ALBANIA

Highlights

- **Robust economic growth is continuing.** GDP grew by 3.8 per cent in 2017, driven equally by private consumption and investment. Monetary policy remains accommodative, while fiscal deficits have been reduced.
- **EU approximation is advancing.** The European Council at its meeting in June 2018 set out the path towards opening EU accession negotiations with Albania in June 2019, subject to further progress in reforms.
- **Consolidation in the banking system is taking place.** The banking sector now comprises 14 banks, two fewer than in mid-2017. In addition, two other banks are in the process of changing owners.

Key priorities for 2019

- **Power sector reforms should be pursued vigorously.** In the short term the priorities are to further liberalise the market, enforce payment discipline in state-owned companies, and improve the regulatory framework to ensure cost-reflective tariff-setting.
- **Infrastructure projects should be carried out transparently.** Albania's requirements in areas such as roads, railways and ports remain numerous, but it is vital that investment projects are tendered according to best practice competitive rules and standards.
- **Factors holding back credit growth should be tackled.** Non-performing loans have declined but remain high by regional standards and are holding back credit growth; efforts to reduce them further should be intensified.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	1.8	2.2	3.4	3.8	4.0
Inflation (average)	1.6	1.9	1.3	2.0	2.3
Government balance/GDP	-5.5	-4.1	-1.8	-1.4	-2.2
Current account balance/GDP	-10.8	-8.6	-7.6	-6.9	-7.1
Net FDI/GDP [neg. sign = inflows]	-8.1	-8.0	-8.7	-8.4	-6.9
External debt/GDP	56.1	63.0	61.9	63.2	n.a.
Gross reserves/GDP	20.4	27.5	26.1	27.1	n.a.
Credit to private sector/GDP	39.4	37.5	34.4	32.2	n.a.

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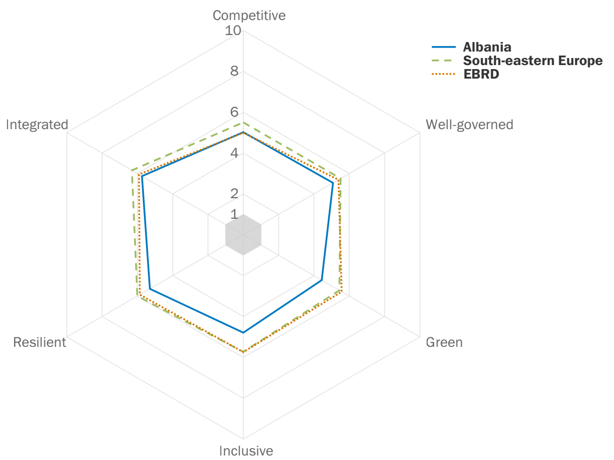
Macroeconomic performance

The economy continues to grow strongly. GDP grew by 3.8 per cent in 2017, following 3.4 per cent in 2016. Growth in 2017 was driven equally by private consumption and investment. The construction of two major energy projects, namely the Norwegian investment in hydropower plants on the river Devoll and the Trans Adriatic Gas Pipeline (TAP), was the main contributor to overall investment, although the direct economic impact on GDP is expected to decelerate in the short term (construction continued to slow down in the first quarter of 2018, following its peak in the first half of 2017). Economic activity accelerated in the first half of 2018, with growth reaching 4.4 per cent year-on-year, driven mainly by industry (including electricity production, fuelled by heavy rainfall particularly during the second quarter following a prolonged drought in the second half of 2017), which contributed more than half of value added.

Further monetary easing has occurred amid a strengthening currency. Average inflation in 2017 was just 2 per cent, once again below the central bank's target of 3 per cent, and has continued to be below the target in the first half of 2018. In response, the Bank of Albania made another cut to its key policy rate by 0.25 percentage points in June 2018 to 1 per cent, a new historical low. The central bank's low interest rate policy in recent years has supported the overall lowering of interest rates across several segments of the financial market, thus stimulating private domestic demand to some extent. However, lending remains sluggish, especially for business loans. Meanwhile the lek has been appreciating against the euro in recent years, and particularly during 2018, providing a further justification for the policy rate cut. This reflects the ongoing de-euroisation policy initiative of the central bank in the financial sector, as well as the capital conversion of some banks (see below) and a good tourism season. Some unrecorded cross-border activities may also be contributing to the appreciation pressures. In early June 2018 the Bank of Albania intervened in the market to dampen these pressures.

Fiscal policy continues to be prudent. Restoration of a significant degree of fiscal stability was among the major achievements of the authorities in the past few years, assisted by an IMF programme which ended in early 2017. The 2017 budget deficit was 1.4 per cent of GDP, the lowest level in the last two decades, while the government's 2018 budget targets a deficit of 2 per cent of GDP. The government is taking steps to reduce public arrears further, especially those related to VAT reimbursements and local government arrears, particularly of the capital Tirana. Public debt had fallen to approximately 70 per cent of GDP as of the end of 2017, and is equally divided between external and domestic creditors, but recently signed infrastructure projects under a public-private partnership (PPP) framework are adding to potential public debt liabilities in the future.

Assessment of transition qualities (1-10)



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The short-term outlook remains positive but risks remain. Growth of 4.0 per cent is expected in 2018, with a similar rate (3.9 per cent) projected for 2019. Monetary policy is expected to remain growth-supportive, and the pass-through from lower interest rates to an increased pace of credit lending is expected to rise gradually, in line with the ongoing efforts to tackle non-performing loans (NPLs) in the banking sector. Private consumption and investment are expected to remain the main drivers of growth, both having a boost from increased confidence. The economy will likely benefit from enhanced foreign investor interest, especially if there is further progress in the EU approximation process. However, downside risks remain, associated with the embedded structural weaknesses in public administration and infrastructure, the potential slow-down of the reforms due to internal political tensions, as well as vulnerability to external shocks in Albania's main economic partner, the eurozone.

Major structural reform developments

The European Commission has recommended the launch of EU accession talks with Albania. In April 2018 the European Commission (EC) issued the recommendation to open EU accession negotiations with Albania. The European Council at its meeting in June 2018 set out the path towards opening EU accession negotiations in June 2019, subject to further progress in reforms. Meanwhile, the EC has launched the screening process to evaluate the readiness of the country to start accession talks, with a focus on the crucial rule of law chapters 23 and 24 of the EU's *acquis communautaire*. Albania applied for EU membership in 2009 and has been an EU candidate since June 2014. The speed of EU approximation remains conditional on (among other things) tangible progress in implementing judicial reform, in particular with regard to the law on re-evaluation of judges and prosecutors, known as the vetting law, and progress in the fight against corruption and organised crime. The EC has also urged the government to pursue civil service reform, including a change of their recruitment model, basing it fully on candidates' professional achievements (rather than on their political orientation, as is currently sometimes the case).

Progress in business environment reforms has been mixed. The country was ranked 63rd overall (out of 190 countries) in the World Bank *Doing Business 2019* report, two places up from a year ago, and more than 20 places higher than a few years ago. The most notable reform over the past year registered in the report was in enforcing contracts, as Albania made this area easier for doing business by amending the code of civil procedure, thus establishing a simplified procedure for small claims and introducing time standards for certain court events. However, the most problematic areas, according to the report, are still in the areas of enforcing contracts, dealing with construction permits and getting electricity.

Plans to develop renewable energy sources are advancing. In August 2018 the government invited bids for a 50 MW photovoltaic solar power plant near the southern coastal city of Vlora. Albania relies entirely on hydropower production, but the government is moving forward with its plans to diversify renewable sources by targeting the implementation of 120 MW of solar and 70 MW of wind power capacity by 2020.

The power distribution operator, OSHEE, has started the process of unbundling. The company registered three new companies in April 2018, thus beginning the unbundling process in response to pressure from the Energy Community. OSHEE will operate as the key company managing the three new subordinated companies: the Distribution System Operator, which will manage and operate the power distribution network; the Free Market Supplier, which will manage the unregulated supply and trading of electricity; and the Universal Service Supplier, which will manage the final stage of the power delivery to customers in the regulated market. The government is considering plans to float OSHEE on the stock exchange at some point.

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Major road projects are advancing amid concerns about openness of procurement. In February 2018 the government signed a €240 million contract with local company Gjoka Construction for the construction, operation and maintenance of a section of the Arber road, connecting Tirana with the Macedonian border. Similarly, in July 2018 the government awarded a €225.8 million contract to local company Gener 2 for the construction, operation and maintenance of the Kashar-Thumane motorway, connecting Tirana with the northern part of the country. Both projects are within the framework of the government's €1 billion PPP programme announced in 2017. The scheme, which envisages financing of the construction by contractors and repayment of long-term debt by the government, has been criticised by some observers, including the IMF, because of the potential for hidden liabilities for public finances and the fact that projects are based on unsolicited bids. Meanwhile, an attempt to introduce the first toll road in the country – the Durres-Kukes motorway – initially encountered significant resistance from local communities because of the perceived high cost of the tolls, but came into force in September 2018.

Consolidation and change of ownership in the banking system are ongoing. In the fourth quarter of 2017 the Albanian branches of Intesa Sanpaolo (the fourth largest bank in the country) and Veneto Bank (among the smallest banks in the country) began to merge, a process expected to be completed by the end of 2018. In February 2018 the local American Bank of Investments (ABI) signed an agreement with the National Bank of Greece (NBG) to buy the Greek bank's Albanian branch. In August 2018, FYR Macedonia's Komercijalna Banka signed a binding agreement with Albanian investment group Balfin to acquire together Tirana Bank from Greece's Piraeus Bank. And in August 2018 the Hungarian OTP Bank acquired an 89 per cent stake in Banka Societe Generale Albania, the country's fifth-largest bank with a market share of 6 per cent. OTP Bank expects to close the transaction in the fourth quarter of 2018, pending regulatory approval.

BOSNIA AND HERZEGOVINA

Highlights

- **The economy has once again proved to be resilient to reform slow-down and political uncertainty.** GDP grew by 3.0 per cent in 2017, following similar growth rates in the previous two years.
- **Reforms have slowed down in 2018 in advance of elections.** Some progress occurred in late 2017 when the law on an increase of the fuel excise duties was adopted, paving the way for a resumption of infrastructure financing. Since then, reforms have slowed markedly and the latest review of the IMF programme has been delayed.
- **Privatisation in the Federation remains stalled, despite having announced plans.** Major assets remain in state hands and there appears to be little appetite to make substantive progress.

