WORLD BANK GROUP

Towards Better Jobs

![World Bank Group logo] **WORLD BANK GROUP**

Western Balkans
Regular Economic Report No.28 | Fall 2025

Towards Better Jobs

Acknowledgments

Table of Contents

Figures

Tables

Boxes

Abbreviations and Acronyms

AE	Advanced Economies
AI	Artificial Intelligence
BAU	Business-as-usual
CAD	Current Account Deficit
CBAM	Carbon Border Adjustment Mechanism
CEE	Central and Eastern European
CESEE	Central, Eastern, and Southeastern Europe
ECA	Europe and Central Asia
EIB	European Investment Bank
EMDE	Emerging Markets and Developing Economy
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GEPU	Global Economic Policy Uncertainty index
GNI	Gross National Income
H1	First half
ICT	Information and Communications Technology
ILO	International Labour Organization
IMF	International Monetary Fund
IPA	Instrument for Pre-Accession Assistance
IPL	International Poverty Line
JQI	Job Quality Index
LFP	Labor Force ParticipationLFS Labor
	Force Survey
LFS	Labor Force Survey
LIC	Lower-income Country
LHS	left-hand scale
LMIC	Lower-Middle-Income Country
LTGM-PC	Long-Term Growth Model Public Capital Extension
NPL	Non-Performing Loan
OECD	Organisation for Economic Co-operation and Development
PISA	Programme for International Student Assessment
pp	percentage point

PPG	Public and Publicly Guaranteed
PPP	Purchasing Power Parity
Q1	First Quarter
Q2	Second Quarter
RGF	Reform and Growth Facility
RHS	right-hand scale
RS	Republic of Srpska
SEPA	Single Euro Payment Area
SME	Small and Medium Enterprise
SoE	State-owned Enterprise
TFP	Total Factor Productivity
TIPS	TARGET Instant Payment Settlement
UMIC	Upper-Middle-Income Country
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
US	United States
VAPW	Value-added per worker
VET	Vocational Education and Training
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	The six countries collectively grouped as the Western Balkans

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

Overview

Overview

Recent Economic Developments

Growth in the economies of the six Western Balkan countries (WB6) is expected to slow in 2025, due to the combined effects of a continued weak external environment coupled with heightened domestic pressures in several countries. As a group, the WB6 countries are projected to see the regional growth rate slow to 3.0 percent in 2025, from 3.6 percent in 2024 (Table O.1). Nevertheless, this growth rate still exceeds that of the European Union (EU), supporting continued, albeit gradual, convergence with living standards in advanced economies. In 2024, average gross domestic product (GDP) per capita in WB6 stood at 41 percent of the EU average, measured in purchasing power parity terms, and less than a quarter of the EU average in gross national income (GNI) per capita terms. With current growth trends, most WB6 countries will likely achieve high-income status by 2040 but none are expected to reach current EU GNI per capita levels within the next 40 years. This underlines the critical need for the WB6 economies to undertake structural reforms to raise the rate of potential growth.

Serbia faces the steepest slowdown in 2025, while North Macedonia and Montenegro are seeing modest gains. Growth in Serbia–the region's largest economy–is expected to slow by 1.1 percentage points (pp) to 2.8 percent in 2025. In Kosovo, Albania, and Bosnia and Herzegovina, growth is expected to slow by between 0.3-0.6 pp to 3.8, 3.7, and 2.6 percent respectively, while North Macedonia and Montenegro are expected to see growth increase by 0.3 and 0.1 pp, to 3.1 and 3.3 percent respectively.

The regional slowdown reflects shifts in the underlying drivers of growth. Consumption will remain the main engine of growth in 2025, supporting the resilience of the services sector, but its contribution is expected to ease, adding 2.8 pp to WB6 growth compared to 3.5 pp in 2024. A resurgence in inflation is expected to dampen household purchasing power, despite continued increases in wages and social benefits and modest gains in employment. Public infrastructure spending and credit growth (mainly households' mortgages) continue to support investments in the region, partially offsetting weak foreign private investment (FDI), and driving growth in the construction sector. Overall investment is expected to contribute just 1.1 pp to regional growth in 2025, a sharp drop from 3.1 pp in 2024. Net trade is expected to reduce growth by 0.9 pp in 2025, an improvement from a 3.1 point drag a year earlier, reflecting a gradual export recovery and front-loading of orders to trading partners in response to tariff announcements, amid rising goods imports but also supporting industrial activity.

Weakening consumption is weighing on employment, with regional employment expansion losing momentum through the course of 2025. Employment growth slowed to just 0.1 percent in the first half (H1) of the year compared to 2.0 percent in H1 of 2024. As a result, average employment rates across WB6 held near last year's levels, drifting to a regional average of 48.6 percent. Albania continues to post the highest employment rate (15+) in the region, at 58.3 percent–above the EU27 average of 54.5 percent–with Montenegro following at 53.8 percent, Serbia at 51.4 percent, North Macedonia at 46.3 percent, Bosnia and Herzegovina at 42.4 percent, and Kosovo at 39.2 percent. The flat employment rate reflects not only weaker job growth but also a shrinking working-age population (both inactive individuals and the labor force)–highlighting pressures from population aging and outmigration and signaling tightening in labor supply. On the demand side, employment growth was supported by the services sector across the countries with lesser contribution from public administration, while agriculture added

to employment growth in North Macedonia. The region's unemployment rate fell by 0.5 pp to 10.5 percent in H1 2025–suggesting labor demand persists.

After a period of decline, inflation has intensified, largely due to rising food and utility prices, potentially dampening household consumption and exposing limits to monetary frameworks. Despite easing global food and energy prices, inflationary pressures in the WB6 in 2025 remained elevated due to local shocks (including droughts and other adverse weather conditions) that amplified their impact. As a result, the regional headline inflation rate rose from 3.7 percent in January to 4.5 percent in July, as flood-related supply disruptions in Bosnia and Herzegovina, an electricity tariff hike in Kosovo, and rising utility bills in Montenegro and Serbia added to the pressure. Wage and fiscal policies also played a role, with minimum wage hikes in Bosnia and Herzegovina, and Montenegro, and social contribution cuts in Montenegro. Albania stands out for its more moderate inflation (2.5 percent in July) as domestic price pressures have been offset by a stronger Lek. The renewed rise in inflation has exposed the limits of monetary policy frameworks in the WB6, with Albania opting for rate cuts while others held firm or relied on fiscal tools in response.

Favorable borrowing conditions, along with strong household demand and rising wages, have maintained rapid credit growth in the WB6. Private sector credit growth in the WB6 region accelerated to 14 percent year-on-year in June 2025–the highest since May 2009–driven by strong demand from both corporate and retail segments, particularly for mortgages. Household credit growth outpaced corporate lending in most countries, reaching 15.6 percent year-on-year, compared to a growth rate of 12.7 percent for corporate lending. Despite the high credit growth, risks to financial stability remain moderate, as non-performing loans (NPLs) declined in all WB6 countries and capital adequacy ratios remain solid.

With a slower export recovery relative to the moderation in domestic demand, the external deficit is set to widen to 7.1 percent in 2025. The regional current account deficit (CAD) is estimated to widen by 0.5 pp, primarily led by Montenegro, Serbia, and North Macedonia where both trade and income balances deteriorated. In contrast, Albania's trade balance is estimated to improve, driven by a strong rebound in goods exports, which in turn supported the narrowing of the CAD. The region's remittances inflows are expected to ease in 2025 amidst still soft activity and labor market slack in host countries. Kosovo, one of the region's largest recipients of remittances, is estimated to observe the most significant slowdown by 1 pp of GDP in 2025, followed by Bosnia and Herzegovina and Albania, as rising domestic wages are gradually reducing the earnings gap with EU countries.

Not only is the CAD widening in 2025, but a smaller share of it will be financed by FDI. After the 2024 surge, net FDI inflows to the WB6 have softened amid high uncertainty and weaker investor sentiment across Europe, especially in Germany and Italy–key manufacturing investors for the Western Balkans. FDI inflows are estimated to average 4.7 percent of GDP in 2025, financing only 70 percent of the CAD for the region, a level which has not been seen since the pandemic. Weaker inflows are expected in Serbia (due to reduced investments in mining, telecommunications, and construction), North Macedonia (due to a decline in loans from parent companies to their affiliates), and Montenegro (due to lower equity investments in foreign companies and banks).

Fiscal deficits in the WB6 are projected to widen in 2025, as slowing growth weighs on revenues while spending pressures continue to mount. North Macedonia and Montenegro are projected to post the largest deficits at 4.0 and 3.7 percent of GDP respectively, while Kosovo is set to record the smallest at 0.8 percent. Bosnia and Herzegovina and North Macedonia are the only economies expected to reduce their fiscal deficits compared to last year–driven by cuts

in goods and services spending in Bosnia and Herzegovina and stronger revenue performance in North Macedonia. With growth expected to slow in 2025, the regional fiscal deficit is projected to widen by 0.4 pp but is expected to stay low overall, averaging below 3 percent of GDP. Primary fiscal balances are expected to be negative in all countries except for Albania where it will stay positive at 0.5 percent of GDP, although lower compared to last year.

Nevertheless, total public and publicly guaranteed (PPG) debt is expected to decline slightly for the region as a whole to 44.4 percent of GDP by the end of 2025 from 45.0 percent of GDP in 2024. Bosnia and Herzegovina accounts for most of the improvement on the back of a narrowing fiscal deficit–with a projected decline of 1.5 pp of GDP. Albania and Serbia follow with 0.8, and 0.7 pp of GDP declines respectively, driven by net redemption of external debt, while North Macedonia sees a 0.5 pp increase due to rising direct public debt. In level terms, North Macedonia and Montenegro are expected to maintain the highest PPG ratios in the region at 62.9 and 60.6 percent of GDP respectively, followed by Albania at 53.4 percent, Serbia at 46.8 percent and Bosnia and Herzegovina at 25.7 percent, while Kosovo remains the lowest PPG debt to GDP ratio at 17.1 percent.

Outlook and Risks

A modest Euro-area recovery should help to support improved regional growth by boosting investment and exports, though at a lower rate than in recent years, with a full rebound not expected until 2027. Besides consumption, investment is expected to fuel WB6 growth in 2026 by 1.4 pp, while net exports are projected to gradually improve and increase their contribution to growth in 2027 as external uncertainties subside. All countries are projected to see growth driven mainly by consumption and investment–with Albania's GDP stabilizing at 3.5 percent in 2026–27, Kosovo at about 3.9 percent, and Serbia recovering to 4.0 percent by 2027. In North Macedonia, Montenegro,

and Bosnia and Herzegovina, growth in 2026-27 is expected to stabilize at 3.0, 3.2, and 3.2 percent respectively, supported by reforms, EU integration, and investments.

Building on recent gains, inclusive growth should drive further poverty reduction, although persistent pockets of vulnerability require more carefully targeted interventions. The downward trend in poverty rates is projected to continue but moderate over the medium term to reach 12.2 percent by 2027–in part on account of slowing employment growth. While poverty is falling, progress is uneven and vulnerable groups–such as the unemployed, rural populations, and those with low education–require targeted policies and support programs.

Risks are tilted to the downside, but swift implementation of EU-backed reforms could significantly lift growth. Downside risks include continued unfavorable domestic political developments, sustained global trade and investment uncertainty, and tighter global financing conditions. Any de-escalation in the drivers of uncertainty would, however, likely trigger a strong response in the WB6 as pent-up private investment and trade activity would support a stronger growth recovery in the region. An additional upside risk is the potential for accelerated implementation of structural reforms as part of the EU Reform and Growth Facility (RGF) which could support notably faster growth and convergence if fully implemented.

The EU Growth Plan offers a strategic path for the WB6 to overcome structural barriers and boost long-term growth through continued reform efforts. Without deeper structural reforms, the region risks remaining on a path of modest gains constrained by demographic pressures and stagnant productivity. By contrast, decisive actions to boost total factor productivity (TFP), health and education outcomes, expand labor force participation (LFP), and improve investment efficiency could transform the long-term growth trajectory of the WB6 and bring EU

living standards within closer reach by almost three decades. Collectively, full implementation of reforms outlined in the RGF to close 70 percent of critical gaps in five key areas with the EU in 20 years could add as much as 3 percent to baseline annual GDP per capita growth in the WB6 according to World Bank staff estimates. These five key areas of improvements are: (i) digital infrastructure; (ii) regulatory quality; (iii) government effectiveness; (iv) financial development; and (v) female LFP. Reforms in regulatory quality (1.13 pp), government effectiveness (0.95 pp), and digitalization (0.63 pp) offer the largest growth gains, while female LFP (0.35 pp) and financial sector development (0.03 pp) remain key for inclusive, long-term growth.

Spotlight: Jobs Challenge in the Western Balkans

Economic change over the past decade, with increasing trade, robust FDI, and sectoral shifts, has helped create over one million new jobs and cut absolute poverty rates in the Western Balkans by almost two-thirds. Nevertheless, while some higher value-added sectors have expanded employment, it is low and mid-productivity firms that still employ most WB6 workers in not necessarily "high quality" jobs. While workers are increasingly more educated–nearly 30 percent of young workers now hold a tertiary degree– foundational learning remains weak and Programme for International Student Assessment (PISA) scores trail EU averages. This limits productivity gains which have lagged even as wages have risen. Still, employers who are mostly offering lower skilled jobs with lower wages that are not attractive to workers are motivating outmigration.

The region, therefore, faces a labor market paradox: labor shortages coexist with persistently high unemployment (above 10 percent), and relatively low LFP (below 55 percent), especially for women, youth, and the elderly. In addition, demographics are tightening: the working-age population has already shrunk markedly and is projected to fall by nearly one-fifth by 2050. Over the next five years, on current population, growth, and labor market trends, the region will be "missing" over 190,000 workers unless it increases activation. Moreover, the green transition and the rise of AI will intensify pressures–with about 20 percent of workers at risk or needing substantial reskilling.

As the WB6 transitions toward a more modern economy, job quality, wage alignment, and task content need to catch up. A jobs strategy for the Western Balkans should aim to raise participation (increased child/eldercare, activation, longer working lives), build future-ready skills (stronger foundational learning, market-aligned tertiary education), improve job quality and inclusion (formalization, social protection), boost firm productivity and competitiveness, and harness digital and green opportunities through scaled re/upskilling and flexible work models.

TABLE 0.1. Western Balkans outlook, 2022–27

	2022	2023	2024	2025[e]	2026[f]	2027[f]
Real GDP growth (percent)						
Albania	4.8	4.0	4.0	3.7	3.5	3.5
Bosnia and Herzegovina	4.2	2.0	3.0	2.6	3.0	3.2
Kosovo	4.3	4.1	4.4	3.8	3.8	3.9
North Macedonia	2.8	2.1	2.8	3.1	3.0	3.0
Montenegro	7.7	6.5	3.2	3.3	3.2	3.2
Serbia	2.6	3.8	3.9	2.8	3.0	4.0
WB6	3.5	3.5	3.6	3.0	3.1	3.6
Contribution of components to real GDP growth (percentage points)						
Consumption	2.9	0.9	3.5	2.8	2.8	2.9
Investment	1.1	0.1	3.1	1.1	1.4	1.3
Net exports	-1.2	0.7	-3.1	-0.9	-1.0	-0.6
Exports	6.5	1.5	0.7	1.9	2.4	2.7
Imports (-)	4.6	0.8	3.8	2.8	3.3	3.3
Consumer price inflation (percent, period average)	11.9	9.1	3.3	3.9	3.1	2.7
External sector (percent of GDP)						
Goods exports	28.1	24.2	22.2	21.6	21.3	21.2
Trade balance	-18.6	-14.0	-15.3	-15.4	-15.3	-14.6
Current account balance	-7.7	-4.0	-6.6	-7.1	-6.9	-6.4
Foreign direct investment	6.8	5.0	5.7	4.7	4.9	4.9
External debt	75.1	66.1	65.7	52.3	51.9	51.5
Public sector (percent of GDP)						
Public revenues	34.4	35.2	36.1	36.1	36.0	36.0
Public expenditures	37.0	36.6	38.2	38.6	38.1	37.9
Fiscal balance	-2.6	-1.4	-2.1	-2.5	-2.2	-1.9
Public and publicly guaranteed debt	49.5	45.1	45.0	44.4	44.6	44.3

Sources: National statistical offices; Ministries of Finance; central banks; World Bank staff estimates.
Note: e = estimate; f = forecast.

Chapter 1. Economic Update and Outlook

Chapter 1. Economic Update and Outlook

Recent Economic Developments

Growth is moderating as domestic pressures outweigh external headwinds

Global trade policy uncertainty, rising geopolitical tensions, and declining commodity prices have shaped the external environment for the Western Balkans (WB6) in 2025. Despite heightened tensions and ongoing supply chain adjustments, however, the frontloading of orders due to tariffs helped offset some of these developments and trade growth proved more resilient than initially expected. Commodity prices–especially oil and industrial metals, declined sharply due to subdued demand and ample supply, further supporting consumption and capital goods imports. In advanced economies, particularly the Euro area, growth is expected to remain modest in 2025 (Figure 1.1)–with outcomes more robust than initially foreseen and supported by domestic demand resilience despite trade-related uncertainties. As a result of these global and regional developments, goods exports from the Western Balkans began to recover gradually, contributing to an improvement in the region's growth.

Still, the region's growth is estimated to have slowed down from 3.6 percent in 2024 to 3.0 percent in 2025 as weaker domestic demand outweighs gains from a narrowing trade deficit. The moderation of domestic demand reflects the impact of heightened domestic political uncertainty, decoupling of domestic and imported prices, and labor market mismatches and shortages, all of which started to weigh increasingly on consumer and investor decisions. The sharpest slowdown is expected in Serbia, where political developments are expected to affect investment and consumption–pushing growth 1 pp below 2024. In contrast, North Macedonia is expected to see a 0.3 pp

acceleration of growth, on the back of strong public infrastructure spending and a modest export recovery (Figure 1.2).

FIGURE 1.1: Global growth

Source: Haver Analytics Database; World Bank.
Note: AEs = Advanced Economies; EMDEs = Emerging and Developing Economies. Bars show GDP growth presented in June 2025 *Global Economic Prospects report.*

While convergence continues, without faster growth, the Western Balkans cannot close the living standards gap with the EU within a generation. GDP per capita growth in the region slowed, except in countries where a stronger population decline helped offset weaker output gains. Most countries in the region continue to evidence population declines that are exacerbated by outmigration–particularly to higher-income EU countries. Overall, growth in the six countries of the WB6 is estimated to remain near its last decade average in 2025. At this rate, convergence will remain slow, as the income level in the region was only 41 percent of the EU average in 2024 in purchasing power parity (PPP) terms,[1] having improved only 8.3 pp since 2014. World Bank simulations show that without reforms to accelerate growth, none of the WB6 economies will reach the EU gross national income (GNI) per capita levels before 2070,[2] underscoring the need for stronger growth to narrow the gap with EU living standards faster.

---

1. Based on 2024 World Development Indicators (WDIs) in PPP 2021 international $. Using the GNI per capita Atlas method in current US$ which determines World Bank income thresholds, WB6 countries are only 23 percent of the EU average based on 2024 data.
2. Based on GNI per capita terms using Atlas method (See Box 1.5)

On the demand side, growth remains consumption driven, although its contribution is easing as inflation erodes purchasing power. Consumption is expected to add 2.8 pp to WB6 growth in 2025 down from 3.5 pp in the previous year, as the recent resurgence in inflation is dampening the purchasing power of households amidst moderate increases in wages, employment, and social transfers. Montenegro is expected to have the highest contribution of consumption to growth at 5.6 pp (Figure 1.2), in line with the observed real growth of wages of 12.2 percent year-on-year (yoy) and 19.1 percent of household lending in the first half (H1) of 2025. Additional social spending of about 0.6 pp of GDP on health, pensions, social and unemployment benefits across the region, especially in Bosnia and Herzegovina, also remains supportive of consumption. Consumption is set to add the least to growth in North Macedonia and Serbia where headline inflation increased the most since early summer, with the two countries also seeing a slowdown in real wage growth.

At the same time, the contribution of investment to growth is weakening with public infrastructure spending only partly offsetting a decline in private investment. Investment as a whole is expected to contribute 1.1 pp to regional growth in 2025, down sharply from 3.1 pp last year, as private investment remains subdued amid low investor confidence and declining FDIs, with growth driven mainly by public investment. Inflows of foreign direct investment (FDI) decelerated in several countries in the region, most notably in Serbia and North Macedonia, where the latter experienced a moderation following a two-decade high last year. By August 2025, industrial business confidence indicators remained in negative territory in both countries, while Albania and Montenegro showed modest signs of improvement. Public investment has the potential to crowd in private investment, but only if it is efficient and supported by strong public investment management and complementary reforms (see Box 1.1).

FIGURE 1.2: GDP growth is expected to moderate in 2025 driven by domestic demand …

FIGURE 1.3: …as net exports remain negative

Source: Regional Statistical Offices, World Bank staff calculations.
Notes: Gross investment includes changes in inventories.

External demand continues to weigh on regional growth but less than in the previous year. Net exports is estimated to reduce growth by 0.9 pp in 2025, an improvement from a 3.1 pp drag a year earlier despite an increase in goods imports. This is due to a gradual export recovery in selected economies and front-loading of orders in trading partners in response to tariff announcements. The largest negative contribution from net exports is estimated in Montenegro and Kosovo (Figure 1.3), as wider merchandise trade deficits outweighed net services exports. In Bosnia and Herzegovina, Serbia and North Macedonia, stronger automotive exports partly offset higher imports driven by highway construction in North Macedonia and preparation for Expo 2027 in Serbia.

BOX 1.1: Crowding-in Private Investment in the Western Balkans

Capital spending for the region reached record levels last year as governments ramped up investment in transport infrastructure and aimed to boost growth as part of the EU Growth Plan. Accelerating public investment can have important impacts on economic development by boosting demand in the short term and enhancing supply in the long term.[3] Initially, increased investment raises the demand for goods and services by the public sector– potentially attracting private investment, creating jobs, and boosting confidence. Over time, additional capital enhances the economy's productive capacity, particularly if it successfully attracts private investment. Attracting private investment is not guaranteed as the pool of investable funds are diverted to the state and the rising demand for funds raises interest rates–especially if funded domestically.

Public investment has potential to spur private investment more strongly in WB6 than in the Europe and Central Asia (ECA) region or the EU. Specifically, the public-private investment multiplier for the WB6 is estimated at about 0.7, with a confidence interval suggesting the effect could be as high as one-to-one–implying that increases in public investment are associated with substantial gains in private investment. Each additional Euro of public investment raises private investment by €0.70 (Figure B1.1). In contrast, the effect is weaker in the ECA region, with a multiplier of about 0.3, and even smaller in the EU at roughly 0.2. Public investment is more effective in stimulating private investment in the Western Balkans–likely reflecting larger infrastructure gaps and higher marginal returns to public capital. Meanwhile, in the EU, the complementarity between public and private investment appears to be more limited (Boehm 2020).

Caution is needed when interpreting estimates of multipliers, as the size of the crowding-in effect

FIGURE B1.1: The relationship between public and private investment

Multiplier

Source: World Bank staff calculations based on data from the International Monetary Fund (IMF).
Note: Based on a regression model of changes in real public investment on private investment from 1980-2019 controlling for country fixed effects and common correlated effects. Public investment shocks are identified as large shifts in cyclically adjusted public investment (see Appendix A1 for details).

depends on several factors, including the source of funding (domestic versus external), the level of existing capital stock, available fiscal space, and the phase of the business cycle. The quality of public investment management and overall spending efficiency also play a critical role.

---

3.   Studies indicate that increased public investment contributes to medium-term growth (see Adarov et al. 2024).

On the supply side, growth is being led by a resilient services sector, while manufacturing and construction have started to regain momentum. Retail and tourism-related services remained supportive of growth in the region (Figure 1.4), but in Montenegro overnight stays fell by 5 percent in H1 of 2025– showing signs of a weaker contribution of tourism to growth. Public administration services grew notably in nearly all countries, while Information and Communications Technology (ICT) services recorded the strongest gains in Serbia and Bosnia and Herzegovina. Professional services, whose value added is rising and which are increasingly exported, contributed over one-fifth of services

growth in most countries, except in Kosovo and Albania. Regional industrial activity is expected to recover gradually in 2025 (Figure 1.5), including in the automotive supply chain which is supported in part by higher electric vehicle production in Serbia and electric car parts production in North Macedonia. Nevertheless, it will remain below historical peaks. Residential and infrastructure construction expanded across most countries but declined by over 10 percent in Serbia. Meanwhile, agriculture's contribution to growth remained negative in Albania and Montenegro, while in Serbia and North Macedonia it is muted, reflecting unfavorable weather conditions in H1 2025.

FIGURE 1.4: Growth continues to be services-driven...

FIGURE 1.5: ...while industrial activity started recovering in 2025

Source: Regional Statistical Offices, World Bank staff calculations.

Job creation is slowing amid weakening demand and intensifying supply side pressures

Job growth remains positive, driven by services, but it is moderating as demand softens and both the working-age population and participation rates decline. By June 2025, net job creation remained positive in annual terms–about 14,400 new jobs (roughly 0.2 percent of total employment). North Macedonia and Bosnia and Herzegovina posted the largest absolute gains (12,300 and 2,800 jobs respectively), however, regional average annual employment growth slowed to 0.2 percent in H1 2025–down from about 2 percent in H1 of last year. Bosnia and Herzegovina's employment growth eased sharply from 2.9

percent in H1 of last year to 0.2 percent, due to employment decline in agriculture, industry and construction. Similarly, Albania registered a 0.9 percent yoy employment decline in H1 2025 after four straight quarters of employment growth, reflecting fewer jobs in agriculture and a shrinking working-age population. In contrast, North Macedonia's employment growth accelerated on the back of robust hiring in agriculture and services and slightly increased participation rate. Country level data suggest that services are leading in the employment growth while agriculture and industry subtract in all countries except for North Macedonia where employment growth in agriculture was robust averaging 15.3 percent yoy in H1 2025.

As employment growth slowed, employment rates across the region held near last year's levels–pulling the regional average slightly lower to 48.6 percent. This reflects not only weaker job growth but also a shrinking working-age population (both inactive individuals and the labor force)–highlighting mounting pressures from population aging and outmigration (Figure 1.6). Albania continues to post the highest employment rate (15+) in the region, at 58.3 percent–above the EU27 average of 54.5 percent. Its rate was flat, however, compared to last year as both employment and the working-age population declined by 0.9 percent yoy. Montenegro recorded the second-highest employment rate at 53.8 percent. In the rest of the Western Balkan countries employment rates were ranging from 39.2 to 42.4 percent in Kosovo and Bosnia and Herzegovina, and from 46.3 to 51.4 percent in North Macedonia and Serbia. The region's unemployment rate fell by 0.5 pp to 10.5 percent in H1 2025 compared to the same period of last year (Figure 1.9). Declines were observed in most countries, from 0.1 pp in Bosnia and Herzegovina to 1.1 pp in North Macedonia. Albania and Serbia were the exceptions where the rate remained unchanged. Albania posted the lowest unemployment rate in the region (8.6 percent) and Bosnia and Herzegovina recorded the highest rate (13.3 percent) in H1 2025.

FIGURE 1.6: …however, outmigration contributes to a shrinking working-age population
(Net migration in 2024. People per 100,000 population)

Source: World Bank Data Bank.

Sectoral labor dynamics suggest that employment is rebalancing toward services across the WB6, consistent with the region's ongoing structural shift. The traditional sectors of agriculture and industry continued to shed jobs, while services were the primary engine of net employment gains in 2025. Albania, where total employment declined, posted the strongest employment gains in services sector (6.3 percent yoy), underpinned by public administration, tourism, and robust services exports[4]. North Macedonia recorded solid employment growth in services (5.6 percent, yoy), led by wholesale and retail trade, ICT, and other private services (Figure 1.7). In Bosnia and Herzegovina, and Serbia, job growth in services was positive but moderate (0.7–1.4 percent), with a more gradual reallocation towards services.

Agriculture and industry observed employment declines at the regional level of 3.5 percent and 2.8 percent respectively in H1 2025 (Figure 1.8). Agriculture saw the steepest contraction across all WB6 countries, except North Macedonia. The decline in Albania (-8.4 percent yoy) reflects continued outmigration and rural aging that is shrinking the sector's labor force–compounded by farm fragmentation and higher input costs (for example, fertilizers). North Macedonia was an outlier with a sizable increase in agricultural employment (+15.3 percent yoy)–also partly driven by a continued rise in informal employment which picked up in 2024 by 16 percent after an ongoing decline over five years. At the same time, industrial employment dynamics in North Macedonia reversed after three consecutive quarters of growth–affected by a decline in automotive supply firms which started labor shedding. Kosovo is estimated to have seen a sharp decline in industrial employment (about -8.1 percent yoy) in H1 2025 which is likely linked to a production suspension by a major mining producer. Despite a significant slowdown in regional employment growth, construction remained a jobs buffer in several economies (Kosovo, Montenegro, Serbia)–supported by infrastructure pipelines and higher public capital outlays.

---

4. World Bank estimates based on administrative data on labor market as Albania does not report employment by disaggregated services sector.

