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WESTERN BALKANS REGULAR ECONOMIC REPORT
No.18 | Fall 2020

An Uncertain Recovery

Western Balkans
Regular Economic Report No.18

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WORLD BANK GROUP
Macroeconomics, Trade & Investment

Acknowledgements

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

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Research assistance was provided by Suzana Jukić. Anne Grant provided assistance in editing, and Budy Wirasmo assistance in designing.

The dissemination of the report and external and media relations are managed by an External Communications team comprised of John Mackedon, Artem Kolesnikov, Paul A. Clare, Lundrim Aliu, Anita Božinovska, Ana Gjokutaj, Jasmina Hadžić, Gordana Filipovic, Mirjana Popović, Sanja Tanić and Carl P. Hanlon.

The team is grateful to Linda Van Gelder (Regional Director for the Western Balkans); Lalita Moorty (Regional Director, Equitable Growth, Finance and Institutions); Enrique Blanco Armas (Lead Economist, Western Balkans); and the Western Balkans Country Management team for their guidance in preparation of this report. The team is also thankful for comments on earlier drafts of this report received from the Ministries of Finance and Central Banks in Western Balkans countries.

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

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The cutoff date for the data used in this report was September 30, 2020.

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An Uncertain Recovery

1. Overview

As elsewhere in the world, in the Western Balkans the COVID-19 pandemic has plunged countries into deep recession. While the outlook remains uncertain, economic activity in the region is now projected to contract by an estimated 4.8 percent in 2020—1.7 percentage points below the forecast in the Spring 2020 *Regular Economic Report* (RER). The primary causes are the drop in both domestic and foreign demand and disruptions in supply chains, especially early in the year when throughout the world countries imposed severe containment measures, such as lockdowns. A second and much stronger wave of the pandemic in the Western Balkans since mid-June and political uncertainty about elections in some countries have further impeded economic recovery. Due to travel restrictions and social distancing requirements, the summer tourism season has essentially been lost, which has hit Albania, Kosovo, and Montenegro particularly hard.

Because of the recession, labor market conditions have taken a turn for the worse and welfare improvements have been interrupted, although government response measures cushioned the blow. Before COVID-19 broke out in early 2020, most of the countries in the Western Balkans had made notable progress in reducing poverty and boosting household incomes. The crisis interrupted, and in some cases reversed, this process. By June, the unemployment rate in the region had risen by 0.5 pp, 139,000 jobs had been lost, and employers struggling with the challenges the pandemic presented have reduced employee work hours. However, job support schemes and other government measures contained the labor market fallout and helped to prevent larger spikes in poverty. Still, in Albania, Kosovo, Montenegro, and Serbia, the COVID-19 crisis is estimated to have pushed more than 300,000 people into poverty—a significant number, but less than half of what it would have been without the response measures.

Policy efforts in the region need to remain focused on fighting the pandemic, limiting the economic damage and facilitating recovery. Following the coronavirus resurgence across much of the region, the pandemic has levelled off in only two countries—Serbia and Kosovo. Policymakers have so far refrained from reintroducing restrictions on a scale like the one observed in the second quarter. However, in light of the arrival of colder weather in the months ahead and stubbornly high infection rates, policymakers may be forced to implement new restrictions. Going forward all countries should ensure that their health care systems are adequately resourced to contain the outbreak. Where infections surge and lockdowns are required, economic policy should continue to cushion household income losses with well-targeted measures as well as provide support to firms suffering the consequences of mandated restrictions on activity. Where infections edge down and economies are reopening, targeted support should be gradually unwound, and policies should provide stimulus to lift demand and ease and incentivize the reallocation of resources away from sectors likely to emerge persistently smaller after the pandemic.

Because the crisis and government responses have created major fiscal pressures, rebuilding fiscal sustainability will be a high priority throughout the region as the recovery takes hold. Falling revenues and rising spending needs together have put heavy stress on fiscal balances. Western Balkan countries have already put forward massive economic packages in 2020, with Serbia's the most sizable—which means that in all six countries deficits will deteriorate drastically, from 4 to 10 percent of GDP for most and almost 12 percent for Montenegro. Deficits will likely stay high in 2021, although not as high as in 2020. Public and publicly guaranteed debt is projected to peak in 2021 at close to 60 percent in North Macedonia and Serbia, 81.3 percent in Albania, and 97.9 percent in Montenegro. Throughout the region tighter fiscal policy and vigilant debt management is central to ensuring committed—and accelerated—debt reduction once the health and economic crises caused by the pandemic are brought under control. In this context, fiscal rules constitute an anchor that will help countries there to gradually reduce their public debt over the medium term.

Across the Western Balkans, resilient recovery will depend on strengthening the fundamentals. In 2022 the total output loss due to the crisis is projected to be fully recovered; but the crisis also offers the opportunity to make growth more resilient in the future by implementing a number of structural reforms. These include more effective public spending and better management of public investments; rebuilding fiscal space by heightening tax compliance, greater efficiency in spending, and new fiscal instruments, such as green taxes and digital taxation; building strong, independent, and accountable institutions; and committed adherence to the rule of law. The recent contraction in global trade and the early expectations of a shift in supply chains in addition demonstrate the importance of structural policies that enhance export competitiveness and diversify products and markets—all of which are greater in regional peers than in the Western Balkans. Moving forward, a resilient economic recovery will require the adoption of more productive processes and services that are well-adapted to the new economic realities. Regulatory changes will be needed to help firms align their business models with the new post-COVID-19 normal while moving to overcome the structural barriers to competitiveness and innovation.

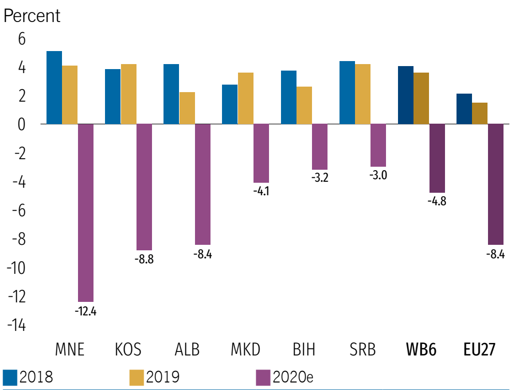
The extent of the recovery and eventual growth is far from risk-free: In the short term the speed of the recovery will depend on how the pandemic evolves and the widespread deployment of a vaccine that allows for the normalization of economic activity. A delayed recovery in the region's main trading partners, especially the EU, could slow economic normalization by diminishing trade and remittance flows. Domestically, the recovery will also be affected by a return to fiscal sustainability and continued stability of the financial sector as repayment moratoriums and other temporary measures are withdrawn. Other domestic factors may also matter, such as the local elections in BiH in November and the national elections in Albania in 2021.

2. COVID-19 has caused deep recessions in the Western Balkans

Like Western Europe and the rest of the world, the Western Balkans are enduring severe recessions in 2020. Since the COVID-19 crisis began, all measures of uncertainty about the path of the global economy have been off the charts. Uncertainty about the development of a vaccine and how the pandemic has changed human behavior is making economic forecasting even more tentative. Output in the Western Balkan region is projected to contract by 4.8 percent in 2020 (Figure 2.1). The recession is driven by a plunge in both domestic and foreign demand and disruptions in supply chains, especially earlier in the year when countries around the world imposed severe containment measures and lockdowns. Since mid-June a second and much stronger wave of the pandemic in the Western Balkans, and in some countries political uncertainty related to elections, have further delayed economic recovery after the sudden stop in some economic activities during lockdowns in the second quarter (Q2). Deeper integration into the now-disrupted global value chains has had significant costs for industry and export-oriented manufacturing, especially for Bosnia and Herzegovina (BiH) and North Macedonia. Growth in both countries and Serbia is projected to drop between 3.2 and 4.1 percent.

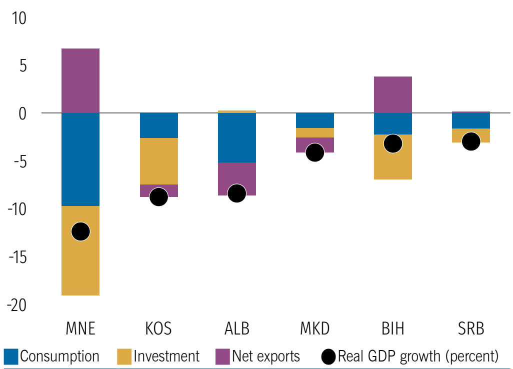
The recession will be particularly severe in Montenegro, Albania, and Kosovo because of their reliance on tourism—the sector most affected by the COVID-19 crisis. Globally, according to the United Nations World Tourism Organization, international tourist arrivals could fall by as much as 50–60 percent. In 2019 tourism accounted for 20 percent or more of GDP in Albania, Montenegro, and Kosovo (due to diaspora visits); in 2020 growth in these countries is projected to decline by 8.4 to 12.4 percent. Due to the resurgence of COVID-19 in the region during the peak summer months, Montenegro's 2020 tourism receipts are projected to reach just 25 percent of 2019 receipts which is projected to cause the only double-digit recession in the region. Given

Figure 2.1. Countries relying on tourism have been hit hardest.



Source: National statistical offices and World Bank staff estimates.

Figure 2.2. After years of fueling growth in the region, consumption has plummeted.



Source: National statistical offices and World Bank staff estimates.

the seasonality of tourism and the long-lasting effects on transport and tourism, growth later in the year is unlikely to compensate for the summer season losses. Only in Kosovo might tourism resume faster: 80 percent of travel service exports are driven by its diaspora.

In recent years consumption has been the main driver of growth in the region but has plunged since the pandemic began. Throughout the region the loss of jobs and wages since the start of the crisis, exacerbated by the high uncertainty, has cut deeply into private consumption (Figure 2.2). Thus, despite a rise in government consumption in all six countries, total consumption is expected to subtract from growth. The decline in total consumption is the largest contributor to negative growth in Montenegro, Albania, North Macedonia, and Serbia. It is projected to subtract 9.7 percentage points (pp) from 2020 growth in Montenegro and 5.2 pp in Albania due to declining tourism revenues, employment, and wages.

A steep decline in private investment as uncertainty has risen is contributing to the recessions (Figure 2.2). In Kosovo and Montenegro, limited fiscal space and further delays in completing projects are expected to also reduce public investment. Public investment in roads contributed to growth in North Macedonia, but lower net foreign direct investment (FDI) is offsetting this effect because of delays in investments announced earlier. Lower net exports are also impeding economic activity in Albania, North Macedonia, and Kosovo. In Albania, drops in tourism and textile processing and lower oil prices in 2020 are driving the projected decline of total exports by 37 percent. Exports are expected to drop by 10.5 percent in North Macedonia primarily due to production cuts by foreign-owned multinational enterprises. In Montenegro and BiH, the drop in import-dependent consumption and investment is cutting into imports so much that net exports are projected to contribute positively to growth.

On the production side, severe contractions in services are driving recession in the region. While economic activity declined in most sectors in the first half of the year, service outputs plummeted in all six countries during the Q2 lockdowns. In Serbia, real value added in services dropped by 6.6 percent y-o-y, despite higher growth in the IT and financial sectors. By June some key drivers of growth in North Macedonia in recent years—trade, tourism, and transport—together contracted by 12.3 percent y-o-y. Manufacturing was also adversely affected in all six countries but most severely in North Macedonia, where it dropped by 16.1 percent y-o-y.

A resilient economic recovery from the crisis requires businesses to adopt more productive processes and adjust services to the new economic realities, but firms in some Western Balkan countries have been slow to adopt new products or processes. Arguably, the COVID-19 crisis will lead to permanent changes in consumption and preferences, accelerating such recent global trends as automation, e-commerce, home-based work, and electronic modes of communication, to which the private sector must adjust. To which extent did Western Balkan firms adopt new products, services, or processes before the crisis which would have raised their productivity and better prepare them to adjust to today's changes? Pre-COVID-19, 40 to 50 percent of all formal firms in Serbia, BiH, North Macedonia, and Albania reported to have adopted new products or services in the last 3 years before the crisis, which is just above the developing country average. In Kosovo and Montenegro only 30 and 20 percent of all formal firms reported to have adopted new products. And fewer firms in the region adopted new business processes: less than 30 percent of firms in all six Western Balkan countries had adopted new business processes before the crisis—just below the developing country average (Box 2.1).

Inefficient and unequal implementation of regulation in some Western Balkan countries undermines the incentives for firms to compete by investing in riskier but more efficient business processes. Whether firms introduce new products or adopt new processes to raise their profits by temporarily breaking away from their competitors depends on different aspects of the business environment that undermine a level playing field among all firms. Among such aspects within the region, the inefficient and discriminatory implementation of regulation in some areas appear to favor some firms over others, relieving any pressure on them to compete by adopting more productive business processes or improving their services. Corruption distorts a level playing field among firms by encouraging profit maximization through lobbying and bribes rather than innovation (Box 2.1).

Box 2.1. Barriers to a recovery led by private sector productivity growth in the Western Balkans.

A resilient economic recovery from the crisis in the Western Balkans requires private sector productivity growth through the adoption of new products and processes adjusted to the new economic realities. Lower revenues and higher spending to mitigate the immediate impact of COVID-19 have shrunk the space for public investment or consumption to support subsequent recovery of the economy. Moreover, the COVID-19 crisis will arguably lead to permanent changes in consumption behavior and preferences, which requires the private sector to adjust. This includes an acceleration of several recent global trends such as automation, e-commerce, home-based work, electronic modes of communication, etc. But it also includes adjusting products and services in sectors that have been strongly affected by the crisis such as tourism, transport, retail trade, restaurants, etc. A strong and sustainable economic recovery in the region thus requires firms that are prepared to adopt new information and communication technology (ICT), services, and processes to raise their productivity helping them to adjust to these changes.

How well prepared is the Western Balkan private sector to adjust to changing demands?

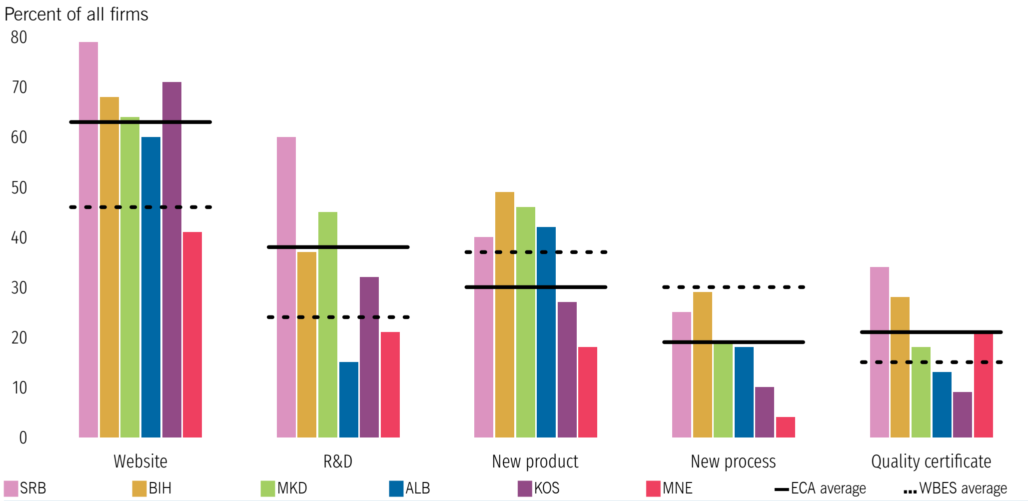
Before entering the crisis, firms in Serbia, Bosnia and Herzegovina (BiH), and North Macedonia were more likely than those in neighboring countries to introduce new products or services. This box draws on the 2019 World Bank Enterprise Surveys (WBES) to assess the readiness of the Western Balkan formal private sector to lead the economic recovery from the emerging global crisis. The survey results provide a mixed picture. Overall, firms in Serbia, BiH, and to a lesser extent also in North Macedonia tended to be on par with the average country in Eastern Europe and Central Asia (ECA) in adopting new products or services before the crisis. In Albania the picture is more mixed while firms in Kosovo and Montenegro were not up to the capacity of firms in Eastern Europe and Central Asia (ECA) to adopt new business models (Figure B2.1.1). For example, more than 40 percent of all formal firms in BiH, North Macedonia, Albania, and Serbia had adopted new

Box 2.1 continued

products or services in the three years before the crisis, which is above the averages in ECA and among all WBES firms. Similarly, almost half of all firms in Serbia, North Macedonia, and BiH invested in research and development (R&D) pre-COVID-19, which better positions them to adjust their products and processes after the crisis. In contrast, firms in Albania, Kosovo, and Montenegro had invested fewer resources into R&D and were less likely to adapt their products and processes to new market conditions before the crisis.

Firms in all six Western Balkan countries had trailed other developing countries in adapting their business processes to new market conditions. Notably, less than 30 percent of all firms in all six Western Balkan countries had adopted new business processes before the crisis—less than the developing country average (Figure B2.1.1). When it comes to IT, almost 80 percent of all firms in Serbia and about two-thirds of all firms in Kosovo and BiH had a website in 2019, exceeding the ECA average. In contrast, only 41 percent of formal firms in Montenegro had a website, less than the developing-country average despite its service-intensive economy.

Figure B2.1.1. Firms in Serbia, BiH, and North Macedonia were more likely to adopt new products or services.



Source: 2019 World Bank Enterprise Survey findings; World Bank staff calculations.

Why have some Western Balkan firms been slow to adopt IT, new services, or new processes?

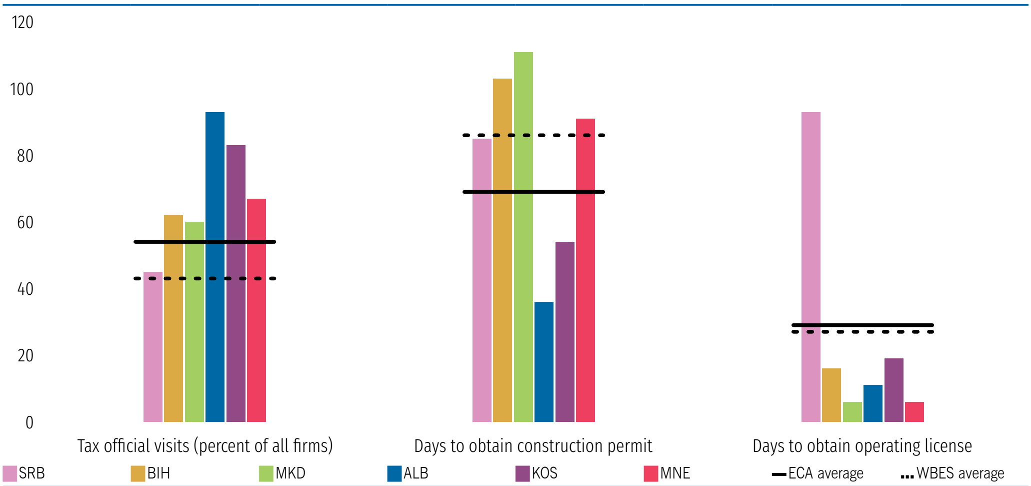
The incentives of firms to adopt new products or processes to raise their profits and market shares by (temporarily) breaking away from their competitors depends on various aspects of the business environment that undermine a level playing field among all firms. The WBES capture 15 different dimensions of the business environment ranging from access to finance, human capital, and different types of infrastructure to regulatory and administrative barriers. Here we focus on two specific aspects of the business environment which rank prominently in the region as business constraints: inconsistent enforcement of regulation and corruption. Both rank among the top 10 and top 5 constraints on growth as perceived by firms in all six Western Balkan countries. Inconsistent enforcement of regulations favors some firms over others by lowering their costs relative

Box 2.1 continued

to competitors, thus giving them profit windfalls, and relieving any pressure to compete based on adopting more productive business processes or developing better services. Similarly, corruption encourages profit maximization through lobbying and bribes rather than innovation.