Key priorities for 2019

- **New growth momentum is needed.** Once new governments are in place following the October 2018 elections, it is vital that a firm commitment is made to a new reform agenda, with a concrete, measureable set of deliverables on improving the investment climate and standards of governance, and advancing the country's EU approximation agenda.
- **The Federation's telecommunications companies should be privatised.** Progress in this area would not only improve the financial viability of the companies but also demonstrate a genuine commitment to attracting investment in key sectors.
- **Further efforts are needed to resolve non-performing loans (NPLs).** While the situation has improved in recent years, banks still face difficulties in writing off NPLs or selling them to non-bank entities.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	1.1	3.1	3.1	3.0	3.0
Inflation (average)	-0.9	-1.0	-1.1	1.2	1.4
Government balance/GDP	-2.9	-0.2	0.3	2.1	1.5
Current account balance/GDP	-7.4	-5.4	-4.9	-4.8	-6.0
Net FDI/GDP [neg. sign = inflows]	-2.9	-1.7	-1.6	-2.1	-2.1
External debt/GDP	61.6	62.3	62.4	61.0	n.a.
Gross reserves/GDP	26.3	29.6	30.5	35.7	n.a.
Credit to private sector/GDP	56.4	55.0	54.4	55.8	n.a.

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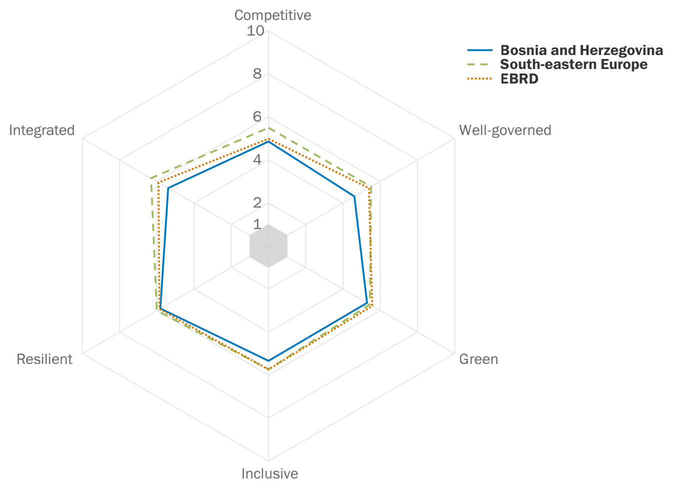
Macroeconomic performance

Moderate growth has continued. The economy grew by an estimated 3.0 per cent in 2017, following similar growth rates in the previous two years, and has once again proved to be resilient to reform slow-downs and political uncertainty. Services, and particularly domestic trade, were the main growth drivers, supported by private consumption. Industry also performed well last year, whereas the agriculture sector had a slight drag on growth. At the same time, there was a significant slow-down in investments, partly due to the significant delays in implementing reforms needed to unlock major infrastructure projects. Remittance inflows to Bosnia and Herzegovina rose by 7.2 per cent in 2017 to €1.3 billion, about 8.0 per cent of GDP, helped by the economic recovery in the eurozone. However, the overall current account remains in deficit at almost 5.0 per cent of GDP. GDP growth continued into the first half of 2018 at a similar pace, of 2.9 per cent year-on-year. Investment levels recovered after a slow-down in 2017, as adoption of the law on an increase of fuel excise duties in late 2017 paved the way for a resumption of infrastructure financing.

Further delays are occurring to the IMF programme amid fiscal concerns. Economic reforms are currently anchored by a €533 million, three-year IMF Extended Fund Facility signed in September 2016. However, progress under the programme has been far from smooth. The first review was eventually completed in February 2018 after an approximately one-year delay. The passage through parliament, after several failed attempts, of the law on an increase of the fuel excise tax in December 2017 enabled the completion of the review. However, the second review is currently on hold because of concerns over new spending proposals in both entities: in the Federation, the government adopted a law expanding benefits for veterans, while the government in Republika Srpska decided to increase the minimum wage and pensions as of 1 July 2018.

Further growth is expected in the short term, but downside risks are significant. The economy is projected to grow by 3.0 per cent in 2018 and 3.5 per cent in 2019. The resumption of infrastructure financing in the roads sector, including for Corridor Vc, and investment should therefore play a more growth-supportive role in the coming period. Nevertheless, uncertainty associated with the aftermath of the general elections in October 2018 and the stalling, or even possible reversal, of reforms remain important downside risks.

Assessment of transition qualities (1-10)



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Major structural reform developments

Progress in reforms remains slow. In February 2018 Bosnia and Herzegovina submitted answers to the EU's questionnaire, received in December 2016. The lengthy time it took to complete the questionnaire reflected the country's complicated, multi-layered administrative structure and internal disagreements. Having received the questionnaire, the European Commission is preparing an opinion on the country's EU membership application. In April 2018 the European Commission noted in its progress report that, although the state-level government had made some progress in implementing legislation changes agreed under the Reform Agenda in place since 2015, delivery on a number of reforms was delayed by lack of agreement within the ruling coalition members. The report urged the authorities of Bosnia and Herzegovina to adopt countrywide strategies in areas such as energy, employment and public financial management, and to step up reforms of public administration and the judicial system.

The business environment remains difficult. Bosnia and Herzegovina was ranked 89th overall (out of 190 countries) in the World Bank *Doing Business 2019* report, the lowest ranking among the Western Balkans countries. Nevertheless, the country has experienced a small improvement in its absolute score, on a scale from 0 to 100 (where the latter represents the best performance), and it now scores 63.55. The most problematic areas remain in dealing with construction permits, protecting minority investors, starting a business and enforcing contracts.

Privatisation in the Federation remains stalled, despite announced plans. In February 2018 the government of the Federation approved the privatisation plan for 2018, which foresees the sale of government equity in four major companies: the engineering company Energoinvest, fuel retailer Energopetrol, aluminium smelter Aluminij and insurer Sarajevo Osiguranje. However, resistance to the privatisation process within the Federation remains strong and prospects for successful sales are limited. There has also been no progress in the past year in privatising the telecommunications companies BH Telekom and HT Mostar, and the related due diligence – a prior action for the IMF programme – has not taken place yet.

Road construction is moving ahead. China's Shandong is close to securing a concession contract for the Banja Luka-Prijedor highway. The Chinese company and the Republika Srpska road company signed a deal to cooperate on the construction of the Banja Luka-Prijedor-Novi Grad highway in November 2017. The arrangement is worth US$ 320 million. The 42 km-long Banja Luka-Prijedor section is the first phase of this deal. The concession is expected to be given for a period of 25 to 30 years and the Chinese company is supposed to secure funds for construction without sovereign guarantees from either the Bosnia and Herzegovina or Republika Srpska governments.

Renewable energy projects are advancing. Bosnia and Herzegovina aims to increase the share of electricity produced from renewable sources to 40 per cent by 2020 from the current 34 per cent. After being delayed for years due to legal issues, the construction of the 49.5 MW Trusina wind park in Republika Srpska is scheduled to start in the last quarter of 2018. The wind park, which is estimated to cost around €72 million, should be operational by the end of 2019. In July 2018 the authorities in Republika Srpska launched a tender for the construction of a 65 MW solar power plant near Ljubinje, which would be the country's largest so far.

Key banking legislation has advanced but has not yet been adopted. The government of Bosnia and Herzegovina has adopted the law on insurance of bank deposits, required by the IMF as part of the set of reforms aimed at stabilising the banking sector. The new legislation secures better protection of depositors and is part of an overall modernisation of the banking sector. Under the new law, banks that obtain permits to operate from the entities' banking agencies automatically enter into the deposit insurance process. The law is one of five to be adopted to reform the banking sector, and needs approval by the state-level parliament, which is still pending.

BULGARIA

Highlights

- **Growth has been robust in the past year.** The economy grew by a healthy 3.8 per cent in 2017, helped by continuing strong domestic demand.
- **Reforms in the energy sector have continued.** The authority of the energy regulator has been strengthened in line with the relevant EU legislation, while an independent energy exchange for intraday trading has been launched.
- **Non-performing loans (NPLs) continue to decline steadily.** As a result of successful portfolio sales, the gross NPL ratio declined below 10 per cent in 2018. While the gross NPL ratio remains above the EU average, the banking sector has accumulated a capital surplus which fully covers net NPLs.

Key priorities for 2019

- **Further efforts are required within the framework of the EU's Cooperation and Verification Mechanism.** In particular, the government needs to implement the new anti-corruption law, further improve the independence and efficiency of the judiciary, and step up the fight against organised crime by improving the legislative framework and increasing transparency.
- **Reforms aiming to prepare the country for joining ERM II and the Banking Union need to continue.** While Bulgaria currently meets the macroeconomic conditions to become part of ERM II, the Bulgarian authorities need to remain committed to undertaking key reforms, including entering into close cooperation with the European Central Bank (ECB), introducing new macro-prudential instruments and amending the existing insolvency and anti-money laundering frameworks.
- **Reforms on improving the business environment need to be implemented.** Bureaucratic processes remain an impediment to doing business while access to skilled labour is a growing challenge. Efforts need to focus on reforming the business environment as outlined in the coalition programme, retaining qualified workers and improving the skills of the existing labour force.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	1.3	3.6	3.9	3.8	3.6
Inflation (average)	-1.6	-1.1	-1.3	1.2	2.6
Government balance/GDP	-3.6	-2.8	1.6	0.9	-0.1
Current account balance/GDP	0.2	0.0	2.3	4.6	2.4
Net FDI/GDP [neg. sign = inflows]	-3.6	-5.4	-3.1	-2.9	-3.1
External debt/GDP	85.5	81.6	76.4	74.0	n.a.
Gross reserves/GDP	44.2	47.3	49.9	44.3	n.a.
Credit to private sector/GDP	59.5	55.3	52.7	51.8	n.a.

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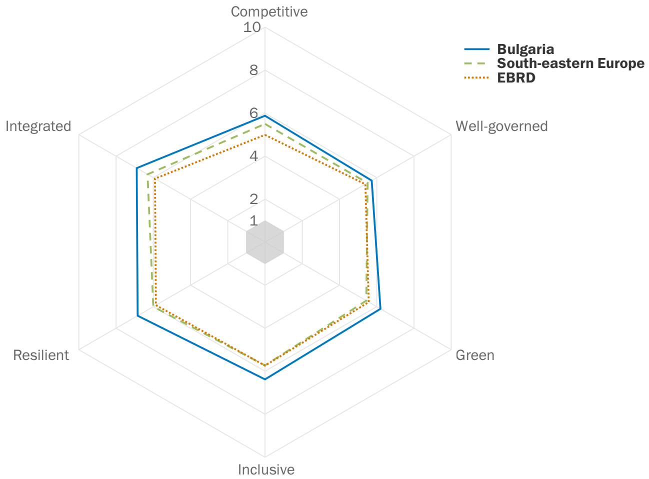
Macroeconomic performance

Growth has remained robust while inflation is rising. The economy grew by 3.8 per cent in 2017 and by 3.4 per cent year-on-year in the first half of 2018. Private consumption has been the main driver of growth, as the tightening labour market as well as minimum and public sector wage hikes pushed real wages up and unemployment down to 5.2 per cent in August 2018. Investment has also been strong, helped by the growing disbursement of EU funds since the second half of 2017. As a result of the recovering energy and food prices, inflation returned to positive levels in 2017, averaging 1.2 per cent, with a further rise in 2018, reaching a five-year high of 3.7 per cent in August 2018.

