Albania

Highlights

- **Economic growth is moderating.** Following a sharp rise in 2022, fuelled by a record tourist season, growth slowed in the first half of 2023 as domestic demand eased as a result of elevated inflation.
- **The legal environment has become more conducive to the development of renewables.** A new law, in force since April 2023, which aligns legislation with that of the European Union (EU), sets out rules on financial support for renewable energy producers and the use of renewable energy in heating, cooling and transport. It also gives market access to "prosumers" (entities producing electricity mainly for self-consumption).
- **Public-sector wages are being reformed.** New laws have given the government more power to determine salaries in the public sector, authorised salary increases for judges and prosecutors, and introduced a new salary-increase scheme for the public administration.

Key priorities for 2024

- **Meaningful revenue-enhancing measures would help medium-term fiscal consolidation following public-sector wage increases.** The government should further decrease arrears, increase the tax-revenue ratio and improve compliance, including with the recently approved income-tax law.
- **Financial and exchange-rate risk should be carefully monitored.** The financial sector is liquid and stable, but vigilance should be maintained in light of the economic slowdown and tighter monetary policy. Ongoing efforts to build higher capital buffers are welcome.
- **Better-targeted fiscal support would help fiscal balances and benefit vulnerable groups.** Despite robust economic growth, the poverty rate remains stubbornly high, highlighting the need to increase the efficiency and scope of social assistance, including through a system of annual indexation of economic and disability benefits.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.1	-3.3	8.9	4.8	2.5
Inflation (average)	1.4	1.6	2.0	6.7	4.8
Government balance/GDP	-1.9	-6.7	-4.6	-3.7	-2.5
Current account balance/GDP	-7.9	-8.7	-7.7	-6.0	-6.0
Net FDI/GDP [neg. sign = inflows]	-7.5	-6.7	-6.5	-6.6	-6.8
External debt/GDP	60.0	64.2	64.2	53.9	n.a.
Gross reserves/GDP	24.4	29.6	32.7	27.3	n.a.
Credit to private sector/GDP	34.1	37.9	36.6	34.0	n.a.

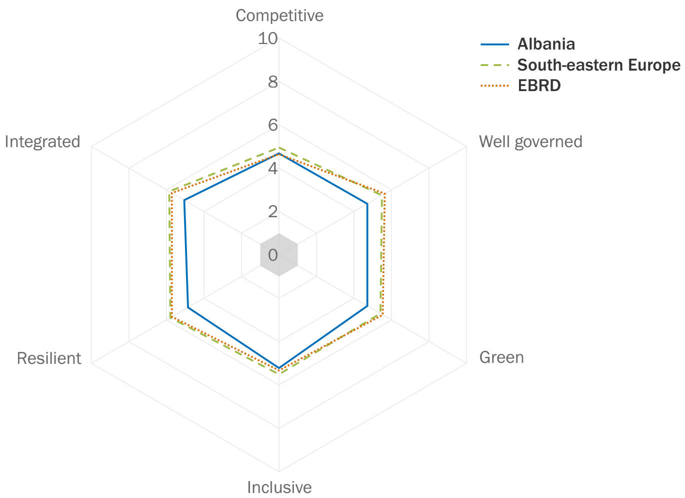
Macroeconomic developments and policy response

Economic growth continues in 2023, but at a more moderate pace. Following a rise in gross domestic product (GDP) of 4.8 per cent in 2022, supported by a record tourist season, growth moderated to 2.8 per cent year on year in the first quarter of 2023 before accelerating to 3.2 per cent in the second quarter of the year. The slowdown was mainly driven by weaker domestic demand resulting from elevated inflation. Goods exports contracted on an annual basis in the first half of the year amid sluggish growth in Albania's key trading partners and sharp currency appreciation. The lek strengthened due to record levels of tourist arrivals alongside robust inflows of remittances and foreign direct investment. In line with lower domestic and external demand, agriculture and industry posted muted growth rates, while service sectors such as real estate, construction, information and communications technology (ICT) and retail trade were the fastest-growing sectors of the economy. Service exports were robust in 2022, as Albania's booming tourism sector recorded its best performance ever in terms of tourist arrivals and overnight stays. The sector is in for another strong performance this year, with the first eight months of the year showing a 27 per cent annual increase in tourist arrivals.

The government has been gradually withdrawing measures that supported the economy during and after the Covid-19 pandemic. In response to elevated inflation, the central bank raised the policy rate several times, from 0.5 per cent in March 2022 to 3.25 per cent in November 2023. Due to higher borrowing costs, credit growth has slowed markedly, but remained positive at 2 per cent year on year in August 2023. Following the implementation of two comprehensive Social Resistance Packages in 2022, aimed at shielding households and businesses from rising prices, the authorities began to reform and increase public-sector wages, and raised the minimum wage by 18 per cent in 2023. The Fuel Transparency Board, which had been setting fuel prices since March 2022, was abolished in June 2023 following a decision by the Constitutional Court. In light of significant local-currency appreciation, the authorities put in place measures to support exporters' liquidity, such as a temporary freeze on profit tax prepayments, an acceleration of value-added tax (VAT) refunds and a full refund of excise taxes on petroleum gas and certain types of oil. The government has committed to maintaining a budget surplus in 2023, one year ahead of the deadline set by the Organic Budget Law. To support the state budget and help repay an existing Eurobond that matures in 2025, Albania tapped into external markets by way of an oversubscribed five-year €600 million Eurobond in June 2023.

Growth is expected to moderate in the near term because of the unfavourable external environment. Economic growth is expected to slow to 2.5 per cent in 2023 as the growth prospects of Albania's key trading partners remain muted, persistently high inflation constrains disposable income at home and abroad, and tight global and domestic monetary policies restrict credit growth. Nonetheless, the continued strong performance of the hospitality sector tilts the risks to the upside. Growth is set to pick up in 2024 – we forecast to 3.3 per cent – in line with an expected improvement in the global outlook, bringing it closer to the economy's medium-term potential.

Assessment of transition qualities (1-10)



Structural reform developments

The Albanian Power Exchange (ALPEX) became operational with the launch of the day-ahead market. With the regulatory framework for the joint power exchange in Albania and Kosovo having been completed in 2022, the day-ahead market was launched in April 2023. The ALPEX exchange was awarded the status of a nominated electricity market operator in both countries in July, paving the way for market coupling. Starting in June 2023, responsible bodies in Albania can issue guarantees of origin for electricity, enabling trading in line with EU rules.

The authorities are tackling money laundering and terrorist financing. Since June 2022, the Albanian authorities have been addressing notable shortcomings with regard to trustees being subject to anti-money laundering/combating the financing of terrorism (AML/CFT) requirements, and have streamlined access to beneficial ownership information for competent authorities. Improved measures for regulating and supervising notaries and real-estate agents are now in place, with the licensing authority for notaries now empowered to revoke licences in case of infringement of AML/CFT legislation. Risk-based supervision of real-estate agents has also been introduced. Albania is acknowledged to have made significant progress on addressing strategic deficiencies and was removed from the so-called grey list of jurisdictions, subject to increased monitoring by the Financial Action Task Force (FATF) in October 2023.

Parliament has passed a law establishing a court of arbitration. The law, adopted in July 2023, aims to settle in-country any commercial disputes between the Albanian state and private businesses, rather than use the internationally acknowledged International Centre for Settlement of Investment Disputes (ICSID) procedures often favoured by foreign investors.

The legal framework for renewable energy has progressed. The Law on Promotion of the Use of Energy from Renewable Sources, adopted in April 2023, lays down rules on financial support for renewable energy producers and the use of renewable energy in heating, cooling and transport. It also gives market access to “prosumers”. The law further introduces a renewable energy operator, a public joint stock company that will serve as a contracting party for producers eligible for support under the law.

Public-sector wage reform has begun. The package of three laws adopted in May 2023 gives the government greater power to determine salaries in the public sector, authorises salary increases for judges and prosecutors, and introduces a new salary-increase scheme for the public administration. The laws were accompanied by an 18 per cent increase in the minimum wage and should, according to the authorities, spark a follow-on increase in wages in the private sector, with the ultimate goal of the average monthly wage reaching €900 by 2024.

Bosnia and Herzegovina

Highlights

- **Growth is moderating in 2023.** Following robust acceleration in 2022, output growth slowed significantly in the first half of 2023, due mainly to worsening net exports, as external demand has been continuously weakening.
- **Some missing parts of the legal framework for renewables have been completed.** The adoption of a set of energy laws in the Federation of Bosnia and Herzegovina (FBiH) streamlines administrative procedures for the construction and operation of renewable energy facilities and reforms the incentives system for renewable energy. Similar laws are already in place in the Republika Srpska (RS) entity.
- **The government has approved the draft National Energy and Climate Plan (NECP).** The draft NECP is aiming for a carbon emissions trading scheme by 2026, taking into account the European Union (EU)'s upcoming Carbon Border Adjustment Mechanism (CBAM), and sets the coal power plant shut-off date for 2030.