FIGURE 1.7: Trade and hospitality sectors are the main contributors to growth in services employment
(Contribution of sectors to total employment in services (pp))

Legend:
- Trade and hospitality
- ICT
- Financial and real estate
- Other services
- Total Services

X-axis: H1'24 H1'25 (BiH); H1'23 H1'24 (KOS); H1'24 H1'25 (MKD); H1'23 H1'24 (MNE); H1'24 H1'25 (SRB)

FIGURE 1.8: Agriculture and industry are dragging employment growth down at the regional level
(Percent, yoy growth)

Legend: Q3 23　Q4 23　Q1 24　Q2 24　Q3 24　Q4 24　Q1 25　Q2 25

AGRICULTURE: 4.5, 2.1, 1.7, -2.1, -0.4, -3.3, -3.9, -3.1
INDUSTRY: 1.4, 1.4, 1.1, 0.6, 0.4, 0.0, -2.0, -3.6
CONSTRUCTION: 2.7, 5.4, 4.6, 0.7, 0.7, -0.6, -0.3, 2.0
SERVICES: 2.9, 2.6, 0.4, 0.3, 0.5, 1.3, 2.3, 2.5
GENERAL GOVERNMENT: 1.9, 1.2, -0.2, -0.1, -0.8, 0.2, 0.8, 1.1

Source: National statistical offices, World Bank staff claculations.
Note: (i) Albania does not report employment by desagregated services sectors; (ii) Trade and hospitality includes wholesale and retail trade, accommodation and food sectors. Other services include administartive and support services, professional, scientific and technical activities, entertainment, recreation, and other services.

Overall positive employment trends mask enduring pockets of weakness in the labor market–with women and youth in several countries seeing limited benefits. Women's participation in the labor market remains broadly unchanged or even declining in several countries, while the LFP gap between men and women remains stubbornly high at between 12.2 and 14.4 pp in Montenegro, Albania, and Serbia, 18.9 and 22.8 pp in North Macedonia and Bosnia and Herzegovina, and highest at 33.6 pp in Kosovo. The youth unemployment rate increased in the region by 1.4 pp to an average of 25.8 percent in the first half of 2025 (Figure 1.9). At the country level Bosnia and Herzegovina recorded the largest increase in youth unemployment rate (+5.9 pp) reaching 34.7 percent–the highest in the region. In Serbia, the youth unemployment rate increased by 1.1 pp to 23.4 percent, while in North Macedonia it remained unchanged at 27 percent. In Albania the youth unemployment rate declined the most (by 2.9 pp)–to 16.5 percent, the lowest in the region–but this decline was not due to rising employment among young people rather it suggests that young workers

are either moving into inactivity or migrating out of the country. Overall, regional patterns on youth unemployment may indicate that young, highly educated entrants to the labor market face difficulties securing suitable jobs, as labor demand in the Western Balkans remains concentrated in low-skilled, manual, and routine occupations that are less attractive and offer limited career prospects (see Chapter 2).

During H1 2025, real wages in the WB6 countries experienced notable growth, primarily attributable to increases in minimum wages. The expansion in average gross real wages varied, with North Macedonia registering a 5.9 percent increase and Montenegro leading with a 12.2 percent rise (Figure 1.10). Minimum wage adjustments in real terms were particularly pronounced, ranging from a modest 4.1 percent increase in North Macedonia (0.3pp above average inflation in H1 2025) to a substantial 50.1 percent surge in Bosnia and Herzegovina (46.5 pp above average

inflation in H1 2025). Albania stands out as an exception where the minimum wage remained unchanged since 2024 following the 2023 increase and actually declined in real terms by 2.1 percent in H1 2025, yet the country still saw a robust 9.4 percent increase in average real gross wages. This divergence may indicate that strong labor demand–particularly in construction, public administration, and, to a lesser extent, the services sector–is being met with supply constraints, likely driven by a declining working-age population. The region's average replacement rate, defined as the ratio of the minimum wage to the nominal average wage, has also trended upward, reaching 50.1 percent on average in H1 2025. Montenegro and North Macedonia recorded the highest replacement rates at 55.8 percent and 53.5 percent respectively while Bosnia and Herzegovina has the rate at 46.7 percent.

FIGURE 1.9: While total unemployment rates have declined, youth unemployment is rising in the region

(Total unemployment rate (15+years), percent, and Q1 2025-Q1 2024 (pp change))

(Youth unemployment rate (15+24 years), percent, and Q1 2025-Q1 2024 (pp change))

Source: National statistics offices and World Bank staff estimates.
Note: H1 2025 numbers for Kosovo are estimates as Labor Force Survey (LFS) data were not available in the time of report preparation.
Montenegro H1 2025 data are not directly comparable with H1 2024 data as LFS methodology has been changed in 2025.

The rise in wages has contributed to higher unit labor costs across the region, although the rate of increase has moderated compared to 2024 (Figure 1.11). Bosnia and Herzegovina registered the largest yoy increase in real unit labor costs (10.4 percent) in H1 2025, while its labor productivity growth was among the lowest at 1.6 percent. Serbia and Albania reported unit labor cost growth rates of 4.2 percent and 4.8 percent, respectively, with both countries seeing a deceleration in these rates and some improvement in labor productivity, although productivity growth remains below the increase in unit labor costs. While the growth in unit labor costs in North Macedonia is slowing, labor productivity growth is also subdued. Overall, the persistent gap between wage and productivity growth underscores mounting pressures on regional competitiveness and highlights the need for policies that better align wage dynamics with productivity improvements.

Poverty continued its downward trend supported by rising employment and incomes. Measured at the US$8.30/day 2021 PPP line (see Box 1.2), poverty has been declining from 31.3 percent of the population in 2016 to 15 percent in 2024 in the WB6. The downward trend is expected to continue in 2025 reaching 13.9 percent, supported by increased wages and social benefits to offset food and energy price pressures. However, the resulting improvements in living standards are not experienced equally across population groups. Further poverty reduction will hinge less on simply adding workers and more on accelerating the shift towards higher-productivity sectors, better quality of jobs, and upgrading firms. This will help lift earnings in a durable way and broaden who benefits (see Chapter 2).

FIGURE 1.10: **Annual growth in average real gross and minimum wages**
(Percent)

FIGURE 1.11: **Annual growth in real unit labor costs and labor productivity**
(Percent)

Source: National statistical offices, World Bank staff calculations.
Note: Kosovo data on average gross wage was not available at the time of report preparation.

BOX 1.2: Global Poverty lines: methodological update and implications

The World Bank has updated its global poverty lines to reflect changes in the cost of living and consumption patterns of people around the world based on newly available data. The new poverty lines are US$3.00 per person per day for low-income countries (LICs), US$4.20 for lower-middle-income countries (LMICs), and US$8.30 for upper-middle-income countries (UMICs). These lines are based on 2021 PPP rates and updated national poverty lines.

The update to the international poverty lines (IPLs) reflects: (i) improved PPP factors for comparing the cost of living across countries based on the new 2021 International Comparison Program data replacing the 2017 PPPs; (ii) greater accuracy in welfare measures for several LICs that have enhanced their household surveys and adjusted their poverty lines; and (iii) updated values of national poverty lines among middle-income countries, which reflect rising standards of what it means to be in poverty, especially in some UMICs where poverty lines are explicitly defined relative to mean or median living standards. At the IPL, the resulting change in its value is mostly due to new data and new poverty lines in LICs. For UMICs, new lines explain more than one-third of the overall change in levels (Table B1.2).

As a result of the update, the poverty rates are measured at a higher level. This does not mean that poverty suddenly increased. Rather, the update provides a more accurate benchmark that better reflects the current living costs and the updated national poverty lines. Furthermore, the update does not alter recent poverty dynamics for individual countries or the region overall. The poverty trends remain the same under both the old and new poverty lines. (Figure B1.2).

FIGURE B1.2: Evolution of PPP 2017 U$6.85/day and PPP 2021 U$8.30/day poverty rates in WB6 countries

Notes: Disposable income-based estimates from the EU's Survey of Income and Living Conditions.

TABLE B1.2: Changes in international poverty lines across country groupings

Country group	2017 PPP lines (US$)	Only update PPP (US$)	2021 PPP lines (new data + lines) (US$)
LIC	2.15	2.50	3.00
LMIC	3.65	4.00	4.20
UMIC	6.85	7.70	8.30

Inflation is rebounding reflecting domestic pressures

Inflation in the WB6 rose from 3.7 percent in January 2025 to 4.5 percent in July, as food and utility costs surged, adding to existing price pressures from wage growth. Although global food and energy prices have been easing in 2025 (Figure 1.12)–reflecting improved supply conditions and softer demand at the global level–localized shocks have continued to intensify price pressures across the region. Flood-related supply disruptions in Bosnia and Herzegovina, an electricity tariff increase in Kosovo and rising utility bills in Montenegro and Serbia have all added to the strain. A second consecutive year of weak agricultural production in the region, in the context of growing climate shocks, has further contributed to food price inflation. Wage and fiscal policy choices also played a role, including minimum wage hikes in Bosnia and Herzegovina and Montenegro, and social contribution cuts in Montenegro. The sharpest increases between January and July were recorded in Bosnia and Herzegovina,

Montenegro, and Kosovo, while in North Macedonia inflation also accelerated after March, following a temporary two-month government freeze on certain food items. Albania's inflation remained the lowest compared to its neighbors (2.5 percent as of July 2025), as rising wages were largely offset by a strong lek.

Core inflation in the region has remained elevated, reflecting persistent domestic pressures (Figure 1.13). Rising unit labor costs, driven by rapid wage growth and modest productivity gains, have contributed to these pressures. This effect has been especially pronounced in the service sector where labor accounts for a large share of total costs. On average in January - July 2025, core inflation was higher than headline in Albania, North Macedonia, Montenegro, and Serbia. Unit labor costs rose sharply, outpacing productivity growth and feeding into higher core inflation. In contrast, Bosnia and Herzegovina and Kosovo saw headline inflation outpace core inflation– reflecting temporary surges in food and energy prices.

FIGURE 1.12: Global food and energy prices continue to fall…
(Yoy change in percent)

FIGURE 1.13: …while inflation in the WB6 countries remains sticky
(Yoy change in percent)

Source: World Bank Pink Sheet, Regional Central Banks and Statistical Offices, World Bank staff calculations.

Producer prices have been rising across the Western Balkans–with consumer prices following at different speeds across countries. In three of the six Western Balkan countries– Albania, North Macedonia, and Kosovo– producer prices have been rising faster than consumer prices, suggesting that higher input costs may be initially absorbed by firms rather than fully passed on to households. This reflects either squeezed profit margins, as in Albania, or temporary policy interventions such as North Macedonia's freeze on selected food items. In Kosovo, May's electricity tariff increase and energy market liberalization have pushed up production costs, although there has not been sufficient time for these to be transmitted to consumer prices. By contrast, in Montenegro, Serbia, and Bosnia and Herzegovina, consumer prices have outpaced producer prices, driven by service-sector inflation and policy-related measures including wage increases, higher utility tariffs, and tax changes.

With inflation rising across the Western Balkans, central banks responded differently– reflecting their exchange rate regimes and available policy space. Albania was the only country to ease, with the central bank cutting its policy rate to 2.5 percent in July to align headline and core inflation with its 3 percent target. Central banks elsewhere adopted a more cautious stance, closely watching domestic demand strength and rising food and energy prices. The National Bank of North Macedonia held its rate at 5.35 percent after a modest 20 basis-point cut in February and used instead macroprudential measures to support price and exchange rate stability. Similarly, the National Bank of Serbia kept its rate steady at 5.75 percent, unchanged since September 2024, even as inflation rose to 4.8 percent in July and breached the upper bound of its 3±1.5 percent target corridor in June (Figure 1.14). Kosovo, Montenegro, and Bosnia and Herzegovina, whose currencies are tied to the Euro, lack independent monetary policy and instead rely on fiscal and structural measures to maintain price stability.

FIGURE 1.14: Albania's central bank eased its policy rate while others remained cautious…
(Dynamics of national policy rates, percent)

FIGURE 1.15: …while allowing for different degrees of exchange rate flexibility
(percent change in official exchange rate vs Euro)

Source: Regional Central Banks and World Bank staff calculations.

Financial sector is demonstrating resilience

Favorable borrowing conditions, along with strong household demand and rising wages, have maintained rapid credit growth in the WB6–with lending expanding at double-digit rates. Abundant liquidity, euroization, and ongoing financial deepening have further fueled credit expansion. Private sector credit growth in the WB6 region accelerated to 14 percent yoy in June 2025–the fastest pace since May 2009. The expansion was driven by strong demand from both corporate and retail segments, particularly for mortgages. Montenegro and Kosovo led with growth rates of 19.7 and 19.0 percent, respectively, while Bosnia and Herzegovina recorded the lowest growth at 9.0 percent (Figure 1.16). Household credit growth outpaced corporate lending in most countries, rising 15.6 percent yoy, with Kosovo and Montenegro leading (Figure 1.17). Corporate credit growth reached 12.7 percent, narrowing the gap with household lending. Loan-to-deposit ratios rose across the region to average 79.2 percent in March. By June, Kosovo and Montenegro exceeded 90 percent, while Albania remained at a comparatively low of 64.3 percent.

While the rapid credit expansion supports economic convergence, it also raises concerns about overheating, housing market imbalances, and future risks to financial stability. For now, risks to financial stability remain moderate. Non-performing loans (NPLs) declined across all WB6 countries over the past year, while capital buffers remain solid. The regional average NPL ratio fell by 0.8 pp between March 2024 and March 2025, with Montenegro showing the most improvement, and Kosovo, Serbia, and North Macedonia maintaining the lowest levels. Capital adequacy and liquidity ratios held steady at 19.2 percent and 27.0 percent respectively, well above regulatory minimums. Despite these positive trends, forward-looking risks are emerging. According to the July 2025 Central, Eastern, and Southeastern Europe (CESEE) Bank Lending Survey, banks foresee NPLs to rise over the next six months, reflecting concerns about household debt sustainability amid rapid credit growth, particularly in mortgage lending. Rapid increases in loan-to-deposit ratios may lead to future funding pressures. These developments highlight the need for close supervisory oversight and timely macroprudential measures. Strengthening lending standards, monitoring household indebtedness, and maintaining adequate liquidity and capital buffers will be critical to safeguarding financial stability as the credit cycle matures.

FIGURE 1.16: Credit growth continues to rise…
(Private sector credit growth, percent yoy)

FIGURE 1.17: …for both firms and households
(Change in credit outstanding, June 2025, percent yoy)

Source: Regional Central Banks and World Bank staff calculations.

At the same time, financial sector reforms are improving access to finance, particularly through modernizing payments. Recent legal and regulatory changes have advanced regional integration with the Single Euro Payments Area (SEPA). Montenegro and North Macedonia were approved to join SEPA's geographic scope in November 2024 and March 2025 respectively, while Albania's banks received approval in April 2025 to offer SEPA credit transfers starting in October 2025. In May 2025, the European Payments Council Board approved Serbia's inclusion in SEPA, and Kosovo is preparing legislative reforms to align with EU standards.

By enabling faster, cheaper, and more reliable cross-border transactions, SEPA participation can expand financial inclusion, boost efficiency, and unlock new opportunities for households and businesses by facilitating smoother financial transactions and expanding access to credit and savings (Box 1.3). In the context of double-digit credit growth and rising household indebtedness, however, broader access to financial services will help accelerate growth (See Table 1.2) but also require strong supervisory frameworks and robust macroprudential oversight to ensure that greater connectivity does not exacerbate financial vulnerabilities.

BOX 1.3: Strengthening Financial Inclusion in the Western Balkans

In the Western Balkans, both account ownership and the share of the population using digital payments have increased sharply in the last decade. New data from the 2025 Global Findex Database (collected in 2024) captures information on how adults surveyed in 141 economies use financial services. Of the WB6, North Macedonia and Serbia had the highest levels of financial inclusion–with over 80 percent of adults having an account for financial services. All six countries had a double digit increase in the share of adults using an account between 2011 and 2024, with Montenegro posting the highest growth during that period, followed closely by Bosnia and Herzegovina and Kosovo (Figure B1.3a), although some countries plateaued or had slight declines in account ownership between 2021 and 2024. Similarly, in all WB6, the share of adults making or receiving digital payments increased in the last decade (by 13 pp in Albania and Serbia to a high of 29 pp in Bosnia and Herzegovina). Serbia and North Macedonia had the highest use in digital payments in 2024 at 77 and 75 percent respectively, above the ECA region average of 69 percent (Figure B1.3b).

This rapid uptake of digital financial services is closely linked to broader trends in digitalization, regulatory reforms, and the expansion of mobile and Internet infrastructure. Mobile phone ownership now exceeds 90 percent, and smartphone usage ranges from 79 to 88 percent. Phone ownership (particularly smartphones) can help increase account ownership and usage of accounts, as they enable access to a wider range of digital services. Regulatory reforms and the rise of fintech have also played a key role. The COVID-19 pandemic further accelerated digital payment adoption, prompting a shift away from cash.

Still, gaps in financial inclusion persist across underserved groups in the Western Balkans, particularly among women, individuals with lower incomes or education levels, and those outside the workforce. North Macedonia, Albania, and Kosovo report lower account ownership among women compared to men, and all except Kosovo show higher account ownership among the wealthiest 60 percent than the bottom 40 percent. Those with lower education and who are out of the workforce are also less likely to hold financial accounts. Reasons for not having accounts vary, but using a family member's account was common across all WB6 countries–especially in North Macedonia and Montenegro where over 70 percent cited this reason. In Albania and Montenegro, more than one-half of respondents cited lack of money, while over one-quarter in Albania, Montenegro, and North Macedonia pointed to high fees. In addition, over 20 percent in Montenegro and North Macedonia noted that financial institutions were too far away (Figure 1.3c).

Closing remaining gaps in financial inclusion will require a multifaceted approach as expanding access to financial services can stimulate investment and create opportunities for employment and entrepreneurship. Continued investment in digital infrastructure will help reduce transaction costs, improve transparency, and support business formalization. Encouraging competition and welcoming new entrants can lower costs and improve service delivery. Simplifying account opening procedures, promoting financial literacy and innovative digital financial solutions, especially those targeting women, rural populations, and individuals with lower education levels, are also important steps to overcome persistent access barriers. All these need to be coupled with adequate regulatory supervision.

FIGURE B1.3: Trends in Financial Inclusion and Digital Financial Services in the Western Balkans

a. Financial account ownership has increased sharply in WB6 countries

b. The share of the population using digital payments also increased the last decade

c. For adults without accounts, barriers to account ownership differ by country

Adult without an account (%), 2024

	Not Enough Money	Fees for financial services too high	Family member has account	Financial Institutions too far away	Do not trust institutions	Lack of necessary documentation
Albania	80	38	33	15	21	6
Bosnia and Herzegovina	24	21	52	11	16	18
Kosovo	19	16	59	10	8	7
Montenegro	55	27	71	26	21	24
North Macedonia	24	26	89	22	16	20
Serbia	31	11	58	9	10	16

29% 40% 60% 80%

External deficits are widening amid a weak external environment

External pressures continue to mount in the Western Balkans in 2025 as weaker trade performance and political uncertainty weigh on the region despite falling global commodity prices. The Western Balkans are particularly exposed to these external headwinds, given trade openness of 112 percent of GDP and the Euro area accounting for 53 percent of its exports (Figure 1.18). Elevated trade policy uncertainty, which reached record levels in 2024 (Figure 1.19), disrupted trade flows and dampened investment. The current account deficit (CAD) for Western Balkan countries is estimated to widen by 0.6 pp to 7.1 percent in 2025, driven primarily by Montenegro, Serbia, and North Macedonia, where trade balances deteriorated and income balances weakened (Figure 1.20). In most of these countries, merchandise imports rose strongly, reflecting higher demand for consumer and capital goods. This surge was amplified by a widening price differential as major suppliers experienced slower inflation, making imports relatively cheaper. In contrast, Albania's external position is estimated to improve, supported by a strong rebound in goods exports, which in turn supported the narrowing of the CAD. (Figure 1.21).

The net services export surplus in the region is estimated to narrow by 0.5 pp to 11.5 percent in 2025, led by weaker manufacturing exports and sharply higher construction imports. The region saw a notable increase in imports of construction services, particularly in Serbia, North Macedonia, and Bosnia and Herzegovina as demand for construction workers for road construction and residential buildings exceeded local supply. Exports of manufacturing services weakened, most notably in manufacturing-oriented countries such as Serbia, North Macedonia, and Bosnia and Herzegovina. Travel services exports grew in double-digits in Albania, Kosovo, and North Macedonia. Exports of telecommunications, computer and information services remained resilient in most countries, particularly in Kosovo (21 percent) and Serbia (14 percent).

FIGURE 1.18: Shares of ECA exports to the United States and Euro area

FIGURE 1.19: Global and trade policy uncertainty

Sources: Caldara et al. (2020); Baker et al. (2016); World Bank; World Integrated Trade Solution.
Note: CA = Central Asia; CE = Central Europe; ECA = Europe and Central Asia; EE = Eastern Europe; GEPU = Global Economic Policy Uncertainty index; RUS = Russian Federation; SCC = South Caucasus; TPU = Trade Policy Uncertainty index; TUR = Türkiye.
Figure 1.18. Last observation is 2023 (2021 for Belarus, the Russian Federation, and Tajikistan).
Figure 1.19. Blue and light blue lines show the 3 mma GEPU and TPU, which measures media attention to news related to economic policy uncertainty and trade policy uncertainty. The last observation is June 2025.

FIGURE 1.20: The regional CAD is widening in 2025…

Source: Regional Central Banks, World Bank staff calculations.

FIGURE 1.21: …amidst a pick-up in goods imports

Remittances have long supported the current account, but their positive contribution is set to slightly shrink by 0.2 pp to 5.7 percent of GDP in 2025 (Figure 1.22). Kosovo, one of the region's largest recipients, is expected to experience the sharpest slowdown, with remittances declining by about 1.0 pp of GDP in 2025, followed by Bosnia and Herzegovina and Albania. The deceleration comes from weaker economic activity in host countries, notably in the EU, and from rising wages in the Western Balkans which make emigration somewhat less attractive. Nevertheless, persistent labor shortages in the EU, higher living standards, and slow domestic reforms will continue to propel emigration, keeping remittances as an important income source for the Western Balkans.

Net FDI inflows to the WB6 are expected to decline to an average of 4.7 percent of GDP in 2025 from 5.7 percent in 2024, financing about 70 percent of the region's CAD–the lowest since the pandemic (Figure 1.23). Although FDI inflows from EU countries have slowed, the EU remains the region's leading foreign investment partner, even as inflows from other countries such as Türkiye and China rise.

In Serbia, net FDI inflows more than halved from €2,281 million in H1 2024 to €942 million in H1 2025–with the most significant falls in the mining, telecommunications, and construction sectors amid heightened political uncertainty. North Macedonia followed, with inflows dropping from €732 million to €541 million, almost entirely due to a decline in loans from parent companies to their affiliates after a surge in the previous year. In Montenegro, FDI eased as equity investments in companies and banks fell, partly offset by higher intercompany lending and real estate investment. FDI inflows in real estate also remained strong in Kosovo, continuing a historical trend, and in Albania, reflecting positive momentum in the tourism sector. Among the WB6, FDI financing of CAD is lowest in Montenegro and highest in Albania–highlighting differences in external financing structures across the region.

FIGURE 1.22: Remittances and net services surpluses eased…
(Percent of GDP)

FIGURE 1.23: … and net FDI financed over two-thirds of the region's CAD
(Percent of GDP, 2025)

Source: Regional Central Banks, World Bank staff calculations.

Fiscal deficits are expanding driven by weaker revenue growth

Fiscal deficits in the WB6 are projected to widen in 2025, except for North Macedonia and Bosnia and Herzegovina, as slowing growth weighs on revenues while spending continues to rise. Midyear fiscal outcomes were mixed: Albania posted a surplus, while other countries recorded deficits ranging from 0.2 percent of GDP in Serbia to 2.5 percent in North Macedonia. With growth expected to slow in 2025, the regional fiscal deficit is projected to widen by 0.4 pp, reaching an average of 2.5 percent of GDP in 2025 (Figure 1.24). While Bosnia and Herzegovina and North Macedonia are expected to narrow their deficits compared to last year, reflecting stronger revenue collection in both countries, other economies are facing deteriorating balances. North Macedonia and Montenegro are projected to post the largest deficits at 4 percent and 3.7 of GDP respectively, while Kosovo is set to record the smallest at 0.8 percent. Primary fiscal balances are expected to be negative in all countries, except in Albania, where a surplus of 0.5 percent of GDP is anticipated, consistent with the fiscal rule mandating a non-negative primary balance, although lower than last year's level.

Public expenditure is increasing in 2025, fueled by notably higher spending on social benefits. In the first six months of 2025, expenditures grew by double digit rates across the region, except for Serbia, where growth was slightly lower at 9.3 percent yoy. For the year as a whole, regional spending is projected to rise by 0.4 pp of GDP– bringing total outlays to 38.6 percent of GDP (Figure 1.26). The largest increases are anticipated in Albania (1.3 pp) and Serbia (1.0 pp), whereas Kosovo and Montenegro are set to see slight declines of 0.3 and 0.5 pp respectively. Social benefits are the main driver of higher expenditures, with spending expected to reach a decade-high 13.8 percent for 2025. Bosnia and Herzegovina saw the steepest rise (+3.3 pp), driven by sharp minimum wage hikes–64 percent in the Federation and 44 percent in Republika Srpska, as about 50 percent of employed population receive the minimum wage. In contrast, Kosovo's social spending is expected to fall by 0.5 pp of GDP in 2025–reflecting a high base in 2024 following one-off, post-COVID contingent spending.

FIGURE 1.24: Fiscal deficits are widening…

(Fiscal deficit, percent of GDP)

FIGURE 1.25: …driven by weaker revenue and stronger expenditure growth

(Expected annual change in expenditures, revenue and fiscal balance in pp of GDP in 2025)

Source: National statistical offices, Ministry of Finances, World Bank staff calculations.

FIGURE 1.26: Social benefits and capital spending are driving expenditure growth
(Shares in total public expenditure (percent))

Source: National Ministry of Finances, World Bank staff calculations.

Wage spending is also rising–driven by public sector pay increases and employment. Regionally, the wage bill is projected to increase by 0.2 pp of GDP in 2025–slower than the previous year–but masking notable divergences across countries. The largest increases are expected in Serbia and Bosnia and Herzegovina, where governments have raised wages to offset inflation and retain skilled workers, particularly in health, education, and local administration, while also expanding staffing to strengthen service

delivery. This will lift their wage bills to 9.9 and 10.8 percent of GDP, respectively. Kosovo and Albania follow at 8.3 and 4.6 percent of GDP, driven by gradual increases in public-sector pay and selective hiring. In contrast, Montenegro's wage bill is projected to remain unchanged at 10.2 percent of GDP, while North Macedonia's is estimated to edge down slightly to 7.4 percent of GDP, helped by moderate public-sector wage growth, faster nominal GDP expansion, and declining employment in public administration.

Rising capital expenditures can support growth and have the potential to crowd in private investment (Box 1.1), provided projects are well managed and deliver high-quality outcomes. In the first half of the year, capital spending increased broadly, largely targeting public infrastructure upgrades. Montenegro led the way, with spending up over 8 percent yoy exceeding budget plans. Public investments are projected to increase by 0.3 to 5.9 percent of GDP, driven by highway and railway infrastructure upgrades, with additional energy (solar and wind) and transport projects expected to start this year. Serbia has also maintained strong investment momentum, with spending commitments focused on the Serbia–Expo 2027 initiative and related public works. By contrast, Albania, Kosovo, and North Macedonia saw some increases in capital outlays

but weak execution, with only 70-78 percent of planned spending implemented in Albania and Kosovo and 32 percent in North Macedonia. At the regional level, public investment is projected to reach 5.5 percent of GDP in 2025, with Serbia posting the highest share at 7.2 percent of GDP and Bosnia and Herzegovina the lowest at 4.1 percent–underscoring both opportunities and ongoing challenges in delivering effective infrastructure projects.

Revenues growth is slowing across the region as economic activity softens, although collections remain supported by wage policies, household demand, and inflation. In the first half of the year, revenue rose by 6–11 percent, boosted by higher minimum wages, stronger

consumption, and better tax compliance. The revenue-to-GDP ratio is projected to increase in North Macedonia, Bosnia and Herzegovina, and Albania, but fall by 1.1 pp and 0.8 pp of GDP in Montenegro and Kosovo respectively. In Montenegro, the drop reflects structural tax changes, including permanent reduction in the pension contribution rate for employees and abolition of pension contributions for employers. In Kosovo delays in accessing EU grants amid political stalemate are weighing on revenues. Although EU funds (including grants) to the region are expected to increase, uneven absorption rates limit their impact (see Box 1.4). Overall regional revenues are forecast to stay flat at 36.1 percent of GDP, following a 0.9 pp increase last year.

BOX 1.4: EU pre-accession financial assistance is key to easing financing pressures and driving reforms in the Western Balkans, but its impact hinges on effective use.