Inefficient and unequal implementation of regulation and tax administration raise firms' costs in the Western Balkans and can undermine their incentives to compete through more efficient processes. Firms in Albania, Kosovo, and BiH more often report that their growth is limited by licensing and permits (up to one-third of all firms) and tax administration (up to 40 percent). The perceived growth constraint due to inefficient tax administrations in these countries is reflected in the indicators reported by firms: 93 percent of all firms in Albania and 83 percent in Kosovo reported to have been visited by tax officials in 2019 (Figure B2.1.2). This compares to about two-thirds in BiH, Montenegro, and North Macedonia and 45 percent in Serbia. Thus, firms in all Western Balkan countries except Serbia are more often inspected by tax officials than the average developing country; tax inspections in Serbia are on par with the ECA average. Moreover, the time to obtain a construction permit as reported by firms in BiH and North Macedonia is much longer than the ECA average and obtaining an operating license is much more lengthy in Serbia (93 days) than in all Western Balkan countries (between 6 and 29 days). The inefficient implementation of regulations in these countries add to the cost burden on firms and open the door for public officials to discriminate among firms, undermining fair competition and thus their incentives to innovate.

Figure B2.1.2. Inconsistent enforcement of regulation can discourage business innovation.



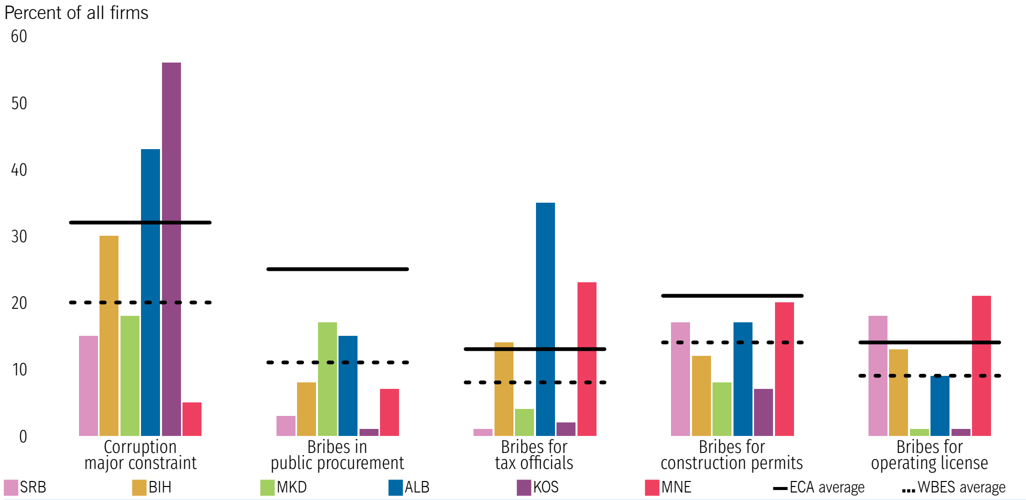
Source: 2019 World Bank Enterprise Survey findings; World Bank staff calculations.

Firms perceive corruption as high in some Western Balkan countries, and bribes are reported in all countries but for different types of regulations, with 56 percent of all formal firms in Kosovo and 43 percent in Albania citing corruption as a major barrier to their growth (Figure B2.1.3). The share of perceived or reported corruption is significantly lower in the other four Western Balkan countries. Interestingly, while the majority of firms in Kosovo perceive corruption as a major constraint, few reported having been asked for bribes. In contrast, at 5 percent Montenegro has by far the lowest share of firms that consider corruption as a major constraint but more than one-fourth of Montenegrin firms reported having paid bribes to tax officials and for construction permits and

Box 2.1 continued

operating licenses to speed up processes to gain an edge over competitors. A significant share of firms in the Western Balkans report bribes as a common practice but the types of regulation requiring these "top-ups" differ by country. In line with the burdensome process of tax inspections, 35 percent of firms in Albania report bribery as a common practice in dealing with tax officials, as do 23 percent in Montenegro, far above the developing country average of 13 percent. Firms in North Macedonia, in turn, more often reported paying bribes to secure government contracts (17 percent), bribes to obtain construction permits were more common in Montenegro, Serbia, and Albania as were bribes for operating licenses in Montenegro and Serbia. Speeding up processes through illegal payments can help some firms to secure lucrative advantages over their competitors without having to invest in the risky process of innovation.

Figure B2.1.3. A significant share of firms report that bribery is a common practice in the Western Balkans.



Source: 2019 World Bank Enterprise Survey findings; World Bank staff calculations.

3. Labor market conditions worsened, but so far job support schemes have contained the fallout

The steep decline in activity has hit the labor market. Restrictions on economic activity and mobility in the Western Balkans and across Europe affected businesses and their workforce in unprecedented ways. Some sectors were required to shut down, supply chains were curtailed, travel was banned, and some workers had to isolate. Throughout the Western Balkans losses have threatened business operations, and business solvency. Most affected have been small and medium-sized enterprises (SMEs) [1]nd informal businesses. By April 2020, all Western Balkan countries had in place programs to encourage enterprises to retain jobs. In addition to health protection measures, tax relief, guarantee schemes, subsidized credit lines, and social assistance measures, most countries also moved to save jobs through partial or full compensation for wage costs.

Job retention schemes have been sizable and timely, but the scope of support varies greatly (Table 3.1). Eligibility criteria ranged from firms mandated by government to close (BiH) and those whose revenues were down at least 30 percent (North Macedonia) to all SMEs and sole proprietors (Serbia). The subsidy per employee varied from €120 to €260 depending on the country's fiscal space. No Western Balkan country limited support to specific sectors, but Montenegro, Albania, and North Macedonia offered more favorable terms to tourism, hospitality, and transport companies. Since governments' goal was job retention, in Serbia companies that had fired more than 10 percent of their employees were ineligible, and in North Macedonia those that received support had to retain workers for two additional months. In some countries salary subsidy schemes were complemented by development bank "soft" loans for paying salaries; other countries offered support to cover social security contributions. Montenegro and Kosovo provided salary subsidies for newly registered employees in order to stimulate business and job formalization.

Despite all these efforts, by June 2020 unemployment in the Western Balkans had risen (Figures 3.1 and 3.2).[2] Though 40 percent of all private sector employees in the Western Balkans (2.1 million) were covered by wage subsidies, the average unemployment rate in June 2020 was an estimated 15.9 percent, up 0.5 pp from June 2019, although Serbia had avoided a rise in unemployment. In North Macedonia, despite government support to protect the labor market (see Box 3.1), the unemployment rate was 16.7 percent, the first increase since 2011. Although Serbia's unemployment rate hit a record low of 7.3 percent in June, the decline was due to more inactivity rather than more employment; the Serbian labor force had shrunk by 120,000 people, mostly from the destruction of informal jobs.

In Q2 of 2020 close to 139,000 jobs were lost, half of them in Albania and Serbia. The drop

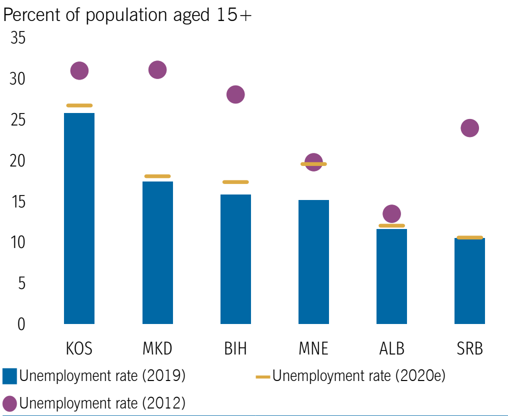
1 See Western Balkans RER No.17, "Coping with the Effects of COVID-19 in the Western Balkans: A firm-level Perspective." http://documents1.worldbank.org/curated/en/444031591289647448/pdf/The-Economic-and-Social-Impact-of-COVID-19-Private-Sector.pdf

2 The COVID-19 crisis caused delays in publication of Q2 labor force survey data for Kosovo and BiH. Using administrative employment and unemployment data helped approximate labor developments in BiH and tax data on those employed were used to assess impact of the crisis on Kosovo.

Table 3.1. Wage subsidy programs in the Western Balkans during the COVID-19 crisis.

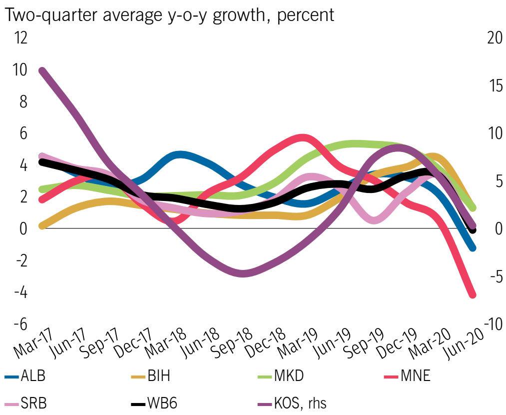
Country	Wage Subsidy Programs
Albania	Initially the salary subsidy scheme support was just for small businesses and the self-employed but was quickly expanded to over 75,000 businesses and self-employed that together had 170,000 employees. The total cost was €76 million. A credit guarantee scheme (€85 million) was introduced for SMEs to pay 3 months of wages (100 percent coverage with the interest paid by the government), which enabled local banks to issue loans totaling €53 million for salaries to 550 companies, benefiting about 46,000 employees.
Bosnia and Herzegovina	Given the high level of fiscal decentralization, BiH had several different schemes at subnational levels, rather than a single national one. Complete data are not available, but for April through June BiH spent an estimated €70 million on salary subsidy schemes, supporting over 460,000 employees—more than half of registered employment. The amount per worker ranged from €101 (half the minimum salary if laid off due to restrictions) to €203 (if forbidden to work by the government).
Kosovo	Subsidies covered private sector wages for two months at a net of €170 per month with additional subsidies for pension contributions for the same period. Informal employees registered for the first time received €130 per month. Employees in essential businesses like food retailers, pharmacies, and bakeries received bonuses of €100 per month for two months. More than 130,000 employees received wage subsidies since the outbreak.
Montenegro	Wage subsidies ranged from 100 percent of the gross minimum wage for closed sectors during lockdown and for tourism, to 50 percent for other sectors. They were in place for April and May, and later extended for closed sectors (100 percent), tourism (70 percent), hospitality, and transport (50 percent) until September. The subsidies also covered 50 percent of the gross minimum wage for employees in quarantine or isolation and parents taking care of children under 7 and 70 percent of the gross minimum wage for 6 months for newly formal employees. The subsidy programs supported over 64,000 employees.
North Macedonia	The salary subsidy was €235 per employee (the net national minimum salary) for April–June; only companies whose revenues were down 30 percent were eligible. Companies in tourism, hospitality, and transport also received subsidies of 50 percent of social contributions. The subsidy benefited about 20,000 companies (1/3 of all active companies) with 130,000 employees (1/3 of all private sector employees). Total cost was about €80 million (0.7 percent of GDP).
Serbia	Serbia provided coverage for five months (May–September) at a minimum of €255 for the first three months and 60 percent of that (or €155) thereafter. About 1 million employees benefitted (about 37 percent of total employment). The total cost was €1.13 billion, about 2.4 percent of GDP.

Figure 3.1. Unemployment rose across the region, except in Serbia...



Source: National statistical offices and World Bank staff estimates.

Figure 3.2 ...and employment plunged.



Source: National statistical offices and World Bank staff estimates.

Box 3.1. Wage Subsidies Preserved 80 percent of Vulnerable Jobs in North Macedonia.

The wage subsidy scheme cushioned the impact of the crisis on the North Macedonian labor market. According to the Employment Agency, 11,734 people lost their jobs since the beginning of the crisis, but that is only 2.8 percent of the registered employees in private companies. Most jobs were lost in manufacturing, and almost half were caused by discontinuation of short-term contracts. According to *Finance Think*, a local think-tank, the wage subsidy scheme helped preserve 80 percent of jobs that would have otherwise been lost.

Figure B3.1 Most subsidies were directed to MSMEs…

Distribution of subsidies by company size (percent)

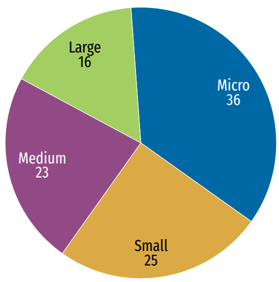
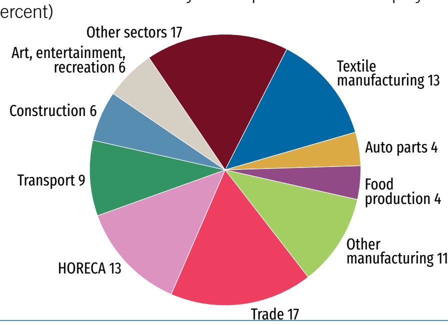


Figure B.3.2. …and to the services sector.

Distribution of subsidies by sector per number of employees (percent)

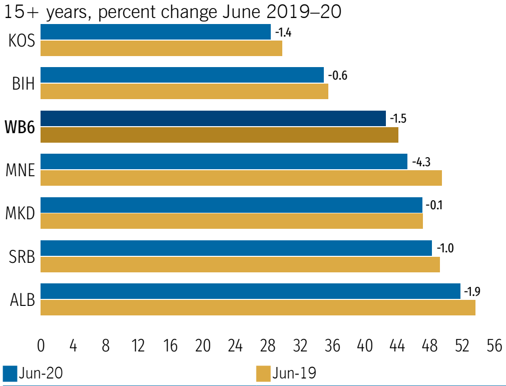


Source: Public Revenue Office.

By June 2020, after an initial 5 percent drop between February and April, the average North Macedonian salary had almost recovered to the pre-crisis level of about €440. However, workers in the sectors most affected, which tend to pay below-average salaries, saw the deepest reductions: tourism (in June still 19 percent below January), the arts, entertainment and recreation, transport, and manufacturing. Wage subsidies helped preserve the jobs but did not sustain the same level of income in those sectors. The scheme was discontinued in July but restored for October-December because the recovery was slow and fragile. To ensure that the whole process was transparent, the government listed all companies subsidized at https://finansiskatransparentnost.koronavirus.gov.mk/.

Figure 3.3. Employment declined throughout the region.

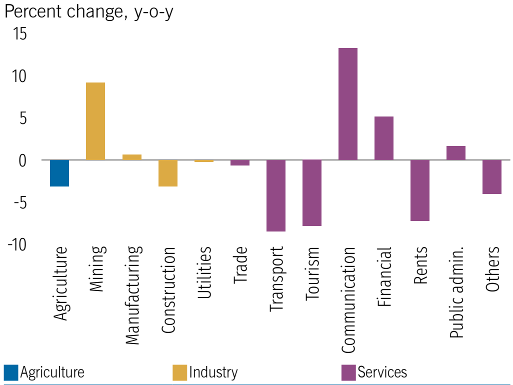
15+ years, percent change June 2019–20



Source: National statistical offices and World Bank staff estimates.

Figure 3.4. Job losses were highest in tourism and transport.

Percent change, y-o-y



Source: National statistical offices and World Bank staff estimates.

would have been even steeper if there had been no wage subsidies: in North Macedonia some 80 percent of the most vulnerable jobs in labor-intensive sectors would have been lost otherwise (Box 3.1). Larger layoffs were also prevented in Montenegro, where the wage subsidies supported more than 64,000 employees, close to half of formal private sector employees. In the Western Balkans employment fell most in tourism, transport, construction, and real estate activities and in wholesale and retail trade (Figure 3.4).

In addition to layoffs, the pandemic has forced businesses to use furlough measures, such as reducing work hours, to cut costs. In Kosovo[3] working hours were reduced and many businesses offered their employees leaves of absence without pay. In Serbia, in Q2 of 2020, 11.4 percent of employees were absent from work—2.4 pp more than in Q1 and 6 pp more than Q2 2019. Two-thirds of employees were absent because the work volume had been reduced for technical or economic reasons—a drastic increase year-on-year. Some 12 percent of workers were working from home. Actual average hours worked weekly in Serbia in Q2 were 36.2, down 7.5 percent from Q2 2019. Though the Q2 large-scale furlough schemes drove down total hours considerably, they did not affect the unemployment rate.

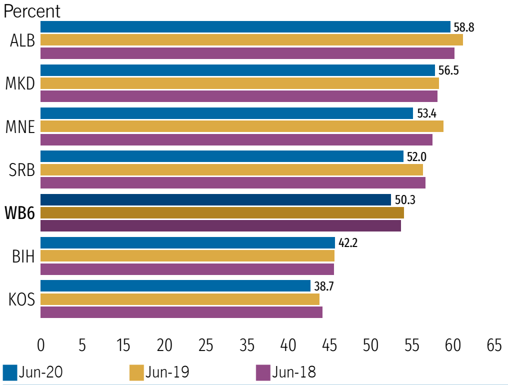
By June, the employment rate, already low even before the crisis, had slipped further: The average in the region was 42.6 percent, down 1.5 pp from a year ago (Figure 3.3). The largest drops were 4.3 pp in Montenegro and 1.9 pp in Albania; in both, closures and travel bans had decimated the tourism season. Given their higher labor force participation rates, male employees were more affected than female. After peaking in Q1 2020, by June the male employment rate in North Macedonia had dropped by 1.5 pp, with most of the jobless becoming inactive rather than registering at unemployment bureaus. The situation was similar in Serbia and Montenegro. Currently, Albania still has the highest employment rate at 51.7 percent; in Kosovo and BiH, only about one-third of those able to work are employed.

The 2018 and 2019 gains in labor force participation were wiped out: In 2019 labor force participation had gone up very slightly (0.4 pp) to 52 percent, mostly due to women entering the labor market (Figure 3.5), but by June 2020 labor force participation had regressed to 50.3 percent with the largest declines being 4.4 pp in Montenegro, 2.8 pp in Serbia, and 1.8 pp in Albania. The drop is consistent with workers obeying stay-at-home orders that went into effect as Q1 ended. About 50 percent of the working-age population in the region were inactive; in Kosovo and BiH inactivity was close to 60 percent. While in the region female labor force participation declined by 1.6 pp to less than 46 percent, although with large variations by country, it was mostly men that moved to inactivity. In Serbia and Montenegro, male labor participation was down more than 3 pp (Figure 3.6).

With the effects of the crisis still unfolding, the employment adjustment will likely intensify. This will be even more obvious once wage subsidy programs expire in Serbia in September and in North Macedonia in December. The magnitude of the impact may even rise, since recovery has not yet begun in the Western Balkans. The epidemiological situation in the summer prevented a swift recovery of output and employment, especially

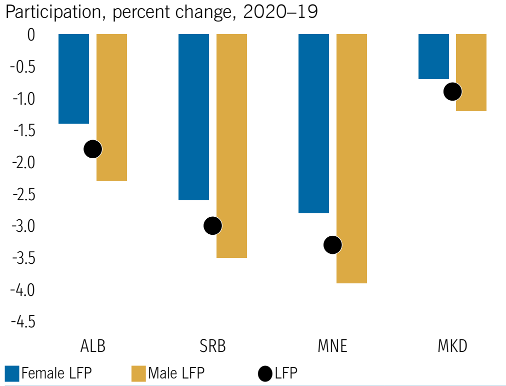
3 According to a World Bank Business Pulse Survey conducted in Kosovo.

Figure 3.5. Labor market participation slumped...



Source: National statistical offices and World Bank staff estimates.

Figure 3.6. ...as more men moved to inactivity.



Source: National statistical offices and World Bank staff estimates.

in countries heavily dependent on seasonal tourism. This had an adverse impact on all related industries and sectors, which are likely to consider reducing their labor force or worker hours. In countries like Serbia and North Macedonia where a fragile recovery has begun, a new wave of infections could interrupt the process. With labor markets continuing to weaken, programs to protect jobs and firms may have to be reintroduced, extended, or expanded. However, given the scale of the economic downturn so far this year, such programs probably cannot prevent a more pronounced rise in unemployment rates in H2 2020. Moreover, second round programs will need to be better targeted—several countries in the region have depleted their fiscal space.