Fiscal policy has remained prudent and public debt levels have declined. Fiscal consolidation has continued in the past two years with revenue growth outstripping expenditure growth, resulting in two consecutive years of budget surpluses in 2016 and 2017. A significant surplus has been reported for the first half of 2018 and the government expects a positive budget out-turn for the year as a whole of around 0.5 per cent of GDP. Helped by sizeable primary surpluses, the public debt-to-GDP ratio has decreased by 3.4 per cent in 2017 to stand at 25.6 per cent, one of the lowest levels in the European Union.

Growth is expected to remain strong over the next two years. Private consumption is likely to underpin stable GDP growth rates, currently projected at 3.6 per cent in 2018 and 3.4 per cent in 2019. Public and private investment will also contribute positively to growth, as the absorption of EU funds will continue. In addition, fiscal policy is expected to support growth due to an increase in the public sector wage bill. Key risks to the outlook are: prolonged weakness in major trading partners, not least Turkey; exacerbation of current labour shortages and worsening of investor sentiments towards emerging markets. While convergence prospects remain high, with GDP per capita standing at 49 per cent (purchasing power parity-adjusted) of the EU average, sustaining the current high growth rates in the long run will require structural reforms to be reinvigorated.

Assessment of transition qualities (1-10)



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Major structural reform developments

Steps have been taken to integrate Bulgaria further into the EU's financial architecture. At the end of June 2018 the Bulgarian authorities officially declared their intention to join the eurozone's exchange rate mechanism, ERM II, and the Banking Union by July 2019, and ultimately the eurozone. The action plan adopted by the government in August 2018 lays out the reforms in financial sector regulation and economic governance to be undertaken over the next year.

There was some progress in implementing the Cooperation and Verification Mechanism (CVM). In February 2018 parliament adopted an Anti-corruption and Forfeiture of Assets Act, thus creating a powerful anti-corruption commission, introducing new conflict of interest regulations and regulating the seizure of illegally acquired assets. Parliament also adopted in March a new Anti-Money Laundering Act, bringing the legal framework in line with the relevant EU directive. Secondary legislation is expected to be published later in 2018.

Bulgaria's business environment remains close to the regional average, although there is room for improvement. According to the latest World Bank *Doing Business 2019* report, Bulgaria ranked 59th out of 190 countries in ease of doing business, dropping nine places compared with the previous year. The report points out that there were no reforms to improve the business environment over the past year. Procedures for starting a business, paying taxes and getting electricity remain burdensome, although Bulgaria performs better than the regional average in importing and exporting procedures.

Energy market liberalisation has advanced, and energy infrastructure improvements have continued. A two-way gas pipeline with Turkey was completed in August while the construction of a new interconnector with Greece is expected to start in late 2018. As part of the efforts to liberalise the market, the Independent Bulgarian Energy Exchange (IBEX) launched intraday trading in April 2018. From 1 July 2018 the electricity market in Bulgaria was further liberalised: all electricity producers with installed capacities above 4 MW, which used to benefit from preferential prices and long-term contracts, are now obliged to sell electricity on the free market. The recent amendments to the Energy Act transpose European legislation by giving the energy regulator powers to strengthen integrity and transparency of the wholesale electricity market for the benefit of end-consumers.

Confidence in the financial sector has improved. NPLs have continued to decline in the past year, as many banks have followed successful policies since early 2017 for the reduction of NPLs, including write-offs and sales of corporate secured NPLs. Even though Bulgaria's gross NPL ratio of 9.1 per cent as of June 2018 remains above the EU average of around 4.0 per cent, net NPLs are fully covered by the capital surplus accumulated in the banking sector. Meanwhile, the banking sector consolidation that started in 2014 has continued into 2018, including the merger of UBB and CIBANK, which was completed in February 2018.

CYPRUS

Highlights

- **A major economic recovery is continuing.** GDP growth in 2017 was 4.2 per cent, and the level of economic output has almost reached the pre-crisis level. Fiscal performance remains strong and the government reached an overall fiscal surplus for the second year in a row.
- **Privatisation remains largely on hold, while liberalisation of the energy sector has been delayed.** There appears to be little appetite for selling a majority stake of the state-owned telecommunications company, although this had been one of the government's priorities during the crisis.
- **The Cyprus Cooperative Bank (CCB) has been liquidated.** The healthy part was bought by the Hellenic Bank, while the state will absorb the remaining parts of the bank.

Key priorities for 2019

- **A new push for renewable energy is needed.** The government is developing a new renewable energy strategy to help meet long-term renewable targets, but a firmer commitment to implementing a competitive tariff regime and support for auctions of renewable energy is necessary for the long-term viability of the sector.
- **Heightened efforts are needed to tackle non-performing loans (NPLs).** The level of NPLs remains exceptionally high by international standards. Recent progress in restructuring of companies and banks and in sales of NPL portfolios are encouraging and should be further developed.
- **Targeted business environment reforms are needed.** The authorities should focus on areas such as contract enforcement and permitting, where Cyprus continues to lag behind best practice in other EU countries.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	-1.3	2.0	4.8	4.2	3.9
Inflation (average)	-0.3	-1.5	-1.2	0.7	0.8
Government balance/GDP	-9.0	-1.3	0.3	1.8	2.1
Current account balance/GDP	-4.3	-1.5	-4.9	-6.7	-3.1
Net FDI/GDP [neg. sign = inflows]	-7.9	47.4	-7.8	-23.1	-5.5
External debt/GDP	554.4	572.7	588.9	557.3	n.a.
Gross reserves/GDP*	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	287.4	282.1	250.5	224.6	n.a.

*Cyprus is a member of the Euro area.

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Macroeconomic performance

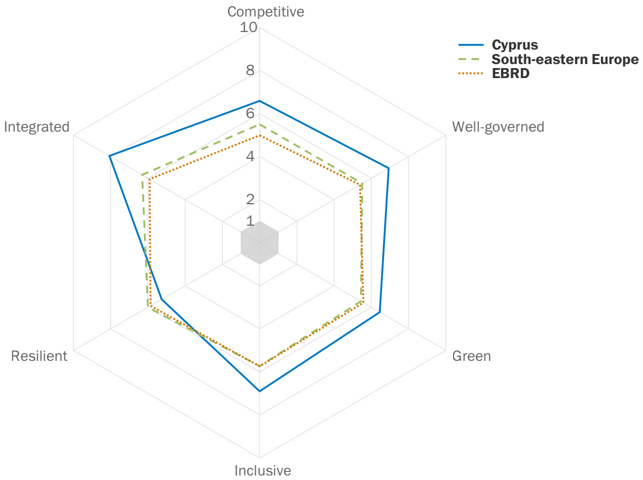
Robust growth is continuing. Economic activity in Cyprus continued at a strong rate in 2017 with GDP growth of 4.2 per cent. Growth in 2017 was mainly driven by investment and private consumption. Gross fixed capital formation accounted for more than 20 per cent of GDP for the first time after 2010, driven by the construction and real estate sectors. After many years of negative contribution to growth, government spending also provided a small growth boost. Net exports were the only drag on growth as imports, supported by rising private consumption and investments, grew by a higher rate than exports. Tourist arrivals in 2017 increased by almost 15 per cent and the leading indicators in the first half of 2018 point to another strong year for tourism in Cyprus, which is continuing to benefit from instability elsewhere. Meanwhile, unemployment has dropped to single-digit levels, reaching 7.4 per cent in September 2018, more than three percentage points lower than a year previously, and more than seven percentage points lower than its peak in 2014. After a few years of declining prices, inflation returned to the economy, averaging 0.7 per cent in 2017 and 0.4 per cent in the first eight months of 2018. The positive GDP trends have continued into 2018 with growth in the first quarter of 4.0 per cent year-on-year and 3.9 per cent year-on-year in the second quarter.

Fiscal performance remains strong. For the second year in a row, the government reached an overall surplus in 2017 of 1.8 per cent of GDP. This was due to a strong recovery in revenue collection owing to the stronger-than-expected GDP growth. These positive trends have helped drive down general public debt to below 100 per cent of GDP by the end of 2017, although the ratio has risen again in 2018 because of the one-off restructuring of the cooperative banks (see below). This is expected to cost the government more than 15 per cent of GDP, putting back the government's debt reduction efforts. However, the move is expected to reduce systemic risks in the banking sector significantly.

Cyprus's credit ratings have further improved in the past year. The latest upgrades by major ratings agencies were by Standard & Poor's in September 2018 and by Fitch in October 2018, both from BB+ to BBB-, lifting the country back to investment grade for the first time since the crisis. The Standard & Poor's upgrade was followed by a 10-year €1.5 billion bond issuance at a yield of just 2.4 per cent, significantly below previous issues.

Strong growth is likely to continue in the short term. GDP growth for 2018 is projected at 3.9 per cent and 3.5 per cent in 2019.These growth rates are likely to be accompanied by further fiscal surpluses, contributing to another reduction in the public debt-to-GDP ratio. However, significant downside risks remain to this forecast, given the relatively undiversified nature of the economy and reliance on a few sectors, and given the difficulties in reducing the burden of exceptionally high levels of NPLs on the financial sector, which are still around 40 per cent of total loans.

Assessment of transition qualities (1-10)



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Major structural reform developments

Overall reform momentum has been limited in the past year. The election cycle in early 2018 contributed to the slow-down in reforms. Privatisation remains largely on hold; the law abolishing the privatisation unit in the Ministry of Finance, passed in 2017, was upheld by the Supreme Court in February 2018. Regarding the telecommunications company CyTA, the plan now is to corporatise the company, with the government retaining a majority stake. The business environment still has serious deficiencies in several respects, notably in the areas of contract enforcement and dealing with construction permits, as illustrated by the country's poor overall ranking (57th out of 190 countries) in the World Bank's *Doing Business 2019* report.

Energy sector liberalisation has been delayed. The authorities are committed to liberalising electricity and gas markets by July 2019, but progress to date has been slow, and the target may be missed. A step forward occurred in 2018 when a licence was given to F. E. First Electric Supply, the first independent power producer in Cyprus. This supplier would interact with producers and consumers of electricity based on bilateral contracts. Further licences are expected to be granted in the coming months. However, plans for full unbundling of the sector have been delayed.

