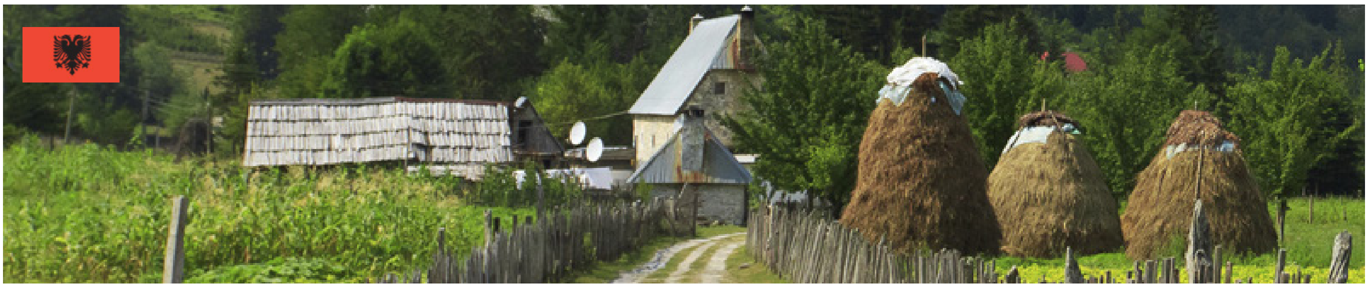

Albania

Highlights

- **The economy is growing steadily.** Real gross domestic product (GDP) growth slowed to 3.9 per cent in 2023 (from 4.8 per cent the previous year), according to the most recent data, revised in line with EU methodology, and is expected to remain at a similar level in the short term, thanks to continued tourism growth and rising private consumption as a result of lower inflation and higher wages.
- **Electricity market coupling with Kosovo has taken place.** This is the first coupling project in the Western Balkans region and has the potential to provide substantial benefits to both economies in terms of supply security and the price competitiveness of electricity.
- **The Public Finance Management Sectoral Strategy for 2023-30 has been approved.** The new strategy focuses on transparency, accountability and efficiency in managing public resources to enhance service delivery and drive economic development.

Key priorities for 2025

- **The business climate must improve if the private sector is to develop further.** Priorities include strengthening the enforcement of justice and anti-corruption reforms, adopting a unified investment law, implementing adequate consumer protection laws and reducing cash payments throughout the economy.
- **Reforms to enhance revenue generation should be followed through.** The amended income-tax law, which came into effect in 2024, broadened the tax base by making self-employed professionals subject to personal income tax. However, the adoption of a new law on property tax has been postponed. The draft Medium-Term Revenue Strategy, including measures to increase tax revenue as a share of GDP, is set to be adopted soon. Further efforts to implement these laws are needed in order to sustain investments in physical and human capital and to firmly anchor the downward trend in public debt.
- **The implementation of the National Single Project Pipeline (NSPP) should be high on the agenda.** Key short-term measures include ranking the projects on the list and integrating public-private partnerships into the NSPP. A new public finance management strategy for 2024-30 was approved in June 2024 to improve transparency, accountability, fiscal discipline and efficiency in the use of public resources, but implementation of the law and the strategy depends on the availability of funding and human resources.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-3.3	8.9	4.8	3.9	3.5
Inflation (average)	1.6	2.1	6.7	4.8	2.3
Government balance/GDP	-6.7	-4.6	-3.7	-1.1	-2.2
Current account balance/GDP	-8.7	-7.7	-6.0	-1.2	-5.0
Net FDI/GDP [neg. sign = inflows]	-6.7	-6.5	-6.6	-5.8	-5.0
External debt/GDP	63.9	64.0	54.1	46.3	na
Gross reserves/GDP	29.5	32.6	27.4	26.8	na
Credit to private sector/GDP	35.2	33.9	31.5	30.6	na

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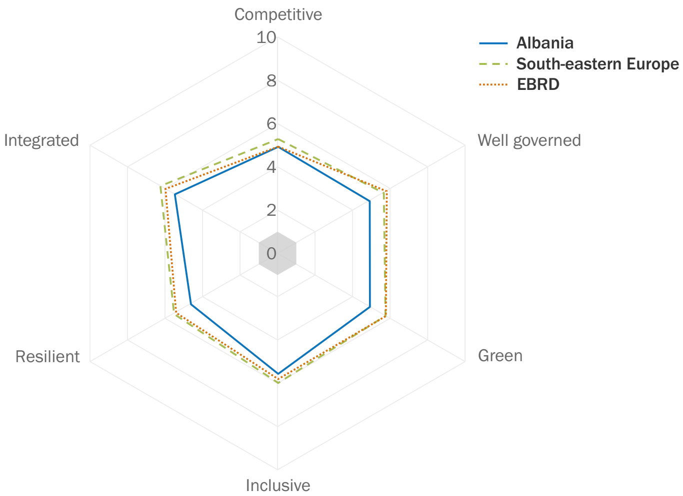
Macroeconomic developments and policy response

Economic growth in 2024 has remained similar to that of the previous year. Following the slowdown in real GDP growth to 3.9 per cent in 2023, according to revised data based on the new methodology, mainly driven by weaker domestic demand, real output rose by 3.9 per cent year on year in the first half of 2024. Growth was driven by construction and services, while industrial production contracted. This was also evident on the expenditure side, where the biggest expansion was recorded in private consumption and fixed investment. In contrast, net exports fell markedly due to a 15 per cent decline in goods exports, dented by currency appreciation and low external demand. As a result, in the first half of 2024, the current account deficit increased by 50 per cent from the first half of 2023 to almost €600 million, despite increasing remittance inflows.

Inflation is back within the target band. Having reached an annual rate of 8.3 per cent in October 2022, inflation has declined steadily ever since, reaching 1.9 per cent in October 2024, partly on the back of the strong local currency appreciation, but also due to a high base effect from 2023. In response to easing inflation, the Bank of Albania (BoA) cut the policy rate by 0.25 percentage point in July and again in November 2024 (to 2.75 per cent). Credit growth started to slow, to around 1 per cent in January 2024, but accelerated sharply to over 12 per cent in the third quarter. Fiscal policy remains expansionary, including a further public-sector wage increase from July 2024, with an estimated budgetary impact of ALL 40 billion (€400 million). The government's budget plan for 2024 forecasts a deficit of 2.5 per cent of GDP, even though a surplus of around 2.4 per cent was recorded in the first seven months. Public debt stood at 55.7 per cent of GDP in the first half of 2024, its lowest level since 2008. The Albanian lek has appreciated by 12.5 per cent against the euro in the past two years, but has remained stable in recent months, partly as a result of central bank intervention in the market.

Steady growth is set to continue in the near term. Real output growth is expected to be 3.5 per cent in 2024 and 3.7 per cent in 2025 on the back of the continued strong performance of the hospitality sector and an improvement in the global outlook. The main downside risks arise from a possible drought, which would negatively affect agricultural output and electricity supply.

Assessment of transition qualities (1-10)



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Structural reform developments

Reform plans are set to receive substantial external support. Under the European Union's (EU) Growth Plan for the Western Balkans, Albania would receive €922.1 million over 2024-27, conditional on fulfilling reforms set out in the country's reform agenda. Key areas of reform include: the improvement of the business environment, human capital development, judicial efficiency, the fight against corruption, freedom of expression, the deployment of renewables and energy market reforms, the digital transition, particularly in public services, and enhanced cybersecurity.

The Public Finance Management Sectoral Strategy 2023-30 has been approved. The new strategy, approved in June 2024, focuses on transparency, accountability and efficiency in managing public resources to improve service delivery and economic development. The strategy outlines several key objectives in six pillars, such as stronger fiscal and macroeconomic policies, enhanced planning and reporting, increased revenue mobilisation, improved budget management, strengthened internal controls and green economy integration. The indicative cost of implementing the strategy is around €11.5 million, most of which is expected to be provided by external development partners. Most of the costs relate to revenue mobilisation and management, including the enhancement of tax and customs administration capacities.

Measures have been taken to boost the attractiveness of jobs in the public sector. In line with the public-sector wage reform undertaken in 2023, the government approved a salary increase, averaging around 15 per cent, for the pre-university education, healthcare and security sectors. The education sector will see the biggest boost, with over €110 million allocated to teacher salaries alone, raising wages by a cumulative 35 per cent to 60 per cent over two years. This investment aims to improve the quality of education by attracting and retaining better-qualified staff. In addition, the government is working on a tax-relief package for young people up to 29 years old, aiming to promote youth employment by offering tax deductions based on age.

A National Employment and Skills Strategy 2023-30 has been approved. The new strategy, approved in March 2023, focuses on skills development and better matching of demand to supply in the labour market. It also aims to foster employment for both women and men through comprehensive labour-market policies.

Amendments to the law on the support and development of start-ups have been passed. These amendments, adopted by parliament in June 2023, allow the establishment of the Start-up Albania agency, which will be responsible for developing and supporting start-ups, both financially and by facilitating communication with third parties during the incubation period, which can last up to 24 months. It will periodically monitor start-ups and facilitators of start-ups that have received grants. In addition, two new bodies will be established to evaluate requests from start-ups and start-up facilitators – the Evaluation Commission and the Appeals Commission, respectively.