4. Progress on poverty reduction is imperiled by the crisis, though government responses have lessened the damage

Welfare improvements in the Western Balkans were interrupted as the COVID-19 crisis pushed economies into recession. Before COVID-19 hit early in 2020, most of the countries in the region had made notable progress in reducing poverty and boosting household income.[4] As is now apparent, the crisis has interrupted, and in some cases reversed, this process. GDP growth forecasts show that lockdown and travel restrictions imposed to contain the spread of the virus caused an unprecedented loss of economic activity in the second and third quarters (Q2 and Q3) of 2020. As a result, the crisis has reversed the employment gains in some Western Balkan countries.

To respond to the crisis, governments quickly announced measures to protect firms and households from the impacts of the lockdowns and other restrictions imposed. The World Bank has conducted a simulation exercise to estimate the impact of the economic crisis on poverty, incorporating policy responses that governments have deployed in recent months to compensate for the sudden loss in activity for many firms and workers.[5] These simulations show that government response measures in the Western Balkans have helped to prevent larger spikes in poverty. While the estimated poverty increases are lower than in the absence of any policy response (first estimated and published in the Spring RER issue), the magnitude of the shock could be larger if business closures and travel restrictions continue until yearend. In addition, it has been challenging for response measures to effectively protect the incomes of the vulnerable, especially those working in the informal sector. The ability of safety net programs to reach this group during the crisis was often limited by the initial system and program design, which in many cases does not have the flexibility to quickly expand beyond the poorest households. Alternative targeting mechanisms and more flexible safety net systems would have covered a larger portion of these populations, thus reducing the impact of the crisis on poverty at similar or lower cost.

Following the same methodology as in the Spring issue, the updated simulation analysis assessed the likely impact of the pandemic on poverty, and the impact of government response measures.[6] The simulations looked at first-order approximations of the impact through multiple channels: income from each sector, type of work, and household private transfers. In the updated version, the simulations assume that the large losses in household income due to the crisis continue through August 2020 (Scenario 2 of the poverty impact analysis in the Spring edition).[7] The estimates are the average impacts for the whole

4 For simplicity, income in this analysis is generally the welfare measure, although consumption is used for Kosovo and Bosnia and Herzegovina. See http://documents.worldbank.org/curated/en/236311590680555002/

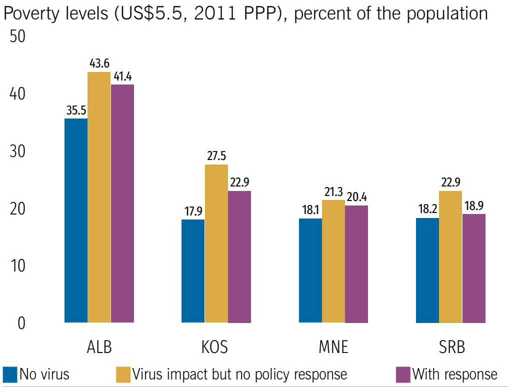
5 The main measures are summarized in Table 3.1 and Box 4.1.

6 Poverty is based on income for Albania, Montenegro, North Macedonia, and Serbia; consumption is the welfare measure for BiH and Kosovo. Economic sectors are grouped into three categories: (1) relatively unimpacted, (2) moderately impacted, and (3) highly impacted. Self-employed workers are assumed to be relatively more impacted than salaried workers. See http://documents.worldbank.org/curated/en/236311590680555002/ for details.

7 These assumptions could underestimate the poverty impact if the crisis is prolonged and aggregate demand remains much lower than in previous years.

year, and the impacts are constructed as most severe in Q2 and Q3. The updated simulations incorporate the wage subsidy and cash support measures for Albania, Kosovo, Montenegro, and Serbia. These are response policies that could be directly mapped to the household surveys used to analyze income distributions.

Figure 4.1. Government response measures are expected to help lessen the impact on poverty.



Source: World Bank simulations based on 2017 income data from the Survey of Income and Living Conditions (SILC) for Albania and Serbia; 2015 income data from the SILC in Montenegro; and 2017 Household Budget Survey (HBS) for Kosovo.

Note: Income measures in the SILC and consumption measures in the HBS are not strictly comparable. "No virus" baseline = poverty as estimated in 2019 based on household survey data in earlier years and growth in real GDP per capita, using the original 2011 PPPs.

In the four countries covered, the COVID-19 crisis is estimated to have pushed more than 300,000 people into poverty even after taking into account response measures, but that is less than half the number who would have been affected had there been no response. Without the response measures, the increase in poverty would have ranged from 3 pp in Montenegro to 10 pp in Kosovo (Figure 4.1).[8] Once response measures are taken into account, the effect is somewhat smaller: poverty was up by 0.7 pp in Serbia, 2 pp in Montenegro, 5 pp in Kosovo, and 6 pp in Albania. The cash transfers are estimated to have increased household income particularly in the bottom quintile. However, even accounting for response measures, the distribution of income losses often continues to be biased against the poor because most benefits are directed to formal workers. In Montenegro, the cash measures compensate income losses mostly in the bottom income quintile, but wage subsidies benefit middle quintiles the most. In Albania, for instance, only social assistance is progressively distributed (higher coverage of lower deciles); wage subsidies are neutral or slightly regressive. In Kosovo, the simulated coverage of wage subsidies to informal workers results in a regressive distribution of benefits, with higher coverage in higher deciles.

Even though governments took action swiftly, countries varied in their ability to use existing social assistance systems to deploy resources effectively to those in need (Box 4.1). As a result, these resources did not mitigate poverty as much as they could have. For instance, in Albania, if the same budget had been allocated to all families with children under 18, the transfer would have covered 70 percent of poor households. In Serbia, while simulations show that the impact of the crisis on poverty is mostly mitigated for now, this could have been achieved with much lower budgets by targeting the poorest individuals or families with children, so that support could have been sustained for much longer.

With the end to the economic crisis uncertain, the pressure on labor markets and incomes is likely to continue for some months. Because the jobs of the poor and vulnerable are often less secure, it may take longer for them to regain

8 Poverty is expected to increase by approximately 3 pp in Bosnia and Herzegovina and 6 pp in North Macedonia in the absence of government interventions (not shown in Figure 1), and analyses incorporating government responses are forthcoming.

income once the economy begins to recover, so the need to protect poor and vulnerable workers and families will continue beyond the scheduled end of the emergency measures. With fiscal space limited, making the best use of current social assistance systems could be cost-effective and enable more sustained support to the most vulnerable during the recovery.

Box 4.1. How did social protection systems in the Western Balkans respond to the crisis?

Safety nets—social assistance—have proved to be effective in providing direct support to poor and vulnerable households to help ensure their basic consumption and protect them from sudden loss of income and the rising costs of essential goods and services. They have been used to respond to economic crises, natural disasters, and epidemics like the 2008 food, finance, and fuel crisis and the 2014–15 Ebola outbreak. Currently, across the globe, countries are harnessing their social assistance programs to protect people from the economic consequences of the COVID-19 pandemic. In the Western Balkans, early estimates showed the virus would have an unprecedented and very harsh impact on employment, especially for unprotected workers and those with informal jobs.[1] The ability of these programs to protect poor households, particularly those with workers in the informal sector, was uneven across countries and often limited by their initial design. Social assistance programs will remain crucial for protecting populations in the Western Balkans from shocks like COVID-19 because of their high rates of informality.[2] Addressing their limitations will therefore be vital to improving the response to future shocks.

All countries in the Western Balkans took steps to protect current beneficiaries of last-resort income support programs. Several provided additional support to beneficiaries; in Albania, BiH, Kosovo, and Montenegro the amount of the transfer was temporarily increased. In Montenegro, the functionality of the Social Card was modified for two ad hoc payments, €50 in April and €200 in August, and families received their payments within three days. In Albania and Kosovo, the social assistance payment was doubled for the first three months of the pandemic. Regular social assistance payments continued to be made into bank accounts, as in North Macedonia, or through post offices, as was done in Montenegro through the post office's door-to-door network, and in Kosovo, which paid people in cash at the post office.

Countries that require beneficiaries to periodically reapply for support waived this requirement during the first few months of the pandemic: Albania, for instance, removed the requirement that households present every three months to the social administrator to review their socioeconomic situation. Beneficiary recertification and home visits were also suspended in North Macedonia. In Kosovo, the government automatically extended support to households that had ceased to be eligible between March and July 2020 due, for example, to the youngest child turning 5 years old. Steps were also taken in most countries in the region to simplify application processes and move these online to comply with social distancing measures. In Serbia, applications, which normally must be done in person at a Center for Social Work, could be submitted by mail or electronically by e-mail or smartphone. It was also possible to simply state the applicants ID number and authorize the agencies to collect all the other documentation they required. Applications in North Macedonia were accepted by phone or online, with all necessary documentation to support the application available electronically through the unique registry of social assistance beneficiaries, which is linked with the administrative databases of several key agencies. Such measures increased the number of beneficiaries enrolled in these last-resort income support programs in some countries—e.g., by 11 percent in Albania.

Box 4.1 continued

The extent to which these programs were used to reach poor households and informal workers who lost their jobs varied significantly, however, largely due to the initial conditions in each country, such as whether the law on social assistance recognizes that an emergency can quickly change peoples' poverty status and allows the program to expand coverage based on poverty criteria. In North Macedonia, for example, the Guaranteed Minimum Income (GMI) program was quickly expanded to people negatively affected by the crisis by amending the eligibility criteria and assessing the income of applicants in the previous month instead of the normal three-month period. In Bosnia and Herzegovina, existing law and the established poverty-targeting system allowed expansion of coverage of the Permanent Social Assistance program. In contrast, in Kosovo, eligibility for the Social Assistance Scheme (SAS) is based on strict categorical requirements that prevented the program from quickly extending support. Instead, the government had to quickly put in place new eligibility criteria to support poor and unemployed households who were not benefiting from other forms of government support and build a new targeting system, which piggybacked on the existing SAS system, with payments of €130 per month for three months paid to over 28,700 beneficiaries. In Albania, the government provided a one-off payment (16,000 Leks. €129) to 4,524 households that had applied to the *Ndihma Ekonomike* between July 2019 and April 2020 but were no longer receiving support. Most countries, though, were not able to put in place the necessary legislative changes quickly enough; in Montenegro, for example, the law could not be changed in a parliamentary election year.

Such differences also have implications for the predictability of such support to new beneficiaries as the pandemic continues to lead to unemployment and job loss. In Kosovo, emergency support to the almost 29,000 households without formal income or other means of government support recently ended. These households are unable to access the regular SAS given the strict eligibility requirements that focus more on household structure (disability, age of youngest child) than on poverty. Although the government is now drafting reforms to the Law on Social Assistance, its passage will take many months. Serbia faces a similar issue; although it quickly paid €100 to all adults, this has proved costly and may narrow the fiscal space to extend further support to poor households in need.

These examples illustrate the importance of having appropriate laws and systems in place in advance of a crisis to protect poor and vulnerable households and help them also weather the post-crisis period. Reforming laws on social assistance to allow coverage expansion or changes in eligibility criteria when a shock occurs would provide the legal basis to expand these programs quickly, eliminating the need for new laws, and to scale them back when the crisis has passed. Investing in robust delivery systems, such as social registries, adaptive targeting systems, simplified and automated registration and verification procedures, and e-payment systems can also support rapid expansion in coverage, as can greater use of technology to comply with social distancing or other difficult circumstances. Finally, supporting legislative commitments with dedicated financing, through contingency budgets or disaster risk financing, can create a system that automatically expands when a crisis occurs.

1. *Spring 2020 RER* – update with data from Fall RER.

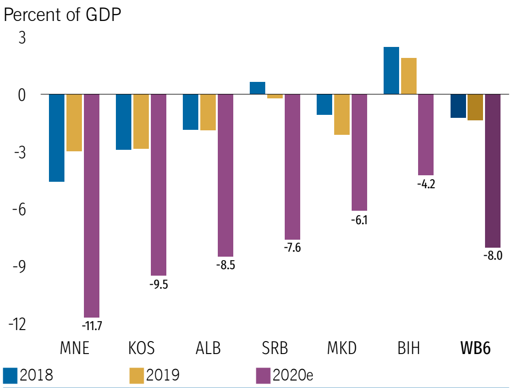
2. World Bank and wiiw (2020): Western Balkans Labor Market Trends 2020.

5. Countering the crisis has had a sizable fiscal cost

The COVID-19 pandemic has caused fiscal deficits to soar in all Western Balkan countries. Their fiscal balances have deteriorated as governments spend more to counter the economic contraction as revenues plummet. The average unweighted deficit is expected to rise from 1.4 percent of GDP in 2019 to 8.0 percent in 2020 (Figure 5.1). Tighter economic contractions in Montenegro, Kosovo, and Albania have caused particularly burdensome deficits there, with Montenegro's increase the largest as a share of GDP, mainly because of the damage the pandemic has inflicted on tourism. Serbia is expected to experience the highest y-o-y deficit increase because of its substantial package of response measures (nearly 13 percent of GDP including tax deferrals) and its relatively low deficit in 2019. In North Macedonia, the drop in indirect tax revenue is somewhat cushioned by employment subsidy spillovers on social contributions, but pandemic costs are expected to triple the deficit. In Kosovo, annulment of the public wage law reduced fiscal pressures and created more space to respond to the pandemic, but the deficit will more than triple from a year earlier given likely additional fiscal measures and the drop in revenue. In Albania, the fiscal deficit is expected to be higher than the regional average because of post-earthquake reconstruction needs. BiH is expected to record the lowest deficit in the region.

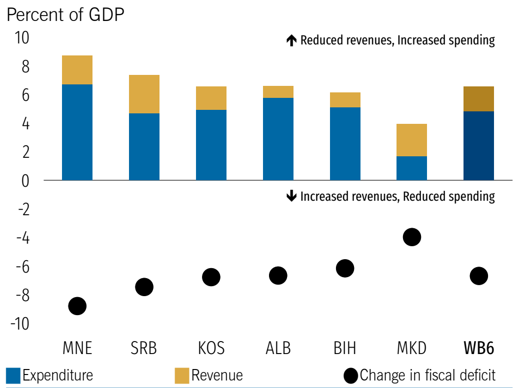
The recession is taking a heavy toll on public revenue. Western Balkan countries are expected to lose an average of 1.7 percent of GDP in revenue—in addition to the revenue loss caused by the nominal contraction of GDP in 2020. Except for BiH, public revenues throughout the region are expected to drop by an average of more than 10 percent y-o-y. A faster drop in revenues compared to growth mirrors the asymmetric impact of the pandemic on economic activities, but also the wide use of PIT and CIT tax deferrals to cushion against it. In Serbia, for example,

Figure 5.1. Fiscal deficits will reach record highs in all Western Balkan countries.



Sources: National statistical offices, Ministries of Finance, and World Bank staff estimates.
Note: North Macedonia data excludes the October budget revision.

Figure 5.2. Governments must spend more despite slumping revenue.



Sources: National statistical offices, Ministries of Finance, and World Bank staff estimates.

30 percent of the fiscal package to ease the COVID-19 shock is attributable to PIT and CIT tax deferrals. With nominal merchandise imports expected to drop by an unweighted regional average of 14.1 percent, indirect taxes are also being heavily affected. In addition to sluggish consumption, the drop in tourism in Montenegro, Albania, and Kosovo (diaspora tourism) is taking a heavy toll on their VAT revenues.

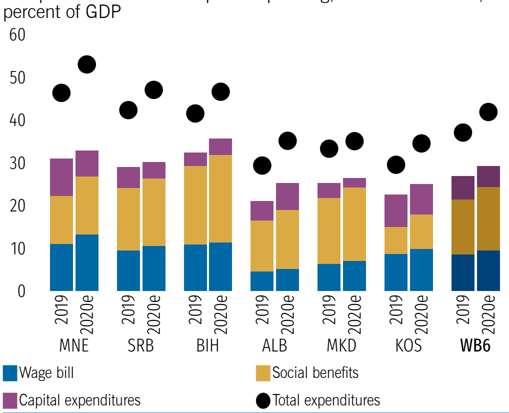
The jumps in public spending reflect not only costly emergency fiscal measures to counter the contraction but also pre-COVID-19 policy changes (Figure 5.2). Western Balkan countries are not only confronting the health ramifications of the pandemic but are also using fiscal policy to absorb the related economic shocks. In 2020, public spending is expected to increase y-o-y from 1.7 pp of GDP in North Macedonia to 6.7 pp in Montenegro; the regional average is 4.8 pp. The increase in spending tracks the magnitude of both the fiscal measures each country has adopted and the contraction in its economy. Most Western Balkan countries revised their budgets after COVID-19 broke out.

In all Western Balkan countries, the social benefits share of total spending is expected to be higher in 2020 (Figure 5.3) because of their use of cash transfers to cushion the impact of the pandemic. The share of wage spending also went up because of both legacy policies and the additional cost of managing the pandemic. In North Macedonia, for example, wages and pensions went up in response to policy changes in 2019; and in Montenegro, the public sector wage bill rose partly due to already budgeted increases in health and education sectors wages. Except for BiH and Albania (for post-earthquake restoration), in 2020 capital spending is expected to decline in the other countries in the region (Figure 5.4).

Western Balkan governments acted promptly to mitigate the impact of the crisis. The scope of government efforts to protect lives and livelihoods was determined by each country's fiscal space. All countries acted to

Figure 5.3. Use of cash transfers to cushion the pandemic impact has increased dominance of social benefits in government spending.

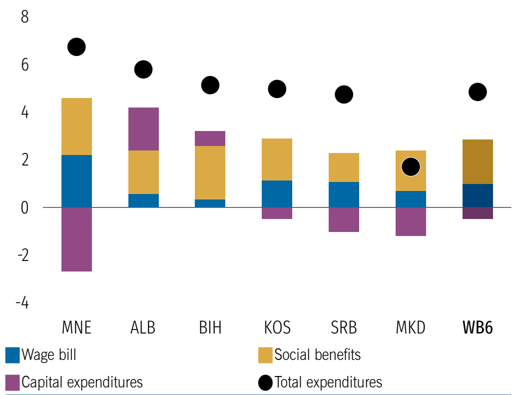
Composition of estimated public spending, 2019 and 2020e, percent of GDP



Sources: National statistical offices, Ministries of Finance, and World Bank staff estimates.

Figure 5.4. Capital spending is expected to decline in 2020 in four Western Balkan countries.

Contribution to change in public spending, in percent of GDP, 2020e



Sources: National statistical offices, Ministries of Finance, and World Bank staff estimates.

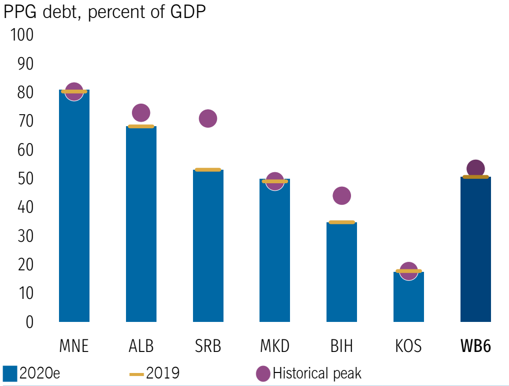
preserve incomes and productive capacities by minimizing layoffs and bankruptcies in the immediate crisis; all introduced wage subsidies for the private sector and cash transfers to the most vulnerable and offered credit lines with subsidized interest rates or guarantees. Without these government interventions, the social and economic impact of the crisis would have been much deeper. With more fiscal space, Serbia introduced a massive fiscal package of support, but it would have been more cost-effective if the measures had been better targeted (see previous section). Montenegro and BiH targeted the most affected sectors for wage subsidies. Social and health support was well-targeted across the region. However, support for households reliant on informal jobs may not have been adequate. Good targeting of government measures ensures not only that those in need receive adequate support but also that spending is more rational, especially when fiscal space is limited. To ensure that spending is fully effective, it is also critical to be aware of the risks of misuse and corruption; to minimize such risks, full transparency is crucial when these measures are designed as well as carried out.