Key priorities for 2024

- **Long-term growth could be boosted by increasing public investment.** Given the availability of fiscal space and existing infrastructure gaps, the authorities should scale up investments that promote growth and the green economy, in addition to improving the capacity of the public administration to implement public investments.
- **More preparation is needed for the EU's CBAM.** Efforts should be intensified given the country's target to introduce a carbon emissions trading scheme by 2026, including aligning excise rates on fossil fuels with the EU acquis, redirecting fossil fuel subsidies to renewable energy sources, and continuing electricity tariff reforms.
- **Faster alignment of the country's legal framework with the EU acquis is necessary to advance the EU accession process.** Alignment of domestic legislation with the EU should follow the 14 priorities set out by the European Commission, leveraging the reform momentum brought on by the country's fresh candidacy status.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.8	-2.9	7.3	3.8	1.5
Inflation (average)	0.6	-1.1	2.0	14.0	5.5
Government balance/GDP	1.4	-4.6	0.6	0.9	-1.1
Current account balance/GDP	-2.5	-2.8	-1.7	-4.5	-4.3
Net FDI/GDP [neg. sign = inflows]	-2.0	-2.0	-2.6	-3.0	-2.4
External debt/GDP	62.1	66.9	55.5	52.1	n.a.
Gross reserves/GDP	34.5	39.0	40.8	35.3	n.a.
Credit to private sector/GDP	57.2	57.7	53.3	48.1	n.a.

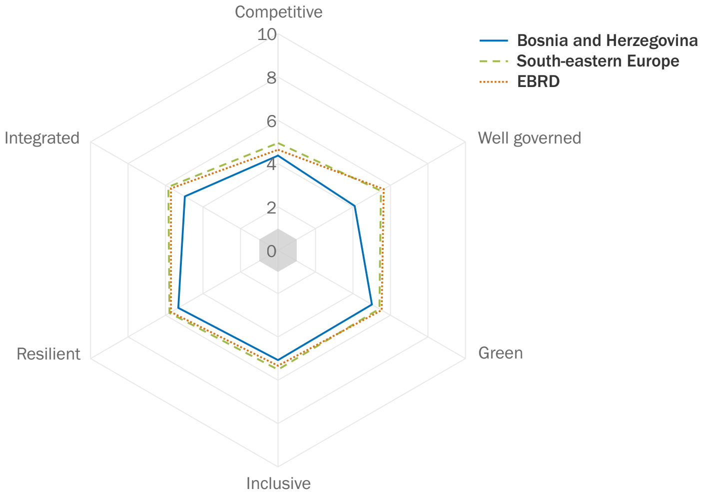
Macroeconomic developments and policy response

Economic growth is slowing. Following robust growth of 3.8 per cent in 2022, the economy expanded by just 1.4 per cent year on year in the first half of 2023, partly due to the slowdown in external demand. As the sizeable industrial sector contracted by 4 per cent in real terms and the net export position deteriorated in the first half of the year, growth was mainly supported by investment on the expenditure side and services (notably retail, tourism and information and communication) on the production side. Mildly negative import growth exceeded export growth (with exports contracting by 4 per cent year on year), and the current account deficit, which doubled in 2022, remained elevated in the first half of 2023. In the face of persistently high inflation, household consumption remained muted despite stable credit growth and consistently high remittance inflows of around 7 per cent of gross domestic product (GDP).

The authorities have used fiscal policy measures to mitigate the effects of inflation. Annual inflation peaked at 17.4 per cent in October 2022 but dropped to 4.1 per cent by September 2023, reflecting global disinflation trends and slowing domestic demand. The authorities continued to employ expansionary fiscal policy in 2023 to protect the population's disposable incomes, including minimum wage increases from the beginning of the year and pension adjustments in both entities, alongside one-off aid to veterans and a cut in wholesale gas prices in the FBiH. Most price control measures have expired, as did the export ban on firewood and pellets in January 2023 and that on logs in July 2023. The central bank increased remuneration rates on required reserves of banks from July 2023, in line with International Monetary Fund (IMF) recommendations and with the goal of narrowing the interest rate gap with the eurozone. A measure limiting retailers' profit margins on essential food and household items was put in place in the FBiH in August 2023, and in the RS in October 2023.

Economic growth is expected to be subdued in the short term, as risks tilt towards the downside. GDP growth is forecast at 1.5 per cent in 2023 and 3 per cent in 2024. The worsening outlook stems from the persistently high inflation rate eroding disposable incomes, the expected further deterioration of net exports due to the ongoing slowdown in the eurozone and other export markets, as well as tighter financing conditions. Domestic political issues are also a risk to the outlook, as witnessed by recent delays to foreign-funded infrastructure projects in the RS. On the positive side, the country's EU candidacy status and relatively quick state- and entity-level government formation may accelerate reforms.

Assessment of transition qualities (1-10)



Structural reform developments

A set of energy laws has been adopted. The FBiH adopted three new laws in July 2023 on: (i) electricity, (ii) energy and the regulation of energy activities, and (iii) the use of renewable energy sources and efficient cogeneration. The laws are set to streamline administrative procedures for the construction and operation of renewable energy facilities, and reform the incentives system for renewable energy so that feed-in tariffs for small plants and feed-in premiums for large plants are determined through auctions. The legislation introduces new categories of participants in the electricity market, such as the "energy community", the "storage operator", and the "prosumer" (an entity producing electricity mainly for self-consumption). A similar piece of legislation, the Law on Renewable Energy Sources, is already in place in the RS, but that law allows bidding procedures to determine incentives for larger renewable capacities only. From January 2023 electricity prices in the RS have been pegged to consumption through block tariffs. From June 2023 issuing bodies in the RS can also issue guarantees of origin for electricity, enabling trading in line with EU rules.

The draft NECP has been approved by the government and has undergone public consultation. The draft NECP takes into account the EU's upcoming CBAM and plans for the introduction of a carbon emissions trading scheme by 2026, while setting the shut-off date for coal power plants at 2030. While the draft plan states there will be no new fossil fuel plants, Tuzla 4 and Kakanj 5, two highly polluting thermal power plants, are set to continue operating beyond their allowed lifetime under the opt-out regime of the EU's Large Combustion Plant Directive, thus breaching the country's obligations under the Energy Community Treaty. Nonetheless, the draft NECP sets an ambitious target for 70 per cent of gross final consumption of electricity to come from renewable sources in 2030 (compared with some 50 per cent in 2022). Public consultation for the document was open until the end of July 2023.

A set of laws related to EU accession has been adopted. The parliament of Bosnia and Herzegovina adopted in August 2023 the Law on the Ombudsman, the Law on Access to Information, the Law on Foreigners and the Law on Wines, while another important piece of legislation, the Law on High Judicial and Prosecutorial Council, was adopted in September. These laws are in line with some of the 14 priorities set out in 2019 by the European Commission in the Opinion on Bosnia and Herzegovina's application for EU membership.

Public enterprise oversight units have been established in both entities. This is an important step for the broader reform of public enterprises, as it should help improve transparency regarding their operations. The RS unit has been up and running since March 2023 but the FBiH unit is yet to be staffed. A registry of public enterprises in the FBiH is available online, now with complete financial reporting, while the RS is working on a roadmap for a comprehensive fiscal risk assessment of public enterprises, according to the IMF.

Bulgaria

Highlights

- **Economic growth is slowing.** Gross domestic product (GDP) growth reached 3.9 per cent in 2022, but momentum waned in the first half of 2023 amid a slowdown in investment and weaker external demand.
- **The new coalition government has committed to far-reaching judicial reform.** It is expected that constitutional amendments will be adopted to reform the Supreme Judicial Council, Office of the Chief Prosecutor and anti-corruption entities.
- **Legislation has been adopted to promote the deployment of renewable energy sources.** A legislative framework for offshore wind energy entered into force in January 2023, and the minimum amount of installed capacity subject to licensing was increased. Other initiatives are also progressing, including to develop a renewable energy storage system.

