



WESTERN BALKANS REGULAR ECONOMIC REPORT

No. 25 | Spring 2024

Invigorating Growth





Western Balkans
Regular Economic Report No.25 | Spring 2024

Invigorating Growth

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The cover image depicts green coverage in urban areas in the Western Balkans region.

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This Regular Economic Report (RER) covers economic developments, prospects, and economic policies in the Western Balkans region: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia.

The report is produced twice a year by a team led by Natasha Rovo, Richard Record, and Isolina Rossi (Task Team Leaders). This issue's core team included World Bank staff working on the Western Balkan countries (with additional contributions to specific sections): Natasha Rovo, Richard Record (Growth section), Sanja Madžarević-Šujster, Joana Madjoska, Tim Pionteck (Labor section), Alexandru Cojocar, Carlos Gustavo Ospino Hernandez, Anna Fruttero, Zurab Sajaia (Poverty section), Milan Lakićević, Besart Myderrizi (Fiscal section), Hilda Shijaku, Isolina Rossi (Monetary section), Alper Oguz, Jane Hwang (Financial sector section), Sandra Hlivnjak, Tihomir Stučka (External section), Christos Kostopoulos, Lazar Šestović, Marie Albert (Outlook section), Megha Mukim, Tianyu Zhang, Serene Vaid, and Nicholas Jones (Spotlight).

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This Western Balkans RER and previous issues may be found at: www.worldbank.org/eca/wbrer/.

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Abbreviations

AE	Advanced Economies	OECD	Organisation for Economic Co-operation and Development
CAD	Current Account Deficit	PISA	Programme for International Student Assessment
CCDR	Country Climate and Development Report	PM _{2.5}	Particulate matter 2.5 micrometers or less in diameter
CESEE	Central, Eastern and Southeastern Europe	PM10	Particulate matter 10 micrometers or less in diameter
CH ₄	Methane	PMI	Purchasing Managers Index
CO ₂	Carbon Dioxide	ppb	parts per billion
CPI	Consumer Price Index	PPG	Public and Publicly Guaranteed
DPL	Development Policy Loan	PPP	Purchasing Power Parity
EBRD	European Bank for Reconstruction and Development	Q1	First Quarter
EC	European Commission	Q2	Second Quarter
ECA	Europe and Central Asia	Q3	Third Quarter
EIB	European Investment Bank	Q4	Fourth Quarter
EMDEs	Emerging Markets and Developing Economies	RCP	Representative Concentration Pathway
EU	European Union	rhs	right-hand scale
FBiH	Federation of Bosnia and Herzegovina	RS	Republic of Srpska
FDI	Foreign Direct Investment	SEPA	Single Euro Payment Area
GDP	Gross Domestic Product	SILC	Survey of Income and Living Conditions
GHG	Greenhouse Gas	SMEs	Small and Medium Enterprises
H1	First Half	SOEs	State-Owned Enterprises
H2	Second Half	TIPS	TARGET Instant Payment Settlement
HBS	Household Budget Survey	UN	United Nations
HEWS	Heat Early Warning Systems	UNDP	United Nations Development Programme
ICT	Information and Communications Technology	US	United States
IFRS	International Financial Reporting Standard	WDI	World Development Indicators
IMF	International Monetary Fund	WHO	World Health Organization
LCU	Local Currency Unit	yoy	year-on-year
LFS	Labor Force Survey	SBA	Stand-By Arrangement
lhs	left-hand scale	SEPA	Single European Payments Area
NPLs	Non-Performing Loans		

SILC	Survey of Income and Living Conditions
SMEs	Small and Medium Enterprises
SOE	State-Owned Enterprise
SWG	Standing Working Group
TARGET	Trans-European Automated Real-time Gross settlement Express Transfer system
TIPS	TARGET Instant Payment Settlement
UAA	Utilised Agricultural Area
UNWTO	United Nations World Tourism Organization
WDI	World Development Indicators
yoy	year-on-year

Western Balkan Country Abbreviations

ALB	Albania
BiH	Bosnia and Herzegovina
KOS	Kosovo
MKD	North Macedonia
MNE	Montenegro
SRB	Serbia
WB6	Western Balkans 6

Note: All comparisons are year on year unless otherwise stated.

Invigorating Growth

1. Overview

Economic growth in the Western Balkans slowed to 2.6 percent in 2023, from the 3.4 percent reached in 2022, reflecting the impact of a weak European economy weighed down by sequential shocks. The ongoing impact of Russia's invasion of Ukraine and the inflationary spike that it unleashed has had an adverse impact on growth in the European Union (EU), a key trading partner for the Western Balkans. The EU's sizable growth slowdown in 2023, plummeting from 3.6 percent in 2022 to an estimated 0.6 percent in 2023, rippled across the region, impacting trade, investment and business confidence in the Western Balkans (WB6).

Growth performance surprised positively in Serbia and Montenegro, while the other four countries performed below expectations.

The post-pandemic recovery throughout 2021 and 2022 displayed strong duality in the performance of WB6 countries—with the relatively more manufacturing-oriented economies (Serbia, Bosnia and Herzegovina, North Macedonia) most affected by the slowdown in the EU (especially in Germany), and the relatively more services-oriented economies (Albania, Montenegro, Kosovo) benefiting most from the robust demand for tourism and international travel. This duality was partially reconciled over the course of 2023, due to a normalization in the pattern of economic activity, as the sources of growth returned to trend. As of end-2023, levels of real GDP in all WB6 countries comfortably surpassed pre-pandemic levels.

The regional labor market continued to perform well in 2023 but is beginning to show signs of cooling. The aggregate employment rate for the Western Balkans as a whole (15+) reached a new historical high of 48.1 percent in 2023. Unemployment declined across all countries, with the overall rate reaching 10.9 percent in 2023. However, while youth unemployment also declined to 25.5 percent, it remains structurally high compared with the EU average of 13.8 percent during the same period. Encouragingly, the labor force participation rate also improved over the course of 2023, averaging 54 percent in 2023, with evidence that after two years of improvements, the female-to-male participation gap for the region increased by 0.5 pp over 2023, to 19.7 percent. Real wages increased in 2023, reversing trends in 2022 during which inflation outpaced wages. However, in all countries except Kosovo, average wage growth was faster than productivity growth, suggesting that the primary drivers of higher pay were more due to minimum wage reforms and labor shortages rather than improved firm-level dynamics.

Overall, the WB6 region has experienced a rise in total hours worked driven by employment growth and labor force expansion, especially driven by women joining the labor force. From 2014 onward, all WB6 countries have seen a rise in total hours worked, although the pandemic did slow the rate at which total hours worked increased. Importantly, since 2014, all WB6 countries have enjoyed consistent positive growth in employment rates, a trend that has withstood the challenges of the pandemic. Women have contributed significantly, with their annual

increase in total hours worked outpacing that of men across all WB6 countries. Furthermore, women's higher participation rates contributed to this trend in all WB6 countries, including in Kosovo where it was disproportionately low. Recently, the WB6 countries have been reforming their immigration policies to meet growing labor demand, to counteract the demographic decline and emigration of workers to the EU.

Poverty in the Western Balkans returned to its declining trend during 2023, but at a slower pace than pre-pandemic. The overall pace of poverty reduction is forecast to have slowed down from over 3 percentage points annually pre-pandemic to roughly 1 percentage point annually between 2022 and 2025. This flattening of the poverty reduction trend is due to decelerating growth in the region and to the sharp increases in the prices of food and energy during 2022–2023, which strained households' purchasing power. The level of vulnerability to income shocks also remains high despite progress on poverty reduction. New data show that around half of all adults in the Western Balkans live in households that report just being able to make ends meet or having to dip into savings or take on debt, and thus are not able to save any portion of their income.

Fiscal consolidation gained ground in most Western Balkan countries over 2023. At 1.5 percent of GDP, the region's estimated average fiscal deficit for 2023 contracted faster than previously expected, dropping by 1.2 percentage points of GDP over the year, and falling to half of the level recorded in 2021. Consolidation was particularly strong in Montenegro and Albania, with Montenegro ending the year running a fiscal surplus. In contrast, Bosnia and Herzegovina was the only

country where fiscal policy saw a significant expansion. In most cases, fiscal performance was supported by higher direct taxation and grants receipts and, despite the decelerating inflationary impetus, all WB6 countries experienced nominal revenue growth during the year. Current spending pressures, particularly for public wages and social benefits but also including interest payments, remained high despite the overall contraction in expenditures in half of the WB6 countries.

A robust fiscal performance and solid rate of GDP growth led to a fall in debt as a share of GDP. Consequently, public and publicly guaranteed (PPG) debt declined in most WB6 countries, with the regional average PPG debt-to-GDP ratio falling from 50.4 in 2022 to 47.3 percent in 2023. North Macedonia stood out as the sole exception, experiencing a 3-pp increase in PPG debt as a share of GDP in 2023. Montenegro recorded the most substantial decline in its PPG debt-to-GDP ratio, falling from 70.9 percent in 2022 to an estimated 62.2 percent in 2023. While the cost of external financing has declined from its peak in 2023, it remains elevated. After a hiatus, economies reengaged with the markets in 2023 with Serbia, North Macedonia and Albania all issuing Eurobonds (followed by Montenegro in early 2024). All issuances incurred greater costs compared with the preceding two years, although spreads with German bonds have begun to narrow.

After increasing to levels not seen in several decades, inflation rates in the WB6 fell significantly during 2023. The primary driver of reduced inflation was decelerating international commodity prices, particularly energy and food, which together account for a high share of consumption baskets in the

Western Balkans. Average inflation for the WB6 as a whole decreased progressively over the course of the year from 14.3 percent in January 2023 to 5.1 percent in December 2023. However, there are notable differences in the pace of price deceleration, with inflation in December 2023 ranging from 2.2 percent in Bosnia and Herzegovina to 7.6 percent in Serbia, with the other countries falling in between. However, second round domestic pressures from wages and production costs remain elevated, as indicated by the persistently high core inflation.

The financial sector in the Western Balkans continued to show resilience throughout 2023, despite slowing growth, inflationary pressures and tighter financing conditions.

Credit growth was slow in 2023, at below 6 percent in the second half of 2023, amid tightening credit supply conditions. Improvements in the asset quality of banks also decelerated during the year. The average non-performing loans (NPLs) ratio improved only marginally by 0.1 percentage points to 3.8 percent, remaining broadly flat during 2023. Higher interest rates helped boost bank lending margins and profitability. Profitability, as measured by return on assets, increased to 2.4 percent in September 2023 from 1.7 percent a year before. As a result, capital buffers in the Western Balkan countries continued to strengthen, thanks to a combination of higher profitability and low NPLs, while liquidity remained broadly stable. As of September 2023, the bank capital adequacy ratio averaged 19.3 percent, far above the regulatory minimum.

The WB6 countries witnessed a notable improvement in their external position during 2023.

The current account deficit declined to a historic low of 4.9 percent of GDP in 2023, from 7.8 percent of GDP in 2022, marking the most significant improvement in the past two decades. The primary driver across the region was import compression, in both volume and value terms, particularly for energy imports, as the effects of the 2022 energy crisis abated. While Bosnia and Herzegovina experienced a marginal uptick in the external deficit, all other countries in the region showed improvements in their external balances, with the most significant improvements seen in North Macedonia (which recorded its second-ever current account surplus) and in Serbia. Furthermore, remittances rose but more slowly than regional GDP during the year. Therefore, despite growing by an estimated €230 million, in GDP terms remittances decelerated to 6.5 percent in 2023 from 7 percent of GDP the year before. The current account deficit at the WB6 regional level is entirely financed by net foreign direct investment (FDI) inflows, which amounted to 5.4 percent of GDP in 2023, exceeding the external deficit by 0.5 percent of GDP. Most countries in the region also witnessed a build-up in foreign exchange reserves during the course of 2023.

Growth projections for the medium term have increased slightly, reflecting cautious optimism that, having weathered a flurry of shocks over recent years, the Western Balkans is beginning to see a return to trend economic performance.

Regional GDP growth for the WB6 is expected to increase to 3.2 percent in 2024 and further to 3.5 and 3.8 percent in 2025 and 2026, respectively (Table 1.1). Risks to the outlook remain tilted to the downside. Persistent weakness in global

growth, and especially in the Eurozone, would translate into weaker investment and trade with the WB6. Similarly, there are a number of domestic factors that put the baseline set of projections at risk including flare-ups in geopolitical tensions, increased outward migration, electoral uncertainty in several countries, and persistent inflation.

However, while the WB6 region is expected to return on its pre-pandemic trend in 2024, this is insufficient to enable meaningful convergence with EU income levels over the medium term. While growth rates for individual countries are expected to be between 2.5 and 4 percent over the projection period, thus leading to average regional growth above the pre-pandemic trend, this is insufficient to provide faster convergence with the EU in terms of income per capita. Measured in purchasing power parity (PPP) terms, GDP per capita in the Western Balkans remains at just 40 percent of the EU average.

But, the EU's new Growth Plan for the Western Balkans offers an opportunity to catalyze growth-enhancing reforms and investments. Approved by the EU in late 2023, the new Growth Plan provides a much-needed mixture of resources for critical infrastructure investments, as well as an impetus for structural reforms. Efforts to improve integration with the single market, particularly through trade and transport facilitation measures as well as via access to the Single Euro Payments Area, in particular, are expected to provide a boost to growth over the medium term.

The structural reform agenda remains critical in order to *invigorate growth* in the Western Balkans toward faster and more sustainable improvements in living standards. Most of

the countries from the region still need to deal with: (i) remaining state-owned enterprises (SOEs) that are inefficient and create distortions to market competition; (ii) education systems that fail to deliver the skills demanded by (future) markets; (iii) public sector institutions that function poorly; and (iv) gaps in critical infrastructure, which raises the costs of doing business and is prone to climate change-related disasters. Addressing these problems—SOEs, governance, education and climate change—with comprehensive, sustainable, and adequately funded policy responses, would unleash significant growth potential.

The spotlight in this edition of the *Western Balkans Regular Economic Report* focuses on the role of cities as engines of growth and leading actor in the green transition. Cities in the Western Balkans are often small and sparsely populated, and they are experiencing demographic decline, limiting the potential of agglomeration economies. The average city is small, with only 30,000 inhabitants, and population density is low, at around 942 inhabitants per square kilometer. This is lower than other countries in Europe and Central Asia (ECA) or in most of the world. These characteristics do not lend themselves to agglomeration economies, and thus limit the potential contribution that urban areas can make to overall productivity and national economic growth. Nevertheless, greening urban development provides an opportunity not only to counteract the effects of demographic decline, but also to promote greener growth in cities and at the national level.

A changing climate has further increased vulnerabilities, with Western Balkan cities exposed to multiple natural hazards, extreme heat and poor air quality. Extreme heat in

cities has worsened considerably. For instance, Tirana, Shkodra, Vlora, Mostar, Sarajevo, and Skopje are up to 4.5–7.5°C hotter in summer compared with their rural surroundings. Many cities in the region exceed safe PM_{2.5} levels and are among the most polluted in Europe. Skopje’s annual mean PM_{2.5} levels are 4.5 times and Sarajevo’s levels are triple the recommended safe level set by the World Health Organization. These cities, along with Belgrade and Pristina, are among the most polluted capitals in Europe.

This spotlight recommends action on three main fronts to make cities in the Western Balkans greener. *First*, it is crucial to reduce urban sprawl and make cities more compact. This can be done via investments to regenerate urban areas to increase density, to encourage mixed use of land in core areas, and the redevelopment of brownfields. *Second*, cities must bring down their emissions, also because this will have immediate improvement on socio-economic and environmental outcomes. The focus should be on key sectors including transportation, buildings, and waste management—which will directly target CH₄, CO₂, PM_{2.5} emissions, and directly impact human health and livability. And *third*, cities must take actions to reduce extreme urban heat and enhance preparedness for it. Measures, such as green roofs, urban parks and gardens, and constructed wetlands, should be promoted given their low implementation costs, and high environmental and social co-benefits, while hard and soft heat adaptation measures, such as shading and extreme heat early warning systems should also be implemented to reduce the effect of heatwaves on human health.

Table 1.1. Western Balkans Outlook, 2020–26

	2020	2021	2022	2023e	2024f	2025f	2026f
<i>Real GDP growth</i> (percent)							
Albania	-3.3	8.9	4.9	3.3	3.3	3.4	3.5
Bosnia and Herzegovina	-3.0	7.4	4.2	1.9	2.6	3.3	4.0
Kosovo	-5.3	10.7	4.3	3.1	3.7	3.9	3.9
North Macedonia	-4.7	4.5	2.2	1.0	2.5	2.9	3.0
Montenegro	-15.3	13.0	6.4	6.0	3.4	2.8	3.0
Serbia	-0.9	7.7	2.5	2.5	3.5	3.8	4.0
WB6	-3.0	7.9	3.4	2.6	3.2	3.5	3.8
<i>Real GDP components growth</i> (percent)							
Consumption	-1.1	4.8	3.1	1.7	2.8	2.7	2.7
Investment	-1.6	2.1	1.3	-0.8	1.3	1.2	1.3
Net exports	-0.3	-0.4	-1.8	1.7	-1.0	-0.4	-0.2
Exports	-5.6	9.9	6.6	1.0	2.3	3.3	3.3
Imports (-)	-5.4	10.3	8.3	-0.6	3.3	3.7	3.6
<i>Consumer price inflation</i> (percent, period average)	1.0	3.2	11.8	9.0	3.9	2.7	2.4
<i>External sector</i> (percent of GDP)							
Goods exports	21.4	25.2	28.5	25.4	26.5	26.6	26.8
Trade balance	-19.4	-16.7	-18.7	-15.4	-16.7	-16.5	-16.1
Current account balance	-8.6	-5.8	-7.8	-4.9	-5.5	-5.7	-5.5
Foreign direct investment	5.3	5.9	6.9	5.4	5.3	5.3	5.3
External debt	87.8	82.8	75.3	71.3	58.2	57.2	46.3
<i>Public sector</i> (percent of GDP)							
Public revenues	34.7	35.9	34.8	36.5	36.3	36.5	36.7
Public expenditures	42.5	38.8	37.5	38.0	38.9	38.7	38.9
Fiscal balance	-7.9	-3.0	-2.7	-1.5	-2.7	-2.2	-2.4
Public and publicly guaranteed debt	60.2	56.5	50.4	47.3	47.5	46.7	42.7

Sources: National statistical offices; Ministries of Finance; central banks; World Bank staff estimates.

Note: e = estimate; f = forecast.

2. Growth returned to its pre-pandemic average, reflecting regional developments and countries' characteristics

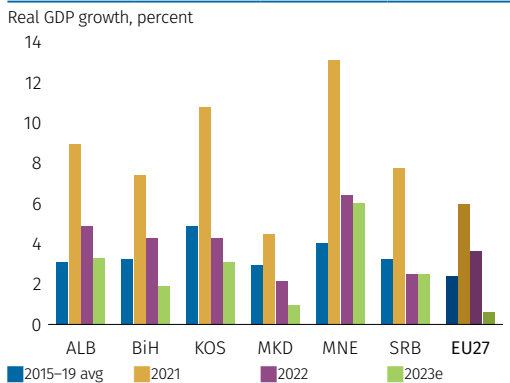
Growth in the Western Balkans is estimated at 2.6 percent in 2023, moderating from 3.4 percent reached in 2022, reflecting the impact of various regional developments (Figure 2.1). Russia's invasion of Ukraine has had an adverse impact on growth in the EU, a key trading partner for the WB6. The EU's sizable growth slowdown in 2023, plummeting from 3.6 percent in 2022 to an estimated 0.6 percent in 2023, rippled across the region, impacting both exports from the Western Balkans and, to a lesser extent, remittances. The global situation has been further complicated by the outbreak of the conflict in the Middle East which, coupled with supply chain disruptions in the Red Sea and Suez Canal, introduced additional layers of global uncertainty. Container shipping rates have surged in early 2024, accompanied by increased shipping times. However, the impact on global trade flows compared with the disruptions witnessed in 2021–22 due to the pandemic has been relatively subdued. This is attributed to lower demand pressures, expanded shipping capacity, and reduced congestion in ports.

Growth performance surprised positively in Serbia and Montenegro, while the other four countries performed below expectations. The post-pandemic recovery throughout 2021 and 2022 displayed strong duality in the performance of WB6 countries—with manufacturing-oriented economies (Serbia, Bosnia and Herzegovina, North Macedonia) mostly affected by the slowdown in the EU (especially in Germany) and services-oriented

economies (Albania, Montenegro, Kosovo) benefiting most from the re-opening of tourism and international travel. This duality was partly reconciled over the course of 2023, due to a normalization in the pattern of economic activities, as the sources of growth returned to trend. At the same time, Serbia and Montenegro surprised with a stronger-than-expected GDP growth, estimated at 2.5 and 6 percent, respectively. On the other hand, while Albania and Kosovo are now estimated to have grown at 3.3 and 3.1 percent, respectively, in 2023, down from 3.6 and 3.2 percent, respectively, from previous projections, growth rates for Bosnia and Herzegovina, and North Macedonia have been reduced to 1.9 and 1.0 percent, respectively, from 2.2 and 1.8 percent (Figure 2.1).

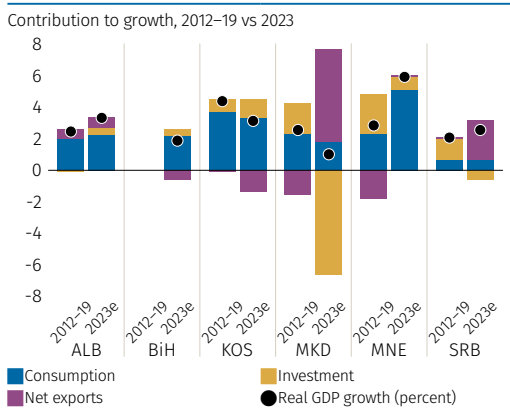
As of end-2023, growth rates returned to, or just below, pre-pandemic low averages, with the exception of Montenegro and Albania. As shown in Figure 2.2, real GDP surpassed the 2019 levels in all WB6 countries, but progress was less marked in North Macedonia, which experienced the slowest recovery of the WB6 post-pandemic. At the same time, as real GDP recovered from the crises, GDP growth rates also normalized. With the post-pandemic recovery boost dissipating, growth rates returned to their pre-pandemic averages, or even below, with the exception of Montenegro and Albania (Figure 2.1).

Figure 2.1. Growth in 2023 is estimated at 2.6 percent, below the pre-pandemic average



Source: National statistical offices and World Bank staff estimates.

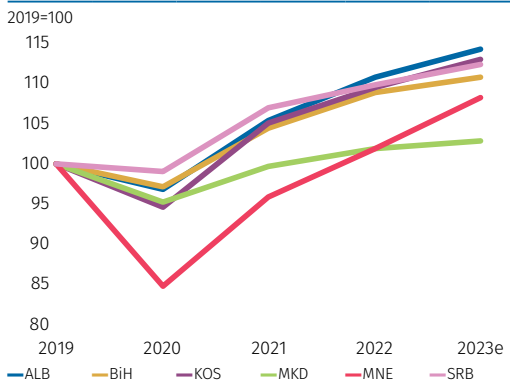
Figure 2.3. Consumption remains the main growth driver in most WB6 countries



Source: National statistical offices and World Bank staff estimates.

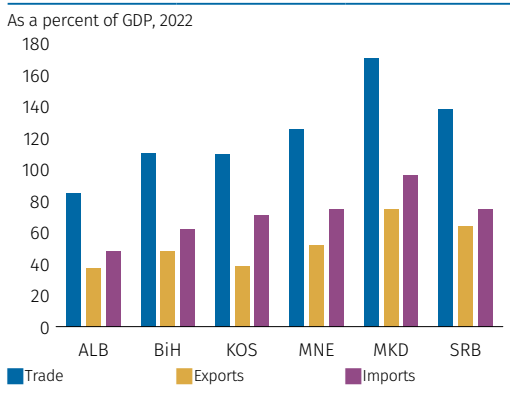
An important channel that helps explain the WB6 countries’ over/under-performance relative to expectations remains external trade. This is particularly the case for Serbia and its stronger-than-expected economic performance in 2023, while the negative or minimal contribution to growth from trade contributes to the downward revision to growth for Bosnia and Herzegovina, Kosovo, and North Macedonia (Figure 2.3). In Albania, external demand, especially for tourism-related services, remained robust—as captured by the record number of tourist arrivals and related

Figure 2.2. Real GDP comfortably surpassed 2019 levels



Source: National statistical offices and World Bank staff estimates.

Figure 2.4. Given the medium to high trade openness, trade is key to growth for the WB6



Source: National statistical offices and World Bank staff estimates.

indicators—but this did not contribute as significantly as expected to growth, due to a combination of a high base effect and the prevailing informality in the tourism sector, which prevented sectoral growth from translating into economic growth. Hence, the overall contribution from net exports to growth was only 0.6 of a percentage point, in line with the pre-pandemic average. All countries with trade openness levels of between 80 and 140 percent of GDP have much to gain from enhancing regional integration. Other countries, such as North Macedonia,

with overall trade already at 171 percent of GDP, are not only highly exposed to regional trade dynamics, but would also require the implementation of domestic structural reforms to benefit further from greater integration (Figure 2.4).

