REGIONAL ECONOMIC PROSPECTS

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Regional Economic Prospects in the EBRD Regions

European Bank
for Reconstruction and Development

Weaker momentum amid fragmenting trade and investment

February 2025

Global growth momentum has remained subdued, with a persistent differential between the economic performance of advanced Europe and that of the United States. Against this backdrop, average growth in the EBRD regions slowed, from 3.4 per cent in 2022 to 2.7 per cent in 2023 and 2024 (according to preliminary estimates) as Russia's war on Ukraine continued to take its toll on the region's economic performance. The outturn in 2024 was weaker than expected in September.

The 2025 growth projection for the EBRD regions has been revised down by 0.3 percentage points relative to the September 2024 forecast. Growth is now expected to average 3.2 per cent this year. Growth projections for central Europe and the Baltic states and the south-eastern EU have been revised down on weak external demand while downward revisions in the southern and eastern Mediterranean reflect the impact of conflicts and weak reform momentum. Average growth in the EBRD regions is expected to pick up to 3.4 per cent in 2026.

Uncertainty surrounding potential increases in tariffs on US imports and reciprocal measures by US trade partners has increased markedly. The increased uncertainty about trade rules can by itself have a significant detrimental effect on trade, investment, and production. Beyond uncertainty, the short-term impact of tariffs and trade restrictions on individual economies would depend on whether such tariffs are universal or apply to selected trading partners.

In a scenario in which the US raises tariffs on all imports by an additional 10 percentage points, GDP in the EBRD regions could be on average 0.1-0.2 per cent lower in the short term. The highest trade exposure to the US in the EBRD regions is observed in Jordan, the Slovak Republic, Hungary, and Lithuania. These estimates account for individual demand elasticities of traded goods as well as indirect exposure to the US via global value chains. These effects could in part be offset by the appreciation of the US dollar while spillovers from weaker growth in key trading partners, such as Germany or China, could substantially amplify the effect of lower direct and indirect exports to the US. In a scenario where tariffs are selective, economies that retain relatively privileged access to the US market may to some extent benefit from trade diversion and inflows of foreign direct investment (FDI).

Average inflation in the EBRD regions declined from 17.5 per cent at its peak in October 2022 to 5.9 per cent in December 2024 but remained more than 1 percentage point above the pre-pandemic average. While energy prices have come down, inflationary pressures increasingly stem from demand-side factors such as looser fiscal policies and rapid wage growth.

While disinflation proceeded largely in line with expectations, interest rates, including in the US, have been declining more slowly than previously expected and term premia – the difference between long-term and short-term interest rates -- increased. This, in turn, reflects higher fiscal deficits across advanced economies and emerging markets. The average general government balance in the EBRD regions *deteriorated by around 2.2 percentage points between 2017-19 and 2024 and is projected to remain around the current level in 2025. Similar trends are observed in the US, France, Germany and many other large economies. Larger government deficits reflect the resurgence of industrial policies accompanying the fragmentation of trade and investment, the fiscal burden of ageing populations and rising defence spending. Defence spending in the EBRD regions nearly doubled over the last decade, from around 1.8 per cent of GDP in 2014 to around 3.5 per cent of GDP in 2023 and is expected to rise further.*

Higher interest rates will further exacerbate fiscal pressures, albeit with a delay. Many emerging markets in the EBRD regions and beyond took advantage of the recent period of favourable financing conditions to lengthen the maturity of their debt profiles and increase the share of local currency debt. At the same time, some economies in the EBRD regions have significant fiscal and external vulnerabilities. Lebanon, Mongolia and Tajikistan, for instance, have high shares of both short-term and US dollar-denominated government bonds.

In **central Europe and the Baltic states** *growth picked up from 0.3 per cent in 2023 to an estimated 2 per cent in 2024 and is expected to accelerate further to 2.7 per cent in 2025 and 2.8 per cent in 2026 as labour markets remain resilient. Nonetheless, the outcome in 2024 was weaker than previously expected and the 2025 forecasts have been revised down on a slower-than-expected recovery in advanced Europe weighing on manufacturing and exports and sluggish investment.*

Growth in the **south-eastern EU** *decelerated from 2.3 per cent in 2023 to an estimated 1.5 per cent in 2024. This outcome was weaker than previously expected on sluggish external demand, a slowdown in investment and more modest fiscal stimulus. Growth is expected to pick up to 2.1 per cent in 2025 (less than previously expected) and 2.4 per cent in 2026.*

Growth in the **Western Balkans** *is estimated at 3.5 per cent in 2024 (unchanged from 2023) and is expected to remain stable at 3.6 per cent in both 2025 and 2026. The downward revision to the 2025 forecast reflects weak external demand and lower domestic spillovers from public investment projects in a context of tight labour markets.*

Growth in **Central Asia** *moderated from 5.7 per cent in 2023 to an estimated 5.4 per cent in 2024 as mining output in Kazakhstan stagnated and Mongolia was hit with extreme weather conditions. It is expected to pick up to 5.7 per cent in 2025 and moderate to 5.2 per cent in 2026. Intermediated trade is unlikely to provide a further boost to growth.*

In **eastern Europe and the Caucasus***, growth slowed from 4.4 per cent in 2023 to an estimated 3.9 per cent in 2024 as the boost from intermediated trade and inflows of labour and capital to the Caucasus waned. Growth is expected to moderate to 3.6 per cent in 2025 before picking up to 4.3 per cent in 2026. The 2025 growth forecast for Ukraine has been revised down as the destruction of electricity infrastructure caused by Russia's war on Ukraine is expected to continue weighing on production.*

In **Türkiye,** *growth moderated from 5.1 per cent in 2023 to an estimated 2.9 per cent in 2024 on tighter monetary policy aimed at bringing down persistently high inflation. Export growth remained strong despite the appreciating real effective exchange rate. Growth is expected to pick up to 3 per cent in 2025 (unchanged relative to the September 2024 forecast) and 3.5 per cent in 2026. As inflation declined, real wages have been increasing rapidly.*

Growth in **southern and eastern Mediterranean** *moderated from 2.7 per cent in 2023 to an estimated 2.5 per cent in 2024. It is expected to pick up to 3.7 per cent in 2025 and 4.1 per cent in 2026. The 2024 outcome was weaker than expected and the 2025 forecasts have been revised down relative to September 2024 reflecting the impact of conflicts and slow reform progress.*

Table 1. GDP growth in real terms

	Actual		Prelim.	Forecast (Feb'25)		Revision since Sep'24	
	2023	**2024 Jan-Sep**	**2024**	**2025**	**2026**	**2024**	**2025**
EBRD regions	**2.7**	**2.7**	**2.7**	**3.2**	**3.4**	**-0.1**	**-0.3**
Central Asia	**5.7**	**5.2**	**5.4**	**5.7**	**5.2**	**0.4**	**-0.2**
Kazakhstan	5.1	4.1	4.5	5.2	4.5	0.5	-0.3
Kyrgyz Republic	6.2	8.4	9.0	7.0	6.0	0.0	0.0
Mongolia	7.4	5.0	5.0	6.7	6.0	0.0	-1.3
Tajikistan	8.3	8.4	8.4	7.0	5.7	0.4	0.0
Turkmenistan	6.3	6.3	6.3	6.3	6.3	0.0	0.0
Uzbekistan	6.3	6.6	6.5	6.0	6.0	0.5	0.0
Central Europe and the Baltic states	**0.3**	**1.8**	**2.0**	**2.7**	**2.8**	**-0.3**	**-0.5**
Croatia	3.3	3.8	3.8	3.0	2.6	0.2	0.0
Czechia	-0.1	0.9	0.9	1.9	2.4	-0.2	-0.5
Estonia	-3.0	-1.2	-0.8	1.7	2.6	0.0	-0.8
Hungary	-0.9	0.6	0.5	2.0	2.8	-1.3	-1.3
Latvia	1.7	-0.5	-0.3	2.0	2.5	-1.2	-0.4
Lithuania	0.3	2.3	2.7	2.8	2.7	0.4	0.3
Poland	0.1	2.5	2.9	3.4	3.2	-0.3	-0.4
Slovak Republic	1.4	2.1	2.0	1.9	2.2	-0.3	-0.7
Slovenia	2.1	1.4	1.4	2.0	2.4	-0.1	-0.6
Eastern Europe and the Caucasus	**4.4**	**4.7**	**3.9**	**3.6**	**4.3**	**0.2**	**-0.5**
Armenia	8.3	5.9	5.7	5.0	4.5	-0.5	0.2
Azerbaijan	1.1	4.7	4.1	3.0	2.5	0.3	0.3
Georgia	7.8	9.9	9.5	6.0	5.0	3.0	1.4
Moldova	0.7	0.6	0.5	2.0	3.8	-2.7	-1.5
Ukraine	5.3	4.0	3.0	3.5	5.0	0.0	-1.2
South-eastern EU	**2.3**	**1.6**	**1.5**	**2.1**	**2.4**	**-0.4**	**-0.6**
Bulgaria	1.9	2.3	2.3	2.4	2.8	0.1	-0.5
Greece	2.3	2.3	2.3	2.3	2.3	-0.1	-0.3
Romania	2.4	0.8	0.7	1.8	2.4	-0.7	-0.8
Southern and eastern Mediterranean	**2.7**	**2.5**	**2.5**	**3.7**	**4.1**	**-0.3**	**-0.2**
Egypt	2.9	2.7	2.9	4.2	4.7	-0.3	-0.3
Jordan	2.7	2.3	2.2	2.3	2.6	0.0	-0.3
Lebanon	-0.2	-1.0	-5.7	2.0	3.0	-4.7	0.0
Morocco	3.4	3.1	3.0	3.6	3.4	0.1	0.0
Tunisia	0.0	1.0	1.2	1.8	2.2	0.0	0.0
Turkiye	**5.1**	**3.2**	**2.9**	**3.0**	**3.5**	**0.2**	**0.0**
Western Balkans	**3.5**	**3.6**	**3.5**	**3.6**	**3.6**	**0.0**	**-0.1**
Albania	3.9	4.0	3.9	3.7	3.7	0.4	0.0
Bosnia and Herzegovina	2.0	2.5	2.5	2.8	3.0	-0.3	-0.2
Kosovo	4.1	4.6	4.3	4.0	4.0	0.3	0.0
Montenegro	6.3	3.1	3.1	2.9	3.0	-0.7	0.0
North Macedonia	2.1	2.6	2.4	3.0	3.0	0.2	-0.5
Serbia	3.8	4.0	3.8	4.0	4.0	0.0	0.0
Memo: Egypt (fiscal year to June)	3.8	2.7	2.4	3.6	4.6	-0.3	-0.4
Memo: EEC excl. Ukraine	3.4	5.4	5.0	3.8	3.4	0.4	0.3
Memo: Belarus	3.9	4.5	4.0	2.5	2.5	-0.2	0.0
Memo: Russia	4.1	4.2	4.1	1.5	1.5	0.5	0.0

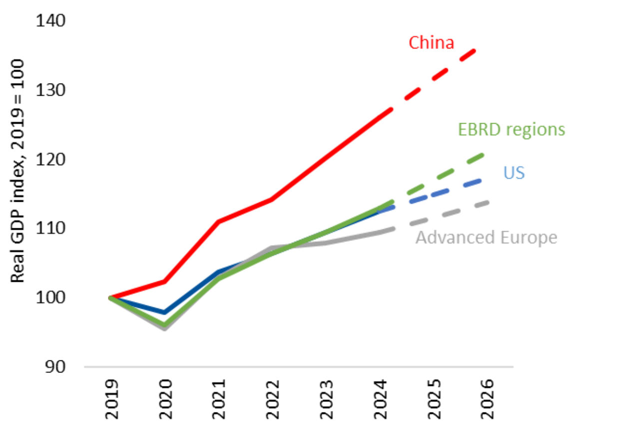
Source: Eurostat for EU economies, national authorities and EBRD. Note: Weights are based on the values of gross domestic product in 2022 at market exchange rates. In the case of 2024 growth, revision since Sep 2024 refers to the difference between the estimated growth in 2024 and the forecast made in September 2024. The table also includes forecasts for Belarus and Russia notwithstanding the fact that Belarus and Russia have had their access to Bank resources suspended under Article 8.3 of the Agreements Establishing the EBRD.

Growth in the EBRD regions slowed in 2024 to an estimated 2.7 per cent

Average growth in the EBRD regions slowed from 3.4 per cent in 2022 to 2.7 per cent in 2023, the first nine months of 2024 (year on year) and in 2024 as a whole, based on preliminary data, as Russia's war on Ukraine continued to take its toll on the region's economic performance. This outcome is 0.1 percentage point below the forecast made in September, with weaker-than-expected outturns in most EU-EBRD economies (see Table 1).

This deceleration, in turn, mirrors sluggish growth in advanced Europe, with a persistent differential between the economic performance of advanced Europe and the United States (see Chart 1).

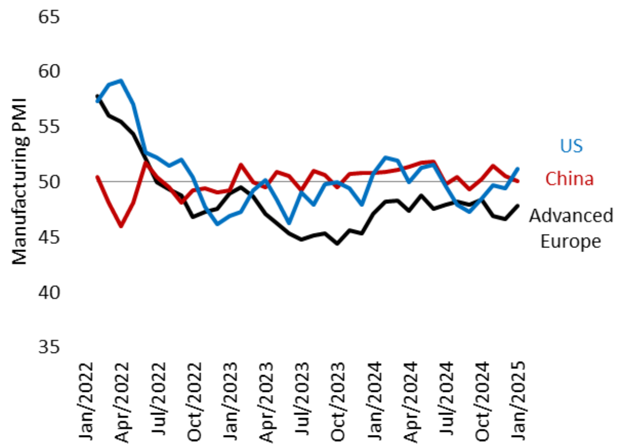
Chart 1. Persistent differential between the economic performance of advanced Europe and the United States



Source: IMF October 2024 World Economic Outlook and authors' calculations.
Note: Advanced Europe based on IMF country grouping excluding economies in the EBRD regions.

This divergence is also visible in purchasing managers' indices (PMI) in advanced Europe and the US. Manufacturing PMI remains in or close to contractionary territory in most economies (see Chart 2, where a value above 50 represents an increase relative to the previous month, while a value below 50 represents a decrease) in part reflecting high and growing uncertainty about the rules governing international trade in goods.

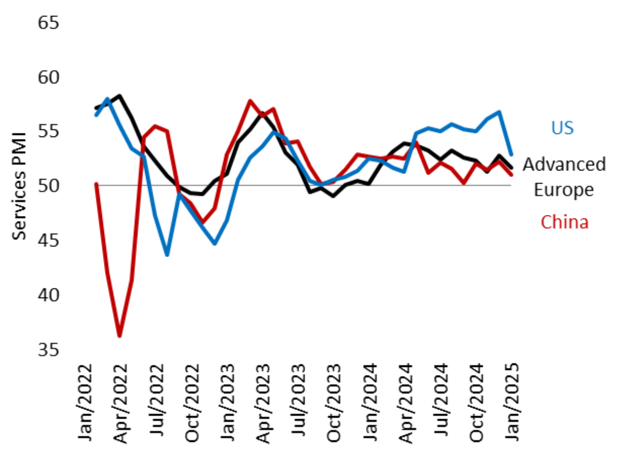
Chart 2. Manufacturing PMI remains depressed in most economies



Source: CEIC and authors' calculations.
Note: Advanced Europe based on IMF country grouping excluding economies in the EBRD regions.

In the services sector, PMI readings in 2024 were significantly higher in the US than in advanced Europe or China. Box 1 further highlights the growing transatlantic divide in the area of innovation.

Chart 3. Services PMI points to diverging paths of the US and other economies



Source: CEIC and authors' calculations.
Note: Advanced Europe based on IMF country grouping excluding economies in the EBRD regions.

Fragmentation of trade and investment

Uncertainty surrounding potential increases in tariffs on US imports and reciprocal measures by US trade partners has increased markedly. In

February 2025 the US increased tariffs on all imports from China by an additional 10 percentage points and suspended exemptions from tariffs for shipments under US$ 800 in value. Tariffs were also announced but then revoked or suspended on Canada and Mexico as well as Colombia. China introduced a number of retaliatory measures, including tighter controls on exports of rare earth minerals, where China enjoys a dominant position in the global markets for raw and / or refined products.

The increased uncertainty about trade rules can have a significant detrimental effect on trade, investment, and production. Beyond uncertainty, the short-term impact of tariffs and trade restrictions on individual economies would depend on whether such tariffs are universal or apply to selected trading partners (as in the case of the US tariff on China).

Increased tariffs imposed on all trading partners would leave no scope for trade diversion and be associated with lower exports for partner economies and likely appreciation of the US dollar relative to other currencies. If tariffs are imposed on certain trade partners selectively, this effect can be compounded by trade diversion for the targeted economy while economies not targeted by tariffs could benefit from diversion of trade and the associated investment.

Estimates of the potential impact of a broad 10 per cent increase in import tariff applied by the US on EU GDP varied widely, ranging from 0.1 per cent to 1.5 per cent, with the largest impacts for open economies such as Germany and industries such as cars, chemicals, and machinery.

For most economies in the EBRD regions, direct trade exposure to the US is relatively limited. For the EBRD regions as a whole, considering only direct trade linkages with the US, GDP in a universal 10 per cent tariff scenario could be 0.1-0.2 per cent lower (see Box 2), with the largest effects for economies such as Jordan (exporting textiles and jewellery to the US), the Slovak Republic, Hungary (both exporting cars and car parts) and Lithuania (petroleum). Exchange rate movements (depreciation of the euro and other currencies against the US dollar) could offset some of the negative effect on exports.

Weaker growth in key trading partners, such as Germany or China, could create further negative spillover effects for the economies in the EBRD regions. Historically, a 1 per cent reduction in GDP in Germany was associated with a 0.8 per cent reduction in GDP in the EBRD regions (see Box 2).