Key priorities for 2024

- **Recovery and Resilience Plan (RRP) implementation should be accelerated.** Bulgaria received its first disbursement from the Recovery and Resilience Facility (RRF) at the end of 2022, and the government submitted a second payment request in October 2023. It is important to show tangible progress on the high number of deliverables to which the authorities have committed.
- **Prerequisites for euro adoption should be finalised.** Having made the decision to delay eurozone accession by another year, the authorities should ensure that all necessary reforms and legal requirements are completed by the middle of 2024.
- **Stronger commitment to decarbonising the energy sector is needed.** Although some of the green transition reforms and investments listed in the RRP are ongoing, the energy sector as a whole, particularly the part based on coal production, needs to be transformed more quickly if it is to align with European Union (EU) targets.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.0	-4.0	7.7	3.9	1.6
Inflation (average)	2.5	1.2	2.8	13.0	8.5
Government balance/GDP	2.1	-3.8	-4.0	-2.9	-2.8
Current account balance/GDP	1.9	0.0	-1.7	-1.4	0.0
Net FDI/GDP [neg. sign = inflows]	-2.0	-4.5	-1.8	-2.5	n.a.
External debt/GDP	61.3	63.3	58.1	52.3	n.a.
Gross reserves/GDP	40.4	50.1	48.7	45.4	n.a.
Credit to private sector/GDP	48.9	51.0	47.9	45.2	n.a.

Macroeconomic developments and policy response

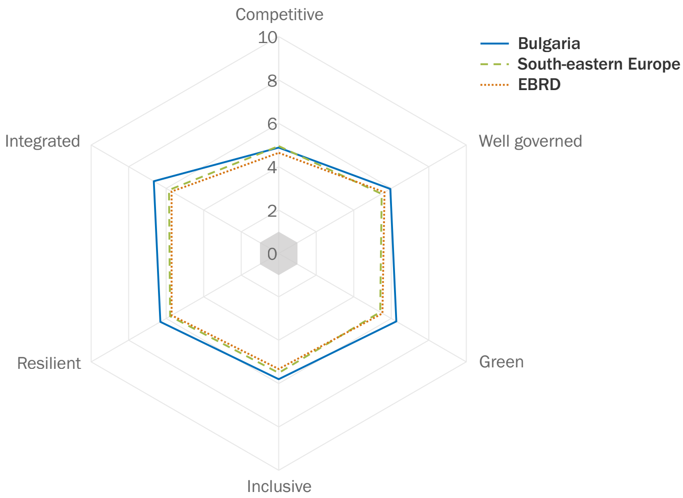
The economy is slowing considerably. After expanding by 3.9 per cent in 2022, the economy has been cooling in 2023 amid weaker external demand and a contraction of public spending and investments. In the first half of 2023 GDP grew 2 per cent year on year, thanks to the surprising resilience of private consumption, which increased by 7.2 per cent. Exports recorded a year-on-year decline of 1.3 per cent in the first six months of 2023. Imports, meanwhile, fell 7 per cent on the year in the first half of 2023, leading to a considerable drop in the trade deficit. Raw materials and energy exports slumped in the first few months of 2023 owing to a drop in coal and nuclear electricity production, and to a moderation in market prices, which rendered Bulgarian electricity less competitive. The fall in exports is also reflected in the year-on-year decline of manufacturing since March 2023. After a strong rebound in the second half of 2022, investments slumped again in the first half of 2023.

Inflation is moderating from a relatively high peak. Consumer price inflation peaked at 18.7 per cent in September 2022, largely driven by food prices. Inflation had dropped notably to 6.3 per cent by September 2023, with most components on a disinflationary trend, though energy tariffs were raised recently. Nominal wage growth has been strong in the past year and reached 17.3 per cent year on year in the first quarter of 2023, before moderating to 13.1 per cent in the following quarter. Since September 2022, real wage growth has turned positive, supporting household consumption.

The fiscal deficit is narrowing. The new parliament adopted a revised 2023 budget in late July that set a government deficit target for the year of just 3 per cent of GDP, well below that set by the provisional government. The administration plans to achieve the lower deficit through better tax collection, measures such as tighter customs and controls obliging firms with more than 100 employees to pay salaries solely through banks. The cash-based budget had recovered to a surplus of 0.3 per cent of GDP by July 2023. Subsidised electricity costs for firms, a key support measure during the energy crisis, have been extended to the end of 2023, but the budgetary cost is expected to be minimal amid lower electricity prices and a contribution from the windfall revenues of state-owned enterprises.

Lower public spending and weak foreign demand are the main drivers of slower growth. Considering how the economy performed in the first half of 2023, we forecast GDP growth for the year as a whole at 1.6 per cent. This downturn in growth relative to 2022 is driven by weaker investments and negative net exports, offset by still resilient private consumption. The planned fiscal consolidation will also lead to lower government spending. The economy should rebound by 2.6 per cent in 2024, by our forecasts, supported by lower inflation, the accelerated absorption of EU funds and revived foreign demand. Another energy price shock and the protracted weakness of key trading partners are the main downside risks.

Assessment of transition qualities (1-10)



Structural reform developments

The European Commission has closed the Cooperation and Verification Mechanism (CVM) for Bulgaria. In June 2023 the authorities reported that the last deliverable from the 2019 evaluation, related to the accountability and criminal liability of the chief prosecutor, had been fulfilled, prompting the closure of the CVM. Nevertheless, Bulgaria will still be monitored through the rule of law mechanism. In addition, the July 2023 report noted, among six recommendations issued, that there had been limited progress compared to last year on addressing high-level corruption and improving the functioning and independence of the Supreme Judicial Council.

Judicial reforms are advancing, including changes to the constitution. The new government has agreed to amend some of the constitution's key articles, including those relating to the term and powers of the chief prosecutor and the Supreme Judicial Council, and to introduce term limits for municipal mayors. The National Investigation Service was separated from the Office of the Chief Prosecutor in June 2023 to become an independent structure in the justice system. The Anti-Corruption Commission was split into two entities, an anti-corruption committee and a committee for seizing property, after the anti-corruption law was amended in September 2023. In July 2023 the European Commission's Rule of Law Report reiterated the need for progress on reforming the Supreme Judicial Council, tackling high-level corruption more effectively and applying integrity standards to people in high-level positions.

Parliament has updated the country's anti-money-laundering framework and public procurement law amid European Commission infringement procedures. In June and July 2023 the Commission announced that it had opened infringement cases against Bulgaria for the incomplete transposition of the EU Anti-Money-Laundering Directive (2018/843) and for outstanding shortfalls in public procurement legislation. In June 2023 parliament adopted amendments to the Prevention of Money Laundering Act to align the legislation with the latest recommendations of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL). In addition, the government proposed a series of changes to the Public Procurement Act to align it with RRP commitments and EU law, largely to streamline and safeguard the tendering process.

Amendments to the insurance bill were adopted as part of requirements for eurozone accession. In July 2023 and after significant delays, parliament adopted changes to national insurance legislation to align it with EU law. The updated law obliges insurers to compensate clients without delay and to refrain from disputing any claims for accidents abroad that are covered by the European Green Card system. Outstanding reforms needed for euro adoption include legislation on personal bankruptcy, amendments to commercial insolvency law and an update to the Law on the Bulgarian National Bank. The latter proposed law was well received by the European Commission and should be adopted by the parliament by the end of 2023.

Parliament adopted the act transposing the EU Whistleblowing Directive (2019/1937). In January 2023, after a delay of more than a year, parliament adopted a bill to transpose EU regulation on the protection of whistleblowers. The act entered into force in May 2023 and obliges firms with more than 50 employees to set up internal whistleblowing channels and procedures by December 2023.

Adjustments to the energy act were made to enable the deployment of renewable energy sources. In early 2023 parliament adopted several amendments to legislation regulating the energy sector to stimulate the development of renewable energy sources. The minimum amount of installed capacity subject to licensing was raised from 5 MW to 20 MW. The act also introduced a framework for energy storage, which is critical for balancing an electricity system based on renewable energy. Another important piece of legislation was an act regulating offshore wind development, which entered into force in January 2023 and sets out the deployment of 62 GW of capacity under the contracts-for-difference mechanism.

Bulgaria aims to double its gas storage capacity while infrastructure is being developed. Bulgartransgaz, the natural gas transmission and storage system operator in Bulgaria, announced in January 2023 that the capacity of the main gas storage facility in the village of Chiren would be expanded to 1 billion cubic metres. The project will also replace outdated Soviet equipment with American technology and will be completed within two years. In addition, the gas pipeline link to Serbia is now under construction and should be operational by the end of 2023.

Kosovo

Highlights

- **Economic growth continues at a robust rate.** Output growth in the first half of 2023 was led by a strong performance of service exports, driven by the tourism and information and communications technology (ICT) sectors.
- **The authorities have renewed engagement with the International Monetary Fund (IMF) under two disbursing programmes.** A two-year precautionary Stand-by Arrangement (SBA) is expected to provide liquidity in case downside risks materialise, while the Resilience and Sustainability Facility (RSF) will provide affordable financing to support Kosovo's climate change mitigation and adaptation efforts.
- **Kosovo has adopted an energy strategy and launched renewable energy auctions.** The energy strategy affirms that coal plants will be phased out by 2050 and includes plans to scale up renewable energy capacity significantly. Kosovo's first renewable energy auction for solar electricity generation was launched as one of the first steps.