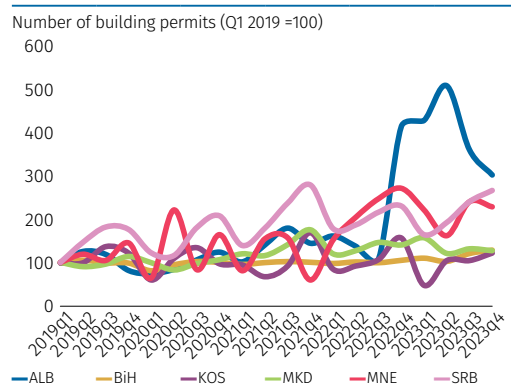
In Albania, Kosovo, and Montenegro, private consumption remained the key driver of growth in 2023, while private and public investment started to pick up (Figure 2.3).

In Montenegro, solid private consumption growth in the first half of the year stood out, underpinned by higher public sector wages, employment gains, and household borrowing. Nevertheless, it slowed down in the second half of 2023. Given a more optimistic stance in the Eurozone, with interest rates expected to have passed their peak, private investment began to pick up, as seen in Albania and Kosovo. In Bosnia and Herzegovina, subdued exports and stagnant investment were offset in part by stronger government consumption. After providing a negative contribution to growth in 2022, investment in Kosovo grew by 3.5 percent (yoy) during Q1–Q3 2023, accompanied by substantial increases in public investment program implementation (32.5 percent).

From the supply side, beyond trade and tourism-related services, construction also contributed significantly to growth, as shown by the increasing number of building permits (Figure 2.5). While services led growth across the WB6 countries, construction became an important engine for growth, particularly in Albania and Serbia, while it contributed negatively to growth in North Macedonia and Montenegro. In Albania, the acceleration in the construction sector rose by double digits, at almost 15 percent in Q2 2023, also reflecting the low comparative base

of the previous year, which was mostly due to supply chain disruptions. The acceleration in the construction sector led most of the private investment growth observed in 2023, as well as the increase in housing prices.

Figure 2.5. Construction has picked up in 2023, for Albania and Serbia



Source: National statistical offices and World Bank staff estimates.
Note: Data for Kosovo are proxied by data for Pristina.

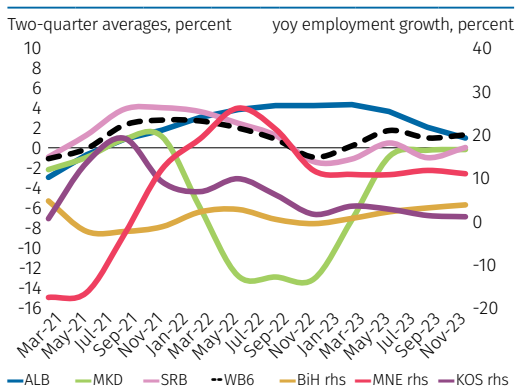
Favorable weather translated into positive contributions to growth from the energy and agriculture sectors, also thanks to the normalization in commodity prices.

In Albania and Montenegro, electricity production contributed positively to growth, while in Kosovo agriculture recorded a positive performance, favored by decreasing agricultural input prices. Similarly, in Serbia, the recovery in agriculture contributed to stronger-than-expected growth, especially in the second half of the year. Meanwhile, the contribution from the agriculture sector remained close to null in North Macedonia and negative in Albania and Montenegro.

3. Employment growth slowed in 2023, as economic growth continued to slow¹

Employment growth continued to lag throughout 2023 across the WB6 countries, with the exception of Bosnia and Herzegovina (Figure 3.1). After employment declined in the second half of 2022, it recovered through the summer of 2023 in most WB6 countries. The overall number of employed increased by about 98,700 in 2023 on an annual basis. Positive contributions came from all countries except for North Macedonia which observed a decline in the number of employed. Kosovo displayed robust employment growth coming out of the pandemic, but employment decelerated from late 2022. However, employment levels across all WB6 countries, except for North Macedonia, are above the pre-crisis levels, with Montenegro, North Macedonia, and Bosnia and Herzegovina numbers affected by a methodological change (Figure 3.2). This is similar to the post-pandemic rebound in economic growth, which was slower for North Macedonia than for the rest of WB6 countries.

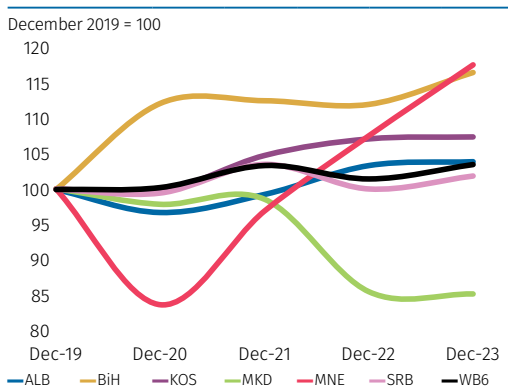
Figure 3.1. Employment growth was modest in 2023



Source: National statistical offices and World Bank staff estimates.

Employment continued to decline in the agriculture sector but strengthened in construction and services. In Q4 2023, the strongest employment growth was seen in construction (8.7 percent yoy) led by a double-digit growth in North Macedonia as it prepares for the highway construction, and services (2.8 percent), while public administration employment also strengthened (0.8 percent) (Figure 3.3). Agricultural employment increased only in Montenegro, while in the other WB6 countries, a decline continued despite increased subsidies to the agriculture sector aimed at containing the impact of food inflation and increased import substitution. Public sector employment saw a rise across all WB6 countries. Retail trade, information and communications technology (ICT), and tourism in Montenegro increased employment by double digits compared with 2022, while in Serbia construction sector employment gained strength in the second half of 2023.

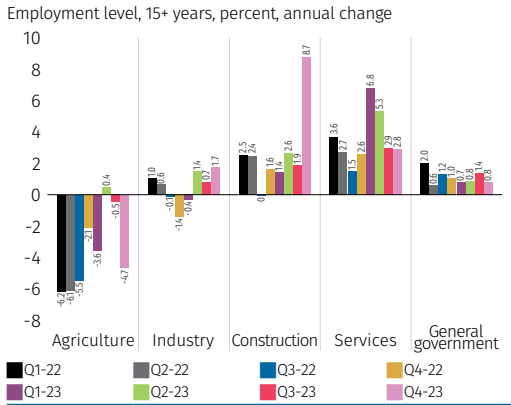
Figure 3.2. In all WB6 countries except North Macedonia, employment levels are above their pre-pandemic levels



Source: National statistical offices and World Bank staff estimates.

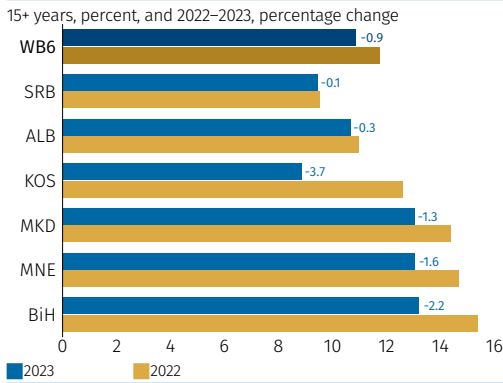
¹ This analysis was affected by: (i) delayed publishing of Labor Force Survey (LFS) data in Kosovo; (ii) a sampling revision in Bosnia and Herzegovina, Montenegro, and North Macedonia in 2021–22 that reduced comparability with previous LFS data. Using administrative unemployment and tax administration data for Kosovo helped provide an approximate picture of the labor market from Q1 2023.

Figure 3.3. Construction and services gained strength, while agriculture continued to decline



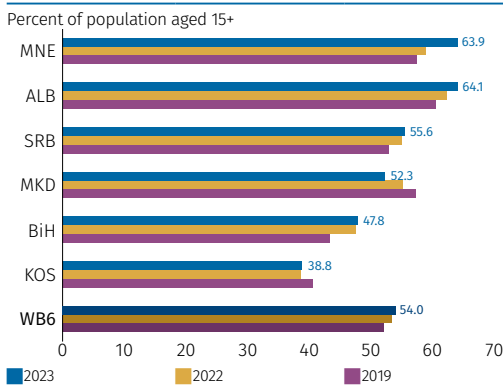
Source: National statistical offices and World Bank staff estimates. Note: employment growth is weighted average.

Figure 3.5. Unemployment rate declined in all WB6 countries in 2023



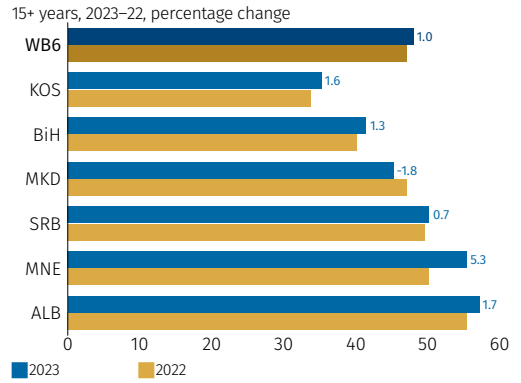
Source: National statistical offices and World Bank staff estimates.

Figure 3.7. More people joined the WB6 labor force



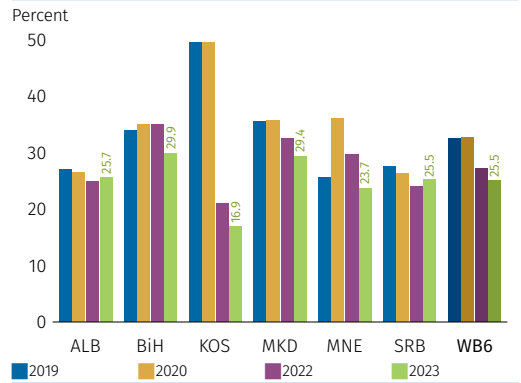
Source: National statistical offices and World Bank staff estimates. Note: Kosovo shows Q1 2023.

Figure 3.4. The employment rate increased compared to 2022



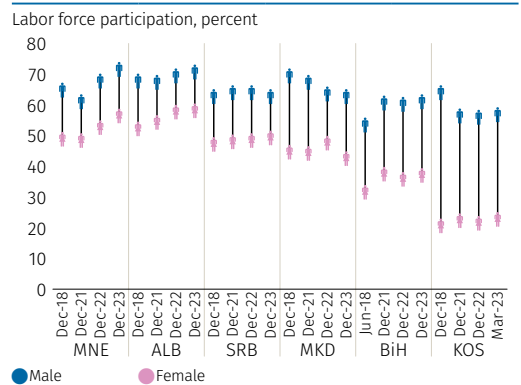
Source: National statistical offices and World Bank staff estimates.

Figure 3.6. Youth unemployment rate was more than double the overall unemployment rate



Source: National statistical offices and World Bank staff estimates.

Figure 3.8. Female to male labor participation gap narrowed to 18 percentage points



Source: National statistical offices and World Bank staff estimates.

The WB6 employment rate (15+, weighted average) reached a new historical high of 48.1 percent in 2023 (Figure 3.4). The largest annual increases were registered in Montenegro and Albania, at 5.3 and 1.7 percentage points, respectively. Albania remained the frontrunner in the WB6, with the highest employment rate of 57.2 percent in 2023, although Montenegro gained speed throughout 2022 and 2023, reaching 55.6 percent in 2023. At 50.3 percent, Serbia increased slightly its employment rate compared with 49.6 percent in 2022, despite stronger-than-expected growth performance. Although its employment rate increased, employment in Kosovo remained low at estimated 35.4 percent in 2023.

Unemployment declined across all WB6 countries, with the overall unemployment rate reaching 10.9 percent in 2023 (Figure 3.5). In 2023, there were on average 824,500 people unemployed in the WB6 region, equivalent to 7.3 percent or 64,700 people fewer than a year ago. On average, Kosovo, Bosnia and Herzegovina, and North Macedonia recorded the largest nominal declines on an annual basis in the number of unemployed, of 31, 14, and 11 percent yoy, respectively. In North Macedonia, this is explained by a rise in inactivity, while in other WB6 countries people moved to new jobs. Albania, Kosovo, North Macedonia, and Montenegro reached their historically lowest annual unemployment rates. The lowest unemployment rates in the WB6 region were observed in Kosovo and Serbia, at 8.8 and 9.5 percent in 2023, while Bosnia and Herzegovina's unemployment rate was the highest, at 13.2 percent.

The region made impressive efforts to bring the youth unemployment rate down following the pandemic; however, it remains

double the overall unemployment rate.

The youth unemployment rate declined to 25.5 percent, 1.6 percentage points below the average 2022 rate (Figure 3.6). This was still well above the youth unemployment rate in the EU, which stood at 13.8 percent in 2023. There were 154,900 young people unemployed in the WB6 countries in 2023, some 15,700 fewer than in 2022. The lowest youth unemployment rate was seen in Kosovo at 16.9 percent, followed by Montenegro. The highest youth unemployment rate was registered by Bosnia and Herzegovina, at 29.9 percent in 2023—the country with one of the largest world diasporas of younger migrants. Despite improvements, the young people in the WB6 countries continue to experience high rates of inactivity, high shares of informal-sector employment, skills mismatches, and continued emigration.

The labor force participation rate improved over the course of 2023 at the WB6 regional level (Figure 3.7). The participation rate averaged 54 percent in 2023, 0.5 of a percentage point higher than in 2022, with the gains coming from all WB6 countries except North Macedonia. The labor force participation rate reached 64.1 percent in Albania—a record for the WB6 region. The lowest ratio of population participating in the labor market was in Kosovo and this has seen almost no improvement since 2021. The increase in the labor force participation rate partly reflected a decline in the working age population. Namely, the working age population over the past year declined across all WB6 countries, except for North Macedonia, reflecting population aging and migration outflows.

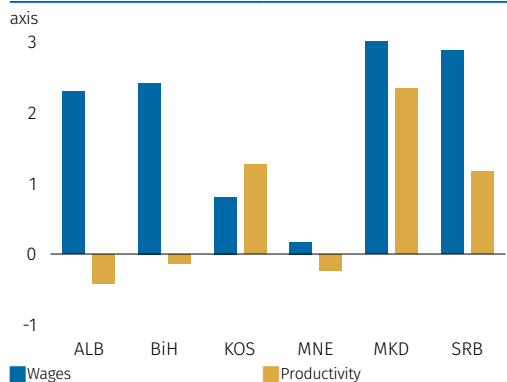
The improvement of the labor force participation rate was the result not only of women, but also men, entering labor

markets in Albania, Montenegro, Kosovo, and Bosnia and Herzegovina (Figure 3.8). The most pronounced increase in female labor force participation was in Montenegro, at 3.5 percentage points (pp), Kosovo at 1.6 pp, and Bosnia and Herzegovina, at 1.3 pp by December 2023. With a female labor participation rate of 57.7 percent, Albania set the record for the WB6 region. Advances were seen in Montenegro's male labor force participation as well (at 71.3 percent being the lead in the region). Female participation rates were also above the regional average of 44.2 percent in Montenegro and Serbia, while the gender gap in Albania narrowed the most—to 12.8 percentage points. After two years of improvements, the female-to-male participation gap for the region increased by 0.5 pp over 2023, to 19.7 percent, with a stark difference of over 34 pp in Kosovo. Bringing more workers into the labor market and increasing labor productivity will be crucial to support future growth. However, visa liberalization in Kosovo,² the relaxed work permitting in some EU countries (such as Germany), and aging create further adverse pressures on the labor market (see Box 3.1).

While inflation outpaced wages despite their double-digit growth across the WB6 region in 2022, real wages increased in 2023. In 2022, real wages declined in all WB6 countries, most notably in Bosnia and Herzegovina where the annual decline averaged 8.7 percent. In the other WB6 countries real wages fell between 1.0 and 3.5 percent. Meanwhile, in 2023, real wages increased by 8.4 percent on average across the WB6, comfortably surpassing the productivity growth of 0.2 percent. This was a

result of the automatic indexation of minimum wages introduced in several countries, strong public sector wage bargaining, and a record shortage of workers in the private sector.

Figure 3.9. Average real wage and productivity growth, 2015–2023



Source: National statistical offices.

Note: Historical productivity estimates are obtained using average hours worked per week, number of employees from Labor Force Survey (LFS) and real output. Estimates for 2023 are obtained using World Bank staff forecasts and assuming no change in average hours worked per week.

Real wages do not reflect productivity growth in most of the WB6 countries since 2015.

This is likely due to underlying firm dynamics (low productivity improvements through sectoral reallocation, between and within firms' reallocation), but also low public sector productivity. On the other side, minimum wage reforms, public sector bargaining power, and labor supply shortages widened the wage-productivity growth differential for most of the WB6 countries.³ This gap was most notable for Albania and Bosnia and Herzegovina, where real wages increased at double-digit rates, despite low or declining productivity. Real wages also rose by more than productivity in Serbia, Montenegro, and North Macedonia, in particular for manufacturing, construction and public sector workers, where wages grew

² <https://www.kosovo-online.com/en/news/analysis/kosovo-rapidly-losing-its-workforce-what-follows-after-visa-liberalization-29-10-2023>.

³ 2023 wage data for Kosovo are not available.

faster than the average wage. High emigration and population aging continued to aggravate labor market distortions in the WB6 region, as

firms increasingly battled with labor availability and a brain drain,⁴ despite a positive wage-productivity growth gap (Figure 3.9).

Box 3.1. Labor markets in the Western Balkans: navigating demographic shifts and emigration

Changes in total hours worked can be decomposed into the impacts of five factors.

Following the recent approach of the International Monetary Fund (IMF),⁵ growth of total hours worked can be decomposed into the impacts of: (i) growth of average hours worked per employed person; (ii) total population growth; (iii) employment rate; (iv) participation rate; and (v) the share of the working age population. However, recent changes in labor force survey methodologies and new census data have limited the cross-country comparability of the data.⁶ Also, the 2020–2022 period should be interpreted with caution, given the pandemic-related fluctuations.

Overall, the WB6 region has experienced a rise in total hours worked driven by employment growth and labor force expansion, while population has declined.

From 2014 onward, all WB6 countries have seen a rise in total hours worked, although the pandemic did slow the rate at which total hours worked increased (Figure 3.10). Trends in average hours worked are highly variable across WB6 countries and time, preventing a clear trend from emerging. The most significant demographic challenge was the decline in populations in Bosnia and Herzegovina, Kosovo, North Macedonia, and Serbia. However, labor market dynamics largely mitigated this negative impact on total hours worked. The working age population in the WB6 remained relatively stable for most countries, while labor force participation witnessed diverse trends across countries. Albania, Montenegro, and Serbia witnessed notable increases in labor force participation rates between 2014 and 2022, although the upward trend is losing momentum. Kosovo and North Macedonia experienced variable participation rates, while Bosnia and Herzegovina has witnessed a decline in its labor force since 2011. Importantly, since 2014, all WB6 countries have enjoyed consistent positive growth in employment rates, a trend that has withstood the challenges of the pandemic.

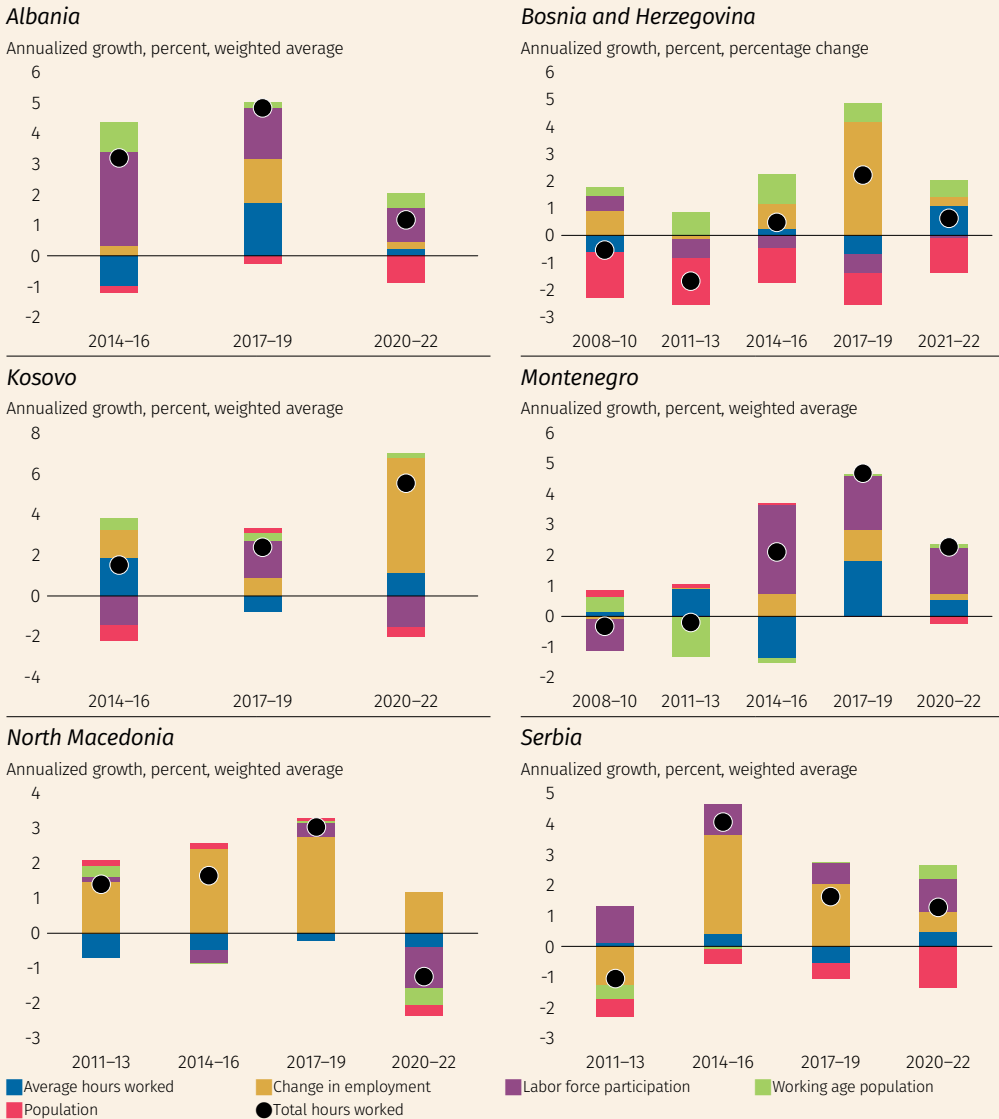
⁴ https://www.rcc.int/balkanbarometer/key_findings/1/business.

⁵ IMF: Regional Economic Outlook Europe, 11/23. Chapter 2: Wage Dynamics in Europe: Are Labor Markets heralding More Inflation? Online Annex. <https://www.imf.org/en/Publications/REO/EU/Issues/2023/10/13/regional-economic-outlook-for-europe-october-2023>.

⁶ Bosnia and Herzegovina's labor market data prior to 2020 have been revised using new census data, affecting comparability. The 2020 growth rate is excluded from the chart due to a fourfold increase in the survey sample size in 2021. In Montenegro, LFS interviews quadrupled in 2022, aligning with Eurostat standards, which impacts comparability with previous years. Kosovo's average work hours data are estimated from employment-weighted averages of employment by hours of work in intervals due to the poor quality of the data. North Macedonia's 2021 and 2022 data lack comparability due to methodological changes and new census data; thus, new rates are applied to old population numbers. The 2021 and 2022 average hours worked were not reported to Eurostat, hence the same estimation method as in Kosovo was applied.

(Box 3.1 continued)

Figure 3.10. Change in total hours worked and contributions

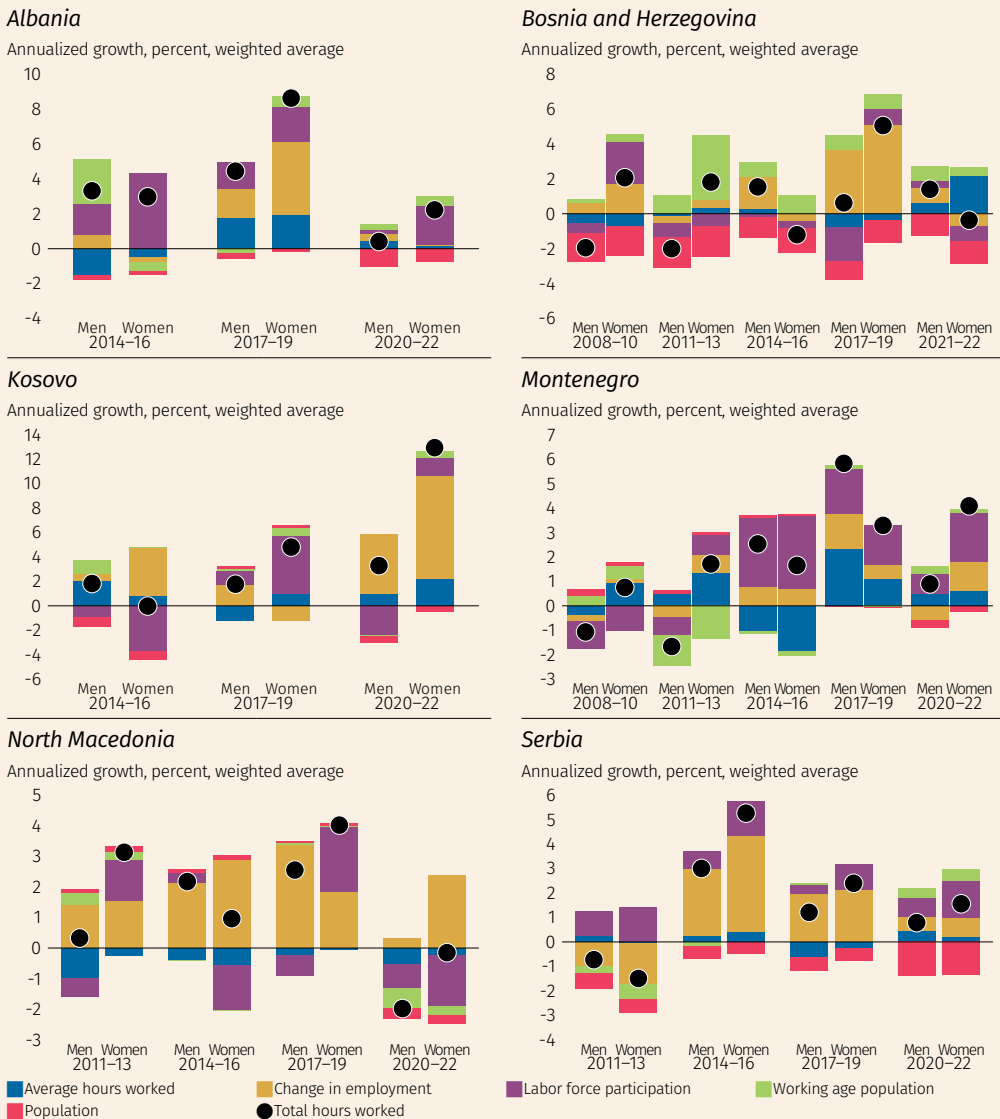


Sources: National statistical offices, Eurostat, World Bank staff calculations.
 Note: See Footnote 6 for a methodological explanation.