All countries must now deal with higher public and publicly guaranteed (PPG) debt. Deep recessions averaging 8 percent, widening deficits, and depleted fiscal buffers in Montenegro, Albania, and North Macedonia are adding 10–17 pp to their PPG debt-to-GDP ratios; the rise in Serbia will be just 7 pp and in BiH 4 pp because the contraction in their economies is likely to average only about 3 percent. On the other hand, Kosovo—which has limited access to international capital markets—will experience a sharper GDP contraction, but its PPG debt-to-GDP will increase only by 6 pp (and remain the lowest in the region) because of the use of government cash deposits and privatization proceeds to finance the additional deficit. In aggregate, the regional ratio is expected to go up by 9.5 pp in 2020, reaching 59.9 by year-end—7 pp higher than its historical high and more than 30 pp higher than before the global financial crisis. In 2020 only Serbia and BiH will avoid historical highs in their PPG debt-to-GDP ratios (Figure 5.5).

Governments across the region have turned to international capital markets to address their emerging financing needs. In June, North Macedonia issued a six-year Eurobond worth €700 million with a coupon rate of 3.675 percent and Serbia a seven-year Eurobond worth €2 billion at 3.125 percent. In June, Albania issued a seven-year Eurobond worth €650 million at 3.65 percent. All three were oversubscribed. The three will use the proceeds to refinance previous debt and cover widening budget deficits.

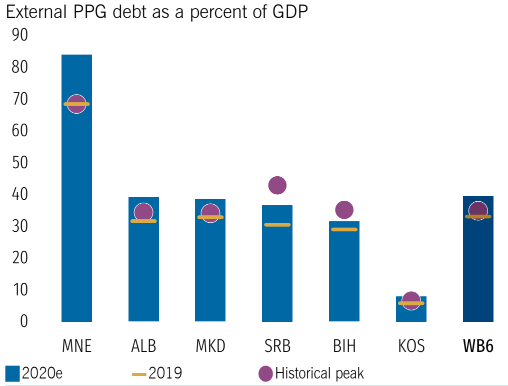
Across the Western Balkans, the multilateral support of the World Bank, the IMF, and the EU has been critical in addressing immediate financing needs and closing gaps. The coordinated backing of the international financial institutions (IFIs) has been crucial to preserving debt sustainability. All countries but Serbia sought support from the IMF Rapid Financial Instrument to address urgent balance-of-payment needs, which then allowed them to apply for EU Macro Financial Assistance (MFA). The MFA has been agreed with all countries but BiH, which is still in negotiations. The World Bank support was of critical importance to Montenegro, which, backed by a World Bank guarantee, raised €250 million at favorable terms from a syndicate of banks. The proceeds were initially

Figure 5.5. PPG debt will reach a new high in the Western Balkans…



Source: National statistical offices and World Bank staff estimates.

Figure 5.6. …mostly due to new external debt.



Source: National statistical offices and World Bank staff estimates.

planned to roll over debt maturing in 2021 but are being used to close the financing gap. The World Bank supported all the other Western Balkan countries through emergency support for health spending, depending on need and ranging from €15 million for Albania to €140 million for North Macedonia.

The already high external debt burden in most Western Balkan countries has been inching up. Eurobond issues, international loans, and IFI financing are expected to cover a large share of their financing needs but in most will push their external PPG debt to historic highs. Montenegro's external debt is forecast to reach 83 percent because of new borrowing and a significant contraction of GDP. In Albania, BiH, North Macedonia, and Serbia external PPG debt as a share of GDP is forecast to range from 31 to 39 percent of GDP; the increase in Kosovo's ratio, the lowest in the region, would be 2.2 pp, to 8 percent of GDP. On average, regional external PPG debt is expected to surge to 40 percent of GDP (Figure 5.6).

Table 5.1. EU, IMF, and WB Support.

€ million, committed

	IMF RFI	EU MFA	World Bank
Albania	174	180	15
Bosnia and Herzegovina	333	250	33
Kosovo	52	100	75
Montenegro	74	60	
North Macedonia	176.7	160	140
Total	**810**	**750**	**263**

All six countries have significant room to improve the capacity of their institutions and their fiscal governance, especially public financial management and transparency. Vigilant fiscal and debt management will be crucial to macroeconomic stability in the medium term, once the recovery takes hold. The COVID-19 crisis has reaffirmed the need for governments to have fiscal buffers and (1) identify comprehensively all the risks to the fiscal outlook, (2) measure their fiscal impact, and (3) manage them proactively, taking into account both explicit and implicit contingent liabilities. For example, in Albania, these risks largely pertain to public-private partnership arrangements, in BiH to state-owned enterprises and cumulative arrears in the health sector, and in North Macedonia to off-budget spending. Once the pandemic recedes, the fiscal rules that have been de facto suspended must be reinstated to help keep public debt sustainable and on a clear downward path. Ensuring public debt sustainability, reprioritizing spending for longer-term recovery, and managing public investments better are all vital for a speedier and resilient recovery in the Western Balkans.

6. Inflation fell markedly because of the pandemic

In spring 2020 inflation slowed in most Western Balkan countries. The COVID-19 crisis depressed domestic demand throughout the region, driving down price inflation (Figure 6.1). The effect was amplified by depressed international prices for oil and other commodities. Partly offsetting these effects were COVID-19-related disruptions to supply chains, which pushed up food inflation in some Western Balkan economies, especially Albania, North Macedonia, and Serbia. When the most severe lockdown measures were lifted at the start of the summer and international commodity prices recovered somewhat, inflation picked up again. However, by July inflation dynamics differed considerably across the region: while in BiH the CPI deflated by 1.3 percent, in Serbia inflation reached 2.0 percent, in line with expectations of the National Bank of Serbia.

To support regional economies during the COVID-19 crisis, monetary policy was eased (Figure 6.3). In Albania and Serbia, which have floating exchange rates, and in North Macedonia, which has a de facto exchange peg, the central banks cut interest rates to support the economy: Albania's policy rate was cut to 0.5 percent in March, Serbia's from 2.25 percent in March to 1.25 percent by June, and North Macedonia's was cut three times, ultimately to 1.5 percent. In addition, all three countries announced new precautionary swap or repo lines with the ECB so they could access additional euro liquidity as needed. In Serbia, the Central Bank used swap and repo purchase auctions to provide liquidity, and the central bank also bought dinar-denominated government securities. In all three countries, central banks intervened significantly in foreign exchange markets during the lockdown to stabilize their currencies and minimize impact on inflation dynamics. As a result, despite the crisis, exchange rates in the region held steady against the euro (Figure 6.4).

Figure 6.1. At first inflation was down in most Western Balkan countries, but by July it varied dramatically.

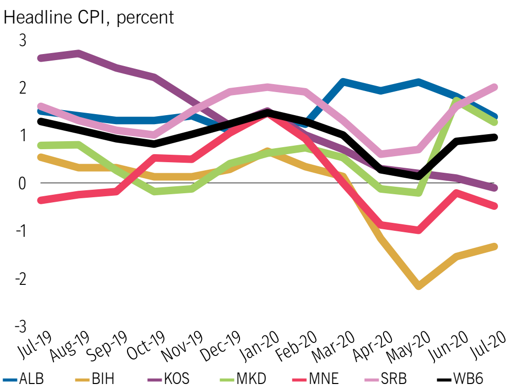
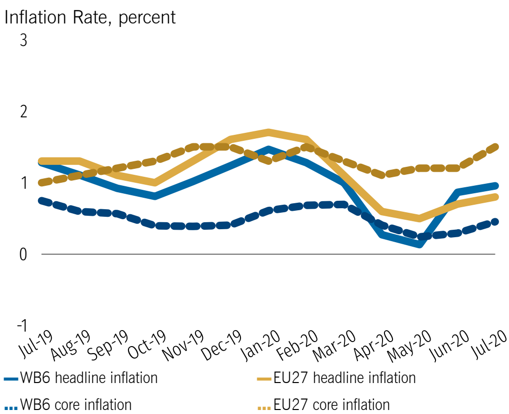
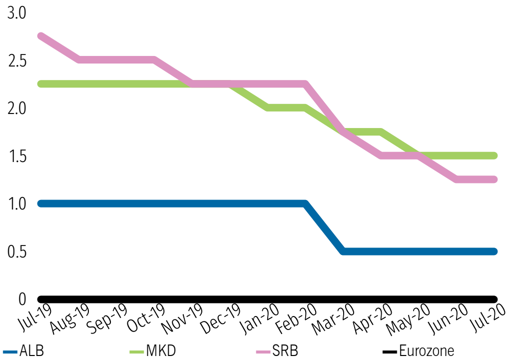


Figure 6.2. Food and oil prices were a major factor in inflation volatility.



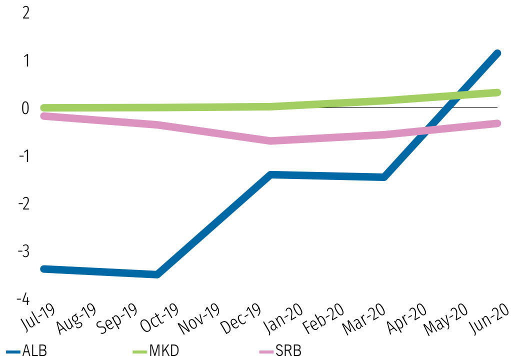
Source: Central banks, Eurostat and World Bank staff calculations.
Note: Food and energy prices are included in headline but not core price indexes. Data for Western Balkans and EU28 are weighted averages.

Figure 6.3. Central banks lowered policy rates to support their economies…



Source: Central banks and ECB.

Figure 6.4. …and for most of 2020 movements against the euro were limited.



Source: Central banks and World Bank staff calculations.
Note: Increase indicates depreciation.

For the rest of the year, inflationary pressures are likely to remain subdued throughout the Western Balkans, with oil prices making negative contributions to headline inflation and economic activity recovering slowly. Uncertainty will make consumer and corporate behavior more cautious. With the outlook for domestic and foreign demand depressed, low investment activity will weigh on the prices of capital goods. As the labor market weakens, uncertainty about job security and wage growth prospects are likely to deter consumption. In the months ahead, as labor market support measures expire or are rolled back, unemployment may rise, further weighing on consumer sentiment. The approaching end of fiscal stimulus programs may also discourage consumption and investment.

Box 6.1. Inflation and Active Independent Monetary Policy.

A feature of the 2020 crisis is the unusual dispersion of inflation outcomes across the Western Balkans; interestingly, the countries with active independent monetary policies were relatively better in terms of preserving low and stable inflation: Bosnia and Herzegovina experienced year-on-year CPI deflation of 1.3 percent in July 2020, while in Serbia inflation reached 2.0 percent. A natural interpretation is that active monetary policy allowed countries to act more forcefully to counteract downward price pressures during the crisis, whether through lower policy rates, direct liquidity interventions, or anchoring inflation expectations, than would have been the case if such policy options were not available.

However, it is advisable to be cautious about over-interpreting the data. It is probable that the Western Balkan countries that choose active monetary policy differ significantly from those that do not in such relevant dimensions as the structures of their economies. Moreover, the Western Balkans are only a small sample of countries, and other factors may have been affecting the data pattern by chance. For instance, during the crisis Albania, North Macedonia, and Serbia were also the countries in the region that saw the steepest increase in food CPI inflation.

Box 6.1 continued

Fully disentangling how different factors drove the dispersion of inflation dynamics by country will require further research—the pandemic is generating a rich set of data with which to analyze how different institutional choices influence resilience to crises.

Figure B.6.1 Countries with active monetary policy were able to avoid falling prices…

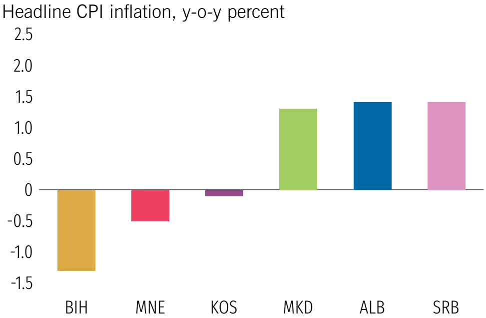
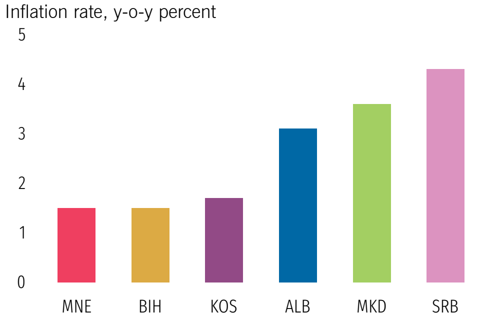


Figure B.6.2 …but saw the steepest rise in food prices.



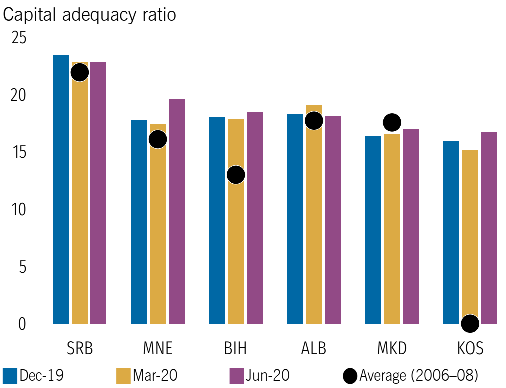
Source: Central banks and World Bank staff calculations.
Note: Food and energy prices are included in headline but not core price indexes.

7. COVID-19 is testing financial sector resilience

The COVID-19 outbreak has presented the financial system in the Western Balkans with its most challenging test since the global financial crisis—and the system has so far held up. Banks entered the crisis more resilient and better placed to sustain financing to the real economy as a result of regulatory reforms since the 2008 global financial crisis. Thus, bank resilience has allowed the system to absorb rather than amplify the macroeconomic shock. Economic and financial policymakers have also responded with action on an unparalleled scale to ensure that the financial system—its intermediaries, markets, and infrastructure—withstands shocks so it can provide the credit and financial services that help households and businesses through these times and ultimately support recovery of the economy. Thanks to borrower relief and prudential measures taken by central banks and regulators, including moratoriums on debt repayment, and temporary changes in the restructuring, classification, and provisioning for loans, financial sectors in the region have been relatively stable throughout the crisis (Box 7.1).

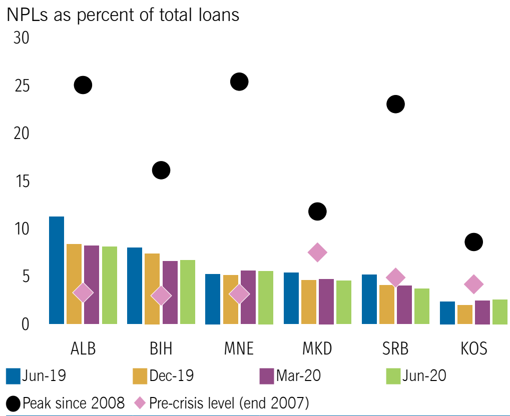
Though banks have sufficient capital and liquidity, pressure on their balance sheets is growing. The abrupt slowdown in economic activity has turned out to be more severe and longer than expected, and some key indicators have deteriorated, revealing the first impacts of the crisis. As of June 2020, bank capital adequacy averaged 18.7 percent, far above the regulatory minimum (Figure 7.1). The ratio of liquid to total assets averaged 27.1 percent, slightly lower than a year ago at 27.9 percent, and loan-to-deposit ratios are below 100 across the board. But bank profitability is now under considerable strain. Compared to 1.7 percent a year earlier, profitability as measured by return on assets has sunk to 1.2 percent due to such factors as the increased cost of impairment provisioning and borrower relief measures. The largest drop was registered by Montenegro (50 percent) followed by BiH (44 percent).

Figure 7.1. Banks are still adequately capitalized.



Source: IMF Financial Soundness Indicators (FSIs), National central banks.

Figure 7.2. The downward trend in NPLs has paused since December.



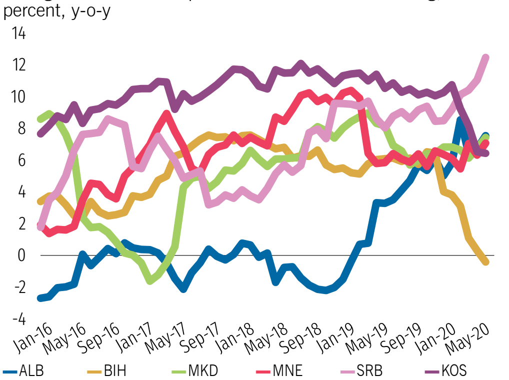
Source: IMF FSIs, National central banks.

As of June 2020, credit growth was still positive in most of the region, with corporate loan growth accelerating in contrast to the pre-COVID trend (Figures 7.3 and 7.4). However, in BiH such growth was negative (–0.4 percent) and in Kosovo it had decelerated. Differences in the scope and design of borrower relief measures are among the main reasons loan growth varied in the Western Balkans. Countries where moratoriums and changes in the classification of credit risk were implemented widely or even compulsory had more borrowers accessing the new options. Higher growth in corporate loans has been driven by the immediate business need for liquidity to compensate for lost revenues, supported in many cases by government-guaranteed support packages. However, banks became more cautious about lending to individuals, especially in riskier areas like noncollateralized consumer finance. As of July 2020, loans outstanding to households and corporates in the region were growing at about the same pace, averaging 7 percent; previously there had been a 3 pp difference in favor of household loans. Serbia saw the strongest growth in corporate loans, slightly above 14 percent, followed by Montenegro at 8.5 percent. Both countries offered borrower relief regimes and government-guaranteed support programs that were widely used. Growth in corporate lending in Albania, Kosovo, and North Macedonia was milder, 6 to 7 percent, and in BiH corporate lending shrank by 1.1 percent. Despite general progress in deepening credit markets in the region, domestic credit to the private sector continues to be far below EU levels.

The consistent downward trend in NPLs in Western Balkan economies since the 2008 global financial crisis was paused in the first quarter of 2020. March 2020 NPLs were unchanged from December 2019 at 5.3 percent, though with notable trend reversals in Kosovo and Montenegro. Prolonged uncertainty and dimming economic prospects have been building up credit risks that may erode asset quality and increase NPLs in the second part of the year. This process has been slowed by the borrower relief measures already cited. To date, Kosovo's NPLs are the lowest in the region. Despite steady downtrends, NPLs are still high in Albania at 8.2 percent and BiH at 6.6 percent (Figure 7.2). Reforms in recent

Figure 7.3. Credit growth has been positive in most Western Balkan countries.

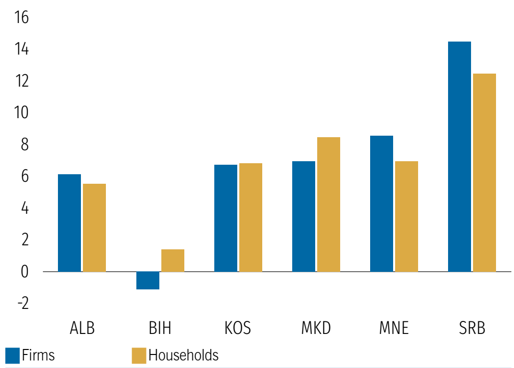
Change in nonfinancial private sector credit outstanding, percent, y-o-y



Source: IMF, FSIs, Central banks and World Bank staff calculations.

