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COMMISSION STAFF WORKING DOCUMENT

on providing Macro-Financial Assistance to enlargement and neighbourhood partners in the context of the COVID-19 pandemic crisis

Accompanying the document

Proposal for a DECISION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on providing Macro-Financial Assistance to enlargement and neighbourhood partners in the context of the COVID-19 pandemic crisis

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1 PROBLEM ANALYSIS AND NEEDS ASSESSMENT

1.1 Introduction

The COVID-19 pandemic has by now spread to all continents. More than 2 million persons have been infected and almost 140,000 persons with confirmed infections have died in its wake (according to WHO data as of 17 April). The initial response focuses on saving lives across the globe, by taking various measures to contain the spread of the virus and strengthening healthcare systems. Many of these measures have brought societies and economies to a standstill, but there can be no tradeoff between saving lives and jobs. On the contrary, getting the virus under control is a prerequisite for sustainable development, be it economic or social.

Measures are also rapidly put in place to limit the economic fallout of the crisis. Notwithstanding these measures, together with the impact of a global recession and the severe stress in the financial markets, most, if not all, enlargement and neighbourhood partners are set for a recession this year. Although the trigger for this crisis is shared across countries, its duration and severity of the recession will differ, reflecting the partners' economic structure (such as the importance of global supply chains, tourism, remittances or, in some cases, the slump in commodity prices), as well as their ability to take effective counteracting measures. Several partners will not only encounter falling economic activity, but sharp increases in unemployment with renewed pressures on public deficits and debts. Moreover, several had considerable liquidity needs already before the crisis. Together with the collapse of trade and the shift in risk aversion away from emerging markets in general, many will see their balance of payments (BoP) come under acute stress. Depending on the spread of the virus, as well as on its economic consequences, there is also a clear and imminent risk related to social stability and security, with possible spillovers within the region and beyond.

Against this background, the European Commission is proposing the use of macro-financial assistance (MFA) to support ten neighbouring partners in the context of the COVID-19 crisis.

MFA is part of the EU's external crisis response toolkit. It is used to address situations of BoP crises in tandem with a disbursing IMF arrangement that is subject to an agreed programme of economic reforms. In this exceptional situation, the Commission proposes MFA programmes also **for partners that benefit from emergency funding from the IMF**, which can come without prior actions and/or conditionality, such as through the Rapid Financing Instrument (RFI). These 'crisis MFAs' will therefore be **shorter in duration** (12 months instead of the usual 2.5 years) and include only **two disbursements**. The first disbursement will be released as soon as possible after the adoption of the MFA Decision and upon the corresponding agreement on a Memorandum of Understanding (MoU) with each partner. The **second disbursement will be released upon the fulfilment of conditions** as detailed in the corresponding MoU. This conditionality is specific to each partner to ensure that it is fully adequate. Moreover, it will need to be formulated in a way that makes it still possible to implement, taking into account the shorter time span and the context of the ongoing pandemic (except for Jordan, where the top-up will be included in the MoU currently under negotiation, which is covering the regular 2,5 years). Thus, while the focus may differ across countries, the conditionality will be done within the framework of the overall objective of the MFA instrument to foster macroeconomic stability whilst improving the overall macroeconomic management, strengthening economic governance and transparency, and improving conditions for renewed sustainable growth.

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Overall, the European Commission submits to the European Parliament and the Council a proposal to grant MFA to ten partners[1] for a **total amount of EUR 3 billion**: **the Republic of Albania, Bosnia and Herzegovina, Kosovo*, Montenegro and the Republic of North Macedonia in the Western Balkans; Georgia, the Republic of Moldova and Ukraine in the Eastern neighbourhood; and the Hashemite Kingdom of Jordan (top-up of the existing MFA) and the Republic of Tunisia in the Southern neighbourhood.** However, the situation is still evolving and the COVID-19 crisis is becoming increasingly challenging also in other countries. MFA remains available also for other eligible countries in situations of balance-of-payments difficulties that may appear later. The Commission will also initiate a discussion on the scope of the EU MFA instrument and how it interacts with other EU external policies.

The assistance would take the form of medium-term loans, with no grant component being envisaged. The proposed MFA is in line with the aims of the EU's Western Balkans strategy, the Eastern Partnership and the orientations of the European Neighbourhood Policy (ENP). It signals to the enlargement and neighbourhood partners that the EU continues to support its partners in this time of unprecedented crisis. In this context, the Commission considers that the political and economic pre-conditions for an MFA operation of the proposed amount and nature are satisfied.

1.2 The macroeconomic situation following the COVID-19 crisis in the enlargement and neighbourhood regions

The economic consequences of the coronavirus pandemic are expected to be severe in the **enlargement region.** Before the crisis hit, the Western Balkan partners were enjoying several years of relatively robust output growth, which averaged more than 3% a year in 2015-2019. However, as the region is closely linked to the EU economy, the sharp downturn in the EU will have knock-on effects on their economies, plunging them into a severe recession. The main transmission channels will be dampened demand for their exports and possibly reduced remittances (from the EU and Switzerland), which is an important source of financing external imbalances. This may be exacerbated by many expatriates from these partners working in the services sector, e.g. hotels/restaurants, i.e. sectors that are hit especially severely by the current crisis. In addition, containment measures and lockdowns will further suppress trade and domestic demand in the near term. Furthermore, health systems are generally weak and underfunded, which might exacerbate the supply shock from reduced labour availability due to sickness and absenteeism, depending also on the spread of the disease. External positions have improved in recent years, but the current account deficit for the region still averaged around 5-6% of GDP in recent years as large merchandise deficits were only partially offset by surpluses in the services and secondary income accounts. The external deficits were to a large extent financed by net FDI inflows; however, this source of financing is now set to take a hit from the crisis. External financing needs remain high while adverse financial market conditions might negatively impact rollover plans, requiring external

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[1] The situation is still evolving, and the COVID-19 crisis could become increasingly challenging also in other countries. The cut-off date to be included in this omnibus MFA proposal prepared in the context of COVID-19 was 17 April 2020. Any additional requests for support coming thereafter will be considered in the traditional case-by-case manner.

* This designation is without prejudice to positions on status, and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence.

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assistance to meet refinancing needs and sustain the capacity for health- and crisis-related measures in some cases.

The economic outlook for the **Eastern neighbourhood countries** has radically changed following the global spread of the corona virus in early 2020. Their economic performance in 2019 was generally strong, with average GDP growth of 3%, an overall moderate inflation and low budget deficits. At the start of this year, forecasts were for a similar performance in 2020, or even better, with growth expected to strengthen because of strong consumer and business confidence underpinning domestic consumption. The spread of the coronavirus has brought an abrupt deterioration of the outlook: all Eastern neighbours appear to be set for a deep recession this year, while its duration and relative severity are still difficult to estimate and will reflect the different channels at play: shocks on the supply and demand side of the economy, including confidence effects, and stress in the financial markets. Being very open economies, all are likely to be heavily affected by the weaker global demand in general, including for tourist services, and lower commodity prices (such as metals). In order to alleviate the burden of the crisis on the economy and population, the authorities have announced a number of health-related, fiscal and monetary policy measures. However, several of them will only be able to sustain these with the help of official external funding

The COVID-19 pandemic will also have a severe impact on the economies of the **Southern neighbourhood**. Most countries imposed timely containment measures in March 2020 to restrict the spread of the virus, but the sharp deterioration in domestic and external conditions will have a sizable negative effect on economic activity. Economic growth had already slowed down throughout 2019 in the region, but the forecasts at the start of this year projected mostly improvements in growth rates for 2020, among moderating inflation and accommodative monetary policies across countries. Despite high uncertainty around the evolution of the crisis, the economic outlook has now rapidly deteriorated and, beyond the health emergency, most Southern neighbours are likely to enter into a recession this year, with limited or no economic buffers. The downturn will materialise through several channels, including shocks from global demand (including from tourism), pressure on public finances and stress in financial markets. While most countries have announced a number of fiscal, financial and monetary policy measures to counter the economic fallout, some countries in the region will be in need of additional financial support from partners to provide liquidity, sustain macro-economic stability and maintain fiscal space.