Women have contributed significantly in the WB6 countries, with their annual increase in total hours worked outpacing that of men across all WB6 countries. Between 2013 and 2022, women’s average yearly contribution to overall total hours worked exceeded that of men by 2 percentage points in Albania, and 1.4 percentage points in Serbia (Figure 3.11). The primary driver for this disparity is a marked rise in women’s employment rates. Furthermore, women’s higher participation rates contributed to this trend in all WB6 countries, including in Kosovo where it was disproportionately low.

(Box 3.1 continued)

Figure 3.11. Change in total hours worked and contributions: disaggregated by gender



Sources: National statistical offices, Eurostat, World Bank staff calculations.
 Note: See Footnote 6 for a methodological explanation.

Recently, the WB6 countries have been reforming their immigration policies to meet growing labor demand, to counteract the demographic decline and emigration of workers to the EU. The WB6 region is increasingly becoming a destination for migrants from less affluent countries, particularly in the ICT, construction and hospitality industries. Russia’s invasion of Ukraine has prompted many Russians and Ukrainians to migrate to the Western Balkans as well. Bosnia and Herzegovina’s foreign workforce has doubled since 2020,

(Box 3.1 continued)

with about 3,500 work permits issued by the end of 2023.⁷ Montenegro has seen a 2-percent increase in its population, primarily due to the arrival of foreign nationals.⁸ Serbia, from February 2024, has eased its policies, allowing work with a temporary residence permit, and offering the prospect of permanent residency after three years.⁹ Albania, having introduced a Single Permit system in 2021, has streamlined the process for foreign workers and extended residence permits to five years, which has led to a rise in the number of foreign residents.¹⁰

7 <https://sarajevotimes.com/there-are-3500-foreign-workers-in-bih/>.

8 <https://balkaninsight.com/2024/01/26/montenegros-population-rise-linked-to-influx-of-foreigners-demographers-say/>.

9 <https://statt.rs/3-dramatic-changes-of-legal-requirements-for-foreigners-in-2024/>.

10 <https://kpmg.com/al/en/home/insights/2021/10/new-law-on-foreigners.html>.

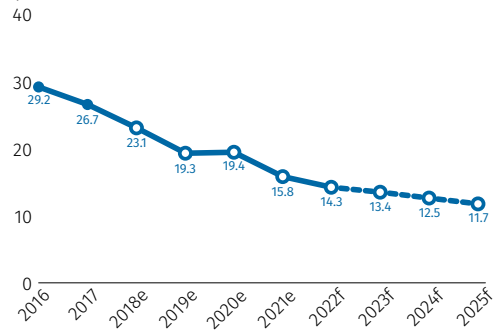
4. The pace of poverty reduction has slowed and vulnerabilities persist

Poverty in the Western Balkans returned to its declining trend during 2023, but at a slower pace than pre-pandemic (Figure 4.1). The pace of poverty reduction is closely linked to the pace of economic growth and is highly impacted by the various shocks that affect households' income-generating ability. The overall pace of poverty reduction is forecast to slow down from over 3 percentage points annually pre-pandemic to roughly 1 percentage point annually between 2022 and 2025, the forecast period. This flattening of the poverty reduction trend is due to decelerating growth in the region, to the sharp increases in the prices of food and energy during 2022–2023, which strained households' purchasing power, and to the decline in real wages in 2022 (see Section 3, and also Regular Economic Report No.23, Spring 2023). Although inflation fell in 2023 and is forecast to continue decelerating through the remainder of the forecast period, its cumulative effects continue to pose a challenge for lower-income households.

Poverty levels across the region have been converging over time. Although poverty rates vary significantly across Western Balkan countries, they have been converging over time. The average deviation of each country's poverty rates from the regional mean has declined since 2020, and this trend is expected to continue. The gap is forecast to narrow in 2024, with a 13.5-percentage-point difference between the countries with the highest and lowest poverty rates (Albania and Serbia, respectively), down from nearly 24 percentage points in 2016.

Figure 4.1. Poverty is expected to decline at a slower rate in the WB6

Poverty headcount, percent of population living on less than \$6.85/day, 2017PPP

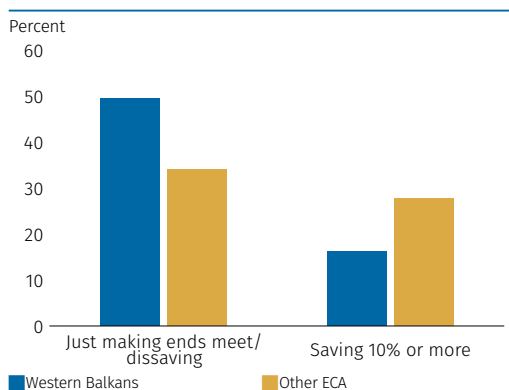


Source: World Bank estimates and forecasts based on 2021 income data from the Survey of Income and Living Conditions (SILC) for Montenegro; 2019 for Albania and North Macedonia; 2021 for Serbia; and 2017 Household Budget Survey (HBS) for Kosovo.

Note: Income and consumption measures from the SILC and the HBS, respectively, are not strictly comparable. Welfare is estimated in US dollars using 2017 PPPs. Due to a lack of comparable data, the regional estimate excludes Bosnia and Herzegovina (BiH). Forecasts are based on GDP per capita in constant LCU, e = estimate, f = forecast.

The level of vulnerability to income shocks remains high despite progress on poverty reduction. Data from the recent Life in Transition Survey collected in 2023 reveal that, in the Western Balkans, half of adults live in households that report just being able to make ends meet or having to dip into savings or take on debt, and thus are not able to save any portion of their income. This compares with only one-third in other ECA countries. Less than one in every five adults in the Western Balkans are in households that are able to save at least 10 percent of their income (Figure 4.2). This points to a high level of vulnerability to falling into poverty as the result of idiosyncratic income shocks in the Western Balkans. Over one-third of adults in the Western Balkans live in households that would not be able to cover more than two weeks of basic household expenses in the event of losing the main source

Figure 4.2. Many households are barely making ends meet...



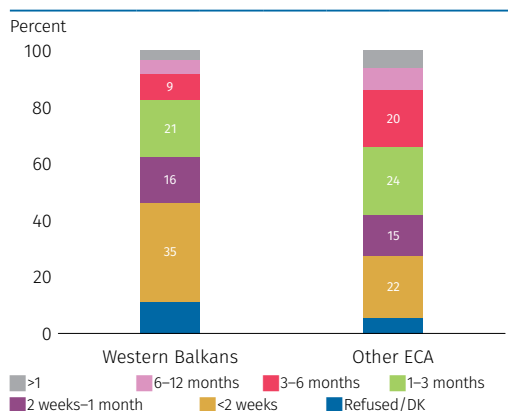
Source: Life in Transition IV data, 2023.

Note: The graph reports the share of adult population living in households of each category.

of household income. Half of the region's population would fail to cover household expenses for longer than one month—a higher degree of vulnerability compared with the ECA region's average (Figure 4.3).

Steady economic growth and job creation are expected to positively impact poverty reduction. Over the past decade, all countries in the region have seen rising employment rates and falling unemployment rates. Despite significant variations in employment rates, they hit record highs in 2023. Concurrently, unemployment rates in the region converged to around 11 percent by the end of the year. Job creation appears to be a considerable factor supporting poverty reduction. Yet, there is evidence of skill mismatches in the labor market, with only just over half of those employed reporting that their skills were the ones needed to carry out their duties, according to Life in Transition Survey data. Even among those with at least post-secondary education, over one-third felt overqualified for their current roles, which underscores the challenges that the region faces in terms of generating high-quality jobs. Although progress has been made,

Figure 4.3. ...and would not be able to cope with a sudden loss of main income source



the WB6 region also still faces the significant hurdle of low female labor force participation, particularly in countries such as Kosovo (see Box 3.1, and also Regular Economic Report, No. 24, Fall 2023).

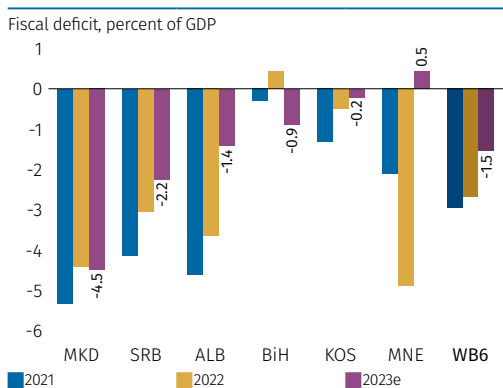
Future poverty reduction is faced with continued threats from structural factors and shocks, such as inflation, demographic challenges, inadequate investments in human capital, natural disasters or climate-related events, and the prevalence of low-quality jobs. A skilled labor force is essential for securing high-quality employment. Yet, results from the 2022 OECD's Programme for International Student Assessment (PISA) reveal that all countries in the region scored below the international average on this assessment. PISA measures 15-year-olds' ability to use their reading, mathematics, and science knowledge and skills to meet real-life challenges. These results, and their negative trends across the region, pose a significant obstacle to securing better employment and enhancing productivity and income, which are key to further reducing poverty. Demographic challenges include a decline in population and migration, especially

among young people, who are the most likely to migrate. Additional challenges include external risks such as geopolitical tensions, global financial conditions, fluctuating commodity prices, and natural disasters or climate-related events, all of which can impact economic performance and poverty reduction efforts.

5. Fiscal consolidation continued, amid rising pressures from current expenditure

Fiscal consolidation gained ground in most Western Balkan countries over 2023. At 1.5 percent of GDP, the region’s estimated average¹¹ fiscal deficit for 2023 contracted faster than previously expected, dropping by 1.2 percentage points (pp) of GDP from 2022, and falling to half of the level recorded in 2021 (Figure 5.1). Consolidation was particularly strong in Montenegro (5.3 pp of GDP), which ended 2023 running a fiscal surplus, and in Albania (2.3 pp of GDP). Bosnia and Herzegovina, on the other hand, was the only WB6 country where fiscal policy meaningfully expanded, though its fiscal deficit level ranks among the lowest in the region, second only to Kosovo. North Macedonia saw a modest rise in its level of the fiscal deficit (excluding state road finances) from the previous year, and its deficit remains the region’s highest since 2021.

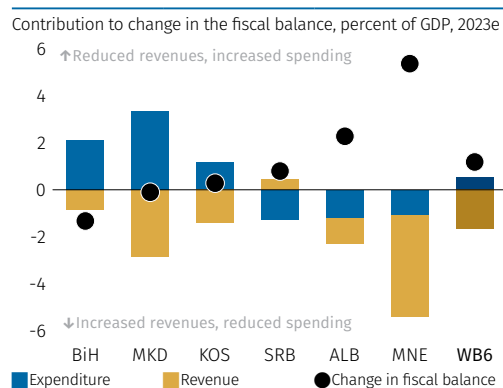
Figure 5.1. Fiscal consolidation continued to gain ground across the region...



Sources: National statistical offices, ministries of finance and World Bank staff estimates.

Solid revenue performance, supported by higher direct taxation and grants receipts, led the improvement of fiscal balances (Figure 5.2). Despite the decelerating inflationary impetus, all WB6 countries experienced solid nominal revenue growth in 2023. Montenegro gained the most (4.3 pp of GDP) in public revenue during the year, but over half of this increase was explained by one-off revenues. Other countries gained from 0.8 to 2.8 pp of GDP. Serbia, the region’s largest economy, experienced a nominal revenue increase of 11.9 percent from 2022, exceeding budget projections, but its public revenues dropped by 0.5 pp as a share of GDP.¹² One-off budget grants, primarily from the EU, contributed to the rise in public revenues and the fiscal consolidation over 2023. Except for Bosnia and Herzegovina, grants receipts accounted for a 0.5 pp of GDP increase in revenues, on average. Personal and corporate income

Figure 5.2. ...against positive revenue performance, and contained expenditures in Serbia and Albania



Sources: National statistical offices, ministries of finance and World Bank staff estimates.

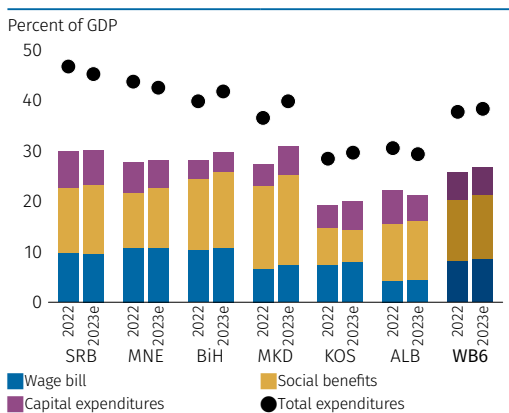
11 From here on, the regional average refers to the regional unweighted arithmetic average.

12 Serbia’s economy is estimated to have grown by 14.8 percent yoy in 2023.

taxes, as well as social insurance contributions, performed well across the region, mirroring increases in wages and profits. On the other hand, amid decelerating inflation, revenues from taxes on goods and services slowed down compared with 2022 in all WB6 countries but Montenegro (nominally contracting in Bosnia and Herzegovina). Overall, Montenegro, Kosovo, and Albania experienced robust increases in total tax revenues as a percentage of GDP.

Current spending pressures, including for interest payments, remained high despite the overall contraction in expenditures in half of the WB6 countries. Expenditures increased in nominal terms across the WB6 region, but as a percentage of GDP they contracted in Serbia, Albania, and Montenegro (1.3, 1.2 and 1.1 pp of GDP, respectively), mainly on account of lower capital spending and retraction of inflationary crisis-related measures. Bosnia and Herzegovina, Kosovo, and North Macedonia saw their expenditures rise as a percentage of GDP (Figure 5.3). However, in contrast to 2022, all WB6 countries with the exception

Figure 5.3. Capital spending was subdued...

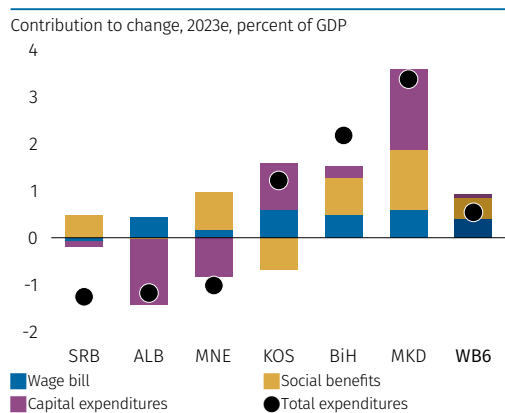


Sources: National statistical offices, ministries of finance and World Bank staff estimates.

of Montenegro and Serbia saw their current expenditures rise (1.9 pp of GDP in Bosnia and Herzegovina and 0.2–1.6 pp of GDP for the rest), highlighting significant current spending pressures. Given the rising sovereign financing costs over 2023, the region experienced an increase in interest payments, ranging from 0.8 percent of GDP in Serbia (from 1.5 percent of GDP in 2022) to 0.2 percent of GDP in Albania (from 1.85 percent of GDP in 2022). Bosnia and Herzegovina and Kosovo—the only two countries in the region without access to international debt markets—did not experience any increase in interest payments (0.8 and 0.4 percent of GDP in 2022, respectively).

Public wages and social benefits dominated current spending pressures in 2023. Social protection spending remained elevated at an average of 12.7 percent of GDP, with spending in Bosnia and Herzegovina, North Macedonia, and Serbia exceeding 13 percent of GDP (Figure 5.4). In Serbia and Montenegro, despite of a contraction in total spending as a percentage of GDP, social protection spending continued to increase. Bosnia and Herzegovina

Figure 5.4. ...while all WB6 countries turned to higher spending on public wages and social benefits



Sources: National statistical offices, ministries of finance and World Bank staff estimates.

saw an estimated 16 percent nominal increase in subsidies, social benefits, and transfers in the Federation of Bosnia and Herzegovina (FBiH), and an 11 percent increase in the same spending items in Republic of Srpska (RS). Kosovo is the only country in the region where social spending contracted compared with the previous year, including because of a decline in the number of social assistance beneficiaries. On the other hand, and after one year of lower real public wages in 2022, all WB6 countries saw increases in public wage compensation, averaging 0.4 pp of GDP, except Serbia where it remained almost unchanged (as a percentage of GDP). In Kosovo, Montenegro, and Albania, spending on wages and compensation nominally increased by more than 15 percent from 2022.

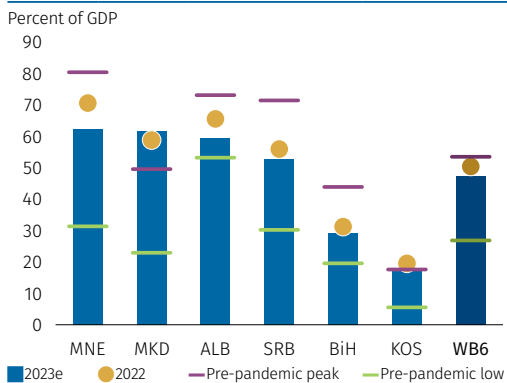
In half of the region's countries, capital expenditure contracted as a percentage of GDP. Capital spending contracted more significantly in Albania (-1.4 pp of GDP) and Montenegro (-0.8 pp of GDP). Serbia, which maintains the highest level of capital spending to GDP in the region, saw a modest decline, from 7.2 percent of GDP in 2022 to 7.0 percent in 2023. In Kosovo and North Macedonia, capital expenditures increased by around 1.0 and 1.7 pp of GDP, respectively, mainly on account of higher spending on transportation infrastructure. Bosnia and Herzegovina also saw a modest increase in capital spending over 2023 but, at 3.8 percent of GDP, it continued to maintain the lowest share of capital spending.

Robust fiscal performance and solid GDP growth led to a decline of public and publicly guaranteed debt as a share of GDP. Although growth performances varied among countries, GDP deflators remain elevated across the board, leading to higher nominal

GDP. Consequently, public and publicly guaranteed (PPG) debt declined in most WB6 countries, with the regional average of the PPG debt-to-GDP ratio falling from 50.4 percent in 2022 to 47.3 percent (Figure 5.5). North Macedonia stood out as the sole exception, experiencing a 3-pp increase in PPG debt as a share of GDP in 2023, attributing to a persistently high fiscal deficit and capital spending borrowing. Montenegro recorded the most substantial decline in its PPG debt-to-GDP ratio, falling from 70.9 percent in 2022 to an estimated 62.2 percent in 2023, owing to robust nominal GDP growth and a fiscal surplus. In Albania, the PPG debt-to-GDP ratio returned to pre-pandemic levels, driven by a blend of fiscal consolidation, higher income, and the appreciation of the Albanian lek. Serbia experienced a reduction of 2.9 pp in its PPG debt-to-GDP ratio. In Kosovo, substantial amortizations in 2023, coupled with limited new borrowing led to a reduction in the PPG debt-to-GDP ratio from 20 percent in 2022 to 17.4 percent in 2023. In addition, the denominator effect, significant debt repayment, and slow project disbursement and implementation caused a 2 pp decrease in PPG debt as a share of GDP in Bosnia and Herzegovina.

While external PPG debt also declined, it accounted for two-thirds of total PPG debt. The external PPG debt-to-GDP ratio declined from 33.1 to 31.7 percent for the WB6 region, due to higher nominal GDP and solid fiscal performance (Figure 5.6). Montenegro's external PPG debt remained the highest in the region at 54.1 percent of GDP in 2023, a decline of 7.7 pp from 2022, owing to limited borrowing and a strong fiscal performance. Similarly, external PPG debt as a share of GDP declined in Albania and Bosnia

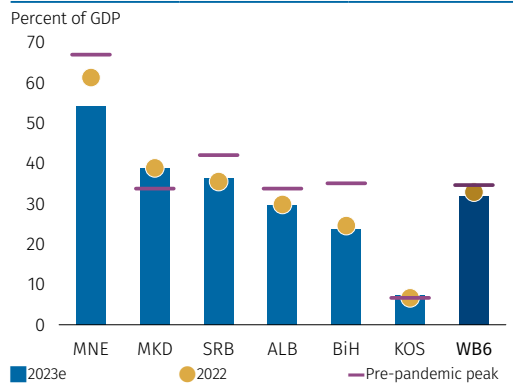
Figure 5.5. Total PPG debt as a share of GDP declined to its lowest in a decade...



Sources: National statistical offices; World Bank staff estimates.

and Herzegovina, albeit marginally, by 0.6 and 1.4 pp, respectively. Serbia’s external PPG debt increased due to country’s borrowing to build up liquidity buffers. Kosovo, and Bosnia and Herzegovina remained the two countries with the lowest share of external PPG to GDP, at 7.3 and 23.5 percent, respectively. Kosovo was also constrained by the required two-thirds of votes needed to authorize the contracting of new external debt. Serbia, Kosovo, and North Macedonia each have an active engagement with the IMF and, over the past six months, the IMF has carried out reviews and made available a total of €63 million for Kosovo, €200 million for North Macedonia, and €400 million for Serbia, although the latter will be treated as precautionary. In 2023, the World Bank provided additional financing through development policy loans (DPLs) approved for Kosovo (€50.6 million), Albania (€110 million), Serbia (€149.9 million), Bosnia and Herzegovina (€92 million), and North Macedonia (€94 million) that aim to assist in strengthening the resilience of the WB6 countries’ economies and their environmental sustainability. Additional DPLs for Serbia and Kosovo (all in the same amounts as in 2023) and the first DPL for Montenegro (€80 million) are expected in 2024. All WB6 countries are

Figure 5.6. ...thanks in part to a decline in external PPG debt



Sources: National statistical offices; World Bank staff estimates.

also expected to benefit from a new €6 billion financial instrument under the new Growth Plan for the Western Balkans (see discussion in the Outlook section), adopted by the European Commission (EC) in November 2023.

After peaking in 2022, the cost of external financing declined, but nonetheless remains elevated. In recent years, many WB6 countries have grown more dependent on external financing and are susceptible to increasing financing costs due to tightening monetary policies. Following a hiatus in 2022, most WB6 countries reengaged with the markets in 2023, albeit in a significantly different environment. In 2023, Serbia issued two Eurobonds—a five-year Eurobond of US\$750 million at a coupon rate of 6.25 percent, and a 10-year Eurobond of US\$1 billion at a coupon rate of 6.5 percent. In March 2023, North Macedonia issued a four-year Eurobond of €500 million at a coupon rate of 6.96 percent. In June 2023, Albania issued a five-year €600 million at a coupon rate of 5.9 percent. In March 2024, Montenegro issued a seven-year US\$750 million at a coupon rate of 7.25 percent. All these Eurobond issuances incurred greater costs for the countries compared with the preceding two years, during which Serbia placed a Eurobond at a coupon

rate of 1.0 percent and North Macedonia at a coupon rate of 1.625 percent. As a result, yields on the existing Eurobonds of Western Balkan countries remain high, although they are, on average, around 1.0 pp lower than six months prior, with the sole exception of the RS's Eurobond (Table 5.1). Spreads with yields on German bonds have narrowed as well.

Notwithstanding this, the credit rating agencies confirmed the ratings of all countries (Table 5.2), with the latest S&P ratings upgrading the outlook from stable to positive in Albania and Montenegro, having already raised the long-term local and foreign currency sovereign credit ratings on Bosnia and Herzegovina to 'B+' from 'B'.

Table 5.1. Yields on Western Balkans countries' outstanding Eurobonds

	Coupon	Maturity	Yield in % (28 Mar 2023)	Yield in % (26 Sep 2023)	Yield in % (14 Mar 2024)	Spreads (basis points)
Albania	3.5	16/06/2027	6.5	5.5	4.6	206.1
	3.5	09/10/2025	6.1	5.5	4.4	103.9
Montenegro	2.785	16/12/2027	8.4	6.8	5.8	325.7
	3.375	21/04/2025	7.3	5.9	4.9	147.9
North Macedonia	6.96	13/03/2027	–	6.0	5.2	265.7
	2.75	18/01/2025	6.4	6.0	5.5	210.4
Serbia	3.125	15/05/2027	5.8	6.2	4.5	202.5
	6.25	26/05/2028	–	6.8	5.8	341.4
Bosnia and Herzegovina, Republic of Srpska	4.75	01/01/2026	7.0	7.1	7.3	445.5

Source: <https://www.boerse-frankfurt.de/en>, accessed on 14 March 2024.

Note: Spreads refer to spreads with yields on German bonds with the same or similar residual maturity.