Figure 7.4. Compared to the pre-COVID trend, corporate loan growth has begun to accelerate.

Change in credit outstanding, July 2020, percent, y-o-y



Source: Central banks and World Bank staff calculations.

years had helped reduce NPLs considerably as Albania, Montenegro, and Serbia wrote off and sold old NPLs. New insolvency laws have also been adopted in recent years in Albania, the BiH entity Republika Srpska, and Kosovo but they have yet to be tested. Deteriorating corporate balance sheets will now make it even more important to reinforce corporate and consumer insolvency regimes to deal with loan defaults and NPLs.

As the COVID-19 pandemic continues to take its toll on their economies, authorities must carefully monitor and move proactively to prevent the build-up of financial stability risks. Central banks and supervisory authorities will need to be vigilant in scrutinizing financial soundness factors more intensively, especially credit and liquidity trends. Forbearance measures could create capital space for banks and reduce the pressure until recovery starts, but they must be carefully designed so that they will be well- targeted and temporary, and stay consistent with international standards for prudential treatment of problem assets[9]; clearly, policymakers must also carefully define strategies for exiting from current regimes. Preventing second-round effects on the economy and supporting financial stability depends on strengthening macroprudential, crisis management, insolvency, and financial safety net frameworks. Furthermore, if the crisis continues to deepen, authorities should be prepared to intervene with all the tools at their disposal; here, crisis simulation exercises would be helpful.

Box 7.1. Prudential measures in response of COVID-19 were directed to resuming lending.

To preserve economic activity, jobs, and livelihoods, policymakers in the Western Balkans have introduced a variety of borrower relief measures, notably moratoriums. Many borrowers are suffering from seriously disrupted income flows, and prospects for a vigorous economic recovery are uncertain. While there are important differences by country in the scope and design of the measures, the common denominator is that they provide relief to distressed debtors through temporary deferment of debt service obligations. Serbia, Kosovo, and Montenegro have given all debtors the right to suspend payments for a specific period: In Serbia, an opt-out regime offered all borrowers a moratorium and, unless they declined the offer within 10 days, it was considered accepted. Regimes in Albania, BiH, and North Macedonia provided the general framework of the moratorium and its accounting effects—banks were required to define their internal criteria for implementing these regimes, and clients had to apply to banks should they wish to benefit. In those countries the moratorium regimes depend on the banks, which undoubtedly are in the best position to assess client creditworthiness, but criteria differences between banks may raise consistency issues. Most countries have been renewing moratorium regimes after the first periods expired, consistent with the prolonged economic uncertainty caused by the COVID crisis. Albania, BiH, North Macedonia, and Serbia have kept the main features of their regimes; Montenegro and Kosovo made their approaches bank-driven rather than defining them as a customer right, which should reduce the potential moral hazard associated with willful defaulters and zombie borrowers in a blanket moratorium regime.[1]

9 See for further information World Bank Policy Note on Borrower Relief Measures in ECA, April 2020; http://pubdocs.worldbank.org/en/993701588092073659/Borrower-Relief-Measures-Note-for-ECA.pdf

Box 7.1 continued

As expected, there is considerable variation in the uptake of the borrower relief measures, with countries whose lending arrangements were generous and legally binding registering the highest use. For example, 81 percent of legal entities and 91 percent of individuals in Serbia used their right to benefit from the first moratorium, but in BiH only 24.3 percent (Federation) and 32.5 percent (Republika Srpska) of BiH's legal entities and 10 percent (Federation) and 3.6 percent (Republika Srpska) of its individuals benefitted from the moratorium measures approved by banks. In line with other countries, in general more legal entities than individuals accepted moratoriums.

In addition, bank supervisors in the region have recently made changes to credit risk classification and coverage. While material differences exist in the extent and nature of the changes made, all countries in the region have sought to ensure that banks were not required to reclassify a massive number of loans as nonperforming or book sizable impairment provisioning charges. BiH, Serbia, and Montenegro have adopted transitory regimes that either allow or preclude banks from reclassifying loans that have benefitted from moratoriums to a worse or better credit risk category. Some countries have also introduced rules that effectively abolish the cure period that customarily applies to previously restructured loans. Furthermore, the stability of the NPL ratio across the Western Balkan region suggests that regulators are lenient in application of Unlikely to Pay (UTP). With moratoria in place in most countries, the number of Days Past Due (DPD) on a loan effectively freezes. Therefore, the stable NPL ratio suggests that only few loans are moved into the non-performing category on account of UTP.

Other countries made broader temporary amendments to their current regimes. Albania temporarily suspended its credit classification and provisioning rules, and North Macedonia changed the definition for nonperforming loans from 90 to 150 days past due until September 30, 2020, if the loans were performing through February.

In these exceptional circumstances, policymakers in the region should carefully define their exit strategies from the current regimes. In particular, they should assess the conditions under which the regimes can be rolled back, such as a period of prolonged economic growth or a clear indication that the pandemic is under control. Here, clear public communication is essential to manage the expectations of banks and borrowers alike by, for example, specifying the circumstances in which special measures will be revoked. In addition to deciding on the timing of the exit from borrower relief measures, banking supervisors need to consider the prudential impact of reverting to pre-COVID-19 rules and perhaps gradual withdrawal from special measures. Here, it is crucial that banks have accurate, current information in order to identify all loans subjected to moratoriums and report those to bank supervisors. At this stage distinguishing between liquidity-distressed borrowers whose repayment capacity can be expected to recover quickly from those whose solvency has been permanently damaged may not always be possible. However, it will become increasingly evident over time. Banks will be expected to reclassify the loans of the clients permanently affected as nonperforming, and bank supervisors will be expected to assess bank loan portfolios through on-site inspections, thematic reviews, and other targeted activities.

Source: World Bank "Policy Note on Borrower Relief Measures in ECA, "April 2020.

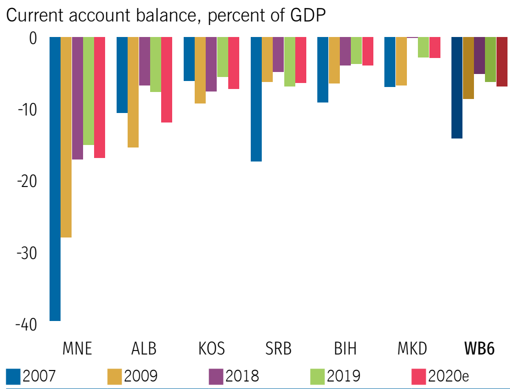
Note: Willful defaulters are borrowers that have the financial capacity to repay but choose not to; Zombie borrowers are those that were already in severe difficulties pre-COVID-19.

8. External imbalances widen in all Western Balkan countries

The disruption to world trade the COVID-19 pandemic has caused is unprecedented: production and consumption have scaled back across the globe. The disruption was particularly pronounced in the first half of the year when according to the WTO merchandise trade was falling by an estimated 13 percent y-o-y, though there has been some recovery since June. The pandemic is causing supply and demand shocks to both goods and services. Goods were affected immediately by the disruption in global value chains (GVCs) and a decline in aggregate demand, but by the end of May the drop in trade in services was steeper, 22 percent y-o-y, led by tourism and related services exports, which were affected by the confinement measures imposed by countries around the world. As in other parts of the world, the pandemic has upended trade flows in the Western Balkans and played havoc with the gains from trade integration the countries achieved over the last decade.

The impact of the trade slowdown on countries in the Western Balkans has varied with their trade structure. For countries like Albania, Kosovo, and Montenegro that are more dependent on services trade, especially tourism, the deterioration in their current account deficits (CADs) has been much worse Figure 8.1. In these countries, trade in services before the pandemic was either larger than the goods trade (Albania) or contributed far more to trade openness (Montenegro and Kosovo). The slowdown in tourist arrivals has also negatively affected related industries like food, entertainment, and retail and has also deeply discouraged tourism-related investments, thus lowering aggregate demand. Of the three countries, for Albania the effect has been to push up the CAD from 7.6 percent of GDP in 2019 to as much as 11.9 percent, because the negative effects of the tourism slowdown are compounded by both the consequences of the 2019 earthquakes and the drop in exports of extractive industries, which tracked the drop in both demand and prices, and of manufacturing. Montenegro is also suffering severely from the slowdown in tourism, which accounts for about 25 percent of its GDP; its CAD is set to increase to 16.8 percent of GDP, making it by far the largest in the region. The restrictions on international travel were particularly damaging for Kosovo, which depends heavily on diaspora-driven service exports; its CAD is expected to widen from 5.5 percent of GDP in 2019 to 7.2 percent.

Figure 8.1. External deficits in the region have widened.

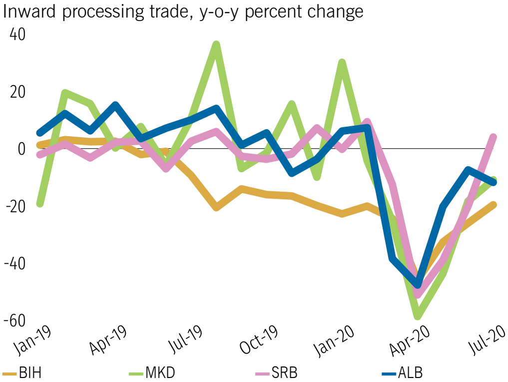


Source: National authorities and World Bank staff estimates.

For North Macedonia, Serbia, and to a lesser extent BiH, the drop in exports depended more on trade in goods through GVCs. For them, the principal cause of export decline is the disruption in supply chains resulting from the slowdown in manufacturing in China, the US, and especially the EU, the main trading partner for Western Balkans countries, and the global drop in aggregate demand caused by the economic downturn. All three are integrated into GVCs through backward links; globally, trade and industrial production have fallen most in countries with strong forward links, which suggests that for the COVID-19 economic shock the demand factor has been more severe than the supply factor, and that has to some extent shielded Western Balkan countries. This is corroborated by the fact that inward processing trade in these countries tumbled between March and June as supply chains were disrupted, but data for July, the last available, indicates a tentative recovery as supply chains re-opened, largely to accommodate demand from EU destination factories[10] (Figure 8.2).

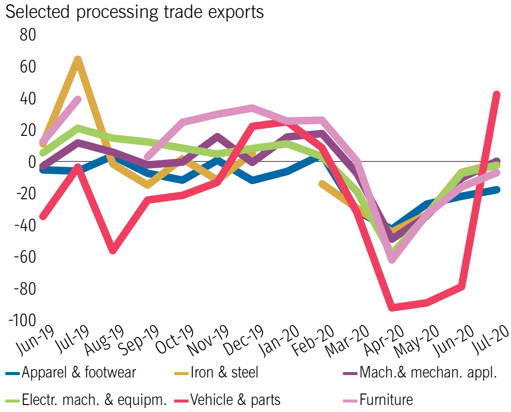
Manufactured exports linked to global value chains are among the most affected sectors of goods trade (Figure 8.3). Manufacturing in the Western Balkans is suffering from both supply disruptions that slowed production and demand subdued by recessions in EU trading partners[11]. Hardest hit have been producers of electrical machinery and equipment, machinery and mechanical appliances, automobiles, iron and steel, furniture and apparel, and clothing and footwear, which are the most integrated in trade with Europe through GVCs; some, like the automotive sector, ground almost to a halt. However, given the relatively high import content of their goods exports, the negative effect on the external positions of BiH, North Macedonia, and Serbia is slightly smaller than in their three neighbors. Trade volume in these countries is expected to recover faster once production restarts and GVCs, especially in the EU, are back in operation. Still, during the recovery phase it would be useful for them to think about how to better position themselves should the pandemic cause a further retreat from trade integration, with higher trade barriers and moves to re-shore production (Figure 8.4). They could, for instance, take advantage of

Figure 8.2. At first inward processing trade plummeted, but has recovered somewhat.



Source: Eurostat ComExt data and World Bank staff calculations.

Figure 8.3. Manufacturing exports linked to global value chains are among those most affected.



Source: Eurostat ComExt data and World Bank staff calculations.

10 As of August, global trade carrying capacity is 0.9 percent higher than last year, with a sustained positive trend, up 3.4 percent in the last three weeks, and much higher it was from February to April.

11 Trade in intermediate industrial goods linked to GVCs account for about two-thirds of North Macedonia's and Serbia's exports.

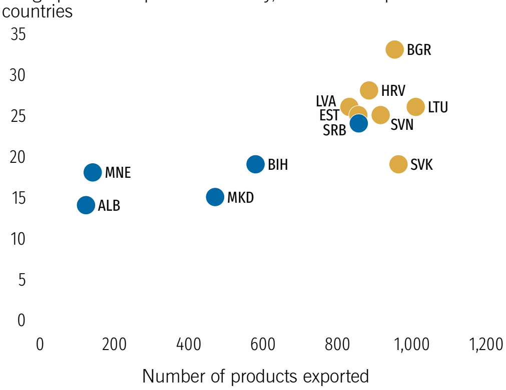
the current re-shoring trends to diversify their products and markets so they can catch up with regional peers. Because they are relatively more integrated into GVCs, North Macedonia, Serbia, and BiH should act to ensure that they can retain, strengthen, or expand their attractiveness as GVC participants by, e.g., ensuring free flow of their manufactured goods across borders to ease the pathway to greater integration and diversification. The other three countries should double their efforts to penetrate GVCs in a sound and sustainable way so that they can diversify their export structure and mitigate shocks.

In the short term, exports are not expected to recover quickly due to restrictions that limit movement of goods and people. The CEFTA Green Corridors for transport of goods introduced in April helped to mitigate the effect of restrictions and let essential goods benefit from priority passage. E-commerce has also supported economic activity during the crisis and can contribute to a resilient recovery (Box 8.1). Still, full recovery and return to pre-pandemic trade levels will not be easy as long as movement of people, goods, and capital is restricted. Continuing global trade tensions and disputes, especially between the US and China, will further complicate the region's recovery; if they persist, they will amplify the slowdown caused by the pandemic and in the medium term may worsen external balances.

The pandemic has affected remittances and FDI dramatically; they compound the negative effects of declining trade and put more pressure on CADs. For most Western Balkan countries, because remittances are the main channel of trade deficit financing, they are important for external stability. Given the global reach of COVIC-19, many emigrants from the region are losing their jobs and have no money to send to their families back home. This is already undermining the external position of countries in the region; it is estimated that remittances will drop to an average of 5.8 percent of GDP, a historic low. Albania, Serbia, and BiH will see the deepest losses because they have the largest diasporas, many now resident in the EU, which is experiencing one of its worst recessions. Kosovo

Figure 8.4. Potential to further diversify export products and markets is high.

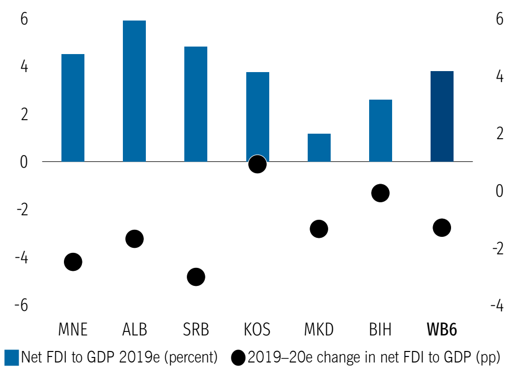
Geographical and product diversity, number of export destination countries



Source: World Bank staff calculations based on COMTRADE and UNCTAD data.

Figure 8.5. FDI has plunged, putting pressure on CAD financing.

Net FDI-to-GDP Ratio



Source: National authorities and World Bank staff calculations.

is the only country that has seen remittances go up, which is explained by the increase in formal channels and inflows from informal channels during summer travel season.

Because FDI inflows into the region declined in 2020, debt had to bear a larger share of the external financing requirement (Figure 8.5). While there are tentative signs of a recovery from the supply side shock to trade and the GVC disruptions, the demand side disruptions may prove more long-lasting, especially as they relate to investment sentiment. In recent years FDI in the region mainly went to sectors that have now been savaged by the crises, such as the automotive and basic materials industries and tourism. A recovery in these sectors that takes longer than expected would delay planned investments. According to UNCTAD, for 2020 global FDI flows are forecast to be cut by up to 40 per cent—bringing them to the same nominal level as in 2005. Apart from Kosovo, all Western Balkan countries are expected to see a major slowdown in FDI inflows in 2020. The biggest declines are expected in Serbia and Montenegro, with Albania and North Macedonia not far behind. BiH is expected to see the smallest cut due to announced investments in energy and road infrastructure. Only Kosovo is likely to see an increase in FDI; there, large investments in energy and mining were made just before the pandemic broke out. However, if the pandemic is prolonged, it could amplify capital outflows from emerging markets like those in the Western Balkans. Such a deterrent to investment would constitute a serious threat to Montenegro, Albania, and Serbia, which rely on FDI to finance their large CADs. With the slowdown in FDI and remittances, CAD financing is being supplemented by external loans, largely from IFIs. This has pushed up external debt across the region, in particular in Montenegro (see Fiscal Section, Figure 5.6).

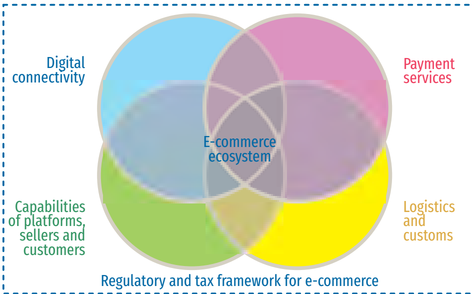
Box 8.1. E-commerce: Gateway to greater regional integration in the Western Balkans?

E-commerce—defined broadly as trade in goods and services facilitated online—is helping the Western Balkans to weather the COVID-19 crisis. By limiting the need for in-person transactions, it has reduced the risk of infections, promoted acceptance of social distancing requirements, and made it possible for businesses to preserve jobs. The full extent of the digitalization jump by the Western Balkans during this crisis has yet to be determined, but a COVID-19 enterprise survey update conducted in June 2020 in Albania found that 18 percent of the Albanian firms surveyed either started or increased online business activity during the pandemic. Preliminary results of a World Bank Facebook survey in August 2020 found that more than 50 percent of the Kosovars surveyed are using e-commerce more frequently than they had pre-crisis.

The Western Balkans now need to build on this momentum. In rebuilding better after the crisis, online markets can facilitate progress in fulfilling the aspiration of countries in the Western Balkans for greater integration of economies in the region. Online markets bridge physical distances, allowing buyers and sellers to transact remotely. In a region where few firms have established internationally recognizable brands, online search can enable customers to find regional products. A track record of positive online customer reviews can establish trust. Where access to finance is limited, online markets offer an opportunity for entrepreneurs to start a business without the large upfront investments that would be necessary to establish a physical store. Firms can experiment with entering into new markets and then scale up at low cost.

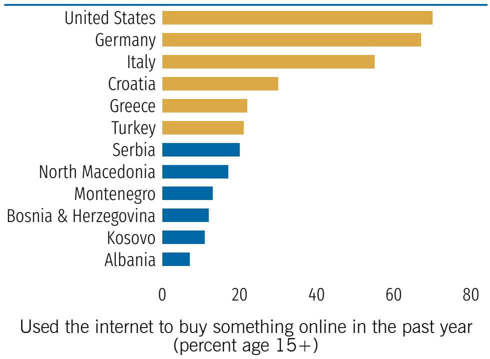
Box 8.1 continued

Digital trade can only thrive at the intersection of a complex multi-sectoral enabling environment…



Source: World Bank E-commerce Diagnostic for Albania—forthcoming.

…and scope for further growth of online markets in the Western Balkans region is large.



Source: World Bank Findex Survey (2017).

