven by investment-related imports, financed by FDI, and by growing consumption-related imports. Fiscal consolidation and related structural reforms are expected to gradually reduce the fiscal deficit to 1.3 percent of GDP by 2019, and the debt-to-GDP ratio to 60 percent of GDP by 2022. Poverty (US$ 5.5/day, 2011 PPP) is expected to decline to 32.8 percent in 2017, to 31.7 percent in 2018 and even further to 30.2 percent in 2019.

Risks and challenges

Economic prospects are balanced. Uncertain global market conditions could reduce Albania's exports and FDI inflows, further translating into lower tax revenues, less public investment and thus slower output growth. Harnessing growth will require macroeconomic stability and progress on structural reforms to improve the business climate including continuing judiciary reforms, energy reform, enhancing public investment management, and improving skills. The post-election is a strategic time to advance these agendas, which should be informed by equity considerations to ensure continued poverty reduction.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	1.8	2.2	3.4	3.6	3.5	3.5
Private Consumption	2.8	1.1	2.9	1.8	2.1	2.6
Government Consumption	6.4	-1.1	3.8	2.5	-1.7	-5.1
Gross Fixed Capital Investment	-4.5	4.0	6.0	8.1	7.2	4.2
Exports, Goods and Services	1.8	1.0	13.0	5.8	5.5	5.8
Imports, Goods and Services	4.3	-2.9	7.4	5.4	5.1	4.2
Real GDP growth, at constant factor prices	2.1	3.1	3.4	3.5	3.5	3.5
Agriculture	2.0	0.8	0.7	0.8	1.5	1.8
Industry	-3.8	5.1	3.2	3.5	3.6	4.2
Services	5.6	3.4	5.1	5.0	4.5	4.1
Inflation (Consumer Price Index)	1.6	1.9	0.9	2.2	2.7	3.0
Current Account Balance (% of GDP)	-12.9	-10.8	-9.6	-13.0	-13.0	-11.8
Financial and Capital Account (% of GDP)	11.2	14.1	7.3	10.4	10.5	9.2
Net Foreign Direct Investment (% of GDP)	8.1	8.0	8.9	8.3	7.0	5.6
Fiscal Balance (% of GDP)	-6.0	-4.9	-1.8	-1.8	-1.8	-1.2
Debt (% of GDP)	72.0	73.1	72.4	70.9	68.1	64.8
Primary Balance (% of GDP)	-3.1	-2.2	0.7	0.5	0.7	1.2
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]	6.5	6.5	5.8	5.6	5.2	4.8
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	35.9	35.4	33.9	32.8	31.7	30.2

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2012-LSMS. Nowcast: 2014 - 2016. Forecast are from 2017 to 2019.
(b) Projection using neutral distribution (2012) with pass-through = 0.87 based on private consumption per capita in constant LCU.

ARMENIA

Table 1	2016
Population, million	3.0
GDP, current US$ billion	10.6
GDP per capita, current US$	3494
International poverty rate ($1.9)[a]	1.9
Lower middle-income poverty rate ($3.2)[a]	13.5
Upper middle-income poverty rate ($5.5)[a]	48.3
Gini coefficient[a]	32.4
Life expectancy at birth, years[b]	74.7

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2014)

Armenia's economy has recovered throughout 2017, on the back of resurging global metal prices and strengthened private investment and consumption, which have also contributed to an improvement in the fiscal outcomes. While medium-term projections envisage a sustained modest recovery, risks are on the downside given uncertainties related to the presidential elections in 2018 and the still volatile external environment. The outlook is revised slightly upwards in 2018-19, and poverty would decline moderately in line with the expected increase in incomes.

Recent developments

After stagnating in 2016, the Armenian economy showed renewed strength during the first half of 2017 as real GDP grew by 6 percent above 2016 level. Growth was driven by industry, services and retail trade. In contrast, agriculture remained weak because of frost and hailstorms in spring, while construction continued its decline, coming in 10 percent below 2016 levels. While exports experienced a strong boost of over 20 percent y/y (largely on the back of extractives, processed food, jewelry, tobacco and textile products), net exports put a brake on growth, as imports spiked on the back of rising investment and consumption.

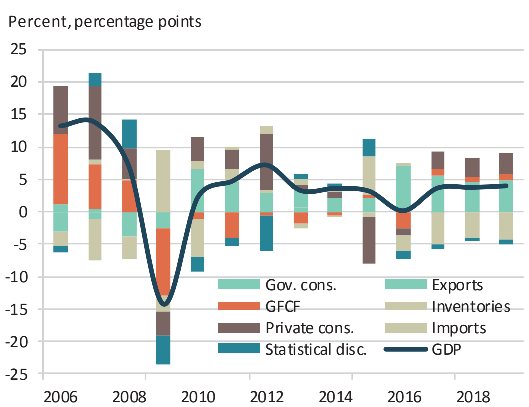
Having registered high deficits of 4.8 and 5.5 percent of GDP in 2015 and 2016, respectively, the central government initiated fiscal consolidation through the 2017 State Budget deficit target of 2.7 percent, in response to the fiscal rule. The fiscal situation stabilized during the first half of 2017, supported by improved tax collection and more disciplined public spending, which helped to contain the budget deficit in line with the budget. Compared with the first half of 2016, tax collection was up by more than 7 percent in nominal terms mostly supported by indirect taxes, reflecting the implementation of the Unified Tax Code, and a 26 percent increase in imports which increased the collection of VAT and customs duties. With public debt expected to remain close to 60 percent of GDP at end 2017, the government plans to maintain tight fiscal policy and continue compliance with the domestic fiscal rule. The increased debt burden is putting pressures on fiscal space as interest payments exceed 2 percent of GDP.

At only 0.9 percent, the 12-month inflation indicates continued deflationary pressures. Food prices rose by 4 percent, while prices for non-food items continued declining by another 3 percent. The January 2017 natural gas tariff reduction contributed to a 2 percent decline in service prices. With the dissipation of the pass-through effect of the dram's depreciation in late 2014, the policy rate has been lowered in steps from 10.5 percent in August 2015 by 4.5 percentage points over the last two years, and kept at 6 percent since January 2017.

After registering a low deficit of 2.2 percent of GDP in 2016, the current account deficit widened in the first half of 2017 as imports grew faster than exports. The 26 percent (y/y) expansion in imports is partly the result of recent improvements in the transparency of customs administration. Trade data show greater penetration of exports into Asian and Middle -Eastern markets, CIS/Russia and the EU. After a cumulative 35 percent decline during 2015-16, remittances have registered some recovery by growing at 11 percent compared with the first half of 2016. At the same time, remittances from Russia grew much faster by 24 percent y/y).

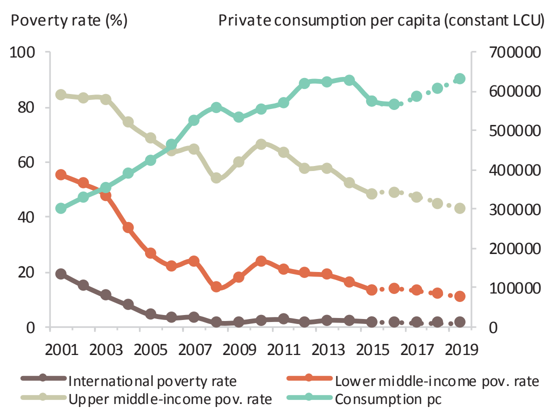
The banking sector began the year in a stronger capital position and in compliance with the new capital requirement set

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



Source: World Bank.

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



Source: World Bank. Notes: see Table 2.

by the Central Bank (in line with Basel III requirements). The average capital adequacy ratio for Armenia's 17 banks was 20 percent, well above the minimum requirement of 12 percent. Dollarization rates for bank deposits and loans declined from over 70 and 66 percent at the beginning of 2016 to about 63 and 62 percent by June-2017, respectively. The banking sector lending to the economy, which was almost stagnant in 2015, grew by 15 percent in 2016 and continued a further 13 percent expansion during the first half of 2017 (y/y). The steady decline in the Central Bank's policy rate since the beginning of 2016 has contributed to about 3-4 percentage point declines in short term lending and deposit rates, and 2-3 percentage points on the long-term.

With regard to poverty developments, sluggish growth in agriculture, and a continuous contraction of construction in combination with the decline of remittances in 2016, negatively impacted income growth among poor and vulnerable households. Thus, the poverty rate measured at the international poverty line of US$3.2/day at PPP 2011 increased by 0.4 percentage points, from 13.5 percent in 2015 to 13.9 percent in 2016 and is projected to decrease to 13.2 percent in 2017.

Outlook

Growth and poverty reduction prospects over the medium term remain positive but subject to significant uncertainty, as risks on external and domestic political fronts remain high. The upcoming presidential elections in April 2018 to be followed by government reshuffling, the modest recovery in Russia which is subject to downside risks from recent sanctions and the unclear situation with Iran justify a cautious forecast of 3.7 percent growth in 2017 and below 4 percent in 2018-19. Under these circumstances, the poverty rate would decline further to 11.0 percent in 2019.

The most recent growth episode shows strong growth in the industry and service sectors, but only minor improvements in agricultural output, and continued decline of construction. These growth trends reflect a rebalancing of the structure of the economy, which may widen disparities between the capital city, secondary towns, and rural areas if labor mobility remains low. As the structural transformation of the economy continues, secondary towns will play an important role in creating job opportunities for people leaving the agricultural sector.

Risks and challenges

The envisaged recovery outlook is predicated on the implementation of much needed structural reforms in public administration, in competition practices and enforcement as well as in broader business environment-related policies, which are handicapped by uncertainties on the political front. This could affect the confidence of households and investors, and underscores the importance of maintaining the course of stable and decisive policy reform.

Despite improved tax collections and contained public spending in the first half of 2017, fiscal tensions remain high, as public infrastructure suffered from drastic spending cuts in 2009, from which they have yet to recover. Striking the right balance to maintain the adequate levels of high-quality capital spending while complying with its fiscal targets will be critical going forward. The outlook also remains vulnerable to persistent regional risks stemming from unresolved territorial disputes and geopolitical tensions.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	3.6	3.2	0.2	3.7	3.8	4.0
Private Consumption	1.0	-7.8	-1.3	3.6	3.7	3.9
Government Consumption	-1.2	4.7	4.1	-2.9	2.5	2.5
Gross Fixed Capital Investment	-2.2	2.5	-11.4	3.9	4.2	4.3
Exports, Goods and Services	6.4	4.9	19.1	13.2	9.2	9.7
Imports, Goods and Services	-1.0	-15.1	7.6	14.2	10.3	10.6
Real GDP growth, at constant factor prices	3.9	4.3	0.7	3.7	3.8	4.0
Agriculture	6.1	13.2	-5.8	0.8	1.9	2.3
Industry	-2.3	2.8	-0.9	8.0	7.2	6.5
Services	8.3	-1.8	8.6	2.4	2.1	3.0
Inflation (Consumer Price Index)	3.0	3.7	-1.3	1.0	3.5	3.2
Current Account Balance (% of GDP)	-7.6	-2.5	-2.2	-4.0	-3.8	-3.6
Financial and Capital Account (% of GDP)	7.9	3.9	4.4	5.9	5.8	5.5
Net Foreign Direct Investment (% of GDP)	3.3	1.5	2.6	4.5	4.8	4.9
Fiscal Balance (% of GDP)	-1.9	-4.8	-5.5	-2.8	-2.7	-2.6
Debt (% of GDP)	43.7	48.7	56.6	58.9	59.6	59.3
Primary Balance (% of GDP)	-0.4	-3.0	-3.6	-0.6	-0.5	-0.3
International poverty rate ($1.9 in 2011 PPP)[a,b]	2.3	1.9	1.9	1.6	1.6	1.4
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	16.4	13.5	13.9	13.2	12.0	11.0
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	52.3	48.3	49.0	47.2	45.1	42.8

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2015-ILCS. Actual data: 2014, 2015. Nowcast: 2016 - 2016. Forecast are from 2017 to 2019.
(b) Projection using neutral distribution (2015) with pass-through = 0.7 based on private consumption per capita in constant LCU.

AZERBAIJAN

Table 1	2016
Population, million	9.8
GDP, current US$ billion	38.2
GDP per capita, current US$	3914
School enrollment, primary (% gross)[a]	106.1
Life expectancy at birth, years[a]	70.8

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

Azerbaijan's economy contracted in the first half of the 2017 owing to oil production cuts, banking sector distress, and declining private consumption. However, a higher-than-expected budget outturn fueled a fragile recovery in the non-oil sector. Lackluster growth is expected in the medium term due to policy uncertainty, the protracted credit crunch, and slow progress in structural reforms implementation. A large number of households remain vulnerable of falling back into poverty, as real wages decline.

Recent developments

The Azerbaijani economy contracted by 1.3 percent (y/y) in the first half of 2017. This was driven by a decline in oil GDP (7.2 percent, y/y) as production volumes were cut in line with the OPEC agreement. On the upside, and despite continued banking sector distress, the non-oil economy expanded by 1.7 percent (y/y) for the first time over a year supported by strong performance of the agricultural and manufacturing sectors.

Annual inflation remained high at 13.9 percent in June 2017. High inflation was driven mainly by the increase in administratively controlled tariffs for electricity, water and gas, and in domestic food prices, reflecting higher demand for Azerbaijani food from Russia. Citing inflationary pressures, the CBAR continued to tighten the monetary policy stance in the first half of 2017, by scaling up the liquidity absorption operations.

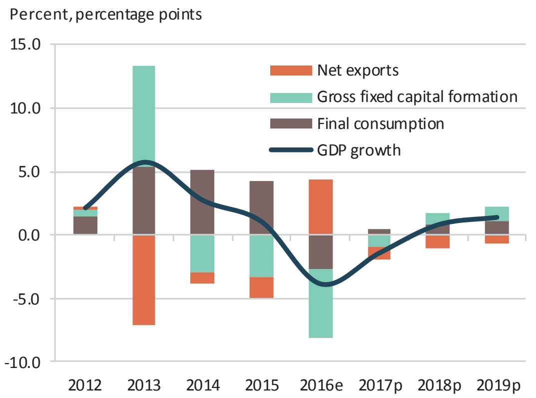
The current account recorded a surplus of 4.4 percent of GDP in the first quarter of 2017, driven by surging exports and a continued import contraction. Despite the sharp cuts in oil production, official statistics show a 42 percent increase in oil exports. Non-oil exports increased by 11 percent amid rising external demand for agriculture products. The manat appreciated by 4.4 percent against the US dollar since end-2016, reflecting the stronger external position and increased liquidity absorption operations. To help avoid excessive exchange rate volatility, the State Oil Fund boosted the CBAR's international reserves from US$3.9 billion to US$5 billion over the first half of 2017.

The troubled financial sector continues to exert a negative impact on the economy. Credit contracted by 15.6 percent in the first half of 2017, and the quality of assets continued to deteriorate. Per official statistics, the non-performing loan ratio reached 13 percent in June 2017, compared with 9 percent at end-2016. While manat deposits grew in the second quarter of 2017, the client deposits (corporate and household) shrank by 4.4 percent during the first 7 months of 2017.

In May 2017, the International Bank of Azerbaijan (IBA) – the largest state-owned bank in the country - defaulted on a US$100 million loan payment and filed for bankruptcy in New York courts. IBA's restructuring agreement for the US$3.3 billion foreign liabilities to external creditors and the Oil Fund was concluded in early September. The plan envisages the conversion of IBA's debt into Government bonds, with up to a 20 percent haircut. Public debt will rise by 6 percent of GDP by end-2017 as a result of the bailout.

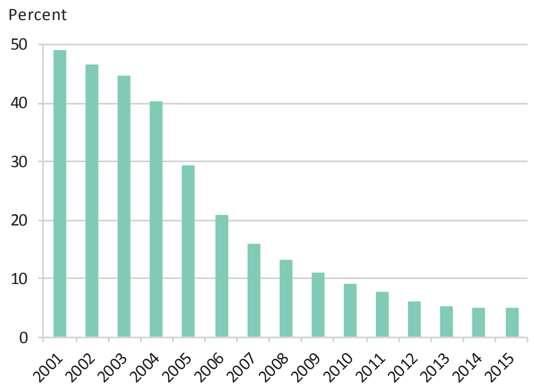
Fiscal policy was expansionary in the first half of 2017, on the back of public investment. Despite this, the consolidated fiscal balance (including balances of the Oil Fund, the social protection fund and the Nakhchivan government) recorded a surplus at 0.3 percent of GDP in the first half of 2017, as increased investment was more than offset by higher-than-expected revenue. The non-oil deficit was 22 percent of GDP for the first half of 2017.

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



Sources: State Statistical Committee.

FIGURE 2 Azerbaijan / Official poverty rate



Sources: Source: State Statistical Committee calculations.

Social conditions continue to be a major source of concern, although poverty is relatively low in Azerbaijan (4.9 percent measured at the national poverty line in 2015). Nominal wage growth of 5 percent in the first half of 2017 was not sufficient to compensate for higher prices. Households continue to experience a decline of their real purchasing power, especially for imported consumption items such as food, which undermines future poverty reduction.

Outlook

Azerbaijan's economy is projected to contract by 1.4 percent in 2017, despite the increase in oil prices. Oil production will remain muted while the recovery of the non-oil economy is unlikely to offset this effect throughout the remaining year given the modest planned budget and ongoing banking sector distress. Inflationary pressures are likely to persist as the Government increased the gasoline prices, and food prices are expected to rise by the end of 2017 due to seasonal factors.

The economy would expand from 2018 onwards, supported by the acceleration of oil GDP as the Shah Deniz gas field - one of the largest gas fields in the world - begins production. Non-oil output will continue to grow at a slow pace due to limited credit growth and weak business environment.

The Government revised the 2017 budget, increasing expenditure against improved revenue prospects. The bulk of the spending increase will be used to capitalize the Azerbaijan Deposit Insurance Fund with AZN 500 million. However, the implementation of some public investment programs may be delayed. The consolidated fiscal balance is projected to reach a surplus of 4.6 percent of GDP, whereas non-oil deficit is expected to be 16 percent of GDP in 2017.

Despite increased social spending, recent developments and a slow recovery of the private sector are not conducive to poverty alleviation in a short term. A large number of households remain vulnerable to falling back into poverty. The reduction in public investment and consumption in 2016 may reduce household welfare through decreasing employment, especially for those employed in the construction sector.

Risks and challenges

The economic recovery is expected to be fragile, threatened by a number of risks. The immediate challenge for the government is to safeguard macroeconomic stability to support economic recovery and poverty reduction. This includes ensuring the banking sector stabilization and resumption of credit growth to support private sector development. Going forward, another challenge is to improve business environment and government transparency to enable the further diversification of the non-oil economy.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	2.7	1.1	-3.8	-1.4	0.9	1.5
Private Consumption	9.9	5.4	-2.8	1.0	1.5	1.9
Government Consumption	4.0	-7.1	-8.1	-4.1	-0.1	0.5
Gross Fixed Capital Investment	1.4	-8.7	-22.8	-5.2	5.4	6.2
Exports, Goods and Services	-1.1	-1.0	-2.0	-2.1	0.3	0.7
Imports, Goods and Services	4.1	-5.0	-10.0	-2.2	2.0	2.4
Real GDP growth, at constant factor prices	2.5	1.0	-3.9	-1.4	0.8	1.5
Agriculture	-1.9	6.6	2.6	2.7	2.8	2.8
Industry	0.3	-2.0	-4.2	-2.7	-0.1	0.7
Services	9.3	6.9	-4.6	0.7	2.4	2.8
Inflation (Consumer Price Index)	1.5	7.7	15.6	11.2	5.0	4.9
Current Account Balance (% of GDP)	13.6	-0.4	-3.6	3.5	4.5	3.9
Financial and Capital Account (% of GDP)	-4.5	-16.8	-7.1	-4.5	-5.5	-4.9
Net Foreign Direct Investment (% of GDP)	3.2	3.2	3.2	2.8	2.6	2.4
Fiscal Balance (% of GDP)	3.2	-6.2	0.3	4.6	7.0	6.5
Primary Balance (% of GDP)	3.3	-5.5	1.0	5.7	8.2	7.5

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.

BELARUS

Table 1	2016
Population, million	9.5
GDP, current US$ billion	47.4
GDP per capita, current US$	5011
Upper middle-income poverty rate ($5.5)[a]	0.7
Gini coefficient[a]	27.9
School enrollment, primary (% gross)[b]	99.0
Life expectancy at birth, years[c]	74.1

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

In the first half of 2017, the Belarus's economy stabilized and grew modestly for the first time in two years. Robust increase in commodity-based exports has helped to support the recovery. The macroeconomic policy stance remains tight despite reduction in policy rates. Real household incomes continued falling, and poverty rate continued to increase. Rising levels of public debt and external imbalances continue to pose risks to medium term growth. There is a risk that policy complacency could undermine reform momentum.

Recent developments

The economy started to stabilize in the first half of 2017 and grew modestly ending a two-year long contraction. Real GDP grew 1.1 percent y/y in the first seven months of 2017 in sharp contrast to the 2.7 percent decline y/y in the same period of last year. Tentative economic recovery in Russia helped to boost exports and support a moderate increase in domestic business activity, especially in industry. Industrial output increased by solid 6.1 percent y/y (vs. 2 percent decline a year ago) driven by expansion of production of investment goods. In contrast, output in construction dropped by 7.5 percent y/y (vs. 17.7 percent y/y decline a year ago) as recovery of fixed capital investments remains slow.

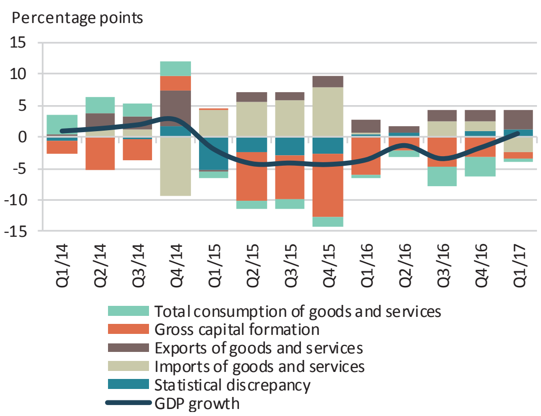
Deterioration of households' incomes slowed with the resumed increase of real wages. In the first half of 2017, real disposable incomes declined by 0.8 percent (vs. 6.6 percent y/y drop a year ago). Consistent with falling real incomes the poverty rate (national headcount ratio) increased from 5.5 percent in Q2 2016 to 5.9 percent in Q2 2017. Moderate poverty, measured at PPP US$ 5.5/day threshold, remains low at 0.7 percent in 2016. However, average real wages in the economy have been growing since February, up by 2.3 percent y/y in January-June along with labor productivity on the back of declining employment levels. While the replacement rate remained below 1, the number of new hires exceeded terminations in July, and the officially registered unemployment rate was low at 0.7 percent.

The macroeconomic policy stance has remained tight, albeit some easing measures introduced recently as inflation stabilizes. Tight fiscal and monetary policies of previous years helped reduce inflation to single-digit (6 percent in July 2017), the lowest level for the decade. Against the background of lower inflation, the National Bank has cut its benchmark rate almost on a monthly basis from 17 percent to 11.5 percent, along with a twofold reduction in lending rates in national currency. However, despite these easing measures, credit continues to contract—a trend from mid-2016—as high levels of corporate indebtedness and risk aversion limit banking system's ability to extend new credit.

Government's official fiscal accounts continue to register a surplus, but public debt levels continuing to increase. General government revenues recorded modest real growth due to increased VAT, excise and corporate income taxes revenues. To meet the public debt obligations, general government expenditures were cut—mainly subsidies and transfers – to generate the budget surplus of 3.2 percent (net of quasi -fiscal expenses). The April 2017 agreements between Belarus and Russia over gas price and oil supplies have paved the way to the disbursement of two tranches of the EFSD loan totaling US$600 million and the issuance of two Eurobonds in the amount of US$800 and US$600 million, for five and ten years, respectively.

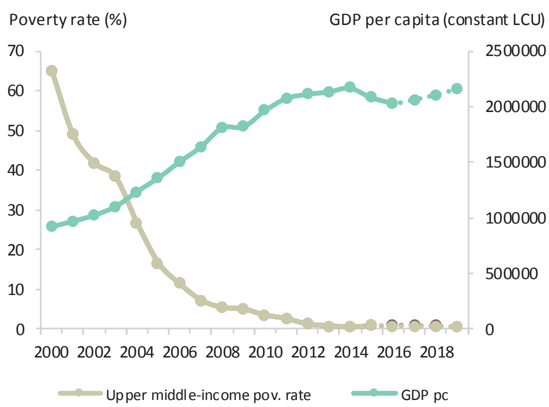
Pressures on external accounts still exist despite sizable external financing received

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.

this year. In January-June, the current account deficit amounted to 2.5 percent of GDP (vs. 7.1 percent a year ago) driven by primary income deficit. Gross international reserves totaled almost US$ 7 billion, up by 42 percent (covering 2.5 months of imports of goods and services). Net international investment position is negative and totals US$ 42 billion as of July 1, 2017 accounting for 81.7 percent of GDP..