EU funding to the Western Balkans is set to rise between 2024 and 2027, but to fully benefit from these resources, countries will need to strengthen their capacity to absorb and manage them effectively. The EU offers the Western Balkans a stable external source of financing for development and reforms through grants or concessional lending instruments. The Instrument for Pre-Accession Assistance (IPA), put in place in 2007 and now in its third phase, is the EU's main financial instrument for candidate countries–with an overall budget of roughly €38.5 billion between 2007 and 2027 (European Commission 2025). Until 2024, IPA funds committed to the Western Balkans amounted to 11.6 percent of the combined GDP.[5] The RGF (European Commission 2025a) that entered into force in May 2024, committed an additional 3.5 percent of the 2024 Western Balkan GDP to be disbursed over four years. Annual commitments average 0.7 percent of GDP for the region (Figure B1.4a) with large variations in indicative allocations per country depending on their level of development and size. Kosovo remains the most dependent on EU funding, allocations for North Macedonia and Montenegro are relatively high while other countries show lower but growing relative allocations (Figure B1.4b).

While absorption rates of IPA I fund allocation were generally high (at about 90-95 percent), with decentralized management, absorption started varying across countries and programming periods (for IPA II contracted versus committed funds vary from 55 to 100 percent).[6] Maintaining strong absorption capacity is essential to fully leverage external funding and sustain progress in EU accession preparations. Implementation shortfalls also mean the fiscal impact of EU funding will be more modest than headline commitments; strengthening it could unlock additional budget funding that provides essential relief during times of heightened fiscal pressures. The economic impact of such flows will eventually depend on how well the funds are spent, rather than simply focusing on absorption levels that may overlook such negative factors as low social or economic rates of return or the displacement of private investments.

---

5.   IPA III is a performance- and needs-based instrument with a total budget of €14.162 billion for 2021–27 (about €4.8 billion to be allocated to the Western Balkans), programmed through annual and multi annual actions rather than pre-set country allocations. The European Commission does not, therefore, provide an official table of "allocations by country for 2021–27" under IPA III as a whole.

6.   IPA III absorption by 2024 does not outperform previous IPA rounds at a comparable point in their implementation cycles, as disbursed-versus-committed rates remain between 30 to 50 percent.

FIGURE B1.4a: EU funds are set to cover an important share of financing for the Western Balkans by 2027

(Annual commitments of EU funds, percent of region's GDP)

Source: World Bank staff estimates based on EU Financial Transparency System data, EU Commission reports, and state statistical offices.
Note: Numbers do not include Macro-Financial Assistance. Data for 2024 assumes one-quarter of the overall Reform and Growth Facility.

FIGURE B1.4b: EU funds allocations vary by country and are set to increase by 2027

(Commitments, percent of country GDP)

Source: World Bank staff estimates based on EU Financial Transparency System data, EU Commission reports, and state statistical offices.
Note: Numbers do not include Macro-Financial Assistance. Data for 2021-27 include also Reform and Growth Facility.

Montenegro has seen consistently strong performance in EU funds disbursement across IPA I–III, while several peers saw gains stall or reverse around the pandemic. Compared with IPA I, Albania's absorption weakened in IPA II (lower contracting rate at 78 percent and disbursement rate at 57 percent of the committed funds), while Bosnia and Herzegovina improved disbursements against contracted amounts under IPA II to above 80 percent, although the contracting rate is below that level. Kosovo contracted about 65 percent of IPA II and has disbursed so far more than one-half of the committed amount. North Macedonia so far has the lowest contracting rate under IPA II–at about 55 percent and has disbursed about one-third of committed funds. Serbia also slowed in IPA II but ultimately contracted 87 percent of committed funds; disbursement at about one-half of the committed amount, however, needs to follow suit. By contrast, disbursements ranged from 76.3 percent in Bulgaria to 92.1 percent in Hungary under the PHARE[7] program (European Commission 2015).

The EUs financial pre-accession assistance has been relatively larger for the WB6 than it was for Central and Eastern European (CEE) countries at their respective peaks, but its intensity declined under IPA II. Under IPA I, WB6 support was larger both as a share of GDP and of public spending than the CEE PHARE[8] averages. WB6 disbursements under IPA I reached about 1.4 percent of government expenditure versus roughly 0.9 percent under PHARE (Figure B1.4c). Since then, EU funding has declined in relative terms during IPA II, while IPA III and the Reform and Growth Facility are still under implementation and will require much improved absorption given the amount of allocated resources. By 2024, Kosovo stands out with disbursements near 1 percent of GDP annually, ahead of Montenegro and CEE entrants Bulgaria and Romania (Figure B1.4d).

The decline in absorption capacity reflects persistent institutional bottlenecks–with weak administrative capacity as a central constraint. Serbia, Montenegro, and North Macedonia face high staff turnover and insufficient personnel training systems, while indirect management structures often lack resources to ensure timely contracting (European Commission 2023; 2023a; 2023b). In North Macedonia, only one-third of IPA III funds were contracted by 2024, just over one-fifth disbursed, and nearly €80 million was lost from

---

7.　The PHARE program was originally established as the Poland and Hungary: Assistance for Restructuring their Economies program.
8.　PHARE was the EU's main pre-accession program before 2004 and 2007 enlargements.

2022 to 2024 (CNN Albania 2024). Political stalemates and sanctions have further depressed absorption, for example Kosovo's delays in accessing €600 million in EU RGF financing as well as the loss of some not yet contracted IPA funds, and in Albania the suspension of IPA III disbursements originally allocated for rural development (GAP Institute 2020; Vox News 2025). The core issue is not the volume of available funds but the ability of national administrations to translate them into concrete reforms and investments, which calls for better planning and project preparation, accelerated implementation, stronger administrative capacity, and targeted resolution of procurement bottlenecks.

FIGURE B1.4c: Disbursement of pre-accession assistance is similar to the former candidate countries, although decelerating
(Average annual disbursement of pre-accession funds of WB6 and CEE, as percentage of GDP and government expenditure)

Source: World Bank staff estimates based on EU Financial Transparency System data, EU Commission reports and state statistical offices.
Note: Averages of yearly EU funding to GDP and EU funding to gov. expenditure, date of disbursements and duration of EU programs are different: IPA I: 2007-20, IPA II: 2014-24 (ongoing), PHARE: 1995 until 2003 for the Czech Republic, Hungary, the Slovak Republic, Slovenia, and 1995-2006 for Bulgaria and Romania.

FIGURE B1.4d: Smaller and less developed countries had higher relative disbursements of EU funds
(Average annual disbursement of pre-accession funds by country, as average percentage of GDP)

Source: World Bank staff estimates based on EU Financial Transparency System data, EU Commission reports and state statistical offices.
Note: For WB6 countries - averages over combined yearly IPA disbursements 2007-24; and averages over all yearly PHARE disbursements before accession: 1995 until 2003 for the Czech Republic, Hungary, the Slovak Republic, Slovenia, and 1995-2006 for Bulgaria and Romania.

Countries continue to diversify their financing mix to lower borrowing costs, mitigate rollover risks, and smooth maturity profiles. Some countries borrowed from international capital markets, while others relied on domestic issuance or multilateral and bilateral support. Albania issued a €650 million 10-year Eurobond with a 4.75 percent coupon in February 2025, while the Federation of Bosnia and Herzegovina placed its debut €350 million five-year Eurobond at a fixed 5.5 percent coupon in July 2025. Montenegro raised a record €850 million via a seven-year Eurobond with a 4.875 percent coupon in March 2025, primarily to refinance maturing debt, including the 2018 Eurobond that came due in April. Kosovo maintained active engagement with the IMF–drawing €95 million under its Stand-By Arrangement in Q2 2025. North Macedonia has secured the second €500 million bilateral loan from Hungary to meet near-term repayments and signed a 10-year strategic partnership with the UK Government to finance infrastructure projects. The partnership establishes a financing framework of £5 billion (approximately €6 billion), with commercial lending terms determined on a project-by-project basis through the UK Export Finance Agency.

Yields on Western Balkans Eurobonds have declined steadily since late 2023, supported by easing global interest rates and improving credit fundamentals (Table 1.1). Serbia's upgrade to its investment rating by S&P in October 2024 compressed its borrowing costs with its 2027 Eurobond now trading near 3.2 percent–the lowest in the region. Montenegro's 2027 bond yield has also fallen sharply, now hovering about 3.8 percent after peaking above 6 percent in 2023. North Macedonia's yields have eased to about 4 percent despite fiscal pressures and persistent inflation, while the Federation of Bosnia and Herzegovina's 2030 issue trades at 4.8 percent. Spreads over German Bunds echo this pattern, staying near 130–205 basis points for most sovereigns but widening to about 260 for the Federation of Bosnia and Herzegovina and a steep 763 for the Republika Srpska, whose distressed-level 9.5 percent yield highlights ongoing credit concerns.

Despite widening deficits, total PPG debt in the region is expected to decline slightly in 2025, falling by 0.6 pp of GDP to 44.4 percent. This marks a sharp slowdown from the average annual decline of 3.7 pp recorded over the past four years. Bosnia and Herzegovina, Albania, Serbia, and Montenegro account for most of the improvement, with projected declines of 1.5, 0.8, 0.7 and 0.6 pp of GDP, respectively. Kosovo is expected to record marginal decreases of about 0.1 pp, while North Macedonia's debt is set to rise by 0.5 pp. As a result, North Macedonia and Montenegro remain the most indebted, with PPG debt ratios at 62.9 and 60.6 percent of GDP respectively, followed by Albania at 53.4 percent, while Kosovo continues to maintain the lowest ratio at 17.1 percent (Figure 1.27).

FIGURE 1.27: PPG debt declining
(Percent of GDP)

Source: National Ministry of Finances, World Bank staff calculations.

TABLE 1.1: Yields on WB6 countries outstanding Eurobonds

	Coupon	Maturity	Yield in %					Spreads (basis points)
			26-Sep-23	5-Mar-24	18-Sep-24	10-Mar-25	9-Sep-25	
Albania	4.75	14/2/2035	-	-	-	-	4.7	204.5
	3.5	16/06/2027	5.5	4.5	4.4	3.9	3.5	155.5
	3.5	9/10/2025	5.5	4.4	4.3	5.5	3.3	-
Montenegro	2.785	16/12/2027	6.8	6.2	5.1	4.4	3.8	191.5
	2.55	3/10/2029	-	-	-	-	3.9	181.8
North Macedonia	6.96	13/03/2027	6.0	5.2	5.0	4.3	4.0	205.5
	3.675	3/6/2026	-	-	-	4.2	3.7	163.8
Serbia	3.125	15/05/2027	6.2	4.5	4.1	3.9	3.2	129.2
	6.25	26/05/2028	6.8	5.9	5.1	5.6	4.7	273.6
Bosnia & Herzegovina, Federation of Bosnia and Herzegovina	5.5	17/07/2030	-	-	-	-	4.8	260.8
Bosnia & Herzegovina, Republic of Srpska	4.75	1/1/2026	7.1	7.9	5.8	7.7	9.5	763.5

Source: https://www.boerse-frankfurt.de/en, accessed on 10 September 2025
Notes: Spreads refer to spreads with yields on German bonds with the same or similar residual maturity.

Outlook and Risks

Outlook remains positive while advancing EU convergence is key

Against a backdrop of heightened global uncertainty and sluggish recovery in the Euro area, growth in the WB6 is expected to rebound slightly by 2027–driven by investment and net trade. With global growth forecast to only modestly recover in 2026–27, the region will be affected by weaker demand from its main trading partners. Growth in the region is expected to moderate in 2026 driven by a modest increase in investment as domestic political uncertainties ease and FDI picks up, and a slight rebound is expected by 2027 (Figure 1.28) as Euro area demand gradually improves. Expectations for accelerated implementation of EU Reform and Growth Facility financing are set to boost investment across the region. Albania, Kosovo, and Serbia are projected to see growth driven mainly by stable consumption and increased investment, with Albania's GDP growth stabilizing at 3.5 percent in 2026–27,

Kosovo at about 3.9 percent, and Serbia rising to 4.0 percent in 2027. In Bosnia and Herzegovina and Montenegro, growth is expected to reach 3.2 percent by 2027, supported by an improvement in net exports and investment, similar to North Macedonia, which is projected to maintain growth at 3 percent throughout 2026–27.

Improved domestic stability and falling global prices are expected to lower inflation in WB6 to 2.7 percent by 2027, with debt levels remaining broadly stable. Inflation is expected to moderate during 2026-27 as global commodity prices are expected to decline further in 2026 amid subdued demand and ample supply. Expectations for reduced domestic uncertainty by 2027 are set to improve fiscal indicators, with fiscal deficits dropping (Figure 1.29) and public debt remaining stable across the region. Revenue performance remains strong overall, and spending is expected to be contained throughout the period. As a result, WB6 countries are projected to either maintain or gradually lower their fiscal deficits by 2027,

while public debt also remains at stable levels as fiscal consolidation picks up in some of the countries experiencing delays.

External demand remains subdued due to global uncertainties but an initial increase in CADs is expected to stabilize over the medium term. Goods exports are expected to remain subdued, as WB6 are particularly exposed to external headwinds. The region's deep integration into European value chains leaves it vulnerable to prolonged Euro area weakness–especially in sectors such as automotive, machinery, and agriculture. While export expansion is expected to remain constrained, Germany's newly legislated fiscal support package could help mitigate some of the drag over the medium term–providing modest support to the subregion and helping to stabilize the CAD by 2027 (Figure 1.29). Net exports are projected to improve their contribution to growth in 2027 across the region, with a slightly more pronounced contribution in North Macedonia and Montenegro. Similarly, the contribution of FDI and remittance inflows is modest given the Euro area outlook but projected to gradually improve as external uncertainties reduce over the medium term.

Sustained reform momentum is essential to lift potential growth and put the WB6 on a faster convergence path with advanced economies, critical for more and better jobs. Without deeper structural reforms, the region risks remaining on a path of modest gains constrained by demographic pressures and stagnant productivity. Although demographic headwinds continue to slow growth, comprehensive reforms that enhance total productivity, improve health and education outcomes, expand LFP, increase private investment and improve public investment efficiency could enable most WB6 countries to reach high-income status by the mid-2030s and achieve current EU per capita income levels nearly three decades earlier relative to current trends (Box 1.5). Faster growth expands the economic space for firms to invest and hire, while reforms help shift employment from low-productivity sectors to higher-value activities. This transition is key to improving job quality, increasing wages, and ensuring that more people can participate meaningfully in the labor market (Chapter 2).

FIGURE 1.28: GDP growth is rebounding as global and domestic uncertainties persist…
(Percent)

FIGURE 1.29: …while both current account (CA) and fiscal deficits are improving across the region.
(Percent of GDP)

Source: World Bank staff estimates.

The EU Growth Plan provides a roadmap to overcome long-standing structural barriers. The EU Growth Plan, with reforms across key areas, is expected to accelerate growth and improve labor market outcomes. Closing 70 percent of critical reform gaps with the EU over the next 20 years could boost GDP per capita growth by an average of 3.1 percent annually for 5 of the WB6 countries, according to World Bank staff estimates (Table 1.2). Potential gains are highest in Bosnia and Herzegovina (4.6 percent) and Albania (3.1 percent), followed by North Macedonia (3.0 percent), while Serbia (2.4 percent) and Montenegro (2.3 percent) see smaller but significant boosts. The five key areas of improvements are: digital infrastructure, regulatory quality, government effectiveness, financial development, and female LFP. These areas are in line with the World Bank Group strategy on jobs, that's build on three pillars: pillar 1 on foundational infrastructure (human and physical), pillar 2 on establishing a business-friendly environment, and pillar 3 on mobilizing private investment.

BOX 1.5: Converging to High-Income Status and EU Living Standards: A Long-Term Growth Agenda for the Western Balkans

The Convergence Gap

The Western Balkan countries are progressing toward high-income status, yet meaningful convergence with EU income levels remains a long-term challenge extending past 2070. While Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia have all reached upper-middle-income status, their average GNI per capita remains below one-quarter of the EU. This is similar to the relative positions of Bulgaria (15 percent), Poland (20 percent), and Estonia (23 percent) when they joined the EU, however, it underscores that achieving full convergence will be a long-term challenge. Based on the Long-Term Growth Model Public Capital Extension (LTGM-PC) in a business-as-usual (BAU) baseline that assumes recent trends continue, WB6 per capita GDP growth is simulated to average 3 percent between 2026 and 2050–with individual country growth ranging from 2.8 percent in Montenegro to 3.4 percent in Albania and Kosovo. All countries are expected to achieve high-income status before 2040–with Serbia and Montenegro likely doing so by 2030 (Figure B1.5a). Nevertheless, the region is anticipated to reach just over one-half of current EU GNI per capita income by 2050, and about 30 percent of EU per capita levels if the EU per capita levels grow at their 2011–19 average, similar to Hungary and the Slovak Republic when they joined the EU. At the current pace, none of these economies are projected to match today's EU per capita levels before 2070.

All WB6 countries are facing a shared challenge of slowing potential GDP and GDP per capita growth–with a projected decline of nearly 2 pp over the next 25 years. Although per capita growth is modestly higher than the average real GDP expansion of 2.4 percent annually, this is largely due to negative population growth averaging -0.7 percent across the region. Under the baseline, regional growth is primarily driven by capital accumulation–both private and public–contributing about 1.7 pp to annual GDP growth, followed by TFP at 1.4 pp, and labor and human capital at 0.4 pp (Figure B1.5b). Growth is, however, constrained by diminishing returns to capital, adverse demographic trends and stagnant or declining productivity and human capital gains in education and health. While negative population growth boosts per capita GDP, the falling working-age to total population ratio reduces both headline and per capita growth by approximately 0.4 pp annually. This slow pace of convergence reflects patterns seen over the past two decades and highlights the urgent need for an ambitious reform agenda to shift the region from incremental to transformative progress.

FIGURE B1.5a: GNI per capita and HIC and EU per capita thresholds at the current pace of reforms

FIGURE B1.5b: Contribution to real GDP growth in the baseline

Source: World Bank estimates from LTGM-PC.
Note K/Y is investment to GDP ratio. WATP= working age to total population.

The Reform Dividend

With ambitious reforms, the WB6 could transform their economic trajectory to reach high-income status by 2036 and EU income levels nearly three decades sooner than expected. Simulations of a coordinated reform package suggest that average GDP growth could increase by 1.8 pp–thereby, raising regional growth to 4.2 percent annually and per capita growth to 4.9 percent between 2026 and 2050. This would allow all WB6 countries to achieve high-income status by 2036 and collectively reach 80 percent of current EU income levels by 2050–with full convergence to current EU income levels occurring nearly three decades earlier than under the baseline. While all countries would benefit, the pace and depth of convergence would vary: Kosovo would reach high-income status by 2036 and EU income levels by 2058; Montenegro would be the first to converge with current EU living standards by 2050; and Albania, North Macedonia, and Bosnia and Herzegovina would follow shortly thereafter.

Reforms targeting productivity, LFP, and human capital are critical for WB6 to unlock higher growth and mitigate the drag from a shrinking working-age population (Figure B1.5c). Reforms that raise TFP are projected to drive the strongest growth–contributing 2.4 pp to total annual per capita growth and 0.7 pp to incremental gains between 2026-50. Over time, this effect would be amplified through induced investment, with rising TFP increasing the marginal productivity of capital. While LFP reforms rank fourth

in terms of total growth contribution (0.7 pp), they are the second-largest driver of incremental growth (0.4 pp), underscoring the importance of mobilizing underutilized labor segments such as women, youth, informal workers, and older adults. Improvements in education and health outcomes would add 0.8 pp to total growth and 0.3 pp to incremental growth annually. Increased private investment (1.0 pp) and more efficient public capital investment (0.3 pp) would further support growth–contributing 0.13 pp and 0.1 pp to annual incremental per capita growth, respectively. Nevertheless, demographic pressures, particularly the shrinking working-age population, are expected to reduce real GDP growth by 0.5 pp annually.

WB6 countries can reverse slowing growth by expanding labor participation, upgrading core skills, and implementing reforms that boost TFP through improvements in the business environment, government efficiency, regulatory quality, and digitalization. These measures, consistent with the EU Growth Plan (See Section 1.3), would enhance productivity and employment (See Chapter 2), accelerate convergence with EU living standards, and support the transition to high-income status and deeper EU integration. The next ten years offer a critical opportunity for action.

FIGURE B1.5c: All Reforms - 2026-50 Contribution to incremental average per capita growth

Source: World Bank estimates from the LTGM-PC.
Note: Reform scenario assumes peaking at 2030, with no explicit assumptions on EU accession. Convergence is in terms of current EU GNI per capita levels, however, given the EU will also be growing during this period, actual convergence may be lower. This scenario is explored in more depth in the background paper.

Among the five reform areas, regulatory quality, government effectiveness, and digitalization offer the largest potential gains–together accounting for most of the projected boost to per capita GDP growth. Improvements in regulatory quality–such as aligning energy sectors with EU standards, adopting carbon pricing, and strengthening vocational education–could raise growth by 1.13 pp annually (between 0.8 pp for Montenegro and 1.6 percentage points for Bosnia and Herzegovina). Government effectiveness reforms, including better public investment management, stronger governance of state-owned enterprises (SoEs), and tackling informality, could add 0.95 pp (between 0.7 pp in Serbia and 1.6 pp in Bosnia and Herzegovina). Advancing digitalization, through secure digital infrastructure, e-signatures, and intelligent transport systems, could contribute 0.63 pp, with the largest gain in North Macedonia (0.8 pp). While gains from expanding female LFP (0.35 pp) and financial sector development (0.03 pp) are smaller, they remain important for fostering inclusive and sustainable growth. Country-level differences point to the importance of prioritizing reforms based on country-specific gaps while leveraging shared

regional priorities. These would, in turn, boost private investment, improve efficiency of public capital, enhance human capital productivity growth, and promote labor market inclusion. All of which are critical for long-term growth and for creating more and better jobs (Chapter 2).

Building on recent gains, inclusive growth should drive further poverty reduction, although persistent pockets of vulnerability require targeted action. The downward trend in poverty rates is projected to continue over the medium term, although more slowly, reaching 12.2 percent by 2027, in part on account of slowing employment growth While poverty is falling, progress is uneven and vulnerable groups–such as the unemployed, rural populations, and those with low education– require targeted interventions. Continued EU-aligned reforms, labor market inclusion, and social protection will be critical to sustaining poverty reduction and advancing convergence with EU living standards (Box 1.5).

TABLE 1.2: Five Key Areas to Increase per capita GDP Growth

Specific Driver**	Summarized Reform Detail from EU Growth Plan target by 2027	EU Growth Plan Area	Per Capita Growth impact (pp) *
Digital infrastructure (TFP, WBG Jobs Pillar 1)	Implement Digital eWallet for public services, update the framework for cyber resilience (NIS2 Directive), secure digital infrastructure including 5G roll-out, improve user friendly digital public services, deploy e-signature and digital identity wallet, and implement Intelligent Transport System and e-freight.	Digitalization	0.63
Regulatory quality (TFP, Human Capital, Private investment; , WBG Jobs Pillar 2)	Align energy sectors with the EU electricity integration package, implement the Renewable Energy Directive, adjust energy tariffs, work on carbon pricing (Emissions Trading System), adopt energy efficiency and building renovation strategies, update Vocational Education and Training (VET) curriculums, and improve the investment attractiveness framework.	Energy, Human Capital, Private Sector	1.13
Government effectiveness (TFP, Human Capital, Efficiency of public investment; WBG Jobs Pillar 1 and 2)	Reform public administration and public investment management, strengthen public procurement and internal financial control, ensure transparent remuneration systems, improve the governance of SoEs, address the informal economy, foster small and medium enterprise (SME) development, and expand e-customs services.	Public Administration Reform, Private Sector, Energy, Human Capital	0.95
Financial development (Private investment; WBG Jobs Pillar 3)	Enhance access to finance, improve payment system integration, and support the development of a knowledge-based economy through research and innovation ecosystems.	Private Sector	0.03
Female labor participation (LFP, Human Capital; WBG Jobs Pillar 1)	Reinforce the education system to address skills mismatches and facilitate school-to-work transitions through vocational and adult education.	Human Capital	0.35
Total estimated annual GDP growth from all reforms			**3.09**

Note: *Growth impact is per capita GDP growth associated with closing 70 percent of reform gap with the EU is respective specific driver within 20 years estimated using the World Bank Growth Ambition and Structural Reforms Tool, averaged for all WB6 countries except Kosovo for which data was unavailable to run the simulation. Reform details from the growth plan were mapped to the relevant variables used in the simulation. However, BiH does not have

**Refers to the variables modelled. Drivers in Brackets link to the macro drivers discussed in Box 1.5 e.g TFP as well as the World Bank Group 3-pillar jobs strategy.

Balancing risks and sustaining reform momentum

Key risks include unfavorable domestic political developments and global trade uncertainty, while upside risks revolve around accelerated EU RGF implementation and an uptick in external demand. An EU-US Trade Framework agreement was published in August 2025, but uncertainty continues to weigh on investor confidence–signaling steady but sluggish improvement. On the domestic side, implementation of EU RGF reform activities has already been facing delays in some of the WB6 countries as of 2025 (such as Bosnia and Herzegovina, Kosovo, and Serbia) stemming from electoral uncertainty and political tensions. These events may further delay key structural reforms, in turn affecting medium-term potential growth. Persistent vulnerabilities tied to PPPs and SOEs add another layer of complexity to the region's fiscal outlook. Although the outlook already embeds some Euro area resilience indicated by early S&P Purchasing Managers' Index readings for H1 2025, an upside risk remains that businesses (services and manufacturing) adapt to trade uncertainty more rapidly and effectively than assumed, and the European Central Bank maintains its pause of further rate cuts. Together, these factors could support demand for WB6 exports and remittance and FDI inflows to the region. On domestic upside risks, four of the six Western Balkans countries received the EU RGF pre-payments by H1 2025, and acceleration of reform activities in 2026 and 2027 has the potential to help WB6 overcome structural barriers to growth.

Chapter 2. Spotlight: Jobs Challenge in the Western Balkans

Chapter 2. Spotlight: Jobs Challenge in the Western Balkans[9]

The Western Balkans have undergone economic change over the past decade, with increasing trade, robust FDI,[10] and sectoral shifts. This has helped create over one million new jobs and cut absolute poverty rates by almost two-thirds, however, while some higher value-added sectors have expanded employment, it is low and mid-productivity firms that still employ most of the workers in not necessarily "high quality" jobs. Further, while income convergence is happening, it remains incomplete—productivity remains weak, and labor shortages and demographic pressures add to the urgency to sustain growth.

Workers are increasingly more educated–nearly 30 percent of young workers now hold tertiary degree– but foundational learning remains weak and Programme for International Student Assessment (PISA) scores trail EU averages. This limits productivity gains, which have lagged even as wages have risen. Still, employers are mostly offering lower skilled jobs with lower wages that are not attractive to workers which motivates outmigration. Finally, despite the minimum wage policy reducing the share of low-paid jobs, most employment in the region remains concentrated below the average wage.

The Western Balkans, therefore, faces a labor market paradox: labor shortages coexist with persistently high unemployment–above 10 percent in 2024-and relatively low labor force participation, below 55 percent, especially for women, youth and elderly. Demographics are also tightening: the working-age population has already shrunk markedly and is projected to fall by nearly one-fifth by 2050. Over the next five years, given current population, growth, and labor market trends, the region will be 'missing' over 190,000 workers—around 2.5 percent of its current labor force— unless it increases activation or emigration slows. Moreover, the green transition and Artificial Intelligence (AI) intensify pressures, with about 20 percent of workers at risk or needing substantial reskilling.

As the region transitions toward a more modern economy, job quality, wage alignment, and task content need to catch up with business environment for more productive firms. Addressing skills mismatches requires both: better preparation of workers and stronger demand for their skills. In the Western Balkans, the weight of the challenge lies more on the demand side: not creating more jobs, but creating better jobs —ones that can fully utilize and reward a growing pool of educated workers. To sustain convergence and create better jobs, governments need to act in a coordinated and decisive way and focus on:

➤ *Creating the foundational infrastructure for jobs (building future-ready skills, raising participation, extending working lives, using migration strategically, supporting youth transition and activation, improving job quality and inclusion);*

➤ *Strengthening governance and creating a predictable regulatory environment (building firm capabilities and supporting technology adoption, fostering competition, reforming SoEs, regulatory reforms, supporting innovative and high performing start-ups, building innovative ecosystem); and*

➤ *Mobilizing private capital for the private sector to expand and create more and better jobs (promoting digital and green upgrading of firms, connecting to the global markets, attracting private sector finance for transformation).*

---

9. The Spotlight has been written by the following team members: Stefanie Brodmann, Arlan Brucal, Andreas Eberhard, Angella Faith Montfaucon, Sandra Leitner, Julius Lemcke, Sanja Madzarevic Sujster (task leader), Marjan Petreski, Tigran Shmis, Viktor Stojkoski, and Cornelius von Lenthe.

10. See Figure A2.1 (Appendix 2) for details on country-specific FDI trends.

The Western Balkans are navigating a profound transformation of their labor markets–driven by demographic shifts, structural change, and the imperatives of post-pandemic recovery. This spotlight highlights the complex jobs challenge facing the region: how to generate more and better jobs amid digitalization, aging, and the green transition. The analysis draws on firm-level[11] and labor force data to examine employment and wage trends, sectoral dynamics, and the evolving demand for skills in economies increasingly shaped by digitalization and the green transition. The analysis also examines the demand for jobs across different types of firms. The next Spotlight will do a deep dive on sectoral jobs and productivity analysis, as well as the factors influencing firms' capacity to create better jobs. It will also provide an impact assessment on productivity and jobs of the proposed policy recommendations.