Table 5.2. Credit ratings of the Western Balkan countries

	Moody's	Standard & Poor's	Fitch
Albania	B1 (stable)	B+ (positive)	–
Bosnia and Herzegovina	B3 (stable)	B+/B (stable)	–
Montenegro	B1 (stable)	B (positive)	–
North Macedonia	–	BB- (stable)	BB+ (stable)
Serbia	Ba2 (stable)	BB+ (stable)	BB+ (stable)

6. Price increases have eased substantially, but inflationary pressures remain elevated

After increasing to levels not seen in several decades, inflation in the WB6 region decreased substantially during 2023, mostly driven by decelerating international commodity prices (Figure 6.1). At the regional level, after reaching its peak in October 2022 (15 percent), the Consumer Price Index (CPI) witnessed a downward trend during 2023, decreasing from 14.3 in January 2023 to 5.1 in December 2023. By December 2023, inflation stood at 7.6 percent in Serbia, 4.3 percent in Montenegro, 4.0 percent in Albania, 3.6 percent in North Macedonia, 2.3 percent in Kosovo and 2.2 percent in Bosnia and Herzegovina (Figure 6.2). Looking at the past year, inflation remained above the regional WB6 average of 9.3 percent in Serbia (12.5 percent) and North Macedonia (9.4 percent). One significant contributor to the reduction in the CPI was the deceleration in international commodity prices (see Box 6.1), including food prices, which represent a larger share of the CPI basket in the WB6 economies compared with the EU average,¹³ and are a key determinant of inflation in the WB6. These global trends were reflected in lower import prices in several countries, such as Kosovo and Albania.

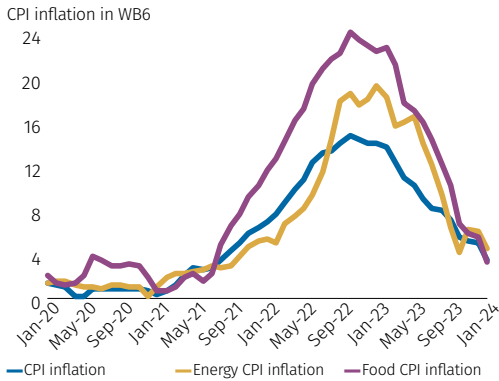
Domestic pressures from wages and production costs remain elevated, as indicated by the persistently high core inflation. In December 2023, core inflation for the WB6 remained high, at 5.3 percent, slightly exceeding headline inflation, even though it has been on a declining trend, since its peak of 9.6 percent in February 2023 (Figure 6.3). Core

inflation remained strongest in Montenegro, where it stood at 7.4 in December 2023 (Figure 6.4). In Albania, inflation expectations started to reflect the persistence of price pressures: one year ahead inflation expectations for businesses and consumers increased at 6.0 and 11.2 percent respectively, considerably above the targeted band of 2.4 percent. Likewise, in Serbia and North Macedonia, inflation expectations have shifted upward. In Kosovo, core inflation picked up in January 2024, reaching 3.7 percent and remaining almost 2 percentage points above headline inflation.

Central banks in the WB6 region continued to tighten monetary policy, reflecting different degrees of exchange rate policy (Figure 6.5 and 6.6). The National Bank of Serbia responded to high inflation by continuously increasing the key policy rate between April 2022 and July 2023. Likewise, in North Macedonia, continuing monetary policy tightening through September 2023 responded to still-high inflation expectations. In Albania, the last monetary policy increase was in November 2023, with policy tightening reassuming, despite currency appreciation. While central banks consistently increased policy rates, in real terms they nonetheless remained negative throughout the year. With inflation expectation persistently high, central banks have further scope for policy tightening, but need to adequately address risks to banking assets quality. In countries with some exchange rate flexibility, currencies in the WB6 experienced appreciation pressures supported

¹³ The simple average of the weight of food in the CPI basket for the region is around 42 percent (IMF, 2023).

Figure 6.1. WB6 consumer inflation was on a downward trend in 2023...



Source: National statistical offices and World Bank staff calculations.

Figure 6.2. ...reflecting heterogeneity among countries

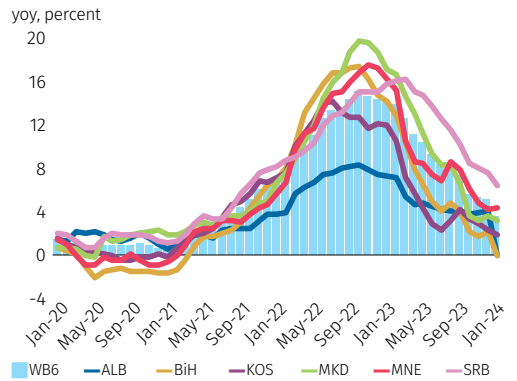
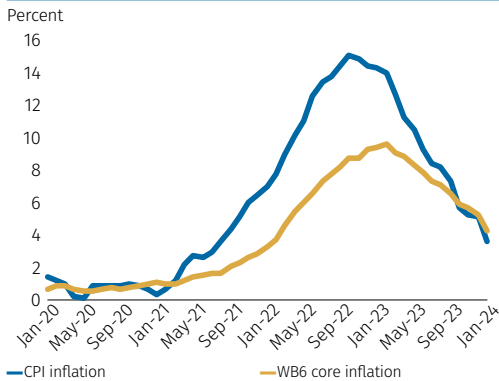
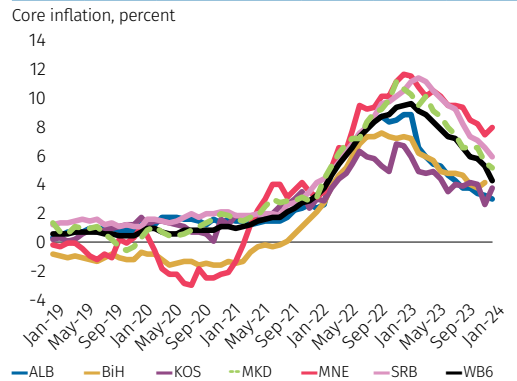


Figure 6.3. WB6 core inflation has remained persistently high, although trending downwards through 2023



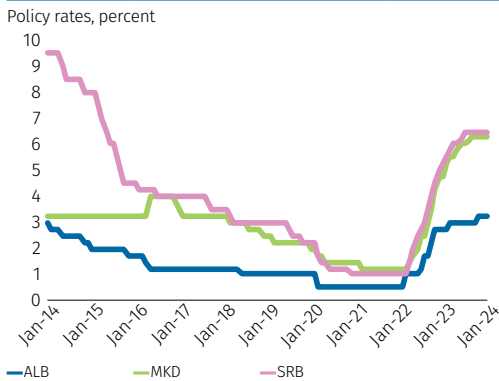
Source: National statistical offices and World Bank staff calculations.

Figure 6.4. The persistence of core inflation is observed in all WB6 countries



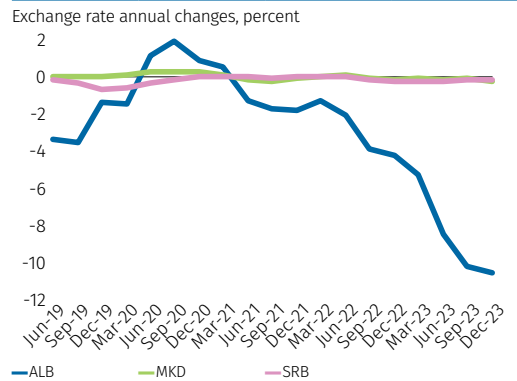
Source: National statistical offices and World Bank staff calculations.

Figure 6.5. Central banks tightened monetary policy in response to persistent inflation expectations



Source: Central banks and World Bank staff calculations.

Figure 6.6. Amid currency appreciation pressures, central banks allowed for different degree of exchange rate flexibility

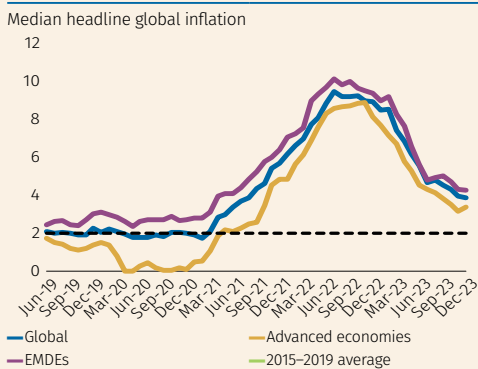


by high inflows of FDI and exports. The central banks of Serbia and North Macedonia (de facto) stabilized their exchange rates, while the Bank of Albania allowed for flexibility, with the Albanian lek appreciating by 9 percent yoy by December 2023.

Box 6.1. During 2023, inflation started to slow across the globe, raising hopes of a further easing of inflationary pressures into 2024

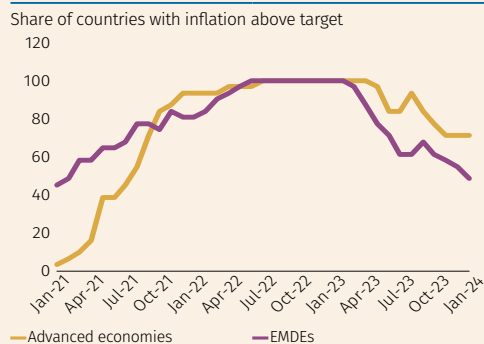
Despite the decline in the rates of inflation seen in 2023, both headline and core inflation remained elevated and above target in many inflation-targeting economies (Figures 6.7 and 6.8). Global median headline inflation stood at 8.4 percent in January 2023, and gradually declined to 3.9 in December 2023. During 2023, inflation declined more prominently in advanced economies rather than emerging market and developing economies (EMDEs) where, on average, price pressures remained more elevated. Key drivers of lower inflation at the global level have been moderating commodity prices, as well as slowing consumer demand. In global markets, the average price of most commodities fell during 2023. However, they remained more than 40 percent above their pre-pandemic levels. The commodity price index fell by 24 percent in 2023, mostly due to decelerating energy prices. Crude oil prices averaged US\$83/bbl in 2023, down from US\$100/bbl in 2022. Consumer food price inflation, measured as yoy change in the food component of a country’s CPI, eased in 2023, reflecting a more ample supply of major crops, but it remained elevated across the globe.¹⁴

Figure 6.7. Inflation slowed across the globe in 2023...



Source: World Bank Global Economic Prospects.

Figure 6.8. ...but remains above target in many inflation-targeting economies



¹⁴ Information from the latest month between October 2023 and January 2024 for which food price inflation data are available shows high inflation in many low and middle-income countries, with inflation higher than 5 percent in 57.9 percent of low-income countries, 71.7 percent of lower-middle-income countries, 48.0 percent of upper-middle-income countries, and 45.5 percent of high-income countries.

(Box 6.1 continued)

The decline in inflation proceeded under markedly different growth conditions across countries. In some economies such as the United States, easing price pressures occurred together with resilient economic activity, while in others (e.g., the Euro area) the decline in the rate of price rises was accompanied by weaker economic growth. The sharp tightening of monetary policy and financing conditions played an important role in bringing down inflation in many advanced economies (AEs) and EMDEs. At the global level, in 2023, wage growth generally remained contained and wage-price spirals have not become a key driver of inflation. The trend of demand shift from goods to services continued, as reflected in a decline of goods inflation and more persistent services inflation. As a result of these trends, median core inflation also decreased—from 6.3 percent in January to 3.9 percent in December 2023—but remained persistent, especially in EMDEs where core inflation stood at 4.3 percent by December 2023.

7. The financial system has maintained resilience while navigating sustained risks

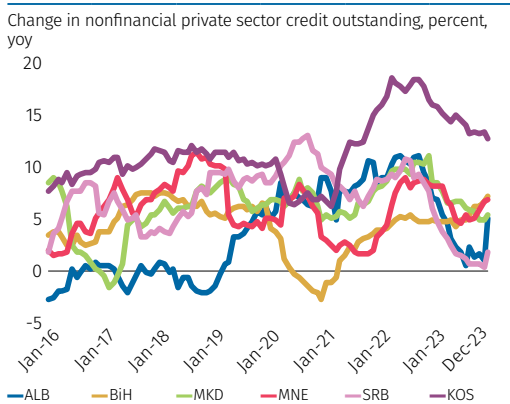
The financial sector in the Western Balkans continued to show resilience throughout 2023, despite heightened geopolitical risks, compounded by inflationary pressures and high interest rates. Asset quality improved slightly, with non-performing loans (NPLs) reaching a new record low, at 3.8 percent of total loans, while profitability increased and capital buffers strengthened.

Credit growth was slow in 2023, at below 6 percent in the second half of 2023, amid tightening credit supply conditions. Average credit growth was below 6 percent in the second half of 2023, with the exception of a slight uptick to 6.5 percent in December 2023. Although there was no major deterioration in household and corporate balance sheets in 2023, tightening of credit supply and financing conditions placed additional strain on borrowers in need of financing, ultimately exacerbating credit risk and the likelihood of default. Credit

growth decreased most in Albania and Serbia, dipping to 1.0 and 0.3 percent, respectively, in November 2023, before starting to recover in December. Credit growth remained strong in Kosovo despite slowing down to 12.7 percent in December 2023 from 16.0 percent at the beginning of the year, while only in Bosnia and Herzegovina did the average credit growth increase in the second half of the year.

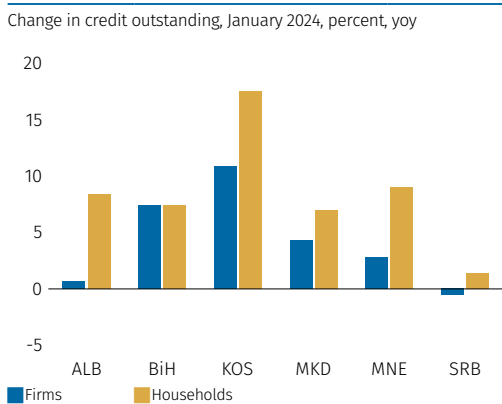
Corporate loan growth continued to be significantly lower than household loan growth throughout the year. Regional average growth for corporate loans declined to 1.0 percent in October 2023, and almost stalled in Albania and Serbia, indicating that banks tightened standards more for small and medium enterprises (SMEs) and corporate clients (Figure 7.2). SMEs may be particularly vulnerable to tightening credit supply conditions, higher financing costs, and a slowdown in economic activity, while

Figure 7.1. Sluggish credit growth dominated H2 2023, particularly in Albania and Serbia



Sources: IMF International Financial Statistics; central banks.

Figure 7.2. Weakening corporate loan growth dipped to 1 percent in October before bottoming out



Source: Central banks.

households' real incomes and consumption remained under pressure due to the higher cost-of-living expenses.

The mismatch between credit demand and supply is expected to narrow in H1 2024. According to the results of the latest Central, Eastern and Southeastern Europe (CESEE) Bank Lending Survey,¹⁵ credit demand remained robust during the second half of 2023, albeit on a gradual declining trend since April 2021. Fixed investments and retail components, especially related to the housing market, contributed negatively to credit demand growth, while the key driving factors remained corporate liquidity needs for inventories and working capital, as well as debt restructuring. Credit needs for fixed investments are expected to resume in the coming months, especially for large corporates, while retail segments are expected to remain weak. Credit supply conditions are expected to deteriorate again over H1 2024, motivated by weak market outlooks, but are gradually moving toward a more neutral situation. Tighter supply conditions are expected to further impact all business segments, with the highest impact on SMEs. Looking forward, despite persistent tightening, cross-border banking groups do not foresee a significant deleveraging or strategic change in the region over H1 2024. Positive funding conditions driven by corporate and retail deposits are expected to continue while central bank funding continues to decline in H1 2024.

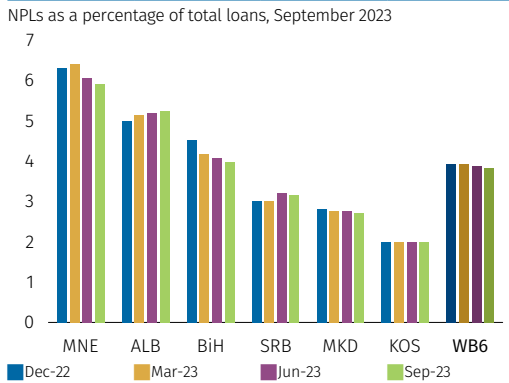
Improvements in the asset quality of banks decelerated during 2023, particularly in WB6 countries with stagnating credit growth. The WB6 average NPL ratio only slightly improved by 0.1 of a percentage point to 3.8 percent, largely remaining flat during 2023 (Figure 7.3). The improvement in asset quality slowed down mostly in countries with low credit growth, such as Serbia and Albania. The NPL ratios were higher than the region's average in Montenegro (5.9 percent), Albania (5.2 percent) and Bosnia and Herzegovina (4 percent). As of September 2023, the NPL ratio increased slightly in Albania and Serbia compared with December 2022, while declining or remaining stable in the other WB6 countries, with the lowest level in Kosovo at 2 percent.

Overall, asset quality remained resilient, despite persisting concerns about the medium-term economic outlook. Sustained high interest rates, ongoing inflation, and a deteriorating economic outlook, along with slowing credit, are expected to put further pressure on the financial sector's vulnerabilities, including those related to highly leveraged borrowers, real estate markets, floating rates loans, and unsecured consumer lending. The widening gap between stage 2 and stage 3 loans¹⁶ is clear evidence of existing and potentially growing pressures on credit risk. As of December 2022, the WB6 average for stage 2 loans was at 11.82 percent of total loans, much higher than the NPLs ratio, at 3.9 percent. Meanwhile, stage 2 loans have been increasing consistently in the post-pandemic environment. The CESEE Bank

¹⁵ EIB Central, Eastern and Southeastern Europe Bank Lending Survey, Fall 2023 (H2).

¹⁶ Stage 2 Assets, in the context of International Financial Reporting Standard (IFRS) 9, are financial instruments that have deteriorated significantly in credit quality since initial recognition but that offer no objective evidence of a credit loss event. Assets are classified stage 3 if the loan's credit risk increases to the point where it is considered credit impaired. The IFRS is published by the International Accounting Standards Board. IFRS 9 specifies how an entity should classify and measure financial assets, financial liabilities, and some contracts to buy and sell nonfinancial items.

Figure 7.3. Asset quality improvements slowed down, with NPL ratios almost flat in 2023



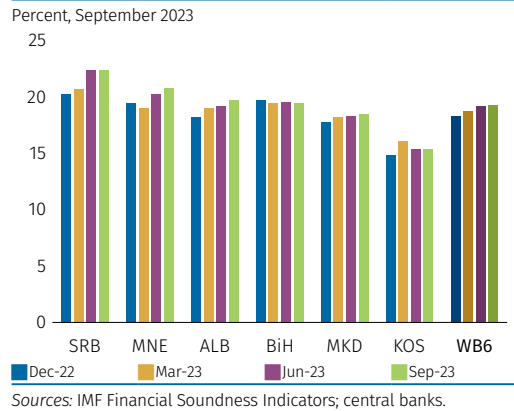
Lending Survey also indicates that, given the unfavorable economic outlook, banks expect that NPLs will increase further during 2024.¹⁷

Capital buffers in the Western Balkan countries continued to strengthen, thanks to higher profitability and low NPLs, while liquidity remained broadly stable in 2023.

As of September 2023, the bank capital adequacy ratio averaged 19.3 percent, far above the regulatory minimum, and higher compared with December 2022, at 18.3 percent (Figure 7.4). The ratio of liquid to total assets averaged 29.6 percent in September 2023, with the lowest in North Macedonia (18.9 percent) and the highest in Serbia (40 percent). Loan-to-deposit ratios were well below 100 percent across the board (74.7 percent on average in September 2023), indicating slower loan growth than deposit growth.

Higher interest rates helped boost banks' lending margin and profitability. Profitability, as measured by return on assets, increased to 2.4 percent in September 2023 from 1.7 percent a year before, supported mainly

Figure 7.4. Banks' capital buffers strengthened



by rising interest rates boosting net interest margins. As of September 2023, Kosovo, Montenegro, and Serbia had the highest profitability (2.6 percent), while Albania had the lowest (1.9 percent). While higher rates may support net interest margins on new bank loans, history has shown that credit exposures can deteriorate rapidly, and loan demand can collapse when an economy enters a recession, affecting bank profitability.

Nevertheless, the uncertain economic backdrop continues to raise concerns about the medium-term outlook. With inflation still high in many countries, major central banks are determined to keep interest rates higher for longer than priced in by markets. The high-interest environment, which is now expected to last longer than previously anticipated, is triggering asset repricing, changing investor sentiment, and altering asset allocations. In recent years, firms and households have managed to shore up their balance sheets with the help of government support programs, pandemic savings, and restructurings. However, weaker growth expectations, slowing credit growth,

¹⁷ Central, Eastern and Southeastern Europe (CESEE) Bank Lending Survey, Fall 2023.

and the extended duration of pressures from higher interest rates and costs of living may strain the debt-servicing capacity of borrowers. In particular, firms with low cash-to-interest-expense ratios and mortgage borrowers will continue to face a higher repayment burden.

Incidents over the past year involving United States regional banks and a globally systematically important bank in the EU, showed the importance of being vigilant and addressing vulnerabilities.

To capture any brewing vulnerability, and to respond adequately and in a timely manner, supervisors should continue to require banks to be fully prepared for potential declines in asset quality. This includes ensuring that banks have robust credit risk monitoring and management, appropriate loan classification, accurate loan staging, and adequate loan loss provisioning. Regulators and supervisors should maintain vigilance and closely monitor real-estate lending (particularly commercial), unsecured consumer lending, highly leveraged borrowers, and sectors particularly vulnerable to rising inflation.

While strengthening financial stability in their bank-dominated economies, WB6 countries should also aim to develop a well-diversified financial system to safeguard stability in the longer term.

A well-diversified financial sector should be consisting of a range of consumer and commercially-oriented segments including banking, capital markets, non-bank financial institutions, insurance, and pensions, offering a wide variety of financial products and services. The insurance sector is one of the key pillars of a diversified financial sector and plays a critical role by providing businesses and households with protection against future risk and uncertainty. The

insurance sector is also crucial in strengthening financial stability. Insurance companies enable economic agents to diversify distinctive risk, thereby supplying the necessary preconditions for certain business activities. Insurance companies are a major source of long-term risk capital to the real economy and are among the largest institutional investors. Their long-term investment horizon can in principle enable them to act as a shock absorber in financial markets. Insurers have longer-term liabilities than banks, greater diversification of assets, and less extensive interconnections with the rest of the financial system. Despite its critical role in financial development and financial stability, the insurance sector in the WB6 region is underdeveloped, offers limited products, and requires capacity building with a strengthened regulatory and supervisory framework. Almost all the countries in the region have embarked in structural reforms to develop their insurance sectors, with the aim of aligning with the EU standards in the coming years (see Box 7.1).

Box 7.1. The insurance sector development in the Western Balkans, and Solvency II

The insurance sector in the Western Balkan countries constitutes a relatively small proportion of the overall financial sector. On average, banking sector assets range from 62 to over 95 percent of GDP in the WB6; in comparison, the banking sector accounts for about 84 percent of GDP in the EU. In contrast, insurance sector assets range from just 2 to 5 percent of GDP, on average, in the Western Balkans, while in the EU the average is 42 percent. Within the relative limited space, the predominant offering by the sector is in the form of motor vehicle insurance.

As a precursor to deepening the insurance sector and improving risk coverage, both the supervisory framework and the capacity of the insurance agencies should be enhanced.

Across the region, many insurance companies are characterized by low solvency margins, implying that the ability of some insurance companies to honor claims to the beneficiaries when they occur is weak, which may require supervisory actions. The insurance regulatory agencies in the region are predominantly reliant upon the Solvency I prudential supervisory framework, which is not risk sensitive. Solvency I has minimal capital requirements and does not commensurately weigh risk for the insurance companies, such as market risk faced by the companies. Instead, Solvency II harmonizes asset and liability valuations, and has a wider scope that imposes higher capitalization requirements and allows for better management of risks within the sector.

Albeit at varying stages of reform, all Western Balkan insurance regulatory agencies are improving their insurance regulatory framework. It is important to note that Solvency II compliance is a long-lasting process, especially when Western Balkan current capacities are considered. Many countries in the region have initiated efforts in this direction by conducting gap assessments and developing roadmaps:

- Albania has developed a Solvency II roadmap and is making plans for its implementation and harmonization with the International Financial Reporting Standards (IFRS) 17 standard.
- Bosnia and Herzegovina has conducted a gap assessment regarding IFRS 9 and 17 and Solvency II, and has started to develop a strategy for the implementation of Solvency II.
- Kosovo has started to develop a Solvency II roadmap and is contemplating amendments in its insurance regulation.
- Montenegro is in the process of modifying its Law on Insurance in accordance with the Solvency II Directive.
- North Macedonia's legislation alignment with the Solvency II Directive remains pending.
- Serbia has adopted the Strategy for Implementation of Solvency II, including amendments between 2016 and 2021.