Outlook

Despite a tentative recovery in 2017, in the medium term economic growth is expected to remain weak as structural bottlenecks persist and domestic demand remains subdued. Improved external conditions are expected to remain in place, supporting moderate growth of 1.8 percent year-on-year in 2017 and 2.1 percent in 2018. Moderate growth will ease trade deficit pressures on the balance of payments, thus helping to maintain a current account deficit below 4 percent of GDP over the forecast period. The major structural bottlenecks – holding back stronger and sustainable economic recovery – include SOE restructuring and mitigation of related fiscal risks, NPL resolution, and better targeted social protection and unemployment assistance systems.

Despite growth of real wages in the economy and nominal increase of wages in the budget sector by 6.5 percent from September 1, the moderate poverty rate (PPP US$5/day) is projected to remain stable during 2017-2018 due to very slow recovery of household incomes as the Government increases household utility tariffs by 8 percent from September 1. Another rise by 10 percent is planned from December 1 to reach full cost-recovery level on all utilities except for heating by beginning of 2018. Moreover, tariffs growth would require more robust mitigation measures by improving the targeting of existing household utility subsidy program. Labor market conditions will remain tight as still weak financial situation and accumulated debts will prevent enterprises from increasing employment.

Risks and challenges

Going forward, the major challenge for Belarus is to avoid falling into a low-growth trajectory. To escape that destiny, it is critical to expand the size of the private sector, to reduce the size of the SOE sector and to strengthen social safety-nets to protect the most vulnerable social groups during the transformation. While today there is a broad consensus as to this direction of change among policy makers, there are diverging views about the pace of this reform path. The latest agreement with Russia has relieved immediate external financing pressures for the economy, creating a risk of slowing—and in some areas reversing—reform momentum. Nevertheless, large external financing needs and high external imbalances continue to pose a risk of adjustment in external imbalances. In addition, there is a significant risk of a disorderly unwinding of financial sector imbalances unless mechanisms for addressing insolvent SOEs and NPL resolution are not put in place.

Government's direct levers to control the economy remain significant, therefore, there is a risk that recently announced policy goals of reaching the average wage of US$500 by end of 2017 and even higher by 2018 would exacerbate internal and external imbalances. More importantly, the re-introduction of short-term demand management measures to support growth would signal a significant reversal of prudent macro policy stance Belarus maintained over the last two years.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	1.7	-3.8	-2.6	1.8	2.1	2.4
Private Consumption	4.3	-2.3	-3.9	2.5	3.0	3.1
Government Consumption	-2.0	-0.6	0.5	0.4	0.6	1.1
Gross Fixed Capital Investment	-5.3	-15.5	-16.7	1.1	3.1	3.9
Exports, Goods and Services	4.6	2.1	2.8	4.2	5.0	6.1
Imports, Goods and Services	2.0	-10.6	-2.1	3.9	5.4	6.3
Real GDP growth, at constant factor prices	2.2	-4.2	-3.0	1.8	2.1	2.4
Agriculture	2.8	-2.8	3.8	2.5	2.8	3.1
Industry	1.5	-6.8	-4.6	2.8	3.2	3.5
Services	3.0	-1.3	-2.9	0.4	0.6	0.9
Inflation (Consumer Price Index)	18.1	13.5	11.8	9.0	7.2	6.5
Current Account Balance (% of GDP)	-6.6	-3.3	-3.6	-3.2	-3.6	-3.5
Financial and Capital Account (% of GDP)	-7.2	-2.3	-1.7	2.2	3.3	1.9
Net Foreign Direct Investment (% of GDP)	2.4	2.9	2.6	2.4	2.6	2.6
Fiscal Balance (% of GDP)	1.0	1.4	1.5	1.9	2.0	2.0
Debt (% of GDP)	25.7	29.5	44.7	49.4	49.8	50.2
Primary Balance (% of GDP)	2.1	3.1	3.5	4.4	4.8	4.3
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	0.4	0.7	0.7	0.6	0.6	0.6

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: f = forecast.
(a) Calculations based on 2016-HHS. Actual data: 2014 - 2016. Forecast are from 2017 to 2019.
(b) Projection using neutral distribution (2016) with pass-through = 0.7 based on GDP per capita in constant LCU.

BOSNIA AND HERZEGOVINA

Table 1	2016
Population, million	3.8
GDP, current US$ billion	16.8
GDP per capita, current US$	4409
School enrollment, primary (% gross)[a]	n.a.
Life expectancy at birth, years[a]	76.4

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

Economic growth in Bosnia and Herzegovina (BiH) reached 3.1 percent in 2016. Growth was driven primary by consumption. Unemployment fell to 20.5 percent in 2017, but remains high. For economic growth to translate into poverty reduction, improvements in labor market participation and employment will be strongly needed. Political uncertainties are still seen as the highest risk for the medium-term outlook.

Recent developments

Growth reached 3.1 percent in 2016, 0.1 percentage points (pp) lower than envisaged by the official estimates (BiH Global Fiscal Framework 2017-2019). Consumption remains the main driver of growth.

On the production side, agriculture and manufacturing contributed about 80 percent, together offsetting a contraction in services.

Unemployment, especially among the youth, remains high, despite significant improvements in the labor market. The unemployment rate fell from 25.4 percent in 2016 to 20.5 percent in 2017, driven by a fall in activity rate and a slight rise in employment rate. Unemployment among the youth has also decreased to 45.8 percent. These positive outcomes should have translated into a slight poverty reduction in 2017.

2017 marked the end of deflation. The consumer price index declined by an annual average of 0.8 percent in 2016 as low global energy prices placed downward pressure on prices. However, a long winter and a rebound of global energy markets led to increasing prices for fuel and imported food after December 2016, raising consumer prices by 1.1 percent y-o-y in June 2017. Given the limited growth in nominal salaries, higher consumer prices provided a reduction to real incomes.

Strong fiscal consolidation in 2015 resulted in fiscal surplus of 0.6 percent of GDP. Still, fiscal accounts are likely to have deteriorated in 2016 and 2017 to a deficit of 0.6 percent of GDP, as stable revenues-to-GDP ratio combined with an increase in social spending and some recovery in capital spending. Recent DSA analysis confirms BiH is moderately indebted country with public debt to GDP ratio slightly above 40 percent of GDP.

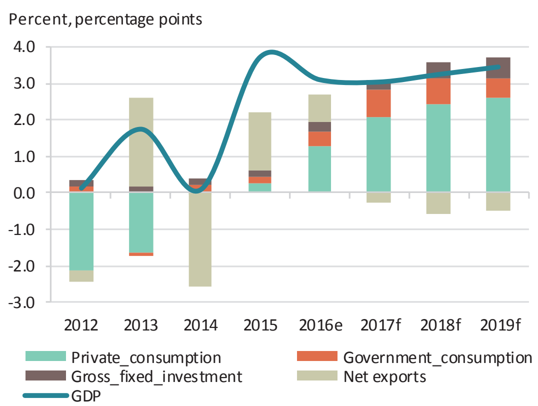
Reaching the agreement on Global Fiscal Framework (GFF) by mid-2017 would be crucial for timely budget implementation. It is decreasingly likely that 2018 budgets will be adopted promptly, as GFF for 2018 -2020 has not been agreed yet.

The current account deficit narrowed in 2016 from 5.6 percent to 4.3 percent as a result of strong growth in exports (up by 6.2 percent) and smaller rise in imports (up by 2 percent). In contrast in 2017 next export are subtracting from growth as imports are starting to pick up. The currency board continues to support monetary policy and international reserves remined at a comfortable level in H1 2017 above 6 months of imports. Share of non-performing loans (NPL) in commercial bank portfolios has also improved: at the end of Q2 2017 NPLs reached 11.1 percent of total loans, down from 11.8 percent at the end of 2016.

Outlook

Supported primarily by rising domestic demand, economic growth is projected to strengthen from 3.1 percent in 2016 to 3.5 percent by 2019. This is considerably lower than the estimated 6 percent growth needed for BiH to catch up to EU income

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



Sources: BiH Agency for Statistics (BHAS), World Bank staff estimates.

FIGURE 2 Bosnia and Herzegovina / Labor market indicators, 2014-2017

Sources: LFS 2014-2017 report, World Bank staff calculations.

levels by 2037 and close the gap with other transition economies that are already part of the EU.
While preparations for submitting official documents as the next step in EU accession process exert some positive pressure on investment sentiment, moderate growth is projected in the medium-term due to slow improvements in the business environment, delays in the construction of corridor Vc and projects in the energy and tourism sectors, as well as uncertainty about tax reform implementation.
As poverty is strongly associated with unemployment and inactivity in BiH, for economic growth to translate into poverty reduction, improvements in labor market participation and employment will remain key. The implementation of new labor laws in both BiH Federation and Republika Srpska, and the introduction of support schemes for first-time job seekers, are expected to support improved employment outcomes in 2018. However, as unemployment remains high, and since real wages are expected to remain largely flat due to the substantial remaining slack in the labor market, poverty is projected to decline at a slow pace over the next couple of years.
The current account deficit is forecast to widen in the short run to medium term due to stronger demand for imports and consumers' preference to imported goods. Overall, in the medium term both fiscal and external deficits will persist until 2019 when a balanced budget is expected to be helped by progress with ongoing structural reform agenda and an ambitious fiscal adjustment. Fiscal consolidation will not be effective if structural rigidities on the expenditure side are not addressed, especially the large public wage bill and sizeable and poorly targeted social assistance.

Risks and challenges

Although deficits remain relatively moderate, the fiscal sector is still characterized by a high tax burden and inefficient patterns of spending.
Political uncertainties that could hold back the reform agenda are the highest risk for the medium-term outlook. The lack of agreement among statistical agencies about the final Census 2013 results may affect negatively welfare monitoring quality, by forcing the statistical offices to continue using an outdated sampling frame.
Upside risks include stronger growth in the EU in 2017.
Still continued progress on the reform agenda is evident as the country is completing a detailed Questionnaire from the European Commission on which its readiness for the EU candidate status will be evaluated.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	0.1	3.7	3.1	3.0	3.2	3.5
Private Consumption	0.0	0.4	1.8	2.9	3.4	3.6
Government Consumption	0.9	0.8	1.8	3.7	3.4	2.6
Gross Fixed Capital Investment	1.1	1.0	1.7	1.6	2.9	3.5
Exports, Goods and Services	4.4	6.3	4.1	2.5	3.1	3.4
Imports, Goods and Services	8.0	0.9	1.2	2.2	3.2	3.3
Real GDP growth, at constant factor prices	1.1	3.1	3.1	3.0	3.2	3.5
Agriculture	-12.7	9.2	5.0	2.8	3.0	3.0
Industry	1.8	3.4	3.0	2.7	3.0	3.0
Services	2.6	2.3	2.9	3.1	3.4	3.7
Inflation (Private Consumption Deflator)	0.9	1.0	-0.8	0.9	1.4	1.4
Current Account Balance (% of GDP)	-7.2	-5.7	-4.5	-4.6	-5.9	-6.8
Financial and Capital Account (% of GDP)	-3.4	-2.0	-1.4	5.8	7.2	8.1
Net Foreign Direct Investment (% of GDP)	-2.5	-1.4	-1.6	1.3	2.3	2.7
Fiscal Balance (% of GDP)	-2.8	0.6	-0.3	-0.6	-0.6	0.0
Debt (% of GDP)	43.6	40.6	41.1	39.5	37.9	35.8
Primary Balance (% of GDP)	-2.0	1.5	0.8	0.6	1.0	1.3

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.

BULGARIA

Table 1	2016
Population, million	7.1
GDP, current US$ billion	52.4
GDP per capita, current US$	7353
Lower middle-income poverty rate ($3.2)[a]	3.8
Upper middle-income poverty rate ($5.5)[a]	8.7
Gini coefficient[a]	37.4
School enrollment, primary (% gross)[b]	99.1
Life expectancy at birth, years[b]	74.5

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

Bulgaria's economic recovery gathered speed in 2017 supported by improved domestic demand. Poverty declined. Further gains in growth, poverty reduction and shared prosperity would hinge on strengthening institutions, boosting the skills and employability of the labor force, and improving the effectiveness and efficiency of public spending.

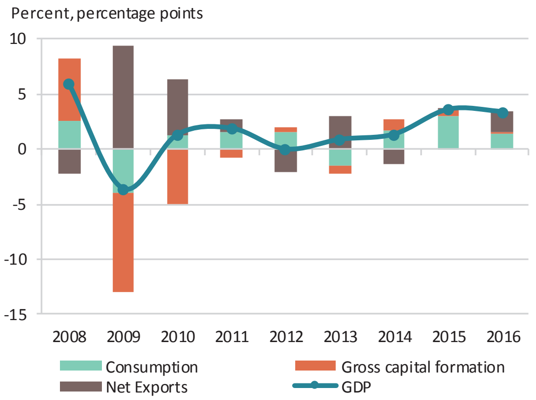
Recent developments

Stronger domestic demand contributed to stronger real GDP growth, which rose from 3.4 percent in 2016 to 3.9 percent year-on-year in the first quarter of 2017 and to 4.2 percent in the second. Private consumption continued to improve because of rising incomes, employment and credit. Real private sector wages increased by about 9 percent year-on-year in the first half of 2017, driven by strong demand in industry and services, widening shortages of labor, and rising minimum wage. Unemployment declined to an eight-year low of 5.9 percent of the labor force in July 2017. New jobs were created in sectors that contribute most to economic growth: industry, trade, transport, tourism, ITC; and real estate. While job creation in construction remained subdued, construction activity picked up significantly as a result of a vibrant real estate market and advanced implementation of EU funded projects. Investment shifted to robust growth this year from a large decline in 2016 and provided solid contribution to overall growth, offsetting the narrowing contribution of net exports. Exports expanded at a robust rate, supported by strong demand from the EU, but imports grew even faster. Improvements in labor market conditions and income growth supported further poverty reduction. Poverty measured using the Upper Middle Income Class line of $5.5 per day (in 2011 PPP terms) is estimated to have declined from 8.5 percent in 2015 to 7.9 percent in 2016. However, income inequality in Bulgaria is one of the highest in the EU, with the income of the richest 20 percent of the population equal to almost eight times that of the poorest 20 percent in 2015. The coverage and adequacy of the social transfer system remains low. Unemployment has declined significantly but regional variations and long-term and youth unemployment remain high. Inactivity among certain groups of the population persists and many citizens – including the elderly, people living in rural areas, and the Roma -- are excluded from economic opportunities. Tapping into this unused pool of labor is crucial for growth in Bulgaria, which is undergoing the steepest decline in population in the world. Fiscal accounts continued to be in surplus in the first half of 2017 despite a slight decline in revenues. Tax revenues and social contributions grew by about 8 percent year-on-year because of improved economic activity and the increase of the pension contribution rate. Non-tax revenues, however, were weaker than a year earlier due to lower grants from the EU. The external current account surplus narrowed in the first half of 2017 compared to a year earlier, as the trade deficit expanded. Stronger imports were driven by higher demand for consumption and investments goods and the increase in oil prices.

Outlook

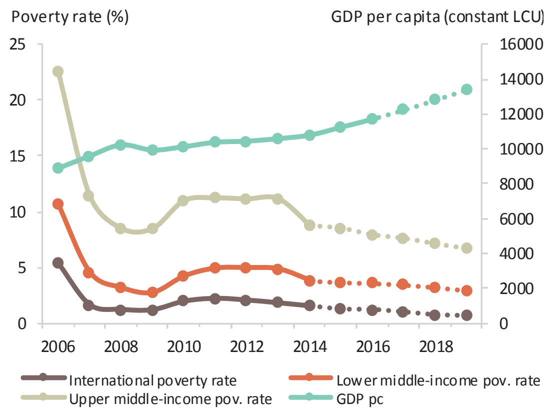
Prospects for 2017 are better than initially expected, with GDP projected to grow at 3.8 percent as robust domestic demand

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



Sources: NSI and World Bank staff estimates.

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



Sources: World Bank. Notes: see Table 2.

outweighs the diminishing contribution of net exports. Household consumption is likely to continue expanding on the back of further improvements in labor market and credit conditions. Investment is likely to remain strong in the second half of the year. Going forward, GDP is projected to pick up to 4 percent in 2019. Strong consumption and, increasingly, investment are likely to be the key driver in the medium term. Export growth is likely to remain robust, albeit slowing down somewhat in line with expected deceleration of economic activity in the Eurozone compared to 2017.

Poverty reduction is expected to continue at a modest pace in the near term. Continued improvements in employment and wages, as well as scheduled increases in pensions, should support real incomes and therefore further reductions in poverty. Poverty is projected to fall to 7.6 percent in 2017, as measured at $5.5 a day in 2011 PPP, to 7.1 percent in 2018, and to 6.7 percent in 2019.

The external current account is expected to continue to be in surplus, although declining by 2019. Export growth is projected to be robust, in line with Bulgaria's improved competitiveness in EU markets and higher commodity prices. Import growth is expected to be driven by higher oil prices and strengthening domestic demand for consumer and investment goods.

The fiscal position is likely to weaken slightly in 2017 compared to 2016 but improve in the medium term. In 2017, the deficit is likely to amount to 0.6 percent of GDP (based on ESA 2010 methodology), reflecting the increases in pensions in July and a faster pace of implementation of EU funded capital projects. Strong revenue collection driven by further improvements in compliance and an increased pension contribution rate is likely to support fiscal consolidation in the medium term. Limited improvements in spending efficiency of select sectors could undermine fiscal consolidation plans going forward and limit the potential of public spending to enhance growth.

Risks and challenges

The key challenge for Bulgaria is to accelerate convergence with the rest of the EU and deal with the negative consequences of its demographic transition. Accelerating convergence would require improvements in productivity and labor force participation. Bulgaria will need to raise productivity growth to at least 4 percent per year to reach the average EU income levels within a generation, as per Productivity in Bulgaria, a World Bank report. This compares with annual average productivity growth of 2.5 percent per year over the last six years while improvements in labor force participation were constrained by skill shortages. A large portion of the population is at risk of poverty or social inclusion.

Enhancing productivity growth would require addressing governance challenges (public administration, judiciary, governance of SOEs), that have undermined Bulgaria's structural transformation. Enhancing the skills and employability of all Bulgarians is also needed. The effectiveness and efficiency of public spending on health, pensions and long-term care also needs to be improved 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)

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	1.3	3.6	3.4	3.8	3.9	4.0
Private Consumption	2.7	4.5	2.1	4.8	4.5	4.4
Government Consumption	0.1	1.4	0.6	2.1	1.5	1.9
Gross Fixed Capital Investment	3.4	2.7	-4.0	4.1	4.4	6.6
Exports, Goods and Services	3.1	5.7	5.7	5.5	5.2	5.0
Imports, Goods and Services	5.2	5.4	2.8	6.2	5.4	5.6
Real GDP growth, at constant factor prices	1.5	3.1	2.8	3.8	3.9	4.0
Agriculture	4.8	-6.8	4.3	2.8	2.2	1.9
Industry	0.3	4.2	2.0	3.4	3.9	3.8
Services	1.7	3.3	3.1	4.0	4.0	4.3
Inflation (Consumer Price Index)	-1.4	-0.1	-0.8	1.5	1.4	1.4
Current Account Balance (% of GDP)	0.1	-0.1	4.2	2.8	2.6	2.0
Financial and Capital Account (% of GDP)	2.9	-3.8	-4.3	-1.6	-1.4	-0.9
Net Foreign Direct Investment (% of GDP)	2.7	5.6	1.5	2.3	2.3	2.5
Fiscal Balance (% of GDP)	-5.5	-1.6	0.0	-0.6	-0.5	0.0
Debt (% of GDP)	27.0	26.0	29.5	26.5	26.2	25.4
Primary Balance (% of GDP)	-4.6	-0.7	0.8	0.4	0.4	0.9
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	3.8	3.6	3.6	3.4	3.2	2.9
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	8.7	8.5	7.9	7.6	7.1	6.7

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice, NSI, BNB, and Eurostat.
Notes: e=estimate, f = forecast.
(a) Calculations based on EU-SILC harmonization, using 2014-EU-SILC. Actual data: 2014. Nowcast: 2015 - 2016. Forecast are from 2017 to 2019.
(b) Projection using neutral distribution (2014) with pass-through = 0.87 based on GDP per capita in constant LCU.

CROATIA

Table 1	2016
Population, million	4.2
GDP, current US$ billion	50.7
GDP per capita, current US$	12164
International poverty rate ($1.9)[a]	1.0
Lower middle-income poverty rate ($3.2)[a]	1.9
Upper middle-income poverty rate ($5.5)[a]	6.1
Gini coefficient[a]	32.3
School enrollment, primary (% gross)[b]	98.9
Life expectancy at birth, years[b]	77.5

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

Growth remained robust in early 2017 at 2.9 percent on a four-quarter basis supported by household consumption, exports and fiscal easing. The poverty rate has likely continued trending downwards to 5.6 percent (at $5.5/day PPP) as labor market improved and real net wages and disposable income increased. Strong fiscal consolidation in 2016 led to Croatia's exit from the Excessive Deficit Procedure in 2017. Yet, new fiscal liabilities and the slow pace of structural reforms, including accelerated outmigration of labor, risk raising potential growth and ensuring sustainability of public debt.

Recent developments

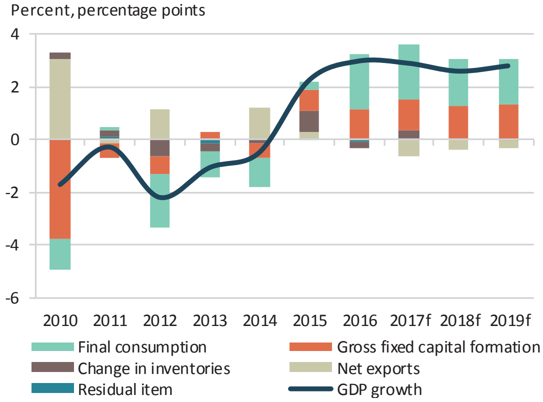
Economic growth strengthened to 3 percent in 2016 on the back of a record-high tourist season, accelerated private consumption growth, and a rebound of investment after six years of recession. Growth remained robust in the first half of 2017 at 2.7 percent, with household consumption as the main driver contributing 2.2 percent to growth, spurred by personal income tax rate cuts. Investment remained solid contributing 1.1 percent to growth, while government consumption contributed an additional 0.3 percent. Despite growth of exports of goods of almost 10 percent, net exports subtracted 1 percent from growth, as imports accelerated due to the consumption boost. Economic recovery and outmigration led to a decline of unemployment to 10.8 percent in July 2017 (down by 2.5 percentage points from the same period last year). On the other hand, the employment and activity rates are still low, remaining at 44.7 percent and 51.2 percent by March 2017, respectively.

Real net wages increased by 3.9 percent year-on-year by June, due to a personal income tax cut, a 2-percent rise in public sector wages and increased labor market pressures by the hospitality sector. Still, compared to the pre-crisis level, real per capita income in 2016 was about 4 percent lower, while the absolute poverty rate measured at US$5.5 at PPP 2011 per capita increased from 4.7 percent in 2009 to above 5.6 percent in 2016.

External imbalances narrowed with the current account surplus, down to 2.6 percent of GDP in 2017 (March, a four-quarter basis). External debt declined to 86.5 percent of GDP in May 2017, at 16 percentage points lower level than in its 2015 peak driven by continued deleveraging of the financial sector and government domestic refinancing strategy. Net FDI declined from 4.2 percent in 2016 to 3.5 percent by March 2017 on a four-quarter basis led by tourism, real estate and financial sector investment.

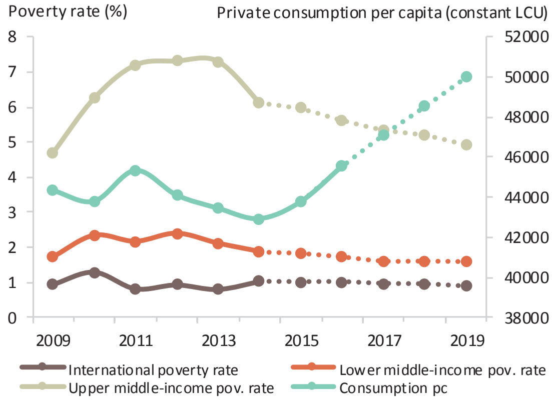
Fiscal consolidation continued in 2016 with the general government deficit (ESA methodology) narrowing to 0.8 percent of GDP in 2016 from 3.4 percent in 2015, boosted by revenue overperformance. Spending in 2016 was restrained due to temporary financing early in the year and snap elections in the second half of 2016. Given the robust primary surplus, public debt decreased to 83.7 percent of GDP in 2016 from 86.7 percent at end-2015. Croatia exited the Excessive Deficit Procedure in June 2017 and is now on target to meet its MTO. Growth recovery helped with containing the fiscal deficit at 0.7 percent of GDP by May 2017 (on a four-quarter basis), with public debt declining further to 81 percent of GDP. However, relaxation of spending with additional 4 percent wage growth, rise in maternity benefits and veterans' benefits will contribute to easing in 2018 despite revenue overperformance. EU absorption (withdrawal of EU funds) picked up as well by over 25 percent in early 2017 due to the base effect.