Structural transformation is underway in the Western Balkans

Employment patterns are gradually shifting away from primary sectors toward services (Figure 2.1). Between 2011 and 2022, formal jobs have declined in agriculture and mining, but expanded in ICT, accommodation and food services, and business services (such as professional services and retail trade). This trend is particularly pronounced in North Macedonia and Serbia (Figure A2.2 in Appendix 2).[12] Within manufacturing, the share of high-tech and niche subsectors (motor vehicles, electrical equipment, and the repair and installation of machinery) have expanded though from the low level, while labor-intensive and heavy industries (apparel, leather, basic metals) have contracted (Figure 2.2). Although skilled market services (ICT) and business services have gained significant employment shares, they still account for only a small minority of jobs.

Between 2011 and 2022, sectoral employment trajectories across the Western Balkans diverged significantly. Agriculture declined in all countries (most sharply in Serbia)–except in Kosovo where rural development efforts likely helped sustain formal agricultural jobs. Services expanded rapidly although with different drivers: accommodation and food services led growth in Kosovo, Montenegro, and Serbia (Figure A2.2 in Appendix 2), while ICT employment rose strongly across all economies. Manufacturing and construction showed more mixed patterns: North Macedonia, Serbia, and Bosnia and Herzegovina gained jobs in higher-value subsectors but lost them in labor-intensive industries, while Kosovo and Montenegro recorded broader gains across both manufacturing and construction.

Structural transformation is underway in the Western Balkans, however, the trajectory differs across countries. Between 2011 and 2022, firms in the bottom two quintiles experienced a decline in employment shares while the upper three productivity quintiles have expanded, especially those in quintiles three and four, however, the distribution is uneven across countries (Figure A2.3 in Appendix 2). In Kosovo and Montenegro, employment expanded across all productivity quintiles even as aggregate productivity declined–reflecting labor absorption into low-productivity activities. North Macedonia shows the sharpest divergence across labor productivity quintiles, followed by Serbia, with strong gains in the upper productivity quintiles.

---

11. Firm-level data used in the report cover employment in registered enterprises and capture dynamics in the formal sector, but do not include informal agricultural employment, self-employment, or the full range of microenterprises, which remain important sources of jobs in the Western Balkans.

12. In the informal sector, the shift from agriculture to services is strong in North Macedonia and Kosovo (Policy Note 1).

FIGURE 2.1: Employment growth was broad-based, except for agriculture and mining
(Employment growth by sector, WB4 countries, 2011-22, 2011=100)

FIGURE 2.2: High-tech and services employment expanded
(Employment size and change by sectors, 2011-22)

Source: World Bank staff calculations based on firm-level data from statistical agencies; WB4 countries exclude ALB and BIH: data for BIH are based on ORBIS while data on ALB are not available.
Note: Total employment is calculated by taking the sum of firm-level employment per sector per year. For country-specific trends including BIH, please refer to Appendix 2 (Figure A2.4). In Figure 2.2, the blue dashed line denotes linear fit, while the red dash line denotes no change in employment shares. Labels are 2-digit NACE Rev 2 code.

Convergence progress notwithstanding, potential growth is slowing

Structural transformation supported strong growth across the Western Balkans. The peak growth performance was recorded during 2000-2009 driven by capital deepening and rising TFP from technology adoption, innovation, and labor productivity gains (Figure 2.3). The following decade saw growth sustained by increases in labor quantity (more people entering the labor market) and quality–higher skills and education. While capital continued to contribute strongly, TFP turned negative across countries, pulling average real growth below 3 percent. During the pandemic and post-pandemic period, real growth proved relatively resilient and, although capital still carried out the growth momentum, there was a nascent recovery of TFP–except in North Macedonia that was unable to unlock TFP gains.

The robust post-pandemic recovery has created a positive and widening growth differential with the EU, supporting convergence. Much of this growth has been driven by increased labor utilization, with strong employment gains narrowing the gap in employment-to-population ratios compared to the EU. Nevertheless, because growth has relied heavily on adding more workers rather than boosting output per worker, labor productivity has lagged. As employment levels converge with those of the EU, sustained catch-up growth will require productivity to play a greater role. Achieving this requires a shift toward more sophisticated, knowledge- and technology-intensive forms of production.

Transitioning to a knowledge economy is central to raising productivity and wages. Western Balkan countries that recorded the largest increases in the share of high-skilled jobs over the last decade also achieved the fastest labor productivity growth (Figure 2.4). Where wage data are available, higher productivity translated into meaningful wage growth, with annual average hourly wage increases of 4.9 percent in Bosnia and Herzegovina and 2.8 percent in North Macedonia. By contrast, Kosovo—where productivity declined—experienced real wage losses of 0.7 percent. Importantly, when wages did rise, gains extended across the skill spectrum—not only to high-skill jobs, which may suggest tight labor market conditions at the bottom end (labor shortage in low-skill occupations or minimum wage hikes) or structural shift in the demand towards low-skills workers (Figure 2.5).

FIGURE 2.3: Capital deepening is still fueling growth, with some nascent recovery of TFP
(Growth accounting, contributions to growth, percent)

Source: The Conference Board (2025). Kosovo and Montenegro data are not available.

FIGURE 2.4: Large increases in skilled employment are associated with higher growth in labor productivity
(Percentage point in high-skill employment and labor productivity growth, 2014-24)

Source: World Bank staff calculations based on national accounts data from statistical agencies and ILOSTAT.

FIGURE 2.5: Wages grew in most countries

(Average annual wage growth, various periods)

Source: World Bank staff calculations based on national Labor Force Surveys. Note: Growth rates are calculated for 2012–2023 (BIH and MKD), 2013–2019 (SRB), and 2012–2022 (KOS). Skill employment follows ILO classifications: ISCO 1–3 (high, tertiary education), 4–8 (medium, secondary), and 9 (low, primary).

Yet the transition to a more skill-intensive economy is progressing too slowly. An increasing share of post-secondary educated workers are employed in jobs requiring only secondary education or less. These vertical mismatches are rising across the region but have been particularly steep in Kosovo, where high-skill job creation has been weakest (Figure

2.6). For post-secondary graduates working in jobs below their qualification level, the earnings' penalty is substantial: between 15 and 30 percent relative to peers whose education matches their occupation (Figure 2.7). This leads to both a drag on individual earnings potential and an underutilization of human capital that could otherwise drive faster convergence.

FIGURE 2.6: The prevalence of post-secondary employees in lower skilled jobs has been on the rise

(Distribution of employees with post-secondary education by skill level of job)

low-skill jobs ● medium-skill jobs ● high-skill jobs

Source: World Bank staff calculations based on national Labor Force Surveys.
Note: High-, medium-, and low-skill employment follow ILO classifications: ISCO 1–3 (high, typically tertiary education), 4–8 (medium, secondary), and 9 (low, primary).

FIGURE 2.7: Post-secondary graduates working in jobs below their qualification level earn significantly less

(Estimated earnings penalty for post-secondary educated workers employed in medium- or low-skill jobs, relative to those in high-skill jobs)

Source: World Bank staff calculations based on national Labor Force Surveys.
Note: Estimates are based on a Mincerian wage regression of log hourly wages on the skill level of post-secondary workers' jobs, controlling for age, gender, and year fixed effects.

Despite progress, most Western Balkan economies remain below one-half of the average income level of the EU,[13] and potential growth is slowing (Figure 2.8). Countries have advanced to middle-income status, but convergence with EU living standards remains a more distant goal. Post-pandemic potential growth has slowed, and if current trends persist, the region faces further deceleration in the years ahead. Baseline projections using the LTGM-PC model suggest that regional GDP growth will average 2.4 percent between 2026 and 2050, declining to 1.5 percent by mid-century (Figure

2.9). Per capita growth is projected to average 3.1 percent over this period, reflecting slower population growth relative to GDP growth, but will also decelerate to 2.4 percent by 2050. Even then, the region would only reach 51 percent of current EU per capita income levels, with significant cross-country variations. These trends are consistent with broader evidence that middle-income countries are more vulnerable to growth slowdowns and risk becoming 'trapped' unless they shift from investment-led to technology and innovation-driven growth.

---

13.   In 2024, only Montenegro just surpassed half of the GDP per capita (in PPP, constant 2021 USD) of the European Union.

FIGURE 2.8: Convergence process needs to accelerate…
(GDP per capita in 2024, PPP, constant 2021 international $)

FIGURE 2.9: …. but potential growth is slowing
(Baseline GDP growth, 2025-50)

Source: World Development Indicators (LHS) and World Bank staff LGTM-PC simulations (RHS).

There is a need for an ambitious reform agenda which sustains long-term growth, accelerates convergence, and creates better jobs. For the Western Balkans, declining demographics–driven by low fertility, aging, and emigration–are already reducing labor supply and weakening domestic demand, a trend that will intensify toward mid-century. Productivity growth has stalled due to weak innovation, limited digital uptake, and low firm dynamism. Human capital gains remain constrained by skills mismatches, persistent gaps in education outcomes, and rising health costs, with PISA 2022 scores more than 80 points below the OECD average. Although investment has continued, rising capital-to-output ratios point to diminishing returns, underscoring inefficiencies in public investment[14] and the urgency of complementary reforms.

Demographic challenges loom large

The Western Balkans are projected to lose nearly one-fifth of their working-age population by 2050, as declining fertility and rising life expectancy reduce labor supply. The region has already lost about 14 percent of its working age population since 2000, which would translate into about 10 percent of employment (Figure 2.10). The demographic shift is particularly acute for younger cohorts– with projected population losses for youth up to 44 percent in Albania by 2030–leaving future labor supply increasingly scarce (Figure 2.11). The demographic pyramid has inverted with this trend compounded by persistently high emigration which continues to drain the region's workforce.

At the same time, labor markets face a paradox: unemployment remains high, especially among women and youth. Individuals with low levels of education exhibit high reservation wage gaps and have been less prone to migrate in the past decade.[15] Nevertheless, labor shortages are already emerging in certain sectors and are expected to intensify economy-wide under BAU scenarios by 2030. While unemployment rates have declined sharply over the last decade– with the number of unemployed cut by one-half to about 730,000 people in the region– unemployment rates for vulnerable groups remain stubbornly high and almost double

---

14. IMF Public Investment Management Assessments outline wide reform agendas for the Western Balkans to improve the efficiency, across the planning, allocation, and implementation phases of public investment—and from the perspectives of both design and effectiveness in practice.
15. World Bank (2024a).

FIGURE 2.10: The region has already lost about 14 percent of its working age population since 2000
(Employment and working age population, percentage change, 2000-23)

FIGURE 2.11: The demographic shift is particularly acute for younger cohorts
(Population age cohorts, percentage change, 2010-30)

	0 to 4	7 to 12	13 to 18
Kosovo	-37%	-49%	-34%
North Macedonia	-19%	-25%	-25%
Montenegro	-18%	-14%	-15%
Serbia	-12%	-10%	-18%
Albania	-22%	-37%	-44%
Bosnia and Herzegovina	-31%	-36%	-39%

Source: World Development Indicators and United Nations.
Note: Estimates based on United Nations population data and WDI employment rate (ILO modeled estimates).

that of EU peers (Figure 2.12). As discussed earlier, wage increases in low-skill jobs reflect scarcity among those *already employed*, but high unemployment shows that *many potential workers* remain locked out. This creates a dual picture: higher wages for incumbents, persistent joblessness for outsiders. This calls for labor market and education policy interventions to activate and upgrade skills of the long-term unemployed.

Labor shortages under the baseline scenario[16] are projected to emerge in most countries by 2030—especially among those with low and medium education levels (Figure 2.13). Shortages of the highly educated are generally not expected before 2050, except in Kosovo. In Bosnia and Herzegovina shortages might be delayed until about 2038 due to stagnating labor demand. Kosovo's labor demand remains strong with a stable working-age population until the mid-2030s–contributing to early shortages. The activation scenario that assumes an increase in participation rates to 78 percent by 2040, aligned

with European employment targets under the European Pillar of Social Rights Action Plan, raises labor supply variably across countries: in Albania, Montenegro, and Serbia, where activity rates are already high, the impact is moderate, and shortages still arise by the late 2020s. In contrast, countries with lower activity rates– North Macedonia, Bosnia and Herzegovina, and Kosovo–experience significant labor supply increases, delaying shortages to the mid-2030s. Conversely, under the high growth scenario (by 1 pp higher than in the baseline), labor demand is projected to increase across the region–leading to the emergence of labor shortages even earlier in industries where employment is already high. These industries include forestry and fishing in Albania; manufacturing and wholesale and retail trade and repair of motor vehicles in Bosnia and Herzegovina and North Macedonia; wholesale and retail trade and repair of motor vehicles in Montenegro and Kosovo; and manufacturing, wholesale and retail trade, repair of motor vehicles, agriculture, forestry, and fishing in Serbia.

---

16. The baseline scenario extrapolates supply and demand of past trends using data from 2019-23, including the COVID-19 pandemic impact. Labor supply is modeled as the product of the working-age population and activity rates while labor demand is derived from the difference between GDP growth and labor productivity growth. Education-specific productivity weights and employment shares are incorporated to reflect skill mismatches–especially among the medium-educated. Demographic factors such as net migration and aging influence labor supply by reducing the working-age population. Notably, Bosnia and Herzegovina, Kosovo, and Albania experience pronounced negative net migration rates, while old-age dependency ratios have increased significantly–especially in Bosnia and Herzegovina, North Macedonia, and Serbia. For projection of demographic trends, the UN median projection scenario of population for 2024-2050 has been used (https://population.un.org/wpp/downloads?folder=Standard%20Projections&group=Population).

FIGURE 2.12: Unemployment rates for vulnerable groups remain stubbornly high, while....
(Unemployment rates, 2024, percent)

Source: World Bank staff calculations based on Labor Force Survey (LFS).
Note: The low education rate is for 2023.

FIGURE 2.13: ...labor shortages will become acute from 2030 without reforms
(Participation and employment rates in the Western Balkans, 2010-50, percent)

Source: World Bank staff calculations based on United Nations and LFS.
Note: Rates refer to 15-64 age groups. The employment rate represents labor demand, while the participation rate represents labor supply.

The Western Balkans will need to work more and longer

Labor force participation has improved in recent years but remains low. In fact, growth of jobs per capita since 2010 was largely led by employment and labor force participation increases, while working age population declined, except for Kosovo (Figure 2.14). The regional participation rate rose from just under 52 percent in 2019 to 54.7 percent in 2024, still well below the EU level of over 75 percent for 2024 (Figure 2.15).

FIGURE 2.14: Increases in the participation and employment rates explain the pace of job creation
(Average contributions, percentage points, 2010-2024 average)

FIGURE 2.15: Despite progress, labor force participation remains low
(Labor participation rates, 15+, 2019 and 2024)

Source: World Bank staff calculations based on International Labor Organization and LFS.

Amid striking gender disparities, raising labor force participation among women will be critical to sustaining growth and supporting convergence. Despite increases in participation rates, women continue to be far less likely to be active in the labor market than men. In Montenegro—the best performer—female labor force participation increased from 48 percent in 2015 to 57 percent in 2024 (or 57 and 66.4 percent, respectively for 15-64 years old), while the male rate rose from 60 to 69 percent over the same period (Figure 2.16). Kosovo and Bosnia and Herzegovina continue to struggle with attracting people to the labor market. As populations age, increasing participation among women and young people is essential to maximize the utilization of the human capital of a declining working-age population. Raising the participation rate to the EU level would add over 2.8 million workers to the Western Balkans labor market.

Women, youth, and the elderly exhibit substantially lower labor market engagement. Albania is the only country that has labor participation rate above the EU's for both gender, except for youth. Compared to 2019, male participation rates across most age groups are now closer to the EU averages, except for

FIGURE 2.16: ....on average 19 pp lower for women.
(Gender participation gap, 15+, percent, 2015-24)

Source: World Bank staff calculations based on LFS.

ages 55-64 and for Bosnia and Herzegovina and Kosovo (Figure 2.17). Both countries need to bring more men to the labor market in their prime working age. Nevertheless, even Montenegro and Serbia that are closer to the EU average of 75.5 percent participation rate for those 55–64 years of age, are 2-3 pp below suggesting that men retire earlier in the Western Balkans. Female participation rates are consistently below the EU averages across all age groups, with the largest gap being for youth and 55+ (Figure 2.18).

FIGURE 2.17: Male participation is now closer to EU average, except in Kosovo and Bosnia and Herzegovina…

(Male labor participation rates, by age groups)

FIGURE 2.18: …while female participation across all age groups is consistently below the EU average

(Female labor participation rates, by age groups)

Source: World Bank staff calculations based on LFS and Eurostat. Albania micro-level LFS was not available.
Note: Kosovo data are for 2022, and Montenegro for 2023.

The Western Balkans labor market continues to underutilize the skills of women– particularly those with a higher education. While women outperform men in educational attainment, especially at the tertiary level, they remain significantly less likely to participate in the labor market. Services–particularly in health, education, and public administration– remain the stronghold of female employment but women are often concentrated in precarious or informal conditions within market non-skilled services such as trade and hospitality (Figure 2.19). Among young adults, women are 15 pp more likely than men to not be in employment, education or training by the age of 24. Furthermore, 37 percent of inactive women 29-65 report care and family responsibilities as the primary barrier to employment (Figure 2.20). This persistence of gender segregation across sectors underscores enduring barriers: women remain underrepresented in much of industry and in skill-services, while dominating non-market and low-wage service sectors. This layered segmentation—by age, education, and gender—reveals both progress and deep-rooted structural rigidities.

FIGURE 2.19: Women are increasingly employed in service sectors
(Share of employed women in sectors, percent)

Source: World Bank staff calculations based on LFS, excluding Albania.

FIGURE 2.20: Care and family responsibilities keep women out of the labor market
(Percent of total inactive by reasons for inactivity among women and age)

Source: World Bank staff calculations based on LFS, excluding Albania.

Barriers to greater female participation include care responsibilities and lack of flexible work arrangements. Many women, especially those with young children and/or living in rural areas, face care responsibilities without sufficient childcare options. Formal jobs that offer flexibility are rare, and part-time employment is financially unattractive due to high fixed contributions. The gender wage gap further erodes incentives to work.

Retirement ages will need to increase further to safeguard pension sustainability and address tightening labor supply. This is particularly relevant for North Macedonia, where women's retirement age remains well below EU levels and men's retirement age also lags the EU average. In all other countries, the statutory retirement age for men is aligned with the EU average, but women's retirement age will only reach the 2022 EU average by 2050 (Figure 2.21). Between 2010 and 2023, the old-age dependency ratio–the population aged 65 or over to the population aged 15-64–increased in all the Western Balkan countries, especially in Bosnia and Herzegovina (by 11 pp) as well as in North Macedonia and Serbia (by about 10 pp each), while it remained relatively low in Kosovo (Figure 2.22). Aging exacerbates labor shortages not only through exits from the labor

market but also through an increased demand for labor-intensive care services. Addressing these issues will require policies that both encourage longer working lives, age-inclusive hiring practices and a provision of care services– thereby also generating jobs for a harder-to-employ population.

Migration has significantly influenced the Western Balkans, with high emigration rates and recently growing immigration to address labor shortages. Net migration—the difference between immigration and emigration— is particularly pronounced in Bosnia and Herzegovina, Kosovo, and Albania, where the average net migration rates amounted to -12, -7 -4.5 per 1,000 inhabitants, respectively, between 2010 and 2019. Western Balkans emigrants are mostly working-age individuals, with youth showing higher migration intentions, and gender distribution nearly equal. Employment is the main driver of emigration, but about 49 percent of male and 40 percent of female tertiary-educated emigrants are overqualified for jobs given abroad.[17] Emigration has helped reduce unemployment from over 20 percent in the 2000s to close to 10 percent in 2024, increased labor force participation, and raised wages, although it also causes skill shortages.

FIGURE 2.21: Workers in the Western Balkans will need to work longer to offset shortages
(Statutory retirement ages, 2022 and 2050)

Source: EU Aging Report and country data.

FIGURE 2.22: Aging also increases demand for care services
(Old-age dependency ratio as individuals aged 65+ per 100 people of working age 20-64 years, 2010-23)

Source: UNDESA (2024).

---

17. World Bank (2024a).

Many firms report difficulty filling vacancies due to workforce emigration, especially in ICT, engineering, manufacturing, and construction, which limits productivity and growth. Some labor shortages are being partially addressed by increasing numbers of foreign-born residents—over 1.1 million in 2020, with recent inflows from countries such as China, Türkiye, Russia, and India—but this is not sufficient in critical sectors.). To better harness the benefits of migration and mitigate its costs, Western Balkan countries could strengthen a suite of migration-services: (i) for emigrants, pre-departure information and training, consular support, social security portability arrangements to protect emigrants and facilitate return, and bilateral labor agreements ensuring rights, fair treatment, and mutual recognition of credentials; (ii) for returnees, reintegration and job-matching support, recognition of experience, and targeted incentives to encourage highly skilled to return; (iii) for diaspora engagement, online platforms, knowledge-sharing events, and investment incentives to deepen collaboration and maximize developmental impact. At the same time, greater participation of women and youth, increases in the retirement age, and targeted immigration policies will be critical to address shortages. But these steps alone will not suffice without broader labor market reforms.

Western Balkan people will need to work smarter with significant improvements in workforce skills

Educational attainment continues to rise in the Western Balkans, particularly among younger generations. Among workers aged 25–34, nearly 30 percent now hold tertiary degrees, and 26 percent of those starting new jobs after 2020 are tertiary graduates. Many of these younger workers are employed in the growing services sector, especially ICT and professional services, where demand for skilled labor with the equivalent of a bachelor's degree is growing in private sector firms (Figure 2.23). These urban-based jobs attract youth and help drive structural transformation. In contrast, older workers with tertiary education are more often concentrated in non-market services such as health, education, and public administration. Sectors such as agriculture, manufacturing, construction and low-skilled services continue to absorb workers with lower levels of education. Agriculture, however, is losing prominence and now has the oldest workforce in the region (average age 50+), reflecting its status as both a legacy sector and an employer of last resort for the least educated (Figure 2.24).

FIGURE 2.23: Educational attainment has increased...
(Educational degrees per sectors)

Source: World Bank staff calculations based on LFS. Albania micro-level LFS data was not available.

FIGURE 2.24: …but age segregation across sectors deepened
(Average age of employed in sectors)

Source: World Bank staff calculations based on LFS. Albania micro-level LFS data was not available.

Despite rising educational attainment, foundational skills remain weak. Results from the 2022 PISA[18] reveal significant learning losses, similar to worldwide trends, since 2018, most sharply in Albania, equivalent to about 2.5 years of schooling. However, in the region, Kosovo still has the most significant learning loss equivalent to 4.6 years (Figure 2.25). Serbia was among few countries to maintain its performance, but even their students remain roughly 16 months behind EU peers. In Bosnia and Herzegovina, results from TIMSS 2023 also point to low achievement levels, about two years behind the EU average and with little change since 2019. Perhaps most concerning, almost no students in the Western Balkans reach high levels of proficiency (levels 5 and 6 in the PISA framework), compared to about 8 percent in the OECD. Learning losses are not consistently larger for girls but vary across proficiency levels. In Montenegro, like in the OECD, learning losses were concentrated among the lowest-performing students; in Serbia, top-performing boys improved further, while in Kosovo and North Macedonia, trends resembled those of

other emerging economies. Overall, the evidence highlights the region's urgent challenge of improving foundational learning and ensuring students acquire the skills needed for higher productivity growth.

Teaching practices create inequities in learning outcomes. In the Western Balkans, teacher-student relationships and effective instruction in mathematics are critical drivers of student success, however, PISA data show that students in more affluent schools benefit from better teaching practices (Figure 2.26). Closing this gap could yield meaningful gains: improving teaching quality in disadvantaged schools could raise average mathematics scores by 5 to 12 points. In Kosovo, differences in teaching practices account for about 14 points of the performance gap, even after controlling for social and structural factors. In Albania, weak teaching practices in fostering mathematical reasoning cost students about 8 points. These inequities contribute to the region's broader challenge: very few students reach advanced proficiency levels.

---

18. Western Balkan countries participate actively in international assessments such as PISA, PIRLS, and TIMSS, with Bosnia and Herzegovina participating in TIMSS but not PISA 2022.

FIGURE 2.25: Learning losses widened compared to EU peers
(PISA 2018 and 2022 scores in mathematics, WB6 and EU average)

Source: PISA 2022.
Note: According to OECD PISA, 25 points are equivalent to one year of learning. Bosnia and Herzegovina stopped participating in PISA.

FIGURE 2.26: Teaching quality upgrade can reduce learning losses of 0.3-0.6 years of schooling
(Teaching practices by quintiles of average socioeconomic factors at the school level expressed in equivalent math PISA points)

Source: PIRLS 2021 and TIMSS 2023.

Students in the Western Balkans spend less time in school and miss more classes than their EU peers–contributing to weaker learning outcomes. Primary school days in the Western Balkans are shorter than in the EU, leaving students with 14 to 28 percent less instructional time each year (PIRLS 2021). This translates into learning losses of 0.6 to 0.8 years of schooling, with girls often more affected than boys, and losses larger than in EU countries. Instructional hours in Serbia and Montenegro are 24–28 percent below the EU average for PIRLS, and in Albania and Montenegro, the gap for TIMSS was 17 percent (Figure 2.27). Secondary school students also receive less classroom instruction, with Kosovo and Montenegro offering 1.5 hours per week less than the PISA average. These gaps are compounded by frequent absenteeism: in Kosovo and Montenegro, class skipping alone explains a 6-to-11-point gap in mathematics scores.

Preschool lays the foundation for learning, but enrollment, despite progress, remains low. Early childhood education is strongly associated with better reading skills, but preschool attendance in the Western Balkans significantly lags EU levels. Between 21 percent (Montenegro) and 75 percent (Bosnia and Herzegovina) of children in the region do not attend preschool, compared to just 5 percent in the EU (Figure 2.28). More concerning, in Albania, Kosovo, and North Macedonia, students who did attend preschool score lower on PISA at age 15 than those who did not. This flip is happening between primary and secondary levels (while in primary, the impact of preschool is still positive)–suggesting the need to improve practices in schools harnessing gains that students accumulate in earlier levels of education.

FIGURE 2.27: Increasing instructional hours can reduce learning losses of 0.6-0.8 years of schooling
(Hours of instruction per year per typical school day)

	Hours per year (PIRLS)	Gap with EU average in % (PIRLS)	Hours per year (PIRLS)	Gap with EU average in % (PIRLS)
Albania	742	-15%	732.9	-17%
North Macedonia	758	-13.5%	852.1	-3%
Montenegro	634	-27.7%	732.5	-17%
Serbia	667	-24.0%	833.1	-6%
Kosovo	754	-14.0%	853.8	-3%
Bosnia and Hersegovina	-	-	843.5	-4%
EU	887	0.0		

Source: PIRLS 2021 and TIMSS 2023.

FIGURE 2.28: Preschool enrollment despite progress is still behind the EU average
(Preschool enrollment rates, percent of children 3-5 years of age in preschool)

Source: WDI and Eurostat. Data for Kosovo was not available.

Smartphone use is undermining learning and wellbeing among youth. Among 15-year-olds in the Western Balkans, smartphone use is nearly universal, with Albania showing particularly high levels of overuse. Excessive use correlates with a loss of nearly one year of learning in mathematics scores, and the negative effect on reading scores is about 20 percent greater. Harmful uses, such as creating and sharing digital content, further depress performance in both subjects. Beyond academic outcomes, overuse is linked to rising anxiety, depression, and addiction among teens–with international evidence pointing to gender-specific mental health risks. Banning smartphones in schools has shown limited effectiveness in reducing use or improving scores–indicating the need for nuanced policies and further research to promote healthy digital habits.

Improving education quality is essential to counter demographic decline and sustain living standards. Higher PISA scores translate into higher lifetime earnings in the Western Balkans. An increase of 20-25 PISA points is roughly equivalent to adding another year of schooling. World Bank analysis[19] shows that one additional year of schooling could increase lifetime earnings by 11.5 percent in Serbia, 4.5 percent in Albania, and 4.2 percent in Kosovo. These findings underscore that investing in learning outcomes is not only an economic imperative for long-term growth and convergence, but also a social priority.

Wages are rising, but education and skills yield limited and uneven returns. Returns to secondary education, that is a wage difference that relates to schooling, in the Western Balkans are positive but modest. Controlling for factors such as age, gender, occupation, and industry, each additional year of schooling up to secondary level raises wages by 0.8 percent on average in the four countries with recent data. The highest returns to secondary education are in Kosovo (1 percent) and lowest in Bosnia and Herzegovina (0.4 percent). In contrast, returns to tertiary education are substantially higher, averaging 4.2 percent per additional year of study, but vary widely across countries (Figure 2.29). They are strongest in Serbia (5.3 percent), Kosovo (4.7 percent), and Bosnia and Herzegovina (4.4 percent), but relatively weak in North Macedonia (2.3 percent). Returns also differ by gender:

---

19. Montenegro and Patrinos (2014).

men benefit more at both secondary and tertiary levels—reflecting the region's large gender wage gap. On average, women earn 12.7 percent less than men with similar levels of education, and in similar occupations and industries, with the gap ranging from 14.5 percent in Bosnia and Herzegovina to 7.9 percent in Kosovo (Figure 2.30).