Albania has set in motion its "Youth Guarantee". The Youth Guarantee, announced in October 2023, aims to ensure that all young people under the age of 25 receive a good-quality offer of employment or the opportunity for continued education, an apprenticeship or a traineeship within four months of becoming unemployed or leaving formal education. The government has also approved a corresponding implementation plan. In the first quarter of 2024, the pilot phase of the Youth Guarantee was launched in three cities – Shkodra, Tirana and Vlora – to test the scheme and allow adjustments before the national roll-out.

The BoA is expected to officially submit an application for membership of the Single Euro Payments Area (SEPA) in 2024. As part of the EU growth plan, Albania has received the green light from the European Commission to join SEPA, a unified payment system encompassing most EU countries and several other European nations. Membership will significantly reduce fees for cross-border transactions between Albanian and EU financial institutions, fostering greater financial interconnectedness and facilitating smoother international commerce. The BoA and other relevant government agencies are actively pursuing the necessary regulatory steps to meet SEPA's stringent requirements.

Resilience in the banking sector is being strengthened. Fast credit growth in recent months has prompted the central bank to increase the countercyclical capital buffer (CCB) from 0 to 25 basis points, indicating that the BoA is taking additional measures to manage systemic risk. In times of strong credit growth, the CCB requires banks to increase their level of capital by 0.25 per cent of risk-weighted assets to build resilience in the banking sector during periods of stress, when losses occur.

Bosnia and Herzegovina

Highlights

- **Growth is accelerating in 2024.** Following a subdued performance in 2023 (1.7 per cent real growth), real economic growth picked up to 2.4 per cent year on year in the first half of 2024, mainly due to a recovery in domestic demand and investment.
- **The European Council agreed to open European Union (EU) accession negotiations with Bosnia and Herzegovina.** However, no date has been set and the negotiating framework has not yet been put in place, pending the completion of required reforms.
- **The Council of Ministers of Bosnia and Herzegovina adopted, in June 2024, a Strategy for the Fight against Corruption for 2024-28, along with an action plan for its implementation.** The adoption of these strategic documents is one of the 14 key priorities the country needs to fulfil to advance on the path to EU membership.

Key priorities for 2025

- **Fiscal reform is needed to rebuild the country's financial reserves and enhance potential growth by shifting resources from current expenditure to capital investment.** This can be accomplished by reviewing employment and wage policies and better targeting of social spending.
- **Electricity pricing remains a significant fiscal risk, requiring urgent reform.** Measures are needed to address a situation in which household electricity prices are largely set below cost recovery levels, with domestic prices subsidised by export revenues. In addition, the authorities in the country's two entities either capped (Federation of Bosnia and Herzegovina) or froze (Republika Srpska) price increases for 2024. In the Federation of Bosnia and Herzegovina, the publicly owned energy utility proposed a block-tariff structure, which would have increased average household prices by 10 per cent, but the proposal was rejected by the regulator.
- **Top priorities should be stronger measures to prevent and combat corruption, enhanced transparency and accountability, and the safeguarding of financial integrity.** Poor governance and the weak rule of law continue to hinder sustained and inclusive growth. The new Law on Anti-Money Laundering and Counter-Terrorism Financing aligns the country's framework with Financial Action Task Force standards, but further efforts are required to ensure its effectiveness.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-3.0	7.4	4.2	1.7	2.8
Inflation (average)	-1.1	2.0	14.0	6.1	2.0
Government balance/GDP	-4.6	0.6	0.9	-1.2	-2.4
Current account balance/GDP	-2.8	-1.8	-4.3	-2.7	-5.0
Net FDI/GDP [neg. sign = inflows]	-2.4	-3.2	-3.3	-3.5	-4.0
External debt/GDP	63.9	57.4	51.7	49.5	na
Gross reserves/GDP	39.8	41.7	35.1	33.2	na
Credit to private sector/GDP	57.7	53.3	48.1	48.3	na

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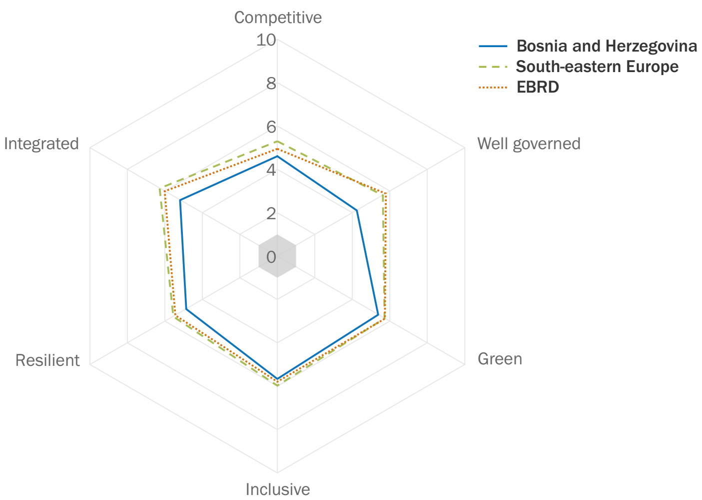
Macroeconomic developments and policy response

Economic growth is accelerating. Following a slowdown to 1.7 per cent in 2023, real gross domestic product (GDP) growth picked up to 2.4 per cent year on year in the first half of 2024. This was on the back of a strong rise in fixed investment and robust growth in private consumption due to easing inflation and growing remittance inflows. The contribution of net exports was negative due to simultaneous growth in goods imports and a decline in goods exports, the latter driven by subdued external demand. The current account deficit almost doubled from the first half of 2023 to around €720 million, or 6.0 per cent of GDP, in the first half of 2024. Foreign direct investment inflows stood at around €500 million in the first half of 2024, which is an 11.0 per cent decline compared with the first half of 2023. On the production side, growth in the first half was driven by services and construction, while industrial production declined.

Inflation is falling but fiscal policy remains expansionary. Inflation has fallen steadily in the past two years, from 14.0 per cent on average in 2022 to 1.7 per cent on average in the first nine months of 2024, in line with global trends. However, the authorities in both entities have followed an expansionary fiscal policy in 2024, with increases in the minimum wage and pension adjustments in both entities and higher public-sector wages in certain cantons of the Federation of Bosnia and Herzegovina. The consolidated state-wide fiscal balance shifted from a surplus of 0.9 per cent of GDP in 2022 to a deficit of 1.7 per cent of GDP in 2023, due to the cumulative effect of multiple permanent increases in public wages and social benefits. The rising deficits, coupled with substantial debt repayments, have resulted in significant depletion of the country's financial buffers.

Economic growth is expected to pick up in the short term. Real GDP growth is forecast to reach 2.8 per cent in 2024, mainly on the back of recovering domestic demand and improving capital investment execution. A further increase to 3.0 per cent is expected in 2025 as external demand recovers, resulting in a rise in net exports. The main downside risks to the outlook are domestic political issues, which often delay or hinder important reforms or infrastructure projects. On the positive side, the country's EU candidacy status could give a much-needed boost to reforms.

Assessment of transition qualities (1-10)



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Structural reform developments

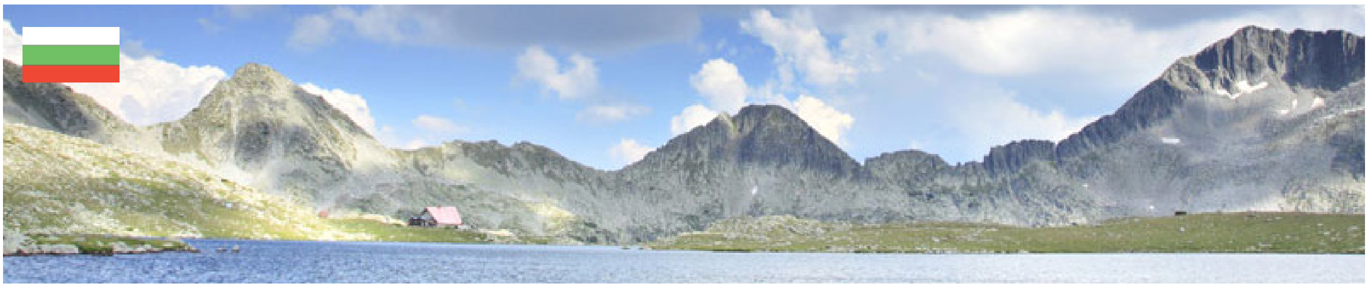
The reform agenda is facing delays, jeopardising external disbursements. The EU's Growth Plan and Reform and Growth Facility for the Western Balkans are designed to accelerate reforms in several areas in Bosnia and Herzegovina. The most important areas are: fundamental rights and democratic institutions; judicial reforms and the fight against corruption; the green and digital transition; improvements to the business environment; and education and labour-market reform. Planned allocations for Bosnia and Herzegovina are close to €1 billion, with one-third of that in grants and the rest in concessional loans. However, disbursement of the funding is conditional on the country adopting the reform agenda (which has not yet been done) and then implementing it.

Parliament passed a new Law on Anti-Money Laundering and Counter-Terrorism Financing. The new law, adopted in February 2024, seeks to harmonise Bosnia and Herzegovina's legal and regulatory landscape with key EU standards. It introduces a comprehensive legal framework that recognises and regulates previously unregulated financial services and products, such as crypto assets and e-money.

