Executive Summary

Europe and Central Asia (ECA) continues to be negatively impacted by the Russian Federation’s invasion of Ukraine, tighter global financial conditions, sticky inflation, and global economic fragmentation. Five-year global growth for 2020–24 is at its weakest in three decades, reflecting a weak recovery in China and a sharp slowdown in the euro area—ECA’s largest trading partner. Synchronized increases in policy rates across advanced and developing economies have resulted in higher bond yields and spreads, weakened market access, and reduced availability of credit. Inflation has partly receded in ECA, as global commodity prices have eased from last year’s peaks, although disinflation slowed during the summer and real incomes have yet to recover from the 2022 cost-of-living crisis.

In this challenging environment, ECA’s growth is projected to remain weak relative to the long-term pre-pandemic average. Although the regional growth forecast has been upgraded to 2.4 percent for 2023, from the 1.4 percent projected in June, the divergence within the region has widened as growth projections were left unchanged or downgraded for about half of the ECA countries.

For Türkiye, growth is projected to increase to 4.2 percent in 2023, up from the 3.2 percent projected in June, because of resilient household consumption and reduced policy uncertainty. The latter reflects the positive steps the authorities have taken to normalize macroeconomic policies following the May 2023 elections. For Russia, increased government spending, largely on military buildup and social transfers, together with stronger credit growth, has led to an upward revision in the growth projection.

The growth projections have also been upgraded for most of the economies of the South Caucasus and Central Asia, as these countries absorbed a significant inflow of migrants, businesses, trade, and money flows over the last year and a half. These developments boosted growth in domestic demand and output and supported currency appreciation and lower inflation. In Eastern Europe, which has endured the most negative effects of the invasion of Ukraine, growth is gradually regaining momentum.
After a large decline in 2022, output is up this year in Ukraine due to more stable electricity supply and increased government spending. However, economic conditions in the country remain in a state of extreme distress amid the escalation of security risks, additional damage to infrastructure, renewed upward pressure on energy prices, and capacity constraints in the grain transport routes to international markets. By contrast, growth in Central Europe and the Western Balkans is expected to be weaker, reflecting the sharp slowdown of activity in the euro area, a slow recovery of real incomes, and tight financial conditions.

ECA’s average annual growth is expected to remain little changed at 2.6 percent during 2024–25, owing to the continued negative effects of Russia’s invasion of Ukraine, weak expansion in the euro area, and slow progress with structural reforms. Growth in Russia is projected to continue to be weak, at only 1.1 percent a year on average during 2024–25, curbed by capacity constraints, tight labor markets, and the lack of access to technology and equipment due to sanctions. Growth in Türkiye is expected to slow over the forecast horizon as well, with monetary policy normalization and fiscal consolidation cooling domestic demand.

Risks to the outlook differ across countries, although they are generally on the downside. Inflation may persist amid increasing labor costs, the heightened volatility of global commodity markets, and the recent surge in global energy prices. Global growth may surprise on the downside, leading to a slower than expected recovery in exports. A drawn-out period of tight financial conditions could trigger renewed bouts of volatility in the global financial markets and test the resilience of the financial systems in ECA. Persistent economic weakness of regional economies and elevated policy uncertainty could further sap the reform momentum and delay the needed green transition.