Skills are rising, but labor demand remains concentrated in low-skilled, manual, routine jobs. Despite higher levels of educational attainment, much of the labor demand in the Western Balkans is still for low-skilled, manual, and routine work (Figure 2.31 and Figure 2.32). More highly educated young people are entering the labor market, but they often end up in occupations dominated by routine and non-analytical tasks. In North Macedonia, for

example, 45 percent of new jobs expected to be created will require only low levels of education, while just 11 percent will require a tertiary education[20]; in the Federation of Bosnia and Herzegovina, only 8 percent of new jobs are projected to require a degree.[21] Among those already employed, tertiary graduates are not fully using their skills: in North Macedonia and Kosovo, 22 percent of their tasks are routine, compared to 18 percent in Serbia and 17 percent in Bosnia and Herzegovina. On average, only 39 percent of the tasks performed by tertiary-educated workers involve non-routine, analytical skills. This misalignment heightens the risk of skills underutilization and depreciation, with long-term costs for growth and the career prospects of the region's youth.

FIGURE 2.29: Returns to tertiary education average 4.2 percent per additional year of study

(Returns to education, by countries)

FIGURE 2.30: On average, women earn 12.7 percent less than men with similar levels of education

(Returns to education, by age and gender)

Source: World Bank staff calculations based on LFS.
Note: Regressions control for age and age-squared, gender, sectors and occupations. Coefficients for education levels are annualized. Montenegro LFS does not provide wage data, while Albania micro-level data are not available.

---

20. World Bank (2025). Growth and Jobs Report for North Macedonia, forthcoming.

21. Federal Employment Institute. 2025. Labour Market Monitoring Report Federation of Bosnia and Herzegovina 2024

FIGURE 2.31: Much of the labor demand in the Western Balkans is still for low-skilled, manual, and routine work

(Types of tasks required of the employed population, by age groups)

Source: World Bank staff calculations based on LFS. Graphs depicted the estimated task contents of occupations in the respective countries based on measures constructed in Mihaylov and Tijdens (2019).

FIGURE 2.32: Only 39 percent of the tasks performed by tertiary-educated involve non-routine, analytical skills

(Types of tasks required by the employed population, by education level)

Source: World Bank staff calculations based on LFS. Graphs depicted the estimated task contents of occupations in the respective countries based on measures constructed in Mihaylov and Tijdens (2019).

BOX 2.1: Online job vacancy portals provide an additional data source to monitor labor demand

Employers' job postings on private or public job portals provide readily available and nearly real-time information on employer demand, in particular for those with higher levels of education. The rapid advances in large language models and decreasing cost of applying such methods are creating an easily accessible rich data source to triangulate existing information on labor demand. Lightcast, a labor market analytics company, started scraping online job postings for multiple Western Balkans countries between late 2020 and early 2021. While online job posting data is useful in triangulating other existing data sources on labor markets, this data is largely informative for higher-skilled, formal and urban jobs. For example, approximately 70 percent of online job postings in the Western Balkans pertain to occupations requiring tertiary education.

Among online job postings, professionals are increasingly in demand, with differences across countries in the type of sectors hiring. By late 2024 an average of 43 percent of online job postings were for professionals, an increase of 13 pp since 2023 (Figure 2.33). Professionals are people whose main job is to apply specialized knowledge, often gained through higher education, to solve complex problems or provide expert services (e.g., doctors, engineers, teachers, lawyers, scientists). While in Serbia and North Macedonia many of occupations are related to the ICT sector (e.g. Software Developers, System Analysts, Web Developers), online labor demand in Albania and Montenegro is more concentrated in the health care sector (e.g. Nurses, Health Care Assistants) and the ICT sector to a smaller extent. Kosovo's labor demand has less of a focus on professionals but hires more broadly in occupational groups less in demand in other countries such as Craft Workers (e.g. mechanics).

FIGURE 2.33: ICT, health, and craft workers are most in-demand through online postings

Source: Proprietary data from Lightcast (2025).
Note: The figure shows the arithmetic average across the five available countries (Albania, Kosovo, North Macedonia, Montenegro and Serbia). Data is presented as a 3-month average.

Skills demanded in online job postings are mostly of social and technical nature, although demand for cognitive and digital skills is increasing. Across the region, employers consistently prioritize socio-emotional (e.g. interpersonal) and technical skills. In the past two years, with the increased demand for professionals, cognitive (e.g. analytical thinking, management) and digital skills have also again increased in demand (Figure 2.34). Job postings in Serbia and North Macedonia signal a relatively high intensity of demand for skills compared to the remaining countries (Figure 2.35). In particular the higher demand for intermediate and advanced digital skills, as well as the demand for language skills are prominent. Managerial abilities, interpersonal skills, and teamwork are also widely required, though they are somewhat less prominent in Kosovo.

FIGURE 2.34: Demand for digital skills have increased …

FIGURE 2.35: .…in particular in Serbia and North Macedonia

Source: Proprietary data from Lightcast (2025).
Note: The figure on the left shows the arithmetic average across the five available countries (Albania, Kosovo, North Macedonia, Montenegro and Serbia), in which the data taken as a 3-month average.

Jobs for the future will require stronger digital and green skills

Rapid technological progress, particularly in AI, and the global transition to low-carbon growth, are reshaping labor demand by altering the skills required and accelerating structural transformation across sectors. The region is exposed to growing risks from automation and AI, while policy shifts such as the EU's Carbon Border Adjustment Mechanism (CBAM), will profoundly affect the region's economic structure—particularly in energy-intensive industries central to employment and exports. These developments present dual challenges and opportunities: they risk exacerbating job displacement, skills mismatches, and regional disparities, but they also offer the potential to raise productivity, foster new forms of employment, and attract investment into emerging green and digital sectors. The region's ability to seize these opportunities will depend on how adaptable the workforce is, how responsive education and training systems become, and how effectively labor market institutions support smooth transitions.

AI brings both risks and opportunities, and while the exact impact of AI on future labor markets is uncertain, its role in the world of work will expand. AI can augment human capabilities and boost productivity, but its effects will vary widely: some occupations may remain unaffected, others face automation risks, while some will benefit from AI as a complementary tool. Analysis of national labor force surveys suggests that the region's occupational structure is increasingly exposed to AI, although outcomes differ across countries. High-risk jobs have risen across the region, especially in Montenegro and North Macedonia, although these two countries still have the lowest shares (Figure 2.36). In contrast, the share of high-opportunity jobs has increased in North Macedonia and Bosnia and Herzegovina but declined in the rest of the region. This suggests that while some countries are better positioned to leverage AI for more productive and complementary employment, others risk falling behind in adapting to technological change. High AI exposure is concentrated in skilled sectors such as ICT and finance, but the greatest risk falls on mid-skill jobs (for example, clerical and sales positions) that are highly exposed to automation yet offer little scope for AI complementarity. This "middle-skill squeeze" is likely to intensify— underscoring the urgency of equipping workers with adaptable digital and analytical skills.

FIGURE 2.36: Automation brings risks and opportunities for the labor market
(Share of employment in high-risk of automation and high-opportunity jobs)

Source: World Bank staff calculations based on LFS.

FIGURE 2.37: Green transition risks are concentrated among low-skilled workers
(Share of 'jobs-at-risk' due to green transition)

Source: World Bank staff calculations based on LFS.

As the world moves toward becoming carbon neutral, many workers will be at risk—either because they are in 'brown jobs' or because they will need substantial reskilling. By 2023, Western Balkans' green exports amounted to 42 percent of total exports, up from 30 percent just a decade ago. The trade is predominantly with the EU, while emerging trade partners include the USA, China, and Türkiye. Approximately 20 percent of the Western Balkan workforce, equivalent to 2.8 million workers, is estimated to be "at risk" in the short to medium term, either because they are employed in "brown jobs" directly threatened by decarbonization, or because they will require substantial upskilling to remain employable.[22]

Brown jobs account for about 7 percent of total employment (ranging from 4 percent in Kosovo to 9 percent in Bosnia and Herzegovina). An additional 13 percent of jobs are not immediately at risk of elimination but face significant task reconfiguration that demands reskilling—with the highest share observed in Kosovo (17 percent). Unlike AI-driven technological change, which primarily threatens

medium- and high-skilled occupations, the risks from the green transition are disproportionately concentrated among low-skilled workers. Nearly one-third of workers with low levels of education in Kosovo—and similarly high shares elsewhere except Albania—are estimated to be employed in at-risk occupations (Figure 2.41). These twin transitions, therefore, expose different segments of the workforce and create a dual challenge for policy makers: designing strategies that simultaneously mitigate displacement risks for low-skilled workers in carbon-intensive sectors and enable medium- and high-skilled workers to adapt to AI-driven technological change.

Notwithstanding progress, job quality still needs to improve

Job quality in the Western Balkans has improved in recent years, with more wage employment and greater access to benefits, but large disparities persist, especially for the youth, the low-skilled, and workers in Kosovo. A multidimensional Job Quality Index (JQI) (for more details Appendix 2) suggests that structural factors such as sector,

---

22. World Bank (2025a).

occupation, and weak institutional protections matter more than individual characteristics in shaping job quality deprivation. Benefits and stability consistently account for 70-80 percent of total job quality deprivation across the region, while wage adequacy, overeducation, and working conditions account for the rest. The wage dimension in the JQI, defined narrowly as *income adequacy*—whether wages exceed two-thirds of the national median wage—plays a smaller role.

BOX 2.2: Job Quality Index

JQI, following the Alkire-Forster method, assesses employment quality based on: (i) income adequacy, whereby wages must exceed the calculated threshold of two-thirds of the median wage in a given country; (ii) access to benefits, whereby jobs must have access to at least one of the six social insurance benefits such as health, pension, unemployment, social assistance, paid annual and sick leave; (iii) employment stability, whereby jobs need to satisfy at least one of the four stability measures such as tenure, written contract, permanent job, and registered firm/employer; (iv) working conditions, whereby work should not be more than 48 hours per week, the worker does not work for a second paid job and/or does not want to work more hours; and (v) skills mismatch, where the worker is deprived if his/her education is higher than needed for the job. These indicators are first aggregated at the individual level into a weighted deprivation score, which reflects how many dimensions of job quality are unmet–with equal weights assigned to each dimension and assuming that all five aspects of job quality are equally important. Data is from the Labor Force Surveys.

However, wages remain the most visible signal of job quality because they reflect whether productivity gains are shared with workers. The wage distribution (Figure 2.38) shows that most employment in the Western Balkans remains concentrated below the average wage. Recent minimum wage increases have compressed the bottom tail—reducing the share of very low-paid jobs—and the middle part of the distribution also slightly improved, while top of the distribution shrank (Figure 2.45). This suggests that progress so far reflects policy-driven compression from below rather than broad-based wage growth tied to higher productivity. Sectors with stronger productivity performance offer better pay (see Figure 2.52), while low-productivity sectors such as agriculture and construction are where wage adequacy and job quality deprivation overlap most.[23]

Progress in job quality improvements is also visible in rising shares of wage employment, which have coincided with falling JQI deprivation in several countries (Figure 2.39). The increase in the share of wage employment alongside declining poor-quality job incidence indicates gradual labor market formalization in the region. Nevertheless, the intensity of deprivation among those still affected has not improved (remaining at about 44–46 percent). The adjusted JQI headcount ratio, which combines incidence and intensity, confirms these patterns: for Bosnia and Herzegovina it fell from 6.5 to 3.3 percent and in North Macedonia from 8.1 to 6.1 percent, while Kosovo, despite some progress, still records the highest level at 26.4 percent in 2023. Country differences remain stark: in 2019, more than 70 percent of wage employees in Kosovo were in so-called poor-quality jobs, falling to nearly 60 percent in 2023—mostly due to limited access to mandatory social insurance, permanent contracts, or formal agreements (Figure 2.40). In contrast, Bosnia and Herzegovina and Serbia had the lowest rates (below 20 percent in 2019, improving further by 2023), with North Macedonia and Bosnia and Herzegovina also showing strong improvements over time.

---

23. This is aligned with the elasticity of jobs to productivity changes for ECA that show that a 1 percent increase in productivity translates into a 0.9 percent increase in employment. Results were obtained by estimating a specification of log employment growth on log total factor productivity, controlling for interaction terms with distortions. Moreover, employment growth in the high-skilled services sector (one of the region's most productive sectors) is about three times more sensitive to productivity shocks than is the manufacturing sector (one of the region's least productive sectors). (World Bank, 2025. ECA Economic Update).

FIGURE 2.38: Minimum wage policy reduced the
share of low-paid jobs
*(Real wage growth in 2020-24 and distribution around the
average wage)*

FIGURE 2.39: Job quality in the Western Balkans
has improved in recent years
*(JQI ratio for wage employees and the share of wage employees,
by country and year)*

Source: World Bank staff calculations based on administrative data
published by relevant statistical offices. Red lines show the fitted
linear regression between sectors' share of average wage and their real
wage growth (2020–2024), estimated separately for each country.

Source: World Bank staff calculations based on LFS and Alkire-
Forster method.
Note: based on the LFS data which may underreport social insurance
received by respondents compared to the Kosovo Pension Savings
Trust data.

FIGURE 2.40: Lack of social insurance and
duration of contracts reduce jobs quality
(Elements of JQI for wage employees, by country and year)

Source: World Bank staff calculations based on LFS and Alkire-
Forster method.

**Job quality deprivation is concentrated in
certain sectors and occupations.** Agriculture,
construction, trade, hotels, and other services
show both high incidence and intensity of
deprivation, reflecting informality, seasonal
work, and weak regulation. By contrast, public
administration, education, health, and finance
sectors offer the lowest deprivation–consistent
with more formal employment. Kosovo stands
out with higher deprivation across nearly all
sectors, often exceeding 40-45 percent, compared
to much lower rates in Bosnia and Herzegovina

and Serbia. Occupational patterns mirror these
trends: workers in elementary occupations, plant
and machine operators, craft and related trades,
and skilled agricultural workers face the highest
deprivation, while managers, professionals, and
technicians experience the lowest. Industry and
market services for low-skilled workers provide
comparatively better job quality than agriculture
and construction.

**Education helps reduce deprivation risk in
most countries.** In Bosnia and Herzegovina,
North Macedonia, and Serbia, secondary
and tertiary graduates are less likely to be in
poor-quality jobs. But in Kosovo, deprivation
remains high even among tertiary graduates,
reflecting both skill mismatches and the limited
capacity of the economy to generate productive,
well-paid jobs (Figure 2.41). Younger workers
(15–24) face the highest deprivation, with
risk declining with age, except for a spike
among older workers (65+ in some countries,
reflecting precarious late-career employment.
Each additional year of age reduces deprivation
risk by about 0.4 percent. Kosovo youth face
particularly severe deprivation. Gender gaps
are modest; when controlling for other factors,
women are slightly more likely to be deprived,
but the effect is small compared to sector and
occupation determinants.

FIGURE 2.41: Secondary and tertiary education does not always reduce deprivation risk
(Adjusted JQI by educational levels, 2019)

Source: World Bank staff calculations based on LFS and Alkire-Forster method.

More and better jobs depend on productivity improvements

Aggregate labor productivity growth in the Western Balkans has lagged aspirational peers such as Croatia. In 2022, all countries in the region, except Serbia, ranked at the lower end in terms of median value added per worker (Figure 2.42). Moreover, their productivity growth since 2011 has been weak relative to Croatia (Figure 2.43)—reflecting persistent structural gaps.

FIGURE 2.42: The value added per worker was lower than with EU peers
(Median value added per worker, 2022)

FIGURE 2.43: Productivity growth has been weak since 2011
(Median value added per worker in 2022 relative to 2011, percent)

Source: World Bank staff calculations based on firm-level data from statistical agencies or firm registries.
Note: Median value added per worker is calculated at the NACE 2-digit level for each year. To calculate (average) median value added per worker per country, we take the average for each country-year bin, weighted by total NACE 2-digit total employment. Observations with missing value added per worker or employment are dropped in the calculation.

Job opportunities has sharply polarized over the past decade, with expanding job opportunities in both high-productivity, high-wage growth occupations and low-productivity, low-wage growth occupations.[24] On one hand, low-productivity occupations absorbed a larger share of the workforce, reflecting rising demand for basic services and entry-level work (Figure 2.44). Yet, these jobs offered little wage progression: average earnings barely improved (Figure 2.45). On the other hand, high-productivity occupations not only expanded in employment but also captured the fastest wage growth, more than doubling average pay by 2022.[25] This divergence means that, although more people are employed, overall labor productivity can rise only modestly, while widening the income divide between high- and low-productivity workers.[26]

FIGURE 2.44: **Employment is rising at both low- and high-skill jobs…**
(Employment growth per labor productivity quintile, WB4, 2011-22)

FIGURE 2.45: …but labor income gains are concentrated at the top
(Wage growth per labor productivity quintile, WB4, 2011-22)

Source: World Bank staff calculations based on firm-level data from statistical agencies.
Note: Labor productivity is measured as value added per worker while wage is measured as wage bill divided by employment. Both are in US$ PPP adjusted. Observations with missing wage or value added were dropped in the calculation for comparability. WB4 countries include Kosovo, North Macedonia, Montenegro and Serbia.

Aggregate productivity growth in the Western Balkans has been driven largely by between-firm dynamics, rather than improvements within existing firms or gains from new entrants (Figure 2.46). In Montenegro and Serbia, within-firm productivity contributions have been negative—likely reflecting weak innovation capacity, poor management practices, limited investment in skills, or reliance on aging capital stock. In contrast, in North Macedonia and Kosovo, new firm entry has contributed negatively to aggregate productivity—suggesting that younger and presumably less efficient firms face barriers such as limited access to finance, regulatory bottlenecks, or weak demand which prevent them from scaling and competing effectively. This pattern highlights the region's difficulty in generating sustained productivity gains from both incumbent firms and new entrants.

24. Using firm-level data from the business registry has data limitations in economies with widespread underreporting of wages and turnover (e.g., Kosovo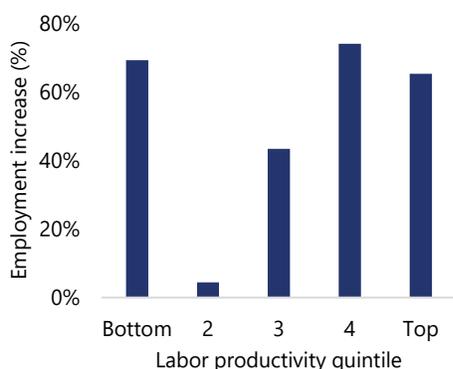 and Serbia with 9% and 35% non-missing wage data), potentially distorting wage-productivity analysis. Notwithstanding, the results are robust even after performing predictive assignment of missing values and inverse probability weighting, both based on size class, 2-digit NACE classification, country- and year-specific effects.

25. Aggregate statistics suggest that low-skilled workers experienced strong wage increases (Figure 2.5), but this largely reflects dynamics outside the formal sector, where minimum wage policies, tight labor supply, or informality drove faster nominal wage adjustments. Thus, average wage-productivity growth at the macro level masks a widening divide: many new jobs are being created at the bottom productive jobs, but the income gains are concentrated at the top.

26. Rising educational returns, as discussed in the previous section, make high-skill jobs more rewarding, but not enough workers have the required education, so employment concentrates at the top and bottom of the productivity distribution. The middle, typically occupations that used to require moderate education, shrinks or stagnates because these jobs either move up (requiring more education) or down (e.g., routine tasks being automated), reinforcing the polarization of the labor market.

Within-country geographical analysis of productivity and employment reveals a growing polarization in the Western Balkans. Capital cities, such as Skopje, Podgorica, Belgrade, and Pristina District, have become dominant employment poles, drawing an increasing share of jobs over 2011-22 and reinforcing regional concentration (Figure 2.47). With the exception of North Macedonia, however, productivity in these capitals has stagnated or declined—signaling that employment expansion has not translated into efficiency gains. Outside the capitals, employment is 'trapped' in regions with low- to medium-productivity activities, meaning that the bulk of employment growth is concentrated in areas where productivity dynamics are weak, further entrenching spatial disparities.

FIGURE 2.46: Reallocations rather than within-firm improvements drove productivity growth.
(Decomposition of labor productivity growth, 2011-22, percent)

Source: World Bank staff calculations based on firm-level data from statistical agencies or firm registries.
Note: Value-added per worker (VAPW) is calculated as (revenues or sales less cost of materials)/employment). Average wage is weighted by employment. Values have been deflated considering changes in prices. Observations where there is missing in any of the two variables were dropped. For Albania and Bosnia and Herzegovina, the access to micro-level firm data was not available.

FIGURE 2.47: Western Balkans' capitals (except for Skopje) increased employment but not productivity
(Labor productivity and employment size by Western Balkan regions)

Source: World Bank staff calculations based on firm-level data from statistical agencies or firm registries.
Note: Value-added per worker (VAPW) is calculated as revenues or sales less cost of materials divided by employment, expressed in USD 2018 prices and adjusted for PPP. Average wage is weighted by employment. Observations where there is missing in any of the two variables were dropped. Regions are defined as per NUTS3 classification. Top employers include: MK008 = Skopje; ME 16 = Podgorica; RS00 = Belgrade; XK619 = Pristina District.

Wage growth tends to be the highest in large employment areas, particularly the capitals of North Macedonia and Serbia but this pattern does not hold in Montenegro and Kosovo due to volatility or structural stagnation (Figure 2.48). In North Macedonia, the highest wage growth was observed in Skopje (MK008), the largest employment hub dominated by retail and wholesale trade. Other areas saw smaller wage

gains. In Serbia, Belgrade (RS00) also combined job growth with wage growth—providing wage gains to workers in retail and wholesale trade as well. Outside the capital, other areas lagged in wages. In Kosovo, wages stayed flat, including the employment capital Pristina, while the large job centers in civil engineering (for example, roads and railways) in Podgorica, Montenegro actually saw failling wages.

FIGURE 2.48: Wage growth was the highest in large employment areas, particularly capitals
(Wage per worker and employment size by Western Balkan regions, 2011-22)

Source: World Bank Staff calculations based on firm-level data from statistical agencies or firm registries.
Note: Average wage is weighted by employment, and is expressed in USD 2018 prices and adjusted for PPP. Values have been deflated considering changes in prices. Observations where there is missing in any of the two variables were dropped.

Despite recent improvements in productivity, most workers are still employed in the low- to middle-productivity sectors (Figure 2.49). Employment has been rising along with productivity in North Macedonia's commerce sector, similarly to Kosovo and Serbia. High-productivity sectors like ICT that generate the most value-added per worker still employ low number of workers, while manufacturing in North Macedonia and Serbia, in particular, employ a large number of workers but exhibit low productivity—hosting also many labor-intensive FDIs in the car-supply chain. Tourism is a source of an important share of employment

(about 7 percent) and its productivity is improving; however, the sector's domestic supply linkages—beyond labor, including food, manufactured goods, and other inputs—are still not being fully leveraged.

Creating more and better jobs will depend on boosting productivity and addressing skill mismatches. Firm upgrading, including digitalization, product and market diversification, attracting FDI that would move up the value chain with larger domestic spillovers, and ensuring demanded skills are available would help with moving the productivity ladder. Sectors

FIGURE 2.49: Yet, most workers are still employed in the low- and middle-productivity sectors
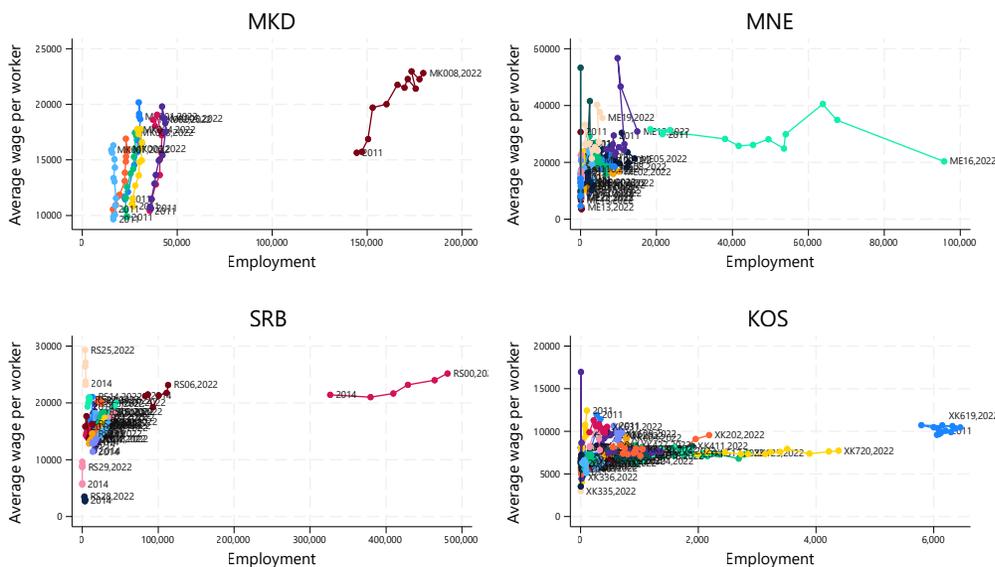*(Labor productivity and employment size by sectors, 2011-22)*

Source: World Bank staff calculations based on firm-level data from statistical agencies or firm registries.
Note: VAPW is calculated as revenues or sales less cost of materials divided by employment, expressed in USD 2018 prices and adjusted for PPP.
Average wage is weighted by employment. Observations where there is missing in any of the two variables were dropped.

that have opportunities for further growth either through productivity-enhancing measures—like higher-value added manufacturing, tourism, agriculture, commerce—or through accessing more skilled workers—like ICT, health and care services, transport construction—are important both in terms of employment shares (around three-fourths) as well as value added (almost 80 percent) of the Western Balkan economies. Within manufacturing, labor productivity and employment have seen increases in medium- and high-tech industries like manufacture of electrical equipment, computer, electronic and optical products, motor vehicles, trailers and semi-trailers, as well as other transport equipment.

A persistent misalignment between wages, employment, and productivity is eroding competitiveness in the Western Balkans. Wage and employment growth in the Western Balkans have consistently outpaced labor productivity

growth, putting pressure on the region's competitiveness (Figure 2.50). This trajectory is in contrast with Croatia, which may suggest that even though more workers are moving into mid- to upper-productivity quintiles, these workers may still be systematically less productive than comparable firms in Croatia. Similarly, while the share of firms in low productivity quintile have declined, some growth in employment can still occur in lower-productivity activities within sectors, which can dilute the overall productivity effect of the observed structural transformation. Overall, the increasing share of employment in higher-productivity quintiles is consistent with structural transformation, but the fact that aggregate productivity growth lags and wage growth outpaces productivity indicates that structural gains are insufficiently strong to offset rising labor costs and the legacy of low productivity in the region.

