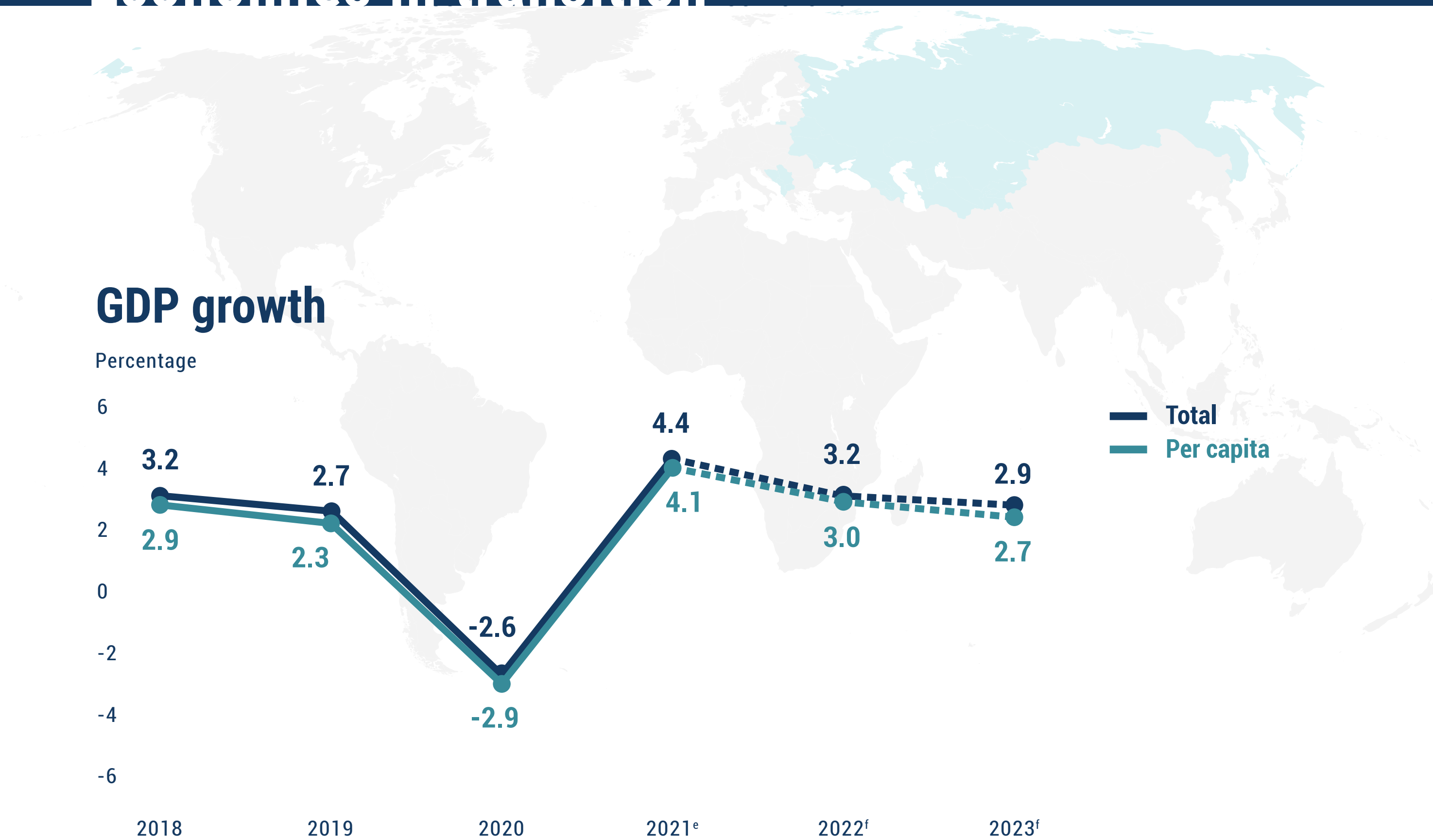
Economies in transition

GDP growth

Percentage



COVID-19 cases & deaths

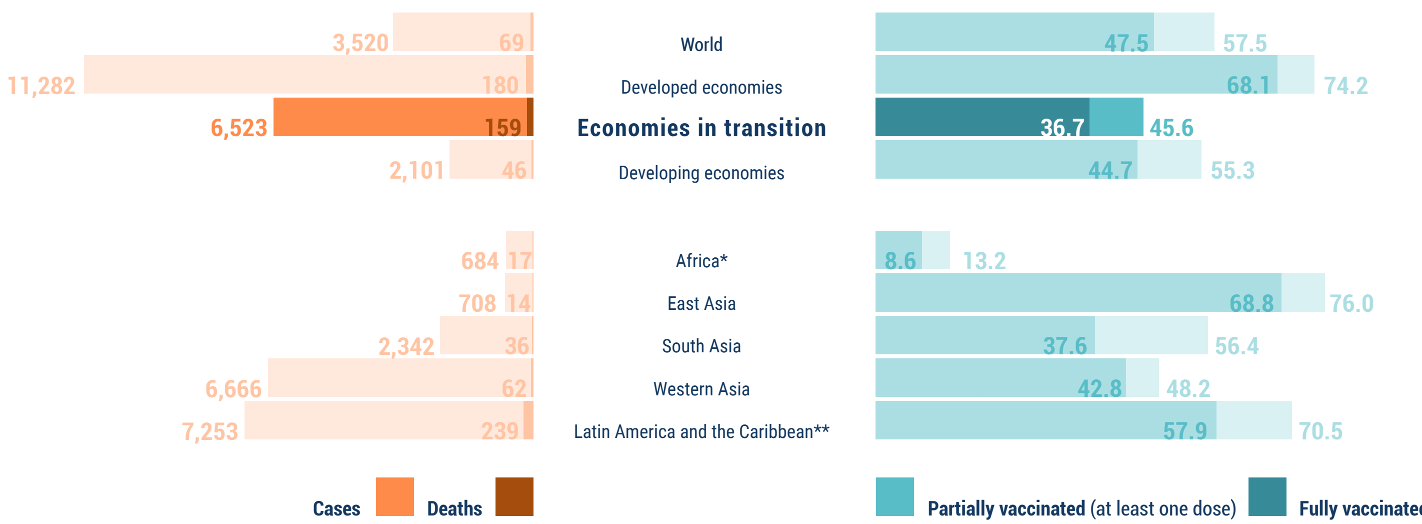
as of 20 December 2021

Per 100,000 people

Vaccination

as of 20 December 2021

Percentage of population



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 2022. The shaded areas therefore do not necessarily overlap entirely with the delimitation of their frontiers or boundaries. Aggregate data for Africa, excluding Libya.

* Excluding Libya; **Excluding Bolivarian Republic of Venezuela. **e:** 2021 estimates. **f:** 2022-2023 forecasts.

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

Economies in transition

- The Commonwealth of Independent States (CIS) and South-Eastern Europe returned to growth amid the lifting of pandemic containment measures, higher commodity prices and an improved external environment.
- Surging inflation is hurting living standards, prompting monetary tightening in the CIS.
- Official development assistance remains important for parts of the region.

The Commonwealth of Independent States and Georgia: the lifting of restrictions and higher commodity prices underpin an economic rebound

Economic growth in the CIS area, including Georgia, resumed in 2021 following contraction in 2020. The turnaround picked up as mobility and activity restrictions were eased or removed. A more favourable external environment, including sharp rises in commodity prices, boosted export volumes and revenues. Services also bounced back while construction activities benefited from support programmes in the Russian Federation and higher remittances sent to Central Asian countries. Better terms of trade for energy-exporting countries improved their current account positions, despite the recovery of imports. In energy-importing countries, remittance flows and tourism revenues along with rebounding domestic demand mitigated current account pressures from import growth.

Private consumption remains the major driver of growth

Growth in the CIS area in 2021 was largely driven by consumer demand, amid raising employment levels, increased retail lending and higher remittances to smaller CIS countries. Investment generally trailed behind amid high uncertainty and subdued foreign direct investment inflows. The relaxation of oil output restrictions under the OPEC Declaration of Cooperation,[7] along with elevated prices for oil and natural gas in late 2021, accelerated recovery in energy-exporting countries.

In the Russian Federation, the main impetus for growth came from the rebound in household spending, boosted by one-off social payments and wage growth due to tight labour market conditions. Investment activity also picked up. The Government launched multiple stimulus packages in 2020-2021, including tax deferrals and guarantees, equivalent to about 6 per cent of 2020 GDP. Despite higher export revenues, protection of reserve buffers against possible external shocks remains a priority. International reserves rocketed to historically high levels in 2021, virtually eliminating debt service risks.[8] That same year, the United States and the European Union introduced additional economic sanctions against the Russian

7 The Declaration of Cooperation is a coordination mechanism for crude oil production by both OPEC member countries and 11 non-OPEC member countries. It is referred to as “the OPEC Plus agreement”. See OPEC (2021) for details.

