

World Economic Situation **and** Prospects

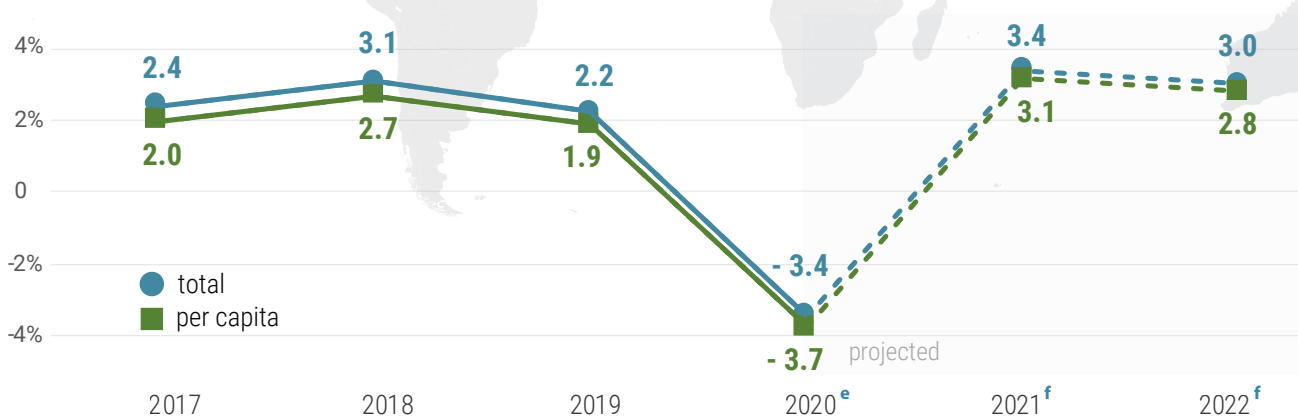
2021



United Nations

Economies in transition

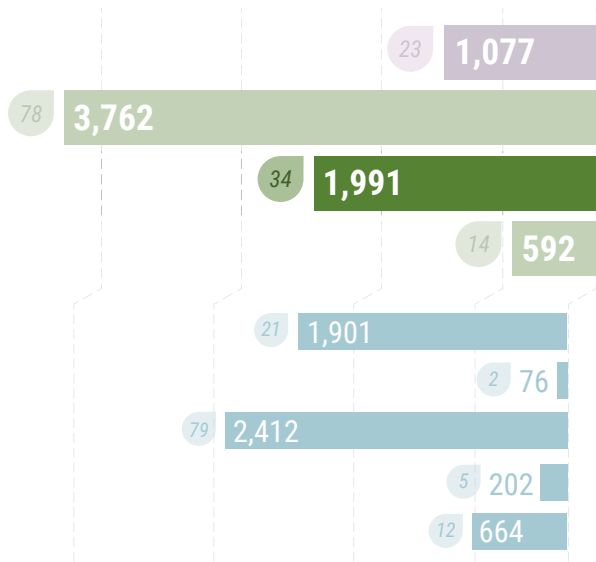
GDP Growth



COVID-19 Cases per 100,000 people

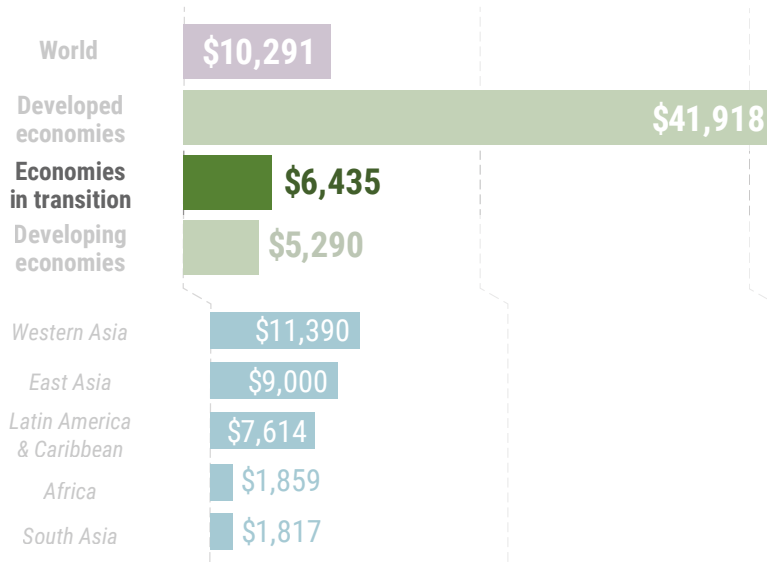
by 1 January 2021

COVID-19 related deaths per 100,000



GDP per capita

2020



Note: The boundaries and names shown and the designations used on this map do not imply official endorsement or acceptance by the United Nations. The map represents countries and/or territories or parts thereof for which data is available and/or analysed in *World Economic Situation and Prospects 2021*. The shaded areas therefore do not necessarily overlap entirely with the delimitation of their frontiers or boundaries. Aggregate data for Africa, excluding Libya.