The Council of Ministers has adopted a Strategy for Fighting Corruption for 2024-28, as well as an action plan for its implementation. The strategy and action plan adopted in June 2024 include five interconnected components: general principles, a vision, strategic goals, programmes, and specific activities aimed at achieving the vision and goals. The three primary strategic objectives are to enhance the system of prevention and coordination mechanisms, improve the mechanisms for detecting, proving and prosecuting corrupt criminal acts, and strengthening inter-institutional, regional and international cooperation.

The electronic certificate for digital representation is finally being implemented. From 1 June 2024 the Agency for Identification Documents, Records and Data Exchange of Bosnia and Herzegovina started entering electronic certificates for digital representation into citizens' identity cards. The legislation prescribing the registration of electronic certificates in ID cards has existed since 2012, but for the past 12 years, citizens have had cards with a chip, but no registered electronic certificates. Registration of electronic certificates enables citizens to comply with EU standards in the field of digital identification.

The government of the Federation of Bosnia and Herzegovina is working on three major reforms in parallel. The reforms are to the fiscal system, income tax policy and the minimum wage. A set of laws designed to relieve the burden on the economy and enable wage growth will be presented to parliament in the coming months. The minimum wage is expected to be raised to BAM 1,000 (€510) per month, which will also serve as the threshold for non-taxable income. Income above that amount will be taxed at a single rate. The proposal reportedly foresees lowering the income-tax rate from 41.5 per cent to 28.0 per cent. Changes are also planned with regard to tax on profits; the rate will remain at 10 per cent, but reinvested profits will be exempt from taxation and a dividend tax of 10 per cent will be introduced.



Bulgaria

Highlights

- **Gross domestic product (GDP) growth has remained relatively resilient in 2024.** The economy grew by 2.1 per cent year on year in the first half of 2024 as investment rebounded after years of weakness and strong wage growth supported the rise in private consumption.
- **Installed renewable capacity is increasing.** In 2023, solar accounted for 8.8 per cent of total electricity production, marking a 140 per cent increase in absolute generation compared with 2021. Bulgaria is becoming an important destination for renewable developers, particularly solar parks.
- **Political uncertainty has led to another revision of the Recovery and Resilience Plan (RRP).** With implementation of the RRP delayed, the caretaker government proposed revising the RRP by October 2024 to amend the investment plan. Bulgaria is also yet to receive approval of the REPowerEU chapter from the European Union (EU).

Key priorities for 2025

- **Absorption of RRF funds should be accelerated.** Bulgaria is facing delays in implementing and receiving funds from the Recovery and Resilience Facility (RRF). Still, while RRF implementation has been more difficult, Bulgaria is progressing well in absorbing the cohesion funds from the 2021-27 framework.
- **Complementary efforts towards greening the energy system are needed.** Despite the impressive progress in increasing solar capacity over the past two years, investments in storage, finalising market reforms and accelerating the phase-out of carbon-intensive production are still needed, alongside energy efficiency measures.
- **The authorities should promptly implement recommendations for improving anti-money laundering.** While significant progress has been made so far, Bulgaria needs to complete all recommended actions to remove the country from the Financial Action Task Force (FATF) grey list.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-3.2	7.8	4.0	1.9	2.2
Inflation (average)	1.2	2.8	13.0	8.6	3.1
Government balance/GDP	-3.8	-3.9	-2.9	-1.9	-2.6
Current account balance/GDP	0.4	-1.1	-2.6	0.9	0.3
Net FDI/GDP [neg. sign = inflows]	-4.0	-1.6	-4.0	-2.8	-0.2
External debt/GDP	62.9	57.9	50.8	48.0	na
Gross reserves/GDP	50.1	48.7	44.8	44.6	na
Credit to private sector/GDP	51.0	47.9	44.5	45.2	na

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Macroeconomic developments and policy response

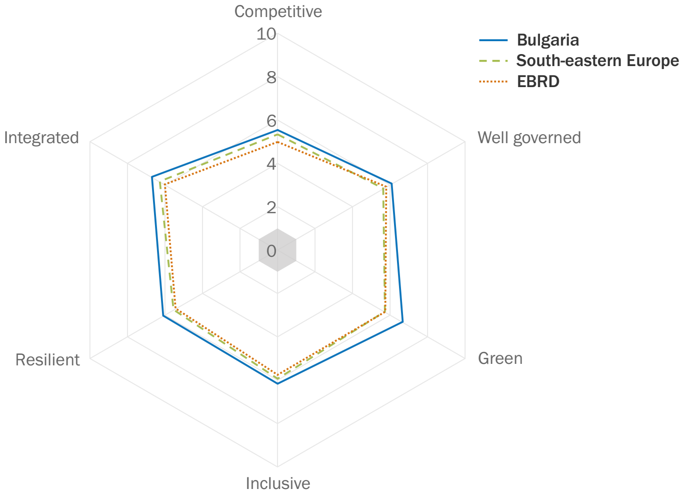
Weak external demand has constrained growth so far in 2024. After slowing to 1.9 per cent in 2023, real GDP growth was 2.1 per cent year on year in the first half of 2024, driven mainly by domestic demand. Amid strong wage growth, private consumption was resilient, and investment growth has held up year on year, given last year's low base. Rising incomes, a lack of alternative investment opportunities and low interest costs led to strong investment in construction, especially in the capital, Sofia. However, weak foreign demand translated into struggling industrial output, which declined by 5.2 per cent year on year in June 2024. As a result, the trade deficit widened in 2024, reflecting the strong domestic demand, after a significant destocking in 2023 led to a large drop in imports. The unemployment rate fell to just 4.3 per cent in the second quarter of 2024.

Real wages are growing strongly, putting pressure on inflation and threatening to delay the adoption of the euro. Average wages increased by 17.1 per cent year on year in the first half of 2024, driven by a 20 per cent minimum wage increase effective from January 2024. Meanwhile, inflation has stabilised since April 2024 at around 2.8 per cent, but fell from September due to lower fuel prices. In July 2024, the inflation rate was still 1.2 percentage points above the reference value (that is, the average of the three eurozone members with the lowest 12-month average inflation plus 1.5 percentage points) for eurozone entry. Fiscal policy has remained mildly expansionary, with a targeted budget deficit of 3 per cent of GDP in 2024, similar to 2023.

Retail credit demand accelerated in 2024. Private investment in Bulgaria improved in 2024, with investments in tangible assets rising by 5.3 per cent year on year in the second quarter. Still, most investments have been channelled to the construction and real-estate sectors, as industry, information and communications technology (ICT) and trade all marked annual declines. This is reflected in the structure of loans, as households increasingly take on mortgages motivated by low interest rates and expectations of euro adoption. As of July 2024, retail loans continued growing and reached 19.6 per cent year on year, while the corporate lending portfolio grew by 8.7 per cent in the first half of 2024.

Growth should remain resilient despite challenges. Considering the growth rate recorded in the first half of 2024, we forecast real GDP to expand by 2.2 per cent for the full year, driven by domestic demand as exports will likely remain weak. In 2025, the economy is forecast to grow by 2.9 per cent, albeit with downside risks related to the political uncertainty and slow absorption of EU funds. Potential euro adoption in 2025 could unlock some investments, support trade and boost the banking sector.

Assessment of transition qualities (1-10)



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Structural reform developments

Bulgaria is moving towards adopting the euro. The relevant law came into force in August 2024. All criteria for euro adoption have been met except for the inflation target. The authorities are aiming at January 2025 for eurozone membership, potentially moving this to July 2025 if the inflation criterion is not met by the end of 2024. Another positive development in Bulgaria's further integration with the EU was the partial entrance to the Schengen area in March 2024 via air and seaports, but there is no clear timeline for full Schengen membership.

Implementation of the RRP is facing substantial delays and challenges. As of September 2024, Bulgaria has submitted two payment requests and received €1.37 billion from the RRF. While some reforms and investments have started, implementation remains well behind schedule owing to frequent government changes. The second request remains blocked as four revised laws need to be approved again by parliament. The REPowerEU chapter is yet to be submitted to the European Commission, which represents a missed opportunity to accelerate the green transition. In addition, the caretaker government from summer 2024 proposed submitting another revised plan, given the limited time available for implementing some investments.

Bulgaria was included in the grey list of the Financial Action Task Force. In October 2023, the Council of Europe's MONEYVAL Committee assessed Bulgaria's framework for fighting money laundering and countering the financing of terrorism, which resulted in Bulgaria being subject to increased monitoring by the FATF. In turn, the country committed to an action plan to address the weaknesses. These included the investment-linked citizenship and residence schemes, beneficial ownership registers and enforcement against corruption and organised crime, in which the authorities have made some progress.

Public investment in infrastructure increased. After considerable declines in 2023, public investment in infrastructure recovered in 2024, supported in part by EU structural funds and Bulgaria's RRP. The government also initiated a large-scale grid modernisation programme in mid-2024, allocating significant EU funds to enhance the power system's capacity to integrate renewable energy sources.