(Box 7.1 continued)

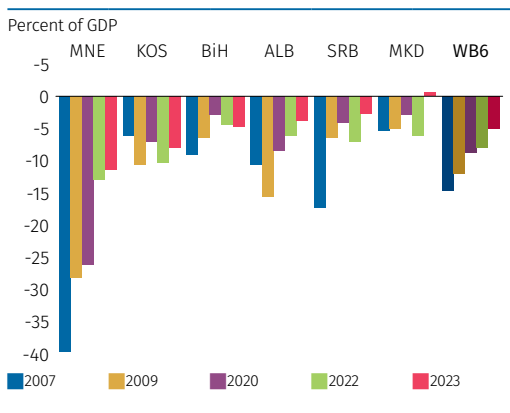
The process of modernizing and aligning the insurance sector's regulatory and supervisory framework is a critical step for the sector's ability to adequately monitor risks and properly insure against losses. The importance of building a modern insurance sector becomes more evident as financial losses associated with climate and environment risks, such as, floods, earthquakes, droughts, that are facing the Western Balkan countries become more frequent and severe. With a strengthened oversight of the sector, the insurance industry could also play a pivotal role acting as an institutional investor within domestic capital markets. Importantly, the harmonization of the insurance regulatory framework and increased capacity of insurance regulation and supervision would also be an important step toward a single financial service market within the EU.

8. The external position is improving on the back of lower import prices and strong net services exports

The WB6 countries witnessed an improvement in their external position during 2023. The current account deficit (CAD) declined from 7.8 percent of GDP in 2022 to a historic low of 4.9 percent of GDP in 2023¹⁸, marking the most significant improvement in the past two decades (Figure 8.1). While Bosnia and Herzegovina experienced a marginal uptick in the external deficit by 0.4 of a percentage point to reach 4.7 percent of GDP in 2023, all other countries in the region exhibited improvements in their external balances. Two countries experienced the most significant downward adjustment in the external deficit, namely North Macedonia with its second-ever current account surplus amounting to 0.7 percent of GDP in 2023, and Serbia, with a compression of 4.3 percentage points to a current account deficit of 2.6 percent of GDP in 2023—a return to normal, after a one-off increase in CAD in 2022 due to the domestic energy crisis (Figure 8.2).

Across all WB6 countries, both merchandise exports and imports exhibited a downward adjustment, in GDP terms, with imports declining more than exports largely due to lower import costs. The WB6 merchandise trade deficit amounted to 27 percent of GDP in 2023, a sizable improvement from a deficit of over 30 percent the year before (Figure 8.3). This was driven not only by a decline in import prices, but also by import volumes, rather than higher exports (except in Serbia). The region witnessed a reduction in demand for exports due to weaker EU growth. This led to a simultaneous decline in the region’s demand for imports of intermediate input. The import of consumption goods, however, remained robust due to private consumption contributing most to real GDP growth in most countries in the region.

Figure 8.1. The regional current account deficit keeps improving...



Source: Central banks, World Bank staff calculations.

¹⁸ These are simple averages across the WB6 countries.

Figure 8.2. ...with North Macedonia and Serbia accounting for largest share of the external adjustment

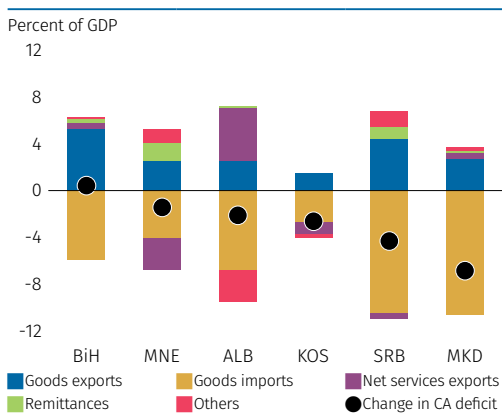
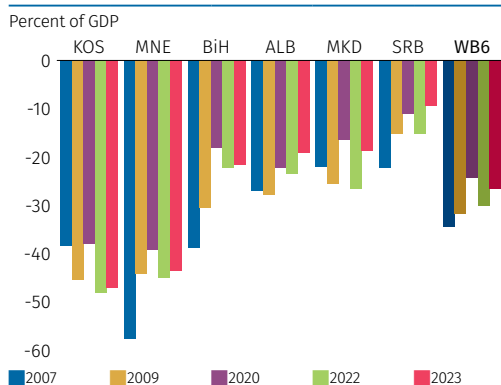


Figure 8.3. The merchandise trade deficit has returned to the long-term average, after the deterioration in 2020...



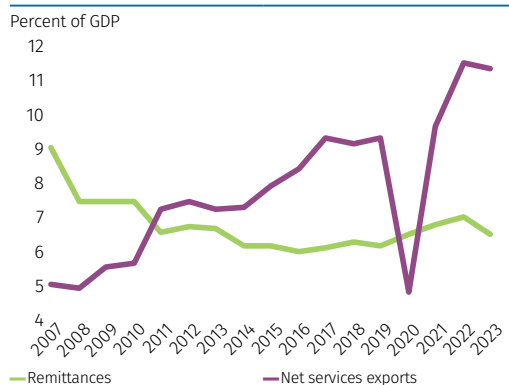
Source: Central banks, World Bank staff calculations.

Two trade stories stand out in 2023—North Macedonia and Serbia.

In North Macedonia, stagnant export growth and declining imports led to a significant contraction in the merchandise trade deficit, which shrunk by an impressive 8 percentage points to close to 18.9 percent of GDP. Despite an increase in food, machinery and transport imports, total merchandise imports declined nominally by 8 percent in 2023 primarily driven by a sharp 60 percent compression in electricity imports and a 23 percent decline in petroleum products compared with the previous year. In Serbia, meanwhile, imports declined by 5.6 percent, while export of goods increased by 3.3 percent (in euro terms). As a result, the merchandise trade deficit narrowed from 15 to 10 percent of GDP, with the import of goods declining due to lower petroleum product imports, chemicals, and manufactured goods.

Robust net services exports contributed to the improvement in the CAD in WB6 countries in 2023. Net service exports remained in 2023 at a record-high level, staying close to 11.5 percent of GDP, as observed in 2022 (Figure 8.4). Net tourism receipts and diaspora travels home accounted for the bulk

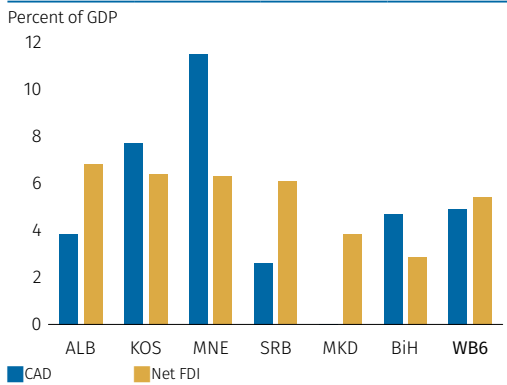
Figure 8.4. ...and remittances remain robust, while net services exports maintain record highs reached in 2022



of net service exports. The regional increase in net service exports was mostly due to an acceleration in tourism receipts in Montenegro by 4.3 percentage points of GDP in 2023 compared with the previous year. Meanwhile, Kosovo's diaspora helped increase net services by 1.1 percentage points to 16.5 percent of GDP in 2023. In Albania, robust service exports, bolstered the current account and caused in part the appreciation of the Albanian lek. As a result, the first three quarters of 2023 marked the first surplus in the current account balance in Albania since 2008. The stronger Albanian lek, however, hurt the competitiveness of goods exports, resulting in a 9.3 percent decline. In the case of Serbia, the key contributor to the positive net services export balance was a fast-growing IT sector. Net exports of IT services reached about 3.8 percent of GDP in 2023.

Remittances rose but more slowly than regional GDP. Therefore, despite growing by an estimated €230 million, in GDP terms net remittances decelerated to 6.5 percent in 2023 from 7 percent of GDP the year before. This is still 0.3 pp of GDP higher than the five-year average prior to the pandemic. Remittances grew most in Kosovo, with an

Figure 8.5. At the regional level, FDI inflows fully finance the CAD, but country differences are significant

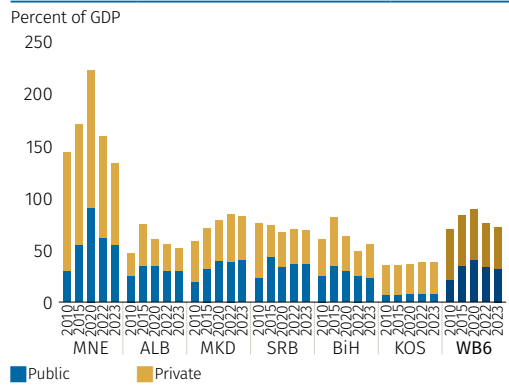


Source: Central banks, World Bank staff calculations.

estimated increase of €149 million. Albania and Bosnia and Herzegovina averaged together about €50 million. In Montenegro remittances inflows declined by 11 percent, while North Macedonia and Serbia exhibited a small decline.

The CAD at the WB6 regional level is almost entirely financed by net FDI inflows (Figure 8.5). Net FDI inflows amounted to 5.4 percent of GDP in 2023, or 0.5 pp of GDP higher than the external deficit. These inflows were predominantly equity investments and reinvestments, with a smaller proportion in inter-company loans. Even in Serbia, where traditionally inter-company loans play a greater role, in 2023 equity investment and reinvested earnings accounted for €3.5 billion of inflows compared with €1.0 billion in intercompany loans. Consequently, non-debt creating financing played a dominant role in the structure of net FDI inflows in the Western Balkans. Albania led with the highest net FDI inflows at 6.8 percent of GDP, closely followed by Kosovo at 6.4 percent and Montenegro at 6.3 percent. The high sovereign risk premium, among others, continues to weigh on FDI inflows in Bosnia and Herzegovina. In 2023, Bosnia and Herzegovina continued to exhibit

Figure 8.6. Total external debt continued its decline in 2023, reaching 71.3 percent of GDP



Source: Central banks, World Bank staff calculations.

the lowest level of inflows in the region estimated at 2.9 percent of GDP, half the average of the remaining five countries in the region. In sum, net FDI inflows exceeded the CAD in Albania, Serbia, and North Macedonia and, at the regional level, more than offset the financing gaps in the other three countries (Figure 8.5).

Total external debt continued its decline in 2023, reaching 71.3 percent of GDP, a significant drop of almost 17 pp from its peak in 2020 (Figure 8.6). This decline was evenly distributed regionally, with both public and private external debt decreasing by about 8 and 9 pp respectively in 2023 compared with the peak observed in 2020. External public debt declined in Albania, Bosnia and Herzegovina, and Montenegro, in GDP terms, in line with the general decline in total public debt and higher GDP. In Albania, external public debt declined in 2023 by about 0.6 percent of GDP. Serbia witnessed an increase in external public debt of close to 1 percent of GDP, which fully accounts for the increase in total public debt from 35.7 percent in 2022 to 36.5 percent in 2023. In North Macedonia and Kosovo, external public debt increased by 0.4 and

0.1 pp of GDP, respectively. Meanwhile, private external debt fell to 39.6 percent of GDP in 2023 at the regional level.

Most countries in the region witnessed a build-up in foreign exchange reserves in 2023. In Serbia, foreign exchange reserves reached a record high of €4.9 billion by the end of 2023, with similar impressive increases observed in North Macedonia, Albania, and Bosnia and Herzegovina. Montenegro, in contrast, experienced a decline in foreign exchange reserves due to larger repayments of external debt and somewhat stronger portfolio outflows.

9. The outlook improved, but growth remains too low for faster convergence with the EU

While the 2023 economic performance for the WB6 region as whole turned out to be in line with previous projections, there was some reshuffling among countries. Montenegro and Serbia were the only countries that performed better than previously projected, while other countries underperformed compared with the previous set of projections. Serbia's growth turned out to be stronger than originally projected (2.5 compared with originally projected 2.0 percent growth in 2023), thanks to a recovery of the agriculture and construction sectors in the second half of the year. Montenegro's 2023 growth estimate is higher by 1.2 pp compared with that originally projected, thanks to a strong tourism season. The remaining four countries had lower 2023 GDP growth than previously projected. As a result of these developments, overall growth in the WB6 region is estimated at 2.6 percent, in line with previous projections.

Projections for the medium term (2024–26) increased slightly, compared with the previous round of projections. Regional GDP growth for the WB6 is expected to increase to 3.2 percent in 2024 and further to

3.5 and 3.8 percent in 2025 and 2026 (Table 9.1). Kosovo and Serbia are expected to drive regional growth over the medium term, while the other four countries will grow at below the regional average. Growth in these two countries is expected to be driven by consumption and resilient services exports. At the other end of the spectrum, consumption is expected to increase in Albania and Bosnia and Herzegovina only gradually, insufficient to contribute significantly to growth. In Montenegro, coming from a very high base, growth is expected to moderate to a still relatively strong 3.4 percent in 2024, supported by tourism and private consumption. In North Macedonia, looming elections and slow progress with structural reforms will keep growth at a relatively low level.

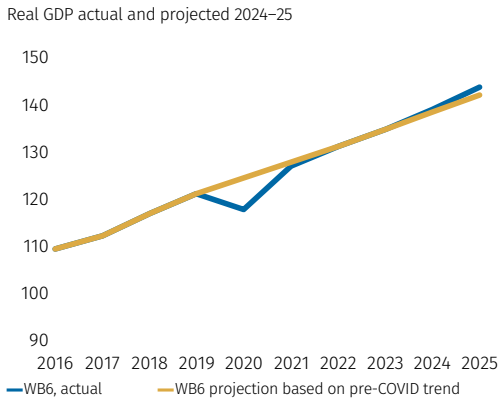
With currently projected growth rates, the WB6 region is expected to return to its pre-pandemic trend in 2024, though this is insufficient to enable convergence with EU income levels over the medium term. While growth rates for individual countries are expected to be between 2.5 and 4.0 percent over the projection period, thus leading to average regional growth above the pre-pandemic trend,

Table 9.1. Real GDP growth

	2023e	2024f	2025f	2026f
Albania	3.3	3.3	3.4	3.5
Bosnia and Herzegovina	1.9	2.6	3.3	4.0
Kosovo	3.1	3.7	3.9	3.9
North Macedonia	1.0	2.5	2.9	3.0
Montenegro	6.0	3.4	2.8	3.0
Serbia	2.5	3.5	3.8	4.0
WB6	2.6	3.2	3.5	3.8

Source: World Bank staff projections.

Figure 9.1. With currently projected growth rates, the WB6 region is expected to return on its pre-pandemic trend in 2024

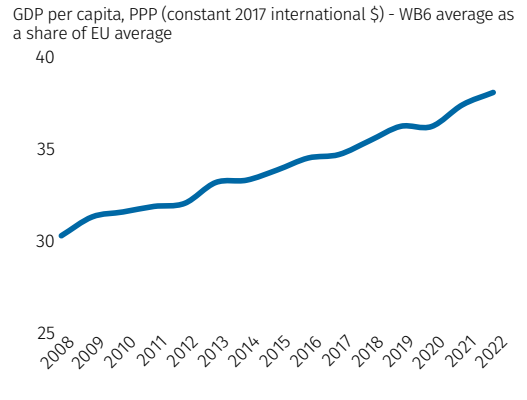


Source: World Bank staff calculations based on data from national statistical offices.
 Note: Based on (i) current projections, and (ii) trend 2012–2019.

this is insufficient to provide faster convergence with the EU in terms of income per capita. Measured in PPP terms, GDP per capita in the Western Balkans remains at almost 40 percent of the EU average (Figure 9.2).

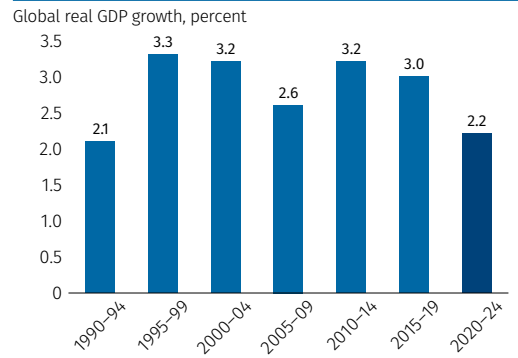
Risks to the outlook are tilted to the downside. First, global growth will be slower than expected (see Box 9.1). A global slowdown in 2024, for the third consecutive year, will be caused mainly by the slowdown among advanced economies. This means that the global economy will face the weakest half-decade growth since 1995 (Figure 9.3). A prolonged slowdown in the EU is particularly worrying since it will translate into weaker investment and trade with the WB6.¹⁹ Second, there are domestic factors that put the baseline set of projections at risk: outward migration (could be in particular worrying in Kosovo); elections (in North Macedonia and Serbia), and elevated inflation for longer period in some of the WB6 countries. In Albania, fiscal

Figure 9.2. Measured in PPP terms, GDP per capita in the Western Balkans remains at almost 40 percent of the EU average



Source: WDI, World Bank staff calculations.
 Note: WB6 is simple average.

Figure 9.3. The global economy is expected to face the weakest half-decade growth since 1995



Source: World Bank, GEP, January 2024.

risks emanate from public-private partnerships and SOEs, in addition to the country’s hydropower-based energy sector, mainly due to variation in hydrology. In Montenegro, the high cost of external financing poses a risk given the country’s substantial financing needs. Additional risks to growth for the WB6 countries emanate from natural disasters and climate change.

19 For the WB6 region, the most important is another round of downward revisions for growth in the Euro area (a cut of 0.6 pp in 2024) by the GEP January 2024 edition.

Box 9.1. This year will continue to be challenging, before brighter horizons appear in 2025–2026

In 2023, global growth reached 2.6 percent but is expected to decelerate in 2024, before picking up again in 2025–2026. The disparity in economic resilience in advanced economies—with the United States’ sustaining robustness vis-à-vis the Euro area’s weakness—is projected to persist during 2024. China’s economic momentum is anticipated to further decelerate, on the back of the real estate sector downturn, which will weigh on the outlook for EMDEs. Global trade is expected to pick up in 2024 after reaching a standstill in 2023, boosted by increased goods demand while services trade growth stabilizes near pre-pandemic levels. However, the trade outlook is expected to remain subdued, weighed down by proliferating trade-restrictive measures, among other factors. The Sentix Global Economic Index suggests an uptick in global activity starting in Q1 2024, with recent positive revisions in consensus forecasts now projecting a modest global growth rate of 2.4 percent for 2024 (Figure 9.4a).

Inflation rates are on a downward trajectory, progressing toward their target levels.

In February 2024, the median global headline inflation was recorded at 3.3 percent, with EMDEs’ inflation higher at 4.0 percent (Figure 9.4b). Core inflation numbers are close to the headline numbers. Inflation significantly dropped in 2023, but remains over target in many AEs and about half of EMDE countries (Figure 9.4b). With major AEs on the brink of loosening monetary policies and most EMDEs already in the process of monetary easing, inflationary pressures are anticipated to ease further. More subdued global demand and marginally reduced commodities prices are expected to facilitate a further decrease in inflation in 2024–25.

Following a lackluster performance in 2023, euro area growth is expected to rebound in 2024.

Growth slowed to just 0.4 percent in 2023, affected by tight credit conditions, low exports, and elevated energy costs. Recent high-frequency indicators, including composite and manufacturing Purchasing Managers Index (PMI) data, signal a relative improvement in the activity for Q1 2024, while remaining in contractionary territory (Figure 9.4c). While growth for 2024 is expected to remain tempered by the continuation of tight monetary policy, the outlook for 2025–26 is expected to improve, as export and investment growth gains momentum, driven by a relaxation of monetary policy constraints and the effective deployment of EU funds. The Western Balkans’ trade trajectory will continue to be strongly influenced by the euro area region, as it remains the primary destination for their exports.

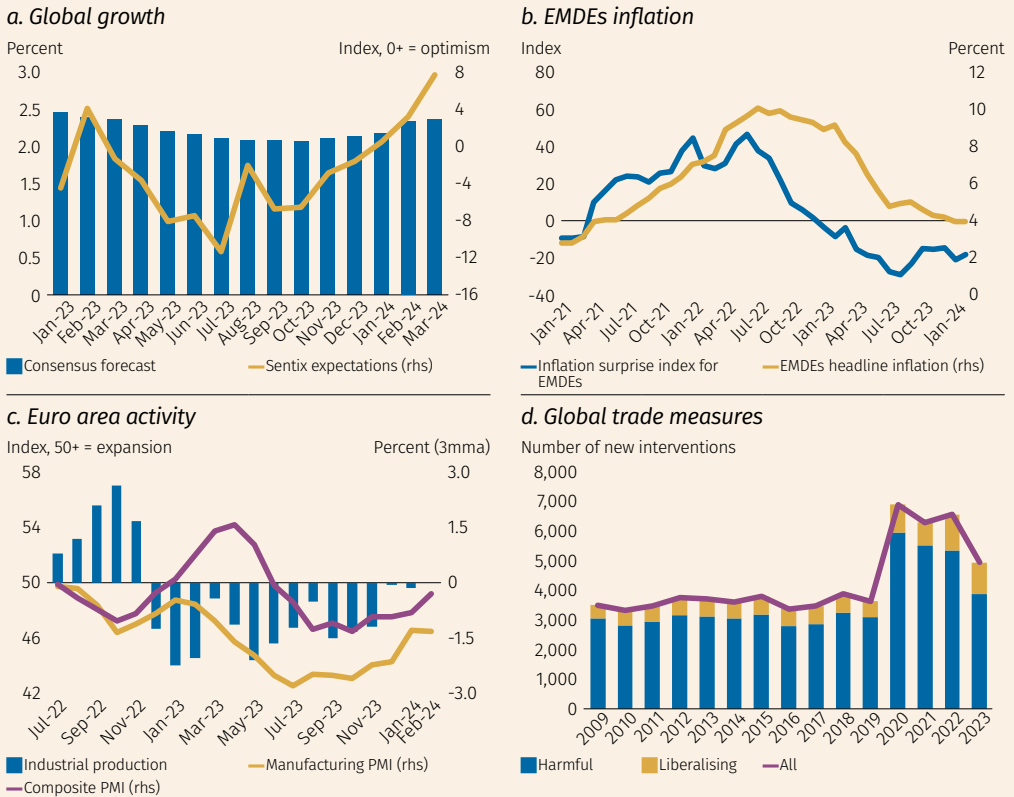
Downside risks to the baseline projections continue to dominate the outlook, notably due to geopolitical tensions.

Russia’s invasion of Ukraine is still ongoing after more than two years and shows no signs of abating. An escalation of that conflict, or the conflict in the Middle East, could increase commodity prices. While inflationary pressures and financial

(Box 9.1 continued)

stress may have eased, global financial conditions could tighten. In the ECA region, numerous upcoming elections will amplify political uncertainty regarding economic policy direction. Moreover, increasing trade fragmentation could lead to higher trade costs and have adverse global repercussions. In 2023, nearly 4,000 new detrimental trade interventions were implemented globally (Figure 9.4d). The trade implications hold significant importance for the WB6, given the average high degree of trade openness at 123 percent in 2022.

Figure 9.4. Global economic developments



Source: Consensus Economics; Global Trade Alert; Haver Analytics; World Bank.
 Note: EMDEs = emerging market and developing economies; 3mma = 3-month moving average.
 a. Bars show the historical consensus forecast estimates for GDP growth. Red line shows the Sentix Index that reflects perceptions about the global economic outlook, based on investor surveys. Values above zero indicate “optimism” while those below zero indicate “pessimism”. Last survey and observation are March 2024.
 b. Red line shows the median headline CPI inflation for EMDEs (yoy). Blue line shows the Citigroup Inflation Surprise Index for emerging markets. Values above zero indicate that inflation data are exceeding expectations, EMDE inflation is median annual inflation. Last observations are February 2024.
 c. Blue line shows the monthly Manufacturing PMI index. Red line shows the monthly Composite PMI. Last observation is February 2024. Yellow bars show the moving 3-month growth rate of industrial production. Last observation is January 2024.
 d. Bars show the number of new trade interventions per year. Last observation is 2023, based on March 25th, 2024 data.

But there are some new opportunities that the WB6 region could seize. First, the EU introduced the new Growth Plan in late 2023 (see Box 9.2). This is a powerful tool to promote reforms and help to build missing infrastructure. Both are critical for faster growth in the WB6

region. Second, diversification in production and exports that has occurred in recent years in most of the countries from the region can enable them to become part of global value chains and benefit from faster growth in other parts of the global economy.

Box 9.2. The EU's new Growth Plan for the Western Balkans offers the promise of faster convergence with EU living standards, if opportunities are grasped

As small economies, the path of the six Western Balkan economies toward higher income, improved living standards and convergence with the EU depends on economic integration within the region, and between the region and the EU. The region's small and fragmented markets cannot exploit economies of scale and agglomeration forces alone, and policies that promote economic integration help pool resources for a more attractive and competitive economic environment. The EU is the largest trading partner for the WB6, with over 80 percent of their exports going to the EU and 60 percent of imports coming from the EU.

The announcement in November 2023 of the EU's new Growth Plan for the Western Balkans has provided renewed impetus behind the regional integration agenda, with a mixture of financing and support for reforms aimed at enhancing economic integration with the EU's single market, as well as boosting economic integration within the Western Balkans through the Common Regional Market based on EU rules and standards. A total of €6 billion in new EU financing is attached to the new Growth Plan over the 2024–27 period, with half to support infrastructure investments and half to be provided as budget support in line with reform actions by the six countries.

However, the impact of reforms, coupled with increased access to the EU's single market, will likely generate significantly larger impacts compared with the direct transfer of resources by the EU. Two critical aspects include: (i) improved trade and transport facilitation, including the extension of the “green lanes” piloted during the pandemic for essential goods to cover substantially all trade through the 10 largest EU27-WB6 border crossing points; and (ii) access to the Single Euro Payment Area (SEPA), allowing for fast and low-cost international payments.

With faster and more predictable border clearance processes, there are increased opportunities for international trade, investments and job creation. New World Bank research suggests that reducing border clearance times to those seen in the average OECD economy (the current average gap is about 3 hours) would be equivalent to immediately lowering tariffs in the WB6 by around 2 percent. This would, on average, deliver welfare (real

(Box 9.2 continued)

income) increases of 1.5–3.0 percent in the Western Balkans in the medium term as cross-border trade expands. Furthermore, the gains are amplified by coordinated action on trade facilitation, and even further by full frictionless trade.