1.3 The macroeconomic situation and financing needs of the partners following the COVID-19 crisis

1.3.1 Enlargement partners

Albania

Albania is particularly vulnerable to the economic fallout from the pandemic due to its close economic relations with some highly affected EU Member States, the importance of the tourism sector and its high refinancing needs. The damages from the November 2019 earthquake, which already absorbed a large part of both public and private reserves for the emergency response, and the limited capacity of the health sector aggravate the situation. Faced with the spread of COVID-19, the government has put strong social-distancing measures in place since 8 March and announced the state of emergency on 28 March. Albania faces a recession with international institutions forecasting real GDP to decrease by around 5% in 2020, driven by a drop in private consumption and in goods and services (tourism) exports. Albania has close economic relations with EU Member States highly affected by the

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COVID-19 crisis, such as Italy, which receives half of Albania's merchandise exports (textiles) and is the largest source of its remittances (amounting to 5.2% of GDP). Furthermore, Albania strongly depends on travel and tourism, which accounts for 9% of GDP and about 23% of employment. The annual peak of tourism revenue is usually in the third quarter, much of which is at risk this year. The IMF expects the current-account deficit to widen to 11.2% of GDP in 2020. Foreign reserves are covering over 6 months of imports, providing some buffer, but external financing needs are high. In particular, the government needs to refinance foreign debt amortisation of EUR 545 million (3.8% of GDP) in 2020, partly by issuing a EUR 500-600 million Eurobond. The government postponed the Eurobond issuance from May to October, the latest possible date, but the conditions will certainly be less favourable than the 3.4% interest of the 2018 Eurobond – if it can be placed at all.

Table 1: Selected Macro-Economic indicators for Albania

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, %	1.8	2.2	3.3	3.8	4.1	2.2
Consumer price inflation, %, end of period	0.7	1.9	2.2	1.8	1.8	1.1
Key monetary policy rate, %, end of period	2.3	1.8	1.3	1.3	1.0	1.0
Unemployment rate, %	17.5	17.1	15.2	13.7	12.3	11.5
General government balance, % of GDP	-5.2	-4.1	-1.8	-2.0	-1.6	-1.9
Public debt, % of GDP	70.1	72.7	72.4	70.2	67.7	66.3
Current account balance, % of GDP	-10.8	-8.6	-7.6	-7.5	-6.8	-7.6
International reserves, USD billion	2.5	2.9	2.9	3.3	3.7	3.5
International reserves, months of imports	5.2	7.4	6.8	7.0	6.8	6.5
Gross external debt, % of GDP	69.5	74.4	73.5	68.8	65.2	60.5
Foreign direct investment, % of GDP	8.4	8.3	9.3	8.8	8.5	8.1

Sources: WIIW, IMF

With the adopted measures, which only cover the most urgent needs for about 2 months, the fiscal deficit is set to reach 4% of GDP and public debt could increase from 66.3% of GDP to over 69% of GDP, according to the very optimistic budget amendment. Despite very limited fiscal policy space, the government swiftly adopted policy support measures of about 2% of GDP for affected businesses and households, and additional funding for the health sector. The government issued a moratorium on loan repayments together with the central bank, which has lowered its already low policy rate to 0.5% and releases liquidity. Before the corona crisis, the share of foreign debt had increased to about 46% of total public debt and overall interest payments were estimated to reach 2.1% to 2.3% of GDP. Future debt sustainability is likely to weaken with higher interest on the foreign-owned part of the debt, a depreciating exchange rate and the increasing domestic debt, which has usually been of shorter maturity and higher interest. The government requested and the IMF Executive Board approved on 10 April emergency liquidity assistance under the Rapid Finance Instrument (RFI) of about EUR 172 million. The EU announced a reallocation of IPA funding of EUR 50 million. In addition, the World Bank and the Agence Française de Développement have been asked to frontload planned loans of approximately EUR 130 million. The financing gap after IMF and World Bank loans and EU grants could reach about EUR 350 million (2.5% of GDP).

Bosnia and Herzegovina

Having already been on a decelerating growth path, Bosnia and Herzegovina now faces a major recession. During 2019, economic growth decelerated to 2.6% from 3.3% in 2018, largely reflecting deteriorating external demand and a continued political stalemate, delaying necessary structural reforms and negatively affecting investment. Brain-drain has gained substantial momentum in recent years, undermining the country's growth potential. The

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outbreak of the COVID-19 pandemic sharply exacerbated the already ongoing slowdown, in particular affecting transport and tourism, but also workers' remittances, accounting for some 10% of GDP and providing an important lifeline, in particular for lower income households. The latest IMF projection expects a 5% drop in economic activity in 2020.

Table 2: Selected Macro-Economic indicators for Bosnia and Herzegovina

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, %	1.2	4.1	3.4	3.0	3.3	2.6
Consumer price inflation, %, end of period	-0.4	-1.3	-0.5	0.7	1.6	0.2
Key monetary policy rate, %, end of period*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Unemployment rate, %	27.5	27.7	25.4	20.5	18.4	15.7
General government balance, % of GDP	-2.0	0.7	1.2	2.6	2.3	1.0
Public debt, % of GDP	41.6	41.9	40.4	36.1	34.2	31.7
Current account balance, % of GDP	-7.2	-5.1	-4.7	-4.3	-3.7	-3.6
International reserves, USD billion	4.8	4.7	5.0	6.3	6.6	7.0
International reserves, months of imports	5.5	6.6	7.0	7.6	7.3	7.0
Gross external debt, % of GDP	53.4	54.3	54.8	54.2	54.1	55.6
Foreign direct investment, % of GDP	3.0	2.2	2.1	2.5	2.3	2.8

** Banks use the Euribor as a reference*

Sources: WIIW, IMF, Bosnia & Herzegovina Agency for Statistics

Despite rather sound fiscal headline numbers, the country's fiscal space is very limited. The health sector is poorly equipped for coping with the virus-related strong increase in the demand for intensive care and requires substantial additional spending. The economic slowdown and announced measures to alleviate the COVID-19 related shock will lead to a large drop in revenues and a sharp increase in transfers, which will severely worsen the budget balance. Given the country's currency board regime with the euro as it anchor currency, the room for monetary policy is very limited. As the crisis is expected to hit exports and remittances, the IMF projects the current account deficit to widen to 7.5% of GDP in 2020, resulting in a strong increase in external financing needs. Due to the country's poor credit rating, access to international financial markets is very limited, while the country's financial markets are too shallow to accommodate these financing needs. Against this background, the Bosnian authorities have already requested emergency financing from the IMF amounting to up to EUR 330 million (nearly 2% of GDP). Current estimates point to a remaining financing gap of some EUR 500 million (2.8% of GDP) in 2020, after expected IMF and World Bank contributions.