Energy transition is progressing despite a lack of wider sectoral reforms. Bulgaria expanded its renewable energy capacity in 2024, despite challenges in deploying grid-scale storage and onshore wind projects. In 2023 and 2024, the country had around 80 per cent annual growth rates of electricity generation from solar panels. Amid the increasing reliance on solar, the Ministry of Energy announced in March 2024 a new energy storage incentive programme, offering tax credits for businesses and households investing in battery systems. This move is aimed at balancing the grid and supporting further renewable energy integration. The authorities also made some progress in diversifying energy sources, aiming to reduce reliance on Russian gas and promoting Bulgaria's role as a transit hub for energy. Plans to expand production capacity at the Kozloduy nuclear power plant also proceeded despite new plans to avoid using Russian components. Moreover, an EU-funded retraining programme for coal industry workers was launched in January 2024, focusing on skills needed for the renewable energy sector and thereby addressing potential job displacement concerns in coal-dependent regions.

The government is simplifying the process for foreign workers to obtain permits. This reform aims to tackle skills shortages in key sectors of the economy by digitising work visa applications and fast-tracking visa applications for high-skilled sectors such as IT, healthcare and manufacturing. For low-skilled sectors such as tourism and transportation, the government broadened the list of countries eligible for 90-day visa-free work permits. It also introduced regional incentives to attract workers to underdeveloped regions.

The banking system is technically ready for euro adoption. As part of the reform package for euro adoption, parliament approved in January 2024 a new law that addresses previous recommendations and brings the Bulgarian National Bank's operations in line with European Central Bank standards. The move enhances the central bank's independence and modernises its governance structure, which may help to boost political credibility and smooth out inflation expectations.

Kosovo

Highlights

- **Economic growth has accelerated in 2024.** Real output growth picked up from 3.3 per cent in 2023 to 4.9 per cent year on year in the first half of 2024, driven by government social spending, which boosted private consumption, together with an increase in fixed investment.
- **Kosovo is on track with its International Monetary Fund (IMF) programmes.** In May 2024, the IMF Executive Board completed its second reviews of Kosovo's Stand-By Arrangement (SBA) and Resilience and Sustainability Facility (RSF) arrangement, making available about €16.4 million and €9.5 million of budgetary support, respectively, under each one.
- **The Assembly adopted a new law on renewable energy sources.** The law, adopted at the end of 2023, provides for a competitive bidding process to support renewable energy projects, replacing the previous system of feed-in tariffs. In April 2024, Kosovo concluded its first solar auction.

Key priorities for 2025

- **Fiscal reforms to strengthen the revenue base should be high on the agenda.** The reforms should aim to close loopholes and reduce exemptions by amending tax legislation, and lower fiscal risks by improving the financial oversight and accountability of publicly owned enterprises.
- **Further strengthening of public investment management remains essential.** A recent update of the Public Investment Management Assessment highlighted some progress, such as improved budgeting practices for projects. However, significant challenges persist, particularly in the planning and implementation phases of the project cycle.
- **Application of the Digital Agenda 2030, in place since June 2023, should be accelerated.** The agenda provides a comprehensive framework for digital transformation, including 5G technologies and the digitalisation of businesses and public services. The latter is still in the early stages, with only 10 per cent of all public services offered online and most of them for information only.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-5.3	10.7	4.3	3.3	4.0
Inflation (average)	0.2	3.4	11.7	5.2	2.5
Government balance/GDP	-7.8	-1.2	-0.7	-0.2	-1.1
Current account balance/GDP	-7.0	-8.7	-10.6	-7.6	-7.6
Net FDI/GDP [neg. sign = inflows]	-4.2	-4.0	-6.8	-6.5	-5.4
External debt/GDP	37.0	37.1	38.6	39.8	na
Gross reserves/GDP	17.0	16.2	15.4	15.0	na
Credit to private sector/GDP	51.6	50.8	52.8	55.4	na

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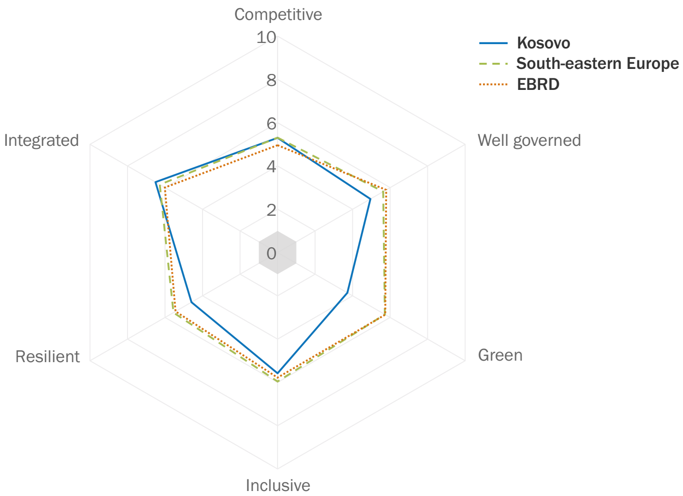
Macroeconomic developments and policy response

Economic growth is accelerating. Real output expanded 3.3 per cent in 2023, driven by services, particularly tourism (probably related to the diaspora), and trade, while the contributions of industry and construction were smaller, but also positive. Real growth picked up to 4.9 per cent year on year in the first half of 2024, although growth in industry, construction and services was far lower (averaging around 2.7 per cent). There is a large discrepancy between data on sectoral value added and overall real gross domestic product (GDP) growth, indicating potential data-quality issues. On the expenditure side, real growth was driven by the recovery of private consumption, boosted by easing inflation, rising wages and one-off social transfers, as well as fixed investment. Net exports made a negative contribution due to the higher growth in imports of goods and services compared with exports. This was reflected in the current account deficit, which expanded by €150 million year on year, reaching 15 per cent of GDP in the first half of 2024. Foreign direct investment inflows continued in the first half of 2024, totalling around 7 per cent of GDP.

The fiscal balance was better than expected in 2023, leaving room for expansionary policy, in line with declining inflation. Inflation peaked at 14.2 per cent year on year in July 2022, mainly as a result of higher food and oil prices, and has fallen steadily since then, reaching 0.4 per cent in October 2024, the lowest level in the region. The general government deficit was 0.2 per cent of GDP in 2023, far below the projected 2.25 per cent, driven by higher revenues, which offset a substantial increase in public investment (more than 30 per cent compared with 2022). Despite this surge, capital spending remained significantly below target. The resulting fiscal space enabled the government to provide one-off financial support of €100 per person to all children and pensioners in December 2023, at a total cost of €68 million, or 0.75 per cent of GDP. The 2024 budget provides a moderate fiscal impulse, financed by a rise in the net domestic issuance of government debt and World Bank budgetary support (a US$ 100 million [€91.3 million] Development Policy Operation). Government debt is low, at around 17 per cent of GDP at the end of 2023, far below the maximum 40 per cent allowed by the country's fiscal rules, providing room for further public investment.

The economy is expected to continue growing, but the short-term outlook is subject to downside risks. Real GDP growth is forecast to accelerate to 4 per cent in 2024 and 2025, supported by robust private consumption, as well as an increase in public infrastructure investment. Downside risks to the outlook include slower-than-planned implementation of public investment projects and prevailing geopolitical uncertainty, which may affect trade flows and the availability of international funding. Upside potential, in contrast, exists in the possibility of faster structural reform and additional financing provided under the EU's Growth Plan.

Assessment of transition qualities (1-10)



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Structural reform developments

Under the EU's Growth Plan for the Western Balkans, Kosovo is slated to receive €882.6 million in 2024-27. Disbursements are conditional on the country fulfilling reforms set out in the reform agenda. Key areas of reform include: the rule of law, democracy and freedom of the media, judicial performance and integrity, the fight against corruption, the digitalisation of public services and cybersecurity, decarbonisation policy and renewables deployment, and overall private-sector development.

Progress is being made under the ongoing disbursement programmes with the IMF. A two-year precautionary SBA serves as a liquidity buffer in case downside risks materialise, while the RSF provides affordable financing to support Kosovo's climate change mitigation and adaptation efforts. The IMF's second review of the two programmes was completed successfully in May 2024, giving the government access to €16.4 million from the SBA and €9.5 million from the RSF.

Kosovo's parliament, the Assembly, approved a law promoting the use of renewable energy sources. This law, approved in April 2024, fully transposes EU directives and aims to modernise the energy sector by reducing carbon intensity and enhancing energy efficiency. Among other things, it provides a basic framework for renewable energy through competitive auctions, regulates the use of public-private partnerships to expand green energy capacity and sets market prices as the benchmark for regulatory purposes. In March 2024, Kosovo concluded its first solar auction. To encourage more private-sector investments in renewable energy through corporate power purchase agreements, secondary legislation would need to be adopted.

Day-ahead market coupling between the Kosovan and Albanian electricity markets under the Albanian Power Exchange (ALPEX) has begun. Operations started at the beginning of 2024. ALPEX, which became operational in Albania in March 2023, aims to establish a more competitive market in Albania and Kosovo and to provide electricity to both countries at more favourable prices.