Figure 9.5. Coordinated action to reduce border waiting times in the WB6 would boost income

Welfare gains and effect on per capita income in WB6 countries: reducing waiting times at the border by 3 hours

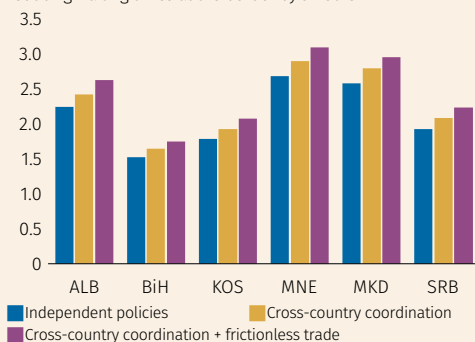
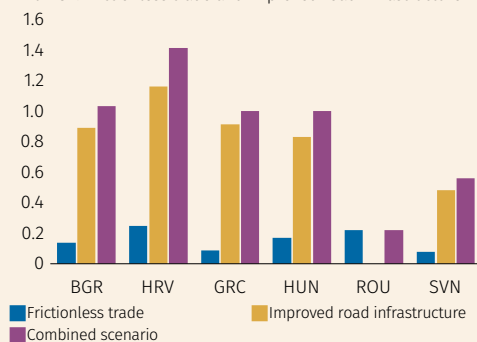


Figure 9.6. Neighboring EU countries also benefit from faster trade in the WB6, especially if it is coupled with investments in connectivity infrastructure

Welfare gains and effect on per capita income in EU27 countries: WB6-EU27 frictionless trade and improved road infrastructure



Source: Taglioni et al. (2023) The Economic Effects of Market Integration in the Western Balkans, World Bank Policy Research Working Paper No. 10491. <https://openknowledge.worldbank.org/handle/10986/39982>.

Improving trade facilitation in the Western Balkans also generates tangible welfare gains for neighboring countries in the EU, especially those countries that either trade intensely with, or transit through, the WB6. The largest gains are seen in Croatia, Bulgaria, Greece, Hungary, Romania and Slovenia. The impact of frictionless trade between the WB6 and the EU27 results in welfare gains in these neighboring countries of around 0.2–0.3 percent. However, when coupled with an additional scenario of improved primary road infrastructure for better connectivity in the Western Balkans, the benefits of frictionless trade are sharply amplified. In this scenario, the same group of neighboring EU countries sees welfare gains ranging from 0.56 percent in Slovenia to 1.41 percent in Croatia.

Access to the Single Euro Payments Area is a fundamental aspect of the EU's new Growth Plan for the Western Balkans. For domestic financial transactions in the WB6, cash-based services are still dominant even if significantly more expensive than digital options. Cross-border transactions, critical for foreign trade and remittances, are also significantly more expensive for WB6 countries. According to World Bank calculations, costs for micro and small businesses trading between WB6 economies can be as high as six times more than those incurred by their peers in the EU. Furthermore, the cost of sending remittances to the WB6 economies is 6.71 percent of the total transaction amount, far above the global target of 3 percent set by the United Nations (UN). Reducing the cost of payments to the 3 percent of global target would save €500 million annually in fees paid by WB6 residents. Access to

(Box 9.2 continued)

the European TARGET Instant Payment Settlement (TIPS) system as indirect participants, even before becoming EU members, would enable payment service providers to offer fund transfers to their customers in real time and around the clock.

The structural reform agenda remains significant, which should be seen as an opportunity and not a burden from the past.

Most of the countries from the region still need to deal with remaining state-owned enterprises (SOEs) that are inefficient and create market distortions; with education systems that fail to deliver the skills demanded by (future) markets and below the levels of peer countries in ECA (as measured by the PISA tests); infrastructure that is poorly managed or missing altogether, which raises the costs of doing business and is prone to climate change-related disasters (as it has been apparent in Albania in the case of earthquakes, droughts in Kosovo, North Macedonia and Serbia, and floods in Serbia and North Macedonia, among others). Addressing these problems—SOEs, governance, education and climate change—with comprehensive, sustainable, and adequately funded policy responses would unleash significant growth potential throughout the WB6 region.

10. Heatmap: Western Balkans Indicators

Western Balkans Indicator Heatmap

Color shading: lighter - lower values, darker - higher values

		ALB	BIH	KOS	MKD	MNE	SRB
Macro-financial management							
Real GDP growth	Q3 23	3.5	1.9	3.0	1.2	6.6	3.6
Inflation*	Dec 23	4.0	2.2	2.3	3.6	4.3	7.6
Employment rate	2023	57.2	41.5	35.4	45.4	55.6	50.3
Credit growth	Dec 23	5.0	7.2	12.7	5.3	6.9	1.8
NPLs*	Q3 23	5.2	4.0	2.0	2.7	5.9	3.2
Inclusive growth							
Poverty rate*	2022	23.5	-	23.4	18.3	10.3	8.5
GINI index*	latest	29.4	33.0	29.0	33.5	36.8	35.0
LFP gender gap*	2023	15.2	23.4	34.0	19.2	12.7	14.1
Unemployment rate*	2023	10.7	13.2	8.8	13.1	13.1	9.4
Youth unemployment rate*	2023	25.7	29.9	16.9	29.4	23.7	25.1
International economic integration							
Exports	2022	37.4	48.1	38.6	74.0	51.5	62.9
Imports*	2022	47.8	61.9	71.4	94.9	74.4	74.5
CAB	2022	-6.0	-4.3	-10.3	-6.1	-12.9	-6.9
FDI	2022	6.7	3.0	6.3	5.0	13.2	7.2
Remittances	2022	5.5	7.9	13.4	2.7	6.5	6.2
Sustainable growth							
Fiscal balance	2022	-3.7	0.5	-0.6	-4.4	-4.9	-3.0
Expenditures*	2022	30.5	39.7	28.4	36.5	43.4	46.4
Revenues	2022	26.8	40.2	27.9	32.1	38.6	43.4
Public and publicly guaranteed debt*	2022	65.4	31.5	20.0	59.0	70.9	55.6
Emissions*	2022	1.7	6.1	4.8	3.6	3.7	6.0

* For these indicators, higher values are associated with worse outcomes.

Macro-financial management: Notes: Real GDP growth, inflation and credit growth are expressed as year-on-year, employment as a rate and NPLs as percent of total loans. Sources: National statistical offices; central banks; World Bank staff.

Inclusive growth: Notes: Poverty rate calculations is based on ECAPOV harmonization using SILC-C data except for KOS where poverty rate calculations is based on ECAPOV; Household Budget Survey (HBS) data. Income measures in the SILC and consumption measures in the HBS are not strictly comparable; Poverty is defined as living on less than \$6.85/day per person in revised 2017 PPPs; GINI - 2020 (ALB, SRB), 2019 (MKD), 2018 (MNE), 2017 (KOS), 2011 (BiH). Sources: National statistical offices; World Bank staff.

International economic integration: Notes: Indicators are expressed as percent of GDP. Exports and imports refer to exports and imports of goods and services. Sources: National statistical offices; central banks; World Bank staff.

Sustainable growth: Notes: Indicators are expressed as percent of GDP, except emissions which are expressed as tonnes per person. Emissions refer to annual total emissions of carbon dioxide (CO₂), excluding land-use change. Sources: National statistical offices; central banks; Global Carbon Budget (2023); Population based on various sources (2023) – with major processing by Our World in Data; World Bank staff.

11. Spotlight: Greening Cities

11.1 Cities, growth and green growth—What do we know?

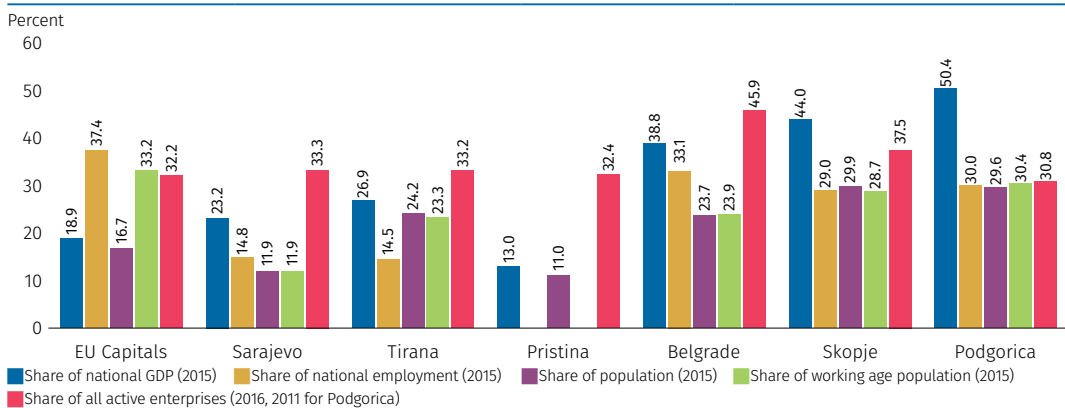
Cities as engines of growth

Urbanization is both an indicator and a driver of development. Fifty-six percent of the world’s population lives in cities, generating more than 80 percent of global GDP.²⁰ In 2022, 60 percent of the Western Balkan region’s population, on average, was urban—15 percentage points lower than the average for the EU.²¹ Between 1960 and 1990, urban population growth was rapid, at almost 2 percent a year.²² This has implications for national development, given that cities are where economic development really happens. They allow workers to be closer to jobs, increasing opportunities and fueling productivity. They bring people together

physically, facilitating the exchange of ideas and bringing about innovations. These are referred to as agglomeration economies. High population densities also make it cheaper to provide services efficiently and equitably. As a result, many of the benefits of urban life—productivity and livability—are associated with proximity within the city. Capital cities in the region have indeed been contributing to national growth given their high population concentration and large shares of national economic activity (Figure 11.1).

Unfortunately, structural, and demographic challenges, as well as exposure to climate effects, have limited the ability of Western Balkan cities to drive national growth. Although the late 20th century came with rapid urban population growth and expansion,

Figure 11.1. Capital cities account for a large share of national GDP, population, labor force, jobs, and active enterprises



Sources: World Bank, 2019; Eurostat Data Browser; OECD Kosovo Economy Profile 2022. Note: EU capitals calculation based on average of 27 EU country capitals for 2015. Share of all active enterprises: the number of active enterprises for EU capitals shown for 2016 and based on available data for 19 capital cities, for Pristina (Kosovo) shown for 2019; and share of national employment—the number of employed persons for EU capitals calculated for 2017.

20 World Bank. 2023. Urban Development. <https://www.worldbank.org/en/topic/urbandevelopment/overview>.
 21 Calculated based on 2022 World Bank Open Data (World Bank. 2023. Urban population (% of total population) —Albania, Bosnia and Herzegovina, Montenegro, Kosovo, Serbia, and North Macedonia. Accessed January 2024. <https://data.worldbank.org/indicator/SP.URB.TOTL.IN.ZS?locations=AL-BA-ME-XK-RS-MK>.) Note: Excludes Kosovo as data are not available.
 22 World Bank. 2019. Western Balkans and Croatia - Urbanization & Territorial Review. <https://documents1.worldbank.org/curated/en/306721565242541252/pdf/Overview.pdf>. Note: Excludes Kosovo as data are not available.

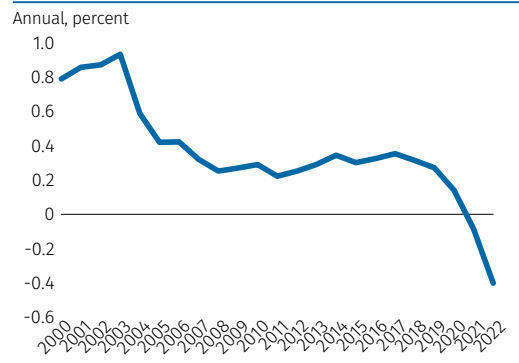
the trend in recent years has reverted due to demographic decline. Capital cities in the region also appear to be underperforming: they are growing more slowly than capital cities in the EU and other parts of the region.²³ In addition, they suffer from low productivity, show only modest employment gains, and have had relatively low or stagnant GDP growth since 2009.²⁴ A changing climate is exacerbating the existing pressures, with the WB6 region exposed to more unpredictable shocks, such as flash floods and wildfires, together with slow-onset stressors such as heat and drought continuing to worsen. These climate-triggered hazards pose a threat to cities' economic potential and to their residents.

Small, sparse, and shrinking cities in the Western Balkans

Cities in the Western Balkans are often small and sparsely populated, and they are experiencing demographic decline, limiting the potential of agglomeration economies. Since the early 2000s, many Western Balkan cities, especially the smaller ones, have been shrinking (though they are not necessarily in economic decline), mainly because of changing demographics and outmigration.²⁵ In the past two decades, the Western Balkan countries have shown a decreasing trend in annual population growth, with the annual percentage becoming negative since 2021 (Figure 11.2). In 2022, the Western Balkan countries experienced an average annual urban population decline of 0.38 percent,²⁶ with Serbia experiencing the

greatest decline of 2.1 percent. The average city, as defined above—see Box 11.1, is small, with only 30,000 inhabitants, and population density is low, at around 942 inhabitants per square kilometer. This is lower than other countries in ECA or in most of the world.²⁷ These characteristics do not lend themselves to agglomeration economies, and thus limit the potential contribution that urban areas could make to overall productivity and national economic growth.

Figure 11.2. Annual urban population growth of the Western Balkan countries, 2000–2022



Source: World Bank staff calculations based on World Bank Urban Development Data. World Bank. 2023. Urban population growth (annual %) – Albania, Bosnia and Herzegovina, Montenegro, Kosovo, Serbia, North Macedonia. Accessed January 2024. <https://data.worldbank.org/indicator/SP.URB.GROW?locations=AL-BA-ME-XK-RS-MK>.

Note: Excludes Kosovo as data are not available.

Cities: hotspots of climate change

A changing climate has further increased vulnerabilities, with WB6 cities exposed to multiple natural hazards, such as urban floods, landslides, and extreme heat. Extreme

23 World Bank. 2019. Western Balkans and Croatia - Urbanization & Territorial Review. <https://documents1.worldbank.org/curated/en/306721565242541252/pdf/Overview.pdf>.

24 Ibid.

25 Restrepo Cadavid, Paula, Grace Cineas, Luis E. Quintero, and Sofia Zhukova. 2017. Cities in Europe and Central Asia: A Shifting Story of Urban Growth and Decline. Washington, DC: World Bank. <http://monstat.org/eng/pxweb.php>.

26 Calculated based on World Bank Urban Development Data (World Bank. 2023. Urban population growth (annual %) – Albania, Bosnia and Herzegovina, Montenegro, Kosovo, Serbia, North Macedonia. Accessed January, 2024. <https://data.worldbank.org/indicator/SP.URB.GROW?locations=AL-BA-ME-XK-RS-MK>.) Note: Excludes Kosovo as data are not available.

27 World Bank. 2019. Western Balkans and Croatia - Urbanization & Territorial Review. <https://documents1.worldbank.org/curated/en/306721565242541252/pdf/Overview.pdf>.

heat in cities has worsened considerably—see the Western Balkans Regional Country Climate and Development Report (forthcoming) for details across each of the six countries. For instance, Tirana, Shkodra, Vlora, Mostar, Sarajevo, and Skopje are up to 4.5–7.5°C hotter in summer compared with their rural surroundings.²⁸ In addition, many WB6 cities, including Skopje (North Macedonia), Tetovo (North Macedonia), Sarajevo (BiH), Belgrade (Serbia), and Pristina (Kosovo), also face increased PM_{2.5} concentrations and are among the most polluted in Europe in terms of air quality, which has deteriorating effects on the environment and human health. Moreover, urban expansion on steep slopes has made larger cities in the Western Balkans

prone to high landslide risks. Built-up surface areas of 16.5 percent (about 6.3 percent of the population) in urban centers currently face moderate to very high landslide risk.²⁹ Meanwhile, the risk of urban floods, triggered by intense rainfall, has been increasing in all WB6 countries in recent decades, leading to substantial damage and economic loss.

Cities as potential agents for greener growth and development

Urban areas are not passive onlookers, since they are not only large contributors to climate change, but also at the forefront of changes in policies and public sentiment. Globally, cities account for over 70 percent of total CO₂ emissions, mainly because of fossil

Box 11.1. Defining cities and greenness

A **city** is defined as a spatially contiguous, dense cluster of population grid cells in a global 1 square kilometer population grid. Each cell has a population density of at least 1,500 people per square kilometer and the aggregate population of the set is at least 50,000. This definition was devised by the EC in collaboration with several other international organizations (Dijkstra et al. 2021) and is also officially endorsed by the United Nations Statistical Commission as a recommended method for making international comparisons of urban areas. This definition is used in place of official national definitions of cities in the WB6 countries to allow for standardized study and comparisons.

Greenness measures a city's environmental footprint, with greener cities having more positive or fewer detrimental effects on the environment. In this report, it is measured by greenhouse gas (GHG) emissions, specifically carbon dioxide (CO₂) emissions, methane (CH₄) emissions, air pollution (PM_{2.5}), urban heat, and vegetation cover. Greenness is linked closely to climate change. For instance, particulate emissions are related to CO₂ emissions, suggesting that measures to reduce local pollution may also help in climate change mitigation, and vice versa. Furthermore, enhancing urban vegetation not only cools cities, countering climate change and the urban heat island effect, but also captures atmospheric carbon.

²⁸ World Bank. 2024 [Upcoming]. WB6 CCDR.

²⁹ Based on overlapping European Landslide Susceptibility Map version 2 (ELSUS v2) with Global Human Settlement Layer (GHSL) dataset-GHS-SMOD R2023A and GHS-POP R2023A – GHS population grid (2020 and 2030).

fuels used in the transportation sector, and carbon-intensive materials and energy used in the buildings sector.³⁰ Within the WB6 region, Serbian cities were the leading contributors to CO₂ emissions in 2018. More than 87 percent of CO₂ emissions came from the combustion of fossil fuels in Serbia, Montenegro, and Bosnia and Herzegovina.³¹ Less compact cities emit even more GHG with their expanded transportation system and greater energy needs. Indeed, cities can be vocal advocates of climate action, often demonstrating new ways to transition to a greener and more sustainable development path.³² These actions can include coordinated urban planning alongside investments in transportation infrastructure, targeting both compactness and connectivity. Investments in energy-efficient buildings (or retrofits of existing structures) are expensive, but their returns are high.³³ Cities in the Western Balkans are no stranger to climate action and they have already trialed many policies aimed at greening. Under the EU initiative “Green Agenda for the Western Balkans”,³⁴ many cities have pledged action to implement the EU 40 percent GHG reduction target by 2030, and taken climate mitigation and adaptation actions to be aligned with the European Green Deal. Elbasan (Albania), Sarajevo (BiH) and Podgorica (Montenegro) are part of the 100

“Climate-Neutral and Smart Cities” by 2030 under the 2021 EU mission.³⁵

Greening not only mitigates climate change, but is also good for growth, resilience, and inclusion. Urban greening and climate actions yield significant benefits, according to the “Triple-A” Dividend of Resilience³⁶ framework from the WB6 Country Climate and Development Report (CCDR), including avoided losses, accelerated economic potential, and amplified environmental and social co-benefits. Climate actions in urban areas promote sustainable economic development, especially in sectors such as transportation, energy, and waste management. Moreover, investments in greening are also associated with high developmental and environmental co-benefits, such as increased productivity, job creation, improved aesthetics, and recreational values, and enhanced ecological values and biodiversity. Policy changes in managing waste will be good for human health, air pollution, and for methane emissions. For instance, the Urban Renewal program in Albania has spent more than €365 million and implemented 581 projects on urban requalification, facades, education, and green innovation, including transforming 29 main squares and seven urban boulevards, and implementing 24 urban

30 Dasgupta, S., et al. 2022. Cutting global carbon emissions: Where do cities stand? <https://blogs.worldbank.org/sustainablecities/cutting-global-carbon-emissions-where-do-cities-stand>.

31 World Bank Blogs. Muldabayeva and Nikolic. 2023. Towards greener and more resilient cities in Serbia: How improved urban planning can help. <https://blogs.worldbank.org/sustainablecities/towards-greener-and-more-resilient-cities-serbia-how-improved-urban-planning-can-help>.

32 Mukim, M., and M. Roberts (eds.). 2023. Thriving: Making Cities Green, Resilient, and Inclusive in a Changing Climate. © Washington, DC: World Bank. <https://openknowledge.worldbank.org/entities/publication/7d290fa9-da18-53b6-a1a4-be6f7421d937>.

33 Oikonomou, V., S. Ebrahimigharchbaghi and M. Peretto. 2023. Cost-benefit Analyses of Investments in the Energy Saving Measures of the Residential Sector in Central and Eastern Europe. Institute for European Energy and Climate Policy (IEECP). https://ieecp.org/wp-content/uploads/2023/05/FOUR_SCENARIOS_VERSION_Greenpeace_-IEECP.pdf.

34 European Commission. 2020. Guidelines for the Implementation of the Green Agenda for the Western Balkans. https://neighbourhood-enlargement.ec.europa.eu/system/files/2020-10/green_agenda_for_the_western_balkans_en.pdf.

35 European Commission. 2023. EU Mission: Climate-Neutral and Smart Cities. https://research-and-innovation.ec.europa.eu/funding/funding-opportunities/funding-programmes-and-open-calls/horizon-europe/eu-missions-horizon-europe/climate-neutral-and-smart-cities_en.

36 Developed in the WB6 CCDR. (World Bank. 2024 [upcoming]. Western Balkans 6 CCDR.) Original term is “Triple Dividend of Resilience”, modified in the WB6 CCDR to “Triple-A Dividend of Resilience” to hint at potential financial dividends from these economic and other co-benefits. Triple Dividend framework was developed and described in Tanner, T., et al. 2015. The Triple Dividend of Resilience: Realizing Development Goals through the Multiple Benefits of Disaster Risk Management, London and Washington, DC: Overseas Development Institute and World Bank.

forestation programs.³⁷ In cities such as Podgorica (Montenegro) and Skopje (North Macedonia), projects have been launched to enhance sustainable wastewater treatment and also safeguard people’s health and bring environmental benefits to the urban areas and surrounding rivers and lakes.³⁸ In Albania, a €40 million investment in public building retrofitting in urban areas for climate-resilience and energy efficiency is expected to yield massive returns, with energy savings alone accounting for €500 million.³⁹

11.2. How green are cities in the Western Balkans?

Cities influence climate dynamics through their carbon footprint, atmospheric particulate matter concentrations, and biophysical attributes. Analyzing the extent of greenness of cities is crucial to understanding their role in exacerbating or mitigating climate change, as urban areas are at the forefront of both environmental challenges and opportunities for sustainability. The challenges faced by WB6 cities in terms of emissions and sustainability are rather unique to the region. In recent years, capitals in the WB6 have often been listed among Europe’s most polluted cities, and over 25 WB6 cities suffer from pollution that exceeds prescribed limit values.⁴⁰ This section focuses on analyzing key measures of the extent of greenness using data on carbon dioxide (CO₂), methane emissions, and emissions of

particulate matter of 2.5 microns or less in diameter (PM_{2.5}) for a sample of 39 cities in the region. It explores how these environmental outcomes correlate with fundamental urban attributes, including size and development level, offering insights into the “greenness” of cities and their contributions to climate dynamics. This is followed by analyzing the degree of extreme heat-related events in the past few decades, focusing on the issue of rising intensity of urban heat islands in the region.

A. By and large, urban emissions in the Western Balkans are worse, relative to the region

Many cities in the region exceed safe PM_{2.5} levels and are among the most polluted in Europe (Figure 11.3). Skopje’s (North Macedonia) annual mean PM_{2.5} concentration levels are 4.5 times the World Health Organization’s (WHO) safe threshold, Tetovo’s (North Macedonia) annual mean PM_{2.5} concentration levels exceed it by over 8 times, and Sarajevo’s (BiH) levels are triple the recommended safe level, indicating a critical environmental health crisis.⁴¹ These cities, along with Belgrade (Serbia) and Pristina (Kosovo), are among the most polluted capitals in Europe. The main contributors are residential heating and cooking (using solid fuels), industrial activities, and transportation. In winter months, residential heating bucks the trend. Figure 11.3a illustrates the average annual PM_{2.5} emissions across WB6 cities,

37 BIRN, Urban Renewal Database, 2020. <http://rilindjaurbane.reporter.al/>.

38 The Western Balkans Investment Framework (WBIF). 2023. Podgorica Wastewater Treatment Plant. Link; WBIF. 2023. Progress made on North Macedonia’s largest environmental project. <https://www.wbif.eu/news-details/progress-made-north-macedonias-largest-environmental-project>.

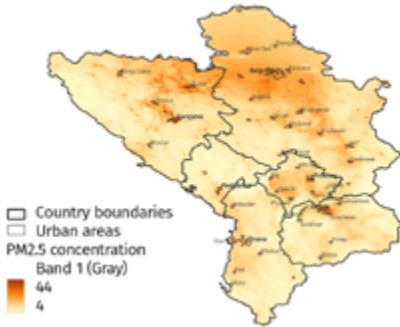
39 Novikova, A., Z. Szalay, M. Horváth et al. Assessment of energy-saving potential, associated costs and co-benefits of public buildings in Albania. Energy Efficiency 13, 1387–1407 (2020). <https://doi.org/10.1007/s12053-020-09883-3>.