To unlock these benefits, countries in the Western Balkans need to come together to build a regional e-commerce market. E-commerce activity in the Western Balkans is lower than in regional and aspirational peers. Catching up will require a holistic multisectoral approach, coordinated through the Western Balkans MAP REA process and CEFTA. Given the region's goals of EU accession, the EU regulatory framework offers a natural anchor for coordinating country efforts. In particular, the following reform areas need to be tackled:

- **Digital connectivity:** Availability of high-speed fixed and mobile broadband access to the Internet is a prerequisite for participating in online markets and can foster economic growth, facilitate social cohesion, and improve citizen well-being. It is therefore not surprising that acceleration of broadband diffusion and deployment of broadband infrastructure are policy aims for leaders in the Western Balkans. However, there are significant differences in broadband penetration not only between countries, but also within countries, especially between rural and urban areas. Sharing infrastructure is an effective way to lower the costs of deploying broadband networks and delivering better connectivity. A good example is Kosovo's partnership between the public and private sectors; it is leasing to private Internet service providers use of the fiberoptic cable network belonging to the public electricity transmission company. Mobilizing private investment is also crucial to connect more rural communities to digital opportunities.

- **Logistics and customs:** Customs procedures for cross-border delivery of small parcels need to be simplified and harmonized, starting with digital processing before parcels physically reach the border. In particular, introducing an online one-stop-shop for VAT payments, as is underway in the EU, can reduce the need for cumbersome VAT payment procedures at the customs office. Logistics services need to strengthen regional partnerships by, e.g., simplifying procedures for cross-border goods returns. Regular publication of the cost of cross-border parcel deliveries, as the EU is already doing, can strengthen competition among logistics service providers. Ultimately, a customs union could significantly reduce the cost of cross-border e-commerce and cause a paradigm shift for regional online markets.

Box 8.1 continued

- **Online payments:** While use of cash is still common in the Western Balkans, regional agreements between postal operators to facilitate cross-border cash-on-delivery payments, such as the BiH-Montenegro-Serbia PostPak scheme, can facilitate regional e-commerce. However, the ultimate objective for the region needs to be full harmonization of the laws for payment services with EU directives, and adoption of new generation payment infrastructures (e.g., instant payment systems); that would support innovative entrepreneurship and adoption of online electronic payment service solutions that are safe, convenient, and available to all.

- **Private sector capabilities and skills:** Education curricula need to emphasize ICT skills that can be marketed in the digital economy. Regular events, such as North Macedonia's annual e-commerce conference, can galvanize local entrepreneurship and support growth of the sector. A regional e-commerce trustmark initiative can support a core code of conduct that strengthens the quality of webshops and builds customer trust.

- **Regulation:** Harmonization of regulations for e-commerce (such as how the law treats online intermediary platforms), digital connectivity, and the broader digital economy are key to emergence of regional e-commerce players. While much has already been achieved in the Western Balkans, still to be completed are (1) a harmonized regime for mutual recognition of digital signatures across the Western Balkans; (2) joining an international online dispute resolution platform; and (3) upgrading to EU standards data protection, privacy regulations, and consumer protection across the Western Balkans and aligning with the EU Digital Single Market (DSM). Taxation legislation needs to be updated to offer transparent guidance on treatment of the digital economy, including cross-border transactions. In general, the EU e-commerce directives provide a sound anchor for such regulatory reform in the Western Balkans. Digital connectivity regulations need to be aligned with the EU's new Electronic Communications Code to accelerate deployment of broadband services across the region.

While e-commerce can support regional integration, greater regional integration may also contribute to growth of the digital economy in each country in the region; in time, these two structural shifts may together be central to realizing Western Balkan aspirations for economic growth. The region's entrepreneurs need access to a regional market if they are to realize meaningful economies of scale. If the Western Balkans can present itself as an integrated economy, aligned and integrated with the EU's DSM, they can become more attractive for foreign investors, including many businesses that can help local shops to go online, such as e-commerce intermediary marketplaces, online payment solutions, and logistics fulfillment centers. Digitization and regional integration can feed on each other to help countries in the Western Balkans to realize their aspirations for economic growth.

E-commerce is part of a broader digitization agenda for the region. The Balkans Digital Highway initiative, co-financed by the EU Western Balkans Investment Framework, is designed to combine digitization and regional integration by improving access to high-speed broadband services nationally and regionally, within and between participating countries, and advancing infrastructure-sharing opportunities in the region and with neighboring countries. The initiative has already succeeded in bringing together four of the six Western Balkan countries, and has managed to attract expressions of interest from some EU member states in being part of or at least collaborating with the initiative when the project is finalized. This would promote establishment of an even greater network system in the region and beyond. Such cross-border interconnection with other EU member states is of

Box 8.1 continued

particular importance given the accession goals of Western Balkan countries because it will also allow them to put in place or upgrade and align with EU regulations, standards, and best practices for the digital sector and related industries.

Ultimately, the objective for the Western Balkans is to deploy digital solutions to increase regional integration and rectify inequalities in socioeconomic development. This can be done by bridging gaps in national and international digital infrastructure and enhancing digital cohesion. This initiative will provide quick and sustainable outcomes for all participating countries and the region as a whole. Governments will benefit by saving public funds and avoiding unnecessary duplication of infrastructure; service providers and telecom operators will benefit from lower costs for installing infrastructure and optimizing their networks; and citizens and businesses will benefit from improved broadband access, no matter how rural and remote their location.

9. Resilience lies in building stronger fundamentals through sustained reform

Seven months after coronavirus was declared a pandemic, countries in the Western Balkans are in deep recession, with the economic outlook heavily dependent on the course of the pandemic. For 2020 the contraction in the region is expected to average 4.8 percent, with 12.4 percent forecast for Montenegro; above 8 percent for Albania and Kosovo; 4.1 percent for North Macedonia; 3.2 percent for BiH; and 3 percent for Serbia[12]. The forecast assumes that the number of COVID-19 cases remains under control in H2; despite continuous pressures on the health system, implications for the economy should be less extreme than in Q2, when lockdown measures were very strict. However, activity will still be limited by international travel restrictions, necessary domestic containment measures, and high investment uncertainty; and Albania, Montenegro, and Kosovo will lose most of the peak tourism season. For Montenegro, the loss is estimated at 75 percent of expected tourism receipts (y-o-y). The combination of domestic restrictions and travel bans has also disrupted goods supply chains; Kosovo's 11 percent y-o-y drop by July 2020 in intermediate goods imports used for manufacturing illustrates the severity of the impact. For North Macedonia, the contraction in demand and supply chain disruptions have been worse than anticipated and, together with the second, stronger COVID-19 outbreak since June, have led to the country's deepest recession in 20 years. The recession in BiH will be its deepest in 25 years. Throughout the region, the government-supported programs that have been crucial to keep businesses afloat and save jobs are also expected to alleviate the poverty impact of the COVID-19 crisis.

12 Risks to the Serbia's real GDP growth forecast are to the upside and the actual drop there may be lower.

Table 9.1. GDP forecast.

Percent

	2019	2020e	2021f	2022f
Albania	2.2	-8.4	5.0	3.9
Bosnia and Herzegovina	2.6	-3.2	3.0	3.5
Kosovo	4.2	-8.8	3.7	4.9
Montenegro	4.1	-12.4	6.9	4.2
North Macedonia	3.6	-4.1	3.6	3.5
Serbia	4.2	-3.0	2.9	3.3
Western Balkans	**3.6**	**-4.8**	**3.5**	**3.6**
EU27	1.5	-8.4	4.5	..
Central and Eastern Europe (CEE)	3.9	-5.2	4.4	..

Source: World Bank (Global Economic Prospects June 2020), national statistical offices, and World Bank staff estimates.

Note: CEE: Bulgaria, Croatia, the Czech Republic, Hungary, Poland, and Romania.

Assuming that new COVID-19 outbreaks are contained through winter and spring, there are no new lockdowns, and a safe and effective vaccine is available by June 2021, growth in the Western Balkans is projected to gradually recover in 2021 and 2022. As exports, consumption, and investment gradually rebound, all six countries will begin to recover, with Albania growing in 2021 at 5.0 percent and Montenegro at 6.9 percent, given a stronger base effect. Starting from a very low base in 2020, tourism is expected to be pivotal to recovery, supported by construction and investment. In Albania, further reconstruction from the earthquake is also expected to boost growth, as has occurred in other developing economies after similar disasters. In Montenegro, completion of construction of the priority section of the motorway is expected to push investment in 2021.

The crisis and government responses to it have created significant fiscal pressures, which makes maintaining fiscal sustainability a high priority. The combination of lower revenues and higher spending needs is adding stress to fiscal balances. Because Western Balkan countries have put forward massive economic packages, fiscal deficits will reach 4 to 10 percent of GDP; Montenegro is the outlier at almost 12 percent. Deficits will still be high in 2021, although not as high as in 2020. Public and publicly guaranteed debt is forecast to reach new peaks in 2021—close to 60 percent in North Macedonia and Serbia, 81.3 percent in Albania, and 97.9 percent in Montenegro. Thereafter, assuming that gradual fiscal adjustment starts in 2021, debt is expected to start falling. To ensure firm and accelerating debt reduction, however, tighter fiscal policy and vigilant debt management must be a high priority throughout the region once a recovery is underway. Fiscal rules can help to gradually reduce countries' public debt over the medium term.

The ultimate impact of the COVID-19 crisis on employment will vary by income group and by economic sector. Depending on how long it lasts, the crisis might lead to permanent business closures and job losses, putting at risk recent development gains. Lockdowns, supply chain disruptions, and stricter social distancing have had particular impact on some sectors where minimum wage labor predominates, so that poorer households are carrying the heaviest burden. The employment outlook therefore depends mainly on recovery in the most labor-intensive industries and service sectors. In Albania, jobs recovery will also depend on how much is invested in reconstruction following the 2019 earthquake. It is not yet clear how effective government employment measures have been in relation to jobs and poverty across the region due to the widespread and long-standing challenges of high informality and weak social protection.

Although over the medium term growth is expected to return to pre-crisis levels as the pandemic is brought under control, there are still risks, both domestic and external. As recovery proceeds, the total output loss due to the crisis is projected to be fully recovered in 2022; but the extent of the recovery and subsequent growth depend on a range of domestic factors such as how the pandemic evolves; the capacity of all economic actors to recover; the availability and effectiveness of additional policy support; the deterioration of public finances; and the financial sector, where NPLs may rise as moratoriums end. Political tensions may also endanger the recovery, and local elections will generate additional pressures in BiH in November 2020, and national elections in Albania in 2021.

Recovery in 2021 and 2022 will depend crucially on how well trade flows are revitalized. Due to the high dependence of the Western Balkans on EU economies, delayed recovery in the EU would dampen growth prospects for the region. The recovery of the EU and other trade partners will also determine the flow of remittances, which fuels consumption; in several countries, remittances are thus expected to help drive recovery. In Kosovo, remittances through July 2020 went up 10 percent (y-o-y), complementing the social safety net. In Albania, however, from April through June, remittances were down

35 percent y-o-y. The economic disruption caused by COVID-19 has also made attracting and retaining FDI much more difficult as both sectors attractive to FDI and foreign investors have been highly affected. In 2019, most FDI went to real estate (83 percent) and construction (12 percent); manufacturing and tourism, the sectors with the highest growth potential, received relatively little. The fact that these sectors have been hard hit by the crisis will make them even less attractive to investors. Moreover, the pandemic is also affecting the home countries of significant FDI partners, especially Italy, Germany, Austria, and the US. For Albania, more than 40 percent of FDI comes from the EU—and almost 10 percent is from Italy, one of the countries most affected.

Although downside risks dominate, the outlook is also associated with upside risks, mainly the EU integration process. The package of proposals for more user-friendly rules of origin in EU trade agreements with neighboring countries in the Pan-Euro-Mediterranean region, including those in the Western Balkans, may by increasing trade, contribute to the economic recovery from the coronavirus outbreak. More investment may also accompany implementation of the recent agreement on economic normalization between Kosovo and Serbia and the launch in Albania and North Macedonia of EU accession negotiations. Enhanced trade facilitation and EU integration may also benefit the region because of a possible nearshoring trend within European supply chains—a prospect receiving more attention since the COVID-19 shock disrupted global supply chains. Nearshoring would be particularly relevant for Serbia, BiH, and North Macedonia and for specific sectors, such as the automotive. The EU recently adopted an Economic and Investment Plan for the Western Balkans which sets out a substantial investment package mobilizing up to €9 billion of funding for the region to support sustainable connectivity, human capital, competitiveness and inclusive growth, and green and digital transition (See Box 9.1 for more details).

Strengthening human capital remains a key priority. In addition to well-functioning health systems, the epidemic underscored the importance of such solid fundamentals as robust social protection mechanisms, enhanced human capital, and strong institutions. Social protection mechanisms should be directed to identifying and supporting groups vulnerable to adverse economic shocks, and social assistance spending should first target the poorest. Demographic challenges caused by aging societies and expanding emigration complicate the scenario, as does low human capital. According to the Human Capital Index (HCI) 2020, a child born in the region today will only be 57 to 63 percent as productive when she grows up as she would be if she enjoyed complete education and full health, although an exception is Serbia, where the HCI is somewhat higher at 68. Although HCI rankings have improved over time, those in the Western Balkans are far below the average for the whole of ECA, and COVID-19 has no doubt caused them to deteriorate.

A resilient recovery will require continued structural policy action in all six Western Balkan countries. Key among these are policies that boost private sector led growth and productivity, including consistent and efficient implementation of regulations, as well as policies that support greater competitiveness and innovation (see the separate Spotlight). The EU funding for the six Western Balkan countries in the Multiannual Financial Framework (MFF)

Box 9.1. For a modern, greener, and more prosperous Western Balkans region.

On October 6, 2020 the European Commission adopted the Economic and Investment Plan for the Western Balkans mobilizing up to €9 billion of EU funding for the region. The plan aims to spur the long-term economic recovery of the region, support a green and digital transition, foster regional integration and convergence with the European Union. In addition, the Western Balkans Guarantee facility is expected to mobilize up to €20 billion over the next decade by providing guarantees to help reduce the cost of financing for both public and private investments and to reduce the risk for investors. The investment package will be a key driver for facilitating increased public and private investments in the region by European and international financial institutions.

The Plan identifies ten investment flagships to promote a modern, greener and more prosperous region. They are in the areas of sustainable transport, clean energy, greening the Western Balkans, the digital future, boosting the private sector, and human capital. In particular, three initiatives aim to improve core transport corridors in the region, a necessary condition for trade and economic growth. Other initiatives intend to support renewable energy and the transition from coal, renovation of public and private buildings to increase the energy efficiency and reduce greenhouse gas emissions. In line with the new Green Agenda, also recently presented, another initiative will focus on waste and wastewater management. Investment in digital infrastructure will help ensure universal access, low costs, and enhance both digital skills and cybersecurity, key components of the Digital Agenda. Another flagship initiative is centered on increased investments in the private sector to boost competitiveness and innovation, in particular of small and medium sized companies Finally, with a special focus towards young people and women, vulnerable groups and minorities, in particular Roma, the last flagship initiative foresees a Youth Guarantee for human capital development at many different levels—education and training system, employment, health and social protection.

for 2021–27 includes additional funding under Next Generation EU. This will boost economic growth and resilience in the region in sync with European neighbors and the ability to tackle structural inefficiencies.

The crisis has highlighted the need to establish fiscal buffers and strengthen institutions. Improving public spending and better management of public investments are paramount, especially for highly vulnerable countries like Albania and Montenegro. Rebuilding fiscal space will require determined efforts to build tax compliance, spend more efficiently, and explore new avenues for enhanced revenue collection, such as green taxes and digital taxation. Strong, independent, and accountable institutions and adherence to the rule of law are necessary not only for more accountable public spending but also to encourage fair treatment of the private sector. Commitment to this direction is represented by new agreements like the Memoranda of Understanding between the EU and Albania, Kosovo, Montenegro, and North Macedonia, which cover areas related to governance and fighting corruption.

As the crisis evolves, and in preparation for possible new shocks, Western Balkan countries should rely on strong fundamentals. These generally take years to build, but will be critical not only to weather the storm but also to map a vibrant and resilient path forward. Such action could help turn the crisis into an opportunity to boost growth and reduce vulnerabilities.

Box 9.2. Emerging global risks.

The global economy is gradually recovering despite the continuing rise in COVID-19 cases. The pandemic has sent the global economy reeling into its steepest recession in eight decades. The baseline forecast in June projected a 5.2 percent contraction in global GDP in 2020, despite unprecedented policy support (World Bank 2020a). Since then, the number of confirmed cases of COVID-19 has accelerated to over 30 million globally, with over 950,000 deaths. Livelihoods have also been deeply disrupted, with estimates equating the fall in working hours to the loss of 400 million full-time jobs in the second quarter of 2020 (ILO 2020). Despite the continuing spread of the virus, recent data indicate that the global economy is slowly firming as mobility indicators improve and as services and manufacturing begin to recoup earlier losses (Figure B9.1). However, shifts in consumer behavior and continued restrictions on movement continue to depress international travel.

The global outlook is subject to considerable uncertainty about the duration of the pandemic and the potential rollout and distribution of a vaccine. The global forecast published in June assumed that mobility restrictions would begin to be lifted in mid-2020 as the virus retreated. To varying degrees, however, restrictions on movement and interactions have been extended or reintroduced as COVID-19 cases again surged. Although a vaccine could arrive in the first half of 2021, its distribution is likely to take longer, especially in emerging markets and developing economies (EMDEs). Delays to a vaccine could prolong the economic damage and generate financial market turmoil, which would hit economies in the Western Balkans particularly hard because they are so open to global trade and financial flows.

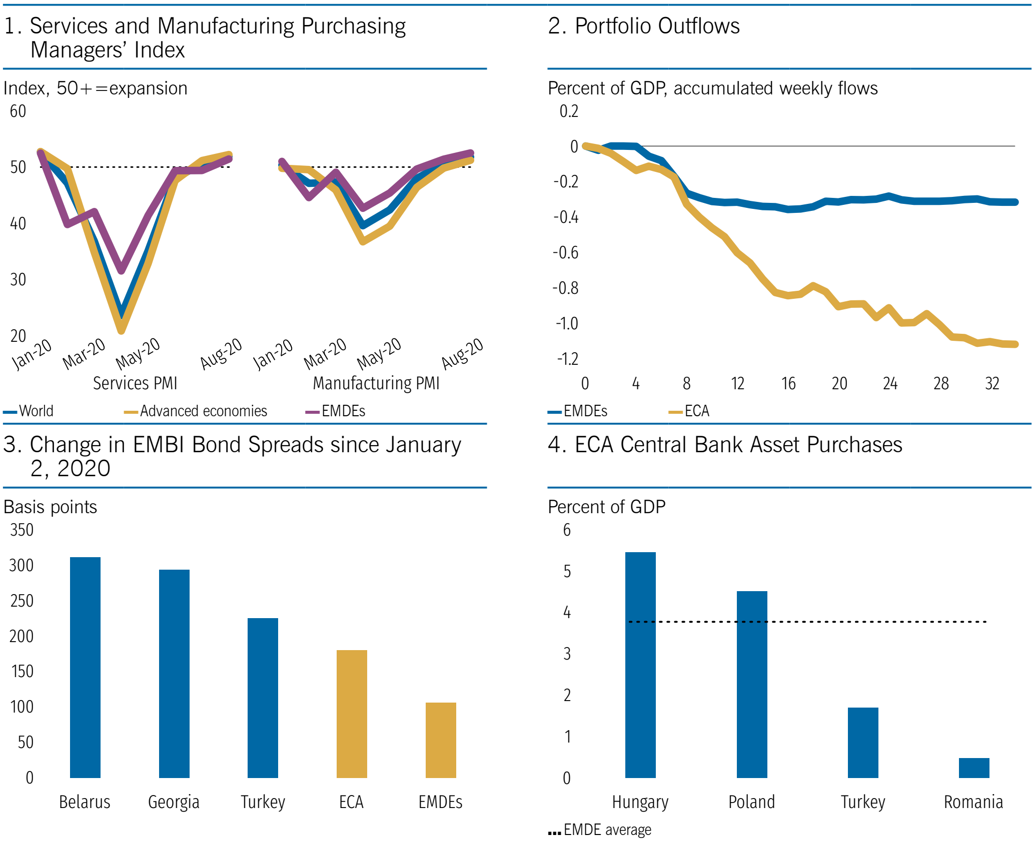
Financial market volatility has reemerged, with particular impact on EMDEs in Europe and Central Asia (ECA). In early September a major divergence between bullish investor sentiment and uncertainty about the strength of the global recovery triggered a severe repricing of global risk assets. This came after a long period of steady gains during which global equity markets recouped most of the losses suffered in late March when the pandemic was at its height. Nevertheless, the market is still highly volatile, a sign of persistent risk aversion. The recovery of portfolio flows to EMDEs braked abruptly in the third quarter of 2020, though the recovery has not even taken hold in ECA. Instead, portfolio outflows from ECA have persisted as rising COVID-19 cases and heightened policy uncertainty weighed on investor sentiment (Figure B9.2.). As a result, currencies in a number of EMDEs in ECA experienced renewed depreciation pressures, particularly economies confronted by a drawdown of foreign reserves or a spike in social unrest or political uncertainty. Although the EMBI (J.P. Morgan Emerging Market Bond Index) bond spread has stabilized across EMDEs, it still quite high in ECA economies grappling with rising financial pressures (Figure B9.3).