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 consumption per capita



Sources: World Bank (see notes to Table 2).

Outlook

Growth is expected to remain at 2.9 percent in 2017, and keep the momentum thereafter standing on average at 2.7 percent in 2018-19, led by personal consumption and exports led by strong tourist performance. Personal consumption is expected to remain robust reflecting fiscal easing, labor market recovery, and increased consumer confidence. Export of goods is key in supporting growth, as firms further integrate in the EU market and external demand from main trading partners strengthens. Investments will intensify benefitting from the EU funds absorption, especially public investment in infrastructure.
The fiscal deficit is expected to increase to 1.3 percent in 2017 as fiscal easing with tax reliefs and spending relaxation materialize. Spurred by growth, public deficit should decline afterwards to an average 1.0 percent in 2018-2019, which would lead to a further gradual public debt decline to 76.4 percent of GDP in 2019.
Positive labor market developments, with ILO-unemployment rate falling below 10 percent by 2019, 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, supports the decline of unemployment and it is expected that the absolute poverty rate measured at the US$5.5 at PPP 2011 will decline further to 4.9 percent in 2019.

Risks and challenges

Downside risks have moderated. Although fiscal outcomes are better than expected, new fiscal expansion and domestic policy uncertainty adds to the risks of slowing down the pace of structural reforms and achieving sustainability of public debt.
Additionally, risks include: still high levels of private sector indebtedness, an ongoing pre-bankruptcy proceeding of the largest firm Agrokor, and the possibility of a further rise in the risk premium for emerging markets. The country must refinance around 11 percent of GDP of public and guaranteed debt a year in 2017-19. The country's credit rating remained speculative albeit the outlook improved to stable, suggesting that acceleration of the pace of consolidation and structural reforms (of business environment, regulatory reforms) could lead to a rating improvement.
Job creation will be key to achieving a sustainable reduction in absolute poverty. During the most recent economic recovery, total employment continued to decline and employment rates remained at a very low level (compared to other EU countries). High out-migration in combination with early exit out of the labor force reduced the size of the labor force, raising further concerns over pension and health system sustainability.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	-0.5	2.2	3.0	2.9	2.6	2.8
Private Consumption	-1.6	1.1	3.3	3.3	2.7	2.6
Government Consumption	-0.8	-1.4	1.3	1.0	1.2	1.5
Gross Fixed Capital Investment	-2.8	3.8	5.1	5.6	5.6	5.9
Exports, Goods and Services	6.0	9.4	5.7	5.7	5.0	4.8
Imports, Goods and Services	3.1	9.2	5.8	7.3	6.0	5.5
Real GDP growth, at constant factor prices	0.0	2.1	2.8	2.9	2.6	2.8
Agriculture	-4.4	1.5	-2.1	2.0	2.2	2.2
Industry	1.0	2.5	4.3	2.6	2.8	2.8
Services	-0.1	2.0	2.5	3.1	2.6	2.9
Inflation (Consumer Price Index)	-0.2	-0.5	-1.0	1.5	1.4	1.4
Current Account Balance (% of GDP)	2.0	4.8	2.7	2.0	1.3	0.6
Financial and Capital Account (% of GDP)	-0.8	-3.5	-1.4	-0.8	-0.2	0.5
Net Foreign Direct Investment (% of GDP)	1.7	0.6	4.2	4.2	4.2	4.1
Fiscal Balance (% of GDP)	-5.4	-3.4	-0.8	-1.3	-1.0	-0.9
Debt (% of GDP)	86.6	86.3	83.7	81.6	79.0	76.4
Primary Balance (% of GDP)	-1.9	0.2	2.4	1.9	2.2	2.1
International poverty rate ($1.9 in 2011 PPP)[a,b]	1.0	1.0	1.0	1.0	0.9	0.9
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	1.9	1.8	1.7	1.6	1.6	1.6
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	6.1	6.0	5.6	5.4	5.2	4.9

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.
(a) Calculations based on EUSILC harmonization, using 2014-EU-SILC. Actual data: 2014. Nowcast: 2015 - 2016. Forecast are from 2017 to 2019.
(b) Projection using neutral distribution (2014) with pass-through = 0.87 based on private consumption per capita in constant LCU.

GEORGIA

Table 1	2016
Population, million	3.7
GDP, current US$ billion	14.3
GDP per capita, current US$	3864
International poverty rate ($1.9)[a]	8.3
Lower middle-income poverty rate ($3.2)[a]	25.6
Upper middle-income poverty rate ($5.5)[a]	54.6
Gini coefficient[a]	38.9
School enrollment, primary (% gross)[b]	116.9
Life expectancy at birth, years[b]	74.7

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

Georgia's growth accelerated to 4.9 percent in the first half of 2017 (y/y), driven by construction and tourism. In 2017 growth is projected at 4 percent, led by external demand and public investment. The fiscal deficit is projected to remain elevated at 4.1 percent of GDP by year-end, unchanged from 2016. Poverty is expected to return to its declining trend as economic growth recovers and translates into higher income.

Recent developments

Georgia is experiencing a solid recovery in 2017 on the back of stronger growth in the U.S., Europe and Russia. Exports rose by 30 percent in the first half of 2017. Similarly, remittances recovered significantly (by 20 percent y/y), with a positive impact on non-tradeable sectors. Pulled by the resulting boost in domestic demand and net exports, real GDP grew by 4.9 percent in the first 6 months of the year *(y/y)*.

The recovery in exports and remittances, along with an accelerated adjustment of imports, helped to narrow the current account deficit from 13.5 percent of GDP in Q1 2016 to 11.8 percent in Q1 2017. Foreign direct investment financed nearly 93 percent of the deficit. The external debt stock rose by 6.6 percent *(y/y)* by end-March 2017 driven by the higher external financing needs. However, external debt still declined in terms of GDP, standing slightly above 100 percent of GDP.

Fiscal policy was expansionary in the first half of the year. To support growth, the government boosted capital spending by 32 percent, and current spending by 7 percent. Nevertheless, the fiscal deficit narrowed, as revenues over performed, increasing by 18 percent y/y in the same period. The sharp increase in excise tax rates from January 1, 2017 contributed to the solid tax collections.

The NBG raised the monetary policy rate twice in 6 months of 2017 (by 50 basis points) to tackle rising inflation expectations. Annual inflation increased to 5.7 percent by end-August, largely reflecting effect from higher excise taxes. NBG expects this effect to expire by early 2018, with inflation returning to its target by 2018.

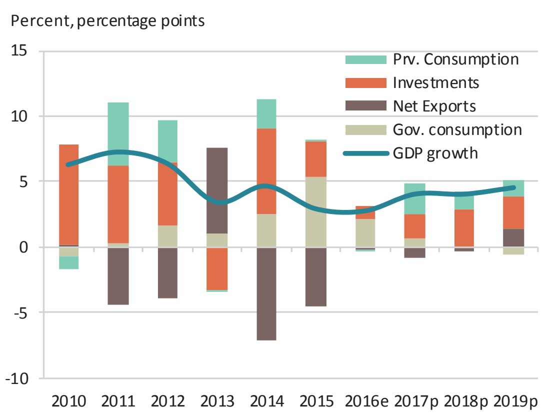
Prudent banking supervision reinforced banking sector stability. The sector has remained profitable, yielding a return on assets of 3 percent and a return on equity of over 20 percent as of end-June 2017. Nonperforming loans (more than 90 days past due) represented only 3 percent of gross loans in 2017, down from 4.4 percent as of mid-2016.

Poverty at $3.2/day was estimated at 25.6 percent in 2016, slightly higher than in 2015. The increase in poverty breaks a declining trend that started in 2010, which was propelled mainly by employment opportunities and social assistance. The positive outcomes from labor markets in early 2017, especially among the less-skilled, suggest poverty will start again to decline in 2017, but also highlights the vulnerability of the population just above the poverty line to labor market fluctuations.

Outlook

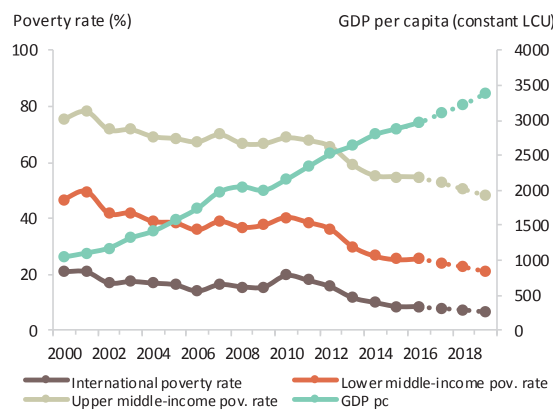
Economic growth is projected to increase to an average rate of 4.5 percent a year over the medium-term, but downside risks to growth remain. The pick-up in growth in 2017 will largely be driven by high public investment and the recovery in the export markets—propped up by the uptick in global oil prices and the improving growth prospects in Georgia's key trading partners, including Russia FDI

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



Sources: World Bank Estimates based on Geostat statistics.

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



Sources: World Bank (see notes to Table 2).

inflows, which largely originate from Azerbaijan and Turkey, remain resilient. In the outer years, growth prospects factor in the continuously strengthening economic ties with the EU. The downside risks arise primarily from possible adverse global developments stemming from U.S. Federal Reserve interest rate increases and uncertainty about China's economic rebalancing efforts.

At the domestic level, Georgia's growth recovery is predicated on a sustained reform program. In particular, this would entail the continuation of recent policies that have created favorable conditions for private investment and a enhanced business climate, productivity growth, and greater export competitiveness, as well as ensuring that a prudent macroeconomic policy framework remains well-embedded.

Fiscal sustainability is expected to strengthen through revenue enhancing measures announced in the 2017 budget to counter the impact of the adoption a Estonian-type of tax model. The latter, which replaced the corporate income tax with a dividend tax, came into effect in January 2017, and is expected to lower tax revenues by 1.5 percent of GDP. To offset this loss, the government increased excise for tobacco and fuel, and introduced an excise tax on cars. In addition, under the 2017 budget, the government committed to restrain current spending. The fiscal deficit is then expected to narrow in 2017-20 as a result of these measures. However, in 2017, the fiscal deficit is expected to remain at 4.1 percent of GDP due to larger investment spending, and in line with the IMF-supported program. Over the medium-term, capital expenditures and net lending are budgeted to increase from 6.5 percent of GDP in 2016 up to 9 percent. Georgia's public debt stood at 40 percent of GDP in the first half of 2017. However it is likely to decline to 37 percent by the end of 2017 before rising back to 40 percent by 2019.

The poverty rate is projected to decline through 2019 reaching 20.9 percent. Economic recovery (and of construction activity, in particular, supported by anticipated investments) is expected to drive poverty reduction through increased job opportunities. However, employment generation in tradeable sectors will be critical for sustaining a declining poverty trend going forward. Limited fiscal space makes social transfers as a key driver of poverty reduction unlikely in the near future.

Risks and challenges

Key macroeconomic vulnerabilities faced by Georgia include risks to external and fiscal sustainability. The possibility of tighter financial conditions and financial market volatility could hit global markets and some of Georgia's main export destinations. This calls for vigilance by Georgia which is financially open. On the fiscal front, lower corporate tax revenues, high social spending commitments and plans to ramp up capital spending may challenge fiscal consolidation. Contingent liabilities arising from state owned enterprises and the existing power purchase agreements with hydropower companies also pose potential risks to fiscal sustainability.

Poverty reduction may stall in coming years if private sector employment growth is not sustained, as it was the case in 2016. Rural poverty will remain high unless agricultural productivity improves and non-agricultural employment opportunities are created.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	4.6	2.9	2.7	4.0	4.0	4.5
Private Consumption	3.2	0.1	-0.3	3.6	2.2	2.1
Government Consumption	11.2	22.1	7.5	2.0	-0.4	-2.3
Gross Fixed Capital Investment	24.4	11.7	3.5	7.0	10.2	8.2
Exports, Goods and Services	0.4	6.0	-0.8	5.2	5.4	6.4
Imports, Goods and Services	11.1	10.4	-0.3	4.6	3.9	2.5
Real GDP growth, at constant factor prices	4.4	3.2	2.6	4.0	4.0	4.5
Agriculture	1.6	1.5	0.0	2.0	2.5	3.0
Industry	4.6	4.1	5.5	4.0	4.2	4.8
Services	4.7	3.1	1.9	4.2	4.1	4.6
Inflation (Consumer Price Index)	3.1	4.0	2.1	5.5	3.0	3.0
Current Account Balance (% of GDP)	-10.6	-11.9	-13.4	-10.5	-9.7	-8.4
Financial and Capital Account (% of GDP)	10.6	11.9	13.4	10.5	9.7	8.4
Net Foreign Direct Investment (% of GDP)	8.1	9.0	9.9	9.1	8.8	8.3
Fiscal Balance (% of GDP)	-2.9	-3.8	-4.1	-4.1	-3.8	-3.5
Debt (% of GDP)	35.6	41.4	38.6	37.4	38.7	39.9
Primary Balance (% of GDP)	-2.1	-2.8	-2.9	-3.3	-2.9	-2.6
International poverty rate ($1.9 in 2011 PPP)[a,b]	9.8	8.3	8.3	7.8	7.3	6.4
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	26.6	25.3	25.6	24.0	22.6	20.9
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	55.0	54.8	54.6	52.6	50.3	48.0

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2016-HIS. Actual data: 2014 - 2016. Forecast are from 2017 to 2019.
(b) Projection using neutral distribution (2016) with pass-through = 0.87 based on GDP per capita in constant LCU.

KAZAKHSTAN

Table 1	2016
Population, million	17.8
GDP, current US$ billion	137.3
GDP per capita, current US$	7715
Lower middle-income poverty rate ($3.2)[a]	0.4
Upper middle-income poverty rate ($5.5)[a]	7.8
Gini coefficient[a]	26.5
School enrollment, primary (% gross)[b]	111.3
Life expectancy at birth, years[b]	71.6

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2014)

Kazakhstan's economy expanded in the first half of 2017 led by an increase in oil production and an accommodative macroeconomic policy stance. Over the medium term, the GDP growth rate is expected to hover around 3 percent a year, and other economic and poverty indicators are projected to improve. Going forward, economic transformation and inclusive growth will rest on the successful implementation of key ongoing structural and institutional reforms, focusing on macroeconomic adjustment, private sector development, and human capital.

Recent developments

As Kazakhstan's economy started to recover from the crisis caused by the fall of global oil prices, GDP grew by 4.2 percent year-on-year (YoY) in the first half (H1) of 2017, compared to 0.1 percent in H1-2016. The oil sector was the main driver of economic growth, as oil output increased by 9.7 percent in H1-2017 due to the commissioning of the long-awaited off-shore oil field Kashagan in October 2016. More favorable terms of trade—as oil prices increased by 30 percent YoY in H1-2017—also contributed to better performance of the oil sector. Additionally, the construction sector rebounded and grew by 5.9 percent YoY due to new large capacity expansion projects in the oil sector. The non-oil economy also expanded, on the back of dynamic activity on the manufacturing, agriculture, transport, and trade sectors. On the external side, robust oil exports improved the trade balance, leading to an accumulation of official reserves and some strengthening of the tenge.

The country's macroeconomic policy stance remained accommodative. Lower inflationary pressures allowed the central bank to cut its policy rate further from 12 percent at the beginning of 2017 to 10.25 percent in August 2017. The inflation rate fell from over 17 percent YoY in July 2016 to 7.1 percent in July 2017, as a pass-through effect from the currency devaluation faded out. As inflation receded, consumer confidence improved, leading to higher private consumption, thus contributing to a recovery in domestic demand. The banking sector continued to struggle, and credit growth remained stalled. To speed up banks' balance sheet repair, the government injected US$6.5 billion (about 4 percent of GDP) into the Problem Loans Fund, and the central bank provided another US$0.5 billion for credit revival.

As for fiscal policy, the non-oil deficit widened in H1-2017 due to the bailout of the banking sector and increased spending to mitigate the impact of falling real incomes on the vulnerable population, including an 8 percent increase (in real terms) in pensions and other social transfers and a continuation of employment support programs.

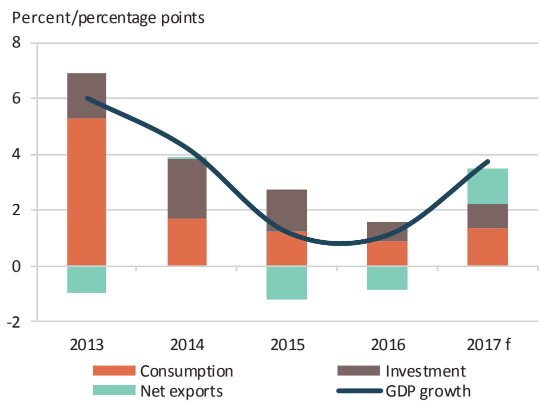
The poverty rate (using the $5.5/day international poverty line) rose from 5.6 percent in 2013 to an estimated 7.8 percent in 2016. Despite the economic recovery and higher consumer confidence, household income remained under pressure, as the labor market has not yet recovered. Real wages and salaries fell by 2.4 percent on average YoY in H1-2017, and the official unemployment rate remained flat at 4.9 percent.

The incidence of poverty increased in all regions of Kazakhstan. The most vulnerable southern regions, such as Kyzylorda and Jambyl, experienced more than a doubling in their poverty rates between 2013 and 2016, from 5.2 to 13.9 percent, and from 5 to 12.5 percent, respectively.

Outlook

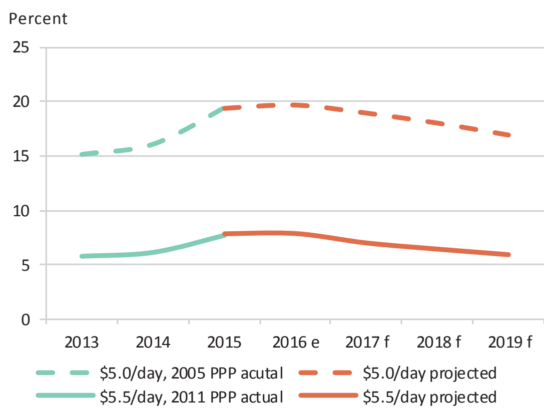
Despite the ongoing economic recovery, growth will remain lower than in the pre-

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



Source: World Bank staff estimates.

crisis period. The growth projection for 2017 has been revised upwards from 2.4 to 3.7 percent. This reflects a better-than-expected oil sector performance in H1-2017, driven by the commissioning of the Kashagan oil field and higher oil prices. Improved consumer confidence and higher domestic demand will drive growth in the non-oil economy.

Nevertheless, the current account and fiscal balances are not expected to see improvements in 2017. The current account deficit is projected to remain elevated due to higher profit repatriation by multinational oil companies. This outflow is partially offset as a share of these profits is reinvested as foreign-direct-investment back into the oil sector in Kazakhstan, boosting the capital and financial account of the balance of payments. The fiscal deficit is estimated to remain high due to the bailout of the banking sector in 2017.

Over the medium term, the GDP growth rate would hover around 3 percent a year, as the oil sector's contribution to economic growth declines relative to 2017. More favorable terms of trade will drive improvements in the current account and fiscal balances. Moreover, fiscal consolidation efforts and the passing of the one-off effects related to the bank bailout will help to narrow the fiscal deficit from 2018 onwards. Finally, implementation of inflation targeting will help stabilize consumer-price inflation at levels below 5 percent per year.

As the economy recovers, labor income, the primary driver of poverty reduction, is expected to return to positive real growth. The poverty rate is projected to decline to 6 percent by 2019 based on the current growth forecast.

Going forward, the successful implementation of structural reforms will assist in transforming the economy and increase the growth potential of Kazakhstan. The ongoing structural and institutional reforms under the 100 Concrete Steps program and the privatization agenda aim to reduce the role of the state in the economy and facilitate the development of a vibrant tradable non-oil economy. Furthermore, restructuring and privatizing state-owned enterprises is expected to increase efficiency in public administration and lower the government's fiscal risks. Prudent fiscal and monetary policies will support economic and price stability and encourage investments in the non-oil economy. Higher incomes will also have positive spillovers on poverty reduction.

Risks and challenges

The low resilience of Kazakhstan's economy to external shocks remains the major challenge for achieving stable and sustainable development and shared prosperity in the country. The downside and upside risks to the medium-term outlook include external and domestic factors. External demand from China and Russia, the country's key trading partners, as well as global oil demand and prices remain the key external factors impacting Kazakhstan's economy. Domestic factors include the pace of implementation of structural and institutional reforms, especially in anticipation of a political transition over the medium term. Unless the government demonstrates significant improvements in the rule of law, the investment climate, and the quality of human capital, there are low chances for expanding the role of the tradable non-oil sector in the economy, with more productive and better-paid jobs that will facilitate poverty reduction.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	4.2	1.2	1.1	3.7	2.6	2.8
Private Consumption	1.4	1.8	1.2	2.5	3.0	3.0
Government Consumption	9.8	2.4	2.4	0.0	-4.1	1.7
Gross Fixed Capital Investment	4.4	4.2	3.0	10.5	9.6	5.7
Exports, Goods and Services	-2.5	-4.1	-4.4	7.4	1.7	1.7
Imports, Goods and Services	-4.0	-0.1	-2.2	3.8	2.7	2.8
Real GDP growth, at constant factor prices	3.9	1.9	1.2	3.7	2.6	2.8
Agriculture	1.3	3.5	5.4	3.0	3.0	3.0
Industry	1.5	-0.4	1.1	6.6	2.7	2.5
Services	5.7	3.2	0.9	2.0	2.5	3.0
Inflation (Consumer Price Index)	6.7	6.6	14.6	7.4	4.6	4.4
Current Account Balance (% of GDP)	2.8	-2.8	-6.2	-5.9	-2.9	-2.4
Financial and Capital Account (% of GDP)	3.2	5.2	6.6	9.1	5.0	3.9
Net Foreign Direct Investment (% of GDP)	2.1	1.7	10.5	5.9	5.2	4.6
Fiscal Balance (% of GDP)	-0.5	-7.9	-6.4	-6.7	-2.1	-1.7
Debt (% of GDP)	14.5	21.9	19.6	18.3	18.3	19.6
Primary Balance (% of GDP)	0.1	-7.1	-5.3	-5.7	-1.4	-0.9
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.3	0.4	0.4	0.3	0.3	0.3
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	6.2	7.8	7.8	7.0	6.4	6.0

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2015-HBS. Actual data: 2015. Nowcast: 2016 - 2016. Forecast are from 2017 to 2019.
(b) Projection using neutral distribution (2015) with pass-through = 0.87 based on GDP per capita in constant LCU.

KOSOVO

Table 1	2016
Population, million	18
GDP, current US$ billion	6.6
GDP per capita, current US$	3647
International poverty rate ($1.9)[a]	0.4
Lower middle-income poverty rate ($3.2)[a]	2.9
Gini coefficient[a]	26.4
School enrollment, primary (% gross)[b]	n.a.
Life expectancy at birth, years[b]	n.a.

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent value (2014).

The economy grew at 3.4 percent in 2016, driven by private consumption and investment. Higher growth rates are projected for 2017-18, boosted by a pick up in public investment and exports. Growth created employment in 2016, supporting poverty reduction; but sustained poverty reduction remains challenging as labor markets remain weak and pressures to seek employment abroad are high. Political fragility can lead to rising fiscal pressures and a higher budget deficit.

Recent developments

Kosovo's economic growth is estimated at 3.9 percent in Q1 2017 compared to a growth rate of 3.6 percent in Q1 2016. Growth is largely driven by a recovery in consumption and investment which contributed 1.7 percentage points (pp) and 3.2 pp respectively to the overall growth rate in Q1 2017. Net exports weighted down on growth in Q1 2017, by as much as 1.1 percent, as imports increased and exports of base metals slowed. An improvement in exports was recorded in the Q2 2017.

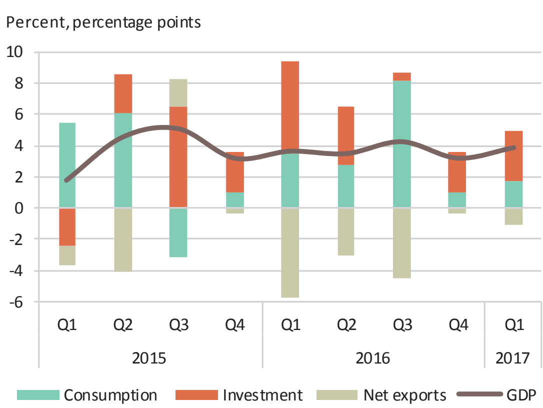
Consumer price inflation reached an average of 1.7 percent by July 2017 y-o-y from an annual average of 0.3 percent in 2016 increasing the cost of living.