Kosovo

The risk of economic contraction is very high in Kosovo. Before the outbreak of corona crisis, the economy was undergoing a cyclical upswing in 2015-2019, with real GDP increasing by 4% annually. The key growth drivers were services exports, gross-fixed capital formation and private consumption, the latter boosted by large remittances from abroad, and by robust wage and credit growth. Services exports (tourism) and private investment were also to a large extent supported by the diaspora. The outbreak of the Covid-19 pandemic and the related shutdown are disrupting Kosovo's trade and financial flows with a drastic impact on the economy. A further vulnerability of Kosovo's economy is the fragile private sector, dominated by micro enterprises with limited liquidity buffers or access to finance. Due to the large informal sector (accounting for around 30% of GDP) and the already high unemployment rate (26% in late 2019), the most likely scenario is a rapid increase in poverty and unemployment. The IMF projects real GDP to contract by 5% and the current account

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deficit to widen to 7.4% of GDP in 2020 as exports and remittances will fall, while financing flows, including FDI, will diminish significantly.

Table 3: Selected Macro-Economic indicators for Kosovo

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, %	1.2	4.1	4.1	4.2	3.8	4.2
Consumer price inflation, %, end of period	-0.4	-0.2	1.3	0.5	2.9	1.1
Key monetary policy rate, %, end of period	9.3	7.7	7.2	6.8	6.0	6.4
Unemployment rate, %	35.3	32.9	27.5	30.5	29.6	25.7
General government balance, % of GDP	-2.2	-2.0	-1.2	-1.3	-3.0	-2.9
Public debt, % of GDP	10.7	13.1	14.4	16.6	16.9	17.5
Current account balance, % of GDP	-6.9	-8.6	-7.9	-5.4	-7.6	-5.8
International reserves, USD billion	0.7	0.7	0.6	0.7	0.8	0.9
International reserves, months of imports	2.4	2.6	2.0	2.1	2.2	2.3
Gross external debt, % of GDP	31.2	33.3	33.2	32.6	30.3	30.3
Foreign direct investment, % of GDP	2.7	5.3	3.6	4.0	4.0	3.8

Sources: WIIW, IMF, ERP, Ministry of Finance Kosovo

Despite moderate deficit and debt-to-GDP levels in 2019, fiscal space is limited. Headline budget deficit and public debt stood at 2.9% and 17.5% of GDP, respectively, in 2019. Kosovo's tax-revenue base is constrained by the large informal economy, while public spending is burdened by costly spending on social transfers for specific groups. As Kosovo has no access to international financial markets (due to the lack of credit rating), nearly two-thirds of its total debt is held by a narrow investor base, with the Kosovo Pension Security Trust and the Central Bank accounting for around 38% and 23%, respectively, of the total. A further 35% of domestic debt is held by commercial banks. The IMF and IBRD hold nearly one third of Kosovo's international debt each while the remaining part is mainly with foreign banks. Due to the unilateral decision to use the euro as its currency, Kosovohas no scope for an independent monetary policy.

Plummeting public revenue combined with large basic payments and the crisis response measures constitute an acute liquidity risk. The IMF estimates that government revenues will fall by 50-60% year-on-year in April-June and projects an annual decline of up to 12.5%. This would lead to a widening of the budget deficit to almost 5% of GDP in 2020. The key drivers are related to a severe contraction in economic activity and the postponement of tax payments. The caretaker government approved an emergency package worth EUR 180 million containing 16 measures, mainly to support affected businesses, reinforce social protection of the most vulnerable households, protect formal and informal employment and support public organisations working in the front-line of the fight against the pandemic. The government bank balance, which has already fallen below the legally prescribed 4.5% of GDP, is expected to decline further to 2.5% of GDP in 2020. Kosovo has requested and the IMF Board approved on 10 April emergency IMF liquidity assistance of EUR 51.6 million through the RFI. Current estimates point to a remaining financing gap of some EUR 210 million.

Montenegro

Montenegro is particularly exposed to the economic fallout from the pandemic due to its very strong reliance on the tourism sector as well as its high external financing needs. Montenegro faces a deep recession in 2020, with the IMF forecasting a steep 9% real contraction of the economy. Tourism, one of the most affected sectors, accounts for more than 20% of GDP and is a key source of foreign exchange, employment and fiscal revenues. However, coronavirus containment measures brought tourism and travel to a standstill at a

time when these activities were about to enter the high season. Official reserves amounted to some 5 months of imports in 2019, providing some buffer, but external financing needs are sizeable. The government needs to refinance maturing foreign debt of about 1.6% of GDP in the remainder of 2020, while an additional 6.8% of GDP worth of foreign debt will need to be refinanced in 2021. The government is currently negotiating a syndicated EUR 250 million loan, backed by a EUR 80 million loan from the World Bank in order to meet some of the rollover needs. In addition, the government requested emergency liquidity assistance from the IMF under the Rapid Finance Instrument (RFI), which could be up to EUR 75 million, and the EU announced a reallocation of IPA funding of EUR 50 million. The remaining financing gap after IMF and World Bank loans as well as EU grants could reach about EUR 120 million.

Table 1: Selected Macro-Economic indicators for Montenegro

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, %	1.8	3.4	2.9	4.7	5.1	3.6
Consumer price inflation, %, end of period	-0.6	1.7	1.0	2.9	1.5	1.2
Key monetary policy rate, %, end of period	8.4	7.7	6.7	6.2	5.8	5.5
Unemployment rate, %	18.0	17.6	17.4	16.1	15.2	14.6
General government balance, % of GDP	-2.9	-8.3	-3.6	-5.3	-2.9	-2.3
Public debt, % of GDP	59.9	66.2	64.4	64.2	70.1	69.0
Current account balance, % of GDP	-12.4	-11.0	-16.2	-16.1	-17.0	-15.2
International reserves, USD billion	0.6	0.7	0.8	1.0	1.2	1.5
International reserves, months of imports	2.9	3.4	3.7	3.7	4.1	5.1
Gross external debt, % of GDP	45.2	53.5	50.6	51.5	59.2	53.8
Foreign direct investment, % of GDP	10.8	17.2	5.2	11.5	8.9	8.2

** Gross external public debt*

Sources: WIIW, IMF

The government has adopted a first package of emergency economic measures. In March, the government adopted measures to deal with the health-related and economic consequences of the COVID-19 pandemic. Despite limited fiscal space, these measures amount to some 2% of GDP and concern in particular deferred payments of taxes and social contributions, a moratorium on loan repayments and on rent payments for the lease of state-owned property, as well as subsidies for businesses and workers. A second set of measures is currently being discussed with social partners and should be adopted in April. Preliminary estimates from the Ministry of Finance expect the fiscal deficit to rise to more than 7% of GDP and public debt to increase by an additional 2.6 pps. to 82% of GDP in 2020, the highest in the region. Montenegro’s unilateral adoption of the euro as its official currency means that it has no monetary policy autonomy.