The Cyprus Cooperative Bank (CCB) is being restructured and sold. The bank is still the second biggest in the country but has struggled to recover from the negative effects of the crisis five years ago, with more than half of its loans non-performing. In March 2018 the government offered the bank for sale and in April 2018 it carried out a balance sheet operation, injecting €2.5 billion into the bank. In June 2018 it was announced that Hellenic Bank, the third largest in the country, would take over management of the healthy part of the bank, consisting of the majority of assets and customer deposits, while the state would absorb the remainder, including the portfolio of NPLs. Hellenic Bank officially took over the operations of CCB in September 2018.

NPLs are being tackled slowly. Despite the economic recovery in recent years, NPLs in Cyprus remain exceptionally high, at 44 per cent of total exposures as of January 2018, only marginally below the level of a year earlier. Some legislative changes have been enacted recently, or are in progress, in order to speed up the process. In particular, in July 2018 the parliament amended the legal framework around insolvencies and foreclosures in order to speed up the process of NPL resolution. Sales of NPLs have advanced during 2018. In January 2018 Hellenic Bank sold €145 million of NPLs to Norway's B2Holdings ASA. In addition, the Bank of Cyprus, the country's biggest bank, is in the process of selling a portion of its NPLs to an asset management company. The deal was agreed in August 2018 but is pending regulatory approval. This would represent the first major such deal in Cyprus since the crisis.

FYR MACEDONIA

Highlights

- **EU approximation is advancing.** The European Council at its meeting in June 2018 set out the path towards opening EU accession negotiations with FYR Macedonia in June 2019, subject to further progress in reforms.
- **The economy has struggled in the aftermath of the political crisis.** Growth was negative in the first half of 2017 but recovered somewhat in the second half, leaving growth for the overall year at zero, and further growth has been modest so far in 2018.
- **Energy sector reforms are progressing.** A new Energy Law, which is fully transposing EU energy legislation, has been adopted.

Key priorities for 2019

- **Renewable energy capacity should be developed further.** The authorities face a window of opportunity in terms of attracting new investments following the introduction of the new energy law.
- **Consolidation in the banking sector should be pursued.** The banking sector has a large number of banks relative to the size of the economy, and a consolidation could help strengthen the sector overall and lending to the real economy.
- **Implementation of the government's digitisation strategy can help to attract investment and jobs.** Progress in areas such as e-governance can help further boost FYR Macedonia's reputation as a business-friendly environment.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	3.6	3.8	2.9	0.0	2.0
Inflation (average)	-0.3	-0.3	-0.2	1.4	1.8
Government balance/GDP	-4.2	-3.5	-2.7	-2.7	-2.9
Current account balance/GDP	-0.5	-2.0	-2.7	-1.3	-1.1
Net FDI/GDP [neg. sign = inflows]	-2.3	-2.2	-3.3	-2.3	-3.3
External debt/GDP	64.9	68.0	70.7	77.1	n.a.
Gross reserves/GDP	26.4	26.3	22.2	24.3	n.a.
Credit to private sector/GDP	48.2	49.9	47.0	48.0	n.a.

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Macroeconomic performance

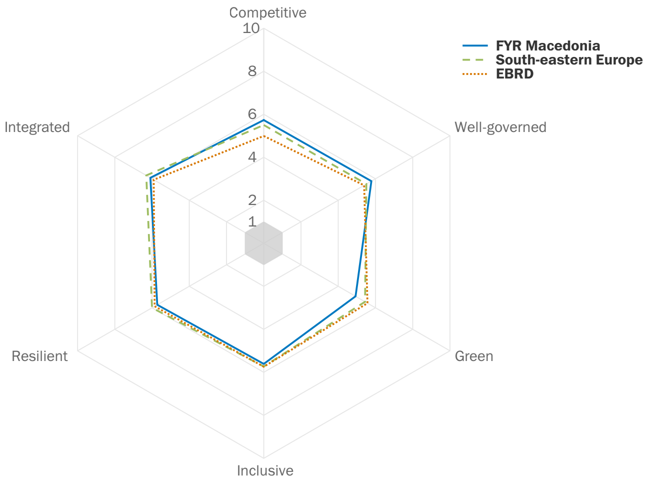
The economy has struggled in the aftermath of the political crisis. Following a few relatively good years of economic performance, the slow-down that began in 2016 continued through 2017 and into the first part of 2018. Growth in 2017 was zero, although a bad first half of the year, when the crisis was still in full swing, was balanced by a recovery in the second half following the formation of a new government. Government consumption also fell in 2017, but private consumption and net exports both increased, with gross exports rising by 18.0 per cent, helping to keep the current account deficit at low levels, of just about 1.0 per cent of GDP in 2017, among the lowest in the region. After a weak first quarter, economic activity picked up in the second quarter of 2018, driven by private consumption and net exports, bringing the overall growth in the first half of 2018 to 1.6 per cent year-on-year. The central bank cut its long-term policy rate by 0.25 percentage points to 3.0 per cent in March 2018. Inflation turned positive in 2017 after three years of price declines, averaging 1.4 per cent.

Public debt has been rising steadily amid continuous fiscal deficits. The government's fiscal deficit in 2017 was 2.7 per cent of GDP, slightly lower than 2.9 per cent planned when the budget was revised in August 2017 by the new government. The level of public debt is still relatively modest at 47 per cent of GDP, and within the Maastricht criteria of 60 per cent of GDP, but has been rising steadily in recent years, by 20 percentage points since 2009. A further rise is expected due to the measures adopted by the government, including business incentives for roll-out of additional employment and an increase in the minimum wage.

The credit outlook and investor confidence are improving. In February 2018, Fitch revised the outlook on its BB rating for FYR Macedonia from negative to positive to reflect the fact that the country's domestic political situation is stabilising. FYR Macedonia is rated BB-/Stable by Standard & Poor's and BB/Positive by Fitch (and not rated by Moody's). Meanwhile, international investors also appear to be showing increased confidence in the country's prospects, reflected to some extent in the historically low interest rate of 2.75 per cent on a seven-year €500 million Eurobond issued in January 2018.

Growth is expected to pick up in the short term. Prospects for short-term private and public investment are improving. The impact of the rising minimum wage and other social protection measures on private consumption is also expected to boost overall growth, while lending conditions are easing, helping businesses. A further rise in exports is also expected in the short term, following last year's strong performance, in light of the improved economic prospects in the European Union (EU), the country's key trading partner. As a result, the 2018 forecast for growth is 2.0 per cent, with a moderate increase to 3.0 per cent in 2019 on the assumption of continued political stability, the unblocking of further reforms and the arrival of much-needed investments. The key downside risk is the possibility of a resumption of political turbulence and uncertainty if progress in resolving the name dispute is not maintained.

Assessment of transition qualities (1-10)



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Major structural reform developments

EU approximation is advancing. In June 2018 the European Council set out the path towards opening EU accession negotiations with FYR Macedonia in June 2019, subject to further progress in reforms. This follows progress in resolving the name issue with Greece, which has held up FYR Macedonia's approximation progress for many years. The council underlined the need for FYR Macedonia to continue making further progress on areas such as judicial and public administration reform and the fight against corruption. Meanwhile, the EC has launched a screening process to evaluate the country's readiness to start accession talks in June 2019, with a particular focus on the crucial rule of law chapters 23 and 24.

Corruption perceptions appear to have worsened, despite the favourable business environment. FYR Macedonia is now ranked joint 107th (out of 180 countries), the lowest in the Western Balkans region, in Transparency International's Corruption Perceptions Index, down from 90th last year and 66th the previous year. On the positive side, the country continues to perform exceptionally well on the World Bank's Doing Business ranking, reaching 10th position in the 2019 report (published in late October 2018) compared with 11th position in the 2018 report.

A new Energy Law is in place. In May 2018 the parliament adopted a new Energy Law aimed at fully transposing EU energy legislation. The law envisages further liberalisation of the electricity market from 2019, foreseeing the appointment of a universal service provider and allowing households and small firms to choose their supplier. The law also encourages the production of electricity from renewable sources. In response, the Energy Community has formally closed several cases against FYR Macedonia. Starting from 2019, the state-owned power producer ELEM will be obliged to direct 80 per cent of its production to a universal supplier, which will be selected via a tender. Gradually this percentage will be lowered; by 2025 only 30 per cent of ELEM's production should be handed over to the universal supplier.

Cross-border energy integration is slowly improving. MEPSO, the country's transmission operator, is currently constructing the Macedonian portion of a 400 kV cross-border electricity interconnection between FYR Macedonia and Albania, the first interconnection between the two countries. Also, in April 2018 FYR Macedonia signed a Memorandum of Understanding (MoU) with Bulgaria that will allow the integration of the two countries' electricity markets. For the MoU to be implemented, FYR Macedonia should first establish an electricity market on a day-ahead trade principle, which is foreseen by the new Energy Law (see above). In the gas sector, FYR Macedonia has signed MoUs with both Greece and Bulgaria to explore the feasibility of developing further cross-border interconnectors, and thus diversifying its gas supply.

FYR Macedonia's regional connectivity agenda is progressing. The construction of the 28 km-long Demir Kapija-Smokvica motorway section in the southern part of the country, leading to the Greek border, was completed in April 2018. With this section and with the final works on the rehabilitation of the part between Negotino and Demir Kapija, the southern section of the pan-European road Corridor X, running between central Europe and Greece via Serbia and FYR Macedonia, has been finalised. Also, FYR Macedonia has invited tenders for the construction of a 34 km-long second section, Beljakovce-Kriva Palanka, of railway Corridor VIII, linking Bulgaria and Albania via FYR Macedonia. At the same time, FYR Macedonia and Kosovo have launched the construction of a new EU-funded joint border crossing which should facilitate enhanced cross-border trade.

Banking sector stability has been strong but the number of banks remains large relative to the size of market. Demand for credit fell sharply during the political crisis of 2016-17, but lending stayed positive, growing by approximately 3.0 per cent in 2017. This is however much lower compared with the previous years. Capital adequacy stood at 16.2 per cent as of the end of 2017, well above the regulatory requirement of 8.0 per cent. NPLs fell to 6.3 per cent, after being stable for the past three to four years at around 10.0 to 11.0 per cent of total loans, reflecting recent measures to write off NPLs that are fully provisioned for over two years. However, despite some consolidation over the years there are still 16 banks in FYR Macedonia, a large number for a small market.

GREECE

Highlights

- **Economic indicators are improving slowly.** The economic recovery that began in 2017 has continued into 2018, but at a relatively modest rate. The unemployment rate has dropped below 20 per cent for the first time since September 2011.
- **Greece has exited its Economic Adjustment Programme (EAP).** The exit in August 2018 took place on schedule and followed a sustained period of reforms. Further debt relief measures have been granted to help ensure debt sustainability over the medium term.
- **Privatisation is proceeding slowly.** While some flagship deals have been completed, others are encountering delays, sometimes due to circumstances beyond the government's control.