Improved revenue collection and low execution of the capital budget produced a temporary surplus of 0.4 percent by July 2017. Government revenues grew by 4.8 percent y-o-y as of July 2017, with tax revenues increasing by 4.4 percent, driven by PIT (by 13 percent) spurred by higher employment. Nontax revenues grew at 8.3 percent y-o-y due to improved collection at the local level. Public investment picked up speed: despite under execution of plan, they grew by 29.7 percent y-o-y in the first seven months of 2017. Expenditures grew by 12.7 percent over the same period, also driven by expanding subsidies and transfers (12.9 percent) to war veterans and ex contributor pensions, and goods and services (10.5 percent y-o-y). Public debt was low at 14.3 percent of GDP in 2016, but is growing quickly.

Current account deficit declined in Q2 2017 due to a faster increase in the value of exports compensating for the widening of the deficit in Q1 2017. While imports grew by 8.6 percent driven by growing domestic demand from January to July 2017, exports grew at the faster rate of 19.1 percent driven by a larger production base, and higher exports prices of metals in the Q2. Increase in service exports and decrease in service imports also contributed to a lower CAD. FDI inflows have recovered in Q1 2017 with a y-o-y growth of 14.8 percent from a fall of 30 percent in 2016, mainly driven by equity investments (47.8 percent) followed by reinvestment of retained earnings (38.5 percent) and less by debt instruments (13.8 percent). FDI outflows also declined sharply improving net position of FDI.

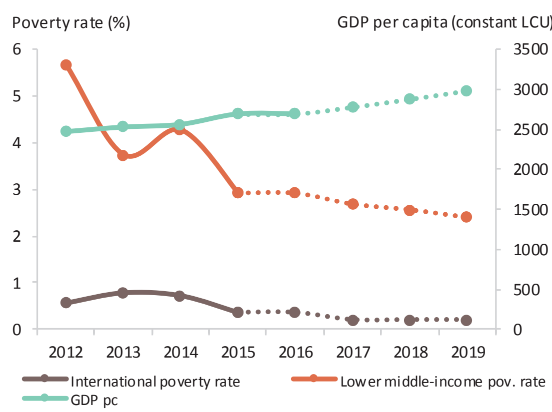
Stronger growth stimulated job creation, but unemployment is increasing and remains high. In the Q1 2017 employment grew by 15.8 percent (y-o-y), driven by job creation in the agricultural sector. The employment rate (for 15-64 y-o-y) increased by 3.4 percentage points, reaching 28.9 percent in the Q1 2017, driven by male employment. On the other hand, female employment is low at 13 percent, and the share of employed in vulnerable employment (defined as the contributing family workers and own-account workers % of total employment) continue increasing and remains high, at 24.1 percent. The unemployment rate also increased by 2.7 percent (y-o-y) reaching 30.5 percent, with more than 60 percent of the unemployed still being long-term unemployed, and more than one third being young.

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



Sources: Statistics Agency of Kosovo and WB staff.

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



Source: World Bank. Notes: see table 2.

The poverty rate (measured as US$ 3.2/day, 2011 PPP) is estimated to have declined to 2.9 percent in 2016.

Outlook

Growth – projected at 4.1 percent in 2017 and 4.2 in 2018 – will be driven by growing consumption, and public investment. Fiscal deficit is expected to reach 2 percent of GDP in 2017, guided by the fiscal rules in place. A gradual increase in deficit is projected, as absorption capacity improves and investment clause for IFI financing continues to be implemented. Public debt is low, but is expected to increase quickly to 16.3 percent of GDP in 2017 and to 20.3 percent in 2019.

The CAD is expected to remain relatively flat at 9 and 8.9 percent as share of GDP in 2017 and 2018, respectively, although trade deficit driven by growth and domestic demand will widen. Expansion of production base across sectors due to continued large investments including FDI is projected to increase exports and substitute imports in medium to long term, and reduce CAD in 2019. The positive trend in export of travel services is expected to improve external balances in the near future. The recent launch of the SAA with the EU and potential large investments in energy generation capacities are expected to boost FDI in the medium term and increase non-debt financing of CAD.

Poverty is expected to continue declining, though slower than in 2016. Vulnerabilities remain in the medium term given downside risks to growth and high unemployment and inactivity rates. Poverty, measured at the lower middle income poverty line (US$ 3.2/day, 2011 PPP), is expected to decline to 2.7, 2.5 and then to 2.4 percent in 2017, 2018 and 2019, respectively.

Risks and challenges

The downside risks to the outlook include perceived fragility of the new government created as a minority government with only 61 out of 120 votes in the parliament. Political fragility can lead to rising fiscal pressures and a delay in fiscal reforms. On the upside, stronger regional and global growth can further support growth in Kosovo.

Reform priorities include shifting sources of growth towards tradable sectors and increasing productivity to address high unemployment, low participation rates, and poverty. This requires significant structural reforms to boost economic growth and make it more inclusive.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	1.2	4.1	3.4	4.1	4.1	4.0
Private Consumption	7.0	4.3	4.8	1.7	2.4	2.9
Government Consumption	0.5	-3.0	-1.6	0.9	2.8	1.8
Gross Fixed Capital Investment	-2.9	12.5	11.1	10.6	8.7	7.0
Exports, Goods and Services	6.4	1.9	2.4	9.4	5.3	7.2
Imports, Goods and Services	8.6	3.8	7.2	4.6	3.7	3.5
Real GDP growth, at constant factor prices	1.6	3.0	1.6	4.1	4.1	4.0
Agriculture	0.8	-4.1	7.6	8.6	-1.8	-1.1
Industry	0.1	5.9	1.2	2.0	6.7	6.3
Services	2.7	3.0	0.5	4.3	4.1	3.9
Inflation (Consumer Price Index)	0.4	-0.5	0.0	1.7	1.7	1.7
Current Account Balance (% of GDP)	-7.5	-8.3	-9.4	-8.7	-8.9	-8.9
Financial and Capital Account (% of GDP)	2.8	8.1	9.4	4.6	6.5	7.8
Net Foreign Direct Investment (% of GDP)	2.2	4.7	2.9	8.1	5.1	6.5
Fiscal Balance (% of GDP)	-2.1	-1.5	-0.9	-2.0	-3.0	-3.0
Debt (% of GDP)	10.4	12.7	14.3	16.3	18.8	20.3
Primary Balance (% of GDP)	-1.8	-1.2	-0.6	-1.5	-2.5	-2.5
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.7	0.4	0.4	0.2	0.2	0.2
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	4.3	2.9	2.9	2.7	2.6	2.4

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2015-HBS. Actual data: 2015. Nowcast: 2016 - 2016. Forecast are from 2017 to 2019.
(b) Projection using neutral distribution (2015) with pass-through = 0.7 based on GDP per capita in constant LCU.

KYRGYZ REPUBLIC

Table 1	2016
Population, million	6.0
GDP, current US$ billion	6.6
GDP per capita, current US$	1083
International poverty rate ($1.9)[a]	2.5
Lower middle-income poverty rate ($3.2)[a]	23.2
Upper middle-income poverty rate ($5.5)[a]	69.9
Gini coefficient[a]	29.0
School enrollment, primary (% gross)[b]	107.7
Life expectancy at birth, years[b]	70.4

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2014)

Macroeconomic developments have been favorable in the first half of the year, thanks to improvements in the regional environment, robust gold production, and an acceleration of regional trade with Eurasian Economic Union (EEU) countries. Going forward, growth is expected to accelerate gradually, but sources of risks will persist, with mounting fiscal challenges.

Recent developments

Real GDP growth reached 6.9 percent in July 2017, year-on-year, compared to a 2 percent decline in the same period a year ago. This performance was driven by gold production, which expanded by 43 percent (with a frontloaded production cycle at Kumtor, the largest gold mine, in 2017). Non-gold output growth was robust at 3.6 percent, with strong performances of non-gold industry and construction more than compensating for low and flat growth of agriculture and services respectively.

On the demand side, private consumption was the main contributor to growth, reflecting a strong rebound of remittance inflows, which grew by about 30 percent in US dollar terms in the first half of the year. Exports also contributed significantly, with robust growth to both EEU and non-EEU markets.

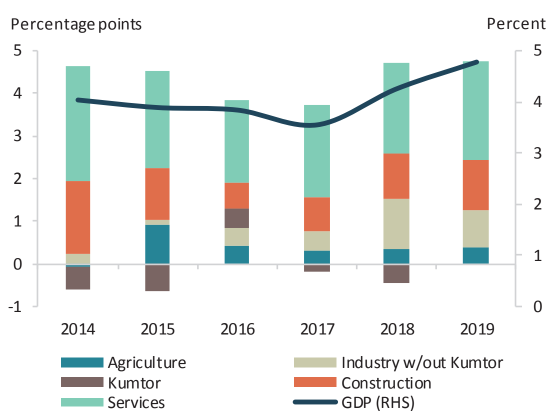
The current account deficit is estimated to have narrowed to 8.4 percent of GDP in the first quarter of 2017 from 14.5 percent in the same period of 2016 - led by the surge in remittances, as well as improvement in the trade balance. Exports grew by 30 percent in the first half of 2017, due to higher volumes of gold production and increased food exports to EEU markets. Meanwhile, imports expanded at a slower rate despite higher remittance inflows. The current account deficit was mainly financed by FDI inflows and government borrowing.

Monetary policy focused on maintaining the stability of the Kyrgyz som to keep inflation under control, while ensuring enough liquidity to accommodate the increase in domestic demand. During January-July 2017, the central bank intervened both as a buyer and a seller, with net sales of US$5.3 million. Inflation remained low, at 3.6 percent, year-on-year, as of July 2017, and credit to the economy increased by 12.7 percent, compared with 0.7 percent a year before.

The fiscal deficit narrowed to 3.8 percent of GDP in July 2017 from 6.9 percent over the same period in 2016, due to one-off higher non-tax revenues and lower current and capital outlays. While tax revenues were stable, non-tax collection increased to 8.2 percent from 7.1 percent, thanks to improved state property management. With slightly higher grant support, total revenues amounted to 33.5 percent of GDP, up from 32.7 percent a year ago. At the same time, expenditures fell to 37.5 percent of GDP, down from 40.8 percent last year, reflecting delays in planned investment projects. The deficit was mainly financed through foreign borrowing, which increased public debt to 62.4 percent of GDP as of end-July 2017, from 61.4 percent at the end of 2016.

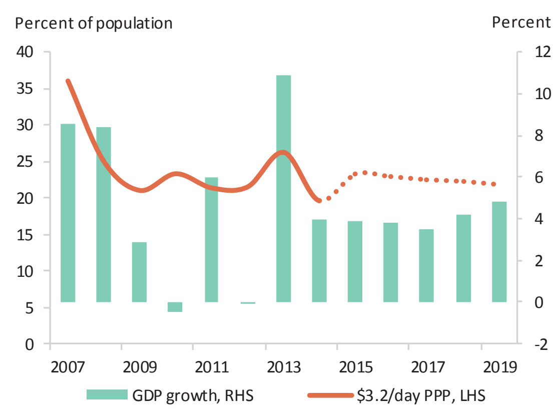
The poverty rate (measured at US$3.2 per day, 2011 PPP terms) is estimated to have fallen slightly from 23.3 percent in 2015 to 22.9 percent in 2016. Low inflation and higher remittance inflows supported households' real purchasing power. The moderate increase in food prices since January 2015 has positively affected the purchasing power of households at the bottom of the income distribution, while limiting real income growth of agricul-

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



Sources: Sources: Kyrgyz authorities and WB staff calculations.

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



Sources: Kyrgyz authorities and WB staff calculations.

tural producers. Moderate growth in services and agriculture, where about 50 percent of the bottom 40 are employed, constrained real labor income growth for the poor.

Outlook

Macroeconomic conditions are expected to remain broadly favorable in 2017, assuming price and exchange rate stability, and that spending pressures can be controlled in the run up to the presidential election in October 2017.

Annual growth is projected to reach 3.5 percent in 2017. While gold production should tapper-off in the second half of the year, high remittance inflows are expected to boost demand, driving non-gold growth to 4.1 percent for the full year. In 2018 growth is expected to increase to 4.2 percent owing to remittance supported-consumption and export growth, as (i) the Kyrgyz Republic continues to upgrade its standards and procedures to EEU norms, freeing up latent supply in agro-products, (ii) further financing from the Kyrgyz – Russian Development Fund targeting access to EEU market is disbursed, (iii) production from new gold mines comes online, and (iv) improved relations with Uzbekistan spur cross border trade.

On the fiscal side, the authorities are aiming to reach a deficit target of 4.7 percent of GDP (3 percent without on-lending) for the whole year. Going forward they have committed to significant fiscal consolidation over 2018-19, to reduce the deficit to 3 percent by 2019 (baseline scenario) mainly through expenditure compression. However, early indications for the second half of 2017, and the adoption of new policies for 2018 (including wage increases and new social entitlements) are likely to make these objectives extremely difficult to abide by.

Modest increases in growth projections for agriculture and construction, and further increases in remittances, are likely to support rural poverty reduction during 2017-18. Private sector real wages are expected to rise slowly, resulting in a slight reduction in urban poverty, where wage employment is more prevalent. Social transfers will continue to play an important role in driving poverty reduction in both urban and rural areas. A scheduled increase in pensions should also benefit poor households given that pensions represent close to 15 percent of income among the poor. The poverty rate is projected to decline to 22.6 percent in 2017 and 22.2 percent in 2018.

Risks and challenges

The economy and the welfare of Kyrgyz citizens will continue to be highly exposed to risks related to exogenous regional developments. Specifically, an economic slowdown in EEU member countries growth would affect the Kyrgyz Republic via remittances and trade. Adverse exchange rate developments, such as relatively sharper depreciations of other EEU currencies, would heighten competition with Kyrgyz producers in the domestic and EEU markets.

A core challenge continues to be the need to accelerate the process of convergence of local production to EEU standards. It is expected that this will help the Kyrgyz producers to utilize the already existing capacities to boost exports of agricultural and textile products in the short and medium run.

Lastly, while countercyclical fiscal policy has helped the Kyrgyz economy to weather the impact of the regional economic downturn, the improvement in the economic outlook makes it important to rebuild buffers and the country's capacity to respond to future shocks. Fiscal consolidation without affecting social programs will be a major challenge.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	4.0	3.9	3.8	3.5	4.2	4.8
Private Consumption	3.0	-0.9	1.8	2.5	3.2	3.5
Government Consumption	-0.5	0.9	2.7	0.5	0.6	0.7
Gross Fixed Capital Investment	17.4	3.9	3.7	5.4	4.5	4.7
Exports, Goods and Services	-6.2	-5.6	2.2	7.5	12.8	16.5
Imports, Goods and Services	1.6	-13.2	-4.0	4.0	6.0	8.0
Real GDP growth, at constant factor prices	4.0	3.9	3.8	3.5	4.2	4.8
Agriculture	-0.5	6.2	3.0	2.2	2.7	3.1
Industry	5.7	1.4	5.9	3.7	5.7	8.1
Services	7.0	3.1	3.6	4.3	4.7	4.8
Inflation (Consumer Price Index)	7.5	6.5	0.4	3.6	4.0	4.0
Current Account Balance (% of GDP)	-17.0	-15.9	-9.6	-8.0	-7.1	-6.1
Financial and Capital Account (% of GDP)	7.9	17.4	9.7	8.5	7.8	7.0
Net Foreign Direct Investment (% of GDP)	3.1	15.1	8.1	6.8	6.6	6.5
Fiscal Balance (% of GDP)	-4.1	-3.0	-6.6	-4.7	-4.1	-3.0
Debt (% of GDP)	53.6	67.3	61.6	62.9	63.3	61.5
Primary Balance (% of GDP)	-3.2	-2.0	-5.7	-3.8	-2.5	-2.0
International poverty rate ($1.9 in 2011 PPP)[a,b]	1.3	2.5	2.1	1.9	1.5	1.2
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	19.7	23.2	22.9	22.6	22.2	21.7
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	66.6	69.9	69.2	68.6	67.9	66.9

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2009-KIHS and 2015-KIHS. Actual data: 2015. Nowcast: 2016 - 2016. Forecast are from 2017 to 2019.
(b) Projection using average elasticity (2009-2015) with pass-through = 0.7 based on GDP per capita in constant LCU.

MACEDONIA, FYR

Table 1	2016
Population, million	2.1
GDP, current US$ billion	10.9
GDP per capita, current US$	5238
International poverty rate ($1.9)[a]	4.9
Upper middle-income poverty rate ($5.5)[a]	24.8
Gini coefficient[a]	35.6
School enrollment, primary (% gross)[b]	90.4
Life expectancy at birth, years[b]	75.3

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

Growth slowed to 2.4 percent in 2016 and turned negative in the first half of 2017 as political uncertainty affected investment, but is expected to recover closing the year at 1.5 percent, supported by consumption and growing investors' confidence after a new Government took office in June 2017. Unemployment eased in 2016 and early 2017, helped by public investment and employment programs; labor force participation fell to its lowest since 2012. Poverty is expected to continue to decline, propelled by job creation.

Recent developments

Political uncertainty took a toll on growth in 2016 and early 2017, but a recovery is expected as confidence is restored. Growth fell to 2.4 percent in 2016 (from 3.8 percent in 2015). It was mainly supported by household consumption, linked to rising employment, wages, pensions, and credit. Concerns about the political situation started affecting investment, which subtracted 1.3 pp from growth in 2016. Net-exports added 0.7 pp, supported by FDI related and services exports propelled by the Eurozone recovery. The economy contracted 0.9 percent in the first half of 2017, as investment declined by double digits. Private consumption growth remained positive, while net-exports had a marginal negative contribution. Construction and services, traditional drivers of growth, contributed negatively in the first half of 2017, while other sectors had small positive contributions. The establishment of a new government in June is helping restore confidence among investors, and is likely to support growth the second half of the year.

Deflation persisted in 2016, but receded in the first half of 2017. Low international prices, combined with lower utility prices led to a deflation of 0.2 percent in 2016. Nevertheless, a recovery in oil prices and increases in prices of beverages and tobacco, communications, lifted inflation to 0.9 percent in the first half of 2017.

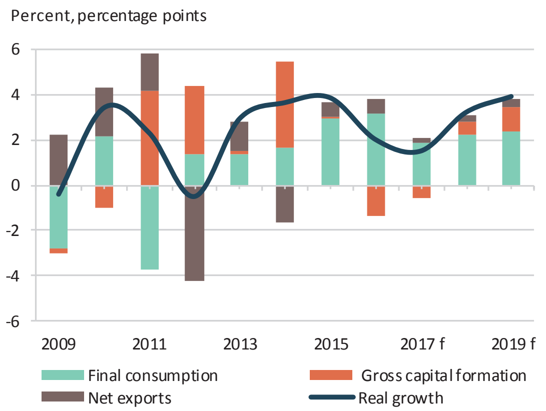
Unemployment continued to fall, helped by fiscal interventions to encourage jobs creation. Employment grew 2.5 percent y-o-y in 2016 and 2.7 percent in the first half of 2017. A large share of newly created jobs are linked to employment programs in trade, transport services and manufacturing. Labor force participation stood at around 57 percent, in 2016 and early 2017, the lowest rate since 2012. Unemployment rate fell to 22.8 percent in the first half of 2017, a historic low. Despite government efforts, youth unemployment and long-term unemployment remain high at 46 and 81 percent, respectively. Wages continued the upward trend started in 2014.

The current account deficit (CAD) widened from 2.1 percent of GDP in 2015 to 3.1 percent in 2016, but remains manageable. The solid increase of exports was not enough to compensate for higher dividends and profit repatriation, pushing up the CAD. The CAD narrowed back to 2.1 percent of GDP in the first half of 2017, helped by strong exports. Net FDI, which performed well till May (amounting to 1.5 percent of GDP), declined significantly in June, but was partially compensated by other financial investments. Foreign reserves stood at 4.7 months of imports in July 2017.

Credit continued to expand in the first half of 2017. Credit growth was strong in 2016 (6.5 percent) and continued to increase in the first half of 2017 (10.9 percent y-o-y). This dynamic was helped by a recovery corporate lending (particularly in June) and growing household lending. But, non-performing loans increased slightly, reaching 6.7 percent in Q2 2017.

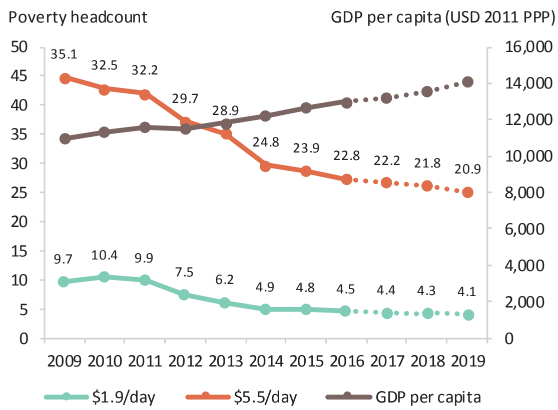
Fiscal performance in the first part of 2017 has been broadly in line with the approved

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



Sources: FYR Macedonia State Statistics Office and World Bank staff calculations.

FIGURE 2 FYR Macedonia / Annual and projected poverty rates and real GDP per capita



Sources: WDI and own calculations based on SILC 2010-2015.

budget. The new Government adopted a supplementary budget in July 2017, which rebalances expenditure and revenues but leaves the targeted deficit unchanged at 2.9 percent of GDP. This is slightly larger than the 2.6 percent of GDP achieved in 2016. The supplementary budget foresees a shift in the speeding structure to cover electoral promises and changes in revenue to adjust for lower expected growth. The biggest expenditure cuts are on country branding and promotion. and capital spending (to match expected execution). Pensions, subsidies, social assistance, and health are expected to increase, partially compensating for the savings in other items. The new budget considers lower revenues from most taxes, but higher revenues from excise and contributions. The public and publicly guaranteed debt increased from 46.4 percent of GDP in 2015 to 47.7 percent of GDP in 2016 and remained stable in nominal terms in the first half of 2017.

Poverty is estimated to have declined in 2016. Using the poverty line for upper middle income countries (US$5.5/day at 2011 PPP), poverty is projected to have fallen to 22.8 percent in 2016, continuing a decreasing trend present since 2009. Employment growth and increases in salaries, especially in the labor-intensive sectors, are expected to have contributed to poverty reduction in 2016 and early 2017. Increases in social assistance and pensions are expected to contribute to poverty reduction in 2017, though their impact is expected to be lower than that of the labor market income.

Outlook

Affected by the political uncertainty in the first half of the year, growth is expected to decline to 1.5 percent in 2017, but expand to increase to 3.2 and 3.9 percent in 2018 and 2019, respectively. The main drivers are expected to be consumption, fueled by growing employment, and investments, both public (as the two highways under construction should be finished by 2019) and private (which is expected to pick-up as confidence is restored). The fiscal deficit is expected to reach 3 percent of GDP in 2017, but then gradually decline to 2.2 percent by 2019. The PPG debt is expected to increase to 55 percent by 2019.

Poverty is expected to continue its downward trend in the next years. Real wage growth and continuous improvement in labor markets 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. Inclement weather in summer 2017 may have led to a slight increase in poverty among households depending mainly on agriculture income.

Risks and challenges

As the political situation is being resolved and confidence restored, the primary source of downside risk is the fiscal situation which could threaten stability and undermine growth prospects in the medium term. The main fiscal pressures steam from the high fiscal deficit, rising public debt, deteriorating public financial management, arrears accumulation and the pension system deficit. Considering the important role played in recent years, a reduction or reorientation of public spending could affect employment creation, stalling poverty reduction. The main upside risk is a faster than expected growth in the EU, increasing the external demand for Macedonian products.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	3.6	3.8	2.4	1.5	3.2	3.9
Private Consumption	2.2	3.7	4.2	2.4	2.8	3.0
Government Consumption	3.0	2.1	1.6	1.5	1.7	1.7
Gross Fixed Capital Investment	5.7	2.1	-3.9	-2.6	2.8	4.7
Exports, Goods and Services	16.5	6.7	11.5	8.4	6.9	6.3
Imports, Goods and Services	14.1	5.2	7.6	6.3	5.1	4.6
Real GDP growth, at constant factor prices	6.5	4.5	3.2	1.2	3.2	3.9
Agriculture	2.2	-0.7	2.8	0.5	1.2	1.0
Industry	11.8	7.8	7.6	2.0	5.6	5.1
Services	5.0	3.9	1.3	0.9	2.3	3.7
Inflation (Consumer Price Index)	-0.3	-0.3	-0.2	0.9	1.6	2.0
Current Account Balance (% of GDP)	-0.6	-2.0	-3.1	-3.1	-2.9	-2.9
Financial and Capital Account (% of GDP)	-0.6	1.9	3.1	2.9	2.6	2.6
Net Foreign Direct Investment (% of GDP)	2.3	2.3	3.6	2.6	3.0	3.2
Fiscal Balance (% of GDP)	-4.2	-3.6	-2.6	-3.0	-2.7	-2.2
Debt (% of GDP)	38.1	38.1	39.0	39.7	41.6	42.0
Primary Balance (% of GDP)	-3.2	-2.4	-1.5	-1.7	-1.3	-0.7
International poverty rate ($1.9 in 2011 PPP)[a,b]	4.9	4.8	4.5	4.4	4.3	4.1
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	24.8	23.9	22.8	22.2	21.8	20.9

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.
(a) Calculations based on SILC harmonization, using 2014-SILC grouped data (survey year). Actual data: 2014. Nowcast: 2015 - 2016. Forecast are from 2017 to 2019.
(b) Projection using neutral distribution (2014) with pass-through = 0.87 based on GDP per capita in constant LCU.