8 In late 2021, international reserves of the Russian Federation exceeded total external debt by around one third.

Federation, in particular forbidding banks based in the United States to purchase Russian sovereign debt on the primary bond market. The decline in the share of non-residents in the Russian domestic bond market was rather limited in 2021, however. The Government in any case was able to issue debt denominated in the local currency and borrow from domestic banks. Economic growth is likely to moderate from the estimated 4.2 per cent in 2021 to 2.7 per cent in 2022 as the Government moves towards fiscal consolidation. The ambitious $360 billion National Development Projects Plan, comprising large investments in infrastructure and the social sphere, was postponed.

In Ukraine, a good harvest, higher steel prices and a surge in construction boosted output in 2021. Economic potential is constrained by the conflict in the East, however, as well as a challenging business environment and large-scale emigration. IMF lending will be important for meeting external debt service obligations in 2022. In Belarus, despite the absence of generalized lockdown measures, domestic demand remained weak amid political tensions. Exports performed well, supported by higher prices for refined oil products and fertilizers, despite sanctions imposed on the country in 2021 by several parties, including the European Union.

In Central Asia, the rebound in remittances in 2021 spurred private consumption; most countries registered high growth rates. Poor performance of the gold sector dampened recovery in the Kyrgyz Republic, however. Pandemic-related restrictions introduced by China in 2020 damaged cross-border trade with Kazakhstan, Kyrgyzstan and Tajikistan, affecting many small businesses.

Following the rebound in 2021, output growth in the CIS area is expected to decelerate in 2022, given weaker base effects, the moderation of consumer demand, more restrictive macroeconomic policies and persistent structural constraints. Without more ambitious reforms, growth will settle around moderate pre-pandemic expansion levels. The aggregate GDP of the CIS and Georgia, after a 2.6 per cent contraction in 2020, increased by an estimated 4.3 per cent in 2021 and is forecast to rise by 3.2 per cent in 2022. Integration processes within the framework of the Eurasian Economic Union[9] are expected to continue, including for financial systems.

Vaccination against COVID-19 is progressing slowly

Vaccination rates in the region remain relatively low, rendering it vulnerable to further waves of infection. In late 2021, the situation in the Russian Federation sharply deteriorated, prompting a one-week lockdown. COVID-19 cases also spiked in Georgia and Ukraine.

Labour markets have improved

Unemployment in the CIS area declined through 2021, approaching pre-pandemic levels in the best-performing countries. They include the Russian Federation, where limited inflows of migrants added to the tightness of labour markets, and numerous sectors such as construction saw shortages of workers. The unemployment rate declined to a record low of 4.3 per cent in September. Authorities relaxed some restrictions imposed earlier, such as by lifting entry bans on Tajik and Uzbek citizens who had committed minor violations.

9 Eurasian Economic Union members are Armenia, Belarus, Kazakhstan, Kyrgyzstan and the Russian Federation. Cuba, Moldova and Uzbekistan are observers.