Key priorities for 2019

- **Agreed fiscal targets should be adhered to in the post-programme period.** This is vital for maintaining a stable macroeconomic framework and for bolstering investor confidence in Greece's economic recovery.
- **Greece should enhance cross-border links in the region.** The government's new growth strategy rightly recognises Greece's potential to develop closer links with neighbouring countries, and it will be important to capitalise on the new momentum by advancing important cross-border infrastructure and energy projects and breaking down barriers to trade.
- **Privatisation should be speeded up.** The current programme has seen some successes but delays to the process have also been relatively common, thus holding back vital investment flows.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	0.7	-0.4	-0.2	1.5	2.2
Inflation (average)	-1.4	-1.1	0.0	1.1	0.7
Government balance/GDP	-3.6	-5.7	0.6	0.8	0.5
Current account balance/GDP	-1.6	-0.2	-1.1	-0.8	-0.8
Net FDI/GDP [neg. sign = inflows]	0.1	0.2	-2.4	-1.7	-1.7
External debt/GDP	220.4	245.5	236.1	238.8	n.a.
Gross reserves/GDP*	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	115.8	112.5	108.6	100.0	n.a.

*Greece is a member of the Euro area.

CONTINUES

Macroeconomic performance

Modest economic growth has continued in 2018. After marginally negative growth in 2016, the economy was boosted in 2017 by strong performances in the industrial sector, another excellent tourism season, and improved confidence following progress in the EAP, particularly after completion of the second review in June 2017. GDP growth in 2017 of 1.5 per cent has been followed by an acceleration in growth in the first half of 2018 to 2.2 per cent (year-on-year), with continued improvements in exports, the main driver of growth. Other economic indicators are also moving in a positive direction, including industrial production, employment, and consumer confidence, while unemployment (seasonally adjusted) has fallen to 19.0 per cent as of July 2018, the lowest level since mid-2011. Inflation has turned positive in 2018 but remains low at 1.1 per cent in September 2018 (year-on-year).

Investment is recovering from rock-bottom levels. By 2016, the level of gross fixed capital investment had fallen to just €20.5 billion, or a mere 12 per cent of GDP, versus €60.5 billion in 2007. Signs of a turnaround are apparent: there was a significant increase in gross fixed capital formation in 2017 by 9.6 per cent to €22.5 billion, due mainly to higher investment in transport and machinery equipment and weapons systems. However, net investment levels are still negative because of the ongoing depreciation of the existing capital stock. According to Eurostat estimates, between 2010, when net investment reached its peak, and 2017, the net capital stock of the country fell by 8.5 per cent in real terms, versus a rise of 7.2 per cent in the European Union (EU) as a whole.

Fiscal and external imbalances have been eliminated. Following Greece's exit from the EU's Excessive Deficit Procedure in July 2017, the government achieved a further primary surplus of 4.2 per cent of GDP in 2017, far exceeding the 1.75 per cent target agreed under the adjustment programme. Further short-term fiscal measures are in the pipeline, including reforms to pensions and personal income tax in 2019 and 2020, respectively, with both measures designed to yield savings of 1 per cent of GDP. The primary fiscal surplus is targeted at 3.5 per cent of GDP in 2018-22, as agreed with the European institutions, and at an average of 2.2 per cent for 2023-60. On the external side, there has also been a dramatic reduction in current account imbalances in recent years. The current account was in slight deficit in 2017 at -0.8 per cent of GDP. Exports of goods rose by 4.6 per cent (in real terms) in 2017, and there was a substantial increase in both travel receipts and receipts from shipping, of 10.5 per cent and 21.7 per cent, respectively.

Short-term growth is likely to continue. The improving trends in investment, employment and confidence are expected to strengthen through 2018 and 2019, leading to further growth of 2.2 per cent in 2018 and 2.3 per cent in 2019. Concerns about debt sustainability have been alleviated somewhat by debt relief measures announced in mid-2018 that reduce the payments schedule in the coming decade. However, the economic recovery is conditional on sustained reforms through the post-programme period, and any backtracking in reforms or increased uncertainty about the policy direction of the country could damage investor confidence and lower growth prospects.

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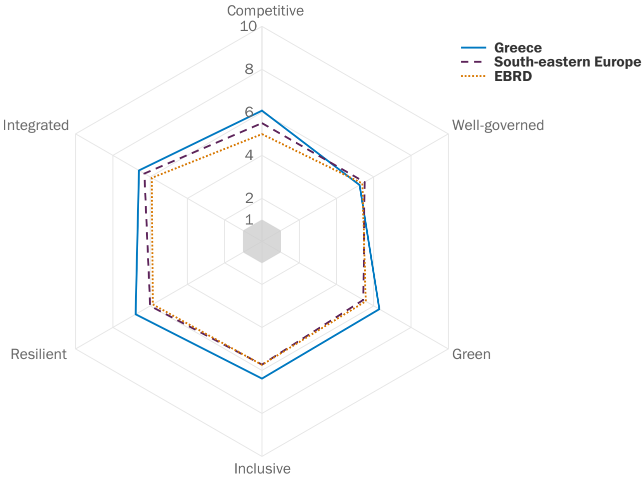
Assessment of transition qualities (1-10)



Major structural reform developments

Greece has exited its adjustment programme following significant reforms across the board. The exit from the three-year EAP, signed in August 2015, took place on schedule on 20 August 2018. Reform delivery stepped up once the third review of the programme was completed in early 2018. Discussions on the fourth and final review began in February 2018 concerning 88 key deliverables, starting with the adoption of the 2018-22 Medium Term Fiscal Strategy and including tax policy reforms, the full merger of social insurance funds, full implementation of pension reforms, healthcare expenditure rationalisation and centralisation, structural policies to support competitiveness and growth (including labour market reviews), and progress on the privatisation front. All 88 prior actions were successfully completed in time for the Eurogroup meeting on 21 June 2018. At this meeting, members agreed on the broad parameters of the post-programme framework which is one of “enhanced surveillance”, and on further debt relief measures, some of which are conditional on positive reviews of reform implementation by the institutions during the post-programme period.

A new growth strategy has been adopted. The government first presented the strategy to international partners in April 2018. The strategy is wide-ranging, covering many policies designed to encourage inclusive growth, jobs and investment. The strategy also signals the authorities’ intention to enhance Greece’s role throughout the wider south-eastern European region by reducing barriers to trade and by developing cross-border infrastructure and energy projects.

Privatisation is advancing gradually. The privatisation strategy being implemented by the Privatisation and Investment Fund (the Hellenic Corporation of Assets and Participations) includes eight finalised privatisation projects and 22 ongoing projects. A significant deal under way in 2018 is the sale of 66 per cent of the gas transmission systems operator, DESFA. In April 2018, the preferred bidder was selected with an offer of €535 million. Other major projects in preparation and at an advanced stage include Egnatia motorway, the development of Hellenikon (site of the former Athens airport) and an extension of the concession agreement for Athens International Airport, but these and other projects have also met with significant delays, sometimes due to circumstances beyond the government’s control.

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Financial sector stability is improving but asset quality remains a concern. The banking system is still burdened by an exceptionally high level of non-performing loans (NPLs), but all banks are addressing the problem using a variety of tools and according to targets agreed with the Bank of Greece. As of June 2018 the NPL ratio was 32.8 per cent of total loans, while the non-performing exposure (NPE) ratio – a broader measure of bad loans that also includes debts not expected to be paid in full without realisation of collateral – was 47.6 per cent. The volume of NPEs has dropped by more than 17 per cent since its peak in March 2016. In the second quarter of 2018 the reduction in NPEs was driven mainly by sales, while e-auctions are also increasingly being used following legislative changes introduced over the past year and the removal of legal and technical impediments to e-auctions of collateral backing NPLs.

Further improvements have been made to the business environment. Many of these reforms have been guided by the OECD's Toolkit recommendations and relate to the reduction or removal of regulatory barriers across a range of sectors. At the same time, Greece's ranking on the World Bank's ease of doing business assessment remains low by EU and OECD standards, at 72nd place out of 190 countries in the *Doing Business 2019* report, with persistently low rankings in registering property, enforcing contracts and getting credit.

Important governance reforms are being introduced. A key pillar of the three-year EAP was public administration reform and building a modern state. Important steps have been taken in the past year to improve the management of human resources in public institutions and the development of a more modern staff appraisal system.

KOSOVO

Highlights

- **Robust economic growth is continuing.** GDP grew by 3.7 per cent in 2017, driven by investment and net exports. Unemployment has also continued its declining path, although the rate is still among the highest in Europe.
- **Plans to build a new coal-fired plant have advanced.** The government signed a contract with power generator ContourGlobal to build a 500 MW coal-fired power plant, with a value of €1 billion.
- **Cross-border transport infrastructure is being enhanced.** The reconstruction and development of Kosovo's major road and railway infrastructure network is taking place**.**

Key priorities for 2019

- **Privatisation should be re-energised. Little progress has been made in this area in recent years.** Attracting private ownership and investment into state-owned enterprises could give the economy a much-needed boost.
- **A major reform push in the energy sector is needed.** Renewable energy investments and energy efficiency measures can help mitigate power shortfalls, while enhancing environmental sustainability and energy security.
- **Implementation of key cross-border infrastructure projects needs to speed up.** Infrastructure development is key to Kosovo's continued integration within the region. Finalisation and rehabilitation of the main transport links to pan-European corridors would boost trade and investment with neighbouring countries.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	1.2	4.0	4.1	3.7	4.0
Inflation (average)	0.4	-0.5	0.3	1.5	0.8
Government balance/GDP	-2.4	-1.8	-1.3	-1.2	-3.4
Current account balance/GDP	-6.9	-8.6	-7.9	-6.6	-7.2
Net FDI/GDP [neg. sign = inflows]	-2.2	-4.7	-2.9	-4.0	-3.9
External debt/GDP	31.2	33.3	33.2	32.6	n.a.
Gross reserves/GDP*	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	33.6	34.5	36.5	38.6	n.a.

*Kosovo uses the euro as its legal tender.