The Central Bank of Kosovo continues to advance the institutional reform agenda. The draft Law on Banks, approved by the government in May 2023, aims to improve financial-sector stability, among other things, by raising basic capital requirements and setting the criteria for the establishment and licensing of banks, their organisation and sound management. The central bank is also working to strengthen its governance structures, with IMF support, in line with its newly adopted five-year plan. The plan also envisages the modernisation of the country's financial market infrastructure and competitiveness through infrastructural development and the harmonisation of the regulatory framework with that of the EU.

A new Law on Administration of Tax Procedures has been adopted. The new law, approved by the Assembly in December 2023, amended the legal requirement for the formalisation of economic activities or undeclared work. It also regulates information-gathering and -sharing with third parties, such as commercial banks and other countries. Other amendments include the requirement to reduce cash transactions to a maximum of €300 per transaction.

The Tax Administration of Kosovo adopted an annual action plan to shrink the informal economy. The action plan, passed in July 2023, aims to address the incorrect or non-declaration and non-payment of personal income-tax obligations and to identify high-income taxpayers who do not file or incorrectly file personal income-tax obligations.

An important milestone has been reached on the Energy Roadmap between Kosovo and Serbia. The signing of a commercial contract between distribution company KEDS and the newly established Elektrosever in December 2023 marks progress in putting electricity regulation and billing into operation. The conclusion of this contract has enabled billing to start in four municipalities in the north of Kosovo, reducing fiscal risks.

Montenegro

Highlights

- **Economic growth has remained strong.** After rapid real growth of 6.4 per cent in 2022 and 6.3 per cent in 2023, the economy expanded 3.4 per cent year on year in the first half of 2024, despite a high base in the first three months of 2023, driven by rising consumption and investment.
- **The government has developed a fiscal strategy for 2024-27.** The strategy envisages an increase in wages and pensions, a reduction in the tax burden on labour and the introduction of a single value-added tax (VAT) rate for hospitality services.
- **Significant infrastructure investments are under way.** The government is acquiring financing for several ambitious projects in the energy, railway and education sectors.

Key priorities for 2025

- **Structural fiscal reforms are essential for healthy public finances.** These include strengthening revenue administration, improving the targeting of social spending, containing the growth of the public wage bill and improving the oversight of state-owned enterprises (SOEs). A commitment to meeting the public debt target of 60 per cent of GDP by 2028, in line with the Law on Budget and Fiscal Responsibility, is necessary for a credible medium-term fiscal framework.
- **Preservation of the operational independence and institutional credibility of the Central Bank of Montenegro is vital.** Emerging pressures on the central bank to place an administrative cap on bank lending rates could lead to unintended consequences, such as curtailed European Central Bank policy transmission, adverse selection and credit rationing.
- **The authorities should continue to enhance the anti-money laundering and countering the financing of terrorism (AML/CFT) framework.** Large inflows into the real-estate sector mean cross-border money laundering risks need to be addressed. A rise in real-estate prices, fuelled by insufficiently vetted financial flows, indicates shortcomings in AML/CFT preventative measures among real-estate agents, as highlighted in a 2023 MONEYVAL report.[1]

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-15.3	13.0	6.4	6.3	3.8
Inflation (average)	-0.2	2.4	13.0	8.6	4.5
Government balance/GDP	-10.9	-1.7	-4.1	0.7	-3.2
Current account balance/GDP	-26.1	-9.2	-12.9	-11.4	-12.4
Net FDI/GDP [neg. sign = inflows]	-11.2	-11.7	-13.2	-6.3	-4.0
External debt/GDP	224.1	191.5	161.8	138.5	na
Gross reserves/GDP	43.5	31.7	31.1	19.3	na
Credit to private sector/GDP	60.0	52.3	47.3	43.8	na

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[1] https://rm.coe.int/moneyval-2023-26-summ-montenegro/1680ae59a6

Macroeconomic developments and policy response

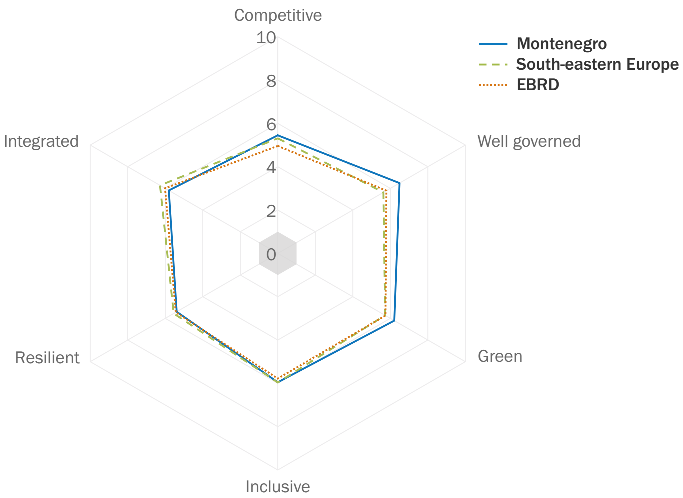
Robust economic growth continues. After 6.4 per cent real gross domestic product (GDP) growth in 2022 and 6.3 per cent growth in 2023, the economy expanded 3.4 per cent year on year in the first half of 2024, despite a high base in the first half of 2023. Growth was driven by services, predominantly trade and hospitality and professional and administrative services, while industrial production recorded a deep decline, caused mostly by a drop in electricity production. Tourism recorded sluggish growth of just 1.0 per cent year on year in the first eight months of the year, compared with record 2023 levels. On the expenditure side, growth in the first half of 2024 was driven by rising private consumption and investment. Private consumption increased by 8 per cent compared with the first half of 2023 due in part to the rise in pensions from the beginning of 2024 and an improvement in the labour market. Investment grew by 9.6 per cent on the year and is expected to maintain its momentum in the short run, with the completion of preparations for the launch of major construction projects such as the Matesevo-Andrijevica section of the Bar-Boljare highway. The net export contribution to GDP growth was negative in the first half of the year due to a double-digit decline in exports caused by lower electricity exports and tourism revenues. Consequently, the current account deficit expanded by €300 million on the year in the first half of 2024, reaching almost €900 million, or around 30 per cent of GDP. Net foreign direct investment inflows decreased by 5.0 per cent in the first half of 2024 from the same period in 2023.

The government announced further fiscal expansion and extended the list of products subject to retail and wholesale margin caps to tackle inflation. Annual inflation peaked at 17.5 per cent in November 2022 and has dropped steadily since then, reaching 1.2 per cent in October 2024. In July, profit margins on staple food products, such as wheat flour, sugar, salt and sunflower oil, were capped at 5 per cent for wholesalers and 7 per cent for retailers. The number of capped products was extended to 71, with different caps on wholesale and retail margins depending on product type. The caps will last until the end of January 2025. Wage increases of around 25 per cent, on average, were announced for October 2024 as part of the government's Europe Now 2.0 programme, along with a rise in the minimum wage to €700 per month. A 52 per cent increase in the minimum pension, affecting a third of Montenegrin retirees, has been in effect since January 2024 and a further increase is expected in January 2025. This fiscal expansion could stoke another round of inflationary pressures, depending on the pricing behaviour of firms facing increased demand.

Debt sustainability risks are elevated, but so far manageable. General government debt peaked at 107 per cent of GDP in 2020, but has since moderated, coming in at 60.3 per cent of GDP at the end of 2023 on the back of public debt repayments and strong economic growth. In the first quarter of 2024, public debt rose to 66.4 per cent of GDP, due to the issuance of a US$ 750 million (€678 million) seven-year international bond in March. The proceeds of the bond issue will be used to repay debt maturing this year (€519 million), so the net effect on public debt will be modest, at around 2.3 per cent of GDP.

Real GDP growth is projected to slow. After higher-than-expected real growth in 2023, a deceleration to 3.8 per cent is projected for 2024, due to the moderation of tourist inflows after a record season last year. A further slowdown to 2.9 per cent is forecast for 2025 due to the long rehabilitation of the Pljevlja thermal power plant, currently supplying around 40 per cent of the country's electricity, leading to a decline in electricity production and an increase in energy imports. In contrast, upside potential arises from the effects of the Europe Now 2.0 programme through elevated private and public consumption.

Assessment of transition qualities (1-10)



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Structural reform developments

The Western Balkans growth plan will support reforms in Montenegro. Under the European Union's growth plan, the country stands to gain €383.5 million, subject to the implementation of reforms proposed in the reform agenda. The focus areas of the agenda are: the rule of law and fundamental rights, the fight against corruption, secure digital infrastructure and an increase in the efficiency of public services, cybersecurity, decarbonisation policies, an improvement in the business environment and human capital development.

The justice system is undergoing extensive reform. The 2024-27 Judicial Reform Strategy was adopted in May 2024, alongside a suite of new legislation aimed at improving the independence, impartiality and accountability of the state prosecution service and the judiciary. High-level judicial officials have been appointed to fill most vacant positions in recent months. However, Montenegro's judicial institutions remain hindered by a lack of investment in human resources and information and communications technology (ICT) infrastructure.

Efforts to enhance the business environment have resumed. In March 2024, the Competitiveness Council approved an action plan targeting the removal of 11 major barriers to business by 2026. The operations of local and foreign companies are currently impeded by informality, inefficiencies, delays in administrative processes, an overly complex legal framework and the administrative burden of parafiscal charges, as well as the inadequate quality of e-services. Additional challenges include a lack of transparency in decision-making, arbitrary interpretation and enforcement of laws by public authorities, and limited access to finance for small and medium-sized enterprises.