40 Green Agenda for the Western Balkans. Regional Cooperation Council. 2021. <https://balkangreenenergynews.com/wp-content/uploads/2021/10/GAWB-ACTION-PLAN-Final-04.10.2021.pdf>.

41 Regional Note on Air Quality Management in the Western Balkans: Bosnia and Herzegovina, Kosovo, and North Macedonia. World Bank. 2020. <https://documents1.worldbank.org/curated/en/330811585586168639/pdf/Regional-Note-on-Air-Quality-Management-in-the-Western-Balkans-Bosnia-and-Herzegovina-Kosovo-and-North-Macedonia.pdf>.

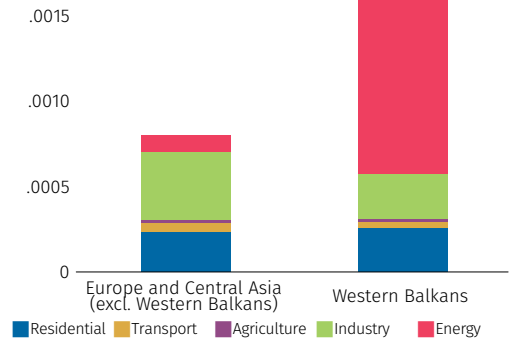
Figure 11.3. PM_{2.5} concentrations, in cities and by region

a. Annual average PM_{2.5} concentration in cities



b. Per capita PM_{2.5} emissions in WB6 and ECA regions

Average PM_{2.5} emissions, 2015 (tonnes per year per capita)



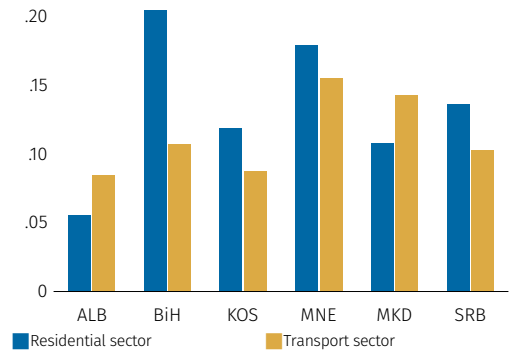
Source: Based on data for 39 Western Balkans cities (Panel a and b) and 1,307 ECA (excluding WB6) cities (Panel b) from the European Commission’s Global Human Settlement (GHS) Urban Centre Database R2019 (https://ghsl.jrc.ec.europa.eu/ghs_stat_ucdb2015mt_r2019a.php), which derives its PM_{2.5} emissions data from the EC’s Emissions Database for Global Atmospheric Research (EDGAR v5.0).

highlighting a notably high concentration in the Sarajevo metropolitan area of Bosnia and Herzegovina, followed closely by Skopje in North Macedonia. Figure 11.3b shows that per capita PM_{2.5} emissions in the Western Balkans are substantially greater than those in the rest of ECA. While industry and transport contribute to PM_{2.5} emissions across ECA countries, the Western Balkans have a noticeably larger footprint across all sectors, especially in agriculture and energy. Podgorica (Montenegro) and Niš (Serbia) experience the highest levels of residential combustion in the region, contributing to over 20 percent of their total PM_{2.5} pollution, in contrast to cities in Bosnia and Herzegovina, where such combustion constitutes around 10 percent of the overall PM_{2.5} pollution.⁴²

Given its greater reliance on renewable energy for electricity supply, carbon dioxide (CO₂) emissions in Albanian cities are lower than the rest of the WB6 region. Albania has the lowest per-capita CO₂ emissions not

Figure 11.4. Average fossil CO₂ emissions, by country

2015 (tonnes per year per capita)



Source: Based on data for 39 Western Balkan cities from the European Commission’s Global Human Settlement (GHS) Urban Centre Database R2019 (https://ghsl.jrc.ec.europa.eu/ghs_stat_ucdb2015mt_r2019a.php), which derives its CO₂ emissions data from the EC’s Emissions Database for Global Atmospheric Research (EDGAR v5.0).

Notes: The bars show the unweighted average of long-cycle (fossil) CO₂ emissions per capita (measured in tonnes per year per person) of cities.

only in the WB6 region but also in the wider Europe region.⁴³ Both for the residential and transportation sectors, the average CO₂ emissions have been lower than the other five countries. At the opposite end of the spectrum, Bosnia and Herzegovina stands out with the highest average production-based CO₂

⁴² Status of air pollutants and GHG in the Western Balkans. European Commission JRC Science for Policy Report. 2020. https://publications.jrc.ec.europa.eu/repository/bitstream/JRC118679/air_qualityghg_western_balkans_online.pdf.

⁴³ Multi-dimensional Review of the Western Balkans: From Analysis to Action. OECD. 2022. https://www.oecd-ilibrary.org/development/multi-dimensional-review-of-the-western-balkans_8824c5db-en.

emissions from the residential sector, while emissions per capita from the transportation sector are relatively consistent among WB6 countries, with Serbia being the highest. The residential sector is a significant source of emissions in each country, generally surpassing the transportation sector (Figure 11.4).

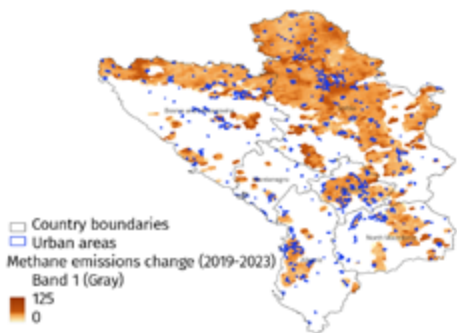
Emissions compound the effects of other hazards. Increasing CO₂ emissions are known to exacerbate urban heat islands, intensify air pollution, and amplify climate-related risks in cities.⁴⁴ Two climate change scenarios for the Western Balkans predict temperature increases of 0.8°C under the Representative Concentration Pathway 4.5 (RCP)⁴⁵ scenario by 2035, and a significant 1.0°C rise under the high-emission RCP8.5 scenario.⁴⁶

Unregulated and poorly managed landfills have resulted in fires, aggravating methane

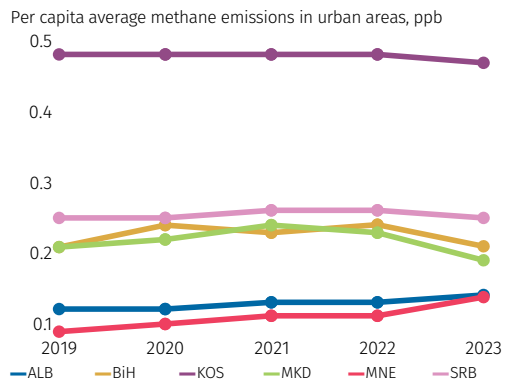
(CH₄) emissions. Increasing methane and particulate matter emissions from waste decomposition and incomplete waste burning are large contributors to climate change and to air pollution. In Albania, the average concentration of PM10 at Sharra solid waste dump, located near the city of Tirana, is almost 10 times higher than the WHO standard.⁴⁷ Across WB6 countries, CH₄ concentrations at dumpsites increased by 16.89 parts per billion (ppb) in 2020, which is higher than the global annual rise of 15.23 ppb in 2020. Figure 11.5, panel (a), depicts the change in concentration of CH₄ emissions in the region between 2019 and 2023. The densest clusters of increases in CH₄ emissions are in Serbia, Kosovo and Bosnia and Herzegovina. In terms of per capita CH₄ emissions specifically for urban areas (Figure 11.5, panel b), Kosovo consistently has the highest numbers, followed by Serbia and Bosnia and Herzegovina.

Figure 11.5. Change in methane emissions

a. Methane growth rate (ppb/year), 2019–2023



b. Per-capita average methane emissions

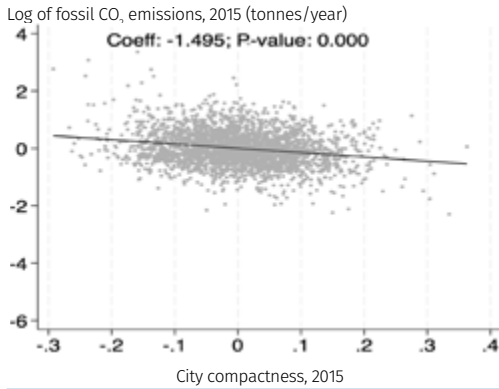


Source: Methane emissions measured as Column-averaged dry air mixing ratio of methane, as parts-per-billion from Sentinel-5 Precursor Tropospheric Monitoring Instrument (TROPOMI). https://developers.google.com/earth-engine/datasets/catalog/COPERNICUS_S5P_OFFL_L3_CH4#bands.
 Note: Urban areas defined using GHS-SMOD R2023A – GHS settlement layers, application of the Degree of Urbanisation methodology (stage 1) to GHS-POP R2023A and GHS-BUILT-S R2023A, multitemporal (1975–2030). <http://data.europa.eu/89h/a0df7a6f-49de-46ea-%209bde-563437a6e2ba>.

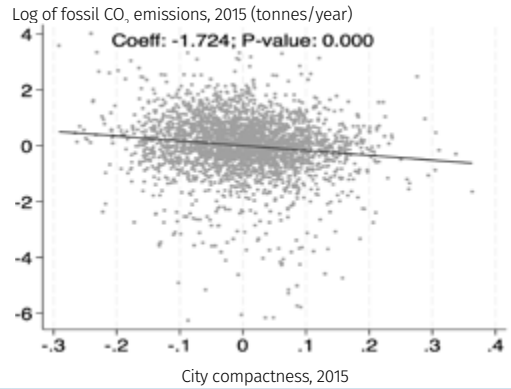
44 To fulfill climate commitments in the Western Balkans there is a need for up-to-date GHG inventories and robust reporting mechanisms, currently only effectively maintained by Montenegro.
 45 Representative Concentration Pathways (RCPs) model potential scenarios for carbon dioxide emissions or atmospheric concentration decreases throughout the century and represent GHGF trajectory forecasts adopted by the IPCC.
 46 Study on Climate Change in the Western Balkans Region. EU Regional Cooperation Council. 2018. <https://www.rcc.int/download/docs/2018-05-Study-on-Climate-Change-in-WB-2a-lowres.pdf/06af8f7432484a6ce384ebcb8c05e8d7.pdf>.
 47 Besnik Baraj Merita Mansaku, Hotspot: Sharra Dumpsite in Tirana, Albania, Meksi EDEN Center. https://ipen.org/sites/default/files/documents/alb1_sharra_dump_in_albania-en.pdf.

Figure 11.6. Relationship between city compactness and CO₂ emissions across cities, residential and transportation sectors

a. Residential sector



b. Transportation sector



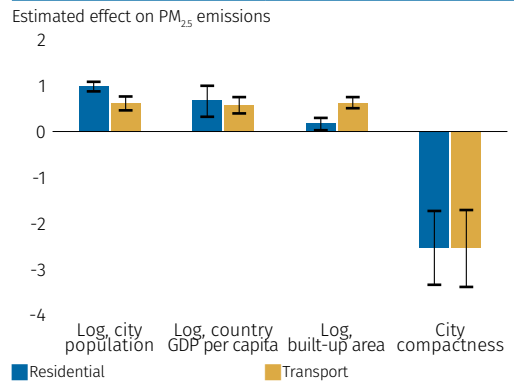
Source: World Bank analysis based on data for 2785 global cities from the European Commission's Global Human Settlement (GHS) Urban Centre Database R2019. https://ghsl.jrc.ec.europa.eu/ghs_stat_ucdb2015mt_r2019a.php, which derives its data on PM_{2.5} emissions from the EC's Emissions Database for Global Atmospheric Research (EDGAR v5.0).

Note: The graphs shows the relationship between log CO₂ emissions in 2015 and a measure of city compactness (the Polsby-Popper Ratio compactness index) controlling for the log of a city's population, the log of its built-up area, a city's climate (precipitation, temperature, biome) and elevation, and country fixed effects.

More compact cities tend to have lower production-based CO₂ emissions from the residential and transportation sectors. Figure 11.6 shows that, for cities in the region, more compactness⁴⁸ is associated with lower CO₂ emissions. Effective urban planning, combined with the effective regulation of land and real estate markets, could limit urban sprawl. These policies, in turn, when coupled with investments in public transportation, have the potential to substantially reduce urban emissions.

Compactness is also associated with lower PM_{2.5} emissions. Controlling for city specific characteristics, such as city GDP per capita, and environmental and geographical factors, the relationship between compactness and estimated impact on PM_{2.5} emissions is also negative (Figure 11.7). In other words, for a given level of development, more sprawling

Figure 11.7. Determinants of air pollution (PM_{2.5}) for cities in the region, residential and transportation sectors



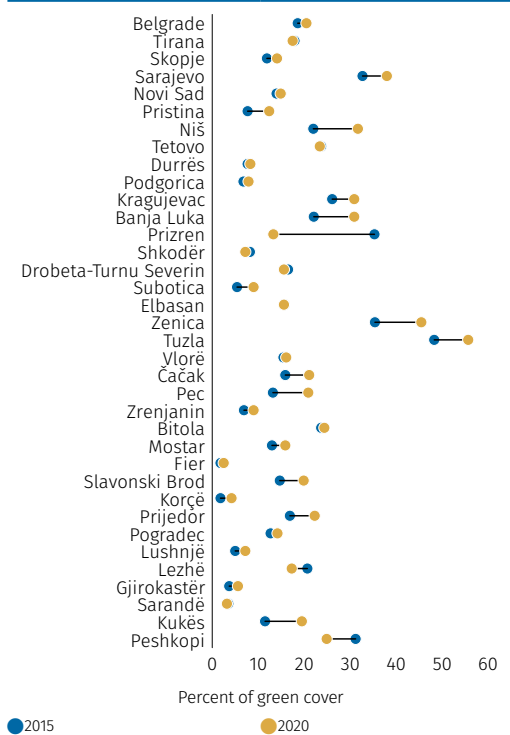
Source: World Bank analysis based on data for 2785 global cities from the European Commission's Global Human Settlement (GHS) Urban Centre Database R2019, which derives its data on PM_{2.5} emissions from the EC's Emissions Database for Global Atmospheric Research (EDGAR v5.0).

Note: For each sector, the graph presents estimated coefficients, together with the associated 95 confidence intervals, from a regression of a city's log PM_{2.5} emissions on the log of its population density, the log of the city GDP per capita of the city, and a measure of the city's compactness (the Polsby-Popper Ratio compactness index) The regressions, which also include country fixed effects and control for a city's climate (precipitation, temperature, biome) and elevation, are based on cross-sectional data for 2015 with robust standard errors.

⁴⁸ City compactness refers to a development pattern characterized by a high density of buildings and infrastructure within a relatively small area. Here urban sprawl (inverse of city compactness) is defined as the percentage of undeveloped land/open space within a square kilometer around an average residential development (using 30m x 30m cells) (Burchfield, M., Overman, H. G., Puga, D., & Turner, M. A. (2006). <https://academic.oup.com/qje/article/121/2/587/1884022>.

cities are more polluted, given the longer average travel times usually compounded by a lack of accessible public transit services. Pristina (Kosovo) is the third most polluted capital in Europe and grappling with urban sprawl;⁴⁹ private vehicles account for over half of its transportation modal share.⁵⁰

Figure 11.8. Percentage of green cover in WB6 urban clusters



Source: World Bank analysis based on data for 36 urban clusters defined in GHS-POP R2023A – GHS population grid. European Commission, Joint Research Centre (JRC). Data on green cover obtained from Dynamic World 10m resolution land cover dataset. <https://dynamicworld.app/>.

B. Green cover across urban areas has improved over the past decade

Overall green cover⁵¹ has improved in the Western Balkans, although some cities experienced a decrease between 2015 and 2020. Studying the distinction between grey urban areas and green spaces can serve as an indirect measure of greenness in cities.⁵² Figure 11.8 shows the percentage of green cover within cities⁵³ (sorted by population) in the region. Large cities in the region, such as Belgrade (Serbia), Skopje (North Macedonia), Sarajevo (BiH) and Pristina (Kosovo), witnessed an increase in green cover between 2015 and 2020, whereas Tirana (Albania), Tetovo (North Macedonia) and Prizren (Kosovo), experienced a fall in overall green cover. Changes in green cover could be linked to changes in land use, but also by changes in CO₂ concentration. This is because a changing climate is associated with an increase in stressors that undermine plant resilience, disrupting forests and ecosystems.

C. Cities are getting hotter—much hotter—lowering productivity and health outcomes

The frequency and intensity of extreme heat events has increased rapidly since the 1990s. The frequency of extreme heat events⁵⁴ for WB6 cities increased from under three days a year in the 1990s to over 40 days a year between 2011 and 2020—a staggering 14-fold increase in just

49 One of the main contributors of sprawl in the Pristina is housing development, which comprises of over 25 percent of total urban land use (Pristina Urban Development Plan, 2013).

50 City of Pristina Green City Action Plan. European Bank for Reconstruction and Development. 2021. https://ebrdgreencities.com/assets/Uploads/PDF/Pristina-GCAP_ENG_August-2021.pdf#:~:text=The%20private%20transport%20modal%20share%20in%20Pristina,transport%20network%20very%20low.%20In%20addition%2C%20the.

51 Green cover is computed as the combination of tree and grass cover (measured from satellite imagery) and excludes cropland within an urban cluster.

52 Schut, A. G., T. E. Ivits, J. G. Conijin, B. ten Brink, and R. Fensholt. 2015. "Trends in Global Vegetation Activity and Climate Drivers Indicate a Decoupled Response to Climate Change." PLoS ONE 10 (10): e0138013. <https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0138013>.

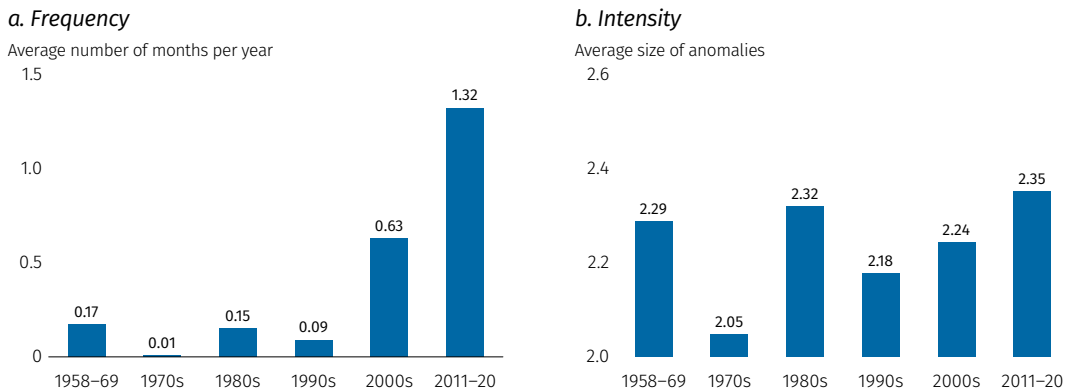
53 Defined here as urban clusters which refers to a contiguous grid cells of 1 sq km with a population density of at least 300 per sq km and a total population of at least 5,000 (low-density threshold).

54 Extreme heat is defined as the average number of months a year a city's temperature was extremely hot relative to its own historical experience. An extreme hot month is one in which a city's temperature for that month is at least 2 standard deviations higher than the month's city-specific historical norm, as calculated over the period January 1958–March 2012. Frequency is calculated as the number of nonconsecutive extreme hot months per year. Intensity is calculated as the average size of the anomaly variable during consecutive extreme hot months.

two decades (Figure 11.9, panel a). Even more worrying, the *intensity* of extreme heat events also increased, albeit more gradually, over the same period (Figure 11.9, panel b). This trend has been observed throughout the broader EU

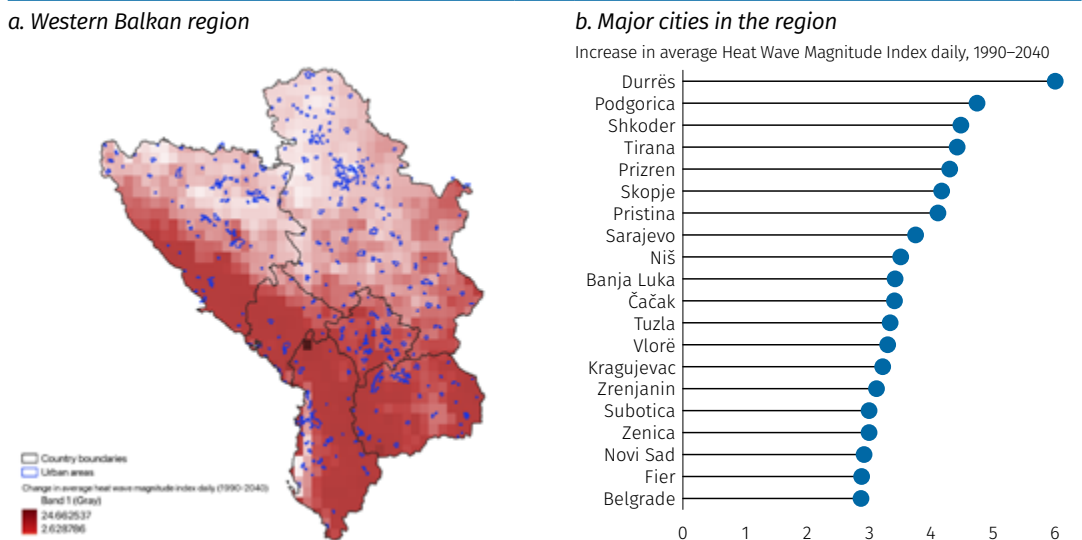
region, as the number of heatwave days and the frequency of long heatwaves rose in many EU capital cities between 1998 and 2015 compared with period between 1980 and 1997.⁵⁵

Figure 11.9. Evolution of the frequency and intensity of extreme heat events for cities in Western Balkans, 1958–69 to 2011–20



Source: World Bank staff calculations based on Climatology Lab, TerraClimate. <https://www.climatologylab.org/terraclimate.html>; European Commission, Global Human Settlement (GHS) Urban Centre Database R2019. https://ghsljrc.ec.europa.eu/ghs_stat_ucdb2015mt_r2019a.php. Note: Panel a presents the average frequency and panel b the average intensity across the regional sample of urban centers that experienced an extreme hot month over the period January 1958–December 2020.

Figure 11.10. Change in average heat wave magnitude index daily (1990–2040)



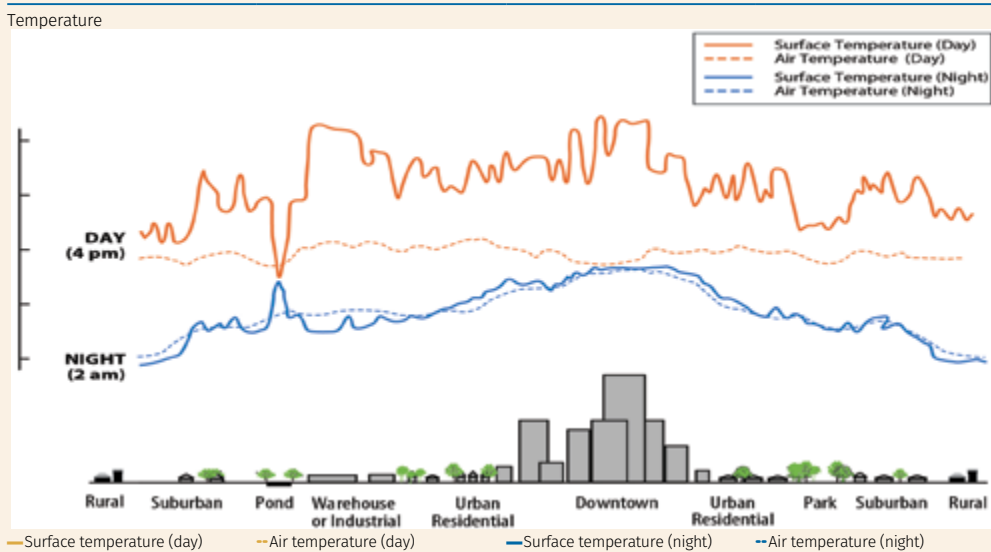
Source: Center for International Climate Research, ClimINVEST. <https://www.arcgis.com/apps/MapSeries/index.html?appid=24aa80957be242a794114cd4c9054518>. Note: Heat wave magnitude index daily (HWMId) is derived by combining the duration (in days) and the intensity (measured by daily maximum temperature) of extended extreme temperature events into one unified numerical index. Value for 1990 obtained as the average for historical model run from 1981–2000, and the projection for the year 2040 is the average of projections for 2031–2050.

55 Bednar-Friedl, B., et al. 2022. IPCC Sixth Assessment Report - Chapter 13 Europe. <https://www.ipcc.ch/report/ar6/wg2/chapter/chapter-13/>.

Box 11.2. Extreme heat will worsen existing inequalities

Western Balkan cities experience ‘thermal inequalities’, with residents of the hottest neighborhoods exposed to more than 5°C higher temperatures than residents of the coolest neighborhoods. An innovative heat stress measurement campaign, conducted in August 2024, revealed striking differences in near-ground air temperatures experienced by residents of cities in Albania, and Bosnia and Herzegovina. Local community volunteers fitted temperature and humidity sensors to their vehicles and drove routes across their cities to collect thousands of temperature measurements, which were used to create area-wide heat maps. In Sarajevo, a temperature disparity of 7.4°C between the hottest and coolest neighborhoods was measured on the fieldwork day, while in Mostar the temperature disparity reached 8.2°C. Measurements in the Albanian cities of Tirana, Shkodra and Vlora showed temperature disparities in the 4–6°C range. Heat stress was shown to be systematically higher in neighborhoods with a high density of built-up surfaces, such as asphalt pavements, and a low incidence of grass, shrubs, and tree canopy. Broad physical interventions such as increasing shade cover and decreasing the use of heat-retaining materials such as concrete and asphalt are likely to mitigate the effects of urban heat. Integrating the results with social vulnerability information will help to identify the populations most in need of awareness-building and social safety net solutions. Community mapping participants recommended a range of actions to reduce the burden of heat stress on vulnerable communities, including increased shade, greenspace access, and support to residents who face health vulnerabilities or work in heat-exposed occupations.