North Macedonia

The economic recovery is disrupted by the external shock. The pace of economic expansion in North Macedonia accelerated in 2019 (+0.9 pp. to 3.6%) on the back of firming domestic demand, including a recovery of investment and supported by a sizeable fiscal stimulus, accommodative monetary policy, and solid increases in bank lending. Labour-market conditions improved continously and the current-account deficit remained contained. The economic upswing is projected to be reversed (temporarily) this year, as extended social and economic containment measures are having a severe impact on output and employment, and trade activity is hit. Current IMF projections expect the economy to contract by 4% in 2020.

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The main economic impact from the crisis is through the trade channels. Exports are an important pillar of growth, amounting to 62% of GDP in 2019 (goods and services). The main trading partner is Germany (49% of total goods exports). Over half of exports are derived from foreign companies established in the country. Their production largely depends on imported intermediate inputs, capital goods and commodities, which exposes them to the risk of supply-chain disruptions as well as lower global demand from third countries. Producers of automotive supplies have already faced a shortage of components imported from China since January, due to COVID-related factory closures there. On the domestic side, the production and internal trade lockdown has already led to a massive drop in output and large layoffs and pay cuts in the workforce. In comparison with regional peers, tourism assumes a less important role in the country's economy, but it is severely hit by the crisis, with strong repercussions on activity and employment in transport and trade.

Table 4: Selected Macro-Economic indicators for North Macedonia

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, %	3.6	3.9	2.8	1.1	2.7	3.6
Consumer price inflation, %, end of period	-0.6	-0.3	-0.3	2.4	0.8	0.4
Key monetary policy rate, %, end of period	3.3	3.3	3.8	3.3	2.5	2.3
Unemployment rate, %	28.0	26.1	23.7	22.4	20.7	17.3
General government balance, % of GDP	-4.2	-3.4	-2.7	-2.8	-1.1	-2.1
Public debt, % of GDP	45.7	46.6	48.7	47.6	48.6	48.8
Current account balance, % of GDP	-0.5	-2.0	-2.9	-1.0	-0.1	-2.8
International reserves, USD billion	2.7	2.2	2.5	2.5	3.0	3.3
International reserves, months of imports	4.9	4.9	4.0	4.2	4.2	4.5
Gross external debt, % of GDP	70.0	69.3	74.7	73.4	73.3	72.2
Foreign direct investment, % of GDP	2.4	2.4	3.5	1.8	5.7	1.8

Sources: WIIW, IMF

The authorities have taken swift and decisive action to mitigate the socioeconomic impact of the crisis. After the central bank lowered the key policy rate and adopted measures to ease credit extension, the government followed with two packages of economic support measures. A first set targets the most impacted sectors, and includes interest-free loans for SMEs; subsidies to employee benefits for April to June, by up to 50% of the average salary paid in 2019 totalling EUR 120 million; and, exemptions from personal and corporate income tax, for April, May and June. A second set of measures, totalling EUR 200 million, includes financial support for private firms affected by the crisis; delay of loan repayments; and a further EUR 8 million in interest-free loans to SMEs.

Fiscal space to accommodate the economic fallout from the crisis is limited. The government expects a revenue shortfall of between 20-40% this year, compared to the original budget. It plans to reallocate budgeted expenditure towards the health sector and the new economic measures, without increasing the expenditure ceiling. In general, fiscal space for discretionary measures to cope with the multiple shocks is limited. Low tax rates, a large array of tax expenditures, and persistent shortcomings in revenue collection have contributed to a decline in public revenue ratios in recent years, adding to fiscal risks from a rising pension deficit and high indebtedness of public enterprises. The share of transfers in total public expenditure of the general government has risen from 51% in 2014 to 57% in 2019. Moreover, particularly high refinancing needs are arising in 2020-2021, including for the amortisation of two maturing Eurobonds, part of a World Bank PBG, and large commercial loans of the Public Enterprise for State Roads, which is tasked with the implementation of major road transport infrastructure. North Macedonia has requested emergency assistance from the IMF in the form of a Rapid Financing Instrument (RFI), which amounts to EUR 177

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million, and was approved by the IMF Board on 10 April. Current estimates point to a remaining financing gap of around EUR 330 million after IMF, World Bank and EU grant funding.

1.3.2 Eastern Partnership countries

Georgia

Notwithstanding strong growth in 2019, Georgia is heading for a deep recession this year. Robust real GDP growth (of 5%) was recorded in 2019, but in March 2020 activity came to an abrupt halt as measures to contain the spread of the virus kicked in. Georgia declared a state of emergency, restricted travel and closed all but essential shops, and later introduced a nationwide lockdown and curfew. Given the importance of the tourism sector (where revenues in foreign currency were equivalent to 19% of GDP in 2019), the impact of the travel ban and the global recession on the outlook is set to be severe. While the depth and length of the recession is uncertain, it can be expected to be broad-based. Recent estimates taking into account the impact of the virus suggest an annual contraction of around 4%, assuming that the economy will start to recover in the fourth quarter of the year.

Georgia has limited space to address the crisis. The budget deficit widened in 2019, despite the solid growth performance. This reflects, in part, efforts to strengthen capital and social spending, in an attempt to improve education and infrastructure to strengthen the economy's growth potential further out. The higher deficit, together with lari depreciation (by 6% in 2019 against the euro), contributed to an increase in the public debt ratio to about 41% of GDP. Georgia's international reserves rose last year (totalling USD 3.5 billion at the end of 2019, which corresponds to around 4 months of imports). However, in March 2020, the central bank drew on its reserves to intervene against the depreciation of the currency (down by 15% in March against the euro). Measures to contain the economic fallout of the crisis initially targeted the sectors most affected (hotels, restaurants, travel agencies etc.) and included postponement of taxes, as well as subsidised loans. More recently, the government has announced a further support package to mitigate the impact of the crisis. Specific measures are to include time-limited support to employees who lost their jobs, transfers to SMEs to subsidise labour costs, electricity subsidies to poorer households etc.

Georgia's balance of payments and public finances have come under heavy pressure due to the COVID-19 crisis, and Georgia has asked the EU, the IMF and other international partners for additional support to cover the financing gap. The 2020 budget deficit is expected to increase from the 2.4% envisaged in the budget law to more than 8% of GDP due to lower revenues in the recession, increased expenditures for support to companies and individuals affected by the crisis, as well as increased healthcare spending. Georgia's balance of payment will deteriorate due to lower revenues from export of services (tourism, transport), lower inflows of remittances (which are equivalent to 10% of GDP), likely lower inflow of FDI and an outflow of portfolio capital. This may be partially counterbalanced by a reduction in the goods trade deficit due to import compression on faltering domestic demand.

The external funding gap is tentatively estimated by the IMF at USD 1.6 billion in 2020-2021, and Georgia will need assistance from its international partners to cover this gap. The IMF has an Extended Fund Facility programme with Georgia, valid until April 2021, of USD 290 million, most of which has already been disbursed. On 14 April the authorities concluded a staff level agreement with the IMF providing for an augmentation of this programme by approx. USD 375 million, of which USD 308 million to be disbursed in 2020. They are also negotiating with several partners, including the World Bank, ADB, AFD, KfW and EIB about

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augmenting policy-based loans. On current information, around 75% of the estimated financing gap for this year remains to be filled.