MOLDOVA

Table 1	2016
Population, million	3.5
GDP, current US$ billion	6.8
GDP per capita, current US$	1913
International poverty rate ($1.9)[a]	0.0
Lower middle-income poverty rate ($3.2)[a]	1.4
Upper middle-income poverty rate ($5.5)[a]	16.3
Gini coefficient[a]	27.0
School enrollment, primary (% gross)[b]	92.4
Life expectancy at birth, years[b]	71.6

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

In the first half of 2017, Moldova registered robust growth supported by favorable conditions in agriculture and strong private consumption. Higher wages and the recovery of remittances brought poverty rate down. Growth is expected to strengthen during 2018 and 2019 supported by growing consumption, investments and robust export growth. While Moldova is slowly rebuilding its macroeconomic buffers, major policy challenges related to governance, particularly in the financial sector, to the efficiency of public spending, and to revenue mobilization remain.

Recent developments

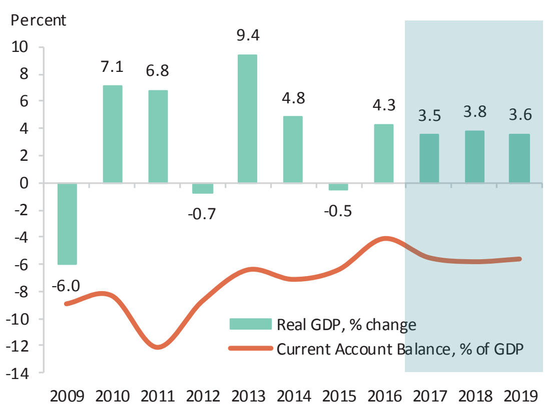
In the first half of 2017, real GDP increased by 2.8 percent mainly driven by private consumption. The observed recovery in remittances, robust growth in wages and the indexation of pensions in 2016 supported consumption growth (+3.6 percent, y/y). Net exports contributed negatively to real GDP growth: on account of a 10 percent appreciation since the beginning of the year, import growth outpaced the robust export performance which was supported by the good harvest of 2016. Higher investment confidence led to a recovery in fixed investment of 4.8 percent y/y, following the sharp decline in 2016. The build-up in inventories added another 2.3 percentage points to the overall growth.

In summer, the Central Bank further lowered the policy rate by 150 basis points to 7.5 percent but credit to the economy remains subdued. The latter, combined with a recovery in deposits, is contributing to persistent excess liquidity. Thus, the Central Bank increased the reserve requirement ratio to a record high of 40 percent. The sharp increase in administrative prices at the beginning of 2017 kept the inflation rate above the target corridor of 5 percent +/- 1.5 percent for the fourth consecutive month in July. Favorable exchange rate developments allowed the Central Bank to increase its foreign reserves, which now exceed 5.5 months of imports.

During the first half of 2017, government fiscal revenues and expenditures registered a double-digit nominal y/y increase, resulting in an almost zero fiscal balance. Current expenditures, particularly subsidies to agriculture and procurement in goods and services, registered the most dynamic increase. Following a slowdown in capital expenditure due to late December disbursement of the external budget support, spending on fixed assets increased by almost 18 percent in nominal terms, y/y in the first half of 2017. Public Debt and guarantees decreased by 4 percentage points of GDP, as compared to end-2016, reaching 40.1 percent of GDP thank to stronger growth.

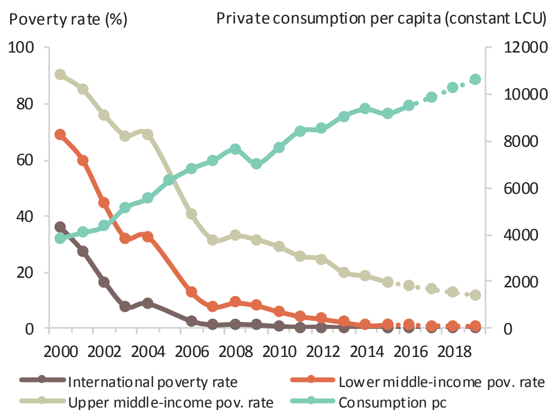
The poverty headcount based on both national and international definitions decreased in Moldova in 2015 compared to previous years. The share of population under the national poverty line decreased to 9.6 percent in 2015 from 11.4 percent in 2014. The international moderate poverty rate of US$ 5.5 /day in 2011 PPP decreased to 16.3 percent from 18.4. During the period 2010-2015 the shared prosperity premium was positive at 2.6 percent, and consumption growth in the bottom 40 percent amounted to 4.1 percent annually. Increases in pensions and remittances were among key drivers of poverty and shared prosperity dynamics in recent years. Labor market dynamics also remain positive, with a decrease in the unemployment rate from 4.9 percent in 2015 to 4.2 percent in 2016, as well as increasing employment rate, particularly in rural areas. Despite progress, considerable spatial disparities remains – rural poverty rate was 11 percentage points higher than urban in 2015 according to the national definition.

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



Sources: National authorities and World Bank estimates.

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



Source: World Bank. Notes: see table 2.

In the first quarter of 2017, the current account deficit increased to 7.5 percent from 5 percent a year earlier as imports growth more than offset the strong export performance. Due to an increase in reinvested revenues, FDI increased to 3.1 percent of GDP, from 1.4 percent in 2016Q1. Transfers through the banking system, a proxy for remittances, increased 9.7 percent in the first half of 2017. Still, external debt was the main source of current account deficit financing. Due to the appreciation of the national currency, the external debt decreased by 5 percentage points to 91 percent of estimated GDP.

Outlook

Economic growth is projected at 3.5 percent during 2017, supported by a good harvest and strong private consumption due to higher remittances and private wage growth. Despite favorable exports developments, the contribution of net trade to GDP growth is expected to remain negative as imports are rapidly expanding. In 2017, the fiscal deficit is forecasted to remain below the planned 3 percent of GDP level thanks to a strong revenue performance which is expected to offset higher expenditures. Should additional international support materialize, public investments could increase further. The revitalization of foreign inflows, and improvements in the financial sector and in the business environment are expected to encourage further private investments. Real growth in public transfers and the ongoing rebound in remittances will help maintain the growth momentum during the remaining part of the forecast horizon. Real GDP is projected to reach 3.8 percent and 3.6 percent in 2018 and 2019, respectively. As the support from the international community is expected to decline, the fiscal deficit is expected to widen but to remain below 2.5 percent of GDP. As consumption and imports strengthen, the current account deficit is expected to gradually increase, but is expected to remain below its historical average thanks to a stronger export performance. The inflation rate is expected to remain on average in the targeted corridor.

Against this background, the poverty rate measured at the Upper Middle Income line of PPP US$5.5/day is projected to decrease by 3 percentage points in 2016-2019, supported by real wage growth (5.7 percent in Q2 of 2017 as compared to Q2 of 2016), as well as remittances and public transfers.

Risks and challenges

Key downside risks to the baseline outlook include a slowdown in the implementation of key growth enhancing reforms, including those related to the restructuring of the financial and energy sector and to the efficiency of public finances. Weak rule of law and vested interests could also halt the reform process – governance and transparency related reforms remain indeed key to strengthen the growth prospects. Parliamentary elections, scheduled in 2018, may also affect the pace of the implementation of the reform agenda. Weaker than expected growth in the main partners, such as the EU and CIS countries, could affect Moldovan economy.

Increasing the efficiency of public spending revenue mobilization would allow Moldova to create the necessary fiscal space for key social and capital expenditures. Compared to peer countries in the region, Moldova could reach the current socio-economic outcomes (in particular in education, health, and vital infrastructure) with less spending. The elimination of tax expenditure that do not a have a clear rationale would create a more efficient and revenue enhancing tax system.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	4.8	-0.4	4.3	3.5	3.8	3.6
Private Consumption	3.2	-2.3	3.6	3.7	3.6	3.6
Government Consumption	0.8	0.7	-0.6	0.1	2.6	0.1
Gross Fixed Capital Investment	10.0	-2.3	-2.8	5.7	6.4	6.5
Exports, Goods and Services	1.0	2.3	9.3	5.5	5.1	5.3
Imports, Goods and Services	0.4	-4.7	5.9	6.7	5.4	5.5
Real GDP growth, at constant factor prices	5.4	-0.2	5.0	3.0	3.7	3.8
Agriculture	8.5	-13.4	18.0	1.5	2.4	3.8
Industry	7.5	3.5	2.6	2.4	3.8	4.6
Services	3.7	3.7	1.6	3.7	4.1	3.5
Inflation (Consumer Price Index)	5.1	9.7	6.4	6.1	4.8	5.0
Current Account Balance (% of GDP)	-7.1	-6.6	-4.1	-5.5	-5.8	-5.6
Financial and Capital Account (% of GDP)	8.2	7.4	3.2	5.0	5.1	4.8
Net Foreign Direct Investment (% of GDP)	3.9	3.5	1.8	2.7	3.2	3.7
Fiscal Balance (% of GDP)	-1.7	-2.2	-1.8	-2.0	-3.0	-2.2
Debt (% of GDP)	38.1	46.4	43.9	42.3	41.9	41.5
Primary Balance (% of GDP)	-1.2	-1.3	-0.5	-0.7	-1.9	-1.2
International poverty rate ($1.9 in 2011 PPP)[a,b]	..	0.0	0.0	0.0	0.0	0.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	1.1	1.4	1.1	0.8	0.6	0.5
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	18.4	16.3	15.0	13.8	12.7	11.7

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2010-HBS and 2015-HBS. Actual data: 2014, 2015. Nowcast: 2016 - 2016. Forecast are from 2017 to 2019.
(b) Projection using annualized elasticity (2010-2015) with pass-through = 0.87 based on private consumption per capita in constant LCU.

MONTENEGRO

Table 1	2016
Population, million	0.6
GDP, current US$ billion	4.2
GDP per capita, current US$	6710
Upper middle-income poverty rate ($5.5)[a]	4.8
Gini coefficient[a]	31.6
Life expectancy at birth, years[b]	76.2

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

After slowing in 2016, growth increased in 2017 due to the surge in investment and tourism. Despite employment rise and unemployment rate decline, labor force participation rate remains low. Poverty is estimated to have declined in 2016, as social transfers surged. Despite positive economic outlook and ambitious fiscal strategy for regaining control over public finances, short-term social impacts of fiscal consolidation and facilitating access to employment of women losing mothers' benefit remain to be the challenge of the policy agenda.

Recent developments

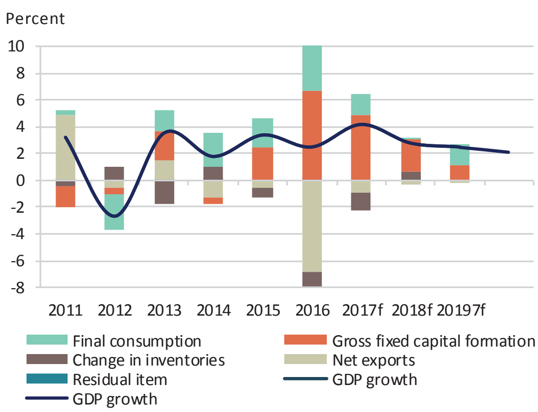
After slowing down in 2016 to 2.5 percent, growth picked up again in the first quarter of 2017 to 3.2 percent due to the highway and civilian construction surge, as well as booming tourism. Investment remained the main driver of growth, contributing 6.5 percentage points of GDP in the first quarter of 2017. Household consumption, supported by social benefits and wage growth, also remained robust, contributing an additional 6.3 percentage points, while government consumption contributed 0.8 percentage points, led by public sector wage rise. In contrast, change in inventories and net exports subtracted over 5 percentage points of GDP each from growth as rapid rise in imports of equipment and materials for the highway and windmills projects combined with the continued weak goods export performance. Growth accelerated in the second quarter and remained robust during the summer. While tourism arrivals remain robust (close to 11 percent more overnight stays by July 2017), industrial production continues falling as growth in the mining sector has not offset sharp declines in energy and manufacturing. Yet, construction surged by close to 23 percent while retail grew by 5 percent in the first half of the year, led by disposable income growth.

Credit to the economy recovered and NPLs declined to below 9 percent, on the back of a surge in new credit to households and government. After widening in 2016, current account deficit (CAD) slightly improved to 17.2 percent on a four-quarter basis by June 2017, despite the surge in imports. Tourism and the base effect from the last year's withdrawal of dividends led to a moderation of service and income accounts. Net FDI picked up to 11 percent of GDP, covering around half of the CAD financing. Yet, external debt grew further to above 164 percent of GDP with some moderation of private sector indebtedness and further rise in public sector debt.

The labor market stagnated in 2016, but have started recovering by mid-2017, as vacancies surged and as mother's benefit cut (a lifetime benefit to mothers with three or more children), that led to a significant female withdrawal from employment and the labor force, started to incentivize job search. The four-quarter average unemployment rate declined to 16.7 percent by June 2017 (one percentage point down from 2016), while the employment rate grew to 45.5 percent. Large employment programs helped reduce youth unemployment rate to a still high 33.5 percent, with long-term unemployment at 80 percent in June 2017.

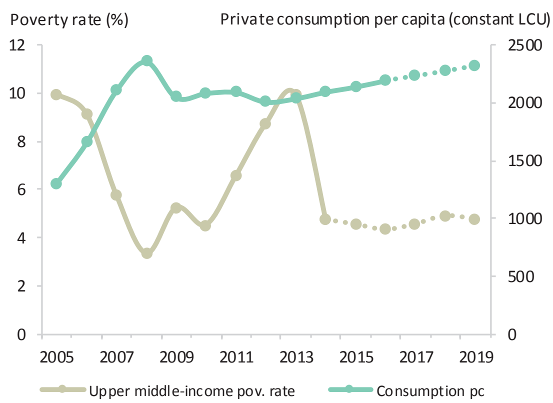
Poverty is estimated to have declined in 2016 and early 2017, as social transfers (mothers' benefits and pension rise) surged. Additionally, led by public sector wage growth of over 6 percent, real wages grew by 3.4 percent in the first half of 2017, well above productivity growth, indicating a rise in unit labor cost by over 7 percent. With these developments, poverty (measured as consumption below the

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.

standardized middle-income-country poverty line of $5.5/day 2011PPP) declined from 8.7 percent in 2012 to an estimated 4.3 percent in 2016. Inflation picked up in 2017 to 2.4 percent by July on the back of oil and food prices.

Government adopted an ambitious fiscal consolidation strategy to tame fiscal risks. By June 2017, the new government adopted a set of fiscal consolidation measures amounting to over 6 percentage points of GDP for the 2017-2019 period. The measures include a rise in excises and VAT, a collection of tax arrears, abolishment of the mothers' benefit (partly compensated by an increase in child benefits), and a reduction of public sector wages, among others. This plan has brought the targeted fiscal deficit down to 4 percent of GDP in 2017, from an initial plan of 6 percent.

Outlook

The economy is expected to grow by an average of 3.2 percent annually in 2017-19 on the back of public investments and personal consumption. While growth of investment will slow down as the highway construction gets to its closure, its contribution to growth will remain strong throughout the projection period. Current imbalances are likely to stay high given the import dependence of the current growth pattern. Inflation is projected at 2 percent in the period 2017-19, as the VAT rate rise adds to the current inflation growth. Fiscal deficit is projected to be brought down to 2 percent in 2017-19, reaching balance in 2019 and maintaining surplus thereafter to comply with the fiscal rule by 2022. While the authorities work on strengthening the financial sector regulation, private sector needs to address weaknesses in some non-systemic banks and use the recently adopted framework to resolve NPLs.

With the potential poverty impact of fiscal consolidation measures, poverty (measured at $5.5/day 2011PPP) is expected to slightly increase in 2017-18 as mothers' benefits phase out. Poverty is likely to resume its decline in 2019 to an estimated 4.8 percent by 2019, subject to improvements in private sector employment and earnings.

Risks and challenges

The positive economic outlook faces high, but moderating, risks. Growing public debt calls for decisive implementation of the recently adopted fiscal consolidation program to create the space for an orderly servicing of the large (above 16 percent of GDP) refinancing needs in the 2019-2021 period. Reducing the deficit will not be easy, but is of utmost urgency given the need to reassure markets and allow for a successful rollover of existing obligations under the credit rating of B+ with a negative outlook. Aware of it, Government has recently approved several fiscal laws to tame fiscal deficit.

External imbalances are still high, adding to an already high external vulnerability. Enhancing policy predictability and accelerating the pace of structural reforms, would be needed for their moderation.

Reducing unemployment, especially for youth and mitigating short-term poverty and social impacts of fiscal consolidation and facilitating access to employment need to be an important part of the policy agenda.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	1.8	3.4	2.5	4.2	2.8	2.5
Private Consumption	2.9	2.2	2.6	2.6	0.6	2.3
Government Consumption	1.4	1.9	8.1	-2.4	-2.2	-1.1
Gross Fixed Capital Investment	-2.5	11.9	29.6	17.2	7.4	3.4
Exports, Goods and Services	-0.7	5.7	5.1	2.5	2.0	2.0
Imports, Goods and Services	1.6	4.4	14.1	2.7	1.6	1.5
Real GDP growth, at constant factor prices	1.9	3.9	2.5	4.2	2.8	2.5
Agriculture	1.8	3.2	3.3	2.1	2.1	2.1
Industry	4.5	5.8	4.7	3.5	3.5	3.5
Services	0.7	3.1	1.3	4.9	2.6	2.1
Inflation (Consumer Price Index)	-0.7	1.5	-0.2	2.3	3.1	2.1
Current Account Balance (% of GDP)	-15.2	-13.3	-19.0	-19.6	-19.8	-18.7
Financial and Capital Account (% of GDP)	3.7	4.4	13.0	15.9	16.3	15.4
Net Foreign Direct Investment (% of GDP)	10.2	17.1	9.8	12.1	12.2	11.8
Fiscal Balance (% of GDP)	-3.1	-7.3	-3.3	-4.1	-1.7	0.2
Debt (% of GDP)	59.9	66.7	67.5	71.9	73.7	73.5
Primary Balance (% of GDP)	-0.9	-4.9	-1.0	-1.6	0.5	2.3
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	4.8	4.6	4.3	4.6	4.9	4.8

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2009-HBS and 2014-HBS. Actual data: 2014. Nowcast: 2015 - 2016. Forecast are from 2017 to 2019.
(b) Projection using point-to-point elasticity (2009-2014) with pass-through = 0.5 based on private consumption per capita in constant LCU and estimated impact of fiscal consolidation.

POLAND

Table 1	2016
Population, million	38.0
GDP, current US$ billion	469.5
GDP per capita, current US$	12365
International poverty rate ($1.9)[a]	0.4
Lower middle-income poverty rate ($3.2)[a]	1.1
Upper middle-income poverty rate ($5.5)[a]	2.8
Gini coefficient[a]	32.9
Life expectancy at birth, years[b]	77.6

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

Poland's economy grew by 4 percent in the first half of 2017. Growth was fueled by a significant pickup in private consumption, boosted by strong labor market performance and continuation of the Family 500+ program. Poverty is expected to have continued to decline in line with growing disposable incomes. The strong growth projected in 2017 will boost budget revenues, and, is expected to lead to further narrowing of the fiscal deficit to 2.1 percent of GDP in 2017. Growth is projected to slow down to 3.4-3.6 percent in 2018-2019 in line with the potential of the Polish economy.

Recent developments

Real GDP growth accelerated in the first half of 2017 to 4.0 percent year-on-year from 2.7 percent in 2016. The growth rate and its structure were very similar in the first and second quarters: with strong private consumption and moderate public consumption, sizeable restocking, and weak but gradually recovering investment. However, the contribution of net exports to growth turned from slightly positive in the first quarter to negative in the second one (-1.5 percentage points), as strong domestic demand translated into higher imports.

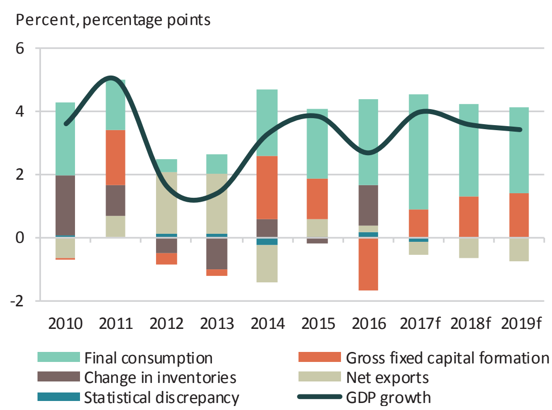
Private consumption remained the main growth driver, expanding by 4.8 percent in the first half of 2017, boosted by robust real income growth due to a record low unemployment rate of 5 percent, robust growth in real wages despite a temporary increase in inflation in early 2017, and the stimulus from the Family 500+ benefit program, introduced in April 2016. Record-high capacity utilization and a record-low unemployment rate - lower than the natural rate estimated by the NBP at 5.6 percent - suggest the economy is operating above its potential. The labor market is increasingly tight, and firms face shortages of labor. Migration, particularly from Ukraine, has helped to mitigate growing wage pressures. Average wage growth accelerated in the second quarter to 5 percent year-on-year in nominal terms from 3.8 percent in 2016.

Investment increased by a modest 0.3 percent year-on-year in the 1st half of 2017, recovering slowly from a 7.9 percent decline in 2016. Total investment is pulled by public investments financed from EU funds, which rebounded after a steep 20 percent drop in 2016. Private investors seem to maintain their wait-and-see attitude despite record low interest rates and record high capacity utilization. However, early indicators (PMI, industrial and construction production, enterprise sentiment) suggest that firms are becoming more optimistic and are increasing their stocks, pointing to a forthcoming rebound in investment.

Poverty and shared prosperity indicators are estimated to have continued to improve in 2017, driven by strong private consumption supported by a strong labor market and the continuation of the Family 500+ program. Moderate poverty is expected to have declined from 2.7 percent in 2015 to 1.7 percent in 2016 using the $5.50/day 2011 PPP poverty line.

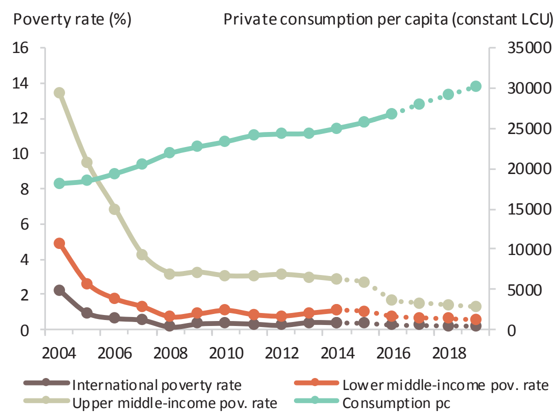
Dynamic growth, together with legislative, organizational, and IT tax administration measures (fuel package, inverted VAT for some construction services, single reporting file, shorter VAT settlements period, more severe penalty sanctions) led to unprecedented improvement in VAT compliance resulting in a 24 percent increase in revenue for January through July 2017 compared to the same period last year. This is the first time since the early 1990s, that the cash-based state budget has recorded a surplus (of 0.3 percent of GDP) in the first half of the year, accompanied by a surplus of the local governments subsector, which reached 0.7 percent of GDP in the first half of 2017. With the back-

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



Sources: MFMod, World Bank.

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



Sources: World Bank (see notes to Table 2).

loading of public expenditures during the year, these surpluses will turn into deficits. Moreover, the rollback in the statutory retirement age will inflate the expenses from October 2017.

Poland's external position remained balanced. The current account deficit was 0.2 percent of GDP in 2016 and is close to balance in mid-2017.

Outlook

GDP growth is expected to increase to 4.0 percent in 2017 from 2.7 percent in 2016 on the back of strong consumption growth and gradually recovering investment, while the contribution of net exports is to be broadly neutral. Over the medium term, growth is expected to gradually moderate towards the potential growth rate of about 3.5 percent, supported by growth in capital accumulation, and against the backdrop of deteriorating demographics and the rollback in statutory retirement age.

Robust private consumption and strong labor market should continue to boost real income growth, and are likely to lead to further declines in poverty incidence. The 8 percent increase in the minimum wage that took effect in 2017 is expected to have increased the incomes of the bottom of the distribution, which has been so far only modestly offset by rising prices. The $5.50/day 2011 PPP poverty rate is projected to decline to 1.5 percent in 2017 and further to 1.3 percent by 2019.