Key priorities for 2024

- **Public investment should be accelerated.** As the authorities take steps to address bottlenecks in public investment management, including through structural benchmarks of the SBA with the IMF, there is space to step up investment, thereby boosting both short- and medium-term growth prospects.
- **Energy sector reforms and targeted support for vulnerable groups are needed to support the country's green transition.** Higher electricity tariffs and the elimination of blanket subsidies should be accompanied by a new definition of vulnerable energy consumers, enabling those most in need to receive support.
- **The recent increase in public sector wages should be accompanied by efficiency gains.** The authorities should improve the financial oversight and accountability of oversized and loss-making public enterprises, a key source of inefficiency.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.8	-5.3	10.7	5.2	3.5
Inflation (average)	2.7	0.2	3.3	11.7	4.7
Government balance/GDP	-2.9	-7.8	-1.2	-0.7	-2.3
Current account balance/GDP	-5.7	-7.0	-8.7	-10.5	-8.1
Net FDI/GDP [neg. sign = inflows]	-2.7	-4.2	-4.0	-6.2	-4.5
External debt/GDP	31.0	37.0	37.1	38.5	n.a.
Gross reserves/GDP	12.2	13.3	13.8	13.2	n.a.
Credit to private sector/GDP	42.0	45.5	43.5	40.4	n.a.

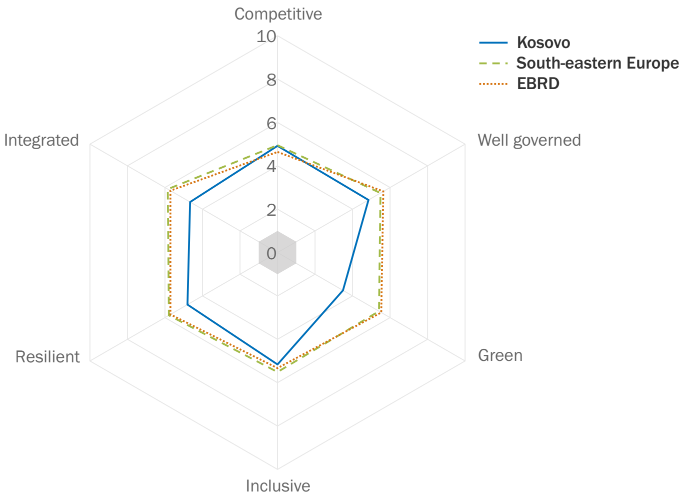
Macroeconomic developments and policy response

The economy has continued to grow in 2023, despite headwinds. Following an expansion of 5.2 per cent in 2022, supported by heightened external demand, gross domestic product (GDP) growth moderated to a robust 2.9 per cent year on year in the first half of 2023, reflecting continued favourable movements in the net export position. Diaspora-related (financial) inflows supported a 6 per cent increase in the retail and tourism sector and boosted service exports which grew by 19 per cent year on year in the first half of 2023, offsetting the contraction of goods exports. With moderate import growth, the net export position moved in a positive direction in the first half of the year. The current account deficit also narrowed by 23 per cent year on year in the first seven months of 2023 but remains elevated compared with the 2019-21 average. Household consumption growth remained positive (growing by 2 per cent year on year) despite persistently high inflation, helped by robust remittances (14 per cent of GDP in the first half of the year), double-digit credit growth to households and a long-awaited hike in public sector wages. Investments remained sluggish, however, reflecting a low level of public investment.

Fiscal measures to support the economy are becoming more targeted. Annual inflation reached 14.2 per cent in July 2022, driven by higher food and oil prices, gradually decelerating to 2.4 per cent in July 2023 before picking up again to 4.2 per cent in September. The energy regulator ended the freeze on electricity tariffs introduced in 2022 by approving an almost 15 per cent tariff increase, effective from April 2023. Meanwhile, the government scaled up subsidies for households that reduce their electricity consumption and for purchases of energy efficiency equipment. The coefficient for public sector wages was raised in February 2023, with the average salary in the public sector increasing by 15 per cent on the year the same month, while in July 2023 the parliament approved a minimum wage increase of 103 per cent for employees under 35 years of age, and an increase of 55 per cent for workers over 35. Public debt remains low, at an estimated 20 per cent of GDP at the end of 2022, allowing space for increased public investment, as envisaged under the SBA with the IMF.

Growth will continue in the short term, but downside risks are significant. GDP growth is forecast to reach 3.5 per cent in 2023, rising to 4 per cent in 2024. Downside risks to the outlook include stickier-than-expected inflation, lower-than-planned public investments and rising geopolitical uncertainty which may negatively affect domestic demand, trade flows, the availability of international funding and investor confidence.

Assessment of transition qualities (1-10)



Structural reform developments

Reform efforts have been somewhat stalled by rising political tensions related to the situation in northern Kosovo and the European Union (EU)-facilitated dialogue with Serbia. In response to the authorities' failure to take measures requested by the EU for a de-escalation in the north of Kosovo, the European Commission decided to take a number of "temporary and reversible" measures, including putting on hold the work of the Stabilisation and Association Agreement bodies and the programming of funds for the Instrument of Pre-accession Assistance (IPA) exercise in 2024 under the Western Balkans Investment Framework (WBIF). The Commission's measures also put on hold the signing of new contracts and suspended high-level meetings (other than those focused on addressing the crisis). In September 2023 the EU indicated that it could impose further measures on both parties if no progress was made in the de-escalation and implementation of the commitments under the Agreement on the path to normalisation between Kosovo and Serbia.

Public sector wage reforms are advancing. The main aims of the reforms are to create a uniform and transparent system of salaries and compensate for real wage losses. The law governing public sector wages was approved in parliament at the end of 2022, following a months-long strike by public sector employees. The legislation entered into force in February 2023, following a significant decrease in real wages in the public sector in the preceding two years.

Renewed engagement with the IMF is alleviating liquidity risks and supporting the greening of the economy. A €100 million two-year precautionary SBA, approved by the IMF Board in May 2023, is expected to provide liquidity in case downside risks materialise, including from Russia's war on Ukraine. The €78 million RSF, approved alongside the SBA, will in turn provide affordable financing for Kosovo's climate change mitigation and adaptation efforts, including through greener electricity production and more efficient energy use. It is also expected to act as a catalyst for other climate financing. Kosovo is the first European country to access the RSF.

A new energy strategy sets ambitious targets for renewable energy generation. The strategy for the 2022-31 period, adopted in March 2023, affirms that coal plants will be phased out by 2050 but envisages modernisation works on three coal-powered thermal power plant units, given that at present some 90 per cent of the country's electricity is produced from lignite. The country is planning to reach a total of 1.6 GW in renewable capacities (up from around 300 MW of existing capacity) by 2031, while a carbon pricing system is to be introduced by 2025. As one of the initial steps, Kosovo's first renewable energy auction for solar electricity generation was launched in May 2023 for 100 MW under a 15-year power purchase agreement with the national market operator, with an extended deadline for bids of the end of January 2024. Market integration with Albania is expected by the end of 2023, as the Albanian Power Exchange (ALPEX), which is now operational, was awarded nominal electricity market operator status in both countries in July 2023, paving the way for market coupling.

Kosovo is revising its policies on attracting foreign direct investment (FDI). The new Law on Sustainable Investment, which aims to accelerate investment into the country while ensuring an equal environment for foreign and domestic investors, passed the first reading in parliament in May 2023. The law foresees the establishment of a new agency within the prime minister's office, which will replace the Kosovo Investment Enterprise and Support Agency (KIESA) in functions related to FDI facilitation and export promotion, with a platform for public-private dialogue to be established within the agency.

A new sovereign fund will manage key public enterprises. A draft law establishing the sovereign fund passed first reading in parliament in July 2023. The five largest public enterprises (out of 18 in total), including the national telecommunications, railway, mining and postal companies, will be transferred to the fund, which will operate as an autonomous public institution under the Assembly. In an additional step to strengthen the management of public enterprises, the authorities have committed to publishing timely quarterly and annual financial reports on those enterprises under the ongoing SBA with the IMF.

Montenegro

Highlights

- **Economic growth has remained strong in 2023.** The economy continued its robust expansion in the first half of 2023 and the tourism sector is on course to exceed pre-pandemic levels in 2023.
- **Tax changes aimed at boosting revenues have been adopted.** The amendments introduce progressive taxation of real-estate sales, higher corporate income taxes for offshore companies and an increase in excise duties on sweets, single-use plastic, tobacco and online gaming.
- **The state-owned electricity company, Elektroprivreda Crne Gore (EPCG), is undertaking its first utility-scale renewable energy investment.** A new 55 MW onshore wind farm near the village of Gvozd in the Nikšić municipality will help the company to accelerate its decarbonisation plan and the country with its broader energy transition.