The government approved the fiscal strategy for 2024-27 in September 2024. An integral part of the strategy is the Europe Now 2.0 programme, which foresees wage and pension increases, a reduced tax burden on labour and a single VAT rate for hospitality services. One of the biggest changes that should relieve the burden on employers is a proposal to reduce pension and disability insurance contributions from the current 20.5 per cent to 10 per cent. The general VAT rate will remain at 21 per cent, but the government proposes introducing a single, third VAT rate of 15 per cent for hospitality services from January 2025.

The informal economy is being tackled. The government's Programme and Action Plan for Suppressing the Informal Economy, 2024-26, is under way, having been adopted in December 2023. The plan contains actions focused on cooperation between central and local government, as well as prevention and repression of informal activities. The plan also includes analysis of the functionality of inspection services. However, it still lacks a monitoring mechanism for reviewing its implementation.

Consumer protection for credit products is being enhanced. In September 2024, the government adopted a new Consumer Credit Law, harmonising legislation with European Union standards and addressing growing needs for enhanced consumer protection, as an ever-greater number of entities are offering new credit products. For the first time, the law regulates the conditions under which credit intermediaries can operate with regard to housing loans and addresses the accountability of creditors for these intermediary actions. The measures are intended to protect consumers and enhance competition among creditors, which will positively influence loan repayment security and the stability of the financial market.

North Macedonia

Highlights

- **Economic growth is picking up in 2024.** The economy grew 2.1 per cent in 2023, down from 2.8 per cent in 2022, as weakening domestic demand was only partly offset by lower imports. A slight slowdown was recorded in the first half of 2024, with real gross domestic product (GDP) growth reaching 1.8 per cent year on year in that period, mainly driven by some services.
- **A two-year Precautionary and Liquidity Line (PLL) with the International Monetary Fund (IMF) is set to lapse in November 2024.** The structural conditionalities of the arrangement focus on the energy sector and the fiscal impact of a large infrastructure project (Corridor 8/10d). The first review by the IMF Executive Board was successfully completed in January 2024.
- **The reform agenda under the European Union's Growth Plan was approved by the European Commission in October 2024.** The Growth Plan for the Western Balkans, adopted by the European Council in May 2024, would provide North Macedonia with around €750 million in 2024-27 upon fulfilment of the conditions set out in the country's reform agenda. The focus areas are judicial reform, the green and digital agendas, and business-environment and human-capital development.

Key priorities for 2025

- **The adoption of implementing legislation for the Organic Budget Law (OBL) needs to be accelerated.** The OBL, which will enter into force with the implementation of an Integrated Financial Management Information System (IFMIS), introduces fiscal rules[1] and a Fiscal Council and strengthens medium-term budgetary procedures. The adoption of secondary legislation to implement the OBL, including the introduction of budget classification, is running behind schedule.
- **Further investment in green transition should be a priority.** This would help North Macedonia reach the ambitious goals set by the National Energy and Climate Plan by 2030, backed by the Just Energy Transition Investment Platform (JETIP), launched in December 2023.
- **The deployment of the Public Investment Management Action Plan and improvements in the legal framework for public-private partnerships and concessions need to be accelerated.** A new Department for Public Investment Management has been set up in the Ministry of Finance, and it is anticipated that the current challenges related to legal, staffing and information technology (IT) issues will be overcome during 2025.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-4.7	4.5	2.2	2.1	2.2
Inflation (average)	1.2	3.2	14.2	9.4	3.5
Government balance/GDP	-8.0	-5.3	-4.4	-4.9	-3.4
Current account balance/GDP	-2.9	-2.8	-6.1	0.4	-2.0
Net FDI/GDP [neg. sign = inflows]	-1.4	-3.3	-5.0	-3.6	-5.0
External debt/GDP	78.7	80.9	82.8	83.2	na
Gross reserves/GDP	31.0	30.8	29.6	33.2	na
Credit to private sector/GDP	55.7	55.5	55.2	55.9	na

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[1] The new Organic Budget Law introduces a 3 per cent limit on the general government deficit-to-GDP ratio and a 60 per cent limit on the general government debt-to-GDP ratio (in principle, applicable since 2023, but suspended by an escape clause until 2025).

Macroeconomic developments and policy response

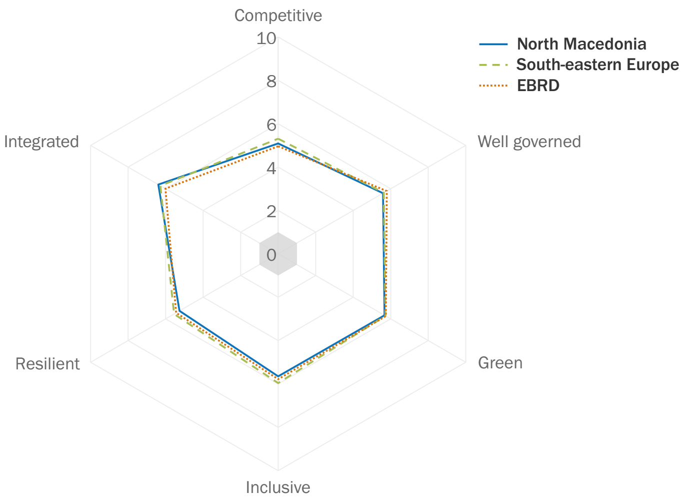
Economic growth is subdued but set to rise in the short term. Real GDP growth slowed from 2.8 per cent in 2022 to 2.1 per cent in 2023 as domestic demand abated due to a deep decline in investment and a slowdown in consumption. Growth remained moderate at 1.8 per cent year on year in the first half of 2024, driven by service sectors, particularly trade and hospitality, supported by easing inflation and rising credit activity. In contrast, industrial production stagnated, while goods exports declined, in line with sluggish demand from major trading partners, switching the current account balance from a surplus in 2023 to a 4.5 per cent of GDP deficit in the first half of 2024. Net foreign direct investment almost doubled compared with the first half of 2023 and, at 6.7 per cent of GDP, was more than sufficient to cover the current account deficit in the first half of 2024. Fixed investment grew at a double-digit pace from a low base the previous year.

Inflation has dropped to low levels, but fiscal policy remains expansionary. The rate of inflation has declined steadily over the past two years, from a peak of 19.8 per cent in October 2022 (the highest level in the Western Balkans region) to 3.5 per cent in October 2024. While food and electricity prices are stabilising, a notable increase has been recorded in the price of services, particularly accommodation services. Monetary policy has eased, with a decline in the key policy rate from a peak of 6.3 per cent to 5.8 per cent in October 2024. Credit activity continues to grow at a similar pace to 2023. Fiscal policy remains expansionary, with another pension increase approved and active from September 2024. The revised 2024 budget foresees a deficit at 4.9 per cent of GDP (similar to last year and higher than the original target of 3.4 per cent of GDP), due to the rise in both current and capital expenditure.

Public debt is rising. The revised budget and greater financing needs for ambitious capital investment kept North Macedonia's general government debt elevated at 49.1 per cent of GDP at the end of the second quarter of 2024. In the first seven months of 2024, the government raised around MKD 49.5 billion (€800 million) on the domestic bond market. It also received the first half of a bilateral loan from Hungary, in the amount of €500 million, with a duration of 15 years (including a three-year grace period) and an annual interest rate of 3.25 per cent. The loan proceeds will be used for municipal capital investment and direct economic support.

Real GDP growth is set to accelerate further in the short term. The economy is forecast to grow by 2.2 per cent in 2024 and 3.5 per cent in 2025 on the back of a recovery in external demand and improving domestic demand, helped by easing inflationary pressures and rising wages, as well as the pick-up in investment driven by infrastructure projects. Downside risks lie in the limited fiscal space created by the country's high public debt levels, the potential for slow progress on European Union (EU) accession and the pace of global (especially eurozone) growth.

Assessment of transition qualities (1-10)



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Structural reform developments

The European Commission approved the reform agenda. North Macedonia stands to gain around €750 million from the Reform and Growth Facility of the EU's Growth Plan for the Western Balkans in 2024-27 once it implements the associated reform agenda. Approval of the reform agenda paves the way for the release of the pre-financing of up to 7 per cent of the total allocation in December 2024. Focus areas are judicial reform, the digitalisation of public administration and cybersecurity, decarbonisation policies, energy efficiency and renewable deployment, and human capital development. There has been little progress in these areas in 2024 because of election-related delays and the time taken to form the new government.

The authorities have adopted a set of energy measures to lower electricity subsidies. The new measures, adopted in 2023, aim to reduce budgetary transfers to the electricity company, ESM, by about two-thirds in 2024. In the medium term, the authorities should continue to implement the ambitious commitments for decarbonisation of the energy sector, with renewable energy supplying electricity at competitive prices to help mitigate pressures from increased energy tariffs and the potential fiscal burden.

The Organic Budget Law is being implemented. Under the law, new fiscal rules will be applied from 2027 in line with the Medium-term Fiscal Strategy 2025-29, bolstering fiscal discipline. Fiscal Council members were appointed by parliament in 2023 and have taken up their work assignments, while the process of recruiting staff to the Council secretariat is ongoing. The Council is expected to become fully operational by the end of 2024.