^e: 2020 estimates, ^f: 2021-22 forecasts.

Source for COVID-19 data: UNDESA calculations, based on data from Johns Hopkins University.

Economies in transition

- Both in the Commonwealth of Independent States and in South-Eastern Europe economic activities are unlikely to experience a quick recovery
- Lower commodity prices amplified the shock in the Commonwealth of Independent States
- Tourism-dependent countries in South-Eastern Europe were hit the hardest

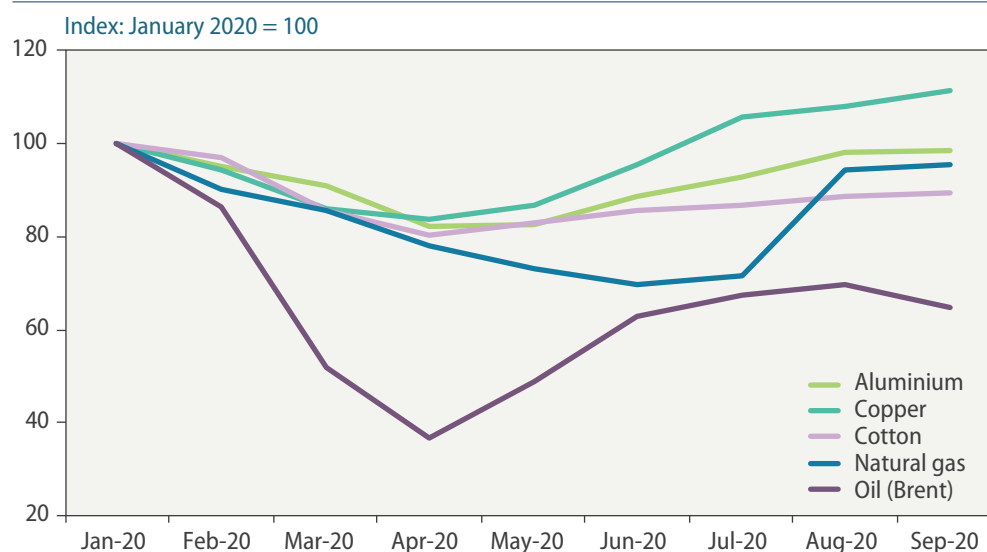
Commonwealth of Independent States and Georgia: the pandemic has unleashed multiple shocks

The outbreak of the COVID-19 pandemic has unleashed multiple shocks in the Commonwealth of Independent States (CIS) and Georgia, having heavily depressed economic activity since the early part of the second quarter of 2020. The imposition of lockdowns and quarantine measures in the region, first introduced around April and then, after some loosening, reintroduced later in the year, caused far-reaching disruptions. Lower commodity prices, including for important non-oil commodities exported by the CIS countries (except for gold, whose higher price benefited gold exporters in Central Asia), exacerbated the contractionary effects of the pandemic (figure III.4). These shocks have been widespread across the region, resulting in declines in output in almost all countries. The magnitude of those declines has depended on a country's economic structure and its capacity to adopt offsetting measures.

The region's services sector has been particularly affected by the pandemic, with international tourism, a critical economic sector for some countries in the Caucasus and Central Asia, having been dealt a telling blow. Trade and transport disruptions in the region and reductions in levels of economic activity in the Russian Federation have led to a decrease in remittances and disrupted temporary migration flows, with a significant impact on small-

Figure III.4

Global prices of selected commodities exported by the CIS countries



Source: UNCTAD and FRED (Federal Reserve Economic Data) database.

Consumption has declined sharply and living standards have been deteriorating

er economies in Central Asia. Although non-service sectors performed relatively better, oil production cuts under the OPEC+ agreement depressed industrial output in Azerbaijan, Kazakhstan and the Russian Federation. In addition, bad harvests contributed to poor economic performance in Azerbaijan and Ukraine. After expanding by 2.2 per cent in 2019, the aggregate GDP of CIS and Georgia is estimated to have shrunk by 3.4 per cent in 2020. Only a modest recovery is expected, with growth of 3.4 per cent for 2021 and 3 per cent for 2022.