Key priorities for 2024

- **Systemic measures are needed to support medium-term fiscal sustainability.** Adopting a medium-term fiscal framework and establishing the fiscal council would help govern a much-needed return to fiscal consolidation in an environment of elevated borrowing costs.
- **Enhancing the business environment would encourage investment.** A more efficient public administration system (to streamline, in particular, the burden stemming from local administration and para-fiscal charges), and more transparent and cohesive economic policymaking are needed to improve investor confidence in uncertain times.
- **The country would benefit from accelerating the pace of green transition.** The National Energy and Climate Plan (NECP), set to govern Montenegro's energy transition, and the country's first law on renewable energy, have not yet been adopted.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.1	-15.3	13.0	6.4	3.5
Inflation (average)	0.4	-0.3	2.4	13.1	8.3
Government balance/GDP	-1.8	-10.9	-1.7	-4.2	-1.7
Current account balance/GDP	-14.3	-26.0	-9.2	-13.2	-10.7
Net FDI/GDP [neg. sign = inflows]	-6.2	-11.2	-11.7	-13.2	-8.0
External debt/GDP	167.4	221.6	191.7	157.9	n.a.
Gross reserves/GDP	27.6	41.5	35.3	32.3	n.a.
Credit to private sector/GDP	51.3	55.7	56.2	55.7	n.a.

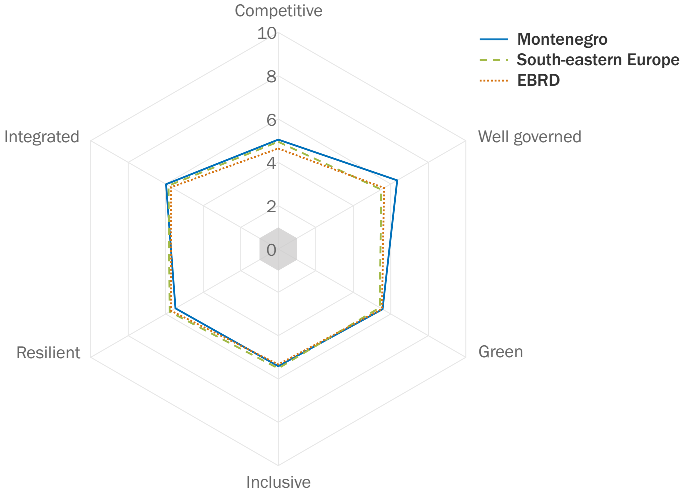
Macroeconomic developments and policy response

Strong economic growth has continued in 2023. The economy grew by 6.4 per cent in 2022, boosted by robust household consumption and a strong performance by the hospitality sector. Gross domestic product (GDP) growth accelerated to 6.6 per cent year on year in the first half of 2023 as household consumption expanded by 10 per cent year on year, driven by the large increase in arrivals from abroad, partly reflecting the substantial inflows of Russian and Ukrainian immigrants. A record year for the tourism sector is anticipated for 2023 as a whole, with foreign tourist arrivals up by 25 per cent year on year and by 13 per cent in the first eight months of 2023 compared with record 2019 levels. Tourism revenues have nearly doubled on an annual basis, while retail trade expanded by 16 per cent in the first half of the year. Economic growth was supported by investment on the expenditure side and a 4 per cent annual increase in industrial output on the production side, driven by an increase in electricity production resulting from favourable rainfall patterns for hydropower generation. The current account deficit in the first half of 2023 remained unchanged from the same period of 2022, as strong service exports offset higher goods imports.

Limited targeted fiscal measures have been introduced. Annual inflation peaked at 17.5 per cent in November 2022, decelerated to 6.9 per cent in July 2023 before picking up again to 7.9 per cent year on year in September. Net nominal wages maintained strong annual growth of 11 per cent in August 2023, given the 80 per cent minimum wage hike and the abolition of healthcare contributions that took place in 2022, and spurred on by an increase in most public sector wages from the beginning of 2023. A set of tax changes was introduced in July 2023 with the aim of boosting budget revenues, and the government brought in lower excise duties on fuel for farmers, fishermen and some transport companies. An extraordinary adjustment in the minimum pension, set to benefit a third of Montenegrin pensioners, was enacted from October 2023. Following several years of elevated fiscal spending (with the government budget deficit for 2022 coming in at 4.2 per cent of GDP), the budget deficit target for 2023 was revised to 2.9 per cent of GDP in May 2023 (down from 5.9 per cent), on account of higher revenues from the EU Energy Support Package and elevated inflation, which boosts government revenues. General government debt has decreased from its peak at 107 per cent of GDP in 2020 but remained elevated at 72 per cent of GDP at the end of 2022.

Growth is projected to slow down amid elevated uncertainty. GDP growth is forecast at 3.5 per cent in 2023 and 3.7 per cent in 2024, with the weak global growth outlook dampen short-term prospects. Nonetheless, strong private consumption and the robust performance of the hospitality sector tilt the risks to the outlook towards the upside. A potential resolution of the current political deadlock presents further upside potential, as this would allow the implementation of the economic reform agenda to resume and public investments to move forward.

Assessment of transition qualities (1-10)



Structural reform developments

Energy market reforms have advanced. A new day-ahead market, launched in April 2023 on the Montenegrin Power Exchange (MEPX), is expected to lead to a more liquid and transparent market. It will benefit both consumers and producers by ensuring fair prices and leading to better integration of energy systems in the Western Balkans and the broader region.

Parliament has enacted a set of amendments to tax laws. The main aims are to reduce tax fraud, bring about environmental and health benefits, and enhance revenues. The amendments, adopted in February 2023 and valid from 2024, introduce progressive taxation of real-estate sales and higher corporate income taxes for offshore companies, as well as higher excise duties on sweets, single-use plastic, tobacco and online gaming. As per amendments to the Budget Law, Montenegro will also establish a fiscal council, an independent body tasked with evaluating the country's fiscal policy and providing recommendations.

Reform and privatisation of state-owned enterprises (SOEs) have been slow. There has been no progress on the previously planned state ownership strategy, the establishment of a list of key companies remaining in state ownership, or plans to improve SOE management and financial performance. Due to a lack of political consensus, a holding company managing SOEs has also not been set up, and the unit in the Ministry of Finance monitoring SOE fiscal risks has been scaled down. Privatisation has also not progressed: the state has instead increased its share in certain SOEs (the Simo Milosevic health institute, Meljine hospital, Plantaze winery and the Bar sea port).

The legal framework for doing business is being enhanced. A public consultation was completed in September 2023 for two key laws on the business environment in Montenegro: the Law on Companies and the draft Law on the Registration of Business and Other Entities. The amendments to the Law on Companies aim to enhance the environment for doing business by harmonising regulations further with three European Union (EU) directives on the use of digital tools and processes, cross-border mergers and divisions, and shareholder engagement. The draft Law on the Registration of Business is a new, complementary piece of legislation governing how businesses are registered (which has so far been regulated through the Law on Companies), which aims to simplify the registration process while increasing the transparency of data and documentation, in line with the EU acquis.

The state-owned electricity company, EPCG, is undertaking its first utility-scale renewable energy investment. A new 55 MW onshore wind farm near the village of Gvozd in the Nikšić municipality will help the company accelerate its decarbonisation plan and the country with its broader energy transition. Once completed, the Gvozd wind farm is expected to generate enough renewable energy output to supply more than 25,000 households per year. It is a milestone project for EPCG, being its first major new-generation asset in more than 40 years, as well as its first wind farm.

An action plan has been adopted to operationalise the Strategy for the Development of Women's Entrepreneurship. An action plan for the 2023-24 period was adopted in July 2023 and focuses on three strategic priorities: enhancing the business environment for women in business, supporting the competitiveness of female-owned businesses, and improving the position of women in business.

North Macedonia

Highlights

- **Economic growth has slowed in 2023.** The economy grew more slowly in the first half of 2023 than it did in 2022, as weakening domestic demand was only partially offset by lower imports and higher net exports.
- **A two-year Precautionary and Liquidity Line (PLL) arrangement with the International Monetary Fund (IMF) is ongoing.** The structural conditionalities under the arrangement focus on the energy sector and the fiscal impact of a large infrastructure project. The first review was planned for May 2023, but has been delayed.
- **Renewable energy sources are being commissioned at an enhanced rate.** In the first half of 2023 the Energy and Water Services Regulatory Commission issued licences for electricity production from renewable energy sources to 278 planned power plants, more than it issued in the whole of 2022.