Figure 11.11. Average surface and air temperature patterns across urban to rural environments



Source: United States Environmental Protection Agency.

More troublingly, the magnitude of heatwaves is set to go up in the next few decades. Between 1990 and 2040, Durrës (Albania) will have the highest increase in the heat wave magnitude index among the sample group of cities. This is followed by capital cities in the region, namely Pristina, Podgorica, Sarajevo, Tirana, and Skopje (Figure 11.10). The number of heat waves is expected to account for as much as 80 percent of summer months in a 4°C warmer world with the average summer temperature in the WB6 being projected to rise by up to 7.5°C compared with pre-industrial levels.⁵⁶ These heat waves have implications for public health and socio-economic wellbeing—see Box 11.2, and have substantially negative impacts on labor productivity in all sectors, especially the agriculture and construction sectors.

11.3. How to make cities greener?

This report recommends action on three main fronts to make cities in the Western Balkans greener. *First*, it is crucial to reduce urban sprawl and make cities more compact. This can be done via urban regeneration and densification, mixed use of land⁵⁷ in core areas, and the redevelopment of brownfields. *Second*, cities must bring down their emissions, not only because this is good for the planet but also because this will have immediate improvement on socio-economic and environmental outcomes. The focus should be on key sectors including transportation, buildings, and waste

management. And *third*, cities must take actions to reduce extreme urban heat and enhance preparedness for it. Green and blue measures, such as green roofs, urban parks and gardens, ponds, and constructed wetlands, should be promoted given their low implementation costs, and high environmental and social co-benefits, while hard and soft heat adaptation measures, such as shading and extreme heat early warning systems (HEWS) should also be implemented to reduce the effect of heatwaves on human health.

1. Make cities more compact

Reducing urban sprawl will go a long way toward making cities greener and will also contribute to growth. Cities that develop vertically are more prosperous, sustainable, and can accommodate more people with less land consumption.⁵⁸ Denser cities depend less on vehicular transportation and have more compact heating networks, which reduce GHG emissions and air pollution, and have other positive environmental effects. Compactness yields additional economic benefits. For example, it increases labor productivity and efficiencies in public service delivery, it leads to agglomeration effects of concentrating economic activity, and it is also associated with reduced costs, including of infrastructure maintenance. Estimates of the average investment required for a package of good quality basic services in dense cities (over 30,000 people per square kilometer) total around US\$325 per capita, US\$1,557 in

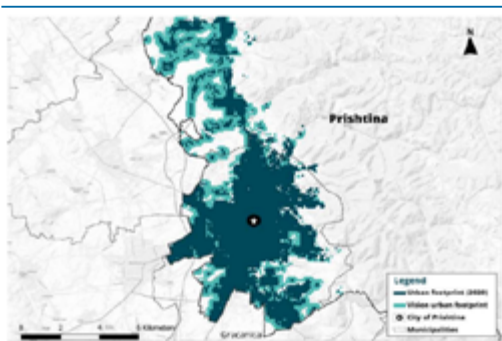
56 Turn down the heat: Confronting the new climate normal. The climate challenge for the Western Balkans. World Bank. 2019. <https://documents1.worldbank.org/curated/en/494741468189532505/pdf/98220-WP-P148173-PUBLIC-Box393168B-pdf.pdf>.

57 That combines multiple related uses, such as residential, commercial, cultural, institutional, or entertainment, into one space. See Raman, R., and U. K. Roy. 2019. Taxonomy of urban mixed land use planning. *Land Use Policy*. Volume 88, 2019, 104102. (<https://doi.org/10.1016/j.landusepol.2019.104102>.) Atlanta Regional Commission. 2011. Quality Growth Toolkit – Mixed Use Development. ([https://web.archive.org/web/20111128011547/http://www.atlantaregional.com/File Library/Local Gov Services/growth_toolkit_mixedusetool_1109.pdf](https://web.archive.org/web/20111128011547/http://www.atlantaregional.com/File%20Library/Local%20Gov%20Services/growth_toolkit_mixedusetool_1109.pdf).)

58 Mukim, Megha (ed.); Roberts, Mark (ed.). 2023. *Thriving: Making Cities Green, Resilient, and Inclusive in a Changing Climate*. © Washington, DC: World Bank. <https://openknowledge.worldbank.org/entities/publication/7d290fa9-da18-53b6-a1a4-bc6f7421d937>.

secondary urban centers, and US\$2,837 in rural areas (Foster and Briceño-Garmendia 2010). Given the declining trend of urban populations in Western Balkan countries, it becomes even more crucial to enhance the density of capital and people. Though often viewed as a considerable regional challenge, urban population decline also presents an opportunity in promoting more compact urban designs, as there is no pressing need to accommodate growing populations in peripheral areas highly exposed to climate shocks. Vertical expansion of urban facilities and public infrastructure should be promoted, while core urban areas should be targeted for high-density development of social infrastructure and mixed land use. Additional actions could include the improvement of public transit capacity and the redevelopment of urban brownfields into urban green spaces, or mixed-use land in line with community needs. These efforts could limit urban expansion (see Figure 11.12 for the city of Prishtina, Kosovo, as an example of compact city planning until 2040), and contribute toward green and sustainable city development.

Figure 11.12. Contained urban expansion areas for Prishtina until 2040



Source: World Bank, 2022. World Bank, 2022. Green, Low Carbon and Climate Resilient Prishtina - Final Report. <https://documents1.worldbank.org/curated/en/099720106182224058/pdf/P1761860f76e7d0010b71706eb958154498.pdf>.

Greening and climate resilience should also be mainstreamed into city strategies and planning. National strategic documents in the Western Balkans rarely consider urban greening, nor are these actions mainstreamed in urban planning frameworks. Authorities, both local and national, should consider greening options, such as the implementation of rainwater harvesting, the creation of green spaces such as urban parks, gardens and green corridors, and the upgrading of wastewater management systems. In addition, nature-based solutions, which have comparable functionality to “gray” engineered solutions but often come with lower costs and are more environmentally friendly, should also be promoted at the city level.⁵⁹

2. Cut emissions in sectors such as transportation, buildings, and waste management

Cutting GHG emissions is essential to the green urban transition, and the focus should be on sectors such as transportation, buildings, and waste management. An integrated, smart transportation system would encourage urban residents to adopt more non-vehicular routines, also maximizing the use of public transportation. In addition, pedestrian and cycling networks should be expanded, with investment priorities given to locations around popular destinations, such as educational and health facilities, shopping centers, transportation hubs, and public green spaces. These actions should also be complemented by green transport policies that reduce GHG emissions from transportation sources, such as the development of emission regulations or tax

59 Van Wesenbeeck, B., Mulder, J., Marchand, M., Reed, D., de Vries, M., de Vriend, H., Herman, P. Dammig deltas. 2014. A practice of the past? Towards nature-based flood defenses. *Estuar. Coast. Shelf Sci.* 2014. 140, 1–6. <https://www.sciencedirect.com/science/article/abs/pii/S0272771413005556>.

schemes for private cars to incentivize the use of alternative fuel vehicles.

Public and residential buildings should be built (or retrofitted) to be energy efficient and resilient to climate risks, including climate-triggered hazards.

Clean domestic energy alternatives and energy efficiency measures should be introduced to residential buildings to replace domestic heating stoves that emit GHG and air pollutants through the burning of coal and wood. This could reduce GHG emissions from domestic heating and provide a healthier, more sustainable, and lower carbon alternative for urban residents. In addition, building renovation programs that aim to enhance climate and disaster resilience should also be launched, with investment priorities given to public buildings such as schools and medical centers. These could also serve as emergency shelters during a disaster event. The investments should be supported with green building codes and regulations that ensure energy and water efficiency of buildings, both for new construction and for retrofitting existing buildings. To ensure its full implementation, green codes should be supported by construction monitoring and building inspections, as well as incentives for building owners, such as property tax discounts.

The urban waste management system needs to be regulated and improved to reduce emissions of methane and air pollutants.

Poorly managed solid waste could generate large amounts of methane, threatening the health and safety of surrounding communities, and contributing directly to climate change. Hence, it is crucial to enhance management

of solid waste, especially dumps and landfills, to reduce harmful methane emissions. Improvements in tools and technologies for data collection, and the upgrading of waste collection and treatment facilities would be a good start. In addition, policies can be implemented to rehabilitate existing dump sites to sanitary landfills and incentivize methane management best practices. Cities in the region are already taking action. For instance, in North Macedonia, a wastewater management project was launched in the capital city of Skopje in 2022, which has helped Skopje transition to a green and climate-resilient city and assisted the country to align with EU environmental and water laws and standards—it is worth noting meeting performance targets related to solid waste would also have an impact on future EU accession.⁶⁰

3. Tackle extreme heat in cities

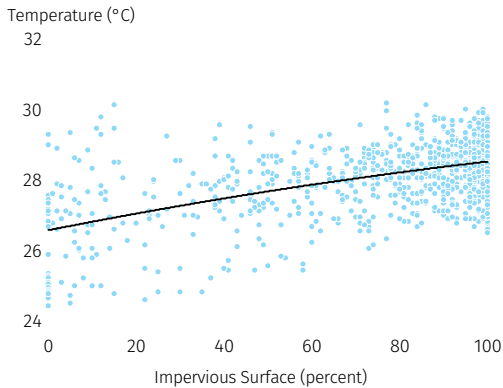
To mitigate the impact of extreme heat, Western Balkan cities can adopt measures to cool physical spaces where dangerous heat exposure occurs, including through greening, shade and urban design.

Urban temperatures increase with the percentage of hard, impervious surfaces in cities, but decrease with a higher percentage of tree canopy cover (Figure 11.13). Place-based cooling measures include: greening at small scale (such as ‘pocket parks’) and large scale (such as urban forests or ecological corridors); blue solutions such as urban lakes, ponds, constructed wetlands, and fountains; and change in the design and construction of buildings. A review of 220 local urban cooling measures around the world found that daily temperatures at project sites

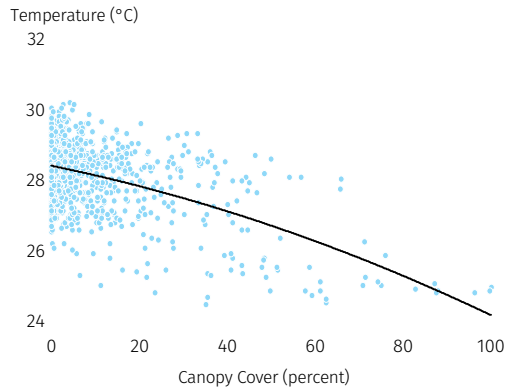
60 WBIF, 2023. Progress made on North Macedonia’s largest environmental project. <https://www.wbif.eu/news-details/progress-made-north-macedonias-largest-environmental-project>.

Figure 11.13. Relationship between urban temperature and percentage of impervious surface (left) and tree canopy cover (right)

a. Impervious Surface



b. Tree Canopy Cover



Source: UHI intensity maps produced by VITO, conducting a simple scatter and regression versus the WorldCover tree canopy database. Note: Panels A represents temperature measurements (in °C) against the percentage of land cover that was impervious surface and Panel B represents the same with tree canopy cover. The relationship is measured between air temperature and ground cover characteristics with one dot representing a 100-meter grid cell. Measurement of near surface air temperature were recorded during vehicle traversed through a city.

fell by 2°C in two-thirds of cases and more than 2°C at the remaining sites.⁶¹ Water-based interventions such as riverside walkways yielded temperature decreases of more than 5°C in some studies, while promoting significant co-benefits for physical and mental health, as well as the promotion of tourism and vibrant commercial districts.

In addition, city-wide adaptation measures should be implemented to reduce the health impact of extreme heat on urban citizens, especially for those who are especially vulnerable such as children, the elderly, ethnic minorities, and people with medical conditions. Hard heat adaptation measures, such as shading, air circulation systems, and drinking fountains, should be implemented in residential buildings and critical infrastructure, especially in key exposure settings such as schools, health centers, and public transport hubs. Meanwhile, soft measures that focus on enhancing public awareness, preparedness,

and response to health risks should also be promoted given their low implementation cost and high benefits from the heat-related mortality and morbidity averted. For instance, extreme HEWS can be implemented by city authorities in partnership with national health and meteorological agencies to provide residents with advance warning of heat waves, as well as medical information on actions that can protect their health in extreme conditions. Given existing investments in weather forecasting capabilities, the cost of introducing HEWSs is low, yet such measures can prevent deaths. In the Italian city of Florence, for example, a study found the odds of mortality during a heatwave for frail elderly people decreased by 9 percent after the introduction of a HEWS.⁴⁸

Information, incentives, and regulation can equip cities for future heat waves. Extreme heat is experienced in the physical spaces of a city: its streets, plazas, markets, homes, workplaces, and transportation systems.

61 Santamouris, M., L. Ding, F. Fiorito, P. Oldfield, P. Osmond, R. Paolini, D. Prasad, and A. J. S. E. Synnefa. 2017. "Passive and Active Cooling for the Outdoor Built Environment: Analysis and Assessment of the Cooling Potential of Mitigation Technologies Using Performance Data from 220 Large Scale Projects." *Solar Energy* 154: 14–33. <https://www.sciencedirect.com/science/article/abs/pii/S0038092X16306004>.

Table 11.1. Key categories of action to cool the physical spaces and prevent harmful heat exposure in cities

Category	Intervention type	Example city
<i>Information and standard setting</i>	Public realm design manual promotes greening, wind-flow and shade	Abu Dhabi
	Street tree planting: approved species list	New York
<i>Direct public investment</i>	Development of a 'green corridor' ecological park	Izmir
	Network of pocket parks favoring under-served areas	Krakow
<i>Actions by city departments and budgets</i>	Residents provided with extreme heat early warnings and health advice	Paris
	Transport agency plants wildflower verges on roadsides and roundabouts	London
	Municipal park kept open longer during high heat alerts	Ahmedabad
	School buildings retrofitted with green, shade and insulation	Barcelona
	Cool roof rebates	Athens
<i>Incentive-based measures</i>	Planning incentives for green space provision (Floor-Area Ratio bonus)	Seattle
	City by-law ('shade ordinance') promotes shaded public spaces	Sacramento
	Wind-flow requirements integrated in planning code	Hong Kong
<i>Mandatory regulations</i>	Passive design regulations for cool building interiors	Tokyo
	Congestion pricing regulating vehicle access to city centers	Milan

Source: World Bank staff elaboration.

Considering the hotter climates that Western Balkans urban residents will experience by mid- and late-century, long-term and coordinated efforts to make physical spaces cooler and prevent harmful heat exposure are important. Fortunately, cities in the region and globally are accumulating growing experience of actions that can mitigate heat stress, often at relatively low cost. While direct public investment is required to create new green spaces such as ecological corridors or pocket parks, cities can also incentivize real estate developers and individual citizens to plant trees and construct buildings that stay cool (Table 11.1). Among recent examples of heat resilience measures, Sacramento (United States) passed a by-law requiring shade awnings to be placed in parking lots, New York developed a list of tree species approved for planting in public spaces, and Abu Dhabi developed a design manual presenting recommended features for public

spaces; each measure promotes and incentivizes the development of more livable city spaces without requiring direct budgetary investment.

11.4. Leveraging existing opportunities

Mayors can do far more to green cities in the Western Balkans, especially if they combine forces with national and EU stakeholders, and private capital markets. With limited financial and technical capacity of national authorities and strained public debt after successive shocks, financing urban greening relies heavily on local authorities, as well as private and international development partners. Already local authorities have implemented sustainable urban plans, invested in building retrofits, and developed urban green spaces. They have an opportunity to do far more, including by tapping external support

from the EU and international programs. City authorities could work with the private sector to unlock green investment and financing opportunities, while the scope for crowding in financing for green projects should not be underestimated.

Western Balkan cities in action

Despite limited resources, and even institutional constraints, cities in the region have already invested in promoting green urban development. Several cities have developed strategic policies, some of which have also been implemented. These include investments in the modernization of

Box 11.3. Green urban development in Serbia

In 2019, Serbia developed its first Sustainable Urban Development Strategy, which was followed by an action plan in 2021. In addition, in the capital city of Belgrade, two climate change adaptation plans have been developed, namely the Climate Change Adaptation Action Plan and Vulnerability Assessment and the Sustainable Energy and Climate Action Plan. The measures under the plans include increasing water storage capacity, improving flood protection, promoting green infrastructure and renewable energy sources, improving public transportation, and retrofitting buildings for climate resilience and energy efficiency. The Green, Livable, Resilient Cities in Serbia Program, launched in 2021, also aims to strengthen national and municipal capacity, alongside promoting local economic development in lagging regions.

Box 11.4. EBRD Green Cities Program in Bosnia and Herzegovina

Cities in Bosnia and Herzegovina have been battling extreme heat and air pollution, while attempting to deal with issues such as inefficient usage of water resources and the lack of modern public transportation systems and waste management services. In this context, three cities—Banja Luka, Sarajevo, and Zenica—joined the EBRD Green Cities program to address their environmental and development challenges and enhance sustainable growth. Green City Action Plans have been developed for the three cities, while energy efficiency regulations and standards have been strengthened. In addition to policy reforms, green investments have also been implemented across the three cities, including improved drinking water quality, increased access to clean urban transport, and the installation of cleaner and more efficient heating measures for schools and hospitals. Such programs can have transformational impacts. It is estimated that green projects could reduce 376,000 tonnes of CO₂ emissions annually and save over 71,400 GJ of energy and almost 4 million m³ of water a year.

Source: EBRD, 2023.

infrastructure, improvements to green building codes, and building local capabilities. Nature-based solutions, such as green roofs and urban parks, are also popular, given the environmental co-benefits and recreational values. Box 11.3 below showcases how urban greening has been promoted in Serbia.

There is also a suite of international programs that support urban greening in the Western Balkans. For instance, the United Nations Development Programme (UNDP), the European Bank for Reconstruction and Development (EBRD), and the World Bank have launched programs to assist sustainable urban development in the Western Balkans. EBRD's Green Cities Program has been implemented in several Western Balkan cities,⁶² and aims to promote green and sustainable growth of cities through the development of Green City Action Plans, sustainable infrastructure investments, and capacity-building (see Box 11.4 below for EBRD's efforts in greening three cities in Bosnia and Herzegovina). Companies can mainstream climate-related activities into their business planning and invest in urban greening projects, as well as investing in development and deployment of new products or technologies in the urban areas.⁶³

The leading role of the EU

The EU is a crucial stakeholder in this context, with the ability to provide technical and financial support via several of its initiatives. Under the EU initiative “Green Agenda for the Western Balkans”,⁶⁴ cities are encouraged to engage in green transformation contributing to the European Green Deal. According to the Action Plan for the Green Agenda,⁶⁵ sustainable urban mobility plans for major urban areas of the Western Balkans will be developed and implemented by 2025, supported by smart cities digital platforms and dedicated applications. These plans combine different sustainable transport modes and options, such as public transportation, car-sharing, car rental services, taxis, and public bike-sharing.

Other EU initiatives, though not mandatory, also promote greening and enhancing climate resilience of urban areas and, thus, should be encouraged among the Western Balkan cities. For instance, as part of the Biodiversity Strategy, the EC has called on European cities to develop ambitious Urban Greening Plans, which include “*measures to create biodiverse and accessible urban forests, parks and gardens; urban farms; green roofs and walls; treelined streets; urban meadows; and urban hedges.*”⁶⁶ Local authorities in the Western Balkan cities could adopt the initiative and develop urban greening plans accordingly. In addition, under the EU

62 EBRD. 2024. EBRD Green Cities. <https://www.ebrdgreencities.com/>.

63 UNEP. 2016. Demystifying Adaptation Finance for the Private Sector. <https://www.unepfi.org/themes/climate-change/demystifying-adaptation-finance-for-private-sector/>.

64 European Commission. 2020. Guidelines for the Implementation of the Green Agenda for the Western Balkans. https://neighbourhood-enlargement.ec.europa.eu/system/files/2020-10/green_agenda_for_the_western_balkans_en.pdf.

65 Regional Cooperation Council. 2021. Action Plan for the Implementation of the Sofia Declaration on the Green Agenda for the Western Balkans 2021–2030. <https://www.rcc.int/docs/596/action-plan-for-the-implementation-of-the-sofia-declaration-on-the-green-agenda-for-the-western-balkans-2021-2030>.

66 European Commission. 2024. Urban Greening Platform. https://environment.ec.europa.eu/topics/urban-environment/urban-greening-platform_en.

Covenant of Mayors for Climate and Energy,⁶⁷ more than 9,000 cities and towns in Europe have committed to climate actions in line with the EU's climate and energy policy framework. Covenant signatories are required to develop a Sustainable Energy and Climate Action Plan, with the goal to reduce CO₂ emissions by at least 40 percent by 2030 and enhance climate resilience. A few Western Balkan cities are already signatories to the Covenant, with scope for many more to sign up. Also, three Western Balkan cities, namely Elbasan (Albania), Sarajevo (BiH) and Podgorica (Montenegro), have pledged to the EU mission "Climate-Neutral and Smart Cities",⁶⁸ which aims to deliver 100 climate-neutral and smart cities by 2030. The commitment is to provide greener, cleaner, and healthier urban environments for the citizens, offer integrated, innovative solutions to urban living issues, and serve as experimentation and innovation hubs that help more European and Western Balkan cities to complete green transition by 2050.

Crowding in innovative sources of financing

Greening is also an opportunity to bring in more innovative sources of financing, both at the national and city levels. Western Balkan countries are taking initial steps toward greening their financial sectors under the assistance of European-owned banks and international institutions.⁶⁹ Such actions can also support urban greening. For instance,

Serbia has issued its first sovereign green bond in 2021, and other green finance instruments, such as microcredit and private equity, would also be open to local authorities. Evidence indicates that city-level greening actions are far more amenable to, and are being increasingly financed through, municipal (green) bonds, tax increment financing, sale of development rights, and other direct and indirect value capture strategies.⁷⁰ In addition, policy actions can be taken to incentivize private capital toward climate actions in the urban areas, such as investment in green urban infrastructure, and innovations in green technology and clean energy. It is estimated that green city investment needs in emerging markets until 2030 amount to a total US\$7.6 trillion.⁷¹ By making upfront capital investments in urban greening through green finance instruments, cities can improve their financial positions while running on lower costs due to more effective urban planning and more efficient management of key sectors. With improved green finance instruments, standards and business sustainability, green finance could be enhanced, which can effectively promote urban green transformation in the Western Balkan countries.

The stakes are high for cities in the Western Balkans and potential investments in greening could have high returns. The specter of climate change looms large, as evidenced by a notable increase in extreme heat events across the region since the early 2000s, and the high

67 European Commission. 2024. Covenant of Mayors – Europe. <https://eu-mayors.ec.europa.eu/en/home>.

68 European Commission. 2023. EU Mission: Climate-Neutral and Smart Cities. https://research-and-innovation.ec.europa.eu/funding/funding-opportunities/funding-programmes-and-open-calls/horizon-europe/eu-missions-horizon-europe/climate-neutral-and-smart-cities_en.

69 World Bank. 2022. Western Balkans Regular Economic Report No.22 - Beyond the Crises. Washington, DC: World Bank Group. <https://openknowledge.worldbank.org/entities/publication/daec74fc-66e7-5e3f-84de-3cfd30259e3>.

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and growing levels of emissions and pollution, although with optimistic trends around green cover. By making their cities more compact, by reducing emissions, and by reducing extreme urban heat, cities in the region have an opportunity not just to mitigate the effects of climate change but also to promote growth, resilience, and inclusion, leading to a greener and more sustainable future for Western

Balkan cities. The decisions made today, in the face of a changing climate and evolving urban landscapes, will shape not only the trajectory of cities in the Western Balkans, but also the development of their national economies. Table 11.2 below summarizes the actions required for greening the Western Balkan cities and public entities responsible for facilitating reforms and investments.

Table 11.2. Policy actions for urban greening in the WB6 countries and main responsible institutions

Actions	Main Institutions
Cross-cutting actions	<ul style="list-style-type: none"> • Regional and supra-national institutions, including the European Commission (to be in the role of a core partner to national and sub-national governments) • National institutions such as the ministry of environment and the ministry of spatial planning (to establish relevant policies in national strategic documents) • Ministries of finance and/or national financial institutions (to facilitate the market for green finance) • Office of the Mayor and/or city council (to design, implement, and monitor relevant policies at city level)
<i>Action 1: Enhance city compactness</i>	<ul style="list-style-type: none"> • Ministries in charge of urban planning, public services, and strategic planning • Ministries in charge of transport and infrastructure
<i>Action 2: Cut emissions in key sectors</i>	<ul style="list-style-type: none"> • Ministries in charge of construction • Ministries in charge of water management • Ministries in charge of transport and/or infrastructure
<i>Action 3: Reduce urban heat and enhance preparedness</i>	<ul style="list-style-type: none"> • Ministries in charge of urban planning, public services and strategic planning • Ministries in charge of disaster and/or emergency management and response • National and/or municipal hydrometeorological service

Source: World Bank staff elaboration.



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