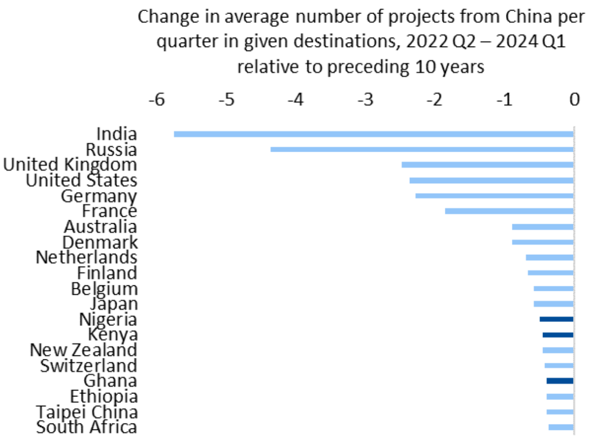
Swift changes in FDI patterns in response to rising geopolitical tensions

Recent experiences suggest that global supply chains respond to rising geopolitical tensions in complex ways. Following the escalation of trade tensions between China and the US and Russia's war on Ukraine, trade and foreign direct investment (FDI) between geopolitically rival blocs of economies (centred around bloc West, economies which imposed sanctions on Russia, and bloc East, including China, Russia and some other economies) contracted sharply (see, for instance, Gopinath et al. 2025; Alfaro and Chen 2024, Cheng et al. 2025).[1]

At the same time, FDI from China and the US into many 'connector' economies (with strong links with both rival geopolitical blocs) as well as Hungary and Spain increased significantly (see Cheng et al. 2025, and Charts 4 and 5). The 'winners' – economies that saw the largest increases in such FDI inflows -- are an eclectic mix, including Vietnam, Mexico, the United Arab Emirates, Spain, Thailand, Malaysia, Saudi Arabia and Uzbekistan.

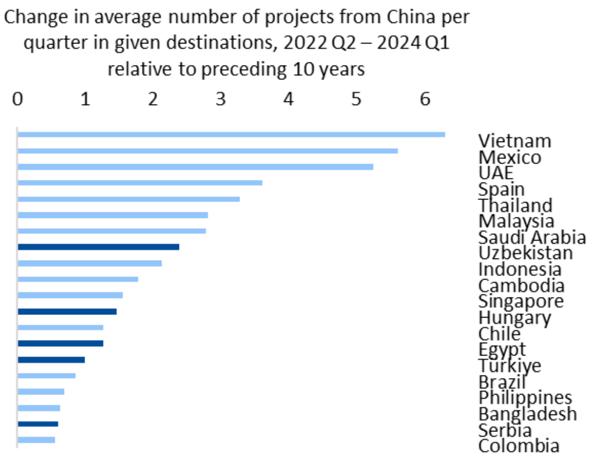
[1] Trends are similar if alternative definitions of blocs are used, based, for instance, on historical voting patterns at the United Nations General Assembly.

Chart 4. FDI from China into the EU, UK and US contracted sharply



Source: Cheng et al. (2025) based on FT fDi Markets database.
Note: 20 economies with the largest declines shown.

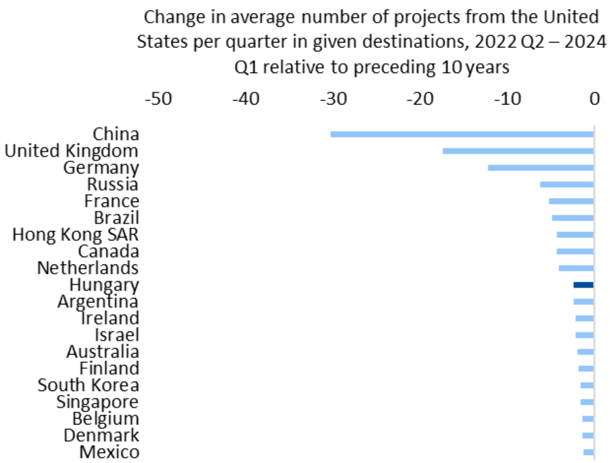
Chart 5. FDI from China into many 'connector' economies increased



Source: Cheng et al. (2025) based on FT fDi Markets database.
Note: 20 economies with the largest increases shown.

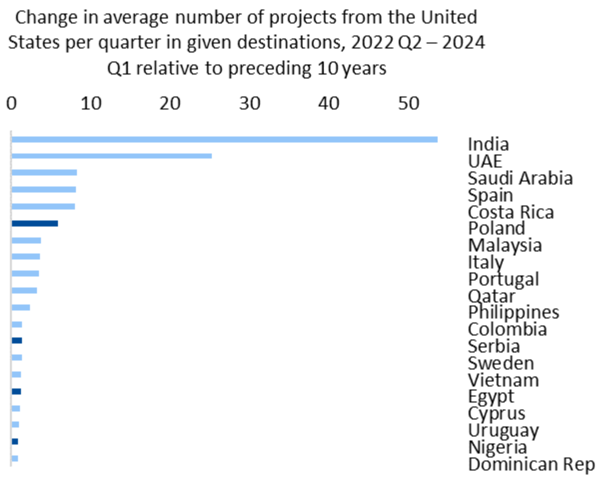
FDI flows from the US also shifted in 2022-24 relative to the previous decade. The sharpest drop is observed for China, while FDI flows into India picked up strongly (see Charts 6 and 7).

Chart 6. FDI flows from the US to China fell sharply



Source: Cheng et al. (2025) based on FT fDi Markets database.
Note: 20 economies with the largest declines shown.

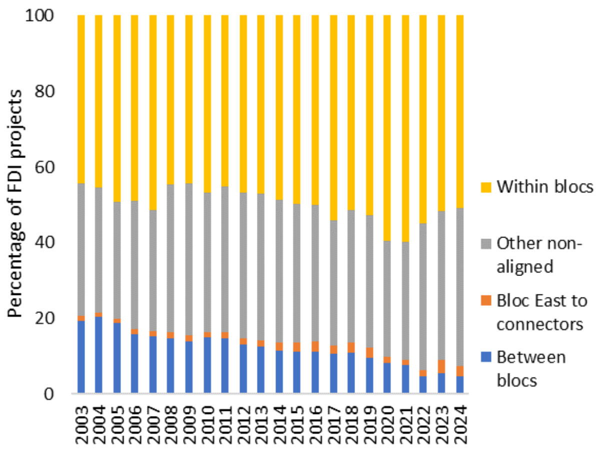
Chart 7. FDI flows from the US to India increased sharply



Source: Cheng et al. (2025) based on FT fDi Markets database.
Note: 20 economies with the largest increases shown.

More generally, FDI between rival geopolitical blocs has been trending down, more so since 2022 (see Chart 8). The main relative gains can be observed in 'connectors' (where FDI to connector economies gained global share more than within-bloc investment), including FDI flows from bloc East (including China, Russia, and some other economies) to connectors (though from a low base; see Cheng et al. 2025).

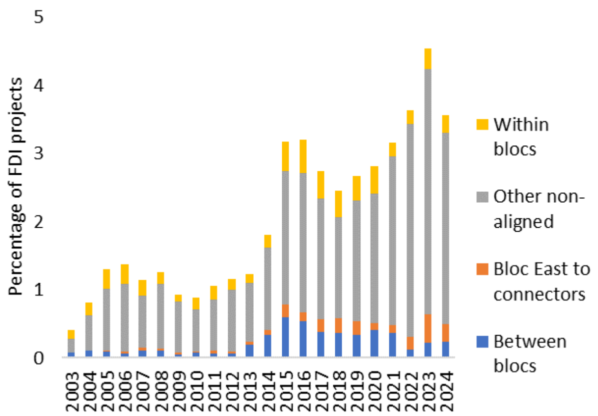
Chart 8. FDI between rival geopolitical blocs has been trending down



Source: Cheng et al. (2025) based on FT fDi markets.
Note: Within and between blocs based on bloc West, defined as countries that have imposed sanctions on Russia; bloc East defined on the basis of Gopinath et al. (2025), comprising Belarus, China including Special Administrative Regions, Mali, Nicaragua, Russia and Syria; other economies are referred to as 'connectors'.

In many cases connector economies that benefitted most from inflows of FDI provide access to large markets. For instance, Mexico has a deep and comprehensive free trade agreement with the US while Türkiye is in a customs union with the EU. Investments into special economic zones (SEZ) have also increased, though account for a relatively small share of total FDI inflows (see Chart 9). In addition to their tax and infrastructure advantages, the speed and predictable regimes offered by SEZ may be increasingly at a premium (see Cheng et al. 2025). In sum, some economies can benefit from the swift redirection of trade and investment against the backdrop of geopolitical fragmentation – provided they retain relatively privileged access to large markets.

Chart 9. Investment in special economic zones has been rising

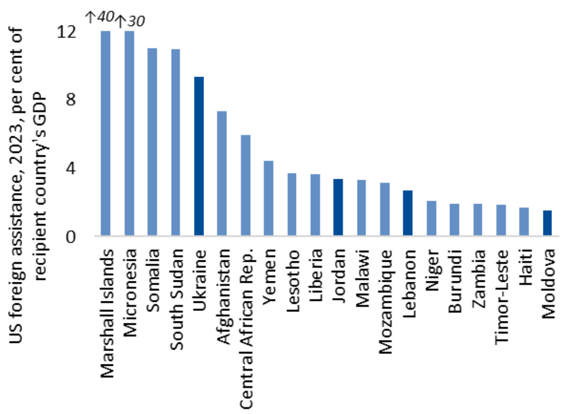


Source: FT fDi markets and authors' calculations.

Reduced international aid

In addition to introducing additional import tariffs, the new US administration announced a review of US foreign aid programmes, with most programmes effectively suspended at the time of writing. Abrupt suspension of US aid may have a profound effect on selected economies, well above any estimates of the impact of high trade tariffs. In the EBRD regions, total US foreign assistance amounts to 1.6 to 3.4 per cent of GDP in Jordan, Lebanon and Moldova and over 9 per cent in Ukraine (see Chart 10).

Chart 10. Some economies in the EBRD regions receive significant foreign assistance from the US



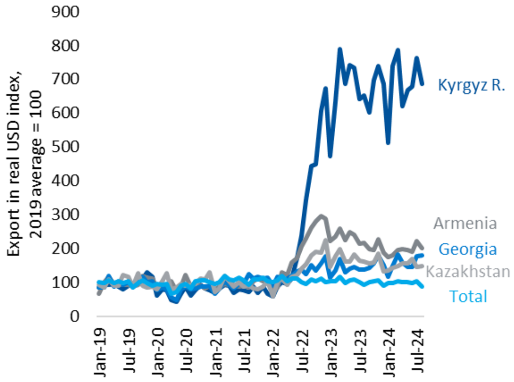
Source: ForeignAssistance.gov, USAID, US Department of State. foreignassistance.gov/data and authors' calculations.
Note: Top 20 economies globally shown.

Intermediated trade moderating

EU exports to the Caucasus and Central Asia remain high relative to the levels seen before the start of the war on Ukraine, however, they have declined relative to their 2023 levels (see Chart 11). EU exports to Armenia, Georgia, Kazakhstan, and the Kyrgyz Republic were 90 per cent higher in January-August 2024 than in the same period of 2021 and 50 per cent higher than in the same period in 2022. However, they were around 5 per cent lower than in the same period in 2023. For a detailed discussion of the role of these economies in intermediating trade with Russia following the imposition of comprehensive trade sanctions by the European Union and a number of other economies, see Chupilkin et al. 2025a and the earlier issues of Regional Economic Prospects.

These trends suggest that intermediated trade remains important for the economies of the Caucasus and Central Asia but is unlikely to provide a further boost to growth. Moderation of intermediated trade may reflect the increased threat of secondary sanctions (applied selectively on certain intermediaries since the second half of 2023), tightening of rules governing transit shipments from the EU through Russian territory (see Chupilkin et al. 2025b) as well as increased trade between other economies that did not impose sanctions on Russia and Russia (see Chupilkin et al. 2025c).

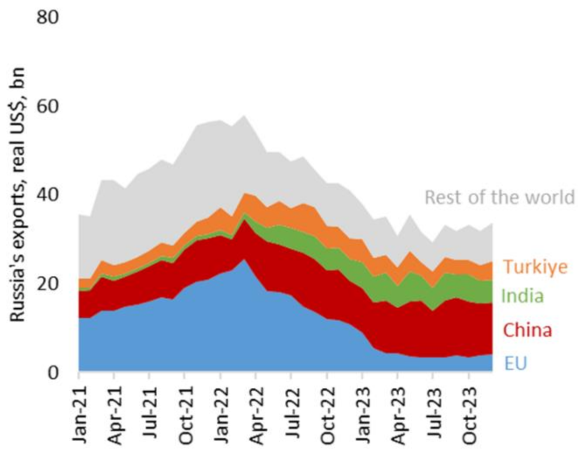
Chart 11. EU exports to Central Asia and the Caucasus remain well above historical trends but are down year-on-year



Source: Refnitiv Eikon and authors' calculations.
Note: Last observation is August 2024.

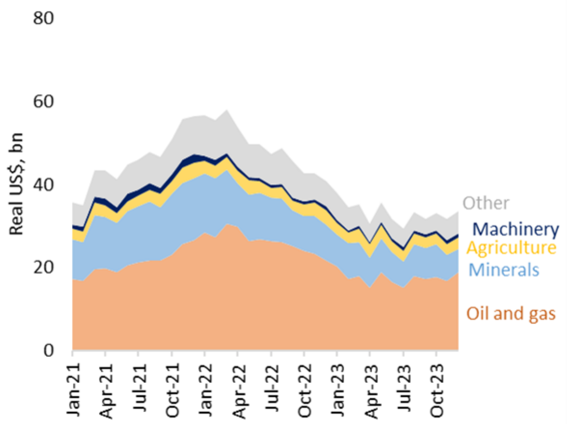
China's share in Russia's total exports also increased sharply, from 17 per cent in 2021 to 35 per cent in 2023 while India's share rose from 2 to 17 per cent over the same period; see Chart 12). Shares of Türkiye, Kazakhstan and Brazil also increased. Overall, Russia's exports fell by 27 per cent in 2023-24 relative to 2021 in US dollar terms. Commodities continued to account for around 80 per cent of total exports (see Chart 13).

Chart 12. Russia's exports shifted from the EU to China and India



Source: UN Comtrade, Refinitiv and authors' calculations.
Note: Based on data reported by importers. Last observation is December 2023.

Chart 13. Commodities continue to account for 80 per cent of Russia's exports

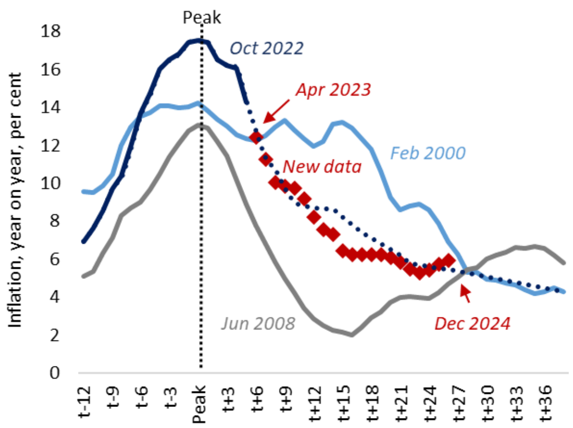


Source: UN Comtrade, Refinitiv and authors' calculations.
Note: Based on data reported by importers. Last observation is December 2023.

Disinflation proceeded as expected

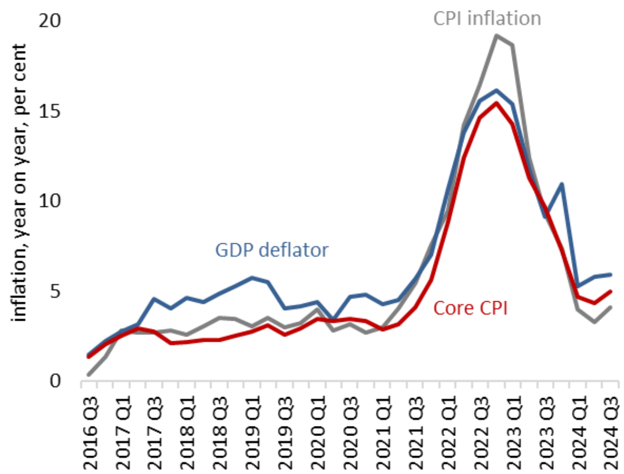
Average inflation in the EBRD regions declined from 17.5 per cent at its peak in October 2022 to 5.9 per cent in December 2024 but remained more than 1 percentage point above the pre-pandemic average (see Chart 14). The median (typical) inflation declined from 15.1 per cent to 3.4 per cent over the same period. This pattern is similar to the one observed in advanced economies and is broadly in line with the disinflation path expected as of early 2023. Trends were broadly similar across headline consumer price inflation, core inflation (excluding energy and food) and GDP deflators (see Chart 15). Core inflation has recently exceeded headline inflation as energy prices came down.

Chart 14. Average inflation is in line with expectations as of early 2023



Source: May 2023 Regional Economic Prospects based on IMF, national authorities via CEIC, World Bank Global Inflation database and authors' calculations.
Note: Simple average across 29 economies in the EBRD regions for Feb 2000, 32 for June 2008, 33 for Oct 2022 (excluding Ukraine 2024 onwards). Dashed line denotes a month-to-month curve fitted based on end of-year and annual average April 2023 IMF inflation forecasts. Curves corresponding to previous disinflation episodes are superimposed in a way that peak inflation (Feb 2020 and June 2008) coincides with the recent inflation peak observed in Oct 2022. For example, Nov 2022 corresponds to July 2008 for the 2008 episode, and so on. Diamonds denote data releases after the May 2023 Regional Economic Prospects.

Chart 15. Core inflation has recently exceeded headline inflation as energy prices came down

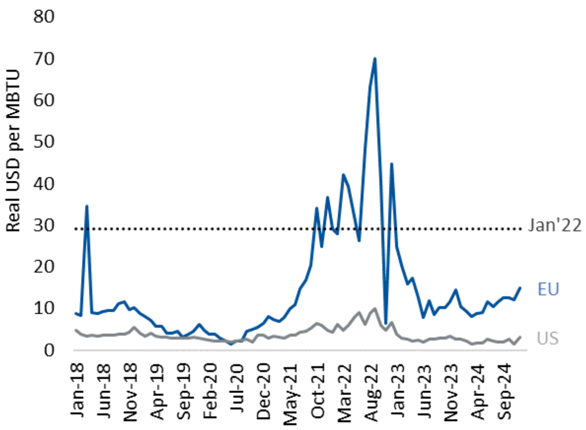


Source: CEIC, national statistical agencies and authors' calculations.
Note: Medians across Czechia, Egypt, Estonia, Greece, Hungary, Kazakhstan, Latvia, Poland, Romania, and Türkiye.