Key priorities for 2024

- **Continued fiscal consolidation under the new fiscal rules is needed.** The authorities should follow up on commitments made under the PLL arrangement with the IMF to continue reducing the budget deficit in the medium term, returning the deficit to limits envisaged under the Organic Budget Law.
- **Public investments need enhanced evaluation, implementation and monitoring.** The first step set out in an action plan created in response to the IMF's Public Investment Management Assessment (PIMA) is to establish a PIMA unit within the Ministry of Finance.
- **Reform efforts and public investment in the transmission network should complement private-sector investment in renewable energy sources.** The draft National Energy and Climate Plan should be updated to reflect the aftermath of the energy crisis. Investments should be made in the transmission network and in making systems more flexible to ensure that renewable energy capacity can be integrated into the power grid. Electricity subsidies, which are still high, should be increasingly directed towards vulnerable groups.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.9	-4.7	3.9	2.1	2.0
Inflation (average)	0.8	1.2	3.2	14.2	10.0
Government balance/GDP	-2.0	-8.0	-5.4	-4.5	-4.7
Current account balance/GDP	-3.0	-2.9	-2.8	-6.0	-3.3
Net FDI/GDP [neg. sign = inflows]	-3.2	-1.4	-3.3	-5.1	-5.2
External debt/GDP	72.4	78.7	81.9	83.6	n.a.
Gross reserves/GDP	29.0	31.0	31.2	29.9	n.a.
Credit to private sector/GDP	46.7	51.6	50.8	52.4	n.a.

Macroeconomic developments and policy response

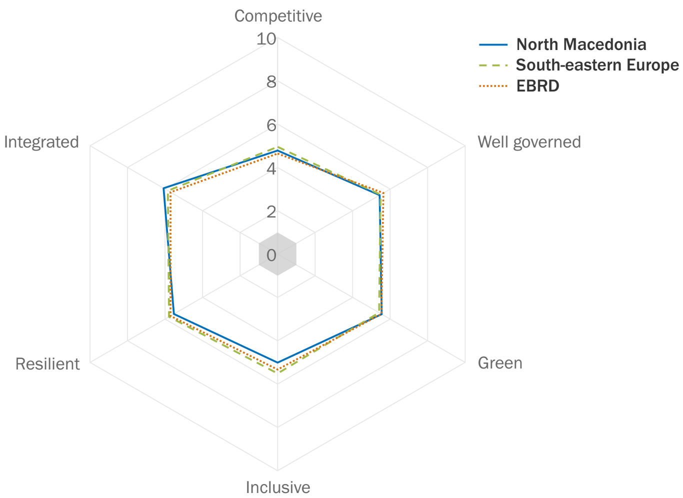
Economic growth continues at a moderate pace. Gross domestic product (GDP) growth slowed to 2.1 per cent in 2022 and moderated further to 1.6 per cent year on year in the first half of 2023 as household consumption growth slowed despite elevated inflation. Net exports turned more favourable in the first half of the year amid a contraction in imports. Exports maintained a positive growth rate in the first quarter of the year, boosted by strong electricity production, before contracting in the second quarter in line with subdued external demand. The current account narrowed to near zero in the first half of the year in line with favourable movements in the trade balance and a sharp increase in remittances. Retail trade performance remained strong, going beyond double-digit growth rates and driving growth on the production side. Meanwhile, the construction sector entered a deep contraction in the second quarter of the year, stifling growth.

Monetary and fiscal measures are supporting the economy amid inflationary shocks. Annual inflation peaked at 19.8 per cent in October 2022 and gradually decelerated to 6.6 per cent in September 2023. The National Bank of the Republic of North Macedonia tightened monetary policy in the past 18 months, raising the policy rate several times, from an all-time low of 1.25 per cent in April 2022 to 6.3 per cent in September 2023. As inflation was largely driven by food prices, the government imposed price caps on basic foodstuffs (including the most popular types of bread, dairy products, pasta, eggs, rice and some fruit and vegetables) in April 2023, before lifting the caps in June, citing favourable market conditions. The parliament approved a pension increase, valid from March 2023, and a hike in the minimum wage effective from April 2023.

The country has turned to external funding to satisfy elevated liquidity needs. In light of a Eurobond repayment coming due, the authorities returned to the external market in March 2023 via a four-year Eurobond of €500 million issued at a 6.96 per cent yield. The issuance came after a month-long delay owing to a government reshuffle and was oversubscribed, with order books exceeding €2 billion. Alongside the ongoing IMF programme, the European Union's (EU) €80 million budget support grant and €100 million in macro-financial assistance are helping to finance the budget deficit. The European Central Bank has extended the duration of a €400 million repo line to the National Bank of the Republic of North Macedonia by another year, until January 2024.

Slow growth is forecast in the short run. Despite the expansionary fiscal policy measures, household demand is set to remain moderate in the short term as inflation is still high. The slowdown in North Macedonia's main trading partners will continue to affect exports, alongside increased uncertainty and tighter financing conditions, which may weigh on investor confidence. GDP growth is therefore likely to remain modest, at around 2 per cent in 2023, before accelerating to 3 per cent in 2024 on the back of an expected global recovery.

Assessment of transition qualities (1-10)



Structural reform developments

A domestic day-ahead power trading platform has been launched. The platform, which was launched in May 2023, aims to encourage investment in renewable energy production and help to make energy systems more stable by providing clear and transparent pricing signals.

Renewable energy sources are being commissioned at an enhanced rate. In the first half of 2023 the Energy and Water Services Regulatory Commission issued licences for electricity production from renewable energy sources for 278 planned power plants, more than were issued in the whole of 2022. According to the regulatory authority, the total installed capacity of the planned power plants licensed in the 18 months from January 2022 to June 2023 amounted to 270 MW, enough to power 104,000 average households if the investments are fully realised.

A two-year PLL arrangement with the IMF is in place, but the first review has been delayed. The IMF Board approved the arrangement in November 2022, providing upfront access to €530 million. The structural conditionalities under the arrangement include gradually eliminating electricity subsidies, improving energy efficiency, and producing a comprehensive and independent study to monitor fiscal risks stemming from the Corridor VIII and Corridor X-d road project. The first review was planned for May 2023, but had not taken place by early September as the impact of the project on public finances was still being assessed. Satisfactory implementation of the arrangement is also a condition for the disbursement of €100 million in macro-financial assistance from the EU, approved in June 2023.

Additional measures and regulations have been introduced to preserve financial stability. The measures are in line with the provisions of the Law on Financial Stability, which was adopted in July 2022. The Financial Stability Committee was set up and held its first meeting in November 2022, and submitted its first annual financial stability report to parliament at the end of March 2023. A decision on the credit risk management methodology was adopted in February 2023 that aims to strengthen the management of non-performing and restructured loans and is due to enter into force in 2024. The National Bank of the Republic of North Macedonia also introduced borrower-focused macroprudential measures (caps on loan-to-value and debt service-to-income ratios) in the first half of 2023 to help contain risks, particularly in the real-estate sector. A new law on bank resolution, adopted in October 2023, introduces a comprehensive framework for addressing problems in troubled financial institutions, including through the establishment of a bank resolution fund.

Tax reform has begun. In line with amendments to the Law on Personal Income adopted at the end of 2022, progressive taxation, which had been set to enter into force from 2023, was abolished. Taxation of interest on savings was postponed until the country accedes to the EU. In turn, the amendments aim to broaden the tax base by targeting undue exemptions and reliefs in the existing system. The amendments are part of a broader effort to reform the taxation system and include amendments to the corporate income tax and value-added tax (VAT) regime adopted by the government in December 2022, but not yet by the parliament (as at September 2023).

Romania

Highlights

- **The economy has slowed after resilient growth in 2022.** Despite numerous headwinds, gross domestic product (GDP) growth reached 4.7 per cent in 2022, but then slowed markedly in the first half of 2023 on the back of falling industrial production and moderating consumption.
- **Reform delays under the Recovery and Resilience Plan (RRP) are accumulating.** As of the end of September 2023, the government was behind on implementing the RRP, delaying future disbursements. For the third payment request, delays relate to investments and reforms in green transition and energy storage, and to corporate governance improvements at state-owned enterprises (SOEs).
- **Hidroelectrica's initial public offering (IPO) has boosted the local stock market.** The large listing brought new investors to the local stock market, boosting its liquidity and regional attractiveness, and acting as a model for the potential listing of other SOEs.

Key priorities for 2024

- **The administrative capacity to implement the RRP needs to be improved.** With increasing delays in reaching RRP milestones, the authorities need to allocate sufficient resources and organise those institutions responsible for delivering the requisite reforms and investments.
- **Fiscal consolidation should be achieved through systematic fiscal reform.** In line with recommendations from the European Union (EU) and other international organisations, the authorities should embark on creating a more efficient, inclusive and straightforward tax system that will yield higher fiscal revenues.
- **Continued reforms and investments aimed at greening the energy sector are needed.** Romania has great potential to develop its renewable energy market, supported by EU funds and associated recent reforms. More work is needed to integrate renewable energy into the grid and adopt a regulatory framework for offshore wind energy.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.8	-3.7	5.9	4.7	1.8
Inflation (average)	3.8	2.6	5.0	13.8	10.7
Government balance/GDP	-4.6	-9.6	-6.7	-5.8	-6.3
Current account balance/GDP	-4.9	-4.9	-7.2	-9.1	-7.3
Net FDI/GDP [neg. sign = inflows]	-2.2	-1.3	-3.7	-3.1	n.a.
External debt/GDP	49.0	57.5	56.7	50.3	n.a.
Gross reserves/GDP	16.7	19.3	19.0	18.3	n.a.
Credit to private sector/GDP	24.3	25.5	26.2	24.6	n.a.