Consumption in the region sharply contracted in 2020 as a result of the restrictions associated with the instituting of quarantines, higher unemployment and lower remittances, which led to a worsening of living standards, despite the provision of government support. While investment also contracted, it seems to have trailed behind the decline in consumption. In a number of countries, geopolitical tensions and internal conflicts in the second half of the year, including domestic political tensions in Belarus in the aftermath of presidential elections and the resumption of hostilities between Armenia and Azerbaijan as related to the conflict in Nagorno-Karabakh, contributed further to disruptions in economic activities and increased uncertainties.

The region's energy-importing countries saw deeper contractions in 2020

The economic contraction in 2020 was deeper in energy-importing countries, as the beneficial effect of lower oil prices on their economies was offset by multiple negative factors. The 2021 recovery in the region should, however, be supported by somewhat improved terms of trade and some breakthroughs in containment of the pandemic. The return to growth will nevertheless be insufficient to compensate for the output losses in 2020 and investment—against a background of persistent economic headwinds—is expected to remain weak. Moreover, within a context marked by multiple risks and increased geopolitical tensions, growth projections are understandably subject to significant degrees of uncertainty. Exchange rate flexibility in most of the CIS countries has helped to offset the shocks, including that of lower energy prices in those energy-exporting countries—Kazakhstan, for example—where the devaluations have been particularly large. It has also helped to reduce the drain on reserves. However, the speed of exchange rate weakening constrained the implementation of policy options and prompted interventions designed to reduce volatility.

Some countries responded to the crisis by implementing large stimulus packages

Countries have reacted to the multiple shocks by implementing large stimulus packages, including an increase in health spending and social benefits. In addition, support—including through direct income transfers, utility subsidies and tax exemptions—has been directed towards individuals and sectors directly affected by containment measures, with small and medium-sized enterprises being a common target in this regard. The size of these programmes, which varies, has been determined largely by the availability of fiscal space. Energy-exporting countries have been able to tap into their sovereign wealth funds to finance increased spending; and in Kazakhstan, for example, the financing of the anti-crisis programme was equivalent to about 9 per cent of GDP.

Inflation remained for the most part contained, while labour-market conditions deteriorated

While inflation-related developments in 2020 in the CIS area have been generally benign, supply disruptions and currency depreciation have created upward pressures in some countries of Central Asia. In Kyrgyzstan, temporary price controls for food items were introduced to dampen inflation pressures; price controls for certain items and services, accompanied by food rationing, were continued in Turkmenistan; and to provide support to households, Kazakhstan capped utility prices. In Uzbekistan, inflation remains relatively elevated, reflecting the impact of past depreciation, but has declined as a result of weak demand and the postponement of utility price increases. By contrast, the impact of the

rouble's weakness on prices has been limited in the Russian Federation. Despite support programmes, unemployment rates have increased throughout the region; and restrictions placed on mobility have contributed to the deterioration of labour markets in countries that rely on temporary migration, aggravating the situation in Central Asia.

Fiscal deficits, which were modest in most CIS countries in 2019, have widened in 2020, owing to lower revenue and higher spending. In the Russian Federation, the central government budget balance will change from a surplus in 2019 to an estimated deficit of over 4 per cent in 2020, as a result of low energy revenues, declining economic activity and tax relief measures. The Government has borrowed in domestic financial markets and issued local-currency debt. Moreover, the stimulus packages enacted for 2020 and 2021 are together equivalent to about 7 per cent of GDP. To accommodate fiscal spending in 2020–2021 in an environment of low oil prices, some components of the fiscal rule have been temporarily relaxed and the application of certain articles of the Budget Code has been extended to 2021 in order to allow the Government to allocate funds for the financing of anti-crisis measures without amending the budget. Despite the country's massive international reserves and the relatively low public debt-to-GDP ratio (estimated at 13.7 per cent in June 2020), overall fiscal spending under the proposed 2021–2023 budget is likely to shrink in real terms, as the Government continues to prioritize fiscal stability. In Kazakhstan, previous fiscal consolidation plans have been postponed, while in Kyrgyzstan, border closures and the reduction of trade have directly impacted revenues, given the importance for that country of custom duties. Public debt ratios have increased sharply as a result of higher financing needs, output contraction and exchange rate depreciation. However, in energy-exporting countries, which can tap into their sovereign wealth funds (as noted above), these increases will be more limited.