An upsurge in inflation is eroding living standards

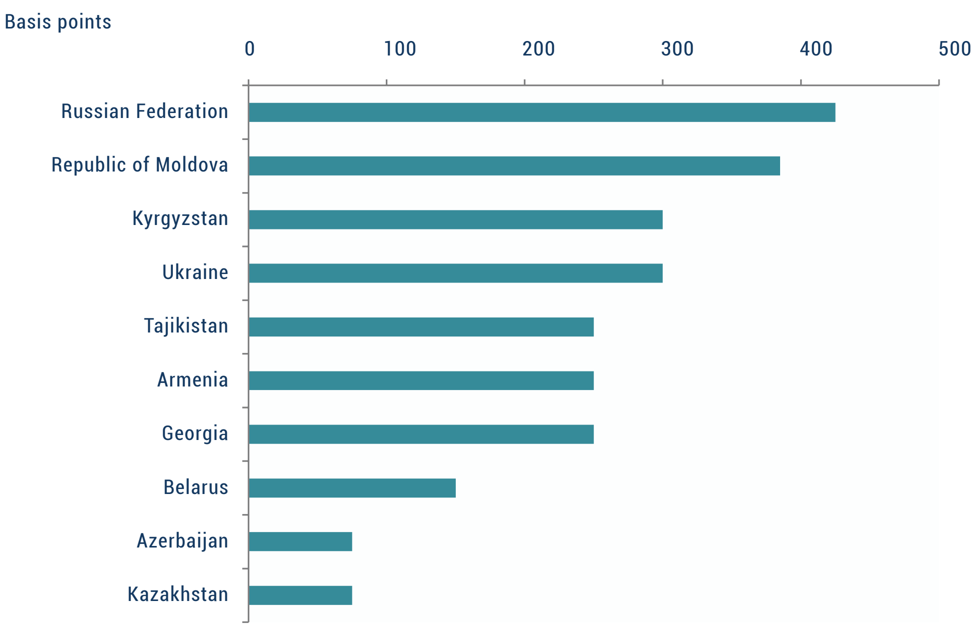
Most of the CIS area experienced a strong upsurge in inflation in 2021, which reached double-digit levels in many countries. The upswing resulted from a combination of supply disruptions, higher food and energy prices, strengthened demand and, in some cases, past exchange rate depreciation. It also came from elevated inflationary expectations and accelerated purchases. Governments responded in various ways. Kazakhstan introduced price controls and export quotas to contain food price pressures. In the Russian Federation, export duties, price controls and agreements with producers were deployed to limit price hikes. In most of the region, inflation is expected to moderate in 2022, except for Moldova, where increases in natural gas tariffs in late 2021 will lead to a double-digit annual consumer price increase.

Monetary policy is significantly tightening

Monetary authorities reacted to the inflationary spike by tightening policies. Interest rate increases in 2021 were substantial, with a series of successive hikes in virtually all countries (see figure III.7). Despite tighter monetary policy, retail lending, in particular mortgage lending, grew rapidly, supporting the recovery of demand. In the Russian Federation, the Central Bank announced plans to curb lending growth in late 2021; a tight monetary policy is expected to continue in 2022 amid concerns about high inflationary expectations.

Figure III.7

Changes in benchmark monetary policy rates in the CIS and Georgia since January 2021



Sources: National central banks data as of 20 December 2021.

The crisis leaves a legacy of public debt

Fiscal policies, although less expansionary than in 2020, have continued to support recovery. Public revenues increased as growth resumed, often exceeding earlier expectations. In the Russian Federation, the deficit fell sharply in 2021 on the back of growing revenues and the return to fiscal consolidation, implying a less supportive fiscal impulse. A tighter fiscal stance is anticipated in 2022, when the fiscal rule is expected to be reinstated. Although public debt in the Russian Federation remains low, at around 20 per cent of GDP, for many other CIS economies, especially energy importers, the crisis has left higher public indebtedness. In Kyrgyzstan, for example, the public debt-to-GDP ratio increased from 54.1 per cent of GDP in 2019 to 68.1 per cent in 2020. The composition of the debt, with a significant share of official financing, represents a mitigating risk factor in the most vulnerable countries. Official financing, critical at the height of the crisis in 2020, remains important, as the recovery of private flows has been limited. Countries from the region have retained good access to international capital markets, however, with a spate of well-received Eurobond issues. The new allocation of the IMF's Special Drawing Rights has alleviated financing needs for many countries, including Ukraine, and helped rebuild reserves.

Looking forward, the region faces multiple downside risks. Volatile commodity prices, especially of oil and natural gas, will remain a major determinant of economic performance. Slow progress in vaccination may lead to a rise in new COVID-19 cases. Mounting geopolitical tensions, internal political strife and the potential for refugee flows from Afghanistan into Central Asia could heighten instability, undermining business and consumer confidence. The banking sector has fared relatively well during the COVID-19 crisis but may come under stress in some countries as temporary forbearance measures are withdrawn and the share of non-performing loans rises, particularly in Ukraine. Persistent price pressures may unleash expectations of rising inflation, leading to quicker policy tightening and domestic tensions.

Box III.1

Sustainable finance in the Commonwealth of Independent States and Georgia

New financial products worldwide are supporting the shift towards sustainable development. This wave of innovation has been accompanied by reflection on the role of financial regulators in both actively contributing to climate change mitigation and adaptation and addressing related risks to the financial system. Sustainable finance is highly relevant for CIS countries, given the importance of hydrocarbons for their economies, including for non-energy-exporting economies through remittances, trade and investment channels, and the related costs of the green energy transition.