The government has issued a tender for infrastructure and capital projects in local municipalities. New projects will be supported by €98 million in budgetary financing. State support is to be provided for culture, sports, environmental protection, road infrastructure, education and social projects in local municipalities, with a total planned allocation of €250 million for this purpose.

Informal activity is being tackled. In June 2023, the government adopted the new Strategy and Action Plan for the Formalisation of the Informal Economy 2023-27. The strategy focuses on building institutional infrastructure for detecting and monitoring informal activity, providing statistical data and indicators that will be used for regular monitoring of the informal economy, and digitalising public procedures. In addition, action has been taken to improve the regulatory framework, particularly as regards labour relations. Implementation of a previous strategy to combat the informal economy remains modest.

Romania

Highlights

- **Economic growth has slowed significantly.** After real gross domestic product (GDP) growth decelerated to 2.4 per cent in 2023, the economy grew by only 1.3 per cent year on year in the first half of 2024, despite strong real wage growth boosting consumption. The fiscal position has also deteriorated further.
- **Pension reform was adopted.** This reform is part of the country's commitments under the Recovery and Resilience Plan (RRP), and addresses inconsistencies in pension formulas alongside introducing new indexation criteria. The recalculation of pensions, starting from September 2024, will cost around 1.5 per cent of GDP in 2025.
- **Despite fiscal pressures, the government continues to support transport infrastructure projects.** Romania's investment in its transport infrastructure has historically fallen below its needs. The authorities have therefore significantly accelerated work on a number of key highway projects, including one to eventually connect Bucharest with northern Ukraine.

Key priorities for 2025

- **The need for fiscal reform is becoming more urgent.** In line with recommendations from the European Union (EU) and other international organisations, Romania should create a more efficient, fair and transparent tax system and administration aimed at increasing fiscal revenues and controlling spending more effectively.
- **Implementation of the RRP must remain a priority.** Amid the growing delays in reaching RRP milestones and the lack of disbursements in 2024, the authorities need to re-energise their efforts to deliver the necessary reforms and investments.
- **Continued reforms and investments to green the energy sector are needed.** Romania has great potential to develop the renewable energy market, supported by EU funds and recent reforms, but capacity has increased more slowly than in regional peers in recent years. More work needs to be done to integrate renewables into the grid and to balance the system.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-3.7	5.5	4.0	2.4	1.4
Inflation (average)	2.3	4.1	12.0	9.7	5.9
Government balance/GDP	-9.3	-7.2	-6.3	-6.6	8.0
Current account balance/GDP	-4.9	-7.2	-9.2	-7.0	-8.3
Net FDI/GDP [neg. sign = inflows]	-1.3	-3.7	-3.1	-2.0	-2.0
External debt/GDP	57.5	56.6	50.6	51.9	na
Gross reserves/GDP	19.3	19.0	18.4	20.3	na
Credit to private sector/GDP	25.5	26.2	24.7	22.8	na

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Macroeconomic developments and policy response

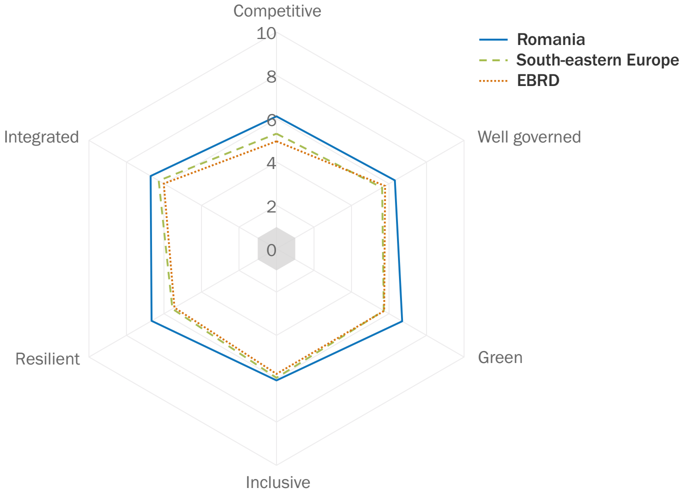
Economic growth in 2024 has been disappointing. In the first half of 2024, real GDP grew by just 1.3 per cent year on year, as a strong rebound in consumption was almost fully offset by higher imports and destocking. Infrastructure investment continued to support growth, however. The rise in imports is reflected in a widening of the current account deficit so far in 2024. After robust growth in 2023, growth in the construction sector, including civil engineering, slowed significantly in the first half of 2024, with the residential sector declining by 21 per cent. The information and communications technology (ICT) sector, which has been an important growth driver in recent years, also slowed significantly in line with global trends, while industrial production stagnated on the back of weak foreign demand.

Inflation is proving sticky amid strong real wage growth and expansionary fiscal policy. Inflation has fallen markedly from its recent peak of 16.8 per cent in November 2022, but was the highest in the EU at 5.4 per cent as of July 2024. Goods inflation has increased on the back of higher taxes and growing consumption while services inflation is still elevated at around 9.0 per cent, albeit on a downward path. Higher core inflation suggests a more difficult disinflationary path in Romania compared with regional peers, mainly as real wage growth has averaged 7.4 per cent so far in 2024, the highest level since 2019. The central bank cut its policy rate twice in summer 2024, to 6.5 per cent. Ample interbank liquidity kept market borrowing rates below the policy rate, stimulating credit demand, especially for consumer loans.

Despite some tax changes, the fiscal position continues to deteriorate in 2024. Fiscal policy continues to be expansionary in Romania, with the half-year deficit at 3.6 per cent of GDP, higher than in the three previous years. While revenues performed well in the first six months, following the tax package announced towards the end of 2023, spending has surged, as capital expenses, salaries and goods and services all increased by over 20 per cent year on year. In July 2024, spending accelerated by an even higher 36 per cent year on year. The most recent estimates by the Fiscal Council see the deficit soaring past 8 per cent of GDP in 2024, which will put consolidation on a long path towards normalisation. Romania has been under the European Commission's excessive deficit procedure since 2020.

Slow growth is likely in the short term. Household consumption will remain strong on the back of a tight labour market and wage growth, but agriculture is being affected by droughts, construction is held back by high interest rates and costs, and foreign demand for exports and ICT services has declined. In addition, the expected fiscal consolidation will further reduce demand in the economy. Another risk is further delays in implementation of the RRP. Considering all the factors, we forecast real GDP growth of 1.4 per cent in 2024, followed by an improvement to 2.6 per cent in 2025.

Assessment of transition qualities (1-10)



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Structural reform developments

RRP implementation is facing delays. As of mid-2024, Romania had received €9.4 billion from its pre-financing and two payment requests. The third payment request, initially scheduled for June 2023, is still under assessment by the European Commission (EC), while the fourth request, also originally planned for 2023, is yet to be submitted. The accumulated delays may lead to another renegotiation of the schedule. Among the main delayed deliverables from the first three payments are milestones related to the decrease of the turnover threshold of microenterprises from €500,000 to a lower level, still to be negotiated. Other delays include signing the contracts for hydrogen capacity, and some milestones related to improving corporate governance in state-owned enterprises (SOEs). Another contentious milestone is public pay reform, which will start after the general election in December 2024.

The government adopted a tax package and administration reforms to increase fiscal revenues. The package, adopted in October 2023, contains multiple fiscal changes worth around 1.2 per cent of GDP, with revenue-side measures accounting for 0.8 per cent of GDP. Among the main tax measures were the partial removal of preferential tax regimes for employees in construction, agriculture and ICT, the removal of some reduced value added tax (VAT) rates, increased microenterprise taxes, and higher turnover taxes for large corporates and financial institutions. The tax authority is also implementing various digitised tools such as e-invoicing, Standard Audit File for Tax (SAF-T), and e-VAT forms to digitise interactions and thus decrease tax evasion.

The digitalisation of the public sector is ongoing. In April 2024, the government launched the procurement process for implementing the dedicated governmental cloud, a project worth €80 million included in the RRP. The cloud infrastructure will host the platforms of the central authorities, a crucial part of the digitalisation of public administration. Other ongoing projects in this area are the digitalisation of interactions with the tax authority (mentioned above), and a framework project for the customs authority, aimed at aligning and updating IT systems.

Pension reform will bring long-term savings but carries significant short-term costs. In November 2023, the government adopted a general pension reform aimed at ensuring the long-term fiscal sustainability and increasing the fairness of the system. The new system introduced a pension calculation formula, which excludes ad-hoc increases and links it to life expectancy, strengthens incentives for longer working lives, and reduces early retirement options. The reform is expected to bring long-term fiscal savings of around 3 per cent of GDP, but the recalculation of entitlements adopted in September 2024 is expected to lead to a significant fiscal impact in 2025 of around 1.5 per cent of GDP.

SOE corporate governance reform has been patchy. An important part of the RRP covers the improvement of SOE corporate governance, in line with Organisation for Economic Co-operation and Development (OECD) standards. The government established a new monitoring agency (AMEPIP) and appointed its management in 2023, but the management resigned in July 2024, leaving the agency's future in doubt. Nevertheless, the updated SOE law to remove existing exceptions was adopted in June 2024. However, the three RRP milestones related to appointing full-term management in key SOEs have only been partially reached so far. As of May 2024, only 25 out of 142 SOEs that operate under the SOE law at central level have appointed full-term boards.