CONTINUES

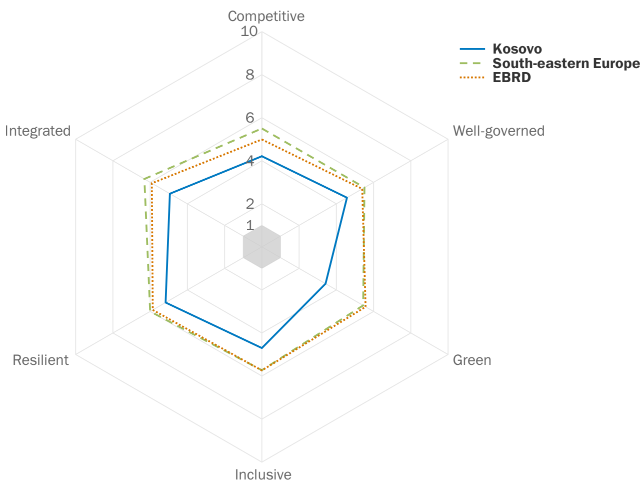
Macroeconomic performance

Robust growth has continued. GDP grew by 3.7 per cent in 2017, slightly below the level of the previous two years. Last year's growth was mainly investment driven, although net exports were also a positive contributor to growth. The unemployment rate continued its declining path over the last three years and now stands at 27.5 per cent, still very high by regional standards. The low rate of labour force participation, especially among women, represents a key bottleneck for further economic development. Growth has continued into 2018 with overall output rising 4.2 per cent year-on-year in the first half of the year. It was again mainly investment-driven, as construction of key transport infrastructure progressed, although private and government consumption were also positive contributors to growth. Inflation averaged 1.5 per cent in 2017.

Fiscal policy has remained moderate. Following the end of the IMF programme in 2017, the government has stuck to a prudent fiscal path, with the government deficit at 1.2 per cent of GDP in 2017. Public debt also remains exceptionally low by regional standards at just 17 per cent of GDP by the end of 2017 (excluding debt related to the Yugoslav era). The government is therefore staying well within the fiscal rule targets of a deficit below 2.0 per cent of GDP and public debt remaining below 30.0 per cent of GDP, although there have been signs of rising spending commitments in 2018. On the external side, the current account deficit remains large at 6.0 per cent of GDP in 2017, although partly balanced by inflows of foreign direct investment which amounted to 4.0 per cent of GDP.

Further growth is likely in the short term. The current forecast for GDP growth in 2018 is 4.0 per cent, with the same projection also in 2019, due mainly to a more favourable external environment and hence higher remittances and exports, as well as an anticipated acceleration of investment, including in public infrastructure. Future growth may also depend on the pace of implementation of the planned new 500 MW thermal power plant (see below), which would represent the biggest investment project in the country. Conversely, a failure to proceed with the project or to put in place alternative arrangements for an adequate power supply could have a serious negative impact on the economy.

Assessment of transition qualities (1-10)



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Major structural reform developments

The government has approved an action plan to meet EU requirements. The action plan, approved in April 2018, is designed to address the country's challenges as identified in the latest European Commission (EC) progress report. The EC noted that corruption remains an issue of concern, and suggested that the country step up the fight against the informal economy, which remains widespread, as well as against tax evasion. The report also recognised that the energy sector continues to face serious challenges and is a major bottleneck for economic development.

Steps are under way to revive the major mining complex Trepca. In May 2018, the government approved the statute for Trepca, almost two years after the complex was put under government control in a bid to save it from bankruptcy. This followed the decision by the parliament to settle the legal situation of the company by transforming it from a socially owned enterprise into a shareholding company, giving the state an 80 per cent stake and miners 20 per cent. Trepca's ownership structure has been disputed by Serbia, which claims the majority stake. The Trepca board is expected to proceed soon with the creation of all managerial structures and an operational plan.

Cross-border linkages with Albania are being strengthened. In June 2018, the parliament endorsed the implementation of the agreement between Kosovo and Albania on the unification of customs points between the two countries. The agreement is expected to facilitate the exchange of goods and the movement of people. Also, in parallel the parliament of Kosovo adopted a resolution on the removal of telephone roaming charges with Albania.

Progress in transport infrastructure is moving ahead slowly. In July 2018, the government approved plans to borrow €80 million from the European Investment Bank to finance the construction of the 30 km Pristina-Peja motorway segment (Kijeve-Zahaq), which leads to Montenegro. The project, which has a total value of €200 million, will be co-financed by the EBRD. The government has also decided to extend the deadline for the completion of the €600 million, 60 km highway that leads from Pristina to the Macedonian border until the end of 2018, built by the American-Turkish consortium Bechtel Enka. In the area of railways infrastructure, the European Union is providing a grant of €38.5 million to Kosovo to co-finance (with the EBRD) the modernisation of the country's railway infrastructure network, thus improving its connection with the Pan-European Corridors VIII and X. This project covers the three sections of the main railroad Route 10 connecting Kosovo with Serbia in the north and with FYR Macedonia in the south.

Plans to build a new coal-fired plant have advanced. In December 2017, the government signed a contract with power generator ContourGlobal to build a 500 MW coal-fired power plant, with a value of €1 billion. In June 2018 ContourGlobal called a pre-qualification tender for the construction of the plant, and in September 2018 the government of Kosovo and ContourGlobal jointly announced that four out of six applicants had pre-qualified for the next stage of the tender. Currently Kosovo relies mostly on two old coal-fired plants, Kosova A and Kosova B, both part of Kosovo Electricity Corporation (KEK), which are considered to be among the worst polluters in Europe. However, the proposed new project has been criticised by environmental groups who argue that the country should look to alternative fuel sources rather than investing in more coal capacity.

New legislation is being introduced in the financial sector. Currently the level of financial intermediation is well below that of neighbouring countries, but the banking system is well capitalised and has a very low level of non-performing loans, at just 3.1 per cent of total loans. The Law on Banks is expected to undergo amendments as regulations are harmonised with Basel and EU standards. The EBRD is assisting the central bank to review and amend the legal framework for the receivership and liquidation of financial institutions. A new draft law on microfinance institutions and non-bank financial institutions is also being discussed and is expected to enter into force by the end of 2018.

MONTENEGRO

Highlights

- **Further progress has been made towards eventual EU membership.** The new European Commission (EC) Enlargement Strategy, published in February 2018, has set 2025 as the year when Montenegro could be ready for membership, provided it makes further progress in reforms.
- **The government has begun implementing a fiscal adjustment strategy.** The strategy is intended to boost the sustainability of the public finances, which have been put under severe pressure because of costs associated with the financing of major road infrastructure.
- **The main power utility is being brought back into almost full public ownership.** The government and Italian utility company A2A have agreed on the accelerated execution of the put option for the company's stake in the power utility EPCG.

Key priorities for 2019

- **Fiscal stabilisation is crucial for economic growth.** Having developed a credible fiscal strategy the government should stick to agreed targets, even if economic growth slows, in order to restore fiscal balance and reduce public debt.
- **Renewable energy projects should be further developed.** Montenegro has significant potential in this area and further development would help the country's green economy transition and improve its energy resilience.
- **Further improvements are needed on economic governance.** Areas of focus in the coming year should include the development of the government's e-governance programme and strengthening of the framework for competition policy.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	1.8	3.4	2.9	4.7	4.2
Inflation (average)	-0.7	1.5	-0.3	2.4	2.8
Government balance/GDP	-0.7	-6.2	-6.2	-7.0	-4.6
Current account balance/GDP	-12.4	-11.0	-16.2	-16.3	-16.8
Net FDI/GDP [neg. sign = inflows]	-10.2	-16.9	-9.4	-11.4	-11.4
External debt/GDP	163.1	161.8	158.8	160.2	n.a.
Gross reserves/GDP*	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	54.1	52.6	51.6	51.4	n.a.

*Montenegro uses the euro as its legal tender.

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Macroeconomic performance

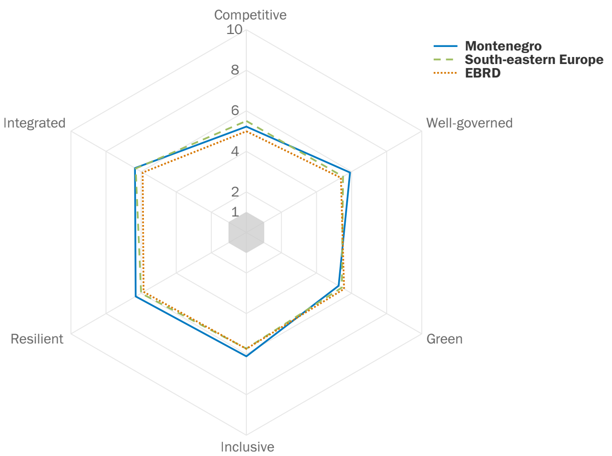
The economy out-performed expectations in 2017. GDP grew by 4.7 per cent, well above the 2.9 per cent growth rate recorded in the previous year. The key drivers of this growth were investment, particularly in the major highway project connecting the port of Bar with the Serbian border and in some flagship tourism developments on the coast; and private consumption, driven by the relatively high rate of lending. However, high imports, as a component of both investment and private consumption, fuelled a large current account deficit of more than 16 per cent of GDP and acted as a drag on growth. The Montenegrin economy depends heavily on tourism (one-fifth of annual GDP), and foreign tourist arrivals in 2017 were up by more than 10 per cent, boosted by new airline connections with EU countries. The unemployment rate as of the second quarter of 2018 was 14.4 per cent, while long-term unemployment is very high, at about 65 per cent of total unemployment. The economy has continued to power ahead in 2018, with growth in the first half of 2018 estimated at 4.8 per cent year-on-year, again with similar drivers as in 2017.

The government has begun implementing a medium-term fiscal adjustment strategy. The sustainability of the public finances is a significant concern, and is among the biggest risks the country is facing. To combat growing fiscal pressures, a new Fiscal Strategy (2017-20) was adopted in June 2017 containing a number of measures, including an increase of VAT and excise duties, a reduction in the salaries of senior public employees, improved tax collection, and the cancellation of benefits to mothers of three or more children introduced the year before by parliament. The main goal of the strategy is to achieve a primary budget surplus from 2019, and an overall budget surplus from 2020. This should put the public debt, which has been rising rapidly in recent years to over 70 per cent of GDP, on a downward trajectory.

In April 2018 the government placed a seven-year, €500 million Eurobond. The interest rate was 3.375 per cent, a record low for the country, implying a positive reaction from the financial markets for the recent fiscal consolidation measures. The country's credit rating, as of October 2018, is B+ by Standard & Poor's and B1 by Moody's, with a stable outlook in the former and a positive outlook in the latter. Further financing will be needed in the coming years to meet significant Eurobond redemptions in the period 2019-21.

Growth is likely to moderate in the short term. The fiscal austerity measures adopted in the past year are expected to bite further, while current construction activities are slowing, as the construction and financing of the remaining highway sections remain unclear. Therefore, GDP growth is projected at 4.2 per cent in 2018 and 3.0 per cent in 2019. The economy will continue to be mainly investment-driven and supported by public investment in transport and energy infrastructure (where construction of the highway continues to be the key project) and flagship foreign direct private investments, particularly in the tourism sector. The main risks include the high level of public debt and limited fiscal space.