Monetary policy in CIS has been loosened throughout the year. In Kazakhstan, the depreciation of the tenge prompted the authorities, in March, to increase the key policy rate, but this hike was later fully unwound. In the Russian Federation, the key rate was cut by 200 basis points to a record low of 4.25 per cent. Amid concerns over exchange rate instability and the signs of a strengthening of economic activities, the authorities paused the loosening process in the second half of the year. In Ukraine, interest rates were cut from 15.5 to 6.0 per cent in the first half of the year, within a context of declining inflation. In the Republic of Moldova, in addition to interest rate cuts, there has been a relaxation of reserve requirements in order to increase liquidity and credit flows. Many countries have also introduced measures aimed at providing support to the banking sector, which has been asked to grant payments holidays and assist in debt restructuring.

Current account balances will deteriorate in most countries in the region, owing to lower hydrocarbons exports, reduced remittances and reduced tourism revenue; and capital outflows have increased the need for balance-of-payments support in some countries. Although debt distress risks in the region are relatively low, some countries appear to be particularly vulnerable. Kyrgyzstan and Tajikistan have benefited from the G20 Debt Service Suspension Initiative, which has saved them the equivalent of 0.6–0.8 per cent of GDP in their 2020 debt servicing costs. Official financing is playing a critical role in covering the external funding requirements in most energy-importing countries. In June 2020, the Executive Board of the International Monetary Fund (IMF) approved a new standby programme for Ukraine (enabling an immediate disbursement of \$2.1 billion), which was designed to address financing needs and advance reforms, and which could unlock access to further

Fiscal deficits are larger and public debt is higher

Monetary conditions in the region have been relaxed

Kyrgyzstan and Tajikistan are benefiting from the Debt Service Suspension Initiative

The economic outlook is marred by uncertainties and reduced policy space

resources. While Belarus, Kazakhstan and Ukraine successfully issued international sovereign bonds, access of the CIS countries to external financing has generally become more difficult (box III.1) amid perceptions of the volatility of risk. Moreover, geopolitical tensions which arose in the second half of the year are further constraining financing options.

The economic outlook for the region is uncertain, with downside risks predominating. The reintroduction of containment measures, should the outbreak of the pandemic lead to a further deterioration, would both inflict new damage in the realm of economic activities and undermine confidence. While the banking sector has remained stable over the course of the current period of turbulence, the deterioration of asset quality and high levels of dollarization in many countries will constrain lending and increase risks. In addition, geopolitical tensions have mounted and, in some cases, have spiralled into real conflict. Clearly, the COVID-19 crisis has exposed existing vulnerabilities in the region and reduced existing policy space.

Box III.1

External financing constraints and the impact of the COVID-19 crisis on the Commonwealth of Independent States and Georgia

The COVID-19 crisis has inflicted multiple shocks upon the economies of the Commonwealth of Independent States (CIS) and Georgia. It has negatively impacted foreign exchange earnings derived from commodity exports, tourism and remittances. Public financing needs related to funding the crisis response have increased, while revenues have slumped; consequently, access to external financing has become ever more critical for many of the countries in the region. However, external financing needs vary across the region, reflecting heterogeneity in economic structures and external trade composition. And for some countries, external financing needs were already large prior to the crisis.

Figure III.1.1

Share of public debt in foreign currency and public debt as percentage of GDP



(continued)

Sources: National Ministries of Finance; IMF projections, World Economic Outlook database, October 2020.

Note: Foreign debt is used as a proxy for foreign currency debt if other data is unavailable.

The energy-exporting countries entered the crisis with large amounts of foreign assets in their sovereign wealth funds and have been able to draw on these resources to partially finance growing budgetary imbalances and smooth exchange rate fluctuations. In Azerbaijan, Kazakhstan and the Russian Federation, those funds are substantially larger than their financing needs. Their public debt ratios are low, although they have increased during the crisis; and total external debt is also low, except for Kazakhstan where local subsidiaries' increased borrowing from their parent companies abroad has elevated private sector external debt in recent years. On the other hand, the introduction of sanctions for the Russian Federation starting in 2014 has significantly reduced the ability of public and private sector entities to borrow from international capital markets.

While the financing situation is less favourable in the region's energy-importing economies, there are nevertheless important differences among them in terms of their market access and liquidity positions. A common denominator in this crisis has been the reliance on official financing. All of these countries, except Belarus and Turkmenistan, have relied on official financing and received International Monetary Fund (IMF) emergency financing. The IMF also approved a new standby arrangement for Ukraine.

These new borrowings will further increase the already large share of external public debt owed to official creditors—both bilateral and multilateral. In Ukraine, commercial borrowing is more significant, which makes it stand out among energy importers; but even in this case, official creditors had accounted for 46 per cent of public and publicly guaranteed external debt by the end of September 2020. In recent years, several countries in the region have taken advantage of a favourable environment for the placement of government bonds in international capital markets, which included debut issues by Tajikistan (2017) and Uzbekistan (2019). In this regard, Georgia and Ukraine are likely to face additional financing constraints, as their international bonds are maturing in the immediate future. However, commercial borrowing has not fundamentally altered reliance on funding from bilateral and multilateral creditors, particularly on the part of the Central Asian countries. The growth of public debt in Kyrgyzstan, for example, is explained by increased bilateral official borrowing, despite the cancellation of debts to the Russian Federation in the aftermath of the 2014 crisis.