Green bonds, where proceeds are used for environmental goals, account for most new offerings. After a slow start compared with other emerging markets, the pace of issuance has picked up. Several financial institutions in Armenia and Kazakhstan and non-financial corporations based in Georgia debuted new products in 2020. Overall issuance in the first nine months of 2021 reached record levels (figure III.1.a). Corporations have pioneered these new financial products and, in line with other emerging markets, financial institutions have been major players. In July 2021, Uzbekistan broke new ground with a sovereign Sustainable Development Goals bond, where proceedings will be allocated to education, water management, health and green transportation, among other ends. The city of Moscow in the Russian Federation issued the first subnational green bond to finance infrastructure projects that reduce air pollution from transport.

New sustainable financial instruments have been accompanied by increased product diversification. For example, some Russian companies in extractive sectors have issued loans linked to sustainability, where interest paid is linked to meeting specified environmental targets. This approach gives issuers more flexibility, as the use of proceeds is not tied to particular projects. Perpetual bonds have been issued by Russian Railways to finance green projects, first in 2020 in the domestic market and then in 2021 in the Eurobond market. While few projects are fully green, the potential pipeline of investable initiatives that could reduce environmental footprints is large. So-called transition bonds, which provide finance for emissions-intensive sectors to meet specific performance criteria, could be of particular interest to the region.

Given the frequent absence of clear comparators, it is difficult to make strong statements on a "greenium" or cost-of-financing advantage. Recent issues have attracted strong investor interest, which has translated into high levels of oversubscription. This has lowered prices and opened access to a broader investor base, which tends to reduce volatility.

From the point of view of issuers, launching a green or sustainable bond has a significance beyond raising revenues at an expected lower financial cost. It allows them to engage with investors and, in the case of corporations, consumers, and to signal their efforts to adopt more sustainable practices and business models. Wide acceptance of these bonds requires alignment with well-established criteria around how proceeds can be used and the existence of suitable monitoring mechanisms, however. According to common practice, issuers have put in place frameworks that detail revenue use and are verified by external parties, but this is a source of additional costs that may deter issuance.

Different forms of financial support have encouraged the development of green finance. For example, under certain conditions, the costs of assessing green bond alignment with globally accepted standards are reimbursed by the Astana International Financial Centre, which aims to become a regional leader in green finance. In the Russian Federation, subsidies to cover part of the cost of the coupon are provided by the national ecology programme. International organizations and multilateral development banks have played roles as anchor investors (European Bank for Reconstruction and Development), helped to identify suitable projects to finance (United Nations Development Programme) or even issued green bonds in domestic markets to raise funding in local currency (Asian Development Bank).

For most countries in the CIS, issuance in external markets is the rule as the investor base for domestic launches remains limited. This relates to the lack of awareness of green instruments among domestic investors but also to shallow domestic capital markets. Judging by developments in other countries and ongoing regulatory initiatives to support demand, green and similar bonds are expected to account for an increased share of total issuance in the future. They still add to the debt burden of issuers,

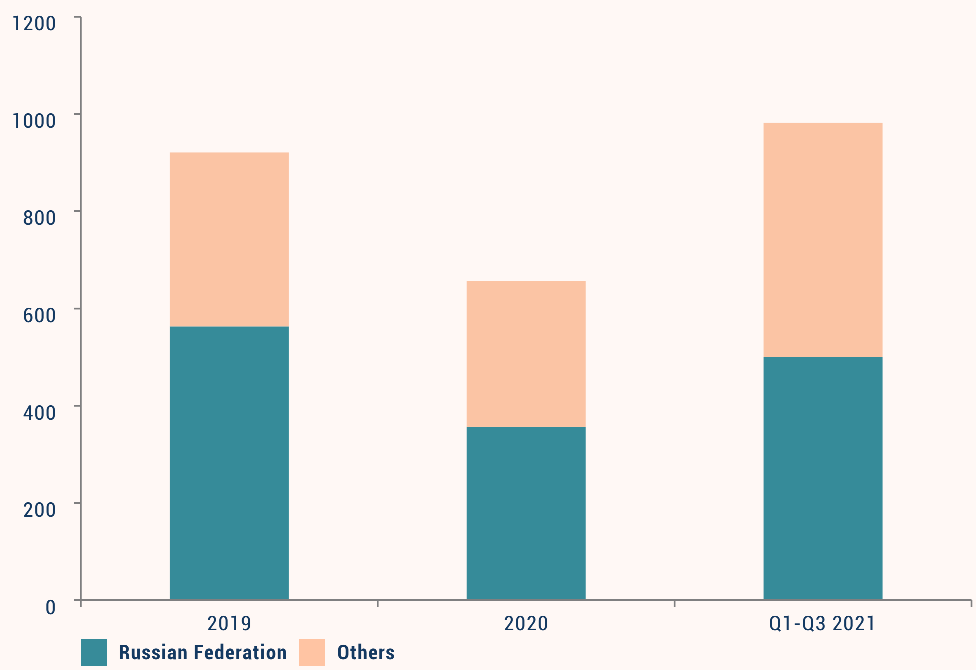
Author: José Palacin, United Nations Economic Commission for Europe