Georgia has an ongoing EU MFA programme. The first instalment of EUR 20 million was disbursed to Georgia in December 2018. The second (and final) instalment of EUR 25 million (EUR 5 million in grants and EUR 20 million in loans) is expected to be disbursed in the second quarter of 2020 subject to implementation of the agreed policy conditions; most of them have already been met. However, reflecting the escalating COVID-19 induced crisis and as an important element of the support to close the financing gap, in addition to the ongoing MFA, a new and higher EU MFA programme is needed for Georgia.

Table 5: Selected Macro-Economic indicators for Georgia

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, %	4.6	2.9	2.8	4.8	4.7	5.1
Consumer price inflation, %, end of period	0.0	0.0	1.8	6.7	1.5	7.0
Key monetary policy rate, %, end of period	4.0	8.0	6.5	7.3	7.0	9.0
Unemployment rate, % LFS	14.6	14.1	14.0	13.9	12.7	10.9
General government balance, % of GDP	-2.3	-1.2	-1.7	-1.3	-1.8	-3.3
Gross public debt, % of GDP	37.2	36.8	40,.3	39.9	39.9	41.2
Current account balance, % of GDP	-10.8	-12.7	-13.1	-8.7	-7.4	-5.1
International reserves, USD billion	2.7	2.5	2.8	3.0	3.3	3.5
International reserves, months of imports	3.7	3.6	3.5	3.4	3.4	4.0
Gross external debt, % of GDP	84.7	109.6	110.7	106,9	101.2	105.1
Foreign direct investment, % of GDP	8.7	10.2	8.6	11.2	7.0	7.2

Sources: Geostat, Ministry of Finance, National Bank of Georgia

The Republic of Moldova

A recession appears unavoidable in the Republic of Moldova (referred to as Moldova hereafter). GDP rose by 3.6% in real terms in 2019, on the back of rising investments, in particular. The impact of the measures to halt the spread of the corona virus (including declaring a state of emergency) and the fallout from the global recession are set to bring the economy to a standstill. Although surrounded by signficant uncertainty, the outlook for 2020 is for a deep recession. Moldova is particularly affected by disruptions to migrant work (remittances account for 15% of GDP in Moldova) and decreased trade with countries hit by the crisis, in particular EU member states such as Romania, Italy and Germany. The inflationary pressures that built up in 2019, when consumer price inflation stood at 7.5%, are fading fast. This reflects to some extent a monetary tightening in the course of 2019, but also the current slump in demand.

Moldova has some space to counteract the shock from the COVID-19 crisis, but not for long and clearly within limits. The budget deficit declined to 1.5% of GDP in 2019, following a number of fiscal measures, taken in cooperation with the IMF, that reined in the deficit. The deficit was set to increase this year to finance rising capital expenditures. Funds of some of these planned infrastructure investment projects are now being reallocated to finance expenditures related to the crisis. Public debt decreased in 2019 to 27% of GDP. The deficit is primarily financed through the issuance of domestic bonds and by IFIs and other international assistance as Moldova has a restricted access to international capital markets. International reserves rose last year to stand at USD 3.1 billion at the end of 2019 (corresponding to about 5 months of imports).

Moldova's balance of payments and public finance have come under heavy pressure due to the COVID-19 crisis. Already before the crisis, the current account deficit was significant

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at around 10% of GDP in the last years. The external funding gap is tentatively estimated at USD 800 million (about 7% of GDP) in 2020 and the fiscal financing gap is estimated at MDL 10.5 billion (around USD 550 million). A three-year EFF/ECF programme with the IMF came to an end in March 2020 and Moldova had already expressed interest in a successor arrangement before the COVID-19 crisis. The IMF has extended about USD 240 million (EUR 220 million) to mitigate the economic effects of the COVID-19 crisis. One-third of the RCF/RFI came from the PGRT at 0% interest rate and two-thirds from general resources at less than 2% interest rate. Moldova has an ongoing MFA programme where the second and third instalments of EUR 70 million in total can be disbursed if the conditions are met before the programme expires in July 2020. In addition, already announced credits from Russia of EUR 200 million for 2020, which were primarily aimed for infrastructure investments, could be reallocated to address the effects of the crisis. However, given the weak and deteriorating balance of payments situation and the limited access to international capital markets, Moldova would be in need of additional assistance to cover the external financing gap.

Table 6: Selected Macro-Economic indicators for Moldova

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, %	5.0	-0.3	4.4	4.7	4.3	3.6
Consumer price inflation, %, end of period	4.7	13.6	2.4	7.3	0.9	7.5
Key monetary policy rate, %, end of period	6.5	19.5	9.0	6.5	6.5	5.5
Unemployment rate, % LFS	3.9	5.0	4.2	3.9	3.0	3.9
General government balance, % of GDP	-1.5	-1.9	-1.6	-0.6	-0.8	-1.5
Public debt, % of GDP	27.3	29.7	36.9	32.7	30.1	27.4
Current account balance, % of GDP	-5.9	-5.9	-3.5	-5.7	-10.6	-9.7
International reserves, USD billion	2.2	1.8	2.2	2.8	3.0	3.1
International reserves, months of imports	5.8	4.7	4.9	5.3	5.5	5.2
Gross external debt, % of GDP	68.0	78.4	76.6	71.8	65.1	63.1
Foreign direct investment, % of GDP	3.2	2.8	0.9	1.5	2.4	4.6

Sources: Moldovian National Bureau of Statistics, National Bank of Moldova, Moldova Ministry of Finance

Ukraine

After a significant improvement in Ukraine's macroeconomic situation over the past few years (up to the third quarter of 2019), the outlook deteriorated rapidly in March following an abrupt government reshuffle which coincided with the outbreak of the global coronavirus crisis. Real GDP growth reached 3.2% in 2019, after a disappointing fourth quarter (+1.5% only), in particular in the industrial and agricultural sectors. While gross fixed capital formation strengthened somewhat to 18% of GDP, it still remains far below the 25%-30% range typical for emerging and developing economies. In the second half of 2019, strengthened demand to hold the hryvnia in the context of a bank-credit contraction kept inflationary pressures down and the consumer-price index fell below the 5% target in December 2019. Foreign reserves continued to grow in 2019 (reaching the equivalent of EUR 23.7 billion at the end of February 2020, which corresponds to above 4 months of imports). However, following the loss of confidence around a government reshuffling in early March and the corona-virus outbreak and ensuing containment measures, the earlier exchange-rate appreciation (+16% in 2019 against the US dollar) was quickly erased (-20% by end-March 2020). In this context, the demand to hold hryvnia weakened and the National Bank of Ukraine (NBU) had to intervene selling the equivalent of about EUR 2 billion in March, which reduced official international reserves by more than 8%. Following containment measures since mid-March, similar to those adopted in other countries, economic activity has been curtailed. Analysts expect a deep recession (with the GDP fall ranging between 4% and

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9%) in 2020. To ensure the sustainability of the recovery, the reform effort pursued so far must be kept, in particular to overcome vested interests and corruption, to further improve the business climate, and to advance privatisation and liberalisation in key sectors such as energy.