FIGURE 2.50: Wage growth has outpaced labor productivity eroding competitiveness
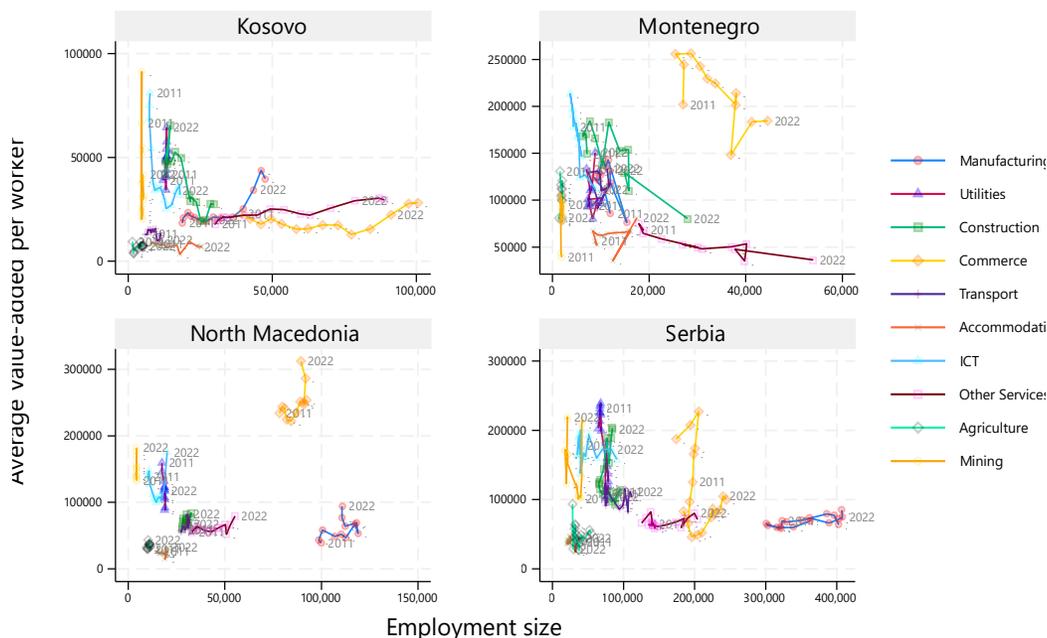*(Wage, productivity and employment growth, 2011-22, 2011=100)*

Source: World Bank Staff calculations based on firm-level data from statistical agencies or firm registries.
Note: VAPW is calculated as revenues or sales less cost of materials divided by employment, expressed in USD 2018 prices and adjusted for PPP. Average wage is weighted by employment. Observations where there is missing in any of the two variables were dropped. Base year for Serbia is 2014; 2011 for others.
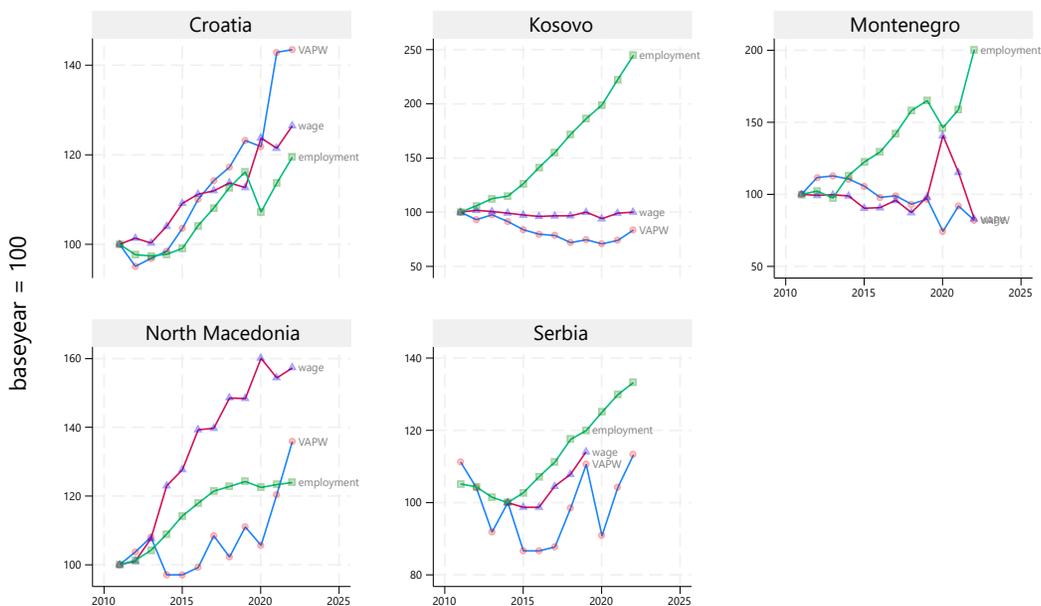
The decomposition shows that the relative importance of firm-level versus sectoral factors varies substantially across countries. Firm-specific attributes are the dominant driver of labor productivity variation in North Macedonia (83 percent) and, to a lesser extent, in Serbia (43 percent) while in Kosovo and, to a lesser extent, Montenegro sector affiliation plays a larger role (Figure 2.51). Differences in management, technology adoption, or internal firm practices are the main determinants of productivity in North Macedonia, rather than the sector and the location in which the firm operates. In contrast, Kosovo remains strongly sector-driven (67 percent), which may emphasize the role of industry-level upgrading. Montenegro and Serbia sit in between– indicating that both firm-level and sectoral interventions can help enhance productivity. Interestingly, the relatively high contribution of geography in Serbia also suggests that location-specific factors, such as infrastructure, local planning and management or even climate, matter more than in other countries.

FIGURE 2.51: Firm-specific attributes are the dominant driver of labor productivity variation, except in Kosovo
(Shapley decomposition of the coefficient of determination (R-sq))

Source: World Bank staff calculation based on firm-level data from statistical agencies or firm registries.
Note: Each bar denotes the relative contribution of each component in the explained variance from the regression model value-added per worker as a function of firm-level attributes (size class, capital per worker, exporter and foreign-owned dummies), industry classification (NACE 1-digit) and geography (NUTS 2-digit). Values have been deflated considering changes in prices. The method follows Shorrocks (2012) Shapley decomposition. For MKD and MNE, exporter status and foreign ownership are missing. A more parsimonious model, dropping foreign ownership and exporter status in all countries, shows qualitatively similar results.

Policies to raise returns to education should be coupled with efforts to boost industry productivity, as education pays off more in productive sectors. In general, returns to education depend on industry-level productivity (Figure 2.52). Cross-country comparison suggests that where average returns are higher (Serbia and Kosovo, see Figure 2.29), education tends to be rewarded more consistently across the labor market (Figure 2.52). This rather "flat" return-to-education pattern might be reflecting less efficient sectoral allocation of skilled labor (that is, educated workers are not necessarily concentrated in high-productivity industries). In contrast, where average returns are weaker (North Macedonia, see Figure 2.29), the payoff to education is conditional on being employed in a high-productivity sector; that is, education alone is not sufficient to generate strong wage premiums. This trend holds true for both secondary and tertiary education. This pattern suggests a segmented labor market, such that educated workers in low-productivity sectors do not see much wage advantage, while those in high-productivity sectors do. This could be seen as a distortion if skilled labor is trapped in less productive sectors, or as a reflection of the economy's industrial structure, where opportunities for educated workers are concentrated in a narrow set of dynamic industries.

Typically, foreign-owned firms, exporters, and larger more mature enterprises consistently outperform their counterparts in terms of employment, labor productivity, and average wages, possibly benefiting from economies of scale and stronger integration into global value chains. In contrast, state-owned enterprises (SoEs) remain less productive than private firms (Figure 2.53). While exporters, foreign-owned and larger companies capture productivity, employment, and wage premia, their overall share of employment has remained relatively

FIGURE 2.52: Education alone is not enough to generate wage premium—productivity matters
(Returns to education, conditional on industry-level labor productivity, 2011-22)

Source: World Bank staff calculation based on firm-level data from statistical agencies or firm registries.
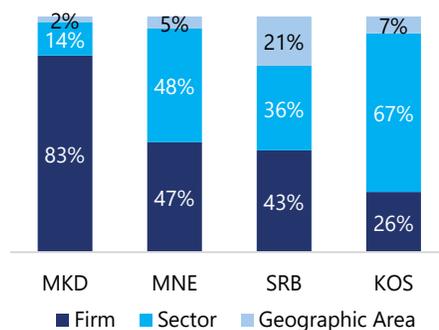Note: Each bar denotes the coefficient (in percent) after regressing wages on education level, interacted with industry-level (NACE-2 digit) value added per worker. Controls include age, gender, occupation, and industry. Whiskers denote 95 percent confidence interval. All includes all three Western Balkan countries. Montenegro is dropped due to missing wage data.

stable over time; for mature firms, the share has been declining (Figure 2.54). Meanwhile, SoEs still represent a sizable share of jobs—about 11–12 percent of total employment in Serbia and around 3 percent in North Macedonia, respectively, although the latter has already declined from about 7 percent a decade earlier. Capital deepening and increasing productivity of such firms would require: (i) improved business environment and governance; (ii) reforming state-owned enterprises (SoEs), including in market contested sectors that crowd out private sector resources; (iii) improved access to finance for startups and innovative firms to thrive and mature; as well as (iv) political and regulatory certainty, to encourage long-term private investment.

FIGURE 2.53: Internationally oriented, larger and more mature firms tend to be more competitive
(Employment, labor productivity and wage premia across firm attributes, 2011-22)

Source: World Bank staff calculation based on firm-level data from statistical agencies or firm registries in Kosovo, Montenegro, North Macedonia, and Serbia.
Note: Each bar denotes the coefficient (in log points) after each outcome variable against firm status (e.g., exporter), controlling for country and year fixed effects. Controls include age, gender, occupation, and industry. All bars are statistically significant at 1% level.

FIGURE 2.54: Firms with productivity, wages, and employment premia had overall share of employment relatively stable over time
(Employment share of exporters, foreign-owned, large, mature and state-owned enterprises, 2011-22)

Source: World Bank staff calculation based on firm-level data from statistical agencies or firm registries.

Emerging jobs policy strategy

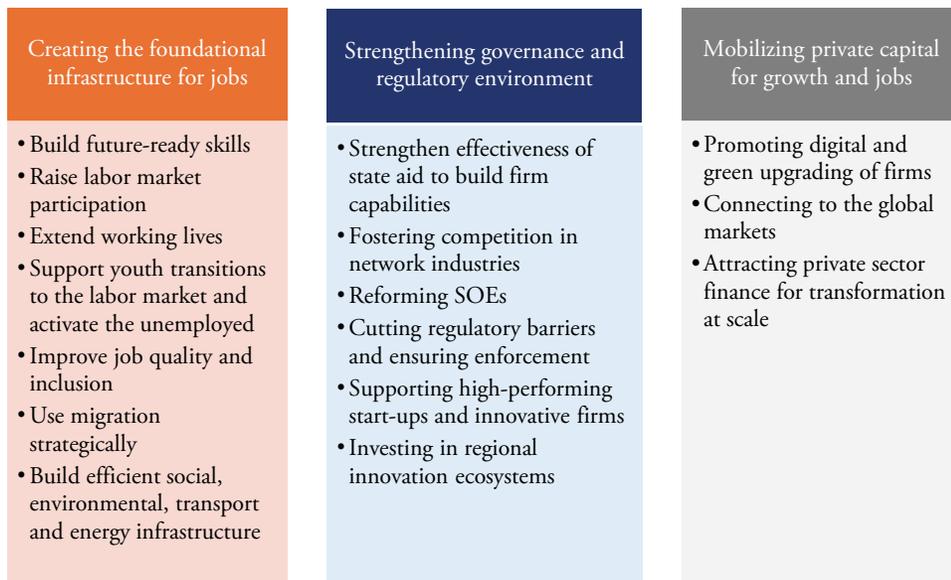**The Western Balkans labor market stands at a critical crossroads.** Despite progress in education and sectoral transformation, future prosperity is at risk from demographic decline, weak productivity growth, and persistent skill mismatches. To sustain convergence and create better jobs, governments need to act in a coordinated and decisive way and focus on (i) creating the foundational infrastructure for jobs; (ii) strengthening governance and creating a predictable regulatory environment; and (iii) mobilizing private capital for the private sector to expand and create more and better jobs.[27]

FIGURE 2.55: A three-pillar approach to jobs in the Western Balkans

Creating the foundational infrastructure for jobs	Strengthening governance and regulatory environment	Mobilizing private capital for growth and jobs
• Build future-ready skills • Raise labor market participation • Extend working lives • Support youth transitions to the labor market and activate the unemployed • Improve job quality and inclusion • Use migration strategically • Build efficient social, environmental, transport and energy infrastructure	• Strengthen effectiveness of state aid to build firm capabilities • Fostering competition in network industries • Reforming SOEs • Cutting regulatory barriers and ensuring enforcement • Supporting high-performing start-ups and innovative firms • Investing in regional innovation ecosystems	• Promoting digital and green upgrading of firms • Connecting to the global markets • Attracting private sector finance for transformation at scale

Together, these actions can help the region counter labor shortages, improve job quality, and boost productivity—ensuring that rising wages are underpinned by sustainable growth. Creating jobs starts with public sector support. Governments can prioritize the health and well-being of their workforces and invest in health care, education, skills training, clean air and water, transportation, and energy required for people and businesses to thrive. These infrastructure investments lay the foundation for sustained economic growth. Good governance and business-enabling policies are necessary to allow the private sector to operate and grow. This includes transparent and accountable institutions, the rule of law, protection of property rights, and efficient public administration. Ineffective bankruptcy laws, weak contract enforcement, corruption, and a lack of access to finance hold back private sector development. These measures would have concrete growth impacts; for example, as per Chapter 1 of this report, raising female labor force participation to the EU level alone would lead to a 0.35-percent higher growth for the region, while TFP increases growth the most. Finally, infrastructure and good regulatory framework are needed to mobilize private capital to finance the transformation at scale and create jobs. Delivering on these priorities calls for concrete steps:

---

27. The three-pillar framework is consistent with a broader discussion of the policy recommendations in the World Bank (2025) ECA Economic Update. While the regional report develops broad recommendations, all recommendations here are Western-Balkan-specific.

1. Creating the foundational infrastructure for jobs

- Build future-ready skills by
i. strengthening foundational learning (extend instructional hours, improve teaching quality especially in disadvantaged schools, and strengthen systems to monitor and act on student absenteeism, by tracking attendance, engaging parents, and offering targeted support for at-risk students),
ii. expanding dual VET and apprenticeships and ensure curriculums are co-designed with employers to match evolving labor market needs,
iii. linking tertiary education to labor market demand through industry-linked programs, tracer studies, and partnerships with high-opportunity sectors such as ICT, high-tech manufacturing, health, and green economy services, as well as
iv. establishing a national labor market observatory to track vacancies, skill demand, wage dynamics, and demographic trends, and use this evidence to guide education, training, activation, and migration policies.

- Raise labor market participation by
i. expanding childcare and elderly care services to enable more women to work and ease the care burden at home while creating quality jobs in care services,
ii. reducing internal mobility barriers by improving transport and housing options,
iii. promoting remote work and digital service delivery to expand job access in lagging regions and create more flexible options for women and youth, and
iv. strengthening labor market information systems so workers can access vacancies beyond their local area.

- Support transitions of youth with education-to-work transition programs, and technological redundancies, facilitating labor market reintegration

of the unemployed through tailored activation measures, such as wage subsidies, reskilling programs, social protection and employment services.

- Extend working lives by
i. aligning retirement ages with EU benchmarks and gradually increase statutory ages, especially for women, while
ii. promoting flexible and part-time jobs for older workers beyond the retirement age.

- Improve job quality and inclusion by
i. prioritizing formalization of jobs in high-risk sectors (agriculture, construction, hospitality) by simplifying registration, and digitalizing registration and reporting to reduce compliance costs,
ii. modernizing labor inspections by using digital, risk-based tools to focus on sectors with the highest job quality deprivation, and reducing arbitrary checks, as well as
iii. expanding access to social insurance and benefits for workers in precarious or informal jobs through contributory incentives or subsidized schemes.

- Use migration strategically by
i. simplifying immigration rules to address early shortages,
ii. supporting circular migration, and
iii. incentivizing returnees and diaspora investment.

- Build efficient social, environmental, transport and energy infrastructure by
i. investing in primary healthcare and preventive care programs, strengthening public health systems, improving access to essential medicines, and building healthcare infrastructure that can respond to health emergencies while maintaining routine services,
ii. investing in water treatment facilities, environmental protection, and air quality monitoring that reduce the disease burden and improve the quality of life and thus

productivity, thereby attracting investment and skilled workers,

iii. investing in key transport corridors, efficient public transit systems, railways, and logistics hubs that reduce commuting time and transportation costs, expanding the effective labor market and enabling businesses to access wider customer bases and supply chains, and

iv. investing in the energy system grid to absorb increasing renewable energy, improving regional energy infrastructure and connectivity to develop regional energy markets and cross-border power transmission and distribution.

2. Strengthening governance and creating a predictable regulatory environment

- Strengthen effectiveness of state aid to build firm capabilities, support technology adoption, and help firms access finance.
- Foster competition in key sectors, especially network industries such as energy, transport, and telecommunications, by reducing barriers to entry, strengthening pro-competition regulation, and ensuring competitive neutrality between public and private providers to lower costs, increase efficiency, and improve service quality, while creating space for more productive firms to grow.
- Reform state-owned enterprises to reduce significant economic and labor market footprint that hinders job creation and traps many workers in low-productivity jobs.
- Cut regulatory barriers and ensure predictable enforcement by streamlining permits, licenses, and compliance procedures, while improving transparency in enforcement. A stable and predictable business environment encourages firms to invest, expand and innovate.
- Support high-performing start-ups and innovative firms with improved access to finance (for example, risk-

sharing instruments, reduced collateral requirements), targeted R&D incentives, and support for workforce skill upgrading, and stronger integration into global value chains.

- Invest in regional innovation ecosystems by developing technology parks, incubators, and research centers that link universities, startups, and established firms, to accelerate knowledge and technology diffusion.

3. Mobilizing private capital for growth and jobs

- Promote digital and green upgrading of firms by
i. incentives for automation, digital tools, and climate-friendly technologies to strengthen competitiveness, attract investors, and prepare firms for the twin transitions.
ii. investing in digital infrastructure, including broadband and server capacity in lagging regions, and shifting from narrow acquisition subsidies toward comprehensive adoption strategies that embed digital tools in business processes.
iii. leveraging automation and AI to enhance productivity and mitigate labor shortages, particularly in sectors such as health care and long-term care, through investments in telemedicine and digital health management,
iv. scaling up reskilling and upskilling programs for workers most exposed to disruption from AI automation (clerical, routine jobs) and decarbonization (carbon-intensive industries), and
v. mainstreaming digital and green skills across all education and training pathways, so graduates and the workforce are prepared for the twin transition.

- Connect better to global markets and revive manufacturing potential by[28]
i. strengthening regional economic integration through improved trade

---

28. Based on the World Bank (2025). ECA Economic Update.

facilitation and transport connectivity, including reforms and investments in border management (including national single windows, process simplification and the adoption of "green lanes"); investments in Ten-T road and rail-freight corridors and measures to improve corridor efficiency (including intelligent transport systems and e-freight).

ii. ensuring predictable regulatory frameworks for the energy transition, including cost-reflective pricing and grid upgrades that de-risk private investment, and

iii. ensuring quality infrastructure for standards, certification, and traceability that will support agrifood upgrading and export diversification, unlocking higher-value markets.

• Attract private sector finance for transformation at scale by

i. deploying public-private partnerships to mobilize private capital for transport, energy, and digitalization infrastructure,

ii. applying regulatory interventions to support the creation of high-quality jobs in highly productive sectors (ICT, energy and infrastructure, health, higher-value added manufacturing) and technologically upgrade firms in existing labor-intensive sectors (tourism, agriculture, care services).

Country Notes

Albania

- After two years of steady 4 percent growth, the economy expanded moderately through mid-2025.
- Consumption softened but remained a strong driver of growth, alongside tourism and construction. Inflation stayed below 3 percent, poverty declined amid stronger labor markets, and public debt continued its downward path.
- Though external risks persist, EU accession progress is likely to support investor confidence, policy continuity, and long-term growth.

Key conditions and challenges

Albania is a small open economy with close linkages to the EU through exports, investment, and remittances. Despite structural challenges, it has maintained a steady growth, averaging 4.2 percent growth in 2022–2024. Tourism, while still the dominant growth engine, requires strategic investment in sustainability and diversification. Per capita income is still one-third of the EU average, with long-term convergence constrained by demographic pressures including outmigration and an aging population, persistent skill gaps, and fiscal pressures from climate events, such as the recent wildfires. Addressing these challenges requires raising additional revenues, improving spending efficiency, and accelerating EU- aligned reforms to boost productivity, labor force participation, and market integration. While poverty has declined, inclusive growth policies and stronger social protection are needed to support vulnerable groups.

Recent developments

Albania's economy grew by 3.4 percent year-on-year (yoy) in the first quarter of 2025, slightly down from 3.7 percent in the same quarter a year earlier, reflecting strong foreign demand and some moderation of domestic demand. Services and construction drove supply-side activity (despite a tapering of tourism growth), offsetting declines in agriculture and other parts of industry. Confidence indicators point to a slight acceleration in the second quarter. Service sector hiring offset job losses in agriculture in the first

quarter of 2025, lowering the unemployment rate to 8.7 percent and lifting the employment rate (ages 15-64) to 69.5 percent for both men and women. This increased demand for labor drove up private sector wages by 9.6 percent yoy. Poverty (upper middle-income line, USD 8.30/day) declined to 23.8 percent in 2024 from 26.4 percent in 2023, reflecting the positive growth trajectory and improving labor market conditions.

Moderation in consumption curbed demand-side pressures, while rising wages were tempered by productivity gains and squeezed profit margins. Low Eurozone inflation and a strong lek kept imported prices in check, leaving overall pressures contained. Inflation averaged 2.2 percent over the first seven months of 2025, rising to 2.5 percent in July, driven mainly by higher food prices and rents. Core inflation was higher at 2.9 percent in July. In response, the Bank of Albania cut the policy rate to 2.5 percent in July, reinforcing favorable financing conditions. This supported a 12.9 percent yoy increase in private sector credit by June, led by household loans for consumption and mortgages and robust SME lending, while lending to large firms and construction slowed. Non-performing loans fell to 4.0 percent in June 2025, down from 4.7 percent a year earlier.

In the first half of 2025, fiscal policy supported demand through moderate loosening, with the overall fiscal surplus narrowing to 2.7 percent of GDP from 4.3 percent a year earlier. Spending rose by 14.1 percent yoy, driven by social

security, wages, and investment, outpacing revenue growth of 6.7 percent. External debt repayments reduced net borrowing, but liquidity remained firm, thanks to the Eurobond issued in the first quarter. As a result, public debt fell to 54.0 percent of GDP by June.

The lek appreciated in recent years due to strong inflows from exports, remittances, and FDI, signaling strength but reducing competitiveness, before stabilizing in early 2025 as foreign currency flows balanced and the Bank of Albania intervened. A 26 percent yoy rebound in goods exports narrowed the current account deficit to 3.2 percent of GDP in the first quarter of 2025 from 6.6 percent a year earlier. Modest goods imports growth alongside more favorable primary and secondary income balances added to the gains. Foreign direct investment held at 6.1 percent of GDP, and foreign currency reserves reached USD 7.7 billion by June, from USD 5.9 billion the previous year.

Outlook

Economic growth is projected to moderate to 3.7 percent in 2025 and 3.5 percent in the medium term, amid global trade uncertainties and a shifting international outlook. Poverty is expected to decline to 22.0 percent from 23.8 percent in 2024. Inflation is projected to increase to the 3 percent target by early 2026 and to hover around that level, as wage growth and a stabilizing exchange rate offset easing international prices.

The fiscal deficit is expected to reach 1.8 percent of GDP in 2025 on accelerated capital expenditures and election related spending. It should narrow in 2026-27 as wage and interest pressures ease and the Medium-Term Revenue Strategy (2025–2027) is implemented, and the EU funds rise gradually. Public debt is expected to decline further, reaching 51.5 percent of GDP in 2027. The current account deficit is projected to stay below its historical average, narrowing to 2.3 percent of GDP in 2025 before stabilizing around 2.5 percent in the medium term, as rising imports for public investment are offset by recovering goods exports and robust tourism revenues.

Geopolitical tensions and global policy uncertainty pose risks to Albania's outlook, mainly through their impact on EU growth. However, strong tourism performance and progress on the EU Growth Agenda could provide important offsets.

ALBANIA - Selected Economic Indicators

ALBANIA	2022	2023	2024	2025e	2026f	2027f
Real GDP growth (percent)	**4.8**	**4.0**	**4.0**	**3.7**	**3.5**	**3.5**
Composition (percentage points):						
Consumption	4.6	2.7	3.2	2.7	2.4	2.4
Investment	0.1	-1.6	3.5	1.3	1.4	1.4
Net exports	0.2	2.9	-2.7	-0.3	-0.3	-0.3
Exports	5.4	3.0	0.0	2.4	2.2	2.1
Imports (-)	5.2	0.1	2.8	2.7	2.5	2.5
Consumer price inflation (percent, period average)	6.7	4.8	2.2	2.5	3.0	3.0
Public revenues (percent of GDP)	26.6	27.2	28.2	28.3	28.7	28.9
Public expenditures (percent of GDP)	30.3	28.5	28.9	30.2	30.1	30.1
Of which:						
Wage bill (percent of GDP)	3.9	4.2	4.5	4.6	4.5	4.4
Social benefits (percent of GDP)	11.3	10.7	11.1	11.2	11.2	11.3
Capital expenditure (percent of GDP)	5.2	5.1	4.6	5.0	5.2	5.3
Fiscal balance (percent of GDP)	-3.6	-1.3	-0.7	-1.8	-1.4	-1.3
Primary fiscal balance (percent of GDP)	-1.8	0.7	1.4	0.5	0.8	0.9
Public debt (percent of GDP)	61.7	55.9	52.9	52.2	51.2	50.3
Public and publicly guaranteed debt (percent of GDP)	64.1	57.6	54.2	53.4	52.4	51.5
Of which: External (percent of GDP)	30.0	26.2	24.0	23.2	22.2	21.7
Goods exports (percent of GDP)	10.7	8.4	6.7	7.3	7.4	7.4
Goods imports (percent of GDP)	34.2	29.3	29.0	27.0	27.2	27.2
Net services exports (percent of GDP)	13.2	15.5	15.5	13.7	13.8	13.9
Trade balance (percent of GDP)	-10.3	-5.4	-6.8	-6.0	-6.0	-6.0
Net remittance inflows (percent of GDP)	4.6	4.3	4.2	3.9	3.8	3.7
Current account balance (percent of GDP)	-5.9	-1.1	-2.4	-2.3	-2.6	-2.5
Net foreign direct investment inflows (percent of GDP)	-6.6	-5.8	-5.4	-5.3	-5.5	-5.7
External debt (percent of GDP)	54.1	45.9	40.6	37.5	36.6	35.7
Real private credit growth (percent, period average)	2.9	-1.8	7.9	-	-	-
Nonperforming loans (percent of gross loans, end of period)	5.0	4.7	4.2	-	-	-
Unemployment rate (percent, period average)	10.9	9.5	8.5	-	-	-
Youth unemployment rate (percent, period average)	24.9	23.6	21.7	-	-	-
Labor force participation rate (percent, period average)	62.4	62.4	63.7	-	-	-
GDP per capita, PPP (current international $)	19,430	21,208	22,066	22,889	23,681	24,501
Poverty rate (percent of population)	29.2	26.4	23.8	22.0	20.4	18.9

Sources: Country authorities, World Bank estimates and projections.

Bosnia and Herzegovina

- GDP growth slowed to 1.7 percent in Q1 2025 from 3.0 percent a year earlier, as industrial weakness, especially in manufacturing, weighed on activity.
- Stronger consumption, fueled by minimum wage hikes, couldn't offset weak investment and exports, while higher food prices lifted inflation to 3.4 percent in June.
- Looking ahead, growth is projected to recover to 3.2 percent by 2027, with the fiscal balance improving as reforms advance.

Key conditions and challenges

Over the past thirty years, Bosnia and Herzegovina's (BiH) macroeconomic stability has been underpinned by three factors: a currency board linked to the euro, efficient indirect tax collection and the prospect of EU membership. Robust fiscal policy delivered budget surpluses during 2015-2019, and while pandemic-driven deficits followed, public debt has remained modest at approximately 34 percent of GDP, reflecting prudent fiscal management.

Average real income growth of just 3 percent per year since 2015 has been insufficient to close the gap with the EU27 average, leaving per capita GDP at only one-third of the EU level in 2024. This slow pace of growth has limited progress in reducing poverty. Although the official poverty rate declined from 16.9 percent in 2015 to 13.5 percent in 2021, economic vulnerability persists—40 percent of adults say they could not cover expenses for more than a month if their main income is lost. Low labor force participation and high vulnerability among elderly households and those with multiple dependents remain pressing concerns.

To unlock BiH's growth potential, the country must shift from a consumption-driven model to one driven by higher investment and improved productivity. It will require accelerating key structural reforms, strengthening oversight of state-owned enterprises, improving the business climate, reducing labor costs, and advancing the transition to green energy.

Recent developments

Real GDP growth decelerated to 1.7 percent in Q1 2025 from 3.0 percent in 2024. On the supply side this was due to weaker performance across key sectors, especially manufacturing (-5.3%) and construction (-0.8%).

On the demand side, inflation eroded real disposable income, hence consumption and investment softened in Q1 2025. Exports grew only 0.4 percent in Q1 2025 while imports increased by 1.6 percent during the same period, further widening the trade deficit by 1.3 percent in nominal terms.

In H1 2025, inflation accelerated to 3.6 percent from 1.7 percent the year before, driven primarily by cost-push factors. Food prices increased faster than prices of most goods and services, resulting in core inflation (1.8 percent) falling behind food inflation (8.5 percent). The acceleration in food prices was triggered by supply disruptions due to the 2024 floods, the global trends reflecting economic uncertainty, and the FBiH Government's decision to increase the minimum wage by 60 percent that took effect in 2025.

Labor market conditions also softened in Q1 2025, amplifying the impact of higher prices on households. Unemployment rose to 13.4 percent in Q1, up 0.8 pp from end-2024, while the activity rate fell by 0.4 pp to 48.7 percent, suggesting fewer people are either working or actively seeking jobs. Participation is especially low among those with only primary education

or less, who make up nearly 30 percent of the working-age population but recorded an activity rate of just 14.7 percent in Q1 2025. These shifts point to growing challenges in the labor market, particularly for vulnerable groups, and highlight the need for targeted policy interventions to boost labor market inclusion and support economic resilience.

Meanwhile, the current account deficit (CAD) widened to 8.9 percent of GDP in Q1 2025 – 0.6 pp higher than in Q1 2024 as the merchandise trade deficit widened to 23.1 percent of GDP. In Q1 2025 almost three-fourths of the CAD was financed by the FDI inflows, which mainly went to the foreign-owned banking sector (new loans). Despite this external imbalance, total external debt remains relatively low, below 45 percent of GDP. Public debt is lower, at about 35 percent of GDP, thanks to a modest budget deficit. The deficit is projected to narrow further to 1.5 percent of GDP in 2025, driven by slightly lower spending on goods and services.