Oil and gas prices below their January 2022 levels

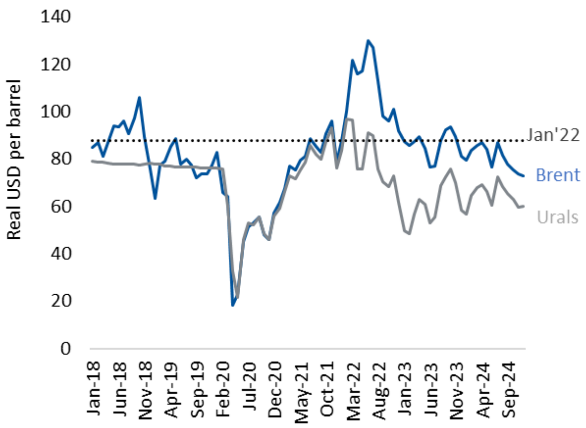
Gas prices in Europe have stabilised around their 2017-21 averages, though have picked up recently on colder weather (see Chart 16). Futures suggest that natural gas prices are expected to increase in 2025 by around 40 per cent in Europe and 70 per cent in the United States relative to 2024 as increases in energy demand are projected to outpace supply. The gap between gas prices in Europe and the United States is expected to persist (current prices are around 5 times higher in Europe). Oil prices are also lower than in January 2022 and have remained close to their 2017-21 averages (see Chart 17).

Chart 16. Gas prices are around their 2017-21 average levels



Source: Refinitiv and authors' calculations.
Note: Prices adjusted for US inflation.

Chart 17. Oil prices are below their January 2022 levels

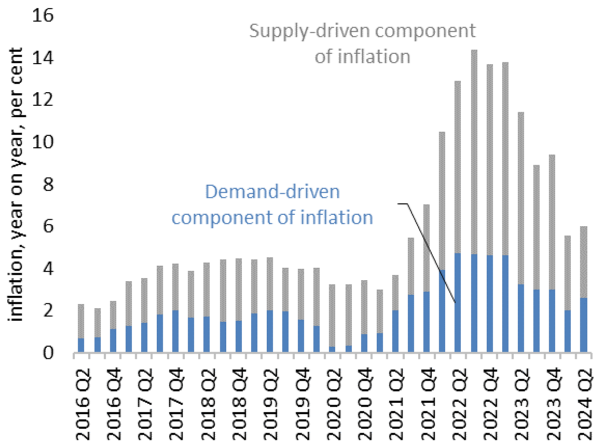


Source: Refinitiv and authors' calculations.
Note: Prices adjusted for US inflation.

Inflationary pressures increasingly demand-driven

In 2022-23, inflation in the EBRD regions was to a large extent supply-driven reflecting high food and energy price inflation and supply chain disruptions (see Chart 18 decomposing inflation into supply- and demand-side factors based on the approach in Shapiro 2022, see Box 3 for details of the decomposition). In contrast, in 2024, demand-side drivers of inflation—such as expansionary fiscal policies and rising wages—became relatively more important (see also Firat and Hao 2023) and average inflation in the EBRD regions started picking up again (see Charts 14 and 15).

Chart 18. Expansionary fiscal policies contributed to inflation

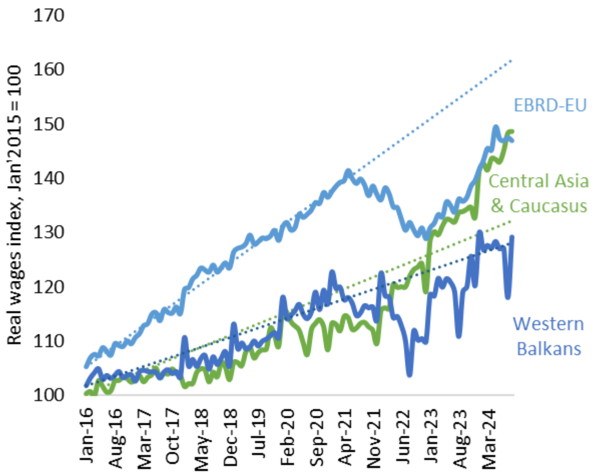


Source: CEIC, national statistical agencies and authors' calculations.
Note: Medians across Czechia, Egypt, Estonia, Greece, Hungary, Kazakhstan, Latvia, Poland, Romania, and Türkiye. The inflation decomposition is obtained by estimating a VAR model using the deflator and the volume of a particular sector in first differences with four lags. This VAR model looks at whether inflation in each individual sector can be attributed to supply- or demand-driven factors, following the methodology used in Shapiro (2022).

Real wage growth resumed

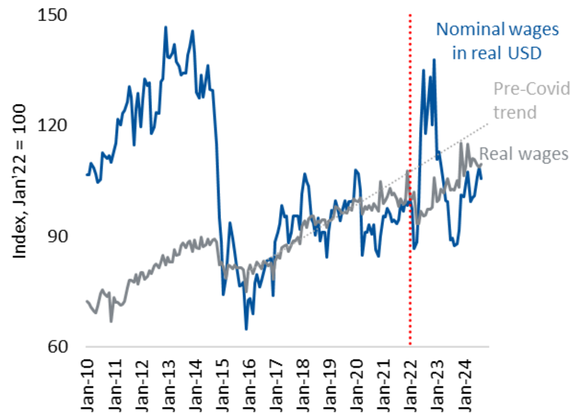
As inflation subsided from its 2022 peak, real wages have been catching up across the EBRD regions. After a period of rapid catch-up, real wage growth has recently moderated in EU-EBRD economies, at around 9 per cent below their pre-Covid trend levels. In contrast, they are well above the pre-Covid trend in Central Asia and the Caucasus (see Chart 19). Türkiye has also experienced fast wage growth in real terms since mid-2022—including on the back of increased exports. In Russia, real wage growth has moderated (see Chart 20). Real wages remain below their pre-Covid trend levels. In US dollar terms they are below their pre-2014 levels.

Chart 19. Real wages remain below their pre-Covid trend in EU-EBRD economies



Source: Refinitiv Eikon and authors' calculations.
Note: Dashed lines denote pre-Covid trends. Simple averages across an unbalanced panel of up to 10 EU-EBRD economies. up to 6 economies in Central Asia and the Caucasus and 5 economies in the Western Balkans.

Chart 20. Real wages in Russia in US dollar terms are below their pre-2014 levels

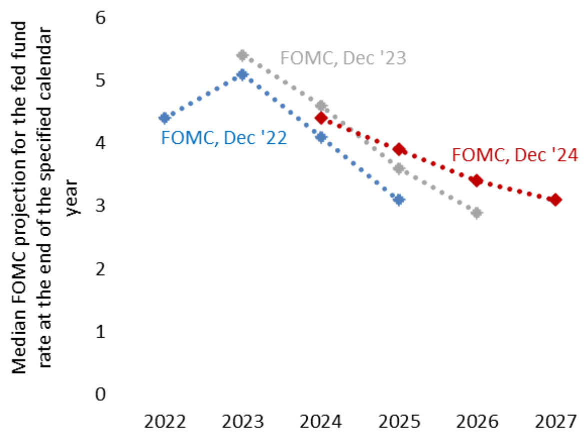


Source: Refinitiv Eikon and authors' calculations.
Note: Last observation is September 2024.

Increased budget deficits put upward pressure on interest rates

While inflation moderated largely in line with expectations, interest rates have been declining more slowly than previously expected, including in the US (see Chart 21). This, in turn, reflects higher fiscal deficits across advanced economies and emerging markets. The average general government balance in the EBRD regions deteriorated by around 2.2 percentage points (from -1.6 per cent to -3.8 per cent of GDP) between 2017-19 and 2024 and is projected to remain around the current level in 2025 before gradually improving (by around 1 percentage point) over the subsequent four-year period. Similar trends are observed in the US, France, Germany and many other large economies. As governments' savings are reduced, changes in global savings-investment balances translate into higher interest rates at longer maturities. Higher issuance of medium- and long-term bonds by governments also translates into an increased term premium (the difference between the cost of longer-term and short-term debt), though term premia remain modest by historical standards.

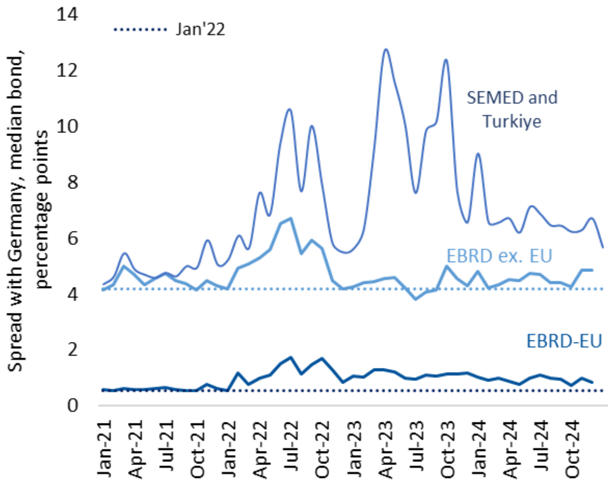
Chart 21. Interest rates in the US have been declining more slowly than previously expected



Source: Federal Reserve Bank of St. Louis and authors' calculations.

In the EBRD regions as a whole, the median yield on 5-year government bonds increased by 2.1 percentage points between early February 2022 and January 2025, reflecting higher rates in advanced economies. All of this increase, on average, reflects changes in global conditions as the spread relative to Germany returned to the levels seen before the start of the war on Ukraine (see Chart 22).

Chart 22. On average, in the EBRD regions, the spread relative to Germany is back to around its pre-war level

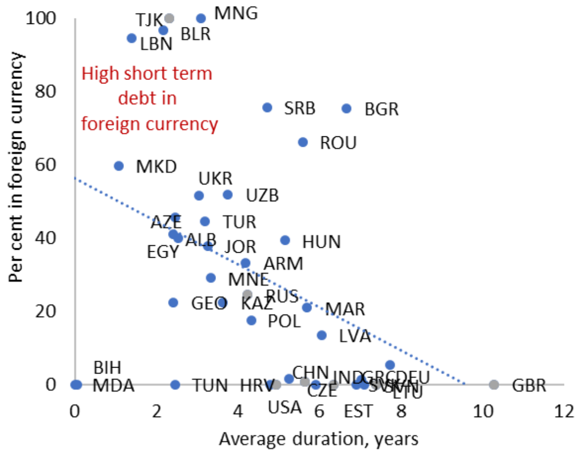


Source: Bloomberg and authors' calculations.
Note: Spread between the German 5-year bond and median government bond in EUR or USD of maturity between 4-7 years. EU-EBRD includes Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia.

Increased interest rates, in turn, can exacerbate pressures on government finances, albeit with a delay. Many emerging markets in the EBRD regions and beyond took advantage of the recent period of favourable financing conditions and compressed term premia to lengthen the maturity of their debt profiles and increase the share of debt denominated in local currency. As a result, increases in global interest rates (and / or appreciation of the US dollar) take longer to translate into increases in governments' debt servicing costs.

Lebanon, Mongolia and Tajikistan stand out among economies in the EBRD regions in terms of fiscal and external vulnerabilities. These economies have high shares of both short-term and foreign currency government bonds (see Chart 23). US dollar denominated debt accounts for over 80 per cent of total government bonds in Mongolia and Tajikistan.

Chart 23. Some economies in the EBRD regions have high shares of short-term and foreign currency government debt

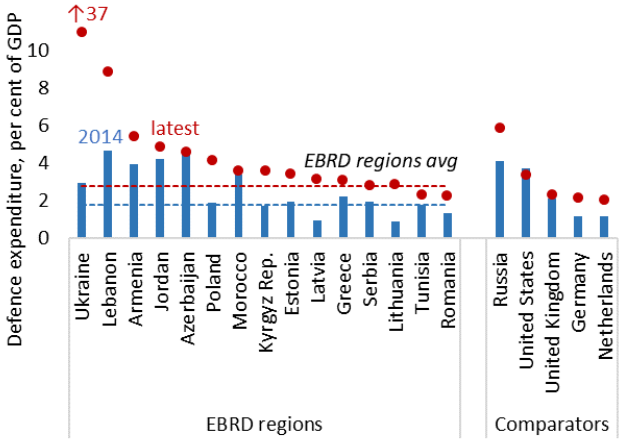


Source: Refinitiv, Cbonds and authors' calculations.
Note: Duration is defined as weighted average (by amount outstanding) of Macaulay Duration, representing the time-weighted average of a bond's cash flows (coupon payments and face value) in years, discounted at the yield to maturity. It accounts for the number of periods remaining until maturity.

While country circumstances vary, larger government deficits often reflect common fiscal pressures across economies. These include, for instance, rising demand for a greater role of the state in the economy in the aftermath of the Covid-19 crisis (see EBRD 2020 and Kóczán and Plekhanov 2023), the resurgence of industrial policies accompanying fragmentation of trade and investment along geopolitical lines (see EBRD 2024 and Kóczán et al. 2025), the fiscal burden of ageing populations (including increased outlays on health care and pensions), as well as the recent rise in defence spending.

Defence spending in the EBRD regions nearly doubled over the last decade, rising from around 1.8 per cent of GDP in 2014 to around 3.5 per cent of GDP in 2023 (2.4 per cent when excluding Ukraine; see Chart 24). 2025-26 budgets often foresee further increases in defence spending (see Chart 24).

Chart 24. The erosion of the 'peace dividend'

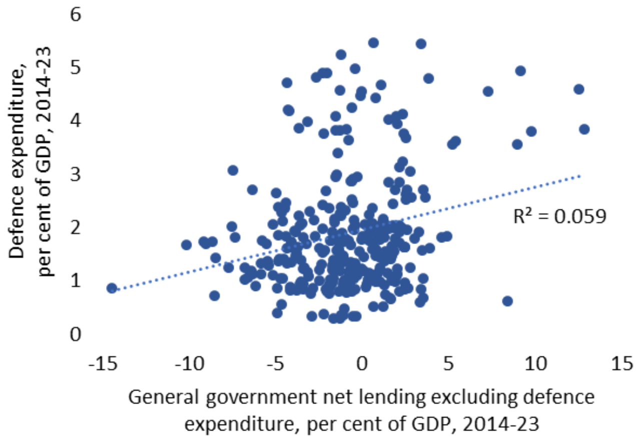


Source: Stockholm International Peace Research Institute (SIPRI) Military Expenditure Database, NATO and authors' calculations.
Note: The latest figures are 2024 estimates for NATO economies and 2023 figures for all other economies. EBRD average is a simple average across all EBRD economies, excluding Turkmenistan and Uzbekistan due to data availability. 15 economies in the EBRD regions with the highest defence spending as per cent of GDP in 2023/24 shown.

Across economies, defence spending was somewhat higher where fiscal space was greater (measured here as a smaller deficit excluding defence spending). This relationship is relatively weak, however, with less than 6 per cent of the variation in defence spending explained by this measure of fiscal space (see Chart 25).

This implies that defence spending is largely driven by other factors and is largely debt financed. Likewise, Kóczán et al. (2025) show that geopolitical factors dominate when it comes to the design of industrial policies, including in economies with higher incomes and stronger institutions.

Chart 25. Across economies, there is only a weak relationship between defence spending and fiscal space

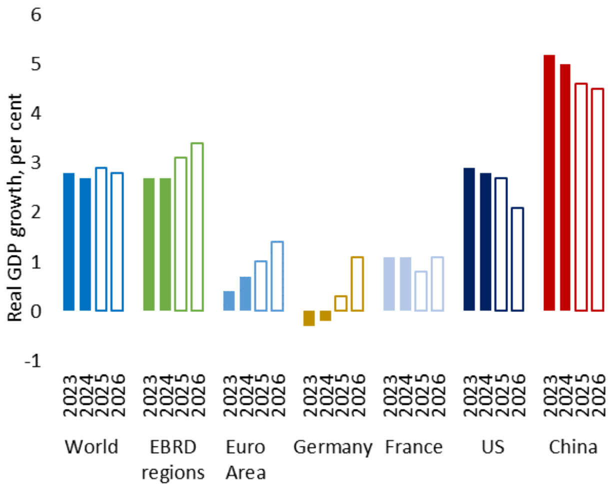


Source: Stockholm International Peace Research Institute (SIPRI) Military Expenditure Database and authors' calculations.
Note: Each dot represents an EBRD economy in a given year between 2014 to 2023. Ukraine (with defence expenditure in 2023 at 37 per cent of GDP is not shown in the chart).

Output in the EBRD regions is expected to grow by 3.2 per cent in 2025 and 3.4 per cent in 2026

Global growth is expected to remain stable yet underwhelming according to the International Monetary Fund's (IMF) January 2025 *World Economic Outlook* (see Chart 26). The divergence between the United States and advanced Europe is expected to persist. This has been reflected in recent revisions to economic forecasts, with repeated upgrades to the projections for the United States (in both the IMF's October 2024 *World Economic Outlook* and the January 2025 *Update*) and downgrades for the Euro area and Germany in particular.

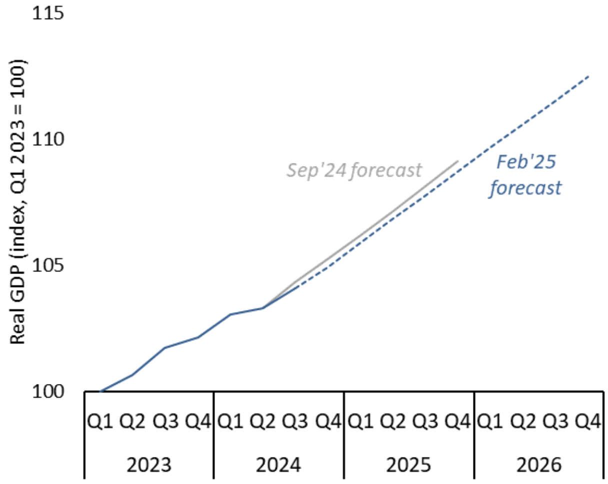
Chart 26. The differential between economic growth in advanced Europe and the United States is expected to persist



Source: IMF January 2025 and October 2024 World Economic Outlook, national authorities and authors' calculations.
Note: World figures are at market exchange rates. 2024 based on national authorities' estimates, except for the World and EBRD, which are based on IMF projections.