Balance sheet pressures are rising in ECA despite substantial liquidity support. As in other EMDEs, central banks in ECA have extended substantial policy support—in terms of both reduced domestic borrowing costs and far-reaching liquidity measures—and some have for the first time carried out unconventional asset repurchase programs (Figure B.9.4). Despite accommodative policy, ongoing uncertainty has led to a broad deterioration in investor sentiment. In some ECA economies this has reignited external imbalances, tightened external borrowing conditions, and triggered the drawdown of international reserves to support domestic currencies. The resurgence in financial turmoil could generate pressure on corporate balance sheets, considering that up to 50 percent of firms are estimated to lack enough income to service their loans in the coming year; this could well aggravate nonperforming loan ratios, especially as central banks have also relaxed regulatory monitoring of financial institutions. Rising defaults and widespread impairment of balance sheets

Box 9.2 continued

could threaten financial stability, cloud the economic outlook, and exacerbate the impact of the pandemic.

Figure B9.



Source: Haver Analytics; Institute of International Finance; J.P. Morgan; World Bank.

Note: Purchasing Managers' Index (PMI) readings above (below) 50 indicate expansion (contraction) in economic activity. Last observation is August 2020. Portfolio flows aggregates calculated using 2019 nominal U.S. dollar GDP. Last observation is September 18, 2020. EMBI refers to the J.P. Morgan Emerging Market Bond Index. Last observation is September 18, 2020. Announced central bank asset purchase programs, expressed relative to nominal local-currency GDP in 2019. The ultimate size of asset purchase programs in Hungary, Poland, Romania, and Turkey will depend on market conditions; data for these countries reflect total assets purchased up to August 13, 2020.

In addition to generating financial stress throughout ECA, in the longer term the pandemic could also have devastating implications for the outlook for EMDEs in the region. In 2020 COVID-19 is thought to be shrinking per capita income enough to tip many millions back into poverty, including residents in ECA EMDEs. Even before the COVID-19 pandemic, growth of labor productivity in ECA had fallen from 5.3 percent in 2003–08 (World Bank 2020) to an average of 1.7 percent in 2013–18, the period following the global financial crisis. The slowdown was particularly dramatic in the Western Balkans, where growth in total factor productivity decelerated considerably due to lack of investment and binding constraints on the private sector, such as corporate over-indebtedness and market concentration (EBRD 2018; Rovo 2020).

Box 9.2 continued

The COVID-19 crisis is expected to exacerbate the slowdown in regional productivity (Shmis et al. 2020; World Bank 2020a). The drop in foreign direct investment in ECA—particularly the economies in the Western Balkans—will prevent much capital accumulation (UNCTAD 2020). The pandemic has also disrupted schooling at all levels, with nearly 90 million schoolchildren in ECA affected, including 3.28 million in the Western Balkans (Schmis et al. 2020). Extended school closures and disruptions to early childhood development programs are expected to set back learning, raise dropout rates, and slow human capital development (Armitage and Nellumns 2020; Burgess and Sievertsen 2020; Wang et al. 2020; World Bank 2020). This, combined with the de-skilling associated with prolonged unemployment, could lead to sizable future earnings losses (Azevedo et al. 2020; Fasih, Patrinos, and Shafiq 2020).

Country Notes

Albania

- Albania's economy was hit hard by an earthquake in November 2019 and then the COVID-19 pandemic. For 2020 employment and GDP are expected to plunge and external and fiscal balances to deteriorate.
- The authorities moved quickly to counter the crisis through, e.g., providing credit guarantee lines for businesses and increasing social transfers for individuals.
- As the pandemic spread slows, reconstruction from the earthquake resumes, and the global economy recovers, a gradual rebound is expected to start in 2021.
- To speed up the recovery, supporting policies should balance alleviating the pandemic impact and reinforcing fiscal sustainability.

Recent Economic Developments

In 2019 growth slowed to 2.2 percent as drought slashed hydropower production; then Albania was devastated by an earthquake in November. But just as reconstruction was getting underway, the global COVID-19 pandemic forced major economic sectors into lockdown. Business closures, scaled-back operations, and disrupted supply chains hurt manufacturing. The tourism season—a lead driver of growth—has been dismal. Consumption and investment decisions have been delayed by the uncertainty about the duration of the crisis. In the first quarter (Q1) of 2020 GDP contracted by 2.5 percent, investment shrank by 16.7 percent, and at 1.1 percent growth in consumption was minimal. Export orders started to decline and imports contracted along with domestic demand. By yearend Albania's GDP is expected to have contracted by 8.4 percent. The fall in private consumption is expected to subtract 5.2 percent from growth. Investment is expected to contribute only 0.2 percentage points (pp) to growth despite all the government financing of post-earthquake reconstruction. Finally, net exports are expected to reduce growth by 3.4 pp.

The crisis also disrupted Albania's labor market; many workers have informal arrangements that are more vulnerable to economic stress. In response to the crisis, the Albanian authorities introduced wage subsidies for the businesses most affected, increased social spending, enacted a temporary moratorium on loan repayments, and offered credit guarantees to facilitate access to working capital. Still, many informal workers and entrepreneurs in the country are suffering. Employment declined across the board and in Q2 it was lower by 3.6 percent y-o-y. Unemployment rose by 0.4 pp to 11.9 percent, and labor force participation fell.

Inflation has been below the target band, averaging 1.8 percent in the first half (H1) of 2020, just 0.3 pp higher than in H1 2019. Food prices have made the largest contribution to inflation—85 percent in Q1 and 90 percent in Q2. Inflation rates peaked at 2.1 percent in March and May because of supply chain disruptions and minor inflationary pressures from imports during the lockdown. Although inflation fell in the fuels subcategory, that did not affect the prices of other goods and services. The negative effects, however, began to ease by the end of May as some containment measures were lifted. Inflation is expected to reflect the decline in domestic demand and continue to be lower than the target band for the rest of 2020.

Monetary policy has been accommodative, with a reduction in the monetary policy rate and injections of liquidity into the banking system. In response to the COVID-19 shock to the economy, the central bank again lowered the base policy rate, by 50 basis points, reaching a historic low of 0.5 percent. To support the liquidity buffers in the banking system, it also abolished the ceiling on short-term borrowing from the central bank. Macroprudential tools, such as a reduction in the capital requirement for government securities in foreign exchange, were also introduced to take advantage of the domestic market's ample foreign currency liquidity and counteract the volatility in international markets. Despite some central bank interventions in the foreign exchange market in 2020, the exchange rate is still flexible, thus helping the Albanian economy to absorb external shocks. By Q2, the domestic currency had appreciated by 1.4 percent against the euro due to less activity with trading partners. The well-capitalized and liquid banking sector has helped to buffer the crisis. In Q2 credit to the private sector rose by an average of 6.8 percent y-o-y.

The current account deficit (CAD) is expected to rise to about 11.9 percent of GDP for 2020. Reduced tourist inflows, fewer textile processing orders, and lower oil prices are expected to suppress exports by 37 percent.

In 2020 Albania's fiscal position is expected to deteriorate as the deficit surges to a projected 8.5 percent of GDP. The decline in economic activity is expected to reduce the tax revenue-to-GDP ratio from 25.7 percent of GDP in 2019 to 24.1 percent. Together, lower revenues and a higher fiscal deficit will push up Albania's public debt to an expected 81.3 percent of GDP.

Outlook and Risks

Assuming the pandemic is contained by yearend, in 2021 GDP is forecast to recover by 5 percent as exports, consumption, and investment begin to rebound. Further reconstruction of structures damaged by the earthquake should also boost growth, as it has in similar situations in other developing economies. Thereafter, growth will depend increasingly on private consumption, supported by the earthquake reconstruction. Private and public investment will also contribute to growth to the extent that the government continues reforms to improve the business environment and invests in infrastructure. Services, led by tourism, and construction are expected to be the main growth drivers by sector.

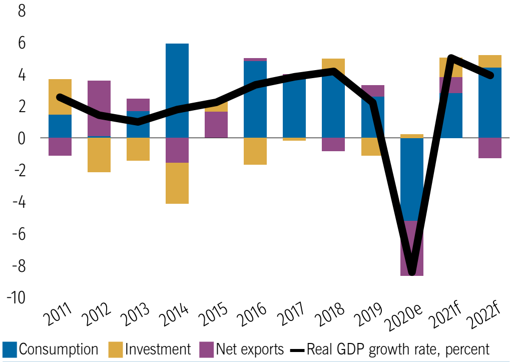
The CAD is expected to decrease to 10.1 percent of GDP in 2021 and then, in line with the pre-crisis trends, to narrow more gradually to 8.7 percent, driven by projected improvements in the trade balance. Over the medium term, service exports, especially tourism and fast-expanding business-process operations, should narrow the trade deficit. In 2021, with a speed-up in infrastructure investment, import growth will be high at 12.8 percent. Over the projection period, inflows of foreign direct investment, mainly in tourism, energy, and manufacturing, are projected to finance most of the CAD.

With economic activity picking up, revenues are projected to recover to 27.6 percent

of GDP by 2022, by which time Albania's public debt is projected to have gone down marginally. The authorities will continue to adhere to the fiscal rule on debt dynamics, which stipulates that the stock of public and publicly guaranteed debt must not increase as a share of GDP from one year to the next and which starting in 2023 mandates a positive primary balance. The employment outlook depends largely on the recovery of the service sectors and the amounts invested in reconstruction.

As a result of the November 2019 earthquake and the COVID-19 pandemic, economic growth plunged in 2020...

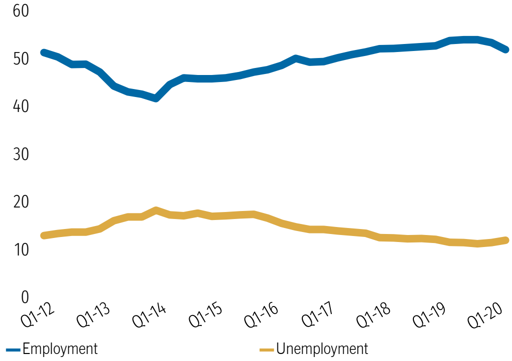
Contributions to growth, percent



Source: INSTAT and World Bank.

...causing a reversal in labor market trends.

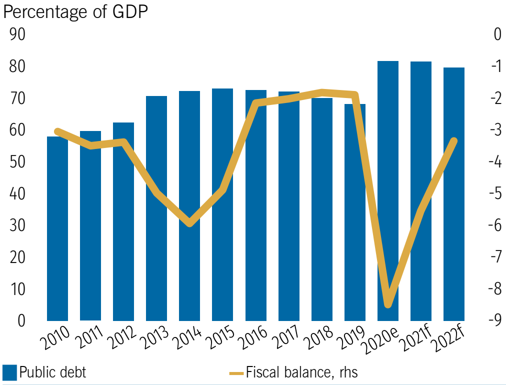
Percent



Source: INSTAT and World Bank.

The government increased spending to alleviate the crisis.

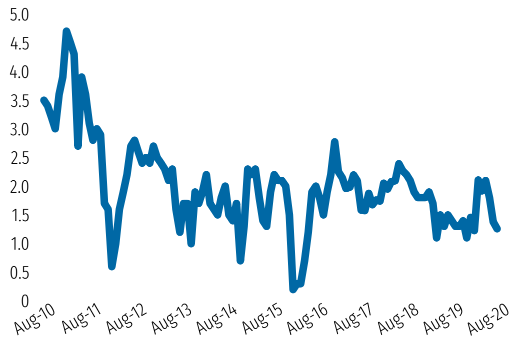
Percentage of GDP



Source: INSTAT and World Bank.

Inflation is low, thus allowing for monetary stimulus.

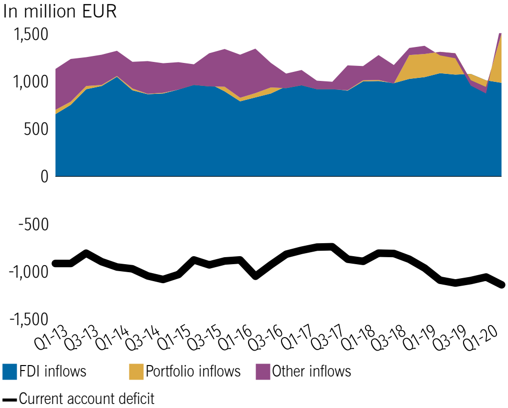
Percent



Source: INSTAT and World Bank.

The current account deficit is on the rise, but is financed.

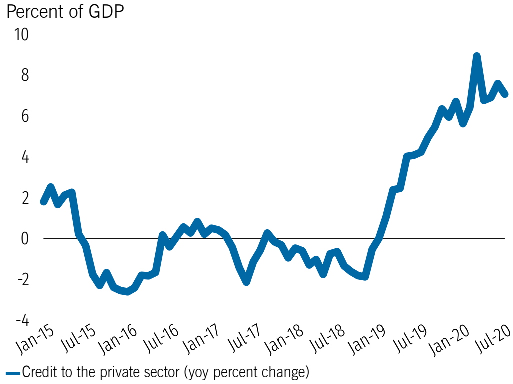
In million EUR



Source: Central Bank and World Bank.

Credit to the economy increased despite the crisis, aided by the government guarantee program.

Percent of GDP



Source: Central Bank and World Bank.

ALBANIA	2017	2018	2019	2020e	2021f	2022f
Real GDP growth (percent)	3.8	4.1	2.2	-8.4	5.0	3.9
Composition (percentage points):						
Consumption	3.7	3.9	2.6	-5.2	2.8	4.4
Investment	-0.2	1.0	-1.1	0.2	1.2	0.8
Net exports	0.3	-0.8	0.7	-3.4	1.0	-1.3
Exports	4.0	1.0	2.0	-12.6	6.6	1.7
Imports (-)	3.7	1.8	1.3	-9.2	5.6	2.9
Consumer price inflation (percent, period average)	2.0	2.1	1.4	2.0	2.5	2.8
Public revenues (percent of GDP)	27.7	27.6	27.4	26.6	27.0	27.6
Public expenditures (percent of GDP)	29.8	29.4	29.3	35.1	32.6	30.9
Of which:						
Wage bill (percent of GDP)	4.7	4.5	4.6	5.2	4.8	4.8
Social benefits (percent of GDP)	12.0	11.6	11.9	13.8	13.6	12.8
Capital expenditures (percent of GDP)	4.4	4.8	4.5	6.2	6.0	4.7
Fiscal balance (percent of GDP)	-2.0	-1.8	-1.9	-8.5	-5.6	-3.4
Primary fiscal balance (percent of GDP)	0.0	0.4	0.2	-5.9	-2.8	-0.8
Public debt (percent of GDP)	67.8	64.6	63.5	76.2	76.2	74.2
Public and publicly guaranteed debt (percent of GDP)	71.9	69.7	68.0	81.3	81.3	79.3
Of which: External (percent of GDP)	32.6	32.9	31.5	39.0	36.8	33.7
Goods exports (percent of GDP)	6.9	7.7	6.8	6.0	6.0	6.0
Goods imports (percent of GDP)	31.3	30.2	32.0	31.0	30.8	30.5
Net services exports (percent of GDP)	9.4	8.6	11.4	5.6	7.3	7.6
Trade balance (percent of GDP)	-15.1	-13.8	-13.8	-19.4	-17.5	-16.9
Remittance inflows (percent of GDP)	5.5	5.2	5.2	4.4	5.0	5.4
Current account balance (percent of GDP)	-7.5	-6.7	-7.6	-11.9	-10.1	-8.7
Net foreign direct investment inflows (percent of GDP)	8.6	8.0	7.6	5.9	6.2	6.8
External debt (percent of GDP)	68.7	64.5	60.5	67.4	62.0	56.1
Real private credit growth (percent, period average)	-2.3	-3.0	1.5	n.a.	n.a.	n.a.
Nonperforming loans (percent of gross loans, end of period)	13.2	11.1	8.4	n.a.	n.a.	n.a.
Unemployment rate (percent, period average)	13.7	12.3	11.5	n.a.	n.a.	n.a.
Youth unemployment rate (percent, period average)	25.9	23.1	21.5	n.a.	n.a.	n.a.
Labor force participation rate (percent, period average)	58.3	59.4	60.4	n.a.	n.a.	n.a.
GDP per capita, PPP (current international $)	11,693	15,101	n.a.	n.a.	n.a.	n.a.

Sources: Country authorities, World Bank estimates and projections.
Note: Youth unemployment rate is for labor force aged 15–29. Statistical discrepancy contribution is divided at the ratio of 80 percent and 20 percent between Consumption and Investment respectively. Change in inventories is included in Investments.

Bosnia and Herzegovina

- The coronavirus (COVID-19) pandemic has pushed BiH into recession and continues to disrupt the normal functioning of the economy. Real GDP projections are for a contraction of 3.2 percent in 2020 and a recovery of 3.0 percent in 2021.
- The number of new daily cases has been volatile, but the overall trend has been relatively stable.
- The immediate challenge is to implement a second set of measures to prevent further COVID-19 infections and to minimize the economic impact of the second-quarter containment measures.
- Addressing persistent unemployment and minimizing private sector layoffs will be the major challenge during and after the crises still unfolding.
- The current crisis reinforces the need for the authorities to stay focused and accelerate structural reforms to make up for the loss in output.

Recent Economic Developments

In 2020, BiH is expected to slip into its worst recession in 25 years. Real GDP growth is projected at -3.2 percent in 2020 because of the slowdown in the most productive sectors, a weaker external environment, and political uncertainty. In the first quarter (Q1) of 2020 growth was positive, reaching 2.0 percent. As lockdown measures were introduced, in Q2 the economy faced a sudden stop. Domestic and external demand dropped, with sharp declines in private consumption and investments. Low domestic demand, consumption and investment has weighed heavily on imports, while the slump in external demand has affected both exports and imports. By July, for the first half (H1) of 2020, exports were down by 14.8 percent and imports by 17.3 percent.

Unemployment, high even before the crisis, is still heading up. The unemployment rate in 2019 was 15.7 percent[1] and has since been pushed up by the COVID-caused dampening of economic activity. Based on tax authority data, just under 16,000 jobs were lost between March and September 2020 in FBiH. In the RS, authorities estimate that about 2,000 jobs were lost. Retail, manufacturing, transportation, and accommodation were the sectors most affected.