Road infrastructure investments are progressing but metro projects are facing delays. A considerable share of EU funding has been dedicated to infrastructure investments, given Romania's large gaps relative to EU standards. While RRP-financed highway sections are progressing relatively well, the two metro projects included in the RRP – the new line connecting the airport in Bucharest and the Cluj metro – are facing some delays and will likely extend beyond the deadlines, especially in Cluj where there is a significant financing gap.

Important energy infrastructure investments are being launched. As part of the RRP, the Ministry of Energy signed two contracts for high-efficiency gas power plants and for hydrogen production. In June 2024, the ministry announced the signing for five combined-cycle gas turbine power plants with a total capacity of 486 MW, also producing district heating. Around half of the target capacity was also signed under the hydrogen production support scheme. The ministry also finally approved the contracts-for-difference (CfD) scheme for supporting renewable investments, although the auctions are yet to be held. Other investments that are behind schedule are in battery storage and supporting relevant projects that would enhance the local value chain for the green transition.

Serbia

Highlights

- **Real gross domestic product (GDP) growth is accelerating.** After 2.6 per cent in 2022 and 3.8 per cent in 2023, similar real growth of 3.8 per cent is expected in 2024, according to newly revised data, on the back of improved domestic demand, driven by easing inflation and the pursuit of ambitious public investment projects.
- **The Serbian authorities and International Monetary Fund (IMF) reached staff-level agreement on the fourth and final review under the Stand-By Arrangement (SBA) and on a successor 36-month Policy Coordination Instrument (PCI) request.** The PCI is a non-financing instrument designed to support strong economic policies with an economic reform agenda. The agreement is subject to approval by the IMF Executive Board in December 2024.
- **A draft bylaw implementing the country's new state-owned enterprise (SOE) governance legislation was adopted in September 2024.** The bylaw sets out the regulations determining the public service obligations of SOEs when implementing broader public-sector goals.

Key priorities for 2025

- **The reform agenda under the Reform and Growth Facility was approved in October 2024 by the European Commission.** Reforms will focus on the rule of law and other fundamentals, governance, the digital and green transitions, human capital development and the business environment.
- **Further SOE governance reforms are key to avoiding future fiscal risks.** An ongoing corporate governance programme in the state-owned electricity production company, Elektroprivreda Srbije (EPS), is essential for the successful restructuring of the company. Governance reforms in other SOEs, such as the railways, should also be accelerated, particularly considering the significant investments undertaken, funded by international loans and backed by sovereign guarantees.
- **The authorities should continue to decarbonise the energy sector.** This can be done by scaling up renewables through auctions and increasing the energy efficiency of buildings, including by way of a switch to consumption-based billing.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-1.0	7.9	2.6	3.8	3.8
Inflation (average)	1.6	4.1	12.0	12.4	4.8
Government balance/GDP	-7.7	-3.9	-3.0	-2.1	-2.7
Current account balance/GDP	-3.9	-4.1	-6.6	-2.4	-3.0
Net FDI/GDP [neg. sign = inflows]	-6.0	-6.5	-6.8	-5.7	-6.0
External debt/GDP	62.8	65.2	66.0	60.4	na
Gross reserves/GDP	27.5	29.4	30.6	33.1	na
Credit to private sector/GDP	45.5	43.4	40.3	35.8	na

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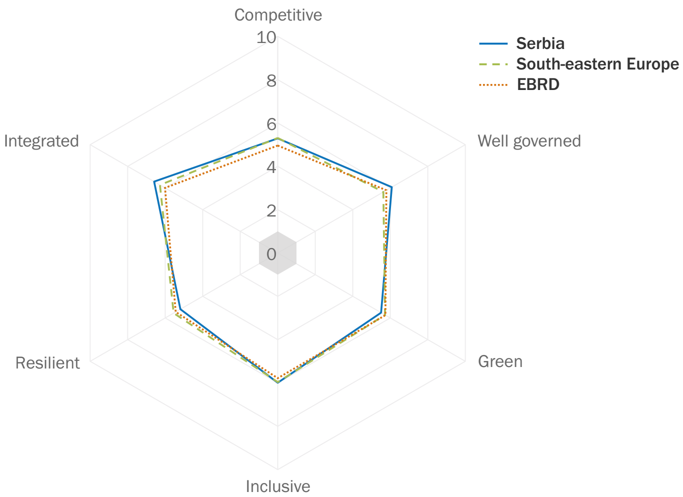
Macroeconomic developments and policy response

Real economic activity is accelerating. After 2.6 per cent real growth in 2022, consistent with the adverse global macroeconomic environment, and an acceleration to 3.8 in 2023, according to newly revised GDP data, real GDP growth picked up further to 3.9 per cent year on year in the first three quarters of 2024 (this figure may also be revised in line with the new methodology). The greatest contributions came from services, predominantly retail trade, catering and tourism, and construction. On the expenditure side, growth was driven by domestic demand – namely, household consumption and fixed investment – while net exports made a negative contribution due to higher growth in service imports, particularly tourism and transport, in line with easing inflation and the recovery in domestic demand. Higher import growth, along with a decrease in remittance inflows and government transfers in the first three quarters of the year, were reflected in a current account deficit of more than €3.3 billion, four times higher than the same period in 2023. Net foreign direct investment inflows remained strong at €3.6 billion in the first three quarters of 2024.

Inflationary pressures are easing, although more slowly than in Serbia's peers. Average inflation fell from 12.4 per cent in 2023 to 4.8 per cent in the first nine months of 2024. The authorities have employed monetary and fiscal policy measures to support the economy in light of still relatively high inflation. Monetary policy shows signs of easing, with the policy rate declining slightly from its peak of 6.5 per cent to 5.75 per cent in September 2024, where it remained until November. A new set of measures announced for the second half of 2024 are easing the fiscal stance by increasing pensions, the minimum wage, average public-sector wages and agricultural subsidies. Despite these expansionary policies, the fiscal deficit is set to remain at 2.7 per cent of GDP, according to the IMF (below the increased target of 2.9 per cent of GDP), which has assessed Serbia's public debt as being sustainable. Serbia received an investment grade rating (BBB-, with stable outlook) by S&P Global, upgraded from BB+ in October 2024, owing to macrofiscal stability, strong growth prospects and sound external buffers. In September, Moody's upgraded its rating to Ba2 (Positive) (two notches below investment grade) from Stable; and in August Fitch upgraded Serbia to BB+ (Positive) (one notch below investment grade) from Stable. The government is expecting another ratings move to investment grade next year, supported by the new IMF Policy Coordination Instrument programme.

Real GDP growth is set to pick up in the near term. Economic growth is forecast to be at its medium-term potential in the short term, at 3.8 per cent in 2024 and 4 per cent in 2025, in line with the expected global recovery. However, the recent revision of historical data on GDP, in line with a new methodology, may affect growth statistics in 2024 and the forecast for 2025. Downside risks arise from possibly low growth in the EU, Serbia's major trading partner, tight labour markets, geopolitical instability affecting supply chains and adverse weather conditions, which may have a negative effect on agricultural production. In contrast, successful implementation of reforms in the area of governance of state-owned enterprises and well-planned and executed capital investment may boost growth further. The medium-term outlook remains robust, underpinned by macroeconomic stability, and a solid track record of strong public and foreign investment.

Assessment of transition qualities (1-10)



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Structural reform developments

Progress on key reforms will unlock important external financing. Serbia is set to receive around €1.6 billion from the funds of the EU's Growth Plan for the Western Balkans once it completes critical reforms set out in the country's reform agenda. Key areas include the justice system and the fight against corruption, the green and digital transition, renewables regulation, private-sector development and improvements to the business environment.

Anti-corruption reforms have advanced. In July 2024, the government adopted a National Anti-Corruption Strategy for 2024-28, aimed at meeting 14 transitional benchmarks for the EU acquis negotiation chapter on justice and fundamental rights. The document covers the areas of policing, health, education, local self-government, construction, financing of political activities, taxes and customs, public procurement, privatisation and public enterprise.

SOE governance is being improved. The new SOE governance law, which takes inspiration from the OECD Guidelines on Corporate Governance of SOEs, came into effect in September 2024, although some transition provisions will last until early 2025. The authorities are working closely with international financial institutions – namely, the IMF and the EBRD – to prepare secondary legislation that will allow the law to be implemented, including bylaws on public service obligations and SOE classification based on ownership rationale, which were also adopted in September 2024. Better staffing and resources at the Ministry of Economy are key to allow the SOE oversight unit to handle its greatly expanded responsibilities under the new law.

Amendments to the Law on Payment Services have been adopted by parliament. The amendments were adopted in August 2024 and will be applied from May 2025. They will harmonise the law with EU regulations. The key goals of the amendments are to enhance market innovation, secure greater competition and transparency of payment services, better protect users and increase payment security. The newly introduced "open banking concept" will allow the clients of financial institutions to initiate payments and have a consolidated overview of information on all of their payment accounts in one platform, regardless of the provider the account was opened with.