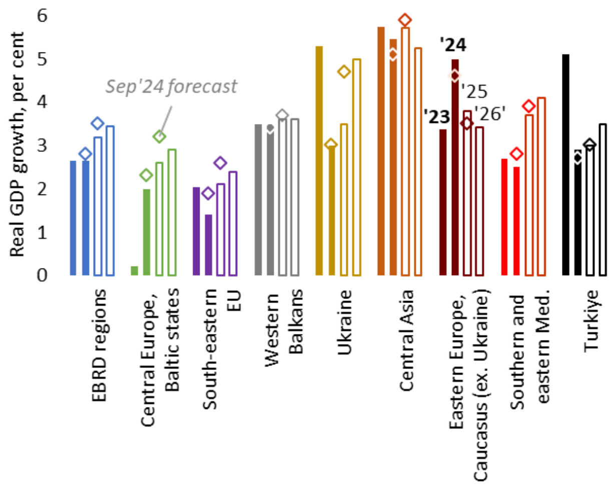
Against this backdrop, the 2025 growth projection for the EBRD regions has been revised down by 0.3 percentage points relative to the September 2024 forecast. Growth is now expected to average 3.2 per cent in 2025 (see Table 1 and Chart 27). Growth projections for central Europe and the Baltic states and the south-eastern EU have been revised down on weak external demand while downward revisions in the southern eastern Mediterranean reflect the impact of conflicts and weak reform momentum (see Chart 28). Average growth in the EBRD regions is expected to pick up to 3.4 per cent in 2026.

Chart 27. Forecasts of growth in the EBRD regions in 2025 have been revised down by 0.3 pp since September 2024



Source: National authorities via CEIC and EBRD forecasts.
Note: EBRD average based on the values of gross domestic product in 2022 in current US dollars from the IMF.

Chart 28. Growth in the EBRD regions is expected at 3.2 per cent in 2025 and 3.4 per cent in 2026



Source: National authorities via CEIC and EBRD forecasts.
Note: EBRD average based on the values of gross domestic product in 2022 in current US dollars from the IMF.

Regional outlooks

Growth in **central Europe and the Baltic states** picked up from 0.3 per cent in 2023 to 1.8 per cent year on year in January-September 2024 and an estimated 2 per cent in 2024 as a whole as economies gradually adjusted to a lower supply of Russian gas and higher energy prices. As part of this adjustment, employment increasingly shifted away from energy-intensive sectors such as metals, minerals, chemicals, plastics, rubber, wood, paper and furniture towards services, notably IT (see Box 2). Growth is expected at 2.7 per cent in 2025 and 2.8 per cent in 2026 as labour markets remain resilient. Growth in 2024 was nonetheless weaker than previously expected and 2025 forecasts have been revised down on a slower-than-expected recovery in advanced Europe weighing on manufacturing and exports and sluggish investment.

Growth in the **south-eastern EU** decelerated from 2.3 per cent in 2023 to 1.6 per cent year on year in January-September 2024 and an estimated 1.5 per cent in 2024 as a whole. This outcome was weaker than previously expected on sluggish external demand, a slowdown in investment and more modest fiscal stimulus. Growth is expected to pick up to 2.1 per cent in 2025 (less than previously expected) and 2.4 per cent in 2026.

Growth in the **Western Balkans** is estimated at 3.5 per cent in 2024 (similar to the level seen in 2023) and is expected to remain stable at 3.6 per cent in both 2025 and 2026. The downward revision to the 2025 forecast reflects weak external demand and lower domestic spillovers from public investment projects in a context of tight labour markets.

Growth in **Central Asia** moderated from 5.7 per cent in 2023 to an estimated 5.4 per cent in 2024 as mining output in Kazakhstan and Uzbekistan stagnated. It is expected at 5.7 per cent in 2025 and 5.2 per cent in 2026, though intermediated trade is unlikely to provide a further boost to growth.

In **eastern Europe and the Caucasus**, growth slowed from 4.4 per cent in 2023 to an estimated 3.9 per cent in 2024 as the boost from intermediated trade and inflows of labour and capital to the economies of the Caucasus waned. Growth is expected to moderate to 3.6 per cent in 2025 before picking up to 4.3 per cent in 2026. The 2025 growth forecast for **Ukraine** has been revised down as the destruction of electricity infrastructure caused by Russia’s war on Ukraine is expected to continue weighing on production.

In **Türkiye**, growth moderated from 5.1 per cent in 2023 to an estimated 2.9 per cent in 2024 on tighter monetary policy aimed at bringing down persistently high inflation. Export growth remained strong despite the appreciating real effective exchange rate. Growth is expected to pick up to 3 per cent in 2025 (unchanged relative to the September 2024 forecast) and 3.5 per cent in 2026. As inflation declined, real wages have been increasing rapidly.

Growth in the **southern and eastern Mediterranean** moderated from 2.7 per cent in 2023 to an estimated 2.5 per cent in 2024. It is expected to pick up to 3.7 per cent in 2025 and 4.1 per cent in 2026. The 2024 outcome was weaker than expected and the 2025 forecasts have been revised down relative to September 2024 reflecting the impact of conflicts and slow reform progress.

Risks

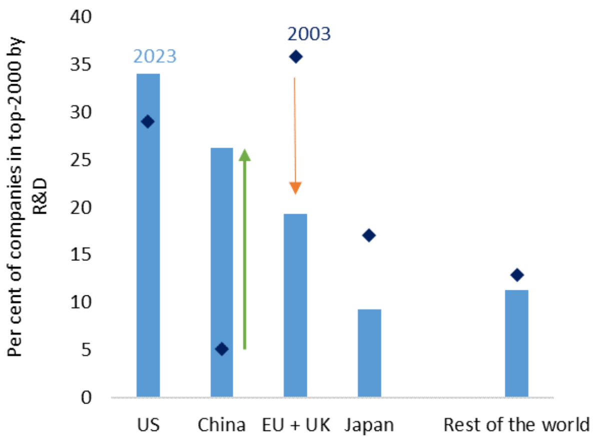
The outlook for growth in the EBRD regions is subject to numerous risks. They relate to further escalation of geopolitical tensions and a potential trade war; a sharper-than-expected slowdown in key trading partners such as Germany and China, renewed inflationary pressures on the back of high nominal wage growth and elevated levels of government spending in the EBRD regions as well as selected advanced economies; and increased frequency of extreme weather events such as droughts or floods.

Box 1. Innovation in the EBRD regions and beyond

The geography of innovation, whether measured using research and development spending or patent applications, has been changing, with a notable shift from Europe to the United States as well as China.

Divergence in growth paths of Europe and the United States coincided with profound shifts in the geography of global innovation, away from Europe. Since 2003, the number of European companies (those in the EU or the UK) in the top 2,000 global firms by spending on research and development (R&D) almost halved. As a result, using this indicator Europe was overtaken by both the US and China, where the number of companies in the top 2,000 by R&D increased five-fold (see Charts 1.1).

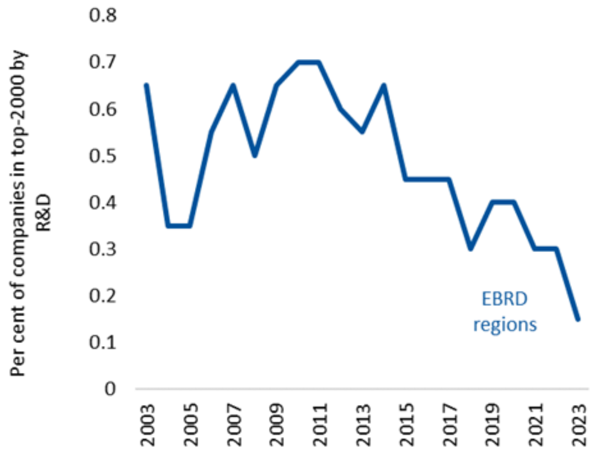
Chart 1.1. Since 2003, R&D has become much more concentrated in the US and China



Source: 2024 EU Industrial R&D Investment Scoreboard and authors' calculations.

In the EBRD regions, the number of such R&D champions peaked at 14 in 2011 and has been progressively declining since (see Chart 1.2). As of 2023, the three companies on that list were Aselsan (a defence electronics company in Türkiye), and pharmaceutical companies Richter Gedeon (Hungary) and Krka (Slovenia).

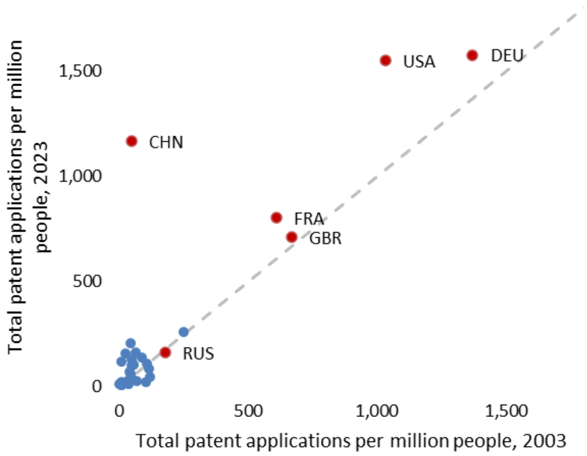
Chart 1.2. The number of R&D champions in the EBRD regions has declined



Source: 2024 EU Industrial R&D Investment Scoreboard and authors' calculations.

Patent applications per million people (filed globally, recorded based on the residence of the inventor) point to similar patterns: they increased sharply in China and to a lesser extent in the US between 2003 and 2023, while they remained broadly stable or declined in France, Germany and the United Kingdom (see Chart 1.3).

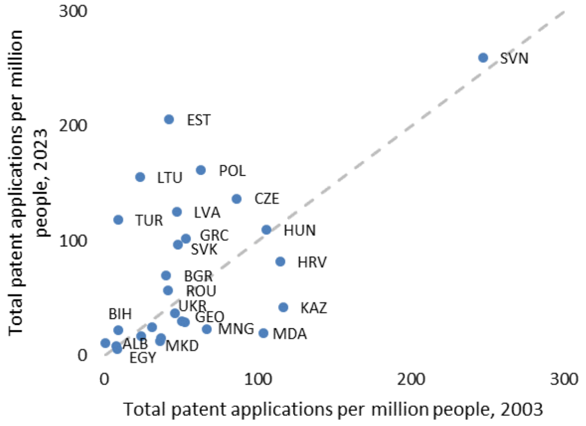
Chart 1.3. Patent applications per million people increased sharply in China and to a lesser extent the US



Source: World Intellectual Property Organization (WIPO), IMF October 2024 World Economic Outlook. Note: Patent applications filed globally, recorded based on the residence of the inventor.

In the EBRD regions, while EU-EBRD economies have seen sharp rises in patent applications per million people in the last two decades, the levels remain significantly lower than in the US, China or major economies in advanced Europe (see Charts 1.4 and 1.3).

Chart 1.4. Patent applications per million people increased in many EU-EBRD economies



Source: World Intellectual Property Organization (WIPO), IMF October 2024 World Economic Outlook.

Box 2. Potential impact of further increases in US import tariffs on economies in the EBRD regions

Much uncertainty remains around potential further tariffs that may be imposed on US imports and this uncertainty is, in itself, detrimental for trade, investment and growth. Selective tariffs imposed on other major trading partners, such as the 10 per cent extra tariff imposed on imports from China in early February 2025, could weaken global growth momentum in general while giving rise to substantial trade diversion as far as exports to the US are concerned. Their effect on the EBRD regions is thus ambiguous. In contrast, tariffs imposed on all trading partners would leave no scope for trade diversion and present greater risks for more open economies. In such a scenario envisaging a universal additional 10 per cent tariff on US imports, GDP in the EBRD regions could be 0.1-0.2 per cent lower in the short term on account of reduction in direct sales to the US, with the largest effects for economies such as Jordan, the Slovak Republic, Hungary and Lithuania. Appreciation of the US dollar could offset some of these effects. On the other hand, those effects could be substantially amplified by weaker growth in key trading partners such as Germany or China.

Much uncertainty remains around potential further tariffs that may be imposed on US imports. This uncertainty is, in itself, detrimental: when sweeping changes are certain, investors tend to respond fast establishing new supply chains and production facilities (see Aiyar and Ohnsorge 2024). For example, in response to the Inflation Reduction Act (IRA) in the US, economies with free trade agreements with the US (such as Morocco, Mexico or South Korea) saw rapid differential increases in inward foreign direct investment in clean-tech sectors where exports to the US could receive favourable treatment for the purpose of IRA's local content provision. Announcements of such projects followed almost immediately after the passage of the IRA (see Cheng et al. 2025).

On the other hand, when uncertainty is high and new rules are viewed as temporary or uncertain, investors may be reluctant to commit to new projects.

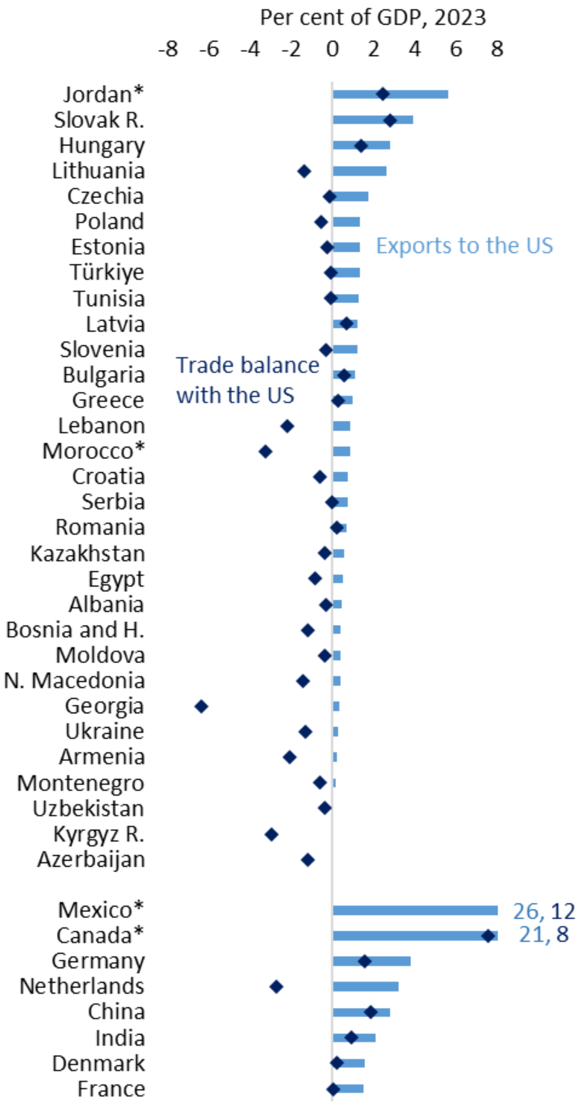
The following analysis examines the potential impact of *selective tariffs*, such as the 10 per cent tariff imposed on imports from China as of early February 2025 (or the 25 per cent tariffs on imports from Canada and Mexico, which were announced and then suspended) as well as the potential impact of *universal tariffs*, looking both at the EBRD regions' direct trade linkages with the US, indirect trade linkages with the US via production chains spanning other economies as well as indirect effects arising, for instance, from exchange rate movements or spillovers from slower growth in other major economies such as Germany or China.

Direct trade linkages with the US

For most economies in the EBRD regions, trade exposure to the US (including indirect linkages via supply chains) is manageable and, if anything, modest compared with the exposure to the gas price shock on the eve of the invasion of Ukraine. As in the case of the earlier gas shock, exposures are concentrated and can be large for specific sectors.

The highest trade exposure to the US in the EBRD regions is observed in Jordan (which has a free trade agreement with the US), the Slovak Republic, Hungary and Lithuania, where exports to the US reached 3 to 6 per cent of GDP in 2023 (see Chart 2.1). For comparison, exports to the US were around 3 to 4 per cent of GDP in China and Germany, 21 per cent of GDP in Canada and 26 per cent of GDP in Mexico.

Chart 2.1. EBRD economies most exposed to the US are Jordan, the Slovak Republic, Hungary, and Lithuania



Source: UN COMTRADE and authors' calculations.
*Note: * denotes free trade agreements with the US.*

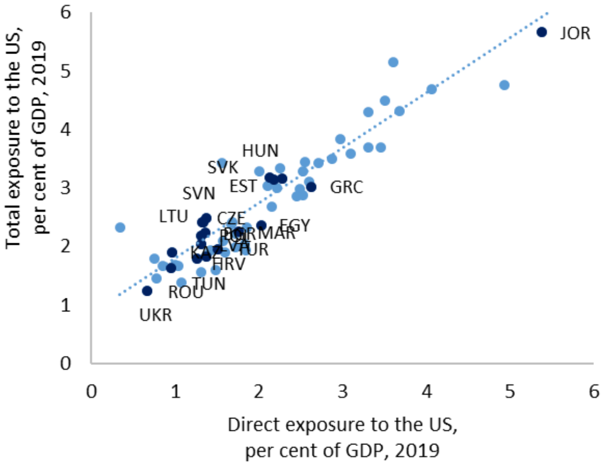
Announced increases in US tariffs (both implemented and suspended) have so far focused largely on US's important trading partners running a large trade surplus with the US (see Chart 2.1, Colombia, not shown, also runs a trade surplus with the US and exports around 5 per cent of GDP worth of goods). Economies in the EBRD regions rank far behind larger exporters to the US, such as Mexico, China, and Canada (accounting for around 13-16 per cent of US imports each in 2023-24) or Germany and Japan (each accounting for around 5 per cent of US imports), with Türkiye, Poland and Hungary, the largest within the EBRD regions, accounting for around 0.4-0.5 per cent of US imports each. The EU as a whole, however, is a sizable source of US imports accounting for 15 per cent of the total in 2024.

Most economies in the EBRD regions run a trade deficit with the US. The Slovak Republic, Jordan and Hungary, however, have a trade surplus of around 1 to 3 per cent of their GDP—a similar magnitude as share of GDP as that of China, Colombia or Germany but much smaller than the surpluses of Canada and Mexico (8-12 per cent, see Chart 2.1).