Assessment of transition qualities (1-10)



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Major structural reform developments

Further progress has occurred on EU approximation. As of October 2018, Montenegro had opened 31 negotiating chapters (out of 33) of the EU's *acquis communautaire*, including two critical chapters related to the rule of law, and had provisionally closed three: Science and Research; Education and Culture; and External Relations. The chapters on Competition Policy and Environment still remain unopened. Montenegro launched EU accession negotiations in 2012. The new EC Enlargement Strategy, published in February 2018, has set 2025 as an indicative timeline for the country's EU membership, noting that Montenegro (and Serbia) could be ready for membership by 2025 provided it makes further progress in reforms.

Progress on privatisation has been minimal in the past year. The only concrete achievement was the agreement on the 30-year lease of Ulcinjska Rivijera with Karisma Hotels Adriatic Montenegro, the only bidder on the tender. Meanwhile the tender for the concession of the port of Bijela is in its final phase. A consortium comprising the Dutch company Damen and Adriatic Marinas, the company which operates the country's flagship investment Porto Montenegro, had expressed interest in obtaining the concession for the port for 30 years, aiming to convert it from a former shipyard into a place for yacht building and repair. At the same time, the process of renationalisation of EPCG, the country's state-owned power utility, has begun, as the minority shareholder Italian A2A has started its exit from the company. In August 2018 the government published a draft concession agreement for the two international airports. The plan is to offer a concession contract on the two airports for 25 to 30 years. The preparation and implementation of public tenders for the privatisation of the health institute in Igalo and the hotel group Budvanska Rivijera are part of the 2018 privatisation plan.

The government and Chinese construction company CRBC have signed a Memorandum of Understanding (MoU) on further motorway construction. The MoU was signed in March 2018 on the possible establishment of a public-private partnership to handle the construction of further sections of the Bar-Boljare highway, which connects the Adriatic port of Bar in Montenegro with the Serbian border. CRBC is already the lead contractor for the construction of the 42 km-long priority section of the highway, worth US$ 1.1 billion, set for completion by the end of 2019. However, in addition to this priority section, the highway includes another four sections – two northern and two southern – with an additional estimated total construction cost of approximately €1.7 billion. In parallel, in April 2018 the government appointed a team to negotiate with interested companies the construction of the two northern stretches of the motorway, leading to the Serbian border. The team's goal is to propose to the government a model for the construction of these stretches as well as to define criteria for tendering them. The team should also assess the gathered offers and start talks with the preferred company or consortium.

The power utility is being brought back into almost full public ownership. In April 2018 parliament approved the agreement on an accelerated execution of the put option that gives A2A the right to sell its 42 per cent stake in power utility EPCG for €250 million (the government has a 57 per cent stake, while the remainder belongs to smaller shareholders). Following parliament's approval, the put option should be executed within two years instead of the originally planned seven years. In line herewith, the government had adopted a budget revision in March 2018 allocating €70 million for the purchase of A2A's shares in EPCG. A2A is exiting EPCG mainly because it disagrees with the government's project to extend the capacity of the country's sole thermal power plant Pljevlja, which now has only one unit of 210 MW.

A second wind park is being developed. The 46 MW Mozura wind park on Montenegro's coast will start operations in the fourth quarter of 2018 after China's Shanghai Electric Power Company has completed the installation of 23 turbines. The project is being carried out by the Maltese state-owned company Enemalta and Shanghai Electric. This is the second wind park project to be developed in Montenegro, following the launch of the 72 MW EBRD co-funded Krnovo wind park last year.

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Financial sector legislation is being strengthened. To address remaining legislative shortcomings in the financial sector, a number of new laws and related directives have recently been introduced. These include a Central Bank Act, a Law on Financial Institutions, and an all-encompassing non-banking financial institutions law covering factoring, leasing, micro-crediting and credit guarantee operations, all adopted by parliament in October 2017. The Law on Voluntary Financial Restructuring adopted some years ago has been extended again, this time to May 2019. Also, the authorities are currently amending a number of pieces of legislation, including the Deposit Insurance Law, the Banking Law and the Law on Recovery and Resolution of Banks, to improve banking supervision and resolution frameworks and make them consistent with the Basel Core Principles for Effective Banking Supervision and the EU's Bank Recovery and Resolution Directive.

ROMANIA

Highlights

- **Following rapid growth in 2017, the economy is slowing down.** Romania recorded one of the fastest growth rates in the European Union (EU) in 2017 at 7.3 per cent, driven by strong private consumption and investment. However, growing fiscal and external imbalances have been accompanied by tighter monetary policy and a slow-down of growth so far in 2018.
- **The resilience of the banking system improved as the decline in non-performing loans (NPLs) continued.** Successive sales of NPLs and fast loan growth have brought the ratio of NPLs down to 5.7 per cent, from a high of 22.0 per cent in 2013.
- **Progress in structural reforms has been uneven.** Some modest progress occurred in implementing the Cooperation and Verification Mechanism (CVM) recommendations, but other measures adopted by the government have prompted concerns about judicial independence and the government's commitment to fighting corruption.

Key priorities for 2019

- **Further reforms to strengthen judicial independence and transparency should be undertaken.** Progress in this area would help to alleviate concerns surrounding the independence of the judiciary and the government's anti-corruption commitment.
- **Privatisation of state-owned enterprises (SOEs) needs to be prioritised. SOEs remain dominant in some sectors such as energy and transport.** Privatisation of these enterprises through initial public offerings (IPOs) would attract investors and increase market capitalisation, thereby helping to upgrade Romania from frontier market to emerging market status.
- **Business environment reforms should be prioritised.** Difficulty in accessing skilled labour, inadequate transport infrastructure and inefficient government bureaucracy constitute the highest reform priorities. In particular, growing labour shortages need to be addressed by retaining and attracting qualified workers.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	3.1	4.0	4.8	7.3	4.2
Inflation (average)	1.4	-0.4	-1.1	1.1	4.7
Government balance/GDP	-1.9	-1.5	-2.4	-2.9	-3.0
Current account balance/GDP	-0.7	-1.2	-2.1	-3.4	-3.5
Net FDI/GDP [neg. sign = inflows]	-1.9	-2.4	-3.3	-2.3	-2.9
External debt/GDP	56.8	55.6	52.9	45.3	n.a.
Gross reserves/GDP	21.6	21.8	21.4	20.1	n.a.
Credit to private sector/GDP	31.1	29.9	28.2	26.4	n.a.

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Macroeconomic performance

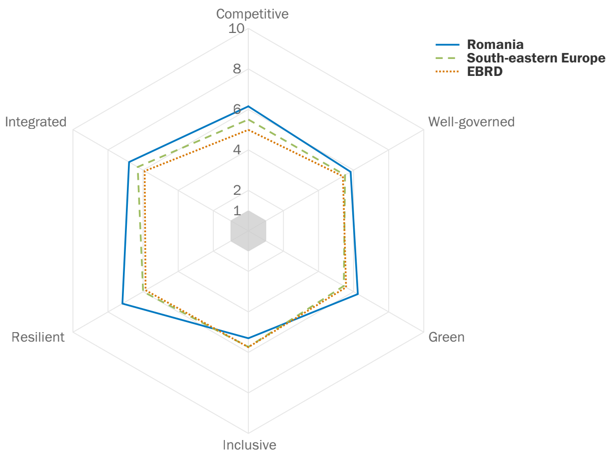
Romania's growth rate of 7.3 per cent was one of the highest in the EU in 2017. Private consumption was the main driver of growth in 2017, supported by a pro-cyclical fiscal policy including cuts in VAT and other consumer taxes. Strong wage growth and low unemployment, at 4.1 per cent in September 2018, also boosted consumption growth. After declining during the previous year, investment also picked up in 2017, fuelled by increased absorption of EU funds. There are signs in the first half of 2018 that the economy is slowing down, with the growth rate for this period reaching 4.0 per cent year-on-year.

To address growing overheating concerns, the central bank has started to tighten monetary policy. The tightening labour market and rising household consumption drove inflation to 5.4 per cent in June, the highest figure since 2013 and well above the central bank's upper target of 3.5 per cent. Consequently, the central bank has started to tighten its monetary policy, raising its main policy rate three times so far in 2018 from 1.75 to 2.50 per cent. Further increases are likely given the continued inflationary pressure and monetary tightening in the USA.

Fiscal and external imbalances have increased. The current account deficit rose to 3.4 per cent of GDP in 2017, driven by rising imports, and continued to grow in the first half of 2018. Meanwhile, the budget deficit reached 2.9 per cent of GDP in 2017 and may exceed 3.0 per cent of GDP in 2018 on the back of continued loose fiscal policies. On the positive side, general government debt is low by regional standards, at 35 per cent of GDP as of the end of 2017, and has been declining.

GDP growth is likely to moderate in 2018-19. Growth is projected to moderate to 4.2 per cent in 2018 and 3.6 per cent in 2019, due to weakening policy stimulus and tighter monetary policy, although growth will continue to be supported by investment linked to EU funds. Downside risks, including the exacerbation of the current labour shortages, changes in global investor sentiment and domestic political and reform uncertainty, may hamper growth in the near term. In the longer term, the diversified economy, large market size and scope for convergence within the EU (GDP per capita, purchasing power parity-adjusted, is 60 per cent of the EU average) should allow growth rates of around 4 per cent to be sustained, provided further structural reforms are undertaken.

Assessment of transition qualities (1-10)



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Major structural reform developments

Romania's investment environment is better than regional peers, although challenges remain. In the World Bank's *Doing Business 2019* report, Romania ranked 52nd out of 190 countries, a deterioration of seven places over the previous year. The slide in performance is in part due to the introduction of new value added tax regulations making starting a business more difficult. Other areas that are particularly challenging include obtaining construction permits and getting electricity, but Romania performs best among the countries surveyed in trading across borders.

Progress under the Cooperation and Verification Mechanism (CVM) continues to be uneven. The coalition's ongoing attempts to pass amendments to several justice laws are a cause for concern – as was the dismissal in July 2018 of the head of the National Anti-Corruption Directorate (DNA) – as they could weaken the fight against corruption.

Plans to privatise state-owned enterprises remain stalled. SOEs remain dominant players in the energy and transportation sectors, weighing on public finances. However, uncertainty surrounding the legitimacy of the Sovereign Wealth Fund for Development and Investment (FSDI), established to hold the state's participation in profitable SOEs, means that prospects for privatisation of these entities remain unclear.

Romania is close to reaching emerging market status, which would have a positive effect on investment. Romania meets most of the criteria required for being upgraded from frontier to emerging market status by the market index maker MSCI. Low liquidity is the main limiting factor, which highlights one of the potential benefits to be gained from privatising SOEs through IPOs. An upgrade to emerging market status could result in a significant increase in inflows to Romanian capital markets.

There was considerable progress in reducing the share of NPLs. Banks continue to clean up their balance sheets and restructure their loan portfolios. The combination of NPL sales and strong credit growth has pushed the NPL ratio down to 5.7 per cent in June 2018, from a peak of 22.0 per cent at the end of 2013. While still above the EU average of around 4.0 per cent, NPLs are expected to further decline over the coming year on the back of further sales.