Macroeconomic developments and policy response

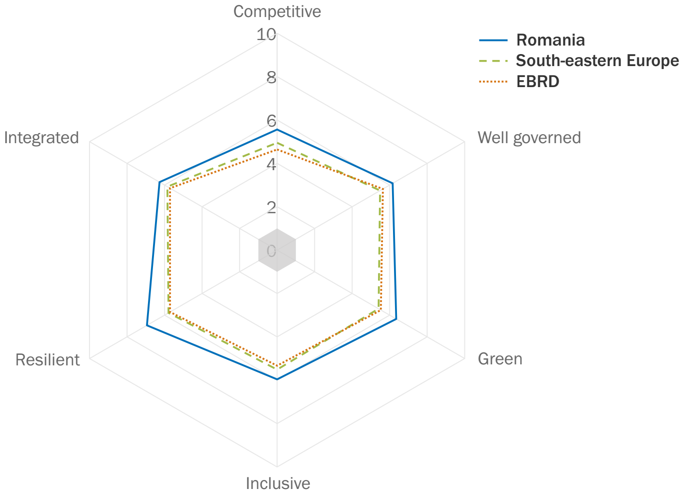
Despite a slowdown, the key economic drivers show resilience. The economy performed strongly in 2022, expanding by 4.7 per cent, despite significant external headwinds, and driven by robust domestic demand and accumulating inventories. In the first half of 2023, growth decelerated to 1.7 per cent year on year, with a notable slowdown in the second quarter. Domestic demand remained resilient amid higher government spending and investment, but falling inventories and an annual decline of goods exports dragged on growth. Industrial production has failed to return to growth so far, reflecting the considerable supply-side shocks in 2022 and weaker foreign demand.

Inflation is on a slow downward path despite stubborn food and core prices. After peaking at 16.8 per cent in November 2022, inflation fell to 8.8 per cent in September 2023. While this trajectory is aligned with the National Bank of Romania's forecast of 7.5 per cent at the end of 2023, risks of stickier inflation remain, especially following the recent increase in a range of taxes (see below). Services inflation is growing steadily, reaching 12.1 per cent in September 2023. The National Bank of Romania has kept the 7 per cent policy rate since January 2023 and signalled that rate cuts were unlikely this year. With stable policy and exchange rates, significant foreign capital inflows and lower credit activity, interbank liquidity reached record levels by the middle of 2023, driving down the three-month money market rate from a peak of 8.2 per cent in November 2022 to 6.4 per cent by September 2023. Still, credit growth in local currency has essentially turned negative in 2023 as companies switched to cheaper foreign-currency loans.

The fiscal position has worsened despite some consolidation efforts. In 2022 the government missed the opportunity to lower the planned deficit by using inflation-boosted revenues and extraordinary budget revenues, such as windfall taxes from energy SOEs. By the middle of 2023, the cash-based fiscal deficit was higher than the corresponding period in 2022, with projections showing a year-end deficit of above 6 per cent of GDP, instead of the targeted 4.4 per cent. Value-added tax (VAT) revenues increased by just 7 per cent in the first half of 2023, reflecting more subdued economic activity, while government spending increased by 16.5 per cent. The government has therefore introduced revenue and spending-side measures to reduce the budget imbalance. Among the key measures are VAT increases on specific products and services, a revenue tax, the elimination of tax benefits for employees in information technology (IT), construction and agribusiness sectors, and lowering administrative spending by cutting advisors and senior management posts. The 2024 deficit is targeted at 3 per cent of GDP, but the International Monetary Fund (IMF) expects a deficit slightly above 5 per cent of GDP, including the effects of the adopted fiscal package.

Moderate growth is likely in the short term. Considering the slowdown in the first half of 2023, we forecast GDP growth for the year as a whole at 1.8 per cent. More moderate private consumption, together with a potential tax reform, will likely define the growth path this year. Stronger agricultural production and exports, EU-funded investments and a tightening labour market provide upside potential, while weaknesses in sectors such as industry and construction will drag on growth. In 2024, amid a normalisation of inflation and easing financial conditions, growth should accelerate to a projected 3.2 per cent in the absence of major shocks.

Assessment of transition qualities (1-10)



Structural reform developments

The European Commission has closed the Cooperation and Verification Mechanism (CVM) for Romania. In November 2022 the Commission concluded that the progress the Romanian authorities had made with judicial reforms was sufficient for the mechanism to be closed, with remaining issues to be addressed through continuous dialogue and the rule-of-law mechanism. The last CVM report noted the progress Romania had made in strengthening the judiciary and combating corruption. The Commission formally started the process of repealing the CVM in June 2023.

The RRP is facing mounting delays. As the authorities had not satisfactorily completed two milestones (investments in new electrolysers for hydrogen production and projects on gas co-generation and district heating) from the second payment request from the Recovery and Resilience Facility (RRF) by December 2022, the Commission triggered a payment suspension procedure that envisages only partial disbursement if the items have not been completed by January 2024. Other milestones with a missed deadline in 2022, which will also affect the third payment request, include two investments in battery storage and supply chains, and improvement to the corporate governance of SOEs. The wider pension system reform, another key requirement of the RRP, was due in the first quarter of 2023. The third payment request, which was initially planned for March 2023, is likely to be submitted around November 2023, meaning Romania may miss out on the funds allocated for 2023.

A minority stake in Hidroelectrica was listed on the local stock exchange. After years of preparation and delays owing to Covid-19 and the war on Ukraine, investment fund Fondul Proprietatea listed almost 20 per cent of Romania's largest energy SOE on the Bucharest Stock Exchange. Local and foreign institutional investors have subscribed to around 80 per cent of the shares. The IPO was valued at €1.9 billion, the largest listing in the history of the local capital market. The deal contributes to the growth and liquidity of the local stock market, as it was reported that new foreign investors had subscribed for the first time in Romania.

The contract-for-difference mechanism was adopted to support renewable energy, and the Neptun Deep offshore gas project was given the green light. In August 2023 the government adopted a regulatory framework to implement the mechanism. The first contracts for 2,000 MW of onshore wind and solar capacity should be assigned towards the end of 2023. The mechanism should stimulate the renewable energy market and accelerate deployment. Another highlight is the Neptun Deep project being developed by the state-owned Romgaz and OMV Petrom, which was approved in June 2023. The project will cost €4 billion and, from 2027, will supply Romania with 10 years' worth of gas.

Three key judicial laws were modified as part of an RRP milestone. In November 2022 the government modified the laws regarding the status of magistrates, judicial organisations and the Superior Council of the Magistracy. The laws aim to improve the efficiency and staffing of the justice system and introduce some digitalisation measures. The government also initiated amendments to the penal code, which the parliament adopted, but which may be sent to the Constitutional Court for approval as some key changes were not aligned with the Court's past recommendations.

A long-term care strategy was adopted with support from the World Bank. The strategy, which was a milestone in the RRP, was adopted in December 2022 and defines the country's priorities until 2030. As the size of the elderly population is expected to increase significantly, the strategy prioritises prevention measures and person-centred care. The strategy also looks to streamline organisational processes for more effectiveness. EU funds and local budgets will finance investments in relevant infrastructure. While the number of private care centres for the elderly has more than doubled in recent years, some of these centres have been exposed as housing residents in dire conditions.

Serbia

Highlights

- **Growth has moderated in the past year.** Lower external demand, which has affected manufacturing output, and persistent inflationary pressures, which have restrained household consumption, have weighed on economic performance.
- **A two-year disbursing programme with the International Monetary Fund (IMF) centred on energy reform is under way.** Measures already taken include increasing electricity and natural gas tariffs, changing the legal status of the largest state-owned electricity company to a joint-stock company, adopting a new law on the management of state-owned enterprises (SOEs) and introducing a new energy investment plan that will be published as part of the forthcoming Energy Sector Development Strategy.
- **Serbia has successfully concluded its first renewable energy auctions.** With the regulatory framework for renewable energy complete, the auctions were launched with support from the European Bank for Reconstruction and Development (EBRD) in June 2023 for 400 MW of wind power and 50 MW of solar photovoltaics. The auctions were successfully concluded in August, with the capacities awarded doubling current wind generation and prices realised for most capacities a little more than half current market prices.