The economic recession is expected to result in a severe deterioration of the budget, which will test the sustainability of the buffers that Ukraine has managed to build up so far. The steady economic improvements over the past years allowed Ukraine to strengthen its public finances. The budget deficit fell below 2% for the last three years and the consolidated public debt-to-GDP ratio decreased to 44.3% of GDP in 2019, or 51½% when government guarantees are included. This rather positive environment has enabled the Ukrainian authorities to take a number of anti-coronavirus crisis measures including limited and temporary tax relief, as well as one-off income support for pensioners and the most vulnerable. The revised 2020 budget, adopted by the parliament on 13 April, provides for a EUR 2.5 billion coronavirus fund for immediate measures to counter the spread of COVID-19, including support to doctors and procurement of medical equipment. Monetary policy measures have also been deployed: the NBU cut interest rates; extended the frequency and the maturity of its liquidity-providing operations; introduced a new loan facility, with a maturity of up to five years, to stimulate bank credit in hryvnia; and introduced capital-relief measures for the banks.

It is unlikely that the government of Ukraine can finance all of its 2020-2021 funding needs at the domestic and international financial markets. In light of the expected recession-driven deterioration of public finances, the Ukrainian parliament revised the 2020 budgetary deficit to 7.5% of GDP, or the equivalent of USD 10.5 billion. While some of the budget deficit can be financed domestically, the government also has USD 5 billion in external debt repayments falling due in 2020. The IMF estimates the overall external financing gap to be around USD 12 billion in 2020. Against this backdrop, the IMF agreed to increase the size of its recently negotiated three-year programme from USD 5.5 billion to up to USD 10 billion, of which USD 3.5 billion would become available this year. Along with a World Bank loan and the remaining EUR 500 million tranche of the EU's existing MFA programme (for which conditions have been fulfilled and which can be disbursed as soon as the prior actions for the new IMF programme have been implemented), around USD 5 billion of financing are available. The remainder of the USD 12 billion gap would need to be covered through additional official financing or through a drawdown of official international reserves.

Table 7: Selected Macro-Economic indicators for Ukraine

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, %	-6.6	-9.8	2.4	2.5	3.3	3.2
Consumer price inflation, %, end of period	17.5	43.4	12.4	13.7	9.8	4.1
Key monetary policy rate, %, end of period	14.0	22.0	14.0	14.5	18.0	13.5
Unemployment rate, % LFS	9.3	9.1	9.3	9.5	8.8	8.2
General government balance, % of GDP	-4.5	-1.6	-2.3	-1.4	-1.9	-2.0
Gross public debt, % of GDP	59.7	67.1	69.2	61.5	52.2	44.3
Current account balance, % of GDP	-3.2	2.3	-1.3	-2.2	-3.3	-0.8
Official international reserves, USD billion	7.5	13.3	15.5	18.8	20.8	25.3
Official reserves, months of imports	1.8	3.0	3.0	3.2	3.3	4.0
Gross external debt, % of GDP	94.1	129.5	120.7	102.9	87.7	79.5
Foreign direct investment, % of GDP	0.2	3.3	3.5	2.3	1.8	1.6

Sources: National Bank of Ukraine, Ministry of Finance of Ukraine

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1.3.3 Southern neighbourhood countries

Jordan

The impact of the coronavirus outbreak on economic prospects is expected to be significant and is likely to plunge Jordan into a recession in 2020. In mid-March, Jordan announced strict measures to contain the spread of the virus, including closure of businesses and banks, travel routes and restrictions on public life. These will affect the domestic services sector, as well as tourism, which accounts for around 11% of GDP. Even before the coronavirus outbreak, Jordan was on a slow growth trajectory, with a steady pace of 2% real GDP expansion per year between 2016 and 2019. In the same context, COVID19 is expected to affect foreign direct investments which already weakened to an average of 2.1% of GDP in the period 2018-2019 from 4.5% of GDP in the period 2016-2017. The subdued growth has had a negative effect on the labour market, with unemployment increasing over the years to reach 19% in 2019. This is at risk of increasing further, depending on the duration of the lockdown.

In an effort to limit the economic damage from the pandemic, Jordan has deployed primarily monetary policy measures. Jordan's central bank cut compulsory reserves for commercial banks to 5% from 7% to inject more than JOD 500 million (USD 700 million) of extra liquidity and reduced the rate in all monetary instruments by 100 basis points. However, the effectiveness of these measures is likely to be curtailed by the lockdown. Furthermore, the central bank's room to lower interest rates further and to provide for liquidity injections is limited by the exchange rate peg to the US dollar. Positively, the current-account deficit narrowed significantly to 3.4% of GDP in the first three quarters of 2019 from 9.3% in the same period of 2018, driven largely by the favourable development of the goods trade balance. While part of this improvement reflected a drop in import-intensive FDI, which muted the impact on the overall balance of payments, foreign reserves nonetheless increased mildly at the end of 2019 to USD 12.2 billion (USD 14.3 billion including gold) or around 7 months of imports. The fall in the oil prices is expected to have a positive effect in the balance of payments in 2020. However, given the disruptive effect of the lockdown to the economy, the regional uncertainty, the widening of the current account, the easing of the monetary policy in relation to the peg with the US dollar and the existence of large obligations in foreign currency (Eurobond of USD 1.25 billion due in October 2020), there is clearly a need for Jordan to preserve its foreign reserve buffer.

Fiscal policy space is severely limited in Jordan. Fiscal consolidation was not sustained in 2019 and the deficit slipped from 2.4% in 2018 to 3.4% in 2019 (including grants). As a result, Jordan has not managed to contain the steady and long-standing upward trend in gross public debt, which stood at 96.6% of GDP at end-2019. This is very high for an emerging market country; in fact, without foreign support through grants and highly concessional lending, debt would already be unsustainable. The fiscal trajectory is expected to worsen severely in 2020. The lockdown of the economy is expected to have a grave impact on revenue collection while additional spending will be required to support the health system. As a result, the fiscal deficit is very likely to widen in 2020 and gross public debt to exceed 100% of GDP. The surge in the interest rates for emerging countries following the outbreak of the coronavirus increases the importance of concessional lending for financing the fiscal deficit.

Jordan has access to a new, four-year arrangement under the IMF's Extended Fund Facility (EFF) of around USD 1.3 billion. This was approved by the IMF Board on 25 March 2020. However, and following the outbreak of the coronavirus, the macro-economic framework has worsened steeply and the IMF programme is likely to be re-designed as new

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considerable financing needs have emerged. The IMF has called publicly for the continuation of donor support as a critical element for the success of its programme. In view of the new financing needs that have emerged, Jordan has requested an increase in its IMF resources on top of the USD 1.3 billion of approved in the context of the EFF programme.

Furthermore, Jordan has access to an existing EU MFA operation of EUR 500 million. The corresponding MFA Decision was adopted by the EP and the Council in January 2020. The MoU is currently under negotiation where a first disbursement could potentially be made in May/June 2020. The COVID-19 crisis calls for a reinforcement of the resources of the MFA programme that was approved in January 2020 as around USD 1.5 billion of the estimated financing gap for 2020 remains to be filled.