Deeper labour market effects have been prevented by wage subsidy programs in both entities and other policy measures targeting affected economic sectors and aimed at improving the liquidity of companies and safeguarding potential job losses. FBiH extended its tax filing deadlines for individuals to April 30 and for entrepreneurs to May 31. RS deferred profit tax payments to June 30 and subsequent installments till yearend. Lump-sum tax on the total income of micro entrepreneurs (1 or 2 employees) was cut by 60 percent. RS also provided KM 17 million in support to closed businesses in March, targeting about 40,000 workers, and about KLM 55 million KM in April, targeting about 60,000 workers and covering minimum wage, contributions and taxes for the closed (micro) companies. The FBiH government also subsidized contributions and paid minimum wages through June for the employees of companies impacted by COVID-19; 10 cantons covered minimum wage in full or in part. Banking

1 Labour Force Survey, 2019.

agencies announced a 6-month moratorium on credit repayment (since extended to the end of the year). Both entities rebalanced their budgets: FBiH allocated about KM 1 billion (3 percent of GDP) to (1) set up a special fund to stabilize the economy (KM 500 million) and (2) establish a KM 20 million Guarantee Fund to supplement the KM 80 million already allocated through the Development Bank. The RS government put in place a temporary credit guarantee scheme tasked to provide up to KM 50 million through the RS Guarantee Fund.

As the economy has fallen into recession and oil prices stay low, deflation has returned. In April, consumer prices in BiH dipped into negative territory, with the consumer price index down by 0.6 percent in H1 (January–June 2020). The main source of the decrease was energy.

Even in the pandemic, the financial sector has been stable. On average, banks are sufficiently capitalized and liquid, but their profitability is eroding. Nonperforming loans reached 6.7 percent of the total loan portfolio in Q2, up from 6.6 percent y-o-y in Q1, but still appear to be sufficiently provisioned by most banks. The capital-to-assets ratio reached 12.6 percent, just slightly down from 12.8 percent at yearend 2019. However, in H1 net profit of the banking sector fell 38 percent y-o-y—the worst result since 2014. In 2020 Q2 the average return on equity was 7.3 percent; it was 10.4 percent at the end of 2019.

BiH's fiscal outlook has deteriorated sharply this year; it may undo much of the work the government has done recently on fiscal consolidation. Higher public spending on crisis-related measures and the related slump in tax revenue will result in a 2020 fiscal deficit estimated at 4.2 percent of GDP, down from an estimated surplus of 0.8 percent in 2019.[2] Because BiH has no access to international markets, the fiscal deficit has been financed primarily through borrowing domestically and from multilateral lenders. Total public debt, mostly concessional, has risen from 33.1 percent at yearend 2019 to an estimated 37 percent of GDP in H1; total external debt is estimated at 70.9 percent of GDP. The fiscal discipline of the past few years has provided some fiscal space for addressing the economic and human costs of the pandemic.

The current account deficit (CAD) is expected to widen to -3.9 percent of GDP. The CAD is estimated to have narrowed slightly in Q1 2020 due to decreases in both exports and imports, though the drop in exports is much lower, mainly due to lower transport and travel inflows. In Q1 foreign direct investment (FDI) was higher than in the last half of 2019. Still, toward the end of 2020 lower demand, both internal and external, is expected to worsen the CAD. Most affected will be services, transport, travel, and remittances. Remittances, projected at 7.4 percent of GDP in 2020, continue to finance the trade deficit. The current account deficit is financed by FDI and other investment. Reserve coverage is adequate owing to official inflows, remittances, and FDI.

Monetary policy will continue to keep the local currency stable. Monetary policy is managed with a currency board arrangement in which the "convertible mark" (KM) is pegged to the euro. The central bank has not used its international reserves for fiscal purposes, in accordance with its governing legislation—the

2 Global fiscal framework for 2021–23 adopted in September 2020.

Law on the Central Bank. It will be important to maintain this policy stance to avoid undermining the currency board and financial stability.

Outlook and Risks

The COVID-19 pandemic has had a major impact on the economy by slowing key productive sectors, lowering demand for exports, and cutting remittances, and the outlook still depends heavily on the pandemic trajectory. Assuming new COVID-19 outbreaks will be restricted to the next two quarters (2), in 2021 BiH growth is projected to return to its pre-crisis growth rate. The authorities are already carrying out more testing through COVID drive-thru PCR testing and COVID-19 hospitals to contain the outbreak and avoid a new lockdown. In addition, a guarantee fund for credit lines for small business is in its finalization phase. Still, as yet no comprehensive second-round prevention and mitigation program has been announced to supplement the Socio-Economic Program (SEP). As the situation improves and the SEP accelerates, investments are expected to increase and exports to rise moderately. Consumption will continue to drive growth, pushing up imports. Remittances will decline in 2020 but in the medium term are again likely to increase and stabilize at 8 percent of GDP. Together with reform progress, they will underpin a gradual pickup in consumption and finance a significant part of the trade deficit that is expected to continue in the medium term.

In general, growth will be supported by sectors oriented to the domestic market and connected to online services. These are less likely to be directly affected by COVID-19 due to measures adopted to increase demand or limit disruptions in agriculture, information and communication technology (ICT), and health and social services. On the expenditure side of GDP, the stabilizing factor is public consumption, which is expected to continue to support growth.

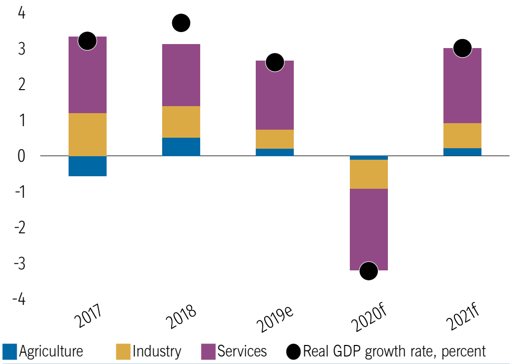
Increased financing needs will reverse the downward debt trajectory of recent years, but debt is expected to remain sustainable. The budget deficit is projected to narrow from 2021 as the economy recovers, based on an assumption that the coronavirus will be steadily contained nationally and globally. We expect public debt to peak in 2021 before declining gradually in the following years.

There are notable risks to the economic outlook. The extent of the downturn will depend primarily on a possible second coronavirus-related lockdown, the scope for additional policy support, the degree of global coordination, and the capacity of households and companies to recover. The government has so far refrained from reintroducing restrictions but may be forced to do so if the number of new cases does not fall; that would hold back recovery of the economy. The immediate challenge for BiH will be to implement such measures yet minimize the economic impact of both current and previous containment measures. Addressing persistent unemployment and minimizing private-sector layoffs will be very difficult both during and after the crisis that is still unfolding. Local elections on the horizon are adding pressures and directing the focus away from the pandemic. The slow pace of structural reforms is also weighing heavily on the government's ability to accelerate growth.

In the medium term it will continue to be important to keep BiH on a reform path in order to address long-standing issues. The reforms must address entrenched structural and institutional problems and enhance competitiveness. BiH needs to unleash the potential of the private sector and reduce the very large footprint of the public sector. It also needs to shift its economy from an internal focus on local consumption and imports to one promoting international integration through investments and exports. BiH's unfavorable demographics and difficult political environment could also exacerbate the pandemic effects and cause an even larger decline in GDP than is currently estimated.

The BiH economy is now expected to post its deepest contraction in modern history.

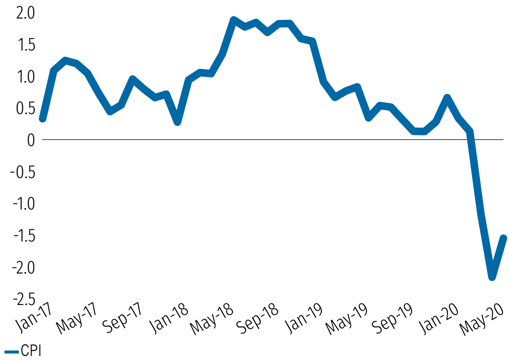
Contributions to growth, percentage points of GDP



Source: BiH Agency for Statistics, World Bank.

Deflation has returned in 2020.

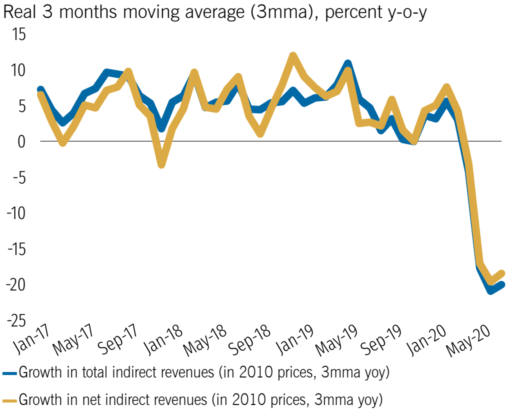
Percent y-o-y



Source: BiH Agency for Statistics, World Bank.

Indirect tax revenues were strong as the year began but are expected to slow due to the crisis...

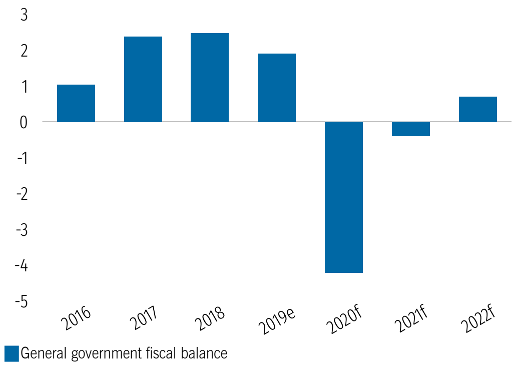
Real 3 months moving average (3mma), percent y-o-y



Source: BiH Indirect Tax Office, World Bank.

...and higher public spending is expected to keep the fiscal balance in deficit.

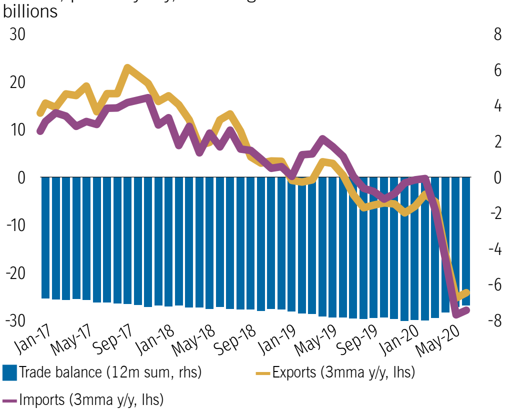
Percent of GDP



Source: Fiscal authorities, World Bank estimates.

The deficit in goods trade continues to widen.

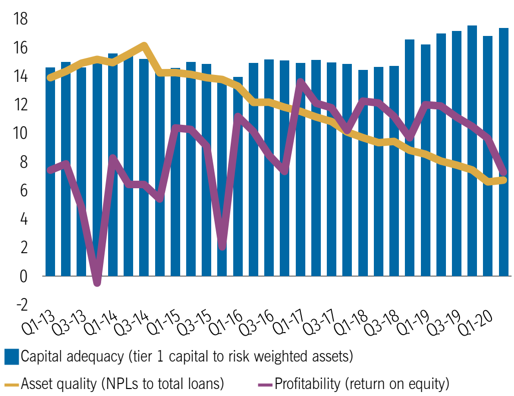
3 mma, percent y-o-y, and the goods trade balance in KM billions



Source: BiH Agency for Statistics, World Bank.

Nevertheless, the financial sector remains stable.

Percent



Source: Central Bank of BiH, World Bank calculations.

BOSNIA AND HERZEGOVINA	**2017f**	**2018**	**2019**	**2020e**	**2021f**	**2022f**
Real GDP growth (percent)	3.2	3.7	2.6	-3.2	3.0	3.5
Composition (percentage points):						
Consumption	n.a.	n.a.	n.a.	-2.3	3.2	3.2
Investment	n.a.	n.a.	n.a.	-4.7	0.5	1.2
Net exports	n.a.	n.a.	n.a.	3.8	-0.7	-0.9
Exports	n.a.	n.a.	n.a.	-2.7	0.3	0.5
Imports (-)	n.a.	n.a.	n.a.	-6.5	1.0	1.5
Consumer price inflation (percent, period average)	0.8	1.4	0.6	0.7	0.5	0.5
Public revenues (percent of GDP)	43.8	42.7	43.3	42.3	43.6	43.0
Public expenditures (percent of GDP)	41.4	40.2	41.5	46.6	44.0	42.3
Of which:						
Wage bill (percent of GDP)	11.0	10.2	10.9	11.3	11.2	10.9
Social benefits (percent of GDP)	17.8	17.8	18.3	20.5	18.9	18.5
Capital expenditures (percent of GDP)	2.3	2.8	3.2	3.8	4.2	3.5
Fiscal balance (percent of GDP)	2.4	2.5	1.9	-4.2	-0.4	0.7
Primary fiscal balance (percent of GDP)	3.2	3.2	2.7	-3.4	0.4	1.5
Public debt (percent of GDP)	36.1	34.2	33.1	38.0	38.2	38.3
Public and publicly guaranteed debt (percent of GDP)	37.7	35.6	34.6	38.6	39.8	39.9
Of which: External (percent of GDP)	30.7	29.9	28.9	31.3	31.3	31.0
Goods exports (percent of GDP)	29.8	31.2	29.0	27.5	27.4	26.6
Goods imports (percent of GDP)	53.4	53.6	51.8	46.6	47.0	47.0
Net services exports (percent of GDP)	7.4	7.4	7.5	4.9	4.9	4.9
Trade balance (percent of GDP)	-16.2	-15.0	-15.2	-14.2	-14.6	-15.5
Remittance inflows (percent of GDP)	8.4	8.1	8.4	7.4	7.8	8.2
Current account balance (percent of GDP)	-4.4	-3.9	-3.7	-3.9	-4.0	-4.6
Foreign direct investment inflows (percent of GDP)	2.1	2.5	2.7	2.6	2.8	2.9
External debt (percent of GDP)	68.5	66.8	66.5	70.9	68.8	67.0
Real private credit growth (percent, period average)	5.3	5.1	5.2	n.a.	n.a.	n.a.
Nonperforming loans (percent of gross loans, end of period)	10.0	8.8	7.4	n.a.	n.a.	n.a.
Unemployment rate (percent, period average)	20.5	18.4	15.7	n.a.	n.a.	n.a.
Youth unemployment rate (percent, period average)	45.8	38.8	33.8	n.a.	n.a.	n.a.
Labor force participation rate (percent, period average)	42.6	42.1	42.1	n.a.	n.a.	n.a.
GDP per capita, PPP (current international $)	12,875	13,200	13,775	14,258	14,550	14,800

Sources: Country authorities, World Bank estimates and projections.

Kosovo

- Kosovo's economy is expected to contract by 8.8 percent in 2020; the persistence of COVID-19 is stifling services exports, private consumption, and investment. Without the increase in remittances and the country's countercyclical fiscal policy response, the contraction would be deeper.
- The recovery is expected to be slower than projected earlier; the pandemic impact will carry over into 2021.
- With revenue collection plunging, the Government is countercyclically expanding current spending through more debt financing and use of privatization proceeds; but execution of public investment continues to linger.
- The COVID-19 shock confirmed the fragility of Kosovo's consumption-based growth model. This reinforces Kosovo's need for a resilient recovery that tackles long-standing structural impediments.

Recent Economic Developments

The COVID-19 pandemic is exerting unprecedented pressure on economic activity. Despite the easing of containment measures in June 2020, indicators available by late August suggest that economic activity continues to decline.[3] Service exports are lower due to limited diaspora visits. Private consumption and investment have also suffered from the pandemic-induced uncertainty and containment measures. A 9 percent[4] drop in goods imports by July 2020 (intermediate goods imports for manufacturing dropped 11 percent) and a 13 percent drop in consumption and trade tax revenue by August 2020 attest to the severity of the contraction. January–June 2020 (H1) saw an across-the-board drop in firm turnover that averaged almost 12 percent, with hospitality services plummeting by 25 percent. Public investment is also expected to decline due to limited fiscal space and further construction delays. However, higher remittances, base metal exports and the fiscal measures adopted have cushioned the pandemic impact.

Kosovo entered the economic crisis caused by COVID-19 with a weak labor market. Labor force participation in Q1 2020 was just 38.8 percent of the working-age population, similar to a year earlier.[5] Unemployment retracted from 26.9 percent in Q1 2019 to 25 percent of the labor force (LF) in Q1 2020 due to declines in both LF participation (0.1 pp) and the employment rate (0.9 pp), which mostly reflected the pre-outbreak situation. In response to the outbreak, more than 130,000 employees received government wage subsidies. COVID-19 crisis is estimated to have had a significant impact on employment and poverty. According to a World Bank Business Pulse Survey (BPS) in Kosovo, most businesses cut working hours, and the main avenue for adjusting employment was granting leave of absence.

3 First quarter national accounts estimate growth at 1.29 percent. However, the estimate is not consistent with 2019 balance of payments statistics.

4 All comparisons are year-on-year unless otherwise stated.

5 Over 70 percent of the Labor Force Survey interviews were conducted before the pandemic outbreak.

The prolonged COVID-19 crisis will weigh on Kosovo's fiscal position. The overall budget deficit is expected to reach 9.5 percent of GDP, up from 2.9 percent in 2019, because of a drop of 13 percent in public revenues, higher current spending in response to the crisis, and a significant contraction of GDP. By the end of August, the Government had spent 2 percent of GDP on its COVID-19 response. Social benefits are expected to reach 8 percent of GDP in 2020, and total subsidies and transfers will increase by at least 22 percent in 2019, reflecting mainly the cost of targeted policy responses, including cash transfers to firms, employees, and households. Public investment, on the other hand, is likely to narrow because of both insufficient fiscal space and construction delays. Several large public investment projects that were expected to advance, many being infrastructure projects financed by international financial institutions (IFIs), are likely to be delayed again. Public and publicly guaranteed debt is expected to reach 23.3 percent of GDP for 2020, to be financed by higher domestic borrowing, use of privatization proceeds, and concessional borrowing from IFIs.

Kosovo's financial sector entered the crisis in sound condition, but the persistence of the pandemic may intensify pressures on it. In July bank deposits were up 12.7 percent, with 44 percent of the increase being household deposits. Outstanding bank loans had also increased by 6.7 percent, but with a marked slowdown in loans issued after March. Average effective interest rate on new loans was down from 6.56 percent in January–July 2019 to 6.24 percent in 2020. Capital adequacy is still above regulatory requirements. By July, nonperforming loans were up slightly to 2.5 percent. At the request of the Central Bank of Kosovo (CBK), commercial banks were asked to defer loan repayments for clients facing financial difficulties from March 16 to June 16 without credit history ramifications or penalties applied. On June 8, the CBK issued a COVID-19 loan restructuring guideline, with September 30 set as the deadline for eligible restructurings. While these measures have cushioned pressures on the financial sector, the persistence of the pandemic and its impact on economic activity still represent a challenging context for the financial sector.

Consumer price inflation declined with lower domestic demand and international oil prices. It had reached 2.7 percent in 2019 but by August it had decelerated to an average of 0.6 percent. Inflation fell mainly because food price inflation slowed considerably, international oil prices fell, and domestic demand lessened. Inflationary pressures picked up after the containment measures eased in June 2020, but then reversed in July and August. CPI inflation is projected to average 0.5 percent in 2020.

The current account deficit will deteriorate to 7.2 percent of GDP in 2020. Despite a projected increase of almost 10 percent in goods exports (13 percent by July), total exports are projected to drop by over 30 percent after service exports contracted dramatically as a result of lower diaspora visits during their peak season (June–August). Imports of goods had declined by 9 percent by July and are expected to be down by 12 percent by yearend. By July, imports of durable goods were lower by more than 16 percent, imports of passenger cars by over 19 percent, and intermediate goods for industrial processing by 11.3 percent. By June, foreign direct investment (