The general government deficit is set to widen again in 2018-2019 to around 2.6-2.7 percent of GDP, which is below the 3 percent Maastricht threshold. The increase in the deficit is due to higher spending on account of the roll-back of the retirement age and higher co-financing of EU-funded capital spending.

Inflation remains low, well below the NBP's inflation target of 2.5 percent. However, labor market bottlenecks and rising unit labor costs are the main source of inflation pressure.

Risks and challenges

Poland's growth prospects may be affected by persisting uncertainty in the global economy, including the monetary and fiscal policy stance in the US and the impact of Brexit negotiations. On the positive side, the global economy and the EU might grow at a faster pace, while commodity prices are projected to remain broadly unchanged and migrants keep filling the existing labor shortages.

Domestically, the main risk to growth is posed by acceleration of unit labor costs on the back of labor shortages. Additional risks may stem from recently proposed changes to the judiciary system, which may be seen as undermining the rule of law, potentially denting investor confidence and affecting relations with the EU.

Further improvements in tax compliance beyond 2017 might be more difficult to achieve but if it occurs, it should offset costs due to the rollback of the retirement age of about 0.4 percent of GDP per year. However, rising costs of rapid aging and the need for fiscal space to co-finance public investment imply that fiscal consolidation should start promptly when the economy is strong.

Continued growth and shared prosperity in Poland will ultimately depend on a more strategic, effective, and accountable state. Continued productivity growth and transition to an innovation-led growth model will require improved consistency and commitment to sound policies, and improved coordination between the public and private sectors and local and national government institutions.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	3.3	3.8	2.7	4.0	3.6	3.4
Private Consumption	2.4	3.0	3.8	4.9	3.8	3.6
Government Consumption	4.1	2.4	2.8	4.1	3.9	3.3
Gross Fixed Capital Investment	10.0	6.1	-7.9	4.7	6.6	7.1
Exports, Goods and Services	6.7	7.7	9.0	6.9	5.7	5.3
Imports, Goods and Services	10.0	6.6	8.9	8.1	7.2	6.8
Real GDP growth, at constant factor prices	3.3	3.7	2.6	4.0	3.5	3.4
Agriculture	0.7	-8.5	2.1	2.5	2.2	2.2
Industry	4.5	3.8	3.6	4.4	4.1	4.1
Services	2.9	4.1	2.2	3.9	3.3	3.2
Inflation (Consumer Price Index)	0.0	-0.9	-0.6	1.9	2.3	2.5
Current Account Balance (% of GDP)	-2.1	-0.6	-0.2	-0.7	-1.0	-1.3
Financial and Capital Account (% of GDP)	3.7	2.3	5.7	3.7	3.0	3.0
Net Foreign Direct Investment (% of GDP)	2.4	2.1	1.0	1.0	1.5	1.6
Fiscal Balance (% of GDP)	-3.5	-2.6	-2.4	-2.1	-2.6	-2.7
Debt (% of GDP)	50.2	51.1	54.4	53.4	53.0	52.8
Primary Balance (% of GDP)	-1.5	-0.8	-0.7	-0.3	-0.8	-0.9
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.4	0.4	0.3	0.2	0.2	0.2
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	1.1	1.0	0.8	0.7	0.6	0.6
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	2.8	2.7	1.7	1.5	1.4	1.3

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.
(a) Calculations based on EUSILC harmonization, using 2004-EU-SILC and 2014-EU-SILC. Actual data: 2014. Nowcast: 2015 - 2016. Forecast are from 2017 to 2019.
(b) Projection using point-to-point elasticity (2004-2014) with pass-through = 1 based on private consumption per capita in constant LCU.

ROMANIA

Table 1	2016
Population, million	19.7
GDP, current US$ billion	186.7
GDP per capita, current US$	9486
Lower middle-income poverty rate ($3.2)[a]	15.2
Upper middle-income poverty rate ($5.5)[a]	28.7
Gini coefficient[a]	39.4
Life expectancy at birth, years[b]	75.0

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

Romania's economy grew 5.8 percent in the first half of 2017, the fastest in the EU. Growth was fueled by the fiscal relaxation measures implemented since the beginning of the year and labor market improvements. The further pick-up in economic activity and the increased support to vulnerable groups contributed to poverty reduction. Growth is expected to remain solid in 2017 and 2018, but there are risks to the outlook, reflecting the deteriorating fiscal position and current account balance.

Recent developments

The economy grew by 5.8 percent in the first half of 2017, driven by an expansionary fiscal policy and improvements in the labor market. Growth was led by private consumption (up 7.4 percent), boosted by the reduction in the standard VAT rate from 20 percent to 19 percent in January 2017, and by increases in the minimum and public sector wages and pensions. Investment growth was timid (1.1 percent), reflecting the poor performance of public investment mainly due to the drop in the EU investment funding. On the production side, ICT (up 12.7 percent) was the main driver. Industry (up 7.3 percent) showed good signs of recovery, while construction (down 4.7 percent) underperformed.

Inflation is on an upward trend, but remains within the central bank's target. Annual headline inflation moved up to 1.4 percent in July 2017, as the base effect of the VAT cut dissipated. The NBR board kept the policy rate unchanged at 1.75 percent in August, amid early signs of corporate credit growth recovery (up 4.3 percent as of July 2017) and concerns over the future fiscal and income policy stance.

Fiscal policy has remained pro-cyclical in 2017. The budget posted a deficit of 0.8 percent of GDP in the first half of 2017, a quarter of a percentage point higher than in the same period of last year. The widening of the deficit reflects a 10 percent increase in public expenditures and a lower-than-expected revenue collection (up 8.2 percent), particularly from VAT (down 4.3 percent). The increase in current spending was driven by hikes in the compensation of employees (up 19.5 percent) and social assistance spending (up 9.8 percent), while public investment spending contracted by 45.5 percent.

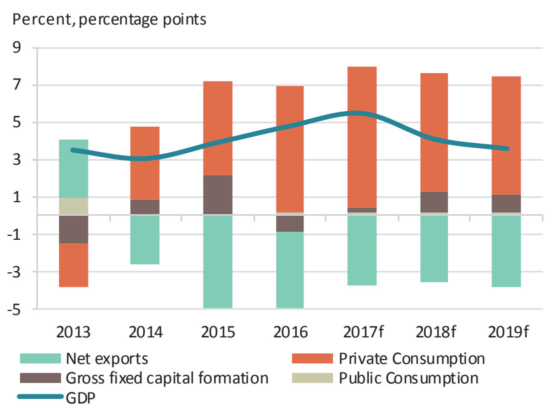
The labor market benefited from the strong economic growth and exhibits signs of overheating, as unemployment fell to 5 percent as of June 2017, an eight-year low, and real wages increased by 13.5 percent. Nonetheless, the low employment rate of 61.2 in Q1 2017, down 0.4 percentage points from the previous quarter, reflects persistent structural rigidities in the labor market.

Poverty measured by the upper-middle income countries $5.50/day 2011 PPP poverty line is estimated to have declined from 28.7 percent in 2014 to 26.0 percent in 2016, in line with increased growth, and private consumption, and a strong labor market. Cuts to the VAT rate have increased household purchasing power and improved welfare outcomes, as food makes up a larger portion of the budgets of the poorest members of society. High poverty incidence continues to be associated with high inactivity levels, particularly in rural and marginalized areas. Income inequality is the highest in the EU and has been increasing.

Outlook

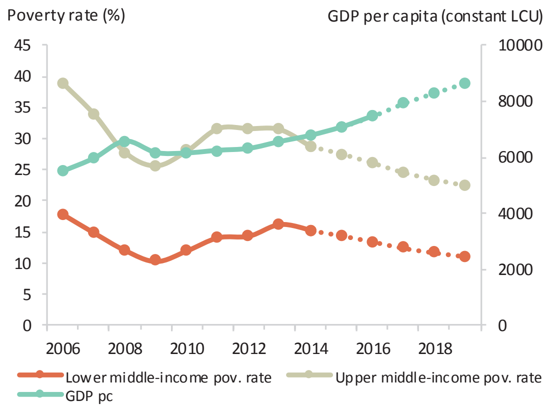
The economy is projected to grow above its potential in 2017 and 2018. GDP will likely expand by around 5.5 percent in 2017, driven by the fiscal stimulus and

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



Sources: World Bank. Notes: see Table 2.

aided by improvements in the European economy. The pickup in consumption is expected to widen the current account deficit to 3.1 percent in 2017, from 2.4 percent in 2016. Inflation is set to rise, reflecting the excess domestic demand and the fading out of the base effect of the tax cuts. The NBR anticipates a gradual increase in inflation towards 2 percent at the end of 2017.

The pro-cyclical fiscal measures passed in 2017 have put pressure on the consolidated budget deficit. The government aims to maintain the fiscal deficit below 3 percent of GDP in 2017 through several fiscal measures, including by hiking excise duties for fuels and requiring selected SOEs to pay dividends in advance for their 2017 profits. Exceeding the deficit limit of 3 percent of GDP would place Romania into the Excessive Deficit Procedure of the EU. The widening of the fiscal deficit will push public debt to just above 49 percent of GDP by the end of 2019 from 44.6 percent in 2016. Public debt remains one of the lowest in the EU, but it is not stabilized by the current fiscal stance.

Strong private consumption growth aided by a lower VAT rate, coupled with low unemployment and continued growth in real wages, should boost real incomes and lead to further declines in poverty incidence. Moreover, the planned introduction of the Minimum Social Insertion Income program (MSII) is expected to improve targeting and increase the level of benefits for the most vulnerable. The $5.50/day 2011 PPP poverty rate is projected to decline to 24.5 percent in 2017, to 23.3 percent in 2018, and to 22.4 percent in 2019.

Risks and challenges

Accumulating fiscal pressures and excess domestic demand limit the space for policy-makers to maneuver in 2017 and beyond. The fiscal and current account deficits are on the rise, and public debt dynamics have not been stabilized. These developments leave the Romanian economy increasingly vulnerable to exogenous shocks. The authorities should consider additional fiscal measures if the budget deficit risks exceeding 3 percent of GDP in 2017 and 2018. Externally, a likely tapering of the quantitative easing in the Eurozone and higher global interest rates may lead to a repositioning in investor sentiment towards the emerging economies and to higher refinancing costs, further reinforcing fiscal pressures. On the upside, a better-than-projected economic performance of the Eurozone will act as a driver for growth in the broader EU, including Romania.

Increasing Romanian's growth potential requires attention to the structural reforms agenda. Public administration reforms and measures to combat corruption, boosting tax revenues through administrative reforms, improving the efficiency and efficacy of public spending, and implementing the new legal framework for the SOE corporate governance agenda remain reform priorities. Renewed efforts are needed to improve labor participation and generate broad-based employment, as unemployment remains high among youth and the low-skilled, and to ensure that all Romanians obtain access to high quality public services. Gradually, the focus of fiscal policy should be rebalanced away from boosting consumption towards supporting a sustainable EU convergence path.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	3.1	3.9	4.8	5.5	4.1	3.6
Private Consumption	4.4	5.5	7.3	8.0	6.5	6.4
Government Consumption	0.5	-0.7	3.3	2.8	4.3	3.1
Gross Fixed Capital Investment	3.2	8.3	-3.3	1.1	4.5	4.2
Exports, Goods and Services	8.0	5.4	8.3	9.6	7.4	6.3
Imports, Goods and Services	8.7	9.2	9.8	10.1	8.3	7.7
Real GDP growth, at constant factor prices	3.2	3.6	4.9	5.5	4.1	3.6
Agriculture	4.3	-11.8	0.0	6.0	2.1	2.1
Industry	3.2	6.6	1.7	5.9	2.7	1.6
Services	3.1	4.7	7.3	5.2	5.1	4.8
Inflation (Consumer Price Index)	1.1	-0.6	-1.5	2.0	2.5	2.8
Current Account Balance (% of GDP)	-0.5	-1.2	-2.4	-3.1	-3.5	-3.8
Financial and Capital Account (% of GDP)	0.4	1.2	2.8	3.5	3.9	4.2
Net Foreign Direct Investment (% of GDP)	1.6	2.2	2.4	2.5	2.8	2.8
Fiscal Balance (% of GDP)[a]	-1.7	-1.4	-2.7	-3.0	-3.6	-3.3
Debt (% of GDP)	44.3	44.4	44.6	46.9	48.6	49.2
Primary Balance (% of GDP)	-0.2	0.0	-1.3	-1.6	-2.1	-1.7
Lower middle-income poverty rate ($3.2 in 2011 PPP)[b,c,d]	15.2	14.4	13.5	12.4	11.7	11.1
Upper middle-income poverty rate ($5.5 in 2011 PPP)[b,c,d]	28.7	27.5	26.0	24.5	23.3	22.4

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e = estimate, f = forecast.
(a) Assumes that the planned public sector wage increases and the reduction in the flat tax will be implemented in January 2018.
(b) Calculations based on EUSILC harmonization, using 2006-EU-SILC, 2011-EU-SILC, and 2014-EU-SILC.
(c) Projection using annualized elasticity (2006-2011) with pass-through = 0.7 based on GDP per capita in constant LCU. Nowcast: 2015 - 2016. Forecast are from 2017 to 2019.
(d) Actual data: 2014. Nowcast: 2015 - 2016. Forecast are from 2017 to 2019.

RUSSIAN FEDERATION

Table 1	2016
GDP, current US$ billion	1286.2
GDP per capita, current US$	8769
International poverty rate ($1.9)[a]	0.0
Lower middle-income poverty rate ($3.2)[a]	0.3
Upper middle-income poverty rate ($5.5)[a]	2.7
Gini coefficient[a]	37.7
School enrollment, primary (% gross)[b]	98.6
Life expectancy at birth, years[b]	70.7

WDI, MPO, Rosstat, and Bank of Russia.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2014)

Supported by higher oil prices and macro stabilization, the Russian economy returned to modest growth in 2017. Moderate poverty increased in 2016 on the back of a decline in real incomes and a fall in social benefits in real terms. The medium-term growth forecast for Russia has been slightly increased following a somewhat stronger than expected recovery of domestic demand and higher exports. Nevertheless, structural reforms will be required to raise the country's long-term growth trajectory.

Recent developments

Spurred on by higher oil prices and macro stabilization, the Russian economy returned to growth in 2017, albeit at a modest pace. Domestic demand rebounded, expanding by 1.7 percent in the first quarter of 2017 after a contraction of 12.2 percent in 2014-2016 caused by a drastic terms-of-trade shock and economic sanctions. Supported by growth in real wages, the ruble's appreciation, and improving consumer credit, consumer demand became the main driver of this growth. Fixed capital investment also expanded, especially in the second quarter of 2017, supported by public investment—both direct and of large state companies in the energy sector. Tradable sectors and accompanying non-tradable sectors, such as transportation, led GDP growth in the first quarter of 2017. A rebound in wholesale trade, real estate and construction positively contributed to GDP growth from the second quarter of 2017.

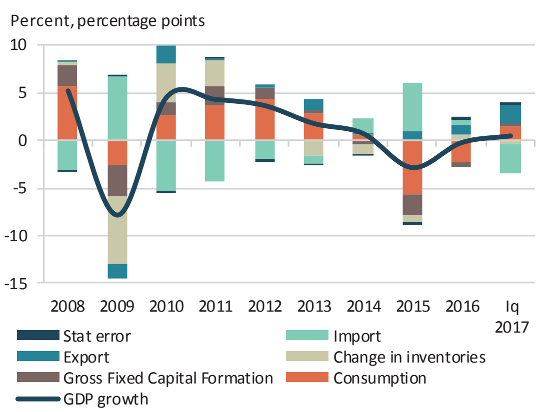
Monetary policy remained prudent and consistent with the inflation targeting framework. In August 2017, the CPI inflation undershot the end-year target, reaching 3.3 percent y/y. Inflation expectations remained elevated, but they were on a downward trend. On September 15, the Central Bank lowered the key rate from 9 to 8.5 percent. The key rate has been reduced by 350 bp since the year beginning.

The banking sector's performance improved with the economic recovery; preserving its stability remains key. Corporate lending growth experienced a low single digit increase, while retail lending accelerated slightly faster. Key credit risk and performance indicators remained stable, while the banks' profitability continued to increase in the first half of 2017. Preserving the stability of the banking system will be key given recent failures of the largest private bank, Otkritie, and B&N Bank. Although there should be no direct implications on the budget, resolving these failures will be the first test of the new resolution mechanism whereby funds from the Central Bank's Banking Sector Consolidation Fund will be injected as additional capital into these banks.

Improved terms of trade supported the current account, despite the significant growth in imports that accompanied a stronger ruble and a recovering economy. The current account increased from US$13.9 billion in the first half of 2016 to US$23 billion in the first half of 2017. The improved trade balance more than compensated for the deterioration of the balance of services and factor-income accounts. The higher current account was mirrored by increased net capital outflows.

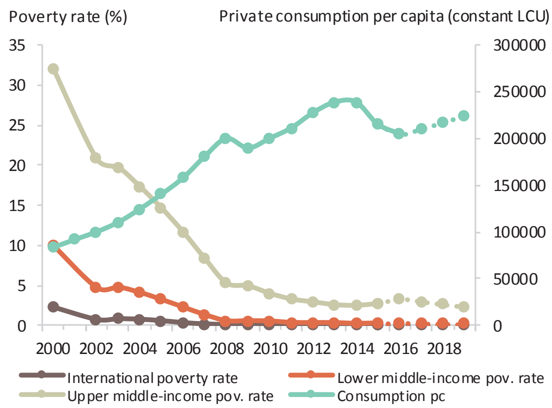
In a context of continued relatively low oil prices, the Russian Government adhered to a path of fiscal consolidation. Amendments to the federal budget law of 2017 reduced the primary non-oil/gas fiscal balance target from -8.4 percent of GDP in 2016 to -7.6 percent of GDP in 2017. In the first half of 2017, the general government's non-oil/gas primary balance improved to -4.7 percent of GDP (from -6.0 percent of

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



Sources: World Bank. Notes: See table 2.

GDP in the same period last year), on the back of lower expenditures and higher non-oil/gas revenues.

Increased geopolitical tensions led to an expansion of U.S. sanctions against Russia, which now cannot be removed without U.S. congressional approval. The U.S. also tightened sanctions targeting Russia's energy, financial, defense, and intelligence sectors. While the expansion of sanctions exerted some depreciation pressure on the ruble, it had a limited effect on the Russian stock market.

Unemployment declined slightly in the first half of 2017, while low inflation allowed real wages to increase. However, real disposable income growth remained negative, driven by contractions in other income sources, including pensions.

The poverty rate in Russia, under its national definition, increased marginally in 2016 to 13.5 percent, compared to 13.3 percent in 2015, and it increased in most regions (53). The international moderate-poverty rate in Russia reached 2.7 percent in 2015 and is estimated to rise to 3.3 percent in 2016 because of a decline in real wages, high inflation, and a fall in social benefits in real terms. The extreme-poverty rate, however, remains marginal, below one percent.

Outlook

The government plans to stay the course on fiscal consolidation. A new fiscal rule will fully come into effect in 2019. In 2018, transitional provisions will be applied. Primary expenditures would not exceed oil and gas revenues at a threshold oil price of US$40 per barrel (in real terms, based on 2017 prices) and projected non-oil revenues. Oil and gas revenues from the oil price exceeding the threshold will be saved in the National Welfare Fund, which would be merged with the Reserve Fund. The rule would smoothen the impact of oil price volatility on the real exchange rate, the budget system, and domestic demand.

In an environment of firming global activity, we expect Russia's economy to grow at a modest pace of 1.7 percent in 2017 and 2018, and 1.8 percent in 2019. Moderately strengthening oil prices are expected to support the recovery in domestic demand. We expect consumer demand and export to be the main engines for GDP growth in 2017, with significant support from investment demand.

Low Total Factor Productivity (TFP) growth and a declining labor force limit the GDP's growth rate in the medium term. Easing this constraint will require deepening and accelerating structural reforms. Priority policy objectives include reducing the role of the state in the economy, protecting property rights, improving the institutional and regulatory frameworks, and promoting fair competition.

The moderate poverty rate is expected to decline in 2017, but will remain elevated through 2018. With constrained public spending, labor income will become the most important driver for increasing incomes for the bottom 40 percent. Some rebound in the real sector, including wage growth in the private sector together with pension indexation to the inflation level, will support disposable incomes and help the poverty rate gradually decline, albeit remaining above the pre-crisis level.

Risks and challenges

This outlook is subject to both downside and upside risks. The upside risk comes from the high-growth momentum of the second quarter rolling over to the second half of the year. Downside risks stem from low oil prices and possible negative impact from the expansion of sanctions.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	0.7	-2.8	-0.2	1.7	1.7	1.8
Private Consumption	1.9	-9.7	-4.5	2.4	2.5	2.7
Government Consumption	-2.1	-3.1	-0.5	-0.1	-0.1	-0.4
Gross Fixed Capital Investment	-1.8	-9.9	-1.8	3.5	2.8	2.8
Exports, Goods and Services	0.5	3.7	3.1	4.0	2.5	2.5
Imports, Goods and Services	-7.3	-25.8	-3.8	10.0	5.5	5.0
Real GDP growth, at constant factor prices	0.9	-2.3	-0.3	1.6	1.7	1.7
Agriculture	1.5	2.9	3.3	1.2	1.7	1.7
Industry	0.2	-2.4	-0.1	1.9	2.0	2.1
Services	1.2	-2.5	-0.5	1.5	1.6	1.6
Inflation (Consumer Price Index)	7.8	15.5	7.1	4.0	4.0	4.0
Current Account Balance (% of GDP)	2.8	5.0	2.0	1.8	1.8	2.2
Financial and Capital Account (% of GDP)	-8.3	-5.1	-1.0	-1.8	-1.8	-2.2
Net Foreign Direct Investment (% of GDP)	-1.7	-1.1	0.8	0.1	0.0	0.0
Fiscal Balance (% of GDP)[a]	-1.1	-3.4	-3.7	-1.9	-1.0	-0.4
Debt (% of GDP)	15.6	15.9	15.6	15.2	15.0	15.1
Primary Balance (% of GDP)[a]	-0.4	-2.6	-2.8	-1.1	-0.3	0.4
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]	0.2	0.3	0.3	0.3	0.3	0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[b,c]	2.4	2.7	3.3	3.0	2.6	2.3

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
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: 2014, 2015. Nowcast: 2016 - 2016. Forecast are from 2017 to 2019.
(c) Projection using neutral distribution (2015) with pass-through = 1 based on private consumption per capita in constant LCU.

SERBIA

Table 1	2016
Population, million	7.1
GDP, current US$ billion	38.2
GDP per capita, current US$	5405
International poverty rate ($1.9)[a]	6.3
Lower middle-income poverty rate ($3.2)[a]	11.2
Upper middle-income poverty rate ($5.5)[a]	24.1
Gini coefficient[a]	39.7
School enrollment, primary (% gross)[b]	101.1
Life expectancy at birth, years[b]	75.3

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

Growth is slowing down in 2017, mainly due to unfavorable weather conditions (severe winter and a long drought) and slowdown in investment. Thanks to the continued fiscal adjustment, Serbia is now running a significant fiscal surplus. Poverty (living on income under $5.5/day, PPP) is estimated to have declined from 24.1 percent in 2014 to 23.4 percent in 2016. Going forward, growth is expected to reach 3-4 percent, although risks remain, especially from policy reversals related to previous fiscal stability program.

Recent developments

While the Serbian economy benefited from a broad-based growth of 2.8 percent in 2016, economic growth slowed substantially in the first half of 2017. Severe and long winter impacted the energy and construction sectors, while the recent drought led to a major decline in agriculture output (which could be as much as 15 percent lower than in 2016). The harsh winter and delays in public capital budget implementation led to a major decrease in investment (both private and public) and their contribution to growth in the first half of 2017. In addition, imports started to increase rapidly, thus dragging down GDP growth.

Real sector developments reflected on labor market performance, with unemployment edging up only slightly in the first half of 2017, compared to the end 2016, to reach 13.2 percent. Average salaries in the first half of 2017 increased by 4.4 percent in nominal terms compared to the same period last year, mainly driven by growth of wages in the private sector. Average pension is 1.5 percent higher than in the same period of 2016.

Since employment and labor income play a strong role in influencing welfare of the poor and vulnerable, poverty (measured as income below the standardized middle-income-country poverty line of $5.5/day in 2011PPP terms) is estimated to have declined from 24.1 percent in 2014, to 23.4 percent in 2016, to 22.8 percent in 2017. The partial increase of salaries and public sector pensions helped household budgets to recover some of the losses from previous fiscal consolidation measures. The energy bill discount program for vulnerable populations was expanded in 2017 to mitigate the impact of increases in electricity tariffs, as part of fiscal reforms. However, a decline in agriculture output in 2017 is likely to have adverse impacts on rural poverty and slow the pace of poverty reduction overall.