Table 8: Selected Macro-Economic indicators for Jordan

Indicator	2014	2015	2016	2017	2018	2019	Dates
Real GDP change, %	3.1	2.4	2.0	2.0	1.9	1.9	Q1-Q3 2019
Consumer price inflation, %, end of period	1.7	-1.6	0.8	3.2	4.5	0.3	End-2019
Key monetary policy rate, %, end of period	4.0	3.8	3.8	5.0	5.8	5.0	End-2019
Unemployment rate, % LFS	11.9	13.1	15.3	18.3	18.6	19.1	Q3 2019
General government balance, % of GDP	-2.3	-3.5	-3.2	-2.6	-2.4	-3.4	End-2019
Gross public debt, % of GDP	89.1	93.4	93.6	94.3	94.4	96.6	End-2019
Current account balance, % of GDP	-7.2	-9.1	-9.8	-10.8	-7.0	-3.4	Q1-Q3 2019
International reserves, USD billion	14.7	15.7	14.8	15.0	12.9	14.3	End-2019
International reserves, months of imports	7.0	8.3	8.1	7.8	6.8	7.7	End-2019
Gross external public debt, % of GDP	31.6	34.9	37.0	41.1	40.3	39.6	Q3 2019
Foreign direct investment, % of GDP	5.8	4.2	3.9	5.0	2.3	2.1	Q1-Q3 2019

Source: Central Bank of Jordan, Ministry of Finance of Jordan, IMF

Tunisia

The country will likely plunge into a recession in 2020, as activity will be negatively affected by the collapse in global demand and the effect of containment measures introduced in mid-March to halt the spread of the coronavirus. The government suspended all international flights and closed its borders, introduced a lockdown and a twelve-hour nightly curfew. On the external side, the sharply deteriorating economic cycle in Europe will impact economic performance, given close industrial and trade links, as well as the expected drop in the tourism sector. The downturn will put additional severe pressure on employment and social stability. It will also result in a further severe deterioration of the budget, reducing revenues and putting additional pressure on expenditure to support the economy and the health system. Having grown at just 1.6% per year on average over the past five years and at only 1% in 2019, Tunisia will face a recession in 2020 with very limited policy buffers.

Several policy measures have been adopted to mitigate the economic impact of the crisis. On the monetary side, this includes a 100 basis points interest rate cut and liquidity support measures. A fiscal support package (worth around 2% of GDP) has been approved, providing financial assistance to poor families, delaying tax debts and loan payments. The government also announced financial measures including a support mechanism to lower interest rates on investment loans, a state guarantee for new credits (TND 500 million, equivalent to around EUR 158 million) and a new investment fund (TND 600 million, equivalent to around EUR 190 million)..

Although Tunisia had a reasonably good year in 2019, macroeconomic imbalances persist, policy space remains limited and financing needs are high. Tunisia managed to reduce its public deficit somewhat in 2018-2019, but it remains relatively elevated at 3.5% of

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GDP, notably in combination with a lacklustre growth performance. Public debt reached 72% of GDP at the end of 2019. The recession is expected to result in a severe deterioration of the budget, reducing revenues while additional spending will be required to support the economy and the health system. As a result, the fiscal deficit will likely widen significantly in 2020 and the public debt will increase. The current-account deficit narrowed to 8.8% of GDP in 2019 (from double digits previously) and foreign reserves rose from a dangerously low level of just 69 days of imports in September 2018 to around 115 days of imports in March 2020. However, increased tourism receipts and remittances were largely behind this positive development in 2019. Both will be severely affected by the COVID-19 crisis due to closed borders and temporary income losses in host countries of Tunisian labour migrants.

The government will most likely not be able to cover its financing needs from domestic and international markets in 2020-2021. The government expects a larger than projected fiscal deficit in 2020 (to an estimated 4.3 % of GDP) for which about USD1 billion (or 2.6% of GDP) in additional external financing would still need to be mobilized. The balance of payments needs will be even larger (around 4.7% of GDP), given the expected fallout of the pandemic on the private sector and its access to external financing. The sharp decline in remittances and tourism (over 7% of GDP), despite lower oil prices, will also lead to a shortfall of foreign exchange revenues. The government needs around USD 3.5 billion in external financing and will have to repay USD 1.6 billion on its external debt during the year, with reimbursement peaks in April and June putting pressure on liquidity. Moreover, financing needs are set to increase further in line with the COVID-19 fiscal impact and response, while access to financial markets will remain very challenging during the year. The foreseen Eurobond emission for 2020 (originally USD 1.1 billion) will most probably have to be cancelled or delayed. While domestic financing might continue to be available, the country faces a situation in which, after IMF and World Bank loans, USD 2.5 billion of the external financing needs for the budget remains to be filled through foreign partners or market issuance.

Tunisia has requested help from the IMF. In response to the COVID-19 crisis, the IMF approved on 10 April a USD 745 million emergency assistance loan under the RFI (100% of the quota). This emergency programme provides bridge financing until a new Extended Fund Facility programme will be worked out. The current EFF programme (approved in 2016) will be cancelled, as it is neither possible to run parallel programmes nor to complete a programme review given the current degree of uncertainty. The country's existing EFF programme would have expired in May 2020 and still had USD 1.3 billion available, but had been dormant since before the October 2019 elections, which delivered a fragmented parliament and turned the formation of a government into a lengthy process.

Tunisia is eligible for MFA support. The country completed a EUR 500 million MFA operation in November 2019 and the authorities had expressed interest in further MFA even before the pandemic. Previous EU policy documents have publicly confirmed the EU's positive predisposition towards renewed MFA support for Tunisia.

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Table 9: Selected Macro-Economic indicators for Tunisia

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, %	2.9	1.2	1.2	1.9	2.7	1.0
Consumer price inflation, %, end of period	4.8	4.1	4.2	6.2	7.5	6.0
Key monetary policy rate, %, end of period	4.75	4.25	4.25	5.00	6.75	7.75
Unemployment rate, % LFS	15.0	15.2	15.5	15.4	15.5	15.2
General government balance, % of GDP	-5.0	-4.8	-6.1	-6.2	-4.8	-3.5
Gross Public debt, % of GDP	50.8	55.4	62.3	70.4	77.9	71.9
Current account balance, % of GDP	-9.1	-8.9	-8.8	-10.3	-11.1	-8.7
International reserves, USD billion	7.7	7.4	6.0	5.6	5.3	7.4
International reserves, months of imports	3.9	3.9	3.0	2.6	2.7	4.4
Gross external debt, % of GDP	63.7	68.4	75.2	86.2	99.4	103.5
Foreign direct investment, % of GDP	2.2	2.3	1.5	2.0	2.5	2.0
Other investment, % of GDP	7.8	6.5	5.5	6.9	8.6	10.9

Sources: Tunisian National Institute of Statistics, Tunisian Ministry of Finance, Central Bank of Tunisia

2 OBJECTIVES AND RELATED INDICATORS OF THE MACRO-FINANCIAL ASSISTANCE

2.1 Objectives

The objectives of the proposed MFA operation are to:

- Contribute to covering the external financing needs of the partner in the context of a significant deterioration of the partner’s external accounts brought about by the on-going COVID-19 crisis.

- Alleviate the partner’s budgetary financing needs.

- Support the fiscal consolidation effort and external stabilisation in the context of the foreseen IMF programme, which could, exceptionally, also be in the form of emergency funding from the IMF.

- Support structural reforms aimed at improving the overall macroeconomic management, strenghening economic governance and transparency, and improving conditions for sustainable growth.

2.2 Conditionality

In view of the critical needs of the beneficiaries in the context of the escalating COVID-19 crisis, the proposed MFA programmes needs to be prepared and adapted to be better fit for purpose at the current exceptional juncture. They have been bundled together to allow for a swifter preparation process; they are valid for one year (compared to 2.5 years for regular MFAs) and come with two disbursements only. To maintain the leverage of MFA and its role in fostering reforms, the second disbursement would still be linked to a limited set of reform actions. Thus, the assistance will be conditional on an IMF arrangement being in place and on the implementation by the partner of the aforementioned specific reform measures that will be agreed by the Commission on behalf of the EU and the partner in a Memorandum of Understanding.