Outlook

Real GDP growth is expected to decelerate modestly in 2025 (production approach) as ongoing political tensions continue to weigh on the pace of essential reforms. Inflation is likely to peak at 3.5 percent in 2025, reflecting pressures from rising food and service prices, planned utility price increases, and ongoing global economic uncertainty. Despite these headwinds, consumption will remain the main driver of growth, providing some resilience in the short term. Unemployment remains unchanged, as the lack of consensus on the growth plan and the recent increase in the minimum wage have limited job creation.

From 2026 onward, growth is anticipated to regain momentum, reaching 3.0 percent in 2026 and 3.2 percent in 2027, supported by stronger investment, improving domestic labor markets, and more favorable external conditions as the EU economy recovers. Private consumption will continue to expand, while the introduction of the CBAM is expected to increase imports, leading to a slight deterioration in the CAD, which should stabilize at 4.7 percent of GDP by 2027. Prudent fiscal policy is set to return the balance to surplus in 2027, driven by highway-related revenues and a stable VAT regime, based on single VAT rate.

In this context, policymakers' near-term priorities should focus on finalizing the reform agenda for the EU Growth Plan, fulfilling legislative requirements to begin EU accession negotiations, and labor market reforms. These efforts, while likely to be delayed by the October 2026 general elections, are expected to accelerate in 2027, helping to underpin improvements in living standards and sustain growth.

The outlook has significant downside risks. A potential escalation of global economic uncertainty and domestic political frictions could lead to lower investments and delay essential economic structural reforms. Ongoing conflicts in Ukraine and the Middle East could also constrain the EU's economy, further affecting demand for BiH exports, FDI and remittances. Inflation, reduced domestic demand, and limited remittance inflows pose additional challenges for poverty reduction.

BOSNIA AND HERZEGOVINA - Selected Economic Indicators

BOSNIA AND HERZEGOVINA	2022	2023	2024	2025e	2026f	2027f
Real GDP growth (percent)	**4.2**	**2.0**	**3.0**	**2.6**	**3.0**	**3.2**
Composition (percentage points):						
Consumption	-	-	3.8	3.4	3.2	3.3
Investment	-	-	0.7	0.0	0.4	0.3
Net exports	-	-	-1.8	-0.8	-0.6	-0.4
Exports	-	-	-0.5	0.0	0.3	0.5
Imports (-)	-	-	1.2	0.9	0.9	0.9
Consumer price inflation (percent, period average)	14.0	6.1	1.7	3.5	1.9	1.7
Public revenues (percent of GDP)	39.9	40.7	41.9	42.4	42.2	42.5
Public expenditures (percent of GDP)	40.3	41.9	43.7	43.9	42.9	42.3
Of which:						
Wage bill (percent of GDP)	10.0	10.4	10.5	10.8	10.7	10.5
Social benefits (percent of GDP)	14.3	15.8	16.3	19.6	19.2	19.3
Capital expenditure (percent of GDP)	3.5	3.4	3.7	4.1	4.0	3.8
Fiscal balance (percent of GDP)	-0.4	-1.2	-1.8	-1.5	-0.7	0.3
Primary fiscal balance (percent of GDP)	0.2	-0.4	-0.8	-0.6	0.2	1.1
Public debt (percent of GDP)	29.3	26.4	26.3	24.5	24.2	23.6
Public and publicly guaranteed debt (percent of GDP)	31.5	28.5	27.2	25.7	25.1	24.5
Of which: External (percent of GDP)	24.9	21.1	20.0	18.3	17.9	17.5
Goods exports (percent of GDP)	35.9	31.1	28.4	27.5	27.0	26.3
Goods imports (percent of GDP)	58.2	51.6	50.3	48.8	48.0	46.9
Net services exports (percent of GDP)	8.7	8.8	8.2	7.2	6.9	6.5
Trade balance (percent of GDP)	-13.6	-11.7	-13.7	-14.1	-14.1	-14.1
Net remittance inflows (percent of GDP)	7.9	7.6	7.8	7.4	7.3	7.1
Current account balance (percent of GDP)	-4.4	-2.3	-4.0	-4.3	-4.5	-4.7
Net foreign direct investment inflows (percent of GDP)	3.1	3.4	3.5	3.4	3.4	3.3
External debt (percent of GDP)	51.5	47.3	47.7	44.9	43.2	41.5
Real private credit growth (percent, period average)	-8.1	-0.7	7.2	-	-	-
Nonperforming loans (percent of gross loans, end of period)	5.4	3.8	3.2	-	-	-
Unemployment rate (percent, period average)	15.4	13.2	12.6	-	-	-
Youth unemployment rate (percent, period average)	35.1	30.1	30.1	-	-	-
Labor force participation rate (percent, period average)	47.6	47.8	49.1	-	-	-
GDP per capita, PPP (current international $)	17,898	18,256	18,731	19,311	19,987	20,747

Sources: Country authorities, World Bank estimates and projections.

Kosovo

- Economic growth remains resilient despite heightened domestic and external uncertainties. In 2025, inflationary pressures re-emerged, driven by higher energy and food prices, and eroding real disposable incomes.
- Over the medium term, growth is expected to stay close to 4 percent, supporting continued poverty reduction.
- However, prolonged delays in forming a new government could negatively impact investment and slow progress on structural reforms.

Key conditions and challenges

Kosovo, one of Europe's youngest countries in a continent that is rapidly aging, has made significant strides in socio-economic development since independence. Between 2013 and 2023, the economy expanded at an average annual rate of 4.3 percent, lifting per capita income by more than 50 percent and driving a significant reduction in poverty. Prudent fiscal management and a rule-based fiscal framework have supported macroeconomic stability. However, despite recent progress, per capita income remains just 15 percent of the EU average, and growth has failed to generate sufficient jobs. Much of the poverty reduction has been driven by private and public transfers rather than broad-based job creation. Moreover, the gains have been unevenly shared, widening disparities across different segments of society.

Low economic diversification and limited competitiveness are constraints to achieving higher and more sustainable growth. Efforts to attract foreign direct investments (FDI) and expand private sector investment have had limited success, and the economy continues to rely on micro, small, and medium enterprises (MSMEs) which face growth constraints and are concentrated in a few sectors. Human capital remains underutilized with low labor force participation and employment, especially among women, limiting the country's growth potential. Declining fertility and persistent outmigration pose further strains on the labor market.

Recent developments

After growing by 4.4 percent in 2024, Kosovo's economy slowed to 3.6 percent in the first quarter of 2025 as household consumption eased and external demand weakened. Private consumption rose by 4.3 percent, still the main driver of growth though at a slower pace compared to the previous year. Real wages increased by 10.3 percent in 2024, supported by a higher minimum wage, but formal employment grew only modestly, averaging 1.4 percent in the first half of 2025. Investment also strengthened, with gross capital formation up 13.6 percent, fueling activity in construction and manufacturing, while financial services expanded alongside rising demand. Strong domestic demand also drove import growth, which surged 14.5 percent in the first five months of the year, outpacing a 12 percent rise in exports and widening the current account deficit. Remittances and FDI inflows provided only limited support, reaching 3.5 percent and 3.6 percent growth, respectively, by May. Higher domestic demand, including through higher government consumption, together with rising prices of food, beverages, electricity, and services fueled inflation in the first half of 2025. Consumer inflation reached 4.3 percent in July 2025, bringing the January-July average to 3 percent. Core inflation also increased steadily over the period, averaging 1.5 percent by July 2025. Fiscal and financial sector risks remain limited, providing a stable backdrop for the economy despite slowing growth. The fiscal position continues to be supported by strong tax

revenue growth (10 percent in the first half of 2025), driven by consumption, and continued formalization. At the same time, expenditure increased by 17 percent, driven by spending on goods and services, and expanded social transfers. Nonetheless, adequate fiscal buffers will support a deficit of 0.8 percent of GDP. The financial sector remained stable, supported by structural reforms and reflecting continued financial deepening.

Private credit growth has continued to accelerate, with total new loans increasing by 17 percent in the first half of 2025. Bank liquidity and asset quality remains sound, with non-performing loans steady at 2 percent as of June 2025.

Outlook

The outlook is favorable, with growth expected to stabilize around Kosovo's potential of 4 percent over the medium term, driven by domestic demand. Consumption is expected to support growth, although at a reduced pace due to the negative impact of price increases. Investment in infrastructure, including in renewable energy generation as well as improvements in existing generation capacities, is expected to provide a positive contribution to economic activity supporting the country in its energy transition. Higher food and electricity prices are expected to drive inflation to above 3 percent in 2025, with negative repercussions on the poor and vulnerable. Increased outlays

on current spending alongside higher public investment execution are set to maintain the fiscal deficit around 1 percent of GDP between 2026 and 2027. Risks to the outlook are tilted to the downside, and uncertainty remains elevated. Prolonged delays in forming a new government could slow the implementation of structural reform agenda and delay access to external financing, including under the new EU Growth Plan. Continued outmigration represents a drag on growth, while untapped domestic potential, particularly among women, could be unlocked by raising female labor force participation. In this respect, addressing the lack of affordable childcare is critical. On the external front, continued geopolitical uncertainty and a further weakening of external demand could weigh on exports and FDI, with detrimental impacts on growth. Fiscal policy should continue to support inclusive growth while maintaining fiscal sustainability. With poverty particularly concentrated in rural areas, growth alone won't bridge the gap, hence targeted, rural-focused policies are needed.

KOSOVO - Selected Economic Indicators

KOSOVO	2022	2023	2024	2025e	2026f	2027f
Real GDP growth (percent)	**4.3**	**4.1**	**4.4**	**3.8**	**3.8**	**3.9**
Composition (percentage points):						
Consumption	2.7	3.3	4.7	4.2	3.8	3.8
Investment	-1.1	1.2	2.0	1.4	1.4	1.6
Net exports	2.7	-0.4	-2.3	-1.8	-1.4	-1.4
Exports	6.4	2.8	3.9	3.1	3.4	3.4
Imports (-)	3.7	3.2	6.2	4.9	4.8	4.8
Consumer price inflation (percent, period average)	11.6	4.9	1.6	3.4	2.9	2.5
Public revenues (percent of GDP)	27.9	29.3	29.9	29.1	28.8	28.7
Public expenditures (percent of GDP)	28.4	29.6	30.1	29.8	29.8	29.5
Of which:						
Wage bill (percent of GDP)	7.3	7.9	8.2	8.3	8.1	8.0
Social benefits (percent of GDP)	8.1	7.0	7.6	7.1	6.8	6.6
Capital expenditure (percent of GDP)	4.7	5.7	6.3	6.7	6.8	7.2
Fiscal balance (percent of GDP)	-0.5	-0.3	-0.3	-0.8	-1.0	-0.8
Primary fiscal balance (percent of GDP)	-0.1	0.1	0.1	-0.5	-0.6	-0.5
Public debt (percent of GDP)	19.7	17.2	16.9	16.8	17.2	17.5
Public and publicly guaranteed debt (percent of GDP)	20.0	17.5	17.2	17.1	17.5	17.8
Of which: External (percent of GDP)	7.2	7.2	7.5	8.3	9.1	10.1
Goods exports (percent of GDP)	10.5	9.0	9.3	8.7	8.4	8.2
Goods imports (percent of GDP)	58.7	56.6	57.1	56.5	56.7	57.2
Net services exports (percent of GDP)	15.4	16.9	17.4	18.2	19.1	20.3
Trade balance (percent of GDP)	-32.8	-30.7	-30.4	-29.6	-29.2	-28.7
Net remittance inflows (percent of GDP)	13.4	13.4	12.8	11.9	11.7	11.3
Current account balance (percent of GDP)	-10.3	-7.6	-8.9	-8.6	-8.2	-7.6
Net foreign direct investment inflows (percent of GDP)	6.3	5.9	6.1	6.0	6.0	6.0
External debt (percent of GDP)	38.6	39.8	41.1	41.7	43.2	44.8
Real private credit growth (percent, period average)	5.2	8.8	12.2	-	-	-
Nonperforming loans (percent of gross loans, end of period)	2.0	2.0	1.9	-	-	-
Unemployment rate (percent, period average)	12.6	10.9	10.8	-	-	-
Youth unemployment rate (percent, period average)	21.4	17.3	19.5	-	-	-
Labor force participation rate (percent, period average)	38.6	40.7	43.2	-	-	-
GDP per capita (US$)	5,445	6,158	6,643	7,249	7,837	8,404

Sources: Country authorities, World Bank estimates and projections.

Montenegro

- Growth is moderating from a high base, and inflation has been stronger than expected, while weak fiscal buffers and heavy debt repayments increase risks.
- In a turbulent global environment, Montenegro remains highly exposed to shocks.
- With European Union (EU) accession within reach, reinforcing fiscal discipline and advancing key reforms is essential to strengthen resilience and secure the benefits of integration.

Key conditions and challenges

Montenegro's small, open economy is vulnerable to external shocks, making resilience critical. As a euroized economy without independent monetary policy, Montenegro relies solely on fiscal policy to achieve macro stability. This heightens the need for structural reforms and responsible fiscal policy. The economy's heavy dependence on tourism underscores the case for economic diversification and sustainable growth.

Before the pandemic (2016–19), Montenegro's annual growth averaged 3.9 percent, driven by highway construction and large tourism projects. But widening external deficits and rising debt left the economy vulnerable. In 2020, the pandemic caused a sharp contraction, pushing public debt to 104.5 percent of GDP. Growth rebounded sharply, averaging 9.1 percent in 2021–23, before slowing to 3.2 percent in 2024. The Europe Now program, launched in 2022 and expanded in 2024, lifted wages and pensions, reduced labor taxation, and boosted formal employment and living standards, even amid high inflation. But it also narrowed fiscal space, with deficits above 3 percent of GDP. Yet, owing to strong economic performance, public debt declined to 59.8 percent by 2024.

EU accession remains the key anchor for Montenegro's reforms and long-term transformation. As of August 2025, the country has provisionally closed seven of 33 negotiation chapters, while progress continues on others. Accession advances not only enhance investor confidence but also drive alignment with EU standards in fiscal governance, competitiveness, and institutional strengthening. EU financial support—through Growth Plan pre-financing and infrastructure investment grants—provides both resources and incentives for reforms. Montenegro's recent entry into the Single Euro Payments Area (SEPA) further deepens financial integration with the EU, lowers transaction costs, and supports investor confidence. With EU membership targeted for 2028, sustaining fiscal discipline and reform momentum is essential for stability, resilience, and inclusive growth.

Recent developments

Growth moderation, which began in 2024, extended into 2025, with GDP expanding by 3.2 percent in the first half of the year. Robust household consumption and investment drove growth, even as tourism remained subdued. By July, overnight stays were down 4.3 percent year-on-year, with the sharpest decline recorded among Russian visitors. At the same time, industrial production grew 0.5 percent, as manufacturing gains offset reduced electricity output. Retail trade rose by 3.9 percent signaling solid domestic demand. This strength was underpinned by a nearly 20 percent surge in real net wages, supported by October 2024's minimum wage hike and reduced pension contributions.

Montenegro's labor market remains tight, but job growth is slowing. By July, employment grew by 4.7 percent according to administrative data, slower than in previous years. Strong household consumption and rising food and utility costs

pushed inflation, climbing from 2.8 percent in January to 4.6 percent in August, averaging 3.6 percent in the first eight months of 2025.

Fiscal and external balances widened. The fiscal deficit reached 1.2 percent of GDP in the first seven months of 2025, slightly better than planned, thanks to strong value added tax, corporate tax, and excise revenues offsetting lower pension contributions. However, expenditure rose faster, driven mainly by higher capital spending. The €850 million Eurobond issued in March secured liquidity for 2025, keeping public debt near 60 percent of GDP. External pressures are intensifying. The current account deficit widened by 10 percent in the first half of 2025, reflecting a growing merchandise trade gap and flat service exports, with only a quarter financed by FDI, which itself fell 4.5 percent. This underscores Montenegro's rising reliance on debt and other external financing sources.

Outlook

GDP growth is projected to average around 3.2 percent over 2025–27, supported by private consumption, rising real wages, and continued investment. Large-scale infrastructure and renewable energy projects, alongside continued foreign interest in real estate, are expected to support medium-term growth. Highway construction, railway reconstruction, and solar and wind investments should sustain investment, improve connectivity, and accelerate the energy transition. However, the pace and efficiency of implementation will be critical. At the same time, higher import needs linked to these projects will keep the current account deficit widened, expected to average 18.1 percent of GDP in 2026-27.

Poverty is projected to decline to 6.6 percent in 2027, with most poor being chronically unemployed, students, or out of the labor force, mainly in the north. Reducing poverty requires targeted policies alongside sustained economic growth.

EU accession remains Montenegro's strongest driver of reform but also raises the bar for fiscal discipline under the new EU fiscal framework. With sizeable financing needs, a credible fiscal framework—sustainable, responsive to development needs, effective in managing fiscal risks, and aligned with EU standards—is essential to maintain investor confidence and ensure long-term growth.

The fiscal deficit is projected at 3.7 percent of GDP in 2025, narrowing gradually to 3 percent in 2027. Public debt is expected to remain broadly stable in the medium term, averaging about 61 percent of GDP. Ensuring sustainability will require continued fiscal discipline and fiscal risk management, particularly in light of the investment program, lumpy debt repayments and elevated external financing costs. Reforms will also be needed to accelerate growth and reduce debt over time.

Risks are two-sided: geopolitical and trade uncertainties could weigh on growth, while EU accession progress could boost prospects.

MONTENEGRO - Selected Economic Indicators

MONTENEGRO	2022	2023	2024	2025e	2026f	2027f
Real GDP growth (percent)	**7.7**	**6.5**	**3.2**	**3.3**	**3.2**	**3.2**
Composition (percentage points):						
Consumption	11.3	6.5	9.2	5.6	3.5	3.1
Investment	5.1	2.6	0.4	1.3	1.2	1.2
Net exports	-8.6	-2.6	-6.4	-3.5	-1.6	-1.1
Exports	7.7	4.0	-1.8	-0.7	1.2	1.3
Imports (-)	16.2	6.5	4.7	2.9	2.8	2.5
Consumer price inflation (percent, period average)	13.0	8.6	3.3	3.7	2.5	2.1
Public revenues (percent of GDP)	39.1	41.6	41.7	40.6	40.5	40.4
Public expenditures (percent of GDP)	42.7	41.0	44.8	44.3	43.7	43.5
Of which:						
Wage bill (percent of GDP)	10.5	10.5	10.2	10.2	10.0	9.8
Social benefits (percent of GDP)	11.2	11.7	13.2	13.3	13.3	13.3
Capital expenditure (percent of GDP)	5.9	5.0	5.6	5.9	5.7	5.7
Fiscal balance (percent of GDP)	-3.7	0.6	-3.1	-3.7	-3.2	-3.0
Primary fiscal balance (percent of GDP)	-2.1	2.4	-1.1	-1.6	-1.0	-0.9
Public debt (percent of GDP)	69.0	58.4	59.8	59.4	61.4	61.0
Public and publicly guaranteed debt (percent of GDP)	70.7	59.9	61.2	60.6	62.5	62.1
Of which: External (percent of GDP)	61.6	51.5	56.6	56.6	58.8	58.6
Goods exports (percent of GDP)	12.8	10.1	8.6	7.9	8.4	8.6
Goods imports (percent of GDP)	57.8	52.4	51.8	52.0	51.3	50.9
Net services exports (percent of GDP)	22.2	23.9	20.7	19.8	19.3	19.8
Trade balance (percent of GDP)	-22.8	-18.4	-22.5	-24.3	-23.6	-22.5
Net remittance inflows (percent of GDP)	6.5	4.7	4.5	4.4	4.2	4.0
Current account balance (percent of GDP)	-12.9	-11.2	-17.1	-19.0	-18.2	-17.0
Net foreign direct investment inflows (percent of GDP)	13.2	6.1	6.4	6.5	6.6	6.7
External debt (percent of GDP)	158.1	128.2	126.5	..	..	..
Real private credit growth (percent, period average)	-4.9	-2.3	7.3	-	-	-
Nonperforming loans (percent of gross loans, end of period)	6.3	5.8	4.1	-	-	-
Unemployment rate (percent, period average)	14.7	13.1	11.5	-	-	-
Youth unemployment rate (percent, period average)	29.4	23.3	26.2	-	-	-
Labor force participation rate (percent, period average)	58.9	63.9	63.7	-	-	-
GDP per capita, PPP (current international $)	27,027	30,887	33,148	34,814	36,638	38,782
Poverty rate (percent of population)	12.2	10.2	8.5	7.5	7.1	6.6

Sources: Country authorities, World Bank estimates and projections.

North Macedonia

- Growth strengthened in the first semester of 2025, driven by services and construction, while the industry is gradually making a recovery.
- Inflationary pressures intensified amidst rising food, services and labor costs. Revenue collection underperformance, rising debt service costs, and a steadily increasing debt level call for fiscal consolidation.
- The growth outlook remains positive, but is contingent on strong investments, which is essential for boosting growth and reducing poverty.

Key conditions and challenges

Output growth gained momentum in 2025, reaching 3.2 percent in the first semester of 2025 following a 2.8 percent expansion in 2024. Poverty, measured by the USD 8.30 per day poverty line, is estimated to have marginally declined by 0.8 pp in 2024. This decline is due to an 8.8 percent increase in real wages since 2023 and a decrease in the number of adults in jobless households.

On the fiscal front, both deficit and debt are above the limits set by fiscal rules, which have not been adhered to since their introduction in 2022. Budget outcomes continue to lag plans, with capital spending and revenue collection underperforming, the latter due to weak collection. In contrast, current spending is increasing faster, driven by pensions, interest payments (which doubled in the last five years) and public sector wages. As a result, debt is expected to surpass the previous year's level and remain above 60 percent of GDP in 2025.

A return to the long-term average inflation rate remains difficult as cost pressures, initially driven by energy, and now increasingly fueled by food prices, have proven hard to control. Continued strong wage growth, not matched by productivity gains, added to these pressures, highlighting the need to boost productivity, remove anti-competitive barriers, and foster productive investment to strengthen market dynamics, lower markups, and ease inflationary pressures.

Achieving stronger long-term growth hinges on accelerating reforms to spur the structural transformation of the economy. Reforms of public administration, energy sector, digitalization, human capital, and private sector development, as outlined in the EU Growth Reform Plan, are essential to fostering faster convergence with average EU living standards.

Recent developments

Output growth in the first semester of 2025 reached 3.2 percent, supported by domestic demand, while net exports remained in negative territory. On the production side, growth was led by services and construction, largely related to highways, while manufacturing is slowly recovering.

Labor market indicators (15+) continued to improve in line with output gains in the first semester of 2025. In Q2, the activity rate rose by 0.1 p.p. year-on-year, while the employment rate increased by 0.6 p.p., indicating job creation outpaced labor force growth. Much of this gain came from an 11.3 percent surge in informal employment, mostly in the agricultural sector, boosting headline figures but raising concerns about job sustainability. The unemployment rate fell by 0.9 pp to 11.5 percent, with a significantly sharper drop among women at 2 pp and a 0.5 pp reduction in the youth unemployment rate to 26.4 percent, which remains high relative to the EU average.

Buoyant domestic demand, supported by rapid credit growth, together with rising food prices, which are highly inelastic, fueled inflationary pressures. The surge in food costs not only lifted headline inflation, which rose from a three-year low of 2.2 percent in August 2024 to 4.8 percent by July 2025, but also pushed up producer prices, which climbed above 6 percent in the first half of 2025. These increases spilled over into core inflation, now at 5.5 percent, prompting the Central Bank to keep its policy rate steady at 5.35 percent in August, further widening the interest rate differential with the Eurozone.

Stronger growth and rising inflation have supported revenue mobilization; however, revenues still fell short of ambitious targets, with collection at 40 percent below expectations in the first half of 2025. The deficit is projected to remain on target unless revenue underperformance persists, and capital spending execution stays slow (at 32 percent of the plan by July 2025).

The current account deficit deepened to 3.4 percent of GDP by Q2 (on a four-quarter rolling basis) on account of a lower services surplus, largely due to stronger imports of construction services, as well as lower private transfers. Net FDI slowed down to 4.4 percent of GDP, while the level of external debt declined to 74 percent of GDP in Q1 2025, both on account of lower intercompany debt.

Outlook

The medium-term outlook remains positive, but downside risks prevail. Growth is expected to average 3 percent in 2025-2027. Risks include underperformance of investment as well as a weakening of activity in key trading partners. Headline inflation is expected to fall below the long-term average of 2 percent in 2027, as underlying inflationary pressures take time to dissipate. Supported by the positive growth outlook, the USD 8.30 poverty rate is projected to decline a further 1.3 pp between 2025 and 2027.

The baseline scenario assumes an acceleration in EU accession negotiations accompanied by stronger reform efforts under the Growth and Reform Plan to advance structural transformation. Transitioning from middle to high income will demand higher productivity, enhanced competitiveness, and stronger sustainability of the country's growth model. Unlocking the full potential of the labor force, fostering fair market competition, spurring innovation, and channeling resources toward higher value-added sectors are essential for faster convergence.

NORTH MACEDONIA - Selected Economic Indicators

NORTH MACEDONIA	2022	2023	2024	2025e	2026f	2027f
Real GDP growth (percent)	**2.8**	**2.1**	**2.8**	**3.1**	**3.0**	**3.0**
Composition (percentage points):						
Consumption	3.6	0.7	2.2	1.7	1.6	1.7
Investment	3.9	-3.5	2.8	2.5	1.8	1.7
Net exports	-5.7	-6.8	-3.4	-1.1	-0.4	-0.3
Exports	7.6	-0.5	-2.8	2.1	2.8	3.1
Imports (-)	-13.3	6.3	0.6	3.2	3.2	3.4
Consumer price inflation (percent, period average)	14.2	9.4	3.5	3.8	2.5	2.0
Public revenues (percent of GDP)	31.6	32.7	33.9	35.2	35.3	35.5
Public expenditures (percent of GDP)	35.9	37.1	38.5	39.2	38.9	38.8
Of which:						
Wage bill (percent of GDP)	6.4	6.8	7.5	7.4	7.4	7.4
Social benefits (percent of GDP)	16.2	16.6	17.9	18.2	18.1	17.8
Capital expenditure (percent of GDP)	4.1	5.3	3.9	4.0	4.1	4.1
Fiscal balance (percent of GDP)	-4.3	-4.4	-4.6	-4.0	-3.6	-3.3
Overall fiscal balance with the Public Enterprise for State Roads included (percent of GDP)	-4.7	-4.6	-4.8	-4.5	-4.1	-3.8
Primary fiscal balance (percent of GDP)	-3.2	-2.9	-2.7	-1.9	-1.5	-0.9
Public debt (percent of GDP)	49.6	49.7	53.8	55.2	56.4	57.3
Public and publicly guaranteed debt (percent of GDP)	58.0	58.1	62.4	62.9	63.4	63.5
Of which: External (percent of GDP)	38.7	39.1	37.8	38.0	38.3	38.4
Goods exports (percent of GDP)	56.2	49.7	43.7	42.0	41.6	41.8
Goods imports (percent of GDP)	82.9	67.8	63.8	62.1	60.2	60.0
Net services exports (percent of GDP)	5.8	5.0	6.9	7.4	6.4	6.7
Trade balance (percent of GDP)	-20.9	-13.0	-13.2	-12.7	-12.2	-11.5
Net remittance inflows (percent of GDP)	2.7	2.3	2.0	2.0	2.0	2.0
Current account balance (percent of GDP)	-6.1	0.4	-2.3	-3.0	-2.4	-2.0
Net foreign direct investment inflows (percent of GDP)	5.0	3.4	7.1	3.7	3.5	3.2
External debt (percent of GDP)	82.8	76.8	79.2	78.5	77.8	77.5
Real private credit growth (percent, period average)	-4.0	-2.9	3.5	-	-	-
Nonperforming loans (percent of gross loans, end of period)	2.8	2.7	2.6	-	-	-
Unemployment rate (percent, period average)	14.4	13.1	12.4	-	-	-
Youth unemployment rate (percent, period average)	32.5	29.3	28.9	-	-	-
Labor force participation rate (percent, period average)	55.2	52.3	52.3	-	-	-
GDP per capita, PPP (current international $)	20,329	20,756	21,337	21,998	22,658	23,338
Poverty rate (percent of population)	19.4	19.0	18.2	16.8	16.0	15.5

Sources: Country authorities, World Bank estimates and projections.

Serbia

- The growth of the Serbian economy has slowed in 2025 due to a mix of internal and external factors.
- GDP growth is expected to reach 2.8 percent this year, with risks tilted to the downside.
- The incidence of poverty declined to 9.5 percent in 2024 and is projected to continue falling, albeit at slower rate, as the remaining poor are often characterized by chronic unemployment and are thus less able to benefit from economic expansion.

Key conditions and challenges

GDP growth slowed to an estimated at 2 percent year-in-year in the first half of 2025, reflecting weaker consumption and a negative contribution to from investment (by 0.2 pp) and net exports (by 2.3 pp). Looking at the production side, the construction posted the largest drag on growth (of 0.3 pp) while adverse weather conditions significantly affected agriculture. This high degree of volatility associated with agricultural output (and the related food industry) underscores the critical need for Serbia to introduce policy and investment measures to mitigate the impact of increasing weather shocks and to promote private sector participation in these measures.