Overall, public and external debt has increased throughout the region in recent years. The growth of total external debt since the 2014 downturn has been driven by increased public liabilities, while the decline in borrowing costs has contributed to increased fiscal space in a few countries. In Ukraine, for example, interest payments fell to about 3 per cent of GDP in 2019, down from 4.2 per cent in 2015. This positive trend, however, is now being reversed.

Foreign currency reserves can help cushion growing external financing needs; and many energy-importing countries—including Armenia, the Republic of Moldova and Ukraine—have increased reserve holdings in recent years, amid an improving balance of payments. In contrast, in Belarus, international reserves remain precariously low. On the other hand, high gold prices have dampened the impact of the crisis on external finances in Uzbekistan and other countries with large gold holdings as part of total reserves.

The high share of foreign currency debt remains a major generator of vulnerability in the region, as countries are unable to tap financing in their own currency (figure III.1.1). While flexible exchange rates have contributed to a partial offset of the impact of declining sources of foreign income, improving competitiveness of exports and discouraging imports, currency depreciation has increased the relative debt burden, thus reducing further fiscal space. As high dollarization rates in energy-importing economies have amplified the destabilizing effect of exchange rate declines, reducing external risks would therefore require further efforts directed towards development of domestic capital markets and reduction of dollarization of those economies. Over the immediate horizon, the continued support of official creditors will be required to stave off reductions in public spending so that countries of the region can fully recover from the crisis, build back better and advance the 2030 Agenda for Sustainable Development.

Box III.1 (*continued*)

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South-Eastern Europe: standstill in tourism-related activities is dragging down economic performance

The subregion of South-Eastern Europe has displayed high rates of COVID-19 infection and has been affected by the repeated introduction of coercive social distancing measures, which has led to business closures and reduced consumer demand. Unemployment has increased from already high levels, reversing some of the improvements seen in previous years. The worsening economic situation in the European Union, the main destination for its exports and a source of investments and remittances, has depressed external demand and reduced income; and supply chain disruptions have dampened manufacturing production. However, as the external and health situations improve, growth is expected to return to the region.

The pandemic's impact in the subregion has varied

The impact of the pandemic on the countries of the subregion has varied. Serbia, with a relatively diversified economy, is likely to have seen only a modest contraction in GDP in 2020, at about 2 per cent, in part because of the implementation of a large fiscal programme (equivalent to 13 per cent of GDP), which contained the fall in output and prevented a sharp deterioration in the labour market. By contrast, the ability to implement expansionary policies designed to offset the contractionary effects of the crisis has been limited in countries with high public debt, including Albania and Montenegro, where tourism is an important contributor to overall output. Consequently, their economies are expected to have contracted by 6-11 per cent in 2020. The tourism industry's recovery will fall short of previous levels, which will exert a persistent dampening effect on economic activity in those two countries. In addition, the impact of government initiatives to support the economy through wages subsidies and credit guarantees, in particular in Albania and North Macedonia, has been limited because of the difficulties inherent in efforts to reach the informal sector.

To counteract the pandemic, the countries in the region increased health expenditures; but with lower fiscal revenues, this has resulted in widening fiscal deficits. After years of surpluses, Bosnia and Herzegovina recorded a fiscal deficit. In those countries with an independent monetary policy, namely, Albania and Serbia, the monetary authorities have cut policy interest rates to support economic activity. The policy interest rate was also cut in North Macedonia, where monetary policy is somewhat constrained by the pegging of the exchange rate to the euro.

Inflation has not been observed in the region

Inflationary pressures in the region have been absent, owing to weak demand and lower energy prices. Moreover, the noticeable deterioration of labour-market conditions in 2020 has represented a setback in the context of previous improvements.

The pandemic has exacerbated structural weaknesses

The subregion is confronting many adverse structural factors—including a challenging business environment, low productivity and the shrinking of its labour force due to population ageing and persistent outward migration—which will limit its recovery. EU accession, although not an immediate prospect, remains a critical anchor for policies and a source of financing. The aggregate GDP of South-Eastern Europe, after expanding by 3.5 per cent in 2019, is expected to have declined by 3.8 per cent in 2020, with a return to growth of 4 per cent expected in 2021 and 3.1 per cent in 2022.