Some exposure to US consumers is indirect. It may involve exporting goods to, say, Germany, where those goods serve as inputs into production of goods that are, in turn, destined for the US market. Total linkages can be computed for selected economies using OECD's Trade in Value Added database.

Across economies, direct and indirect linkages are strongly correlated (see Chart 2.2). EU-EBRD economies are somewhat more exposed to the US when taking into account all linkages (the corresponding dots lie above the trend line on Chart 2.2).

Chart 2.2. EU-EBRD economies are more exposed to the US when taking into account all linkages

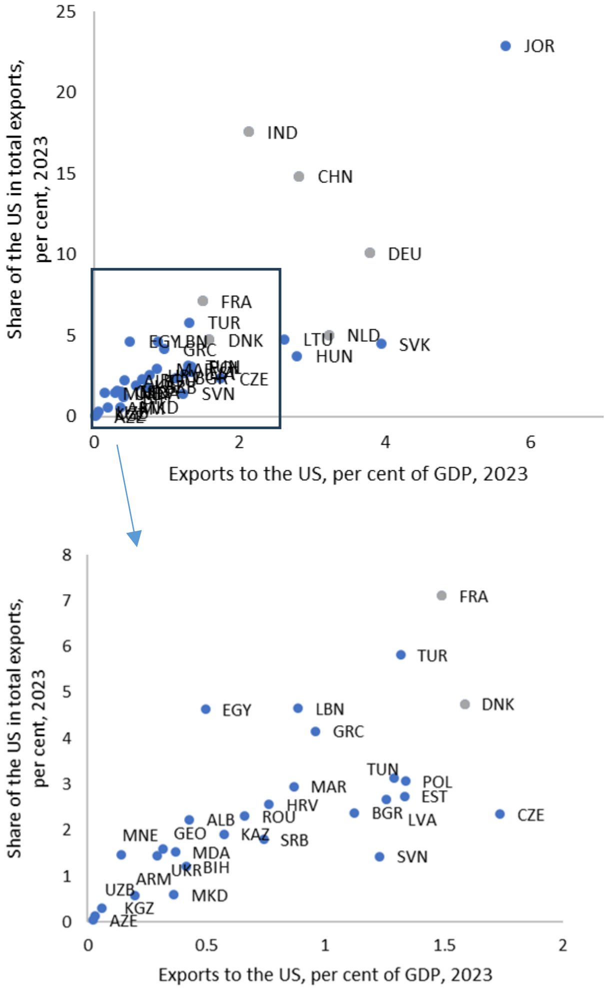


Source: OECD TiVA database and authors' calculations.
Note: Direct exposure is calculated as value added in direct exports to the US and total exposure is calculated as total value added in US demand.

The potential effects of tariffs also depend on the ability of exporters to replace the US with other export markets. This may be more difficult if exporters of a particular product currently have little presence elsewhere (see, for instance, Martinez Turegano 2024).

The US market accounted for 78-80 per cent of Canada's and Mexico's exports in 2023 and 10-15 per cent of China's and Germany's exports (see Chart 2.3). In contrast, while Hungary, the Slovak Republic and Lithuania had large exports to the US, their exports were more diversified across destinations (with the US only accounting for around 4 per cent of their exports). For Jordan, on the other hand, exports to the US are high both as a share of GDP and as a share of all exports (around 23 per cent).

Chart 2.3. Jordan has both significant exports to the US as a share of GDP and a high share of the US in total exports

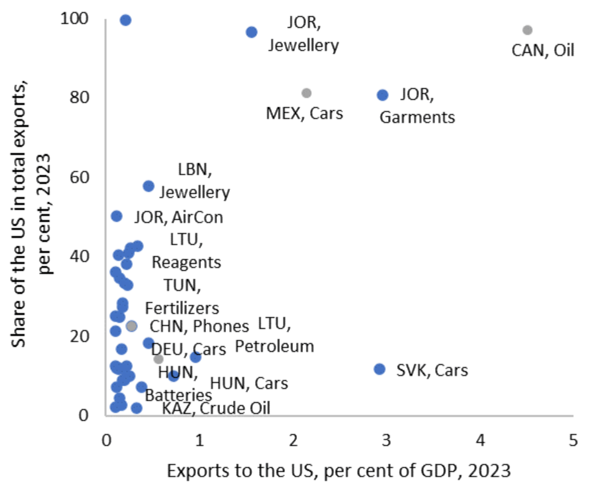


Source: UN Comtrade and authors' calculations.

Exports tend to be concentrated in particular sectors. The Slovak Republic and Hungary primarily export cars, car parts and batteries to the US, Hungary also exports electronics while Jordan mostly exports garments and jewellery.

Zooming in on the potential for redirection of exports in these particular sectors, for Hungary and the Slovak Republic, for car and battery exports, the US accounts for around 7 to 12 per cent of total exports, similar to the exposure for cars from Germany (see Chart 2.4). In Jordan, in turn, the US accounts for 81-97 per cent of total exports for goods such as garments and jewellery—comparable to the exposures for Mexico for cars and Canada for oil. In the EU in general, industries such as chemicals, machinery and cars would be most affected, with spillovers for Emerging Europe (Cingari 2024, Garcia Bercero, Mavroidis and Sapir 2024; Sausay 2024). Any impact of higher US tariffs would compound the earlier effects of higher energy prices and lower global sales of vehicles in per capita terms.

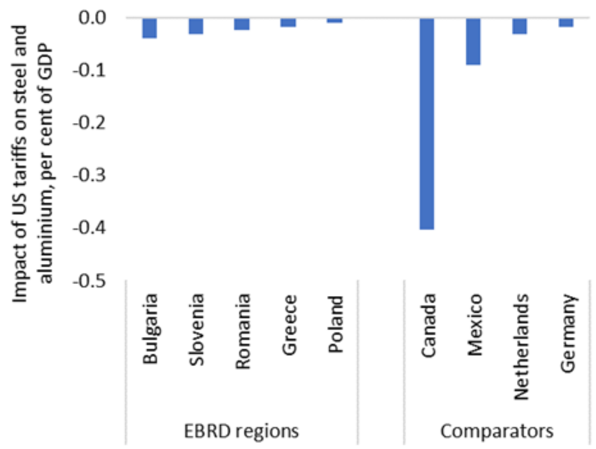
Chart 2.4. Jordan has both significant exports to the US and a high share of the US in total exports for goods such as garments and jewellery



Source: UN Comtrade and authors' calculations.
Note: For economies in the EBRD regions, all HS4 goods with exports to the US of more than 0.1 per cent of GDP shown. For comparators, selected product lines shown.

On 10 February 2025, the US announced an additional 25 per cent tariff would apply to all imported steel and aluminium from mid-March 2025. For economies outside the EU in the EBRD regions this announcement corresponds to a 15 percentage point increase in tariffs on aluminium products while the EU economies are expected to see a 25 percentage point increase in tariffs on steel and aluminium products alongside other major exporters such as Canada and Mexico. Elasticities of import demand vary across steel and aluminium products: for instance, while iron and non-alloy steel bars and rods can be easily substituted with other goods, demand for, say, ferro-niobium (used to increase the strength of alloys, for instance used in cars) is highly inelastic. Taking the volumes of existing exports to the US and the differing elasticities of import demand for individual products into account, a 25 per cent tariff could translate into a reduction of GDP up to 0.03 per cent lower GDP in Bulgaria. Slovenia and Romania (see Chart 2.5).

Chart 2.5. In the EBRD regions, Bulgaria, Slovenia and Romania are more exposed to the announced increases in US tariffs on steel and aluminium

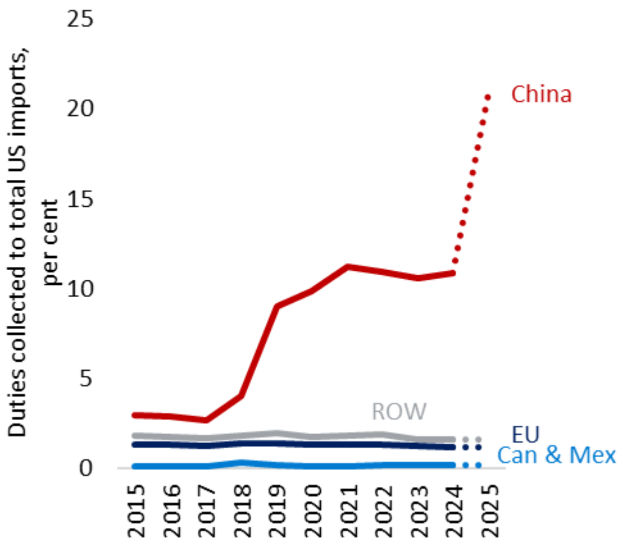


Source: UN Comtrade and authors' calculations.
Note: Based on HS6-level elasticities and assuming a 25 per cent US import tariffs on steel and aluminium products. Economies with an impact of at least 0.01 per cent of GDP in the EBRD regions and select comparators shown. The demand shock for a particular HS6 product is capped at 100 per cent of existing exports.

Potential effects of selective tariffs

Between 2016 and early 2025, China experienced an increase in the effective average US import tariff of around 10 percentage points, with little movement in the average tariffs for other economies (see Chart 2.6).

Chart 2.6. Tariffs on imports from China increased sharply since 2019



Source: United States International Trade Commission (USITC) and authors' calculations.
Note: EBRD regions constructed as the total duties collected on imports from the EBRD regions divided by the total imports from the EBRD regions. Dashed lines denote tariff changes for 2025 in effect as of 13 February 2025.

As of early February 2025, a further 10 per cent tariff was imposed on China and tariffs could start being levied on shipments below US$ 800 in value, which were previously exempt. A 25 per cent tariff on Canada (10 per cent on oil) and Mexico was announced but then suspended. Colombia was briefly targeted with a tariff in a row over deportations.

In a scenario in which additional tariffs are imposed on US imports from selected third countries, the impact on the EBRD regions is ambiguous. The economies not directly targeted by tariffs could benefit from some degree of trade diversion as they face lower competition in the US market. Economies that retain privileged access to the US market (for instance, as part of free trade agreements) may see a rise in inward FDI. On the other hand, they could face greater competition in other markets where exports from targeted economies may be diverted (see Martuscelli 2024).

Potential effects of universal tariffs

In another scenario, all economies may face additional tariffs on US imports, with little scope to benefit from diversion of trade and investment.

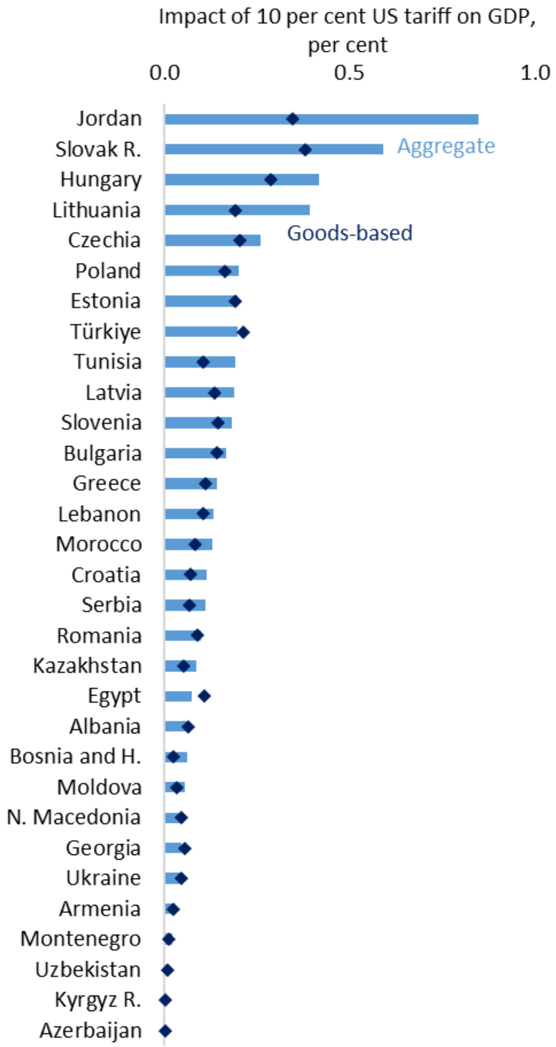
Estimates of the potential impact of a broad 10 per cent tariff on the EU GDP vary widely, ranging from 0.1 per cent (Saussay 2024) to 1.5 per cent (ABN Amro, Cingari 2024). Other estimates include 0.3 per cent over two years (Citi 2024), 0.5-1 per cent over four years (German Economic Institute and UBS Martuscelli 2024, Cingari 2024) and 1 per cent (Goldman Sachs, Cingari 2024). More open economies, such as Germany and the Netherlands would likely be hardest hit, with Germany's GDP being potentially 0.5 per cent (Cingari 2024) to 1.5 per cent smaller (German Economic Institute, Martuscelli 2024) and more muted effects on economies such as France, Italy and Spain.

A simple back-of-the envelope calculation could assume an aggregate elasticity of US imports of 1.5 (that is, a one per cent increase in price reduces demand by 1.5 per cent). In this case a 10 per cent tariff would reduce Germany's GDP by about 0.6 per cent (with the effect falling in the middle of the range of existing estimates).

Applying this approach further yields an impact on Jordan's GDP of about 0.8 per cent, 0.6 per cent of GDP for the Slovak Republic and Hungary and 0.4 per cent of GDP for Lithuania, with an average effect of less than 0.2 per cent of GDP across the EBRD regions (see the bars in Chart 2.7).

Different sectors have varying elasticities to tariffs (see a review by Head and Mayer 2014). For instance, demand for textile products is relatively elastic while demand for commodities such as oil or gas is not. An alternative estimate of the impact of tariffs relies on import demand elasticities at the HS6 level of disaggregation, the highest level of disaggregation of products that is fully internationally comparable and includes items such as sparkling wines or laptops. Accounting for product-specific elasticities of import demand points to smaller effects for Germany (around 0.4 per cent of GDP) and the EBRD regions as a whole (less than 0.1 per cent of GDP), as well as Jordan, the Slovak Republic, Hungary and Lithuania (see the diamonds in Chart 2.7). Somewhat larger effects, for instance, are found for Türkiye and Egypt, which export goods with a higher tariff elasticity (such as vessels, cigarettes and cereals in the case of Türkiye and iron rods in the case of Egypt).

Chart 2.7. A 10 per cent US tariff could reduce GDP in the EBRD regions by 0.1-0.2 per cent

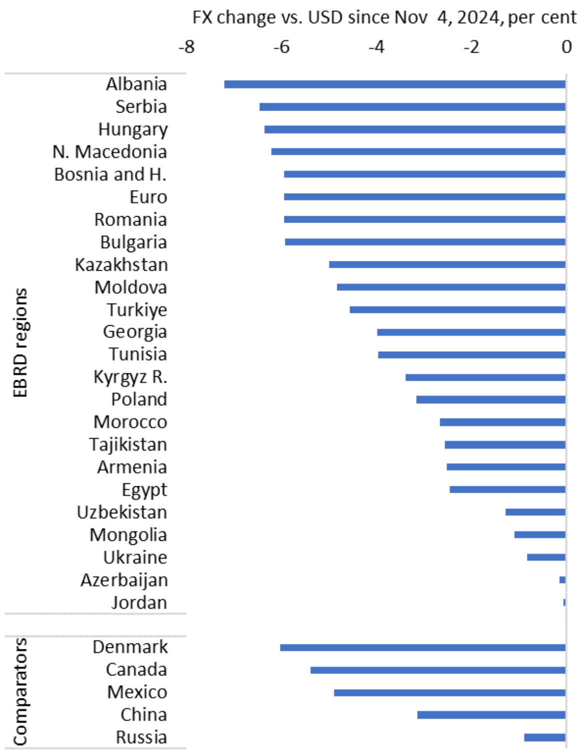


Source: Kee, Nicita and Olarreaga (2008, 2009), UN COMTRADE and authors' calculations.
Note: The demand shock for a particular HS6 product is capped at 100 per cent.

Additional tariffs on US imports are expected to be associated with strengthening of the US dollar against other currencies. Some of this effect already appears to have been priced in by the markets in anticipation of tariffs being imposed by the new US administration.

Currencies in the EBRD regions have generally weakened against the US dollar since the US election (see Chart 2.8). News on whether tariffs may be targeted at critical sectors or universal has also triggered volatility in exchange rates and stock markets, seen, for instance, in the Mexican peso, the Hungarian forint and auto stocks in Europe.

Chart 2.8. Currencies in the EBRD regions have generally weakened against the US dollar since the US election



Source: Bloomberg and authors' calculations.
Note: Changes from November 4 2024 to January 9 2025.

In economies with flexible exchange rates, depreciations relative to the US dollar could absorb some of the impact of tariffs as a dearer

US dollar translates into higher export revenue in local currency terms. As US exports become relatively more expensive for international consumers, some of the costs of import tariffs will be effectively borne by US exporters, which may lose market share.

In economies with exchange rates fixed to the US dollar, appreciating currencies may further disadvantage exporters in global markets. In addition, economies where a significant proportion of debt is denominated in US dollars, US dollar appreciation can increase effective debt servicing costs for governments, corporates and individuals.

Indirect effects

Beyond direct effects through trade exposure to the US, slower growth in key trading partners such as Germany and China would also weigh on growth.

The exports of central European countries tend to follow strongly the export trends of Germany, with correlations reaching 70-80 per cent in Hungary, the Slovak Republic and Slovenia (EBRD 2019). For instance, while for the Slovak Republic direct exports to the US are around 4 per cent of GDP, its exports to Germany are around 18 per cent of GDP. China is an important trading partner and source of investment for Central Asian economies: more than 80 per cent of Mongolia's exports (primarily coal and copper) go to China, China is also the main destination for Turkmen gas, and an important destination for metals, oil and gas exports from Kazakhstan.

Historically quarterly GDP growth in economies in the EBRD regions and in Germany have been strongly correlated. A 1 per cent reduction in GDP growth in Germany is associated with 0.8 per cent lower growth in the EBRD regions. Correlations with China's GDP growth have been, in general, weaker. However, for some economies, such as Mongolia, a 1 per cent reduction in GDP growth in China is associated with 0.6 per cent lower growth.