SERBIA

Highlights

- **Growth is recovering in 2018.** After modest growth in 2017, the economy grew by 4.9 per cent in the first half of 2018 on the back of faster domestic demand growth, primarily investment.
- **Further progress has been made towards eventual EU membership.** The new European Commission Enlargement Strategy for the Western Balkans, published in February 2018, has set 2025 as the year when Serbia could be ready for EU membership, provided it makes further progress in reforms.
- **Non-performing loans (NPLs) have declined to below 7 per cent.** This significant reduction over the past year is mostly a result of the National Bank of Serbia's decision to make the write-offs of fully provisioned NPLs mandatory.

Key priorities for 2019

- **Public sector reforms, including privatisation and restructuring of state-owned enterprises (SOEs), should be advanced.** Significant contingent fiscal risks still stem from large, unreformed SOEs. Better SOE management could also contribute to stronger growth performance and increased resilience to shocks.
- **Small and medium-sized enterprises (SMEs) need better access to finance and clear rules.** SMEs would benefit greatly from the development of non-bank financial institutions and improved tax-related practices, including simplified tax procedures, lower para-fiscal charges, and better predictability of tax decisions and services to tax payers.
- **Further efforts are needed to support market transactions in NPLs.** Efforts should focus on easing access to information for potential investors on NPL portfolios, improving out-of-court restructuring and conducting more efficient judicial processes.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	-1.8	0.8	3.3	2.0	4.2
Inflation (average)	2.1	1.4	1.1	3.0	2.1
Government balance/GDP	-6.6	-3.7	-1.3	1.2	0.7
Current account balance/GDP	-6.0	-3.5	-2.9	-5.2	-5.5
Net FDI/GDP [neg. sign = inflows]	-3.7	-5.1	-5.2	-6.2	-6.0
External debt/GDP	77.1	78.3	76.5	69.5	n.a.
Gross reserves/GDP	29.7	29.1	27.8	25.4	n.a.
Credit to private sector/GDP	43.4	43.4	43.4	43.0	n.a.

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Macroeconomic performance

Growth slowed in 2017, but has accelerated in 2018. GDP growth decelerated to 2.0 per cent in 2017, from 3.3 per cent in 2016. The slow-down was mainly a consequence of a fall in agricultural production due to the summer drought and some difficulties in mining and electricity generation. On the expenditure side, growth was led by rising private consumption and investment, the latter being supported by strong foreign direct investment (FDI) inflows. However, higher domestic demand translated into a fast rise in imports (around 11 per cent), offsetting the strong export performance and resulting in a negative contribution from net exports and a rise in the current account deficit to 5.7 per cent of GDP. Growth recovered strongly in the first half of 2018, reaching 4.9 per cent year-on-year. It was a result of continuing recovery of domestic demand with offsetting effects from net exports due to the continued strong growth in imports. Higher frequency indicators point to stable manufacturing growth, a stagnation in mining, and recovery in electricity production in the first half of the year.

After years of deficits, Serbia has started to record fiscal surpluses. In February 2018, Serbia completed its three-year Precautionary Stand-By Arrangement with the IMF. The programme was marked by significant fiscal over-performance over the whole period. In 2017, the general government registered a surplus of 1.2 per cent of GDP (versus 1.3 per cent deficit in 2016) on the back of higher tax revenues and lower current spending. Developments in the first seven months of 2018 (namely, higher revenues from social security contributions, taxes and excises) point to the possibility of another year of fiscal surplus. In view of the achievements so far, the government has continued to relax austerity measures. This includes a hike of public sector wages by 5 to 10 per cent, depending on the sector, and a 5 per cent increase of pensions from January 2018, as well as a one-off bonus of RSD 10,000 (around €85) to the security forces in December 2017. In addition, the law on reduction of above-average pensions was abolished at the end of September 2018. However, a ban on new hiring in the public sector, introduced in 2013, has been extended until the end of 2018. Public debt fell to 63 per cent of GDP at the end of 2017 and to 60 per cent of GDP at the end of June 2018. However, due to its currency structure (75 per cent in foreign currencies, close to 40 per cent of which is in US dollars), the debt is quite sensitive to exchange rate developments, including euro-dollar movements.

Amid low inflationary pressures, monetary easing continued. After undershooting the target (3±1.5 per cent) for two years, inflation picked up to 3 per cent year-on-year in 2017 on average. This acceleration came on the back of the rise in food and energy prices but was also supported by the increase in domestic demand and foreign inflation (notably in the euro area). However, in the first nine months of 2018 inflation moved to the lower half of the target band, mainly due to low food prices and the high 2017 base effect. The National Bank of Serbia (NBS) responded by lowering the key policy rate to a historic low of 3 per cent in April 2018.

Growth is expected to accelerate to 4.2 per cent in 2018 and slow down to 3.5 per cent in 2019. Faster growth is to be supported by further strengthening consumption and investment, with offsetting effects from higher imports. The risks to the projection are balanced, the main ones relating to the implementation of reforms envisaged under the IMF's Policy Coordination Instrument (PCI) and further pace of eurozone growth.

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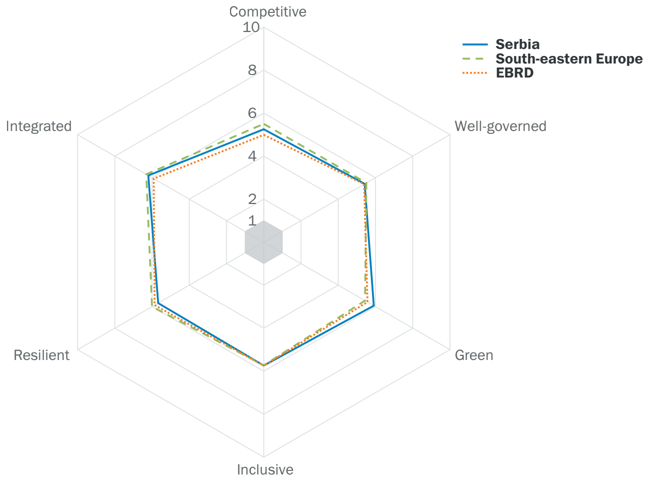
Assessment of transition qualities (1-10)



Major structural reform developments

The business environment remained broadly unchanged. In the World Bank's *Doing Business 2019* report Serbia ranked 48th out of 190 economies. Although it improved dealing with construction permits further (ranking 11th), by reducing time for processing permit applications, it did not make much progress in other areas, resulting in a decrease of five positions from last year's report. Enforcing contracts, resolving insolvency and protecting minority investors are still the most problematic areas for doing business. On the other hand, Serbia has slightly improved its standing in the World Economic Forum's *Global Competitiveness Report 2018*, ranking 65th out of 140 countries (up five places from the previous one).[1] As earlier, market efficiency, institutions and innovation capacity show the biggest gaps.

Serbia has signed a 30-month Policy Coordination Instrument (PCI) with the IMF. This non-financing instrument, signed in July 2018, is to support continued efforts for macroeconomic stability and structural reforms, following the successful conclusion of the three-year Standby Arrangement in February 2018. The new programme is centred around three areas: (i) fiscal policy (that is, safeguarding the fiscal adjustment; and reforming tax policy, tax administration, public employment and wage systems); (ii) monetary and financial sector policies (that is, strengthening the coordination of liquidity management between the National Bank of Serbia and the Ministry of Finance; promoting dinarisation; further reducing NPLs; reforming state-owned financial institutions; aligning financial regulatory and supervisory frameworks with EU standards; addressing identified weaknesses in the AML/CFT framework); and (iii) structural and institutional reforms (that is, tackling the large shadow economy and improving labour force participation; completing restructuring and/or privatisation of SOEs).

Reforms of the public administration have advanced slowly. Following legislation adopted in December 2017, pay levels are to be set across government departments in a more market-oriented, fair and transparent manner. Despite the announcement that coefficients under the new wage system will be applied from January 2019, in November 2018 the government decided to postpone their application to January 2020. "Rightsizing" of the state administration remains a key government priority and, since 2015, the number of public employees has been reduced by close to 30,000, as planned. However, merit-based recruitment and dismissal procedures have not been implemented, and problems remain with political influence in hiring and the high turnover of senior civil servants.

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[1] The rating for 2017 reflects the change in the methodology. According to the old methodology Serbia was ranked 78th in 2017.

Tax administration reform shows mixed progress. In December 2017 the government adopted a new Tax Administration (TA) Transformation Action Plan (2018-23) in order to create a modern tax administration that uses e-business processes, improved taxpayer services and a risk-based approach to compliance. The plan also envisages the removal of the TA's non-core activities and consolidation of core activities into fewer sites. In April 2018 the changes to the Law on Tax Procedure and Tax Administration were adopted. The goal was to reduce tax evasion by broadening the responsibilities for tax payments, extending the competences of tax inspectors, restricting the rights of taxpayers, and securing more efficient tax collection. The amendments also introduce tax services that will be provided by the TA to help the taxpayers settle their taxes in proper amounts and within the deadlines. However, more consultation with all relevant stakeholders in future would be needed since the practical application of some of the rules (including the new VAT Rulebook from October 2017) is unclear.

Privatisation and restructuring of SOEs has progressed somewhat. After several unsuccessful attempts to privatise the company, the government sold its 93.7 per cent stake in the drug-maker Galenika (one of 17 strategic SOEs) in November 2017. In September 2018, two other strategic SOEs were resolved (the Belgrade agricultural company PKB by privatisation and the copper mining and smelting complex RTB Bor by entering into a strategic partnership with a Chinese gold producer). The privatisation of Komercijalna banka has been postponed to 2019, while the resolution of three major loss-makers (all chemical companies) is progressing slowly. In total, around 115 companies (including 10 strategic SOEs) accounting for nearly 45,000 employees in the portfolio of the former Privatisation Agency, remain to be resolved. The restructuring of large public utilities (EPS, Srbijagas) is moving ahead slowly. Following the launch of a concession procedure a year earlier, in March 2018 the government signed a 25-year concession deal for Belgrade airport.

The NPL ratio has fallen significantly. In August 2017 the NBS adopted a Decree on the Accounting Write-Off of Bank Balance Sheet Assets, stipulating the mandatory write-off for loans covered in full by allowances for impairment. As a result, banks have intensified the writing-off of NPLs, which led to the NPL ratio almost halving from September 2017 to 6.5 per cent in August 2018. However, there is still further room for accelerating NPL sales and, eventually, restructuring the debtor companies. The main obstacles relate to strict bank secrecy rules, preventing potential buyers from getting adequate information on NPL portfolios, restrictions on retail NPL sales and NPL sales to foreign entities, as well as inefficient judicial processes.