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2.3 Indicators

The fulfilment of the objectives of the assistance will be assessed by the Commission, including in the context of the ex-post evaluation (see below), on the basis of the following indicators:

- Progress with macroeconomic and financial stabilisation and economic recovery from the COVID-19 crisis.

- Progress with the implementation of reforms, notably the specific policy actions identified as conditions for the second disbursement of the assistance, which will be included in Memoranda of Understanding.

2.4 Delivery mechanisms

The proposed new MFA operations with partners would amount to a total of up to EUR 3 billion. Regarding the form of the assistance, the Commission proposes to disburse the full amount in the form of medium-term loans, in two instalments partner. The decision on the respective size of instalments will be taken on a case-by-case basis and in view of a more complete information on the partner's financing needs and the timing of other international financial support, including from the IMF.

The preferred option is to disburse the assistance in two tranches, with the first tranche being conditional on the IMF arrangement being in place, and the second tranche being also conditional on the implementation of the conditions agreed in the Memorandum of Understanding. There will be a delay of at least three months between the two tranches. The disbursement of the first is expected to take place in around mid 2020, and the disbursement of the second instalment in the fourth quarter of 2020 or the first half of 2021.

MFA is an untied and undesignated macroeconomic support instrument, which helps the partner meet its external financing needs, and may contribute to alleviating budgetary financing needs. The funds would be paid to the Central Bank of the partner. Subject to provisions to be agreed in the Memorandum of Understanding, including a confirmation of residual budgetary financing needs, the funds may be transferred to the Ministry of Finance of the partner as the final beneficiary.

2.5 Risk assessment

There are fiduciary, policy and political risks related to the proposed MFA operation.

There is a risk that the macro-financial assistance, which is not dedicated to specific expenses (contrary to project financing, for example), could be used in a fraudulent way. In general terms, this risk is related to factors such as the quality of management systems in the central bank and the Ministry of Finance, administrative procedures, control and oversight functions, the security of IT systems and the appropriatedness of internal and external audit capabilities.

To mitigate the risks of fraudulent use, several measures will be taken. First, the Memorandum of Understanding and the Loan Agreement will comprise a set of provisions on inspection, fraud prevention, audits, and recovery of funds in case of fraud or corruption. Also, the assistance will be paid to a dedicated account at the Central Bank of the partner. Moreover, alongside reaching an agreement on the Memorandum of Understanding, the Commission services will conduct, if deemed necessary with the support of external consultants, an Operational Assessment, in order to assess the reliability of financial circuits

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and administrative procedures that are relevant to this type of assistance and will determine whether the framework for sound financial management of macro-financial assistance is sufficiently effective in the partner. The Commission is also using budget support under the European Neighbourhood Instrument and the Instrument for Pre-Accession to help the authorities improve their public finance management systems and these efforts are strongly supported by other donors. The assistance will be liable to verification, control and auditing procedures under the responsibility of the Commission, including the European Antifraud Office (OLAF), and the European Court of Auditors.

Finally, there are economic risks stemming from a possible further weakening of the European and global economic environment (taking into account the partners' high dependence on the EU markets), which would have an important effect on their fiscal consolidation efforts even if the necessary reforms have been put in place. These risks are further reinforced if the agreed reform efforts are lacking or incomplete.

Having made a thorough assessment of the risks, the Commission services consider that there are sufficiently strong grounds to proceed with the MFA to the partners.

The Commission services will maintain close contacts with the authorities during the implementation of the macro-financial assistance in order to address quickly any concerns that may arise.

3 ADDED VALUE OF EU INVOLVEMENT

The instrument of macro-financial assistance is a policy-based instrument directed to alleviate short- and medium-term external financial needs. In the context of the current COVID-19 crisis, MFA will help to provide economic policy space for the authorities to mount an effective economic response to the crisis. By helping the partner overcome the economic difficulties reinforced by the COVID-19 crisis, the proposed MFA will contribute to promoting macroeconomic and political stability in the partners. MFA will complement the resources made available by the international financial institutions, bilateral donors and other EU financial institutions. In doing so, it will contribute to the overall effectiveness of the financial support provided by the international community, as well as of other EU financial assistance, including budgetary support operations.

In addition to the financial impact of the MFA, the proposed programme will strengthen the governments' reform commitment and their aspiration towards closer relations with the EU. This result will be achieved, inter alia, through appropriate conditionality for the disbursement of the assistance. In a larger context, the programme will signal that the EU continues to support partners in moments of economic difficulties.

4 PLANNING OF FUTURE MONITORING AND EVALUATION

Although this assistance is of exceptional macroeconomic nature, its monitoring and evaluation will be undertaken in line with the standard Commission procedures.

4.1 Monitoring

Monitoring will involve the review of reports and data provided by the authorities and by review missions to the partner by Commission staff. To monitor the fulfilment of the objectives of the programme, the Commission will use two types of indicators:

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- Existence of and adherence to an IMF-supported programme, including, where relevant, compliance with macroeconomic performance criteria and structural reform benchmarks identified under the IMF programme, as reported by the IMF in the context of the reviews of regular programmes.

- Progress in the implementation of structural policy indicators, which are to be agreed separately with the authorities of each beneficiary country in a Memorandum of Understanding. It is foreseen that the Commission will start the preparation of the Memoranda of Understanding before the formal adoption of the decision on the assistance. Ahead of the second disbursements of the assistance, the authorities will be asked to submit a compliance statement in relation to the agreed policy conditionality. In addition, under the Memorandum of Understanding monitoring system, the authorities will be required to submit relevant economic and reform indicators.

Although this assistance is centrally managed, where appropriate, the EU Delegation/EU Office in the partner will also be called to provide reporting. An annual report on developments in the management of the assistance to the European Parliament and to the Council are foreseen.

4.2 Evaluation

Ex-post evaluations of macro-financial assistance operations are foreseen in the Multi-Annual Evaluation Programme of the Commission's Directorate-General for Economic and Financial Affairs. Ex-post evaluations of the proposed macro-financial assistance operations will be launched within a period of two years after the completion of each operation. A provision for the ex-post evaluation is included in the proposed Decision for the assistance, and will also be included in the Memorandum of Understanding. Budget appropriations from the macroeconomic assistance budget line will be used for this evaluation.

5 ACHIEVING COST-EFFECTIVENESS

The proposed assistance would entail a high degree of cost effectiveness for several reasons:

- First, since the assistance would be leveraged by the assistance provided by the international financial institutions, with which, as noted, it would be closely coordinated, its ultimate impact could be very significant compared to its cost. Moreover, in negotiating specific policy conditions, the Commission will be able to draw on the expertise of those institutions, including the International Monetary Fund and the World Bank, and to influence their conditionality as well in ways that will take into account the EU's views.

- Second, providing coordinated macroeconomic support to the partners on behalf of the EU Member States, the MFA would be more cost efficient than the provision of a similar total amount of financial support by EU Member States individually.

- Third, all of the assistance would be provided in the form of loans, the budgetary impact of which is more limited.

- In addition, the Commission will aim at achieving synergies with other EU policies and instruments used to support the implementation by the beneficiaries of the relevant measures.

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