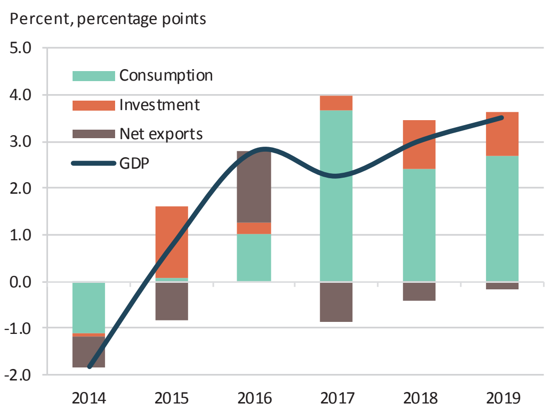
Fiscal consolidation efforts have resulted in a surplus of about 1 percent of GDP in the first half of 2017. Public debt declined to around 68 percent of GDP by June, compared to 74 percent at the end of 2016. Part of the reason for improved budget performance lies in under-execution of the capital budget, which however is having a negative impact on growth.

Inflation increased in the first half of 2017, to reach 3.4 percent y/y. Food prices also went up (by 3.3 percent), affecting the poor disproportionately.

The current account deficit (CAD) shot up by 48 percent (in euro terms) in the first half of 2017 y/y. This resulted from a widening trade deficit, as import increased significantly (13 percent, y/y), because of a higher import of energy and consumer goods. The growing external deficit continued to be financed by FDI, which increased by 7.6 percent in euro terms. FDI covers 97 percent of CAD.

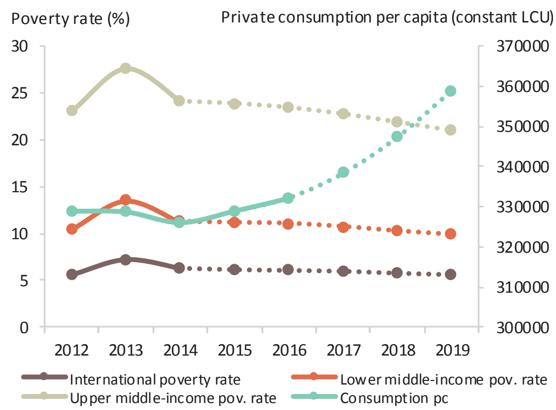
The dinar strengthened slightly (3.3 percent) against the euro through August, while foreign currency reserves decreased by about EUR 260 million through July. The banking sector remains stable and loans to the private sector increased by 1 percent by end-July (y/y), while NPLs

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



Sources: WB staff calculations based on Statistical Office data.

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



Sources: World Bank. Notes: see table 2.

declined to 15.6 percent due to more active role of banks in selling and writing off NPLs.

Outlook

Over the medium term, growth is expected to pick up, thus helping with labor market recovery and poverty reduction. Growth is expected to be driven by increased investment, stimulated by reforms to improve the business climate, and the recovery of consumption (as the fiscal consolidation program gradually expires). Growth is expected to be around 3-4 percent over the medium term.

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 continue declining to around 21 percent by 2019. As part of the government's fiscal consolidation program, another nominal electricity tariff increase in 2017 is expected in the autumn, though smaller than previous increases. The recently expanded energy bill discount program can help protect vulnerable customers, but implementation challenges related to processing of claims remain.

Risks and challenges

While recognizing the positive fiscal consolidation progress since 2015, sustainability of public finances over the medium term and faster growth require further effort toward implementation of structural reforms: in secondary and tertiary education; health financing; privatization of remaining state stakes in SOEs and financial institutions. Also, special attention needs to paid to expanding external imbalances.

The potential distributional impacts of these important structural reforms may present continued challenges to faster poverty reduction in the short run. Despite recent improvements, labor force participation and employment ratios are still low while unemployment is high, especially for the young. Therefore, policy design needs to consider appropriate social assistance and facilitate access to employment.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	-1.8	0.8	2.8	2.3	3.0	3.5
Private Consumption	-1.3	0.5	0.8	3.9	2.2	2.9
Government Consumption	-0.6	-1.5	2.0	5.2	1.6	-3.9
Gross Fixed Capital Investment	-3.6	5.6	6.8	4.6	7.3	10.4
Exports, Goods and Services	5.7	10.2	11.9	9.8	6.5	7.5
Imports, Goods and Services	5.6	9.3	6.8	9.3	5.9	6.4
Real GDP growth, at constant factor prices	-2.0	0.7	3.4	1.7	3.0	3.5
Agriculture	2.0	-7.7	8.5	-10.0	5.0	3.0
Industry	-6.4	3.0	3.1	4.5	4.0	5.0
Services	-0.5	1.1	2.8	2.3	2.3	2.9
Inflation (Consumer Price Index)	2.1	1.4	1.1	3.1	3.5	3.5
Current Account Balance (% of GDP)	-6.0	-4.8	-3.2	-3.9	-4.7	-4.9
Financial and Capital Account (% of GDP)	5.1	3.9	2.4	3.5	3.9	4.1
Net Foreign Direct Investment (% of GDP)	3.7	3.7	3.7	4.8	4.3	4.2
Fiscal Balance (% of GDP)	-6.6	-3.7	-1.3	-1.0	-0.8	-0.7
Debt (% of GDP)	70.4	75.5	73.1	70.5	67.4	64.0
Primary Balance (% of GDP)	-3.6	-0.4	2.2	2.4	3.3	2.7
International poverty rate ($1.9 in 2011 PPP)[a,b]	6.3	6.1	6.1	6.0	5.8	5.7
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	11.2	11.1	11.0	10.7	10.2	9.9
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	24.1	23.9	23.5	22.8	21.9	21.0

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: f = forecast.
(a) Calculations based on EUSILC harmonization, using 2014-EU-SILC. Actual data: 2014. Nowcast: 2015 - 2016. Forecast are from 2017 to 2019.
(b) Projection using neutral distribution (2014) with pass-through = 1 based on private consumption per capita in constant LCU.

TAJIKISTAN

Table 1	2016
Population, million	8.7
GDP, current US$ billion	7.0
GDP per capita, current US$	796
Poverty rate (LCU 175.205/month)[a]	30.3
Gini coefficient[a]	27.1
School enrollment, primary (% gross)[b]	97.3
Life expectancy at birth, years[b]	69.6

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

Tajikistan's economic growth in the first half of 2017 was supported by recovering private consumption and exports, which offset a sharp fall in investment. Protracted uncertainties in the external environment and growing domestic vulnerabilities are weighing on growth prospects. Much needed structural reforms in the financial sector, SOE governance and business climate may facilitate economic growth in the medium term. The outlook on poverty reduction remains positive and anticipated to benefit from economy-wide growth and gradual recovery in remittances.

Recent developments

Real GDP growth slightly decelerated from 6.6 percent in the first half of 2016 to 6.0 percent in 2017, per official statistics. Growth was led by the strong performance in net exports and the incipient pickup in private consumption, supported by recovering remittances. On the supply side, growth was driven by industry – particularly non-energy extractives and services. While agriculture contributed modestly, construction dragged down growth due to a sharp contraction in public and foreign investments, part of which reflects the base effect from the last year.

The financial sector remains depressed, with the system-wide NPL ratio exceeding 50 percent in mid-2017. Credit to the private sector has been contracting since the second half of 2016; the recapitalization of the two largest banks in December 2016 has not reversed this trend. The recently conducted Asset Quality Reviews revealed significant under-capitalization of the several largest banks. While positive steps were made to stabilize the financial system, needed legislative amendments and institutional changes for banking resolution are still pending.

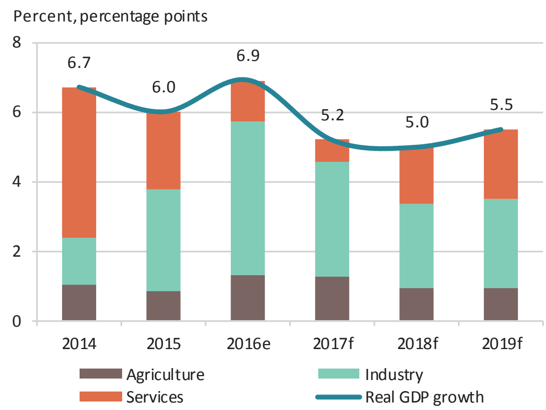
The fiscal position was balanced in the first half of 2017, as the authorities trimmed non-priority government spending against the backdrop of sluggish revenue performance. Tax revenue suffered from a sharp contraction of imports, which was partially offset by non-tax revenues reflecting increased penalty charges for tax incompliance. Public outlays in the first half of 2017 were 10 percent lower than budgeted, while large infrastructure and social-oriented projects were financed in full. In September, the government issued a US$500 million Eurobond to finance the construction of the Roghun hydropower project (HPP), which is expected to push up public and publicly-guaranteed debt to above 50 percent of GDP by end-2017.

The somoni depreciated by 11 percent against the U.S. dollar during the first half of 2017, owing to the monetization of the banking sector bailout, and leading to an improvement in the country's current account. The latter was near-balanced in the first quarter of 2017 driven by a sharp contraction of imports, recovery of exports, and a pick-up in remittance inflows. The large decline in imports reflected primarily the reduced demand for capital goods and construction materials, whereas the export recovery was led by minerals and a general recovery in the demand for Tajik exports by its key trading partners, particularly Russia. By June 2017, official reserves increased to over 3 months of imports.

Inflation rose to 7.4 percent y/y in June 2017, compared to 5.7 percent a year earlier, driven by the somoni depreciation and a supply-side shock on certain domestic agriculture products. To curb inflationary pressures, the central bank tightened monetary policy further, sterilizing excess liquidity in the market and raising the policy rate from 12.5 percent in January 2017 to 16 percent in March.

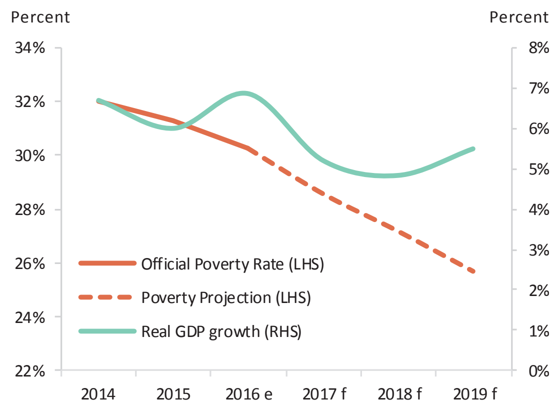
The official poverty rate fell slightly from 31.3 percent in 2015 to 30.3 in 2016, while

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



Sources: TajStat, World Bank staff estimates.

FIGURE 2 Tajikistan / Official poverty rate and real GDP growth, actual and projected, 2014-19



Sources: World Bank staff estimates.

extreme poverty fell from 15.1 percent to 14 percent over the same period. Income from employment remains the primary driver of poverty reduction, however lower remittances continued to slow the pace of poverty reduction in 2016. The trends for urban and rural poverty diverged in 2016. Although poverty fell from 35.3 percent to 33.5 percent in rural areas, it was relatively stagnant in urban areas at around 24 percent. The rising cost of food is expected to negatively affect households that are net-buyers, while benefiting net sellers. Food expenditure accounts for about 75 percent of total consumption for poor households, and the Listening-to-Tajikistan survey identified a large increase in the share of households reducing food consumption to pay for other basic needs - on average from about 40 percent to 62 percent through January-May 2017.

Outlook

The economy is projected to grow by an average rate of 5.2 percent a year over the medium term, supported mainly by the sustained high rates of the industrial output expansion, construction of the Roghun HPP and the resulting increase in electricity production from late 2018 onwards. It is expected that—in line with recovering remittances—private consumption will continue its positive contribution though unlikely to boost growth significantly because of uncertain prospects of the Russian economy.

Medium-term fiscal policy is expected to be contractionary to help bring public debt on a sustainable path. However, in 2017 the deficit is projected to remain high at about 5 percent of GDP, driven by the construction of the Roghun plant and the second-round bank recapitalization in the latter half of the year. However, it is still a significant adjustment compared with the fiscal deficit exceeding 10 percent of GDP registered in 2016.

The poverty rate is expected to fall in line with the projected growth, gradual increase in employment earnings, recovering remittances and expansion of the Targeted Social Assistance (TSA) program envisaged by the Law on Social Assistance. The nationwide poverty rate is projected to fall from 30.3 percent in 2016 to 25.7 percent by 2019.

Risks and challenges

Risks are tilted to the downside due to external and domestic factors. The expected modest performance of the regional economies, and a drop in commodity prices may negatively affect inward remittances and export proceeds.

Poor governance in the financial sector, in state-owned-enterprises and in tax climate remain serious challenges, while limited fiscal space due to the country's high level of debt distress and low domestic and external buffers create vulnerability to potential shocks. Upside risks include higher energy export potential of Tajikistan to be materialized after installation of the Roghun HPP's two generators in 2018-19.

Any lower-than-expected recovery in regional economies or delays in the expansion of the targeted social assistance program could derail expected poverty reduction. Continued challenges in the financial sector would also diminish poverty reduction pace through lower access to credit in pro-poor sectors of the economy and slow the pace of job creation in low-skill sectors, such as construction and agriculture.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	6.7	6.0	6.9	5.2	5.0	5.5
Private Consumption	1.8	-12.3	-4.1	2.4	2.9	3.5
Government Consumption	4.1	3.3	2.4	-8.8	3.2	4.7
Gross Fixed Capital Investment	20.0	24.4	21.2	-2.1	3.8	4.6
Exports, Goods and Services	0.0	0.0	7.7	10.2	7.5	7.8
Imports, Goods and Services	1.1	0.0	-15.0	5.0	5.2	5.6
Real GDP growth, at constant factor prices	5.0	5.4	6.6	5.2	5.0	5.5
Agriculture	4.5	3.2	5.2	5.0	5.1	5.3
Industry	5.1	11.2	16.0	10.7	11.0	11.2
Services	5.3	3.8	2.4	2.1	1.1	1.7
Inflation (Consumer Price Index)	6.1	5.8	5.9	9.0	8.5	7.0
Current Account Balance (% of GDP)	-2.8	-6.4	-3.8	-3.1	-4.4	-5.1
Financial and Capital Account (% of GDP)	5.5	7.9	8.1	7.1	8.4	9.0
Net Foreign Direct Investment (% of GDP)	3.4	5.4	5.0	3.2	3.2	3.4
Fiscal Balance (% of GDP)	0.0	-1.9	-10.1	-4.7	-4.0	-3.2
Debt (% of GDP)	27.9	34.0	41.4	50.7	52.7	53.4
Primary Balance (% of GDP)	0.4	-1.3	-9.6	-3.0	-2.1	-1.4
Poverty rate (LCU 175.205/month terms)[a,b]	32.0	31.3	30.3	28.6	27.2	25.6

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.
(a) Calculations based on 2016 HBS. Actual data: 2014, 2015, 2016. Forecast are from 2017 to 2019
(b) Projection using neutral distribution (2016) with pass-through = (0.7) based on GDP per capita constant PPP.

TURKEY

Table 1	2016
Population, million	79.3
GDP, current US$ billion	863.4
GDP per capita, current US$	10891
International poverty rate ($1.9)[a]	0.3
Upper middle-income poverty rate ($5.5)[a]	10.5
Gini coefficient[a]	41.2
Life expectancy at birth, years[c]	75.4

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2014), 2011 PPPs.
(b) Most recent WDI value (2014)
(c) Most recent WDI value (2015)

Turkey's growth reached 5.1 percent in the first half of 2017, supported by a substantial fiscal stimulus. Expansionary fiscal policy led to worsening of fiscal balances. The depreciation of the Lira and higher prices for energy and food pushed headline inflation to well above the Central Bank target. Poverty reduction has continued but at a slower pace, driven by a labor market that is losing steam. In the medium-term, provided structural reforms regain momentum as domestic uncertainties abate, private investment is expected to gradually pick up and reinvigorate the labor market for sustainable poverty reduction.

Recent developments

From a moderate 3.2 percent growth in 2016, GDP grew by 5.1 percent y-o-y in the first half of 2017, well above expectations supported by a substantial fiscal stimulus, private consumption and net exports. Real exports of goods and services surged thanks to stronger demand in the EU and the depreciation of the Lira. While construction investment made a large contribution to growth, machinery and equipment investment was tepid despite a sharp acceleration of credit growth supported by the Credit Guarantee Fund, indicating that corporates are still cautious.

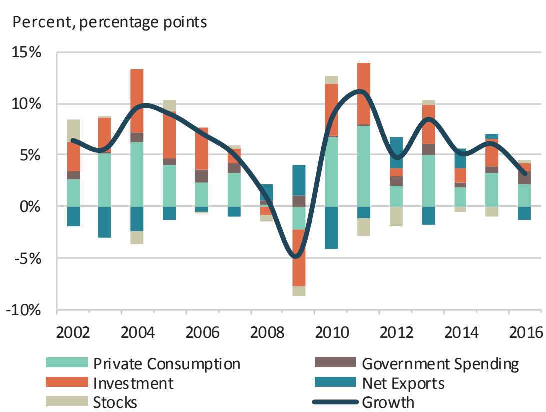
In the first half of 2017, the 12-month current account deficit widened to $34.3 billion from $29.3 billion a year earlier, mainly due to a surge in gold imports and the rebound in oil prices. Tourism receipts are still lower than a year earlier as per capita expenditures of tourists declined, despite increased number of tourists. Financial inflows improved in Q2 due to better global economic prospects, increased global risk appetite and reduced domestic uncertainties.

The foreign-exchange pass-through from the large Lira depreciation and higher prices for energy and food pushed headline inflation to 10.7 percent by August in 2017. The Lira depreciation and the rise in inflation prompted the Central Bank to increase interest rates in an unorthodox manner in 2017. Since early January, the Central Bank increased the late liquidity lending rate and the overnight lending rate by 225 bps and 75 bps, respectively, leading to a 370 bps increase in the average cost of funding. Amid portfolio inflows together with the Central Bank's tightening steps, the Lira appreciated by 10.2 percent as of the end-August to 3.44 vis-à-vis the USD compared to end-January. Due to the large fiscal stimulus, fiscal balances have deteriorated to a deficit of TL25.2 billion in the first half of 2017 from a surplus of TL1.1 billion a year earlier. The 12-month primary balance recorded a deficit in June for the first time in the last decade.

Poverty continues to decrease, but at a slower pace than before the 2009 global crisis. The population with per capita expenditure below the poverty line ($5.5 a day in 2011 PPP) fell to a low of 10.5 percent from 27.3 percent a decade earlier. The availability of more and better paid jobs has been the driving force behind poverty reduction, with social transfers playing a relatively minor supporting role.

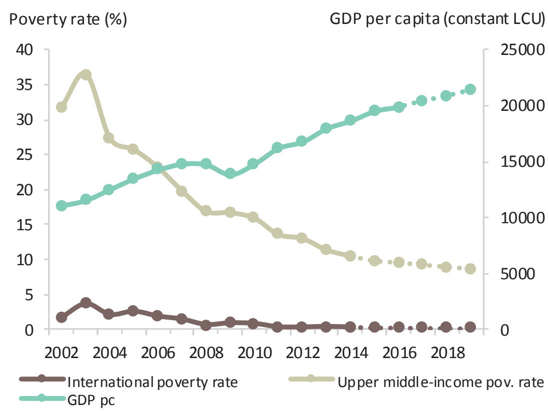
The labor market, however, is losing strength. Unemployment has been on the rise, reaching 10.2 percent of the labor force in May 2017, almost 1 percentage point higher than a year earlier. Moreover, the jobless rate among the youth (ages 15 to 24) reached 19.8 percent, almost 2.5 percentage points higher than in May 2016. On the one hand, female labor force participation is increasing, an indicator where Turkey is particularly lagging relative to peer countries. But female unemployment is also on the rise, as it is increasingly hard for women to find jobs.

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



Sources: Turkstat and World Bank staff calculation.

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



Sources: World Bank (see notes to Table 2).

Outlook

Growth is expected to rebound to 4 percent in 2017 from 3.2 percent in 2016 and may be slightly higher given strong performance in Q2. Temporary fiscal stimulus together with credit facilitation are expected to support private and public consumption in 2017. The fiscal deficit is expected to widen to 2.1 percent of GDP and the primary budget balance to be slightly negative. Exports are likely to grow in 2017 fueled by rising external demand and an increase in competitiveness. While rebounding domestic demand will stimulate import growth, net exports are still expected to contribute substantially to GDP growth in 2017. Private investment is likely to remain weak in 2017 as business confidence recovers slowly. The current account deficit is expected to increase to 4.7 percent of GDP in 2017 due to a rising energy and gold deficit. Inflation is likely to remain above target. With the unwinding of the fiscal stimulus, GDP growth is expected to slow to 3.5 percent in 2018, before picking up to 4 percent in 2019 as the economic outlook improves and political uncertainty eases. Provided structural reforms continue to be implemented and investor confidence resumes, private investment is expected to gradually pick up in the medium-term.

Poverty is forecast to decrease at a slower pace, as the labor market environment remains constrained. The poverty rate is estimated to decline to 9.3 percent in 2017 and further to 8.9 percent in 2018. This forecast could improve if the structural reform agenda regains momentum and higher productivity jobs are created. For people with lower skills, there are increasing policy efforts to connect them to activation programs that will pay off if the labor market picks up.

Risks and challenges

Unless longstanding structural weaknesses are addressed, over the medium-term Turkey will face the risk of slower growth, below the impressive performance over the last decade. The quality of growth has weakened in the past few years, as productivity growth has stagnated and investment spending was mostly driven by construction. Domestic saving rates consistently below investment sustain Turkey's high dependence on external financing. The corporate sector's sizeable open foreign exchange positions with its substantial rollover needs leaves Turkey vulnerable to changes in investor sentiment and external conditions. In an adverse scenario of tighter global liquidity, a new round of lira depreciation would put severe strains on corporate balance sheets, depressing private investment and lowering GDP growth. Tighter global liquidity conditions might constrain domestic credit growth and domestic demand in the medium term. Rigorous progress in advancing structural reforms will be key to restoring investor confidence, mitigating vulnerabilities, and supporting growth.

The government's employment mobilization campaign started in February 2017 aims to create 2 million new jobs to contain the rise in joblessness. The campaign includes a subsidy to employers on salaries of new formal hires for 12 months. From a sustainability perspective, there is a risk that the new jobs will disappear after the subsidy is withdrawn. From an equity perspective, since most formal jobs go to the non-poor, the effects of the campaign will disproportionately benefit higher income households. The main challenge will be how to promote a more inclusive mix of beneficiaries and improve the distributive impacts of the campaign.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	5.2	6.1	3.2	4.0	3.5	4.0
Private Consumption	3.0	5.4	3.7	5.0	3.1	3.6
Government Consumption	3.1	3.9	9.5	8.9	2.2	3.7
Gross Fixed Capital Investment	5.1	9.3	2.2	2.9	3.6	4.0
Exports, Goods and Services	8.2	4.3	-1.9	6.0	5.6	5.4
Imports, Goods and Services	-0.4	1.7	3.7	4.3	4.3	4.7
Real GDP growth, at constant factor prices	5.6	5.6	3.1	4.0	3.5	4.0
Agriculture	0.6	9.4	-2.6	3.0	1.9	1.9
Industry	5.5	5.0	4.6	4.5	3.5	3.7
Services	6.3	5.5	3.1	3.9	3.7	4.4
Inflation (Consumer Price Index)	8.9	7.7	7.8	10.1	8.6	7.9
Current Account Balance (% of GDP)	-4.7	-3.7	-3.8	-4.7	-4.5	-4.6
Financial and Capital Account (% of GDP)	4.4	2.5	2.5	4.7	4.5	4.6
Net Foreign Direct Investment (% of GDP)	0.6	1.4	1.1	1.1	1.2	1.3
Fiscal Balance (% of GDP)	-0.5	-0.1	-1.5	-2.1	-1.6	-1.3
Debt (% of GDP)	31.0	30.0	30.3	30.0	29.4	27.9
Primary Balance (% of GDP)	2.0	2.2	0.5	-0.1	0.5	0.9
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.3	0.2	0.2	0.2	0.2	0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	10.5	9.8	9.6	9.2	8.9	8.6

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2008-HICES and 2014-HICES. Actual data: 2014. Nowcast: 2015 - 2016. Forecast are from 2017 to 2019.
(b) Projection using point-to-point elasticity (2008-2014) with pass-through = 1 based on GDP per capita in constant LCU.