Such indirect effects can be large even where direct trade exposure to the US is limited—for instance, in south-eastern Europe.

Long-run versus short-run effects

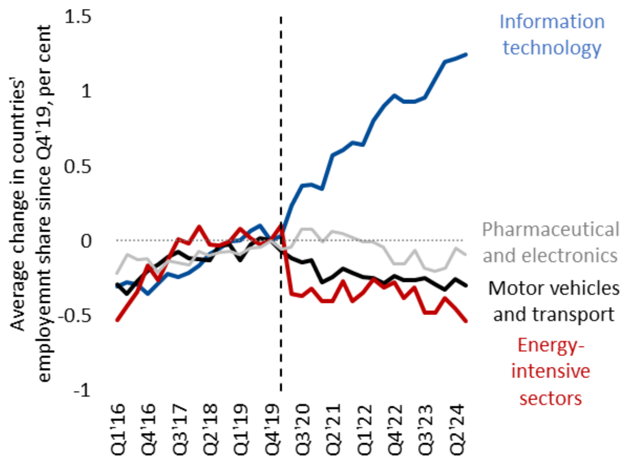
In the longer term, economies adjust to the new external environment and labour gets gradually relocated from negatively impacted sectors to more dynamic areas of the economy.

For example, the earlier energy shock in Europe had a particularly profound impact on the output of energy-intensive sectors such as the production of metals, non-metal minerals, chemicals, rubber and plastics, wood, paper, and furniture (see Plekhanov and Sassoon 2023). Before the Covid-19 crisis, employment in these sectors in the EU economies in the EBRD regions evolved broadly in line with employment in other manufacturing sectors or in IT (measured as a share of total employment in each economy, see Chart 2.9).

After the Covid-19 pandemic and the energy shock, employment in these sectors started steadily diverging. While immediately after the shock, differences in employment changes were small, they became starker with each passing quarter. By mid-2024, energy-intensive sectors shed labour equivalent to 0.5 percentage points of total employment on average. The least energy intensive sectors that increased their output following the gas shock, such as pharmaceuticals, computers, electronics and electrical equipment (see Plekhanov and Sassoon, 2023) largely retained their employment. The IT sector, on the other hand, added employment equivalent to 1.5 percentage points of the total. Construction, health and social services also registered employment increases.

Across the 12 economies, employment in energy-intensive sectors declined by over 300,000 jobs between end-2019 and the middle of 2024, while IT services added 467,000 jobs over the same period.

Chart 2.9. In the longer term, changes in tariffs could amplify ongoing shifts in labour markets



Source: Eurostat and authors' calculations.
Note: Simple averages across EU-EBRD economies. Information technology includes computer programming, consultancy, information services, and computer repairs. Energy-intensive sectors include the manufacture of metals, chemicals, coke, refined petroleum, fabricated metal products, furniture, non-metallic minerals, paper, rubber, plastics, and wood products. Pharmaceutical and electronics include the manufacture of computers, electronics, electrical equipment, and pharmaceuticals. Motor vehicles and transport include the manufacture of motor vehicles, trailers, and other transport equipment.

While in the longer-term economies adjust, large shocks leave scars. Individuals losing jobs in energy-intensive sectors or sectors that may be hard hit by tariffs are not necessarily the same individuals who find employment in dynamic sectors of the economy. Societies may become increasingly polarised and support for right-wing or left-wing populist parties may grow (see, for instance, Guriev and Papaioannou 2022 or Kóczán and Plekhanov 2023).

In addition, various economic shocks arising from restrictive policies may have far greater negative impacts on individuals' consumption and welfare than their impact on GDP. In response to such shocks, individuals are often forced to shift their consumption patterns away from first-best choices towards constrained choices dictated by, say, high tariffs on imported goods, export bans or Covid-19 related restrictions on the consumption of services.

Box 3. Demand-side versus and supply-side drivers of inflation

The spike in inflation following the Covid-19 pandemic and energy price shocks was unusual in its height and breadth as central banks across the world initially underestimated both the scale and persistence of inflation. Unlike many other inflation episodes, it also subsided without triggering a recession in most economies. While initially the post-Covid inflation was driven largely by supply-side shocks, in 2024 demand drivers made a relatively more important contribution to inflationary pressures.

The spike in inflation following the Covid-19 pandemic and energy price shocks was unusual in its height and breadth. Central banks across the world initially underestimated both the scale and persistence of inflation. Even those who foresaw higher inflation may have misjudged its underlying causes (see Bernanke and Blanchard 2023). Furthermore, unlike in similar disinflation episodes in the past, relatively rapid disinflation has so far not been accompanied by recessions or widespread labour market weakness, challenging the accepted view of a trade-off between inflation reduction and economic activity.

Motivated by this, the analysis presented in Chart 17 decomposes inflation into supply- and demand-side factors, employing a methodology similar to that of Shapiro (2022) and Firat and Hao (2023). While much of the recent literature has focused on inflation dynamics in advanced economies, this decomposition covers the drivers of inflation across the EBRD regions.

While demand-driven inflation typically calls for higher real interest rates to encourage saving and reduce consumption and investment, supply-side inflation—provided it does not de-anchor expectations—may not require the same degree of tightening.

The drivers of inflation are decomposed using output and inflation data for specific sectors and a vector autoregression (VAR) model in first differences. The model uses four lags for sectoral deflators (capturing changes in output prices) and quarterly output volumes in each country. The model is used to generate one-period-ahead forecasts and the residuals (errors) from these forecasts are then used to categorise inflation in a given sector as demand- or supply-driven. The underlying logic is that while demand-side shocks (such as expansionary fiscal policies) push prices and quantities in the same direction (in this case increasing both along the positively sloped supply curve), supply-side shocks (such as spikes in energy prices) move them in opposite directions (in this case prices increase while output contracts). If the residuals (forecast errors) for prices and output share the same sign, the price change is classified as demand-driven; if they have opposite signs, the price change is attributed to supply-side factors.

In each economy, the analysis includes up to 22 sectors. In each period and sector, inflation is categorised as demand-driven or supply-driven. The share of demand-driven inflation in a given period is derived as the share of the respective sectors in the total output covered by the analysis. A simple average of these shares across economies, in turn, yields the decomposition presented in Chart 17.

The results suggest that inflation in the EBRD regions was initially driven largely by supply-side shocks. Supply chain disruptions, surging food and energy prices, post-pandemic distortions in key product markets, and restrictions on supply of services during the pandemic all contributed to rising supply-driven inflation. The subsequent energy price shock further fuelled supply-side inflation. Demand-side factors, such as expansionary fiscal policies adopted during the Covid-19 pandemic contributed more modestly.

In 2024, while supply-side pressures eased (reflecting normalisation in energy prices and adjustments in the supply chains), the demand-driven component of inflation remained at historically high levels.

This shift back toward demand-driven inflation presents a more familiar yet still challenging situation for central banks—one that may require maintaining interest rates higher for longer than initially expected.

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Regional updates

Central Asia

Countries in Central Asia posted strong growth in 2024 and are expected to continue expanding at a robust rate in the short term. Growth was driven by domestic demand as incomes grew on the back of real wages increases, continued strong inflow of remittances and favourable tourist seasons in several countries, boosting the services sector. Inflation started accelerating in the second half of the year in nearly all economies, driven by demand-side pressures, energy tariff increases and, in some countries, depreciation against the US dollar. On the fiscal side, the situation is more mixed. Larger countries continue to run budget deficits on the back of elevated expenditures, but some economies also experienced strong growth in revenues. While government debt levels are projected to increase in the near term, growing international reserves provide a comfortable cushion against external shocks.

Kazakhstan

Robust economic growth continued in 2024, driven by the non-oil sector. Historically low unemployment and rising real wages boosted consumption, and investments continued to grow, albeit at a slower rate than in 2023. On the production side, agriculture, construction, trade and transport recorded the highest growth rates, while the mining and quarrying sector slightly declined due to oil output reduction. Following a gradual decline in the first half of the year, inflationary pressures strengthened in the second half and into 2025. Inflation reached 8.9 per cent in January 2025, driven by sustained demand pressures, including on the back of a fiscal stimulus, and the weakening of the tenge in the last quarter of 2024. This prompted the National Bank of Kazakhstan to increase the policy rate by 100 basis points to 15.25 per cent in November 2024 and keep the rate unchanged in the latest decision in January 2025, signalling the monetary authorities' commitment to contain price increases amid rising inflation expectations. The government continues to run a budget deficit because of lower revenue mobilisation and elevated expenditures. GDP growth is projected to accelerate to 5.2 per cent in 2025, helped by the planned expansion of the Tengiz oil field, before slowing down to 4.5 per cent in 2026.

Kyrgyz Republic

According to preliminary estimates, real GDP grew by 9 per cent in 2024 and by 10.6 per cent year on year in January 2025. This strong growth was driven by buoyant domestic demand, supported by a 19 per cent increase in remittances in 2024 and strong real wage growth. Investments increased strongly in 2024 on the back of a doubling of public investments. On the supply side, the construction, domestic trade, and hospitality sectors grew at double-digit rates. Annual inflation fell to 3.8 per cent in August 2024, but has since accelerated, reaching 6.7 per cent in January 2025 on the back of demand-side pressures. The latest reading is still within the central bank's target inflation rate of 5-7 per cent. The central bank's policy rate has remained unchanged at 9 per cent since May 2024. The fiscal position continued to improve last year on the back of an impressive uptick in tax receipts and a slower growth of expenditures. The country's international reserves reached US$ 5.2 billion in January 2025, a record high , the majority of which is gold. Real GDP is forecast to grow by 7 per cent in 2025 and 6 per cent in 2026.

Mongolia

The economy grew robustly in 2024. Strong demand was driven by real wage growth on the back of hikes in public sector salaries and minimum wages in the recent years, as well as strong growth of consumer loans. On the downside, a severe "dzud" (adverse winter weather conditions) led to massive livestock losses in 2024 and a major contraction in the agriculture sector. A consumption- and investment-driven increase in imports combined with a decline in coal export prices (despite record-high production volume of coal) moved the current account from a slight surplus in 2023 to a deficit in 2024. After briefly returning to the central bank's target in mid-2024, inflation accelerated to 9 per cent in December 2024, driven by strong demand and a significant increase in electricity tariffs for firms and households in October 2024, the first such increase since 2019. Real GDP growth is forecast at 6.7 per cent in 2025 and 6 per cent in 2026. The outlook remains sensitive to economic activity in China, the primary destination for Mongolian exports.

Tajikistan

The economy continued to post strong growth in 2024. Real GDP grew by 8.4 per cent in the first three quarters of the year as both private and public investments expanded, the latter on the back of Rogun dam construction and progress on other infrastructure projects. Sector-wise, growth was broad-based, with expansions in industry, services and agriculture. Price controls have helped dampen inflation pressures, with the inflation rate standing at 3.6 per cent in December 2024, below the central bank's target range of 6+/- 2 per cent. The current account likely remained in surplus in 2024 on the back of strong remittance inflows, and international reserves have grown. The fiscal deficit is expected to stay contained in line with the IMF Policy Coordination Instrument (PCI) programme objectives. The first review of the PCI, which aims to improve macroeconomic stability and assist the authorities with structural reforms, was approved by the IMF Executive Board in December 2024, with all but two agreed targets implemented. The economy is expected to grow by 7 per cent in 2025 and by 5.7 per cent in 2026 on the back of ongoing investments in priority infrastructure.

Turkmenistan

According to official statistics, real GDP grew by 6.3 per cent in 2024. The fastest growth was observed in construction, followed by the trade and services sectors. Economic activity was supported by credit expansion, rising wages and investment, which grew by 9.1 per cent. While the authorities do not publish official data on inflation, in March 2024 the IMF expected inflation in 2024 at 5.0 per cent. Both the current account and fiscal balance are estimated to be in surplus, though both are smaller than in 2023. Public debt remains negligible. Real GDP is forecast to continue expanding at the rate of 6.3 per cent in 2025 and 2026 as investments in energy, infrastructure, agriculture, and food processing continue.

Uzbekistan

Economic growth remained strong in 2024, with the services sectors as the main driver. While mining stagnated, industrial production continued to expand at a rapid rate. Inflation peaked in mid-2024 at 10.6 per cent on the back of energy price liberalisation but has since inched down, reaching 9.8 per cent in December 2024. The central bank of Uzbekistan anticipates that headline inflation will drop to the 5 per cent target level in 2026. The current account deficit is expected to have declined in the past year, driven largely by a 30 per cent increase in remittances. Foreign reserves increased to US$ 42.9 billion in January 2025, mirroring higher gold prices. Fiscal consolidation continued in 2024, helped by reduced energy subsidies on the back of tariff hikes, and further budgetary savings measures are planned in 2025 to keep expenditures relatively restrained. The economy is expected to continue growing strongly, at the rate of 6 per cent in 2025 and 2026.

Central Europe and the Baltic states

Economic growth in Central Europe and the Baltics (CEB) accelerated to 2 per cent in 2024, falling short of our September 2024 expectations. The much-anticipated economic upturn in the eurozone, particularly in Germany, CEB's main trading partner, is yet to materialise notwithstanding five cuts to the European Central Bank's main interest rate since June 2024, which brought it to 2.75 per cent in early February 2025. Labour markets remain resilient, and real wages continue to rise, albeit at a slowing rate. A slight uptick in inflation, driven by rising food and *energy prices, is also evident. Household consumption is expected to continue to drive economic growth, albeit at a slower pace, as many economies consolidate public finances and raise taxes. Investment, including from the private sector, is expected to pick up in the second half of this year, bolstered by incoming funds from the EU's Recovery and Resilience Facility (RRF). Potential increases in US tariffs present a downside risk. Hungary and the Slovak Republic, with their relatively larger exposure through the automotive sector, are most vulnerable.*

Croatia

The Croatian economy continued expanding at a fast pace in 2024, with real GDP growth estimated at 3.8 per cent. Real wage growth of 12 per cent supported a rebound of private consumption, while investments expanded notably, continuing the robust investment cycle that started in 2022. Strong absorption of EU funds and acceleration of post-earthquake reconstruction have supported strong growth in construction. Household credit growth accelerated while growth in corporate loans slowed down. The growth of tourist arrivals also slowed down last year, translating into a decline in service exports in real terms, while the number of nights spent was supported by domestic tourism. Industrial output also declined in 2024, with energy production offsetting the declining production of consumer and intermediate goods in the second half of the year. Procyclical fiscal policy further contributed to growth, with the fiscal deficit estimated at 2.1 per cent of GDP. Consequently, inflation has risen since August 2024 and reached 5 per cent in January 2025 on the back of higher process of food, energy and services. Real GDP growth is expected to remain strong at around 3 per cent in 2025, driven by robust consumption and absorption of EU funds. However, downside risks have risen amid accelerating inflation, potential further consumer boycotts, protracted eurozone weakness and escalation of trade tensions. In 2026, Recovery and Resilience Facility (RRF) funds are again expected to support domestic demand while consumption growth is forecast to moderate, reflecting wage dynamics, resulting in output growth of 2.6 per cent.

Czechia

The Czech economy recorded a modest growth of 0.9 per cent in 2024 as overall sentiment remained downbeat. After a drop in 2023, private consumption recovered somewhat as real wage growth turned positive. However, investment declined in 2024 on lower business investment, though it was still higher than the EU average as a share of GDP, while the destocking cycle persisted. Industrial production was subdued, and export growth weakened while imports grew in annual terms in the second half of the year. Inflation accelerated from 2.4 per cent in mid-2024 to 3.3 per cent at end-2024, prompting the Czech National Bank to slow down the easing cycle. In 2025, the economy is forecast to grow by 1.9 per cent on the back of a modest rebound of consumption, but overall uncertainty could again weigh on consumer confidence. The investment rebound is projected to continue on the back of post-flood reconstruction and further monetary easing, but overall eurozone uncertainty could depress the business outlook and future investment. In 2026, GDP growth could reach 2.4 per cent provided major trade frictions that would affect Germany, to which Czechia is highly exposed, can be avoided.

Estonia

Estonia's economy remained in recession for the second consecutive year in 2024, contracting by an estimated 0.8 per cent. The decline in economic activity was broad-based, with investment and exports particularly hard hit. Despite a fall in inflation to 2.8 per cent in January 2025, robust wage growth and persistently high employment rates, household consumption shrank for the third year in a row. The sluggish recovery of key trading partners, notably Finland, Latvia, and Germany, resulted in weak exports to these countries, which in turn dampened industrial production and corporate investment. The economy is estimated to have entered a recovery phase by the end of 2024, bolstered by an improvement in exports and the initiation of new investments. It is the revival in exports and investment that is expected to primarily drive growth this year and next, as the economic outlook in advanced Europe improves. Private consumption is expected to remain somewhat subdued, constrained by new taxes and weakening wage growth. Real GDP growth is forecast to accelerate to 1.7 per cent this year and 2.6 per cent in 2026.

Hungary

Preliminary real GDP growth estimates for Hungary in 2024 indicate a marked economic slowdown, to 0.5 per cent. The prolonged recession in Germany, Hungary's main trading partner, has drastically reduced Hungarian exports, particularly in the automotive sector, weakening industrial production. Investment contracted by around 10 per cent per annum over the past two years, in part reflecting high interest rates (at 6.5 per cent, the highest in the CEB region) and the continued freezing of EU funds as progress with reforms requested by the European Commission has been deemed insufficient. On a positive note, the Chinese electric car factory BYD in Szeged and BMW car and CATL battery factories in Debrecen are set to commence operations in 2025. Production at these factories could boost annual GDP growth by 0.6-0.8 percentage points this year and next, according to central bank estimates. As economic conditions improve in Germany and Hungary’s other trading partners, exports should strengthen too. Government measures targeting growth include the recently expanded rural home renovation programme, the workers’ loan scheme, which increases disposable income for households expanding their families, and the provision allowing pension savings to be used for housing purposes. The parliamentary elections scheduled for the spring of 2026 are likely to delay consolidation of public finances, despite the excessive deficit procedure in place. GDP growth of 2 per cent is expected in 2025, accelerating to 2.8 per cent in 2026.