Key priorities for 2024

- **Prudent policies need to support medium-term fiscal sustainability.** In view of unfavourable global financing conditions, the authorities should save inflation-driven fiscal over-performance or direct it towards investments that promote growth. They should also budget measures to support the economy in line with the fiscal rule and with a view to medium-term sustainability.
- **SOE governance needs further improvement.** The new law on SOEs provides a good starting point for completing the legal framework on SOE governance, and for advancing broader SOE reforms on improving their performance and oversight beyond the energy sector.
- **Further improvements to the investment climate would enhance medium-term growth prospects.** Reforms to support human capital development and better access to finance, strengthen the rule of law and reduce administrative complexities would help to sustain the strong inflow of foreign direct investment (FDI) and encourage much-needed domestic private investment.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.3	-0.9	7.7	2.5	1.8
Inflation (average)	1.7	1.6	4.1	12.0	12.4
Government balance/GDP	0.0	-7.2	-3.3	-0.1	-1.8
Current account balance/GDP	-6.9	-4.1	-4.2	-6.9	-2.3
Net FDI/GDP [neg. sign = inflows]	-7.7	-6.3	-6.9	-7.2	-6.1
External debt/GDP	61.4	65.8	68.4	69.3	n.a.
Gross reserves/GDP	29.1	28.8	30.8	32.1	n.a.
Credit to private sector/GDP	49.0	60.0	52.3	48.4	n.a.

Macroeconomic developments and policy response

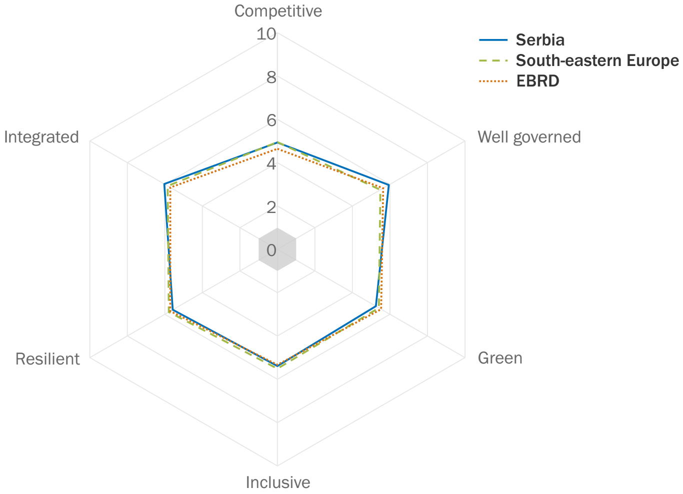
Economic activity is moderating. In line with the adverse global macroeconomic environment, gross domestic product (GDP) growth slowed to 2.5 per cent in 2022 and continued at a muted pace of 0.9 per cent year on year in the first quarter of 2023, before rising to 1.7 per cent year on year in the second quarter of the year. Household consumption growth slowed, ultimately contracting by the first quarter of 2023 as inflation remained firmly at double-digit levels. Construction activity declined in line with muted investment growth, but rebounded in the second quarter of 2023 as the authorities began implementing several sizeable public infrastructure projects. Despite heavy rainfall and occasional flooding, agricultural output grew compared with the previous year, which had been marked by drought. Industry maintained a mildly positive contribution to growth as the recovery of electricity production offset the impact of contracting mining and manufacturing activity. The current account deficit shrank to a fifth of its size year on year in the first half of 2023, driven by cheaper energy imports and strong electricity exports. Despite the shock brought about by the energy crisis, the current account deficit was entirely covered by record FDI inflows in 2022. FDI momentum was maintained in the first half of 2023, up 33 per cent year on year.

Monetary and fiscal measures were employed to support the economy. Increasingly broad-based inflation reached a decade-high level of 16.2 per cent in March 2023, before moderating to 12.5 per cent by July 2023. Inflation peaked later in Serbia than in other Western Balkans countries and the eurozone and is declining at a slower pace, partly owing to ongoing increases in regulated energy prices. The National Bank of Serbia gradually tightened monetary conditions in response, increasing the policy rate several times from 1 per cent in March 2021 to 6.5 per cent in July 2023. The authorities employed fiscal measures to support disposable income, including a pension hike and an increase in public healthcare and education wages, valid from September 2023; a price cap on 20 essential food and household products; one-off assistance for children; tourist vouchers; and state aid for repairing damages caused by storms. An increase in excise duties on fuel, tobacco, alcohol and coffee from October 2023 should contribute to a lower-than-originally-planned government deficit, as outlined in the budget rebalance adopted in September 2023.

The authorities repeatedly accessed external funding. In January 2023 Serbia returned to the external market via two issuances: a five-year Eurobond of US$ 750 million (€690 million) at a 6.3 per cent yield and a 10-year Eurobond of US$ 1 billion (€920 million) at a 6.8 per cent yield, and hedged the issuances against the euro. International reserves reached a record high of €23.6 billion (around six months of import coverage) at the end of August 2023 on account of enhanced access to external funding, including disbursement of the second tranche of the ongoing Stand-By Arrangement (SBA) with the IMF, strong remittances and exports, and central bank interventions in the foreign-exchange market aimed at quelling appreciation pressures.

Growth is set to remain subdued in the near term. Economic growth is expected to slow further to 1.8 per cent in 2023 before returning to nearer its medium-term potential at 3.5 per cent in 2024, in line with expected global recovery. The slowdown in eurozone export markets will weigh on external demand, persistently high inflation will continue to erode disposable incomes, and tight financial conditions on local and external markets, reflected in a slowdown of credit growth, will further damp domestic demand. Early elections could slow the implementation of public investments and economic reforms further, posing a downside risk to the medium-term outlook.

Assessment of transition qualities (1-10)



Structural reform developments

The new IMF programme focuses on energy and public-sector reform. The IMF Board approved a €2.4 billion SBA in December 2022, and the Serbian authorities successfully completed the first review in July 2023. The measures taken so far include increasing electricity and natural gas tariffs, transforming the largest energy SOE into a joint-stock company, and adopting a new energy investment plan that will be published as part of the forthcoming Energy Sector Development Strategy. The new law on SOE management, a key structural benchmark, was adopted in September 2023, following a second round of public consultations. According to the new law, which is aligned with the EBRD-supported State Ownership Policy, more than 20 public enterprises are now obliged to change their legal status from public enterprise to either limited liability or joint-stock company no later than one year from the law's entry into force, alongside other corporate governance improvements. The phased implementation of a centralised public wage and employment registry (ISKRA) is on track, with the registry set to cover most of the 450,000 public-sector employees by the end of 2023.

Serbia completed its regulatory framework for renewable energy and launched renewable energy auctions. Amendments to the Law on the Use of Renewable Energy Sources adopted in March 2023 and accompanying secondary legislation, such as the balancing decree and the feed-in premium decree, enable faster integration of new renewable capacities in the power system and market, while preserving the reliability and stability of the system's operations. Renewable energy producers will now take on a proportion of the balancing costs that the guaranteed supplier (the state-owned electricity company, EPS) used to bear entirely through the feed-in tariff, therefore mitigating the public costs resulting from volatile renewable energy generation. The amendments also grant the Ministry of Mining and Energy the authority to determine maximum offered prices at auctions, unlocking the auctions process. In June 2023 Serbia, with EBRD support, launched renewable energy auctions for 400 MW of wind power and 50 MW of solar photovoltaics, marking the first auction in a three-year plan for market-premium support for 1,300 MW of renewable energy. The auction was successfully concluded in August, with the wind segment quota oversubscribed and the solar segment quota undersubscribed. The capacities awarded will double the current wind generation and prices realised for most of the capacities will be just over half current market prices.

A set of judicial laws related to constitutional changes has been adopted. Parliament needed to approve a set of laws in February 2023 to implement the preceding year's changes to the constitution. As part of these changes, parliament will no longer elect judges and prosecutors; the High Judicial Council and the High Prosecutorial Council will elect them instead.

The Serbian electricity exchange SEEPEX has launched an intra-day market. The new market segment, launched in July 2023, operates on a continuous trading mechanism, enabling market participants to adjust their position almost instantaneously. This is crucial for reducing risks associated with volatile renewable energy sources.

The government approved the 2023-25 Programme for Suppressing the Grey Economy. The Programme, which was adopted in March 2023, sets out 23 measures aimed at strengthening the capacity of inspections and misdemeanour courts, and improving tax supervision and reporting procedures, as well as easing the fiscal and administrative burden on businesses.

Businesses are now solely registered online. A recent amendment to the Law on Registration Procedure requires companies to register electronically with the Serbian Business Registers Agency from May 2023, streamlining the process and aligning it with international best practices.