The fiscal space for adaptation response and investments is limited by the commitment to large public investment projects. Domestic political uncertainty has disrupted policy dialogue and implementation of structural reforms needed to accelerate economic growth.

Recent developments

After a strong 2024, Serbia's economy has lost momentum in 2025. Last year growth was driven by a recovery of private sector consumption and a strong increase in investment. However, the first half of 2025 saw a significant slowdown in private investment (to a large extent driven by a drop in net FDI inflows (by 58.7 percent in H1, compared to the same period of 2024), caused by global uncertainty and domestic political instability. However, industry proved resilient to weaker external demand – particularly from

the EU – with output growing by 2.5 percent year-over-year in the first half of the year. Despite some slowdowns, private consumption stayed strong, supported by wage growth of 10.8 percent (6.3 percent real), a 10.8 percent rise in pensions in the first five months of 2025 and stable employment.

While the labor market appeared stable, deep structural challenges persist. The unemployment rate increased to 8.8 percent in H1 (compared to 8.6 percent in 2024), while youth unemployment remained at 23.5 percent nearly triple the national average, due to skills mismatches and limited job opportunities. Many young Serbians migrate abroad, fueling brain drain and a shrinking workforce. While regional disparities are severe, there is very little internal labor mobility. Reflecting these labor market pressures and inflation eroding incomes, the poverty level (based on the upper-middle income line of $8.30/day in 2021 PPP) was at an estimated 9.5 percent in 2024, staying broadly flat since 2021.

The inflation index edged up again due to an increase in food prices, rents, and utility services. It reached 4.9 percent in July, slightly above the target bound. Food prices were 7.4 percent higher in July than a year ago. As a result, the NBS has kept it unchanged at 5.75 percent since September 2024.

Stronger-than-expected revenues failed to offset surging expenditures, and the fiscal deficit edged up in the first half of 2025, though it remained very low as a share of GDP. Government revenues

performed well in the first half of 2025 (up 6.3 percent in nominal terms, or 1.6 percent in real terms, year-over-year), thanks to a higher-than-planned collection of contributions for social insurance, VAT, and PIT. However, expenditures increased by 9.3 percent in nominal terms (4.5 percent in real terms pushing the consolidated fiscal deficit to just 0.2 of GDP. Public debt continues to decline gradually and reached 45.5 percent of GDP at the end of June.

The current account deficit increased significantly in the first half of 2025 (to nearly 2 billion euros, or 2.3 percent of GDP). Exports are proving to be resilient (up by 10.8 percent in H1) but imports increased even more and from a higher base (up by 11.4 percent in H1). Financing of the CAD is less favorable than in earlier years since net FDI inflows decreased (to reach EUR 942 million in H1 2025). Foreign currency reserves decreased by nearly 2 billion euros in the first half of the year but started to recover as of July (up by EUR 930 million in July) to reach EUR 28.3 billion, covering 6.5 months of imports.

Overall credit increased by 12 percent (year-over-year) through June. Loans to businesses increased by 7.5 percent by June (year-over-year), while loans to households increased by 12 percent, which helped to recover consumption as of Q2, and loans to the government increased by 18.9 percent. Gross nonperforming loans declined to 2.3 percent in June 2025.

Outlook

The Serbian economy is expected to grow at around 3-4 percent over the medium term, driven primarily by consumption and, to some extent, by investment. However, there are downside risks. These include potential budgetary support for struggling SOEs, weaker external demand for Serbian exports amid global trade policy uncertainty, and the impact of extreme weather on agriculture and infrastructure.

Inflation is expected to remain elevated in 2025 and 2026 and to reach the central point of the NBS target band only in 2027. The fiscal deficit is now projected to widen compared to 2023/2024 to reach around 3 percent of GDP since the government embarked on large-scale public infrastructure spending plans.

Economic growth, if sustained, will continue to lift more Serbians out of poverty. However, the remaining poor are increasingly concentrated among pensioners, the long-term unemployed, or those completely out of the labor force. Thus, targeted social assistance, care services for the disabled and elderly, job search support, and training programs will become essential to ensure further poverty reduction.

SERBIA - Selected Economic Indicators

SERBIA	2022	2023	2024	2025e	2026f	2027f
Real GDP growth (percent)	**2.6**	**3.8**	**3.9**	**2.8**	**3.0**	**4.0**
Composition (percentage points):						
Consumption	2.5	-0.1	3.0	2.4	2.8	3.1
Investment	1.0	1.2	4.3	1.0	1.6	1.5
Net exports	-0.8	2.7	-3.4	-0.6	-1.4	-0.7
Exports	8.9	1.6	1.9	2.4	3.0	3.6
Imports (-)	9.7	-1.1	5.3	3.0	4.3	4.3
Consumer price inflation (percent, period average)	11.9	12.1	4.6	4.5	4.0	3.0
Public revenues (percent of GDP)	41.6	39.4	41.0	41.3	40.8	40.6
Public expenditures (percent of GDP)	43.6	41.5	43.0	44.3	43.8	43.6
Of which:						
Wage bill (percent of GDP)	9.2	8.8	9.4	9.9	10.1	10.2
Social benefits (percent of GDP)	12.5	12.5	13.1	13.1	13.0	12.9
Capital expenditure (percent of GDP)	6.8	6.4	7.3	7.2	7.0	7.2
Fiscal balance (percent of GDP)	-3.0	-2.1	-2.0	-3.0	-3.0	-3.0
Primary fiscal balance (percent of GDP)	-1.6	-0.4	-0.1	-1.5	-1.4	-1.4
Public debt (percent of GDP)	50.5	46.6	45.4	44.7	43.4	42.6
Public and publicly guaranteed debt (percent of GDP)	52.9	48.4	47.3	46.8	46.6	46.2
Of which: External (percent of GDP)	34.0	33.7	37.0	36.5	36.0	36.0
Goods exports (percent of GDP)	42.4	37.1	36.2	36.3	35.0	34.6
Goods imports (percent of GDP)	57.2	45.7	44.5	44.9	45.3	44.2
Net services exports (percent of GDP)	3.6	4.0	3.3	3.0	3.5	4.6
Trade balance (percent of GDP)	-11.2	-4.6	-5.0	-5.6	-6.8	-5.0
Net remittance inflows (percent of GDP)	5.9	4.9	4.3	4.4	4.4	4.2
Current account balance (percent of GDP)	-6.6	-2.4	-4.7	-5.5	-5.5	-5.4
Net foreign direct investment inflows (percent of GDP)	6.8	5.6	5.4	3.4	4.4	4.8
External debt (percent of GDP)	65.5	58.7	59.2	59.0	58.8	57.9
Real private credit growth (percent, period average)	-2.7	-9.2	0.9	-	-	-
Nonperforming loans (percent of gross loans, end of period)	3.4	3.2	2.5	-	-	-
Unemployment rate (percent, period average)	9.4	9.5	9.0	-	-	-
Youth unemployment rate (percent, period average)	24.3	25.0	23.0	-	-	-
Labor force participation rate (percent, period average)	54.7	55.4	56.2	-	-	-
GDP per capita, PPP (current international $)	24,655	26,305	27,985	29,866	31,776	33,807
Poverty rate (percent of population)	10.3	10.1	9.5	8.8	8.1	7.7

Sources: Country authorities, World Bank estimates and projections.

Literature

Almeida R., C. Avitabile, and T. Shmis. 2023. "Beyond the learning drop: Why countries in Eastern Europe and Central Asia should act now to avoid a teacher crisis". *World Bank Blog*.

Braghieri L., R. Levy, and A. Makarin. 2022. "Social Media and Mental Health." *American Economic Review* 112 (11): 3660-93.

Center on Positive Behavioral Interventions & Supports (PBIS). 2024. "PBIS: An Evidence-Based Framework for Making Schools Safe, Positive, Predictable, and Equitable". Center on PBIS, University of Oregon. Link.

Chetty, R., J.N. Friedman, and J.E. Rockoff. 2014. "Measuring the Impacts of Teachers II: Teacher Value-Added and Student Outcomes in Adulthood". *The American Economic Review* 104 (9): 2633-2679.

Federal Employment Institute. 2025. "Labour Market Monitoring Report Federation of Bosnia and Herzegovina 2024".

Hanushek, E.A., M. Piopiunik, and S. Wiederhold. 2018. "The Value of Smarter Teachers: International Evidence on Teacher Cognitive Skills and Student Performance". *Journal of Human Resources.* Forthcoming. 10.3368/jhr.55.1.0317.8619R1.

Hattie, J.A.C. 2008. "Visible Learning: A Synthesis of Over 800 Meta-Analyses Relating to Achievement". Oxford, UK: Routledge.

Hovhannisyan, S., V. Montalva-Talledo, T. Remick, C. Rodriguez- Castelán, and K. Stamm. 2022. "Global Job Quality: Evidence from Wage Employment across Developing Countries". World Bank Working Paper, 10134.

International Monetary Fund (IMF). 2021. "Inclusivity in the Labor Market". Working Paper WP/21/141. Geneva: IMF.

Kriechel, B., and T. Vetter. 2019. "Skills mismatch measurement in ETF partner countries". European Training Foundation.

Leitner, S. 2025. "Demographic Change and the Labor Market in the Western Balkans: Projections and Implications". *Background paper*.

Mihaylov and Tijdens. 2019. Measuring the Routine and Non-Routine Task Content of 427 Four-Digit ISCO-08 Occupations. *Tinbergen Institute Discussion Paper 2019-035/V*

Montenegro, C.E., and H.A. Patrinos. 2014. "Comparable Estimates of Returns to Schooling Around the World". Policy Research Working Paper No. 7020. Washington, DC: World Bank Group.

Mullis, I.V.S., M. von Davier, P. Foy, B. Fishbein, K.A. Reynolds, and E. Wry. 2023. "PIRLS 2021 International Results in Reading". Boston College, TIMSS & PIRLS International Study Center.

Orben, A., A.K. Przybylski, S-J. Blakemore, and R.A. Kievit. 2022. "Windows of developmental sensitivity to social media". *Nature Communications* 13 (1649).

Organisation for Economic Co-operation and Development (OECD). 2023. "PISA 2022 Results (Volume I): The State of Learning and Equity in Education". Paris: OECD Publishing.

Patrinos, H.A., and N. Angrist. 2018. "Global Dataset on Education Quality: A Review and Update (2000-2017)". Policy Research Working Paper No. 8592 Washington, DC: World Bank Group.

Petreski, M. 2025. "Sectoral Shifts, Wage Dynamics, and the Value of Education in the Western Balkans". *Background paper.*

Petreski, M. 2025a. "Job Quality Deprivation in the Western Balkans". *Background paper.*

Petreski, M. 2025b. "AI and Jobs in the Western Balkans: A Data-Driven Assessment of Exposure and Complementarity". *Background paper.*

Rivkin, S.G., E.A. Hanushek, and J.F. Kain. 2005. "Teachers, Schools, and Academic Achievement". *Econometrica* 73 (2): 417-458.

Rudolf R., and N. Kim. 2024. "Smartphone use, gender, and adolescent mental health: Longitudinal evidence from South Korea". *Population Health* Volume 28.

Santiago-Rosario, M.R., K. McIntosh, S. Izzard, D. Cohen-Lissman, and E. Calhoun. 2023. "Is Positive Behavioral Interventions and Supports (PBIS) an Evidence-Based Practice?" Center on PBIS, University of Oregon.

Schleicher, A. 2022. "PISA 2022 Insights and Interpretations". Paris: OECD.

Shmis, T. et al. 2025. "Foundational literacy in the Western Balkans". *Background paper.*

Shmis, T., P. Cahu, L. Brajkovic, and J. Gresham. 2025. "Unlocking Potential: Enhancing Education Quality in the Western Balkans Based on Insights from the PIRLS 2021 and PISA 2022 Studies". Education Working Paper; No. 7, January 2025. Link

Shorrocks, A.F. 2013. "Decomposition procedures for distributional analysis: a unified framework based on the Shapley value". *The Journal of Economic Inequality* 11 (1): 99-126.

Studer, J., S. Marmet, M. Wicki, Y. Khazaal, and G. Gmel. "Associations between smartphone use and mental health and well-being among young Swiss men". *Journal of Psychiatric Research* 156: 602-610.

The Conference Board. 2025. "Total Economy Database - Growth Accounting and Total Factor Productivity". Link.

Twenge, J.M. 2022. "Generations: The Real Differences between Gen Z, Millennials, Gen X, Boomers, and Silents—and What They Mean for America's Future". New York: Simon and Schuster.

United Nations, Department of Economic and Social Affairs (UNDESA) (Population Division). 2024. "World Population Prospects 2024". Link

VoxNews (8 December 2025). "Investigations into IPARD funds stall". Link

World Bank. 2023. "Making Teacher Policy Work". Washington, DC: World Bank.

———. Forthcoming. "Growth and Jobs Report for North Macedonia".

World Bank (2025). ECA Economic Update, forthcoming.

Appendixes

Appendix 1: Methodology to Box 1.1

To estimate the impact of public investment on output we run a fixed effects model controlling for country-fixed effects and common correlated effects (CCE):

$$\frac{I_{it}^p - I_{it-1}^p}{Y_{it}} = \beta_i \left(\frac{I_{it}^g - I_{it-1}^g}{Y_{it}} \right) + \varepsilon_{it} \qquad (1)$$

where I_{it}^p is private investment and I_{it}^g is real cyclically-adjusted public investment. The subscripts i reflects countries. To identify public investment shocks, we follow Adarov, Clements, and Jalles (2024) and look at large shifts in cyclically-adjusted public investment. First, output elasticities of public investment are estimated by regressing the log of real public investment on the log of real GDP using heterogenous panel models with CCE. Second, we cyclically adjust real public investment using the estimated elasticities, and an output gap where potential GDP is defined using an Hodrick-Prescott (HP) filter with lambda of 6.25. Third, we use only shifts in real cyclically-

adjusted public investment as defined in equation (1) that are at least one standard deviation away from the country-specific mean. Large increases in cyclically adjusted public investment more likely to reflect discretionary policy moves (Alesina and Ardagna 2010).

Data

The variables are sourced from the International Monetary Fund's Investment and Capital Stock Dataset available from 1960 to 2019. Real GDP and Public investment are in billions of constant 2017 international dollars. To ensure sufficient observations for estimation, only countries with 30 consecutive annual observations are used. Furthermore, since the dataset assumes public and private investment growth are equal when public investment data is missing, we exclude country observations where this is the case. We also exclude observations that are in the 1st and 99th percentile. Estimations are done from 1980-2019.

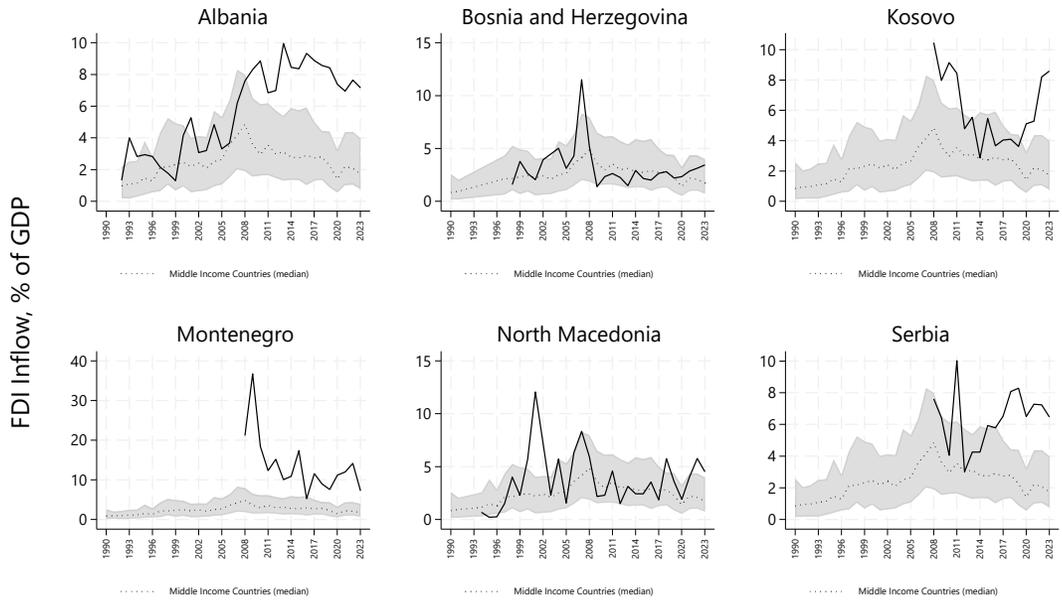**TABLE A1: Impact of public investment on private investment**

Factor	(1)	(2)	(3)
	WB6	ECA	European Union
Public investment	0.693***	0.308**	0.220**
	[0.187]	[0.128]	[0.0985]
Observations	149	406	987
R-squared	0.242	0.194	0.189
F stat	13.88	23.48	65.30
Number of countries	5	14	27

Standard errors in brackets
*** p<0.01, ** p<0.05, * p<0.1
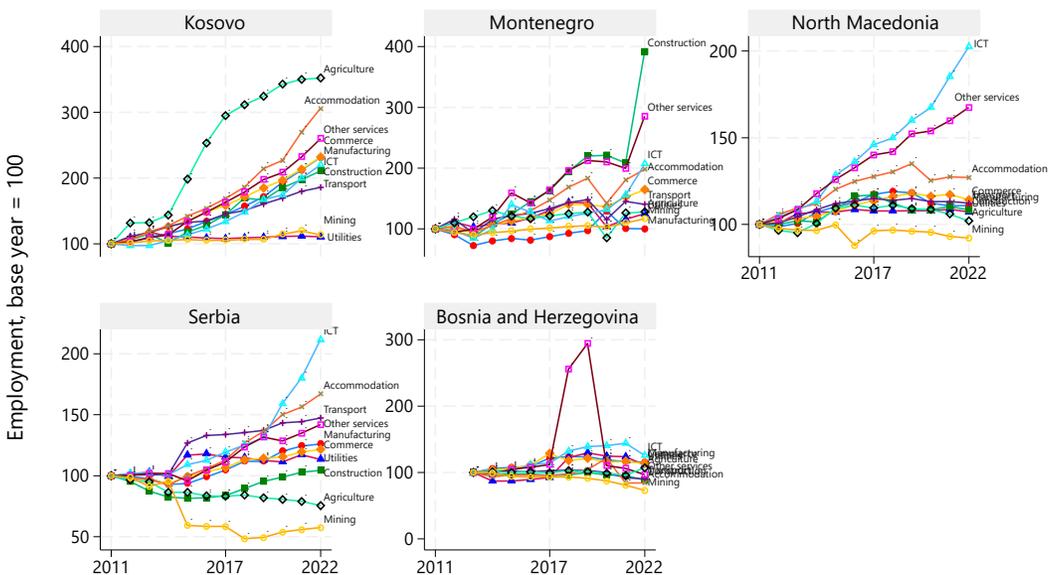
Appendix 2: Detailed Country-level Charts

FIGURE A2.1: Net FDI inflow as share of GDP, Western Balkan countries, 1990-2023

Source: World Bank staff estimates based on UN Conference on Trade and Development (UNCTAD) dataset.
Note: FDI net inflow is the value of inward direct investment made by nonresident investors in the reporting economy, including reinvested earnings and intracompany loans, net of repatriation of capital and repayment of loans. The shaded part is the interquartile range for middle-income countries included in the UNCTAD dataset.

FIGURE A2.2: Employment growth, by sector, Western Balkan countries, 2011-22

Source: World Bank staff calculations based on firm-level data from statistical agencies, excluding ALB and BIH. Data for BIH is based on ORBIS.
Note: Total employment is calculated by taking the sum of firm-level employment per sector per year.

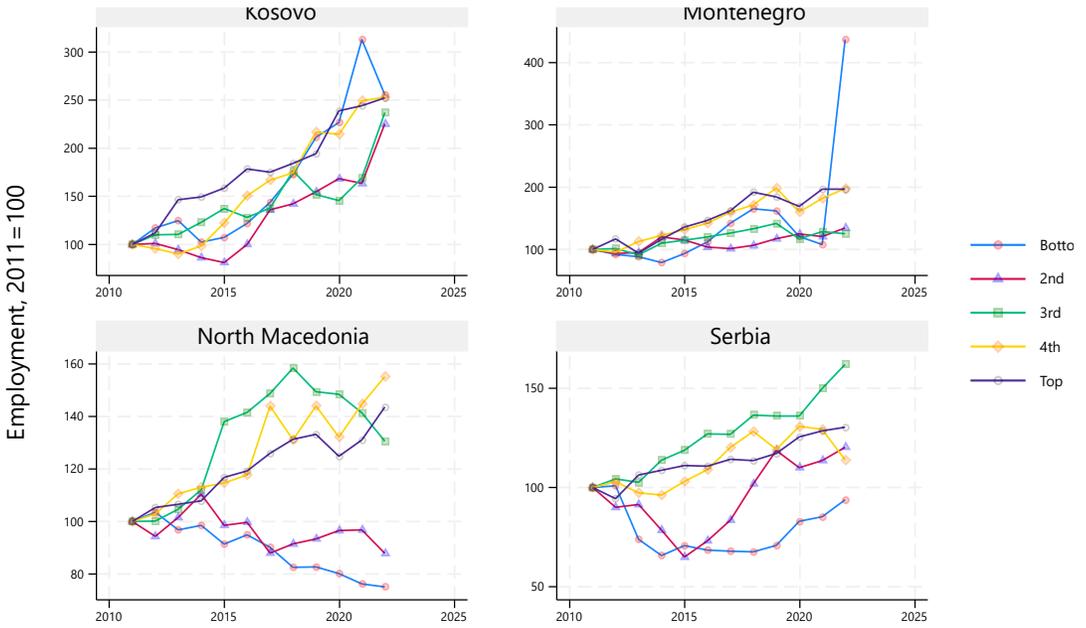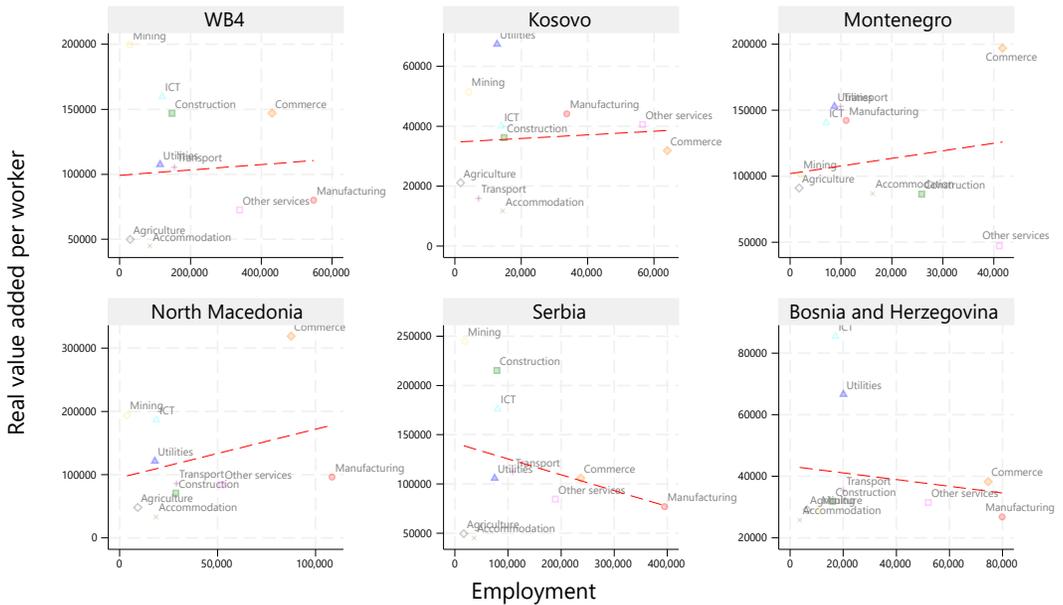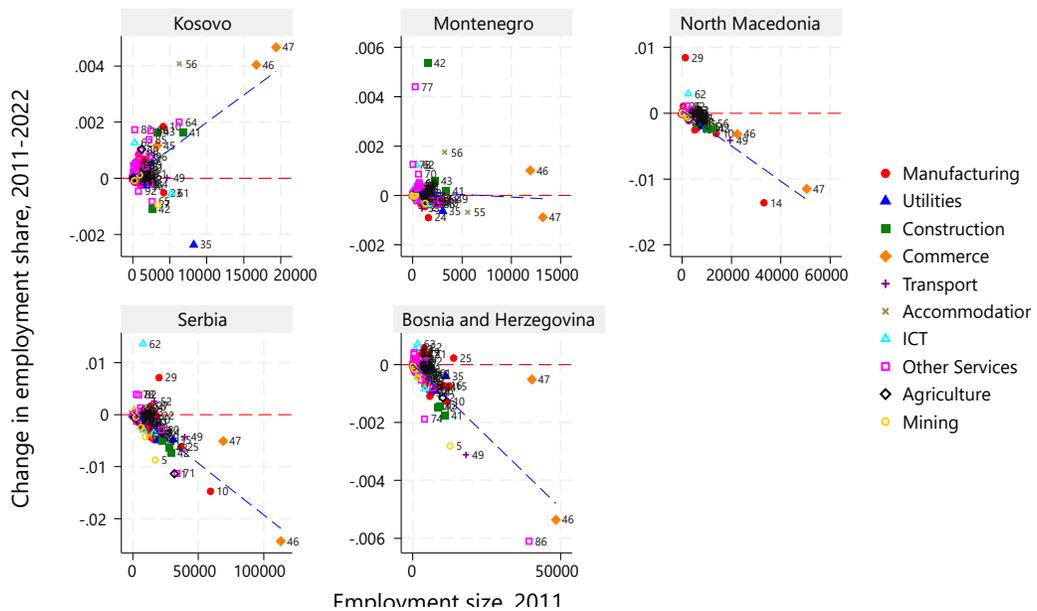**FIGURE A2.3: Employment by labor productivity quintile, 2011-22**

FIGURE A2.4: Average value added per worker and employment in the Western Balkans, 2022

Source: World Bank Staff calculations based on firm-level data from statistical agencies, excluding ALB and BIH. Data for BIH is based on ORBIS.
Note: Real value added per worker is weighted by employment. Observations with missing real value added or employment are dropped.

FIGURE A2.5: Change in employment share and employment size, by countries, 2011-22

Appendix 3. Methodology and Construction of the Job Quality Index (JQI)

The JQI is constructed following the Alkire-Foster method, adapted from multidimensional poverty measurement, and incorporates five dimensions:

Dimension	Variables / Indicators Used	Rule for Inclusion in Dimension
1. Income	- Wage income < 2/3 of country-year specific median income	Wage must exceed the calculated threshold of 2/3 of the median wage.
2. Benefits	- Health insurance	Job satisfies **at least one** of the six listed benefit indicators to be counted as successful in this dimension.
	- Unemployment insurance	
	- Pension contribution	
	- Social security	
	- Paid annual leave	
	- Paid sick leave	
3. Stability	- Tenure ≥ 3 years (or ≥1 year if age 15–24)	Job satisfies **at least one** of these four indicators. Formal employer must not overlap with benefit indicators.
	- Written contract	
	- Permanent job	
	- Employer is formal (public/registered/with accounts)	
4. Working Conditions	- Does not work >48 hours/week	**At least two of the three conditions must be met** for a job to be counted as having adequate working conditions (i.e., a conjunctive rule, not disjunctive like the other dimensions).
	- Does not work a second paid job	
	- Does not want to work more hours	
5. Skills Mismatch	- Over-education mismatch using empirical method (ISCO–ISCED mapping)	Worker is deprived if their level of education is **within** ±1 ISCED level for their occupation at the 2-digit aggregation of ISCO-08.

A worker is considered to be in a low-quality job if they fall short in two or more dimensions—this constitutes the dual cutoff strategy of the Alkire-Foster method:
- The **first cutoff** determines whether an individual is deprived in a given dimension (for example, income below the threshold), and
- The **second cutoff** identifies those who are deprived in a sufficient number of dimensions to be considered as experiencing multidimensional job quality deficits (in our case two, three, four or five).

Once individuals are classified, we compute standard Alkire-Foster indices:
- The **headcount** ratio (H): the proportion of workers in low-quality jobs.
- The **intensity (A)**: the average share of unmet dimensions among those with low-quality jobs.
- The **adjusted headcount ratio ($M_0 = H \times A$)**: a composite measure reflecting both prevalence and intensity of poor job quality.

This methodology not only enables a consistent way to identify workers in poor-quality jobs, but also allows for decomposition by dimension, population group, or geographic area, providing rich policy-relevant insights.

Country	Year	Share of wage employees	Headcount ratio	Average intensity	Adjusted headcount ratio
Bosnia and Herzegovina	2019	74.8%	14.3%	45.3%	6.5%
Kosovo		72.8%	69.7%	46.6%	32.5%
North Macedonia		78.9%	18.2%	44.6%	8.1%
Serbia		72.3%	14.3%	43.7%	6.2%
Bosnia and Herzegovina	2023	86.1%	7.7%	43.0%	3.3%
Kosovo		78.6%	58.7%	45.0%	26.4%
North Macedonia		84.0%	13.7%	44.4%	6.1%

Source: Labor Force Surveys; own calculations.

Towards
Better Jobs