Latvia

Output contracted an estimated 0.3 per cent in 2024. This outcome fell well short of the September forecast as exports and investment disappointed. Industry also underperformed, while wage growth remained high. In 2025 and 2026, a slowdown in wage growth and a rise in inflation are anticipated—the latter began to increase at the end of 2024, driven by higher food prices. In December 2024, inflation rose to 3.4 per cent, up from the 1.3 per cent average for the year. Investments, particularly those co-financed by EU funds, including from the Recovery and Resilience Facility, are expected to be the main driver of economic growth in the short term. Improving bank lending to both households and businesses is forecast to bolster consumption and investment. Passenger numbers at Riga Airport have recovered to pre-Covid levels, and maritime cargo has been performing well. The budget law envisages an increase in defence spending to 3.5 per cent of GDP in 2025, which will likely increase imports and may weigh on fiscal space available to finance social policies. The economy is projected to grow by 2 per cent in 2025 accelerating to 2.5 per cent in 2026.

Lithuania

The economy grew by an estimated 2.7 per cent of GDP in 2024, exceeding expectations. This economic expansion was underpinned by robust performance across the industrial, ICT, professional, administrative, and service sectors. The retail sector, buoyed by increased consumer confidence and real wage growth, saw a notable rise in sales volumes. Inflation rose at the beginning of the year, driven by higher food and energy prices, which somewhat dampened private consumption. Wage growth, bolstered by a 12 per cent increase in the minimum wage from 2025, is expected to moderate but will still outpace productivity growth. This poses a threat to the competitiveness of Lithuania's economy in the medium term. Economic growth is forecast to accelerate to 2.8 per cent in 2025 and 2.7 per cent in 2026, boosted by recovering exports and investment.

Poland

Poland's real GDP growth accelerated to 2.9 per cent in 2024, driven mostly by household consumption. In contrast, corporate investment experienced a marked deceleration. The contribution to growth from net exports was negative due to weak exports to major trading partners. In the third quarter of 2024, half of the decline in Polish exports was due to reduced sales to Germany, particularly in the automotive sector, as Germany's share of Polish exports hit a ten-year low. Meanwhile, China's share of Polish imports rose to nearly 16 per cent, driven by durable goods. Unemployment remains low and private sector wages continued to rise rapidly, at close to 10 per cent year on year in December 2024. While HICP inflation was below 4 per cent at the end of 2024, high wage growth risks reigniting inflationary pressures. Public sector investments co-financed by the RRF are expected to accelerate further in the second half of 2025 as transfers increase. By the end of last year, Poland had received approximately 35 per cent of its total RRF allocation (€59.8bn), with additional two tranches to come in April 2025 and the last four by end-2026. As export market conditions improve, private sector investments by large manufacturers are poised to rebound. Potential increases in US import tariffs on goods from the EU are a source of risk, primarily through negative spillovers from weaker economic activity in Germany. Real GDP growth is expected to reach 3.4 per cent in 2025 and 3.2 per cent in 2026.

Slovak Republic

The economy grew by an estimated 2 per cent of GDP in 2024, slightly below expectations due to the prolonged economic downturn in advanced Europe. Private consumption was a key driver of growth last year, bolstered by rising household disposable incomes. However, growth of wages and employment in the corporate sector has slowed. Car production declined by 8.3 per cent in 2024 as new models came into production, including at the Slovak arm of Stellantis. The Slovak Republic remains the world's largest car producer per capita, with 182 cars produced per 1,000 inhabitants last year. According to the Slovak Automotive Industry Association (ZAP), car production is expected to increase in the coming years as Volvo launches a new car plant near Kosice in 2026. A significant risk for the automotive sector is the potential increase in US import tariffs. According to estimates by the Association of Industrial Unions and Transport (APZD), a 10 per cent tariff on European cars could reduce Slovak car sales in the US by 6-9 per cent, potentially leading to a 4 per cent drop in exports. Slovak exports to the US amount to 4 per cent of GDP, with 12 per cent of all cars produced in the Slovak Republic going to the US market. Beyond the anticipated recovery in advanced Europe, which should boost exports, private consumption is expected to continue supporting growth, notwithstanding fiscal consolidation and an increase in the rate of value added tax (VAT) from 20 to 23 per cent from January 2025. The economy is forecast to grow by 1.9 per cent in 2025 and 2.2 per cent in 2026.

Slovenia

Economic growth in Slovenia slowed to an estimated 1.4 per cent in 2024, owing to a drop in investment and a negative contribution from net exports. Private consumption recorded a modest recovery as inflation dropped to 2 per cent in 2024. After a significant drop in 2023, industrial output failed to make up the losses in 2024 as foreign demand remained weak, although manufacturing recovered in the third quarter. The construction sector also recorded notable declines in output throughout 2024 as infrastructure works' momentum weakened. Government spending was lower than projected, which should lead to a significant correction of the fiscal deficit relative to the latest budget revision. In 2025, output growth could inch up to 2 per cent, driven mainly by domestic demand. However, accelerating inflation and fragile confidence are sources of risk. Investment could recover this year, supported by EU funds absorption and post-flood reconstruction. The trajectory of foreign demand remains highly uncertain in the context of global trade frictions. Provided trade-related downside risks do not materialise, real GDP growth is expected to accelerate to 2.4 per cent in 2026.

Eastern Europe and the Caucasus

Growth accelerated in 2024 in the Caucasus region, driven by higher real wages, even as inflows of capital and migrants from Russia have started to fade, while inflation was more contained than in 2023. GDP growth is projected to moderate in 2025 and 2026, reflecting external vulnerabilities and regional tensions, but could be strengthened by greater regional trade integration. Earlier signs of an economic rebound in Ukraine and Moldova subsided in the second half of 2024 amid a resurgence of inflation. A shortage of domestic electricity production caused by the deliberate Russian attacks on energy infrastructure in Ukraine and the cut-off of supply of Russian gas to the largest Moldovan thermal power plant will continue to constrain growth in both countries in 2025. Inflation has been rising again in recent months due to higher imported electricity prices, the correction of regulated utility prices and significant real wage increases. It is expected to remain elevated in the first half of 2025 but will likely moderate to single digits by the end of the year.

Armenia

Economic activity in Armenia is moderating towards its long-term growth potential after two years of rapid growth. Real GDP grew by 5.9 per cent year on year in the first three quarters of 2024 and an estimated 5.7 per cent for the year as a whole, down from 8.3 per cent in 2023, reflecting waning inflows of capital, the diminishing impact of high-skilled Russian migration, and slower growth in trade and ICT services. Meanwhile, inflation remains well below the Central Bank of Armenia's (CBA) revised target of 3 per cent (±1 per cent). Headline inflation stood at 1.7 per cent year on year in January 2025, and averaged 0.3 per cent in 2024, significantly lower than the 2 per cent recorded in 2023. To support economic activity, in December 2024, the CBA cut its benchmark interest rate by 25 basis points, followed by another 25-basis-point cut in February 2025, to 6.75 per cent. This was the 14th rate cut since June 2023. GDP growth is projected at 5 per cent in 2025 and 4.5 per cent in 2026. Public investment, IFI-backed projects, and infrastructure expansion will continue to support economic activity. A potential breakthrough in border negotiations with Türkiye could strengthen Armenia's position in East-West transit and boost regional trade integration. However, geopolitical volatility remains the key downside risk, as delays in peace negotiations with Azerbaijan could undermine economic stability.

Azerbaijan

The economy grew strongly in 2024, driven by the non-oil sector and public investment. Real GDP expanded by 4.1 per cent in 2024, up from 1.1 per cent in 2023, with non-oil growth reaching 6.2 per cent, compared with 3.7 per cent in 2023. Economic activity was supported by rising real incomes and infrastructure investment, while the oil and gas sector returned to growth in March 2024, as gas production expanded to meet European demand. Meanwhile, inflation remained contained, fluctuating between 0 per cent year on year in April 2024 (the lowest level in more than nine years) and 4.9 per cent at year-end. State price regulation and lower global food prices helped stabilise domestic food-price inflation. The Central Bank of Azerbaijan (CBAR) responded to easing inflation pressures in late 2023 by reducing the key policy rate cumulatively by 175 basis points, from 9 per cent in November 2023 to 7.25 per cent by May 2024, and has maintained it at this level since then. Recognising the need for additional measures to manage robust credit growth, which surpassed 20 per cent in 2024, the CBA announced the activation of a 0.5 per cent countercyclical capital buffer, effective from March 2025. GDP growth is projected to moderate to 3 per cent in 2025 and 2.5 per cent in 2026, but the outlook remains highly sensitive to fluctuations in oil and gas prices and geopolitical tensions in the region. In the medium term, trade along the Middle Corridor connecting China to Europe could create opportunities for Azerbaijan's transport and logistics sectors, while public consumption is expected to benefit from government investments in infrastructure, agriculture, and defence.

Georgia

Georgia's economy is estimated to have grown by 9.5 per cent in 2024, surpassing expectations and accelerating from 7.8 per cent in 2023. ICT, trade, education, public administration, and construction drove the expansion, while the electricity, gas, steam, and air conditioning supply sector contracted. The tourism sector reached record highs in 2024, attracting 7.4 million international visitors. Despite fading war-related financial inflows and Russian migration, domestic consumption remained strong, fuelled by credit growth and wage increases. Meanwhile, inflation remained low in 2024, averaging 1.1 per cent, down from 2.5 per cent in 2023 and well below the National Bank of Georgia's (NBG) target of 3 per cent. The NBG has maintained its policy rate at 8 per cent since May 2024, following a cumulative 150-basis-point reduction earlier in 2024 (the policy rate peaked at 11 per cent between March 2022 and April 2023). The NBG's monetary policy stance remains cautious, balancing support for economic growth with external vulnerabilities. The high real interest rate suggests a deliberate approach to anchor inflation expectations. Real GDP growth is projected to moderate to 6 per cent in 2025 and 5 per cent in 2026, close to the potential growth rate, as political uncertainty, weaker external balances, and slowing credit expansion weigh on economic activity. Lower foreign direct investment and weaker tourism revenues, the result of recent political unrest and widespread protests, may further constrain private-sector growth, while public infrastructure projects and government-backed initiatives, particularly in the transport, energy, and ICT sectors, will help cushion the slowdown. Downside risks remain elevated.

Moldova

Economic growth in the period from January to September 2024 was 0.6 per cent year on year, slightly down from 0.7 per cent in 2023. This sluggish performance was driven by a 10 per cent decline in the volatile agriculture sector and an 11 per cent fall in real exports of goods, largely due to weaker demand from the EU automotive industry. After relatively good performance earlier in the year, industrial production slumped in the fourth quarter of 2024, signalling further pressure on economic activity. At the beginning of 2025, the renewed energy crisis further weighed on economic activity. Gas supplies from Russia's Gazprom mainly to the unrecognised breakaway region of Transnistria ceased after the expiration of the gas transit agreement between Ukraine and Russia on 31 December 2024. As a result, Transnistria's largest gas-powered thermoelectric power plant sharply reduced production, relying on limited coal reserves and halted the flow of electricity to the rest of Moldova. Meanwhile, Moldova imported electricity from Romania at elevated prices. At the beginning of 2025, the National Agency for Energy Regulation approved new tariffs for electricity delivered to end consumers, reflecting higher imported electricity prices. This has added to already accelerating inflation at the end of 2024 due to rising food prices and the scheduled gradual correction of excise rates made at the beginning of 2025. The central bank promptly reacted by lifting the policy rate by 200 basis points to 5.6 per cent in January 2025, the first hike in more than two years. While short-term growth prospects remain anaemic, the recently adopted European Commission's Growth Plan for the Republic of Moldova, worth €1.8 billion for the period 2025-2027 (out of which €285 million is grants), could provide substantial relief. A moderate GDP growth of 2.0 per cent is expected in 2025, rising to 3.8 per cent in 2026.

Ukraine

Ukraine entered 2025 with external financing secured but facing a slowdown in economic growth and accelerating inflation. The continuation of the war and deliberate attacks by Russia on electricity infrastructure caused power shortages, high prices of imported electricity and acute labour shortages. Real GDP growth slowed markedly from over 5 per cent in the first half of 2024 to around 2 per cent in the second half of the year. The resurgence of inflation in the second half of 2024 was driven by rising electricity costs, a correction in regulated utility prices, rapid real wage growth, and currency depreciation against the US dollar following relaxation of the exchange rate peg in October 2023. Annual inflation reached 12 per cent in December 2024 and is likely to remain at a similar level in the first half of 2025 before falling back to single digits towards the end of the year. The central bank reacted by raising the policy rate twice since December 2024, from 13.0 to 14.5 per cent, with further monetary tightening likely. The budget deficit for 2025 is projected at 19.4 per cent of GDP and will be fully financed through US$ 38.4 billion in external budget financing. This includes US$ 13.7 billion from the EU under Ukraine's Facility, US$ 22.0 billion from the G7 countries based on revenue from frozen Russian assets and US$ 2.7 billion from the IMF. The negative factors that weighed on growth in the second half of 2024 are likely to persist in 2025. On the positive side, the proven resilience and adaptability of businesses, the well-functioning Black Sea trade corridor, strong public consumption stimulus and increasing military procurement from domestic industries are expected to support economic growth. Amid extreme uncertainty, GDP growth is expected to reach 3.5 per cent in 2025 and strengthen to 5.0 per cent in 2026, provided that an agreement to suspend fighting is reached by the end of 2025.

South-eastern EU

Economic growth slowed in 2024, reflecting the deceleration in Romania. While private consumption in the region accelerated on the back of strong wage growth, investment weakened in Bulgaria and Romania, partly due to mounting delays in implementing the Recovery and Resilience Facility, while Greece remained among the frontrunners in absorption at the EU level. Strong domestic demand stimulated imports, while exports remained weak. Despite these headwinds, growth is expected to recover slightly as domestic demand remains resilient, but uncertain foreign demand and domestic reform appetite remain key downside risks.

Bulgaria

Real GDP growth reached an estimated 2.3 per cent in 2024, driven mostly by domestic demand. Real wage growth averaged 13 per cent year on year in the first three quarters, supporting private consumption. Positive dynamics in retail sales towards the end of 2024 suggest a robust carry-over effect in early 2025. After strong growth in 2023, investment contracted in real terms in 2024, although construction output remained resilient, in contrast with the trends observed in regional peers. Reflecting this, retail loans grew by 19 per cent last year. On the downside, weak foreign demand translated into a further decline of industrial output, although Bulgaria's entry into the Schengen border-free area could boost exports from 2025 onwards. Inflation stabilised at 2 per cent by the fourth quarter but could pick up slightly in 2025. Fiscal risks related to the eurozone accession increased as the government is expected to propose a budget envisaging a deficit of 3 per cent of GDP and a significant increase in expenditures that needs to be met by better revenue collection in the absence of other measures. While a new government has been formed, RRF implementation remains heavily delayed. The economy is forecast to grow by 2.4 per cent in 2025, amid uncertain outlook for investment and foreign demand. GDP growth is expected to inch up to 2.8 per cent in 2026 on improving EU funds absorption and further regional integration.

Greece

Greece's growth remained robust in 2024 (2.3 per cent year on year in the first nine months), outpacing the euro area average. Growth throughout the year was boosted by EU-funded investment projects and private consumption. In addition, the latest figures show that Greece's tourism sector set new records in 2024 both in terms of revenue and non-resident arrivals. The Economic Sentiment Indicator (ESI) and the Purchasing Managers' Index (PMI) stood at 106.4 and 51.8, respectively, in the last quarter of 2024, pointing to confidence among consumers and producers about short-term economic prospects. Labour market conditions continue to improve, with the unemployment rate of 9.4 per cent (seasonally adjusted) in December 2024, though labour force participation rates remain low by EU standards. Fiscal consolidation continues with the primary surplus in 2025 forecast at 2.5 per cent of GDP. HICP inflation remained relatively elevated at 3 per cent in 2024 due to persistent services inflation. Moreover, core inflation has also been persistent and among the highest in the euro area at 3.6 per cent in 2024 (down from 5.3 per cent in 2023). The implementation of the revised Recovery and Resilience Plan (RRP) is progressing well, mitigating external risks. As of January 2025, Greece had received €18.2 billion in RRP funds (51 per cent out of the total envelope of €36 billion), above the EU average, with 28 per cent of total landmarks successfully completed. The economic outlook remains optimistic with growth forecast to remain steady at 2.3 per cent in 2025 and 2026, subject to downside risks associated with the uncertain geopolitical environment and sluggish eurozone economy.

Romania

Economic growth significantly slowed down in 2024 even as private consumption grew strongly on the back of real wage growth of around 8 per cent, which led to a significant widening of the trade deficit. Strong private consumption growth was offset by further destocking and much weaker investment growth. On the supply side, the slowdown was broad-based, with industry, services and construction experiencing notable decelerations. The political turmoil at the end of the year affected business and consumer confidence, compounding the impact of tax hikes at the end of 2023 and in 2024 on firms' operating margins. Significant public wage increases in 2024 brought the fiscal deficit to 8.7 per cent of GDP despite a strong increase in revenues. With the approval of a seven-year fiscal consolidation plan, the government targets a deficit of 7 per cent of GDP this year. Monetary policy remains tight given still elevated inflation and uncertainty, which weighed on the cost of financing. Real GDP growth is expected to rebound at a slower rate than previously expected at around 1.8 per cent, given the pressure to cut government deficits in an increasingly challenging domestic and external economic environment. In 2026, growth is forecast to return towards its potential level, at 2.4 per cent, assuming renewed structural reform efforts unlock EU funds disbursement and foreign demand recovers.

Southern and eastern Mediterranean

Growth across SEMED in 2024 was mostly muted following a prolonged period of regional instability, with a sharp output contraction in Lebanon as a result of the war with Israel. However, growth began to pick up towards the end of the year and is expected to accelerate further. In Egypt, business and consumer confidence is expected to recover, supported by declining inflation. However, delays in implementing structural reforms are a source of risk to the outlook. Fiscal consolidation is likely to continue in countries with IMF-supported programmes (Egypt, Jordan, and Morocco). The tourism and agriculture sectors are expected to underpin growth momentum in Morocco and Tunisia. The ceasefire in Lebanon and resolution of the political crises are expected to help the economy rebound somewhat. The region's average growth rate is projected to pick up to 3.7 per cent in 2025 and 4.1 per cent in 2026. Downside risks remain significant and include resumption of wars, uncertainty surrounding foreign aid and tariff policies as well as climate-related shocks.