however, and, in most cases, to their foreign currency exposure. These risks need to be understood and managed, including through regulatory actions to ensure transparency and promote demand. More general initiatives are required to foster domestic capital markets. While sustainable finance carries transformative potential, critical constraints could relate to the appropriate pricing of externalities and regulatory reforms in relevant sectors.

Figure III.1.a

Green bond issuance in the CIS and Georgia

Millions of United States dollars



Sources: International Finance Corporation, Amundi, Bloomberg, Climate Bonds Initiative and Environmental Finance.

South-Eastern Europe: growth returns to the region

Economic growth returned to South-Eastern Europe in 2021 after a COVID-19-induced recession in 2020. An improved external environment was a major driver of recovery in these open economies with strong links to the European Union through trade and remittances, and, in the case of Albania and Montenegro, large dependence on the tourism sector. In Serbia, the largest economy in the region, the economy expanded by more than an estimated 6 per cent in 2021 amid soaring private investment and exports. Consumer confidence in South-Eastern Europe has markedly improved; macroeconomic policies have been generally supportive. Investment remained comparatively weak, although in Albania, post-earthquake reconstruction will continue to contribute to recovery. In late 2021, some countries experienced an energy supply crisis induced by the increasing cost of natural gas, leading to more use of coal along with higher prices for it. The pace of economic expansion may slow somewhat in 2022, as fiscal support unwinds to stabilize debt ratios. Aggregate GDP in South-Eastern Europe, after contracting by 3.1 per cent in 2020, is projected to increase by 6.2 per cent in 2021 and a further 4 per cent in 2022.

After years of low inflation, consumer prices have increased

After years of moderate price increases, inflation pressures have returned to the region, driven by the sharp acceleration in food and energy prices and, to a lesser extent, stronger consumer demand. Higher inflation has offset most nominal wage growth and worsened social conditions, with food accounting for up to 30 per cent of consumption spending. Price increases have been steeper in Serbia, while in Bosnia and Herzegovina and Montenegro, a deflationary trend ended. Formal or informal currency pegs constrain monetary policy in the region. While labour markets showed some positive trends in 2021, unemployment remains precariously high in Bosnia and Herzegovina and the Republic of North Macedonia.

Fiscal balances in the region have improved

Fiscal balances in the region improved as revenues increased and spending growth moderated. The fiscal impulse remained positive in 2021 but consolidation is likely in 2022. Countries have retained favourable access to capital markets, despite some deterioration for Montenegro. Several countries issued Eurobonds, including Serbia, which offered its first sovereign green bond. Current account deficits in the region remain high, especially in Albania and Montenegro, and despite a moderate reduction in the latter. Increases in exports and tourism revenues have been offset by stronger domestic demand and higher energy prices.

Structural barriers to growth remain

The outlook for the region is subject to certain risks. Vaccination rates are still relatively low, particularly in Albania and Bosnia and Herzegovina, which could lead to further waves of infection that derail recovery. Structural impediments to growth in South-Eastern Europe remain significant; the pandemic exacerbated already low productivity levels and labour market participation rates. Demographic pressures and outward migration create additional challenges. Geopolitical tensions, while contained, could resurface. Infrastructure deficits, skills shortages and weak governance continue to undermine private investment.

An additional regional cooperation framework was launched

In 2021, Albania, North Macedonia and Serbia agreed to lay the foundation for a single market, including the free movement of labour. This is within the framework of the initial “mini-Schengen” initiative, later renamed “Open Balkans”, which is aimed at removing internal borders by 2023. To some extent, the move reflects frustration with slow progress in accession to the European Union, which should nevertheless continue to provide an anchor for domestic policies and remain a source of financing.