TURKMENISTAN

Table 1	2016
Population, million[a]	5.7
GDP, current US$ billion[b]	36.2
GDP per capita, current US$[b]	6389
School enrollment, primary (% gross)[c]	89.4
Life Expectancy at birth, years [c]	67.5

Sources: UNPD, Macro Poverty Outlook, and WDI.
Notes:
(a) UNPD staff estimates (2016)
(b) World Bank staff estimates (2016)
(c) Most recent WDI value (2014)

Turkmenistan's stable economic performance continued in 2017. The real GDP growth rate increased, the external and fiscal gaps narrowed, while the inflation rate remained moderate. Limited data on social indicators do not allow to perform an impact assessment on welfare. Medium-term growth will continue, supported by higher gas exports to China and import -substitution policies in the non-hydrocarbon sector. Deeper and broader structural reforms are prerequisites for enhancing the country's growth prospects and making the economy more sustainable and inclusive.

Recent developments

Official statistics suggest that Turkmenistan's economy continued growing in 2017. The real GDP growth rate increased by an estimated 6.4 percent year-on-year (YoY) during the first eight months of 2017, compared to 6.2 percent during the same period in 2016. Higher exports of natural gas to China and more favorable terms of trade—as natural gas prices increased by more than 20 percent YoY—were the main growth drivers.

The headline inflation rate accelerated to 3.6 percent between January and June 2017, compared to 0.4 percent during the same period in 2016. Expansionary credit policy and an increase in public sector salaries and pensions (by 10 percent since January 2017) contributed to the higher inflation rate.

In the first eight months of 2017, consumption growth was supported by higher government transfers that drove retail trade up by 17.6 percent YoY, and the transport and communication sectors grew by 10.9 percent YoY. On the other hand, cuts in public investments and lower inflows of foreign direct investment led to only moderate growth in the construction sector of 3.1 percent YoY during the first eight months of 2017.

The external position improved in 2017 due to terms-of-trade gains, solid natural-gas demand from China (while gas exports to Russia and Iran stalled), and a contraction in imports. Cuts in public investment, foreign-exchange controls, and tightened import regulations led to a 25 percent decline in merchandise imports and a significantly improved trade balance, narrowing the current account deficit considerably.

The improved external position allowed the central bank to maintain the exchange-rate peg at 3.5 Turkmen manat per US dollar without significant drawdowns of official reserves. Progressively tightened restrictions on foreign-exchange trade remain in place.

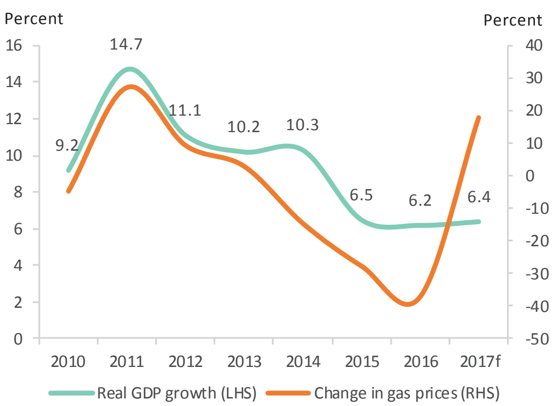
The government continued adjusting its fiscal policy to low hydrocarbon prices. Higher revenue transfers from off-budget funds and lower capital outlays helped narrow the fiscal gap in 2017 despite a large increase in public sector wages and pensions.

Turkmenistan does not release official statistics on living standards, and little is known about its labor market. Data constraints prevent a thorough analysis of the social impact of slower economic growth.

Outlook

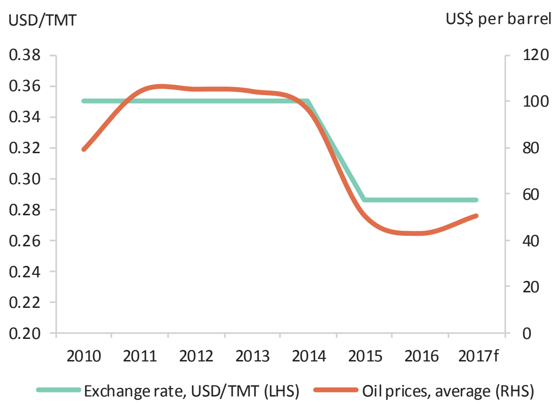
The economic outlook of Turkmenistan will depend largely on the price and external demand of natural gas, although industrial policy (import substitution and non-hydrocarbon export promotion) is expected to gradually help promote nonhydrocarbon activity. Over the medium term, the country's growth rate is projected to hover below 7 percent a year—much lower than the double-digit growth observed in the previous peri-

FIGURE 1 Turkmenistan / Real GDP growth and gas prices



Sources: State Statistics Committee of Turkmenistan.

FIGURE 2 Turkmenistan / Exchange rate and oil prices



Sources: Central Bank of Turkmenistan.

od—despite the continued expansion of gas exports to China.

The external position will continue to improve thanks to higher hydrocarbon exports. The current account deficit is expected to be financed by inflows of foreign direct investment and other capital inflows, allowing the central bank to protect its official reserves and maintain the exchange-rate peg. Fiscal consolidation is expected to continue, which should strengthen fiscal and debt sustainability.

Risks and challenges

Turkmenistan's outlook is subject to both external and domestic downside risks. External risks include lower global hydrocarbon prices or reduced demand for the country's natural-gas exports, either of which could be caused by a sharper-than-expected slowdown in the Chinese economy. A deteriorating external environment could affect hydrocarbon exports and widen the external and fiscal gaps, increasing pressure on the exchange rate and depressing domestic demand. Domestic risks include slowing momentum on the structural reform agenda as well as a reversal of the ongoing efforts to promote economic diversification and private sector development.

Tight administrative control span to social and economic areas and the public sector's large overall role in economic activity remain the key obstacles to private sector development in Turkmenistan. The public sector and state-owned monopolies continue to dominate the economy and the formal labor market. Foreign direct investment remains limited outside the hydrocarbon sector. Deeper structural reforms and improvements in the investment climate could help to attract investors in the non-hydrocarbon sectors and leverage the broader potential of Turkmenistan's economy.

The long-term sustainable and inclusive development of Turkmenistan will depend on successful outcomes of the government's ongoing diversification efforts aimed at expanding private sector activity. The country may greatly benefit from transforming its natural non-renewable resources into a well-balanced portfolio of high-yield financial assets, high-quality productive infrastructure, and high-skilled human capital.

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

	2014	2015	2016 e	2017 f	2018 f
Real GDP growth, at constant market prices	10.3	6.5	6.2	6.4	6.3
Prices: Inflation	6.0	7.4	3.6	6.0	6.2
Current Account Balance (% of GDP)	-6.4	-14.1	-21.0	-8.0	-7.9
of which: Exports of Oil and Gas (% of GDP)	42.0	29.9	18.9	20.7	20.0
Financial and Capital Account (% of GDP)	7.0	5.2	9.8	7.4	8.7
of which: Net Foreign Direct Investment (% of GDP)	8.8	8.6	6.1	5.8	5.6
State Budget Balance (% of GDP)	0.9	-0.7	-1.3	-0.5	-0.9
Public Sector External Debt (% of GDP)	18.0	19.4	23.9	24.3	27.6

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice; International Monetary Fund.
Notes: e = estimate; f = forecast.

UKRAINE

Table 1	2016
Population, million	44.9
GDP, current US$ billion	94.2
GDP per capita, current US$	2097
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]	7.8
Gini coefficient[a]	25.5
School enrollment, primary (% gross)[b]	103.9
Life expectancy at birth, years[b]	71.2

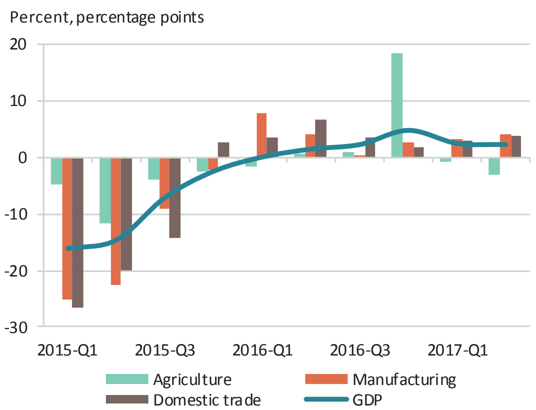
Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2014)

Ukraine's economic recovery remains modest after a cumulative 16 percent decline in recent years. In 2017 significant headwinds remain from the continuing conflict in eastern Ukraine, as well as the difficulty of accelerating reforms in a complex political environment. Growth is projected at 2 percent in 2017 and 3.5 percent in 2018. In the medium term, achieving annual growth in excess of 4 percent will require reform progress to address longstanding structural challenges.

Recent developments

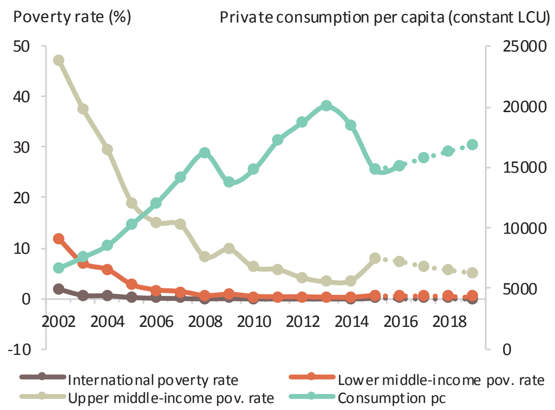
Growth remains weak due to the negative impact from the trade blockade with eastern Ukraine and structural rigidities in the public sectors. Economic growth remained modest in the first half of 2017 as real GDP grew by 2.4 percent year on year (after a 2.3 percent growth in 2016 and a 16 percent cumulative contraction in 2014-2015). Value-added growth in all key sectors—manufacturing, construction, domestic trade, and transport—remained above 3.5 percent in the first half of 2017, pointing to the gradual recovery in business activity. Fixed investment continued to grow above 20 percent, indicative of further strengthening of investor confidence. At the same time, the trade blockade with Donbas and structural rigidities in the public sectors subtracted from growth via decelerating economic activity in mining, electricity generation, health and education sectors. Unemployment and poverty remain high, despite the recovery in GDP growth. The unemployment rate increased marginally in the first quarter of 2017 over the previous year (10.1 percent vs 9.9). Real wage growth accelerated to 20 percent compared to the same period in the first half of 2017 on the back of lower inflation. This led to a decrease in poverty in 2016. After a sharp jump to 7.8 percent in 2015, moderate poverty (consumption per capita below 5.5 USD/day in 2011 PPP) is estimated to have declined to 6.9 percent in 2016. Estimates of poverty dynamics by the National Statistical Services using an absolute poverty line comparable over time show a similar decline between 2015 and 2016, but for much higher incidence levels. Fiscal and balance-of-payments vulnerabilities remain. Fiscal performance has improved in 2016 and in the first half of 2017. General government revenues grew by 16 percent in real terms in 1H2017 due to overall improvements in economic activity with all key tax revenues outperform the half-year plan by 15 percent on average. Value-added tax (VAT) and social security contributions (SSC) contributed the most to the recovery in revenues having grown by 28 and 23 percent, respectively, in real terms. Non-tax revenues also grew considerably in 1H2017 due to additional UAH29bn from recovery of stolen assets. All these additional revenues helped to have a fiscal surplus of 1.8 percent of GDP in the first half of 2017. The 2017 budget, however, was revised such that extra revenues would cover the increased expenditures, rather than reducing the planned deficit. At the same time, the public debt level continues to grow having reached 85 percent of GDP as of July 2017, due to the high cost of banks' recapitalization. Despite improvements in the terms of trade, persisting structural economic imbalances and the negative impact from the trade blockade (lower steel exports and higher coal imports) triggered a further widening of the current account deficit—to 2 percent of GDP over Jan-July 2017. FDIs remain low amounting to just 1 percent of GDP in Jan-July 2017 and the access to external finance for the private sector

FIGURE 1 Ukraine / Real GDP growth (yoy) and contributions to real GDP growth, by sector



Source: Ukraine Statistics Service.

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



Source: World Bank. Notes: see table 2.

remains very limited. The international reserves, however, continued to growth due to official borrowings and new Eurobond placement.

Outlook

The outlook for economic growth remains modest due to significant external and internal headwinds. Significant challenges remain in accelerating reforms in a complex political environment. Growth is projected at 2 percent in 2017 and 3.5 percent in 2018. Renewed reform momentum could support faster economic recovery. There are encouraging signs of a possible increase in reform momentum, including the approval in the first reading of the pension and health reform laws, advanced discussions on land reform. Accelerating reforms would boost annual growth to 4 percent in the next two years, address macroeconomic vulnerabilities, and gradually reduce poverty.

Against this background, the moderate poverty rate (under 5.5 USD/day) is expected to improve in 2017 but remain elevated through to 2019. As public spending is constrained, labor income will become the most important driver of increasing incomes for the bottom 40 percent. A modest rebound in the real sector—including wage growth in the private sector—will support growth of disposable income and a gradual decline in the poverty rate. However, the magnitude of this improvement will depend on the growth structure, especially growth in labor intensive sectors were most of the poor/vulnerable are employed (trade, manufacturing, agriculture, construction).

Risks and challenges

Addressing structural rigidities is critical for unlocking sustainable economic growth and reducing external pressures. Deeper anticorruption reforms, further deregulation and improvement of business climate, banking system stabilization and NPL resolution are critical for restoring FDI growth and improving domestic productivity. Without structural reforms to improve domestic productivity and to increase FDI Ukraine will remain vulnerable to external shocks and commodity cycles. In order to finance the growing deficit of the current account, Ukraine will require external financing. Maintaining cooperation with the IMF and other official creditors will be important to meet external financing needs and bolster investor confidence.

Medium term fiscal and external pressures are projected to remain significant. Despite the strong budget performance in 1H2017, the recent amendments to the budget law will trigger widening of the wage bill to 11.2 percent of GDP (vs 9.3 percent in 2016). Expenditures for Housing Utility Subsidy (HUS) are expected to reach 2.6 percent of GDP in 2017 (vs 1.8 percent in 2016). Fiscal risks are exacerbated by delays with realigning of the gas tariffs, SOE privatization and planned increase in wage bill. In 2017 the general government deficit (including Naftogaz) is expected to widen to 3.6 percent of GDP (vs 2.2 percent in 2016), while public and publicly guaranteed debt is projected to reach 87 percent of GDP in 2017. In order to improve fiscal sustainability and reduce the debt pressures going forward, all structural reforms should balance improving quality of services and fiscal affordability to reduce gradually the fiscal deficit to 2 percent of GDP by 2020.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	-6.6	-9.8	2.3	2.0	3.5	4.0
Private Consumption	-8.3	-20.2	1.8	2.7	3.0	4.5
Government Consumption	1.6	1.8	-0.6	2.4	1.8	1.6
Gross Fixed Capital Investment	-24.0	-8.3	21.4	10.1	6.7	3.8
Exports, Goods and Services	-14.2	-16.9	-1.6	4.8	5.0	5.0
Imports, Goods and Services	-22.1	-22.0	8.4	8.5	4.0	4.0
Real GDP growth, at constant factor prices	-6.7	-9.9	2.3	2.0	3.5	4.0
Agriculture	2.3	-4.7	5.0	-0.5	1.0	3.0
Industry	-11.6	-13.4	3.0	3.0	3.5	4.0
Services	-6.1	-9.5	1.6	2.1	4.0	4.2
Inflation (Consumer Price Index)	12.2	48.7	13.9	10.0	9.0	9.0
Current Account Balance (% of GDP)	-3.4	-0.2	-3.8	-4.1	-4.1	-3.9
Financial and Capital Account (% of GDP)	3.0	-0.2	3.4	3.7	3.8	3.6
Net Foreign Direct Investment (% of GDP)	0.2	0.2	0.2	0.2	0.2	0.2
Fiscal Balance (% of GDP)	-4.5	-1.2	-2.2	-3.3	-2.8	-2.0
Debt (% of GDP)	70.3	76.8	75.6	87.6	77.5	69.0
Primary Balance (% of GDP)	-1.2	2.9	1.7	0.4	1.6	2.0
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.0	0.1	0.0	0.0	0.0	0.0
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.1	0.5	0.5	0.5	0.5	0.4
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	3.5	7.8	7.2	6.3	5.6	5.0

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2015-HLCS. Actual data: 2014, 2015. Nowcast: 2016 - 2016. Forecast are from 2017 to 2019.
(b) Projection using neutral distribution (2015) with pass-through = 0.7 based on private consumption per capita in constant LCU.

UZBEKISTAN

Table 1	2016
Population, million	31.5
GDP, current US$ billion	63.4
GDP per capita, current US$	2009
School enrollment, primary (% gross)[a]	100.2
Life expectancy at birth, years[a]	68.3

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

Uzbekistan's economy has performed well, driven by domestic demand. The outlook is favorable, given the authorities' initial steps to ensure convertibility of the foreign exchange and the improving external environment. Going forward, the adequate implementation of the comprehensive market-oriented reform agenda announced in late 2016 will be key to sustain inclusive and robust growth.

Recent developments

GDP growth slowed to 7 percent y/y in H1 2017 from 7.8 percent in H1 2016, according to official statistics. Growth was broad-based, reflecting the 2016-20 sector support programs. On the demand side, the main driver of growth was the large public investment program for 2015-19, which supported various sectors (e.g. transport, housing, and utilities) as well as investment by the private sector and SOEs. However, real investment growth slowed to 8.3 percent y/y in H1 2017 from 11.8 percent y/y in H1 2016. Private consumption increased slightly in H1 2017 due to stable income growth, (despite the acceleration of food inflation) and a rise in remittances by 30 percent y/y in US dollar terms with the recovery of the Russian economy. Households in the bottom 40 percent of the income distribution are expected to benefit from the recovery of remittance inflows. Food inflation negatively affected net buyers, particularly among households in the bottom 40 percent for whom food accounts for 61 percent of total consumption.

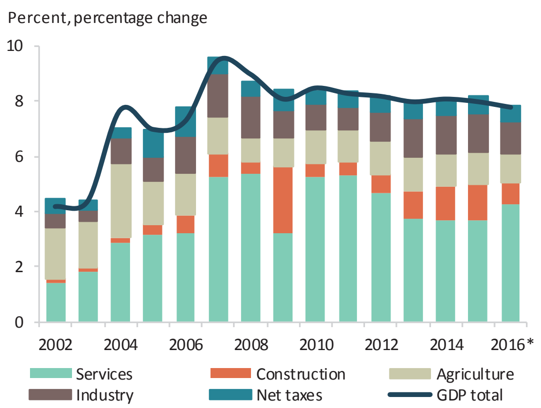
Uzbekistan's mostly mitigated the impact of lower prices of its export commodities in 2014-16 through the expansion of export volume. This trend continued in H1 2017, albeit at a decelerating rate, despite the growth pick up in Russia and China, Uzbekistan's key trade partners. Imports also grew, as lower import prices boosted demand for imported goods, resulting in a small trade deficit. Overall, the current account achieved a small surplus due to the recovery in remittances. Still, the economy's slower growth of both GDP and investment in H1 2017 suggest a broader weakening of the domestic economy, also evidenced by a slowing TFP growth.

During H1 2017—as in previous years—public investment remained robust, but current expenses were cut. To support economic activity, the authorities reduced direct taxes while increasing property and excise taxes in January 2017. The government also launched a privatization program and sold 169 SOEs in H1 2017. This resulted in an overall fiscal surplus in H1 2017.

Monetary and exchange rate policies remained largely unchanged in H1 2017, and the Uzbek som depreciated at a slightly faster rate compared to H1 2016. The policy rate remained at 9 percent in H1 2017, helping total banking loans grow by 29 percent y/y, and total banking deposits grow by 25 percent y/y in the first quarter of 2017. On June 28, 2017, the Central Bank of Uzbekistan (CBU) raised the policy rate to 14 percent, given the higher inflation observed since late 2016 and rising inflation expectations due to the announced foreign exchange reform. Non-performing loans (NPLs) appear to have remained relatively stable at 0.4 percent according to the CBU, while Moody's assessed NPLs at 2.0-2.5 percent in August 2017.

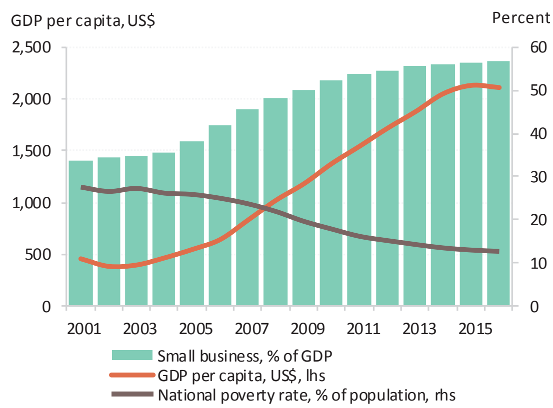
On September 5, 2017, the CBU allowed the official exchange rate to adjust from 4,210 UZS to 8,100 UZS per US dollar, helping converge the official rate with the curb market rate, and establishing a framework to allow it to float thereafter.

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



Sources: Uzbekistan official statistics.

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



Sources: National poverty line is minimum food consumption equivalent to 2,100 calories per person per day and it does not include non-food items.
Note: Poverty is national data. Due to the lack of access to microdata the World Bank cannot verify/validate the official figures/trends after 2003.

The authorities also announced the removal of restrictions to exchange rate convertibility, including the surrender requirements (by which firms were mandated to sale a portion of their export revenues to the CBU at the official exchange rate), widening private participation in the foreign exchange market.

Although validation is not possible due to lack of access to official micro data, the official poverty rate declined from 12.8 percent in 2015 and an estimated 12.4 percent in 2016, driven by robust economic growth, small business development, and targeted social safety net. The distribution of income has become more equitable over time, and the official Gini coefficient fell from 0.39 in 2001 to 0.29 in 2013. However, the official unemployment rate was at 5.2 percent in H1 2017, same as in 2016.

Outlook

The outlook is predicated on the implementation of the reform agenda, including on exchange rate convertibility. If accompanied by complementary market-oriented reforms, this will be an important step to reduce market distortions and encourage private investment in the economy. Fiscal policy will likely be less expansionary to help reign on inflation, with budget spending geared towards mitigating the impact of the exchange rate adjustment on the vulnerable population, supporting critical SOEs and sustaining the public investment program. Monetary policy is expected to be more restrained to contain inflation. A pickup in global prices on the main Uzbek export commodities (e.g. gas, copper, and cotton) in 2017-18 will help narrow the trade deficit, while improved prospects of net remittances will keep the current account in small surplus.

Our baseline scenario projects a moderation of growth to 6.2 percent for 2017 as investment growth is slowing, and 5.6 percent in 2018 as transitional adjustments unravel, given uncertainties, and the fact that remaining rigidities in the economy may not allow for a sufficiently rapid adjustment to take advantage of a more competitive exchange rate. Higher growth should rebound over the medium term (up to 6.3 percent in 2019) as reform implementation in the second half of 2018 becomes more entrenched, reducing uncertainty and supporting private investment and export oriented growth. Private investment (including FDI) is expected to rise over the medium term.

While data limitations do not allow for poverty projections, we expect that increased income growth and revival of net remittances by 2019 to continue progress in reducing unemployment and poverty over the near term.

Risks and challenges

Uzbekistan's economy faces upside and downside risks. On the upside, there are benign prospects for commodity prices, and accelerated private investment due to a greater than envisaged improvement of the investment climate in the context of ongoing reform efforts. On the downside, a slower recovery in the Russian economy due to additional Western sanctions in August 2017, potential delays in other structural reforms and higher inflation could undermine growth prospects.

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

	2014	2015	2016 e	2017 f	2018 f	2019 f
Real GDP growth, at constant market prices	8.1	8.0	7.8	6.2	5.6	6.3
Private Consumption	2.0	1.2	1.0	-1.6	-1.9	-0.8
Government Consumption	8.7	0.6	-12.6	4.8	1.7	4.8
Gross Fixed Capital Investment	9.6	9.6	9.5	8.3	7.8	8.5
Exports, Goods and Services	3.2	7.5	19.2	12.8	9.6	12.9
Imports, Goods and Services	-2.5	-2.6	4.7	5.6	2.8	9.1
Real GDP growth, at constant factor prices	7.9	7.9	7.9	6.2	5.6	6.3
Agriculture	6.9	6.8	6.6	6.0	5.6	5.9
Industry	8.5	8.5	6.9	6.3	5.0	6.4
Services	8.2	8.2	9.0	6.3	5.8	6.5
Inflation (Private Consumption Deflator)	8.9	8.8	10.0	12.0	14.0	12.0
Current Account Balance (% of GDP)	1.7	0.7	0.8	0.9	0.1	0.3
Fiscal Balance (% of GDP)	1.6	0.8	1.2	0.6	0.5	0.4
Debt (% of GDP)	7.1	10.3	11.5	15.1	22.3	26.0
Primary Balance (% of GDP)	1.7	0.9	1.3	0.8	0.8	0.9

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty and Equity Global Practice.
Notes: e=estimate, f = forecast.

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Migration and Mobility

Public concerns in Europe and Central Asia over the sharp increase in asylum seekers and undocumented migrants seem to reflect broader anxiety about reduced job security caused by technological developments and the internationalization of production and work. Policy reforms should help both migrants and nonmigrants cope with increased and unavoidable flexibility in labor markets.

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