Egypt

Output growth is expected to increase from 2.4 per cent in fiscal year (FY) 2024 (ending June

2024) to 3.6 per cent in FY 2025, rising further to 4.6 per cent in FY 2026 as business confidence recovers and structural reform progresses. On a calendar-year basis, growth is forecast at 4.2 per cent in 2025 and 4.7 per cent in 2026. Economic recovery gained momentum from the first quarter of FY 2025 following a period characterised by a deterioration in macroeconomic fundamentals in the presence of parallel exchange rates. Growth in FY25 is expected to be led by the communications, accommodation and food, transportation, and storage (excluding the Suez Canal) and financial services sectors. The manufacturing sector also started recovering following a contraction in the previous year while extractive sectors posted the sharpest contractions. Inflation slowed to 24 per cent in January 2025. Prices will likely continue to fall due to base effects and tight monetary policy, despite necessary future adjustments to fuel prices. The external position has improved since the Ras Al Hikma deal prompting Fitch and S&P GMI to upgrade Egypt's sovereign rating in 2024, but vulnerabilities remain. Reserves continued to grow reaching US$ 47.3 billion in December 2024, supported by increased remittances and tourism receipts which offset a nearly 60 per cent drop in Suez Canal revenues in 2024. Debt-to-GDP is expected to fall to 85 per cent in FY25 from 96 per cent in FY24, though debt servicing costs remain burdensome and are expected to amount to 50-60 per cent of government spending in FY25.

Jordan

Economic growth in Jordan moderated to 2.3 per cent year on year in January-September 2024 as wars in Gaza and Lebanon weighed on business and consumer confidence, while lower government revenues curbed public spending. However, commitment to fiscal discipline and progress on structural reforms have preserved market confidence, resulting in sovereign credit rating upgrades in 2024 by Moody’s and S&P. In the meantime, unemployment remained high, at 21.5 per cent in the third quarter of 2024, while inflation was stable averaging 1.6 per cent in 2024, despite an uptick in the closing months of the year. The Central Bank of Jordan lowered its policy rate by 50 basis points in September 2024, mirroring the decisions of the US Federal Reserve as part of its effort to preserve the currency peg. Foreign exchange reserves remained healthy, covering around eight months of imports. Regional instability affected the external position, with the current account deficit widening to an average of 6.6 per cent of GDP during January-September 2024. Gross general government debt (including sovereign-guaranteed debt) remains high, estimated at 115 per cent of GDP as of December 2024.

In 2025, growth is expected to reach 2.3 per cent benefiting from de-escalating regional conflicts, the re-opening of the Syrian market to Jordanian businesses and recovery in tourism and foreign investment. Meanwhile, uncertainty over US foreign aid and trade policies could weigh on growth. In 2026, growth is forecast at 2.6 per cent as uncertainty decreases.

Lebanon

The Lebanese economy is estimated to have contracted by 5.7 per cent in 2024 as the war with Israel resulted in widespread displacement of people and damages to the country’s infrastructure and physical capital, estimated at US$ 3.4 billion (with estimates of economic losses in excess of US$ 5 billion). The Lebanese Pound has bottomed out, having lost 98 per cent of its value against the US dollar since August 2023. Inflation continuously decelerated, reaching 15.4 per cent year on year in November 2024. As a result of the economic crisis, the economy has largely dollarised. The current account deficit is projected at around 25.0 per cent of GDP in 2024 compared with 28.1 per cent of GDP in 2023. Liquid foreign reserves had increased by US$ 1.0 billion in early 2024 to US$ 10.7 billion, but reversed course after the conflict escalated, declining by US$ 391 million in October 2024. The fiscal position, which showed a small surplus of 0.5 per cent of GDP in 2023, is likely to have deteriorated as conflict-related spending rose while revenues declined. Public debt is estimated at 158 per cent of GDP in 2024, down from 180 per cent of GDP in 2023. Growth is expected to recover to 2.0 per cent in 2025 and 3.0 per cent in 2026 as the economy rebounds and political stability is at least partially restored, following the election of a new president. The projected rebound assumes lasting political stability, progress on critical economic reforms, including banking sector restructuring, and an agreement on an IMF-supported programme, which could help to bring back international donor support and foreign investment to Lebanon.

Morocco

Growth is estimated at 3.0 per cent in 2024, down from 3.4 per cent in 2023. The extraction, manufacturing and construction industries expanded while the drought at the beginning of the year negatively affected the sizable agricultural sector. Core inflation has been stable, standing at 2.5 per cent in the final quarter of 2024, slightly above the preceding quarter's rate of 2.3 per cent. In June 2024, Bank al Maghrib became the first central bank in North Africa to loosen its stance, bringing the policy rate down by 25 basis points to 2.75 per cent. The government deficit amounted to 4 per cent of GDP in 2024, lower than expected on higher tax revenues. Central government debt fell to 69.5 per cent of GDP in 2024 from a peak of 72.2 per cent in 2020 and is expected to continue falling over the medium term as fiscal policy remains prudent. The current account registered a deficit of 1.6 per cent of GDP in January-September 2024. Lower energy imports as well as higher remittances, automotive exports, and tourism receipts (which increased by 20 per cent year on year) are expected to support the external position. Growth is forecast to pick up to 3.6 per cent in 2025 and 3.4 per cent in 2026 as structural reforms yield positive results.

Tunisia

Output growth is estimated at a modest 1.2 per cent in 2024. Inflation averaged 7.1 per cent in January-November 2024, down from 9.5 per cent over the same period of 2023, while unemployment increased slightly, to 16 per cent in the second quarter of 2024. It remains particularly high among women (21 per cent) and youth (41 per cent). The fiscal deficit is expected to improve to 6.3 per cent of GDP in 2025, supported by enhanced revenue mobilisation and lower basic goods subsidies. A medium-term fiscal consolidation plan targets a deficit of 5.5 per cent of GDP and a wage bill of 13.3 per cent of GDP. Public debt remains high, at 82.2 per cent of GDP, and is expected to drop to 80.5 per cent in 2025 reflecting fiscal consolidation efforts. Around half of debt is external, down from more than 70 per cent in 2019. Tunisia's external position has improved but remains vulnerable to major shocks. The current account deficit stood at 1.6 per cent of GDP in January-November 2024, down from 2.3 per cent over the same period the preceding year. Imports contracted (due to lower commodity prices), while mechanical, electric, and olive oil exports improved. Foreign exchange reserves remained stable. At US$ 25 billion in November 2024, they covered 3.7 months of imports. The economy is forecast to grow by 1.8 per cent in 2025 and 2.2 per cent in 2026 as fiscal consolidation continues alongside recovery in exports and tourism receipts.

Türkiye

Growth slowed down from 5.1 per cent in 2023 to 3.2 per cent year on year in the first nine months of 2024 and an estimated 2.9 per cent in the year as a whole. As the turnaround in economic policy towards orthodoxy continued in 2024, domestic demand weakened significantly, and net exports became a key driver of growth.

Monetary policy remained tight, aimed at curbing inflation and restoring macroeconomic stability. The Central Bank of the Republic of Türkiye (CBRT) held its policy rate at 50 per cent between March and December, when it started to ease its policy stance with a cumulative 500 basis points reduction in two steps. At the same time, the CBRT reinforced macroprudential tightening by introducing stricter foreign currency loan limits through reducing the monthly growth cap from 2 per cent to 1.5 per cent in 2024, and further to 1 per cent in January 2025, while also implementing additional measures to sterilise excess lira liquidity. Tighter monetary and fiscal policies led to a significant reduction in inflation, from a peak of 75.4 per cent year on year in May 2024 to 42.1 per cent in January 2025, aided by the sharp appreciation of the Turkish lira in real effective terms, by more than 44 per cent since July 2023.

Despite the real appreciation, the external position improved significantly. Net exports rose further, and the 12-month cumulative current account deficit declined steadily to US$ 7.4 billion in November 2024 (0.6 per cent of GDP) from a peak of US$ 55.6 billion (5.2 per cent of GDP) in May 2023. The improvement was led by a lower energy import bill, lower imports of gold, and strong tourism receipts, with a record 52.6 million visitors in 2024. At the same time, foreign direct investment inflows remained relatively low in the same period, at US$ 10.7 billion (0.8 per cent of GDP). Meanwhile, the CBRT's net reserves (excluding swaps) rose to US$ 43.7 billion at the end of 2024, up from minus US$ 37.5 billion a year earlier, while foreign-exchange reserves stood at US$ 83.5 billion.

Economic growth is expected to remain moderate in 2025-2026 at around 3-3.5 per cent, supported by easing financing conditions, stronger private-sector activity, and robust external demand. Downside risks include still-high inflation, a premature loosening of the policy mix, geopolitical uncertainties, and the impact of the real appreciation of the lira on export competitiveness. Türkiye's high short-term external financing needs make the outlook sensitive to global financing conditions.

Western Balkans

Growth in the Western Balkans stayed around the same level in 2024 as in 2023, at 3.5 per cent, owing to weak external demand from the region's most significant trading partner, the European Union, as goods exports remained subdued. On the other hand, domestic factors (private consumption, rising wages, as well as a rise in public investments) partially offset this negative effect. Tourism has stayed strong, especially in Albania and Kosovo (including diaspora visits from Western Europe), and to a lesser extent in Montenegro. Growth is projected to increase slightly to 3.6 per cent in both 2025 and 2026. However, significant risks remain, including continued sluggish external demand from the eurozone and potential disruptions in global trade, driven in part by the policies of the new US administration. Countries with a strong, export-oriented manufacturing sector, like Serbia, Bosnia and Herzegovina, and North Macedonia, are expected to face indirect negative effects through their exports to the eurozone (and to a lesser extent China) in a scenario with higher US tariffs, while tourism-dependent economies like Albania, and Montenegro as well as remittances-dependent Kosovo may experience more moderate impacts, largely due to a potential slowdown in tourism from EU countries driven by lower growth of disposable incomes. Another risk to growth arises from tight labour markets and rising wages exacerbating inflationary pressures as well as negatively affecting competitiveness and future inflows of FDI.

Albania

At 3.9 per cent, Albania's economic growth in 2024 is estimated to have been higher than forecast in September, supported by the strong performance of tourism, other services, and construction while industrial and agricultural production both declined. Private consumption and public investment were key drivers of growth, while goods exports dropped significantly—impacted by the appreciation of the lek and weak external demand—contributing to a wider current account deficit. Inflation fell to around 2.2 per cent on average in 2024, allowing the Bank of Albania to lower the base rate from 3.25 per cent at the beginning of 2024 to 2.75 per cent as of February 2025. The financial sector remained stable, with increased credit activity. The 3.7 per cent growth forecast for 2025 and 2026 is subject to upside risks from the expected continuation of structural reforms, a strong commitment to EU accession, and the potential for accessing funds and financing through EU integration. However, this upside is counterbalanced by downside risks stemming from weakening demand in the eurozone, a decrease in remittances from abroad, and a weaker tourism season than last year. Adverse climate conditions (mainly potential droughts) could negatively affect energy production and lead to higher electricity imports although increasing solar generation capacity partially mitigates this risk.

Bosnia and Herzegovina

Bosnia and Herzegovina's economic growth in 2024 is estimated at 2.5 per cent, below the level expected in September 2024, reflecting the negative effect of the floods in the fourth quarter of 2024. Net exports made a negative contribution to growth due to a sharp rise in imports and a decline in exports in the first three quarters of 2024. Weak external demand was also reflected in the decline in industrial production. Growth was primarily supported by services and construction, strong private consumption, and the increase in gross fixed capital formation. Inflation declined from its peak of 17.4 per cent in October 2022 to 2.2 per cent in December 2024, in line with global trends. The growth forecast 2025 was slightly revised downward from 3.0 to 2.8 per cent reflecting global and domestic political risks. However, growth may rise marginally to 3.0 per cent in 2026 as the external environment improves. Downside risks are coming from uncertain external demand and a potential intensification of political tensions while acceleration of structural reforms needed for progress in EU approximation represents an upside risk.

Kosovo

At 4.3 per cent, estimated growth in 2024 exceeded expectations, supported by strong private consumption and investments. However, the contribution from net exports remained negative due to higher imports, and the current account deficit widened compared to the first nine months of 2023. Inflation has rapidly decelerated, to around 1.6 per cent on average in 2024 from 4.9 per cent in 2023, mainly due to the slower growth in the prices of food and transportation services. Despite increased fiscal spending on capital investments and wages, the IMF projects a smaller budget deficit (0.7 per cent of GDP) in 2024 than in 2023, thanks to a sharp rise in government revenues. GDP growth is expected to be 4 per cent in 2025 and 2026 with balanced upside and downside risks. On the one hand, Kosovo might experience faster growth provided public investment projects are implemented swiftly, helped by the successful third review under the Stand-by Agreement and the Resilience and Sustainability Facility arrangements with the IMF conducted in December 2024, unlocking access to €36 million in funding. However, Kosovo's economy is still heavily reliant on remittances from abroad, and weak economic performance in the eurozone can negatively affect Kosovo's growth.

Montenegro

GDP growth is estimated to have been lower in 2024 (3.1 per cent) than anticipated in September 2024 (3.8 per cent). Deceleration from the strong growth in 2022 and 2023 reflects a significant slowdown in tourism, after a record season in 2023. Growth in 2024 was driven by private consumption and gross fixed capital formation, supported by expansionary fiscal policy, rising wages and pensions, the introduction of caps on retail and wholesale margins for certain products and ambitious infrastructure projects. However, net exports contracted, partly due to a significant decline in tourism growth after a record 2023, as the surge in tourists and immigrants from Russia and Ukraine abated. Inflation declined significantly from its peak of 17.5 per cent in November 2022, to 2.1 per cent in December 2024. GDP growth is expected to moderate further to 2.9 per cent in 2025 and 3 per cent in 2026, as higher prices in the tourism sector (driven by large wage increases) may constrain demand, while the reconstruction of the Pljevlja power plant (providing around half of electricity for the country) will increase electricity imports significantly. On the other hand, growing wages could support fast consumption growth.

North Macedonia

In North Macedonia, growth in 2024, while modest, exceeded expectations, estimated at 2.4 per cent, following stronger-than-anticipated performance in the first three quarters of the year. It was primarily supported by government and private consumption as inflation eased and credit expanded. On the other hand, industrial output declined, while the trade deficit widened by 16.1 per cent, reaching €3.28 billion, primarily due to low eurozone demand. On a positive note, S&P affirmed North Macedonia's BB-/B sovereign credit ratings in January 2025, maintaining a stable outlook and the economy has benefitted from strong FDI inflows. Looking ahead, growth is projected to reach 3.0 per cent in both 2025 and 2026. Risks relate to the country's high trade openness and exposure to eurozone economies, especially the German automotive industry, which may be impacted by ongoing trade tensions. On the upside, there is potential for higher growth if structural reforms are implemented effectively and ambitious capital investment projects are successfully carried out, although concerns about the country's fiscal space and capacity for implementing such projects remain.

Serbia

Preliminary estimates put growth in 2024 at 3.8 per cent, unchanged from 2023. The main drivers of growth were services, particularly trade, tourism, and construction, while household consumption and investments provided the strongest boost to demand. On the other hand, net exports made a negative contribution to growth due to higher imports of goods on the back of easing inflation. The budget deficit, at 2.2 per cent of GDP, was lower than planned. However, the current account deficit expanded to €4.3 billion in January-November 2024, up from €1.1 billion in the same period of 2023. The widening of the current account deficit was offset by a record FDI inflow of €5.1 billion in 2024. Inflation declined from its peak at 16.2 per cent in March 2023 to 4.3 per cent in December 2024, but remained relatively high in regional comparison. Nevertheless, the central bank cut the policy rate from 6.5 per cent at the beginning of 2024 to 5.75 per cent (as of February 2025). GDP is expected to grow by 4 per cent in 2025 and 2026. Global geopolitical tensions and uncertainty regarding trade tariffs constitute the main downside risks, potentially constraining Serbian exports and FDI inflows to Serbia. On the other hand, significant capital investments related to the Expo 2027 may boost growth. At the same time, a tighter labour market and a potential slowdown of structural reforms against the backdrop of ongoing political tensions pose downside risks.

Belarus

Real GDP growth reached 4.0 per cent in 2024, according to official statistics, driven by rising manufacturing, construction, and trade in the context of continued import substitution efforts and growing dependency on the Russian economy. Exports of goods, however, increased by only 1.2 per cent against the backdrop of sanctions and disrupted trade routes. Meanwhile, imports increased by 6.1 per cent, broadening the trade deficit. Inflation eased to 5.2 per cent at the end of 2024, helped by still-active price controls. The expected slowdown of the Russian economy is reflected in the lower projected real GDP growth in Belarus, at 2.5 per cent in 2025 and 2026, with high downside risks to the outlook.

Russia

In 2024, real GDP increased by 4.1 per cent for the second year in a row, according to official statistics, driven by high military government expenditure, which now amounts to almost 6 per cent of GDP. With the labour market overstretched by conscription and emigration and the unemployment rate at historical lows, inflation has remained stubbornly high, almost reaching double digits. The Bank of Russia raised its policy rate to 21 per cent in December 2024. The growth rate of household loans has been sharply decelerating since the middle of 2024, but corporate loans are still holding up mainly due to demand from defence-related sectors. Real GDP growth is expected to slow to 1.5 per cent in 2025 and 2026, on tighter monetary policy and productive capacity utilisation constraints.

About this report

The Regional Economic Prospects report is published twice a year. The report is prepared by the Office of the Chief Economist and the Department for Policy Strategy and Delivery and contains a summary of regional economic developments and outlook, alongside the EBRD's growth forecasts for the economies where it invests. The report also touches on the economic developments in Belarus and Russia notwithstanding the fact that Belarus and Russia have had their access to Bank resources suspended under Article 8.3 of the Agreements Establishing the EBRD. All historical data are based on estimates by country statistical offices. Since 2022, Russia has stopped releasing detailed statistics on the government budget, external trade and current-account balance. The estimates and projections are based on statistical information available through February 13, 2025.

For more comprehensive coverage of economic policies and structural changes, see the EBRD's country strategies and updates, as well as the Transition Report 2023-24, which are all available on the Bank's website at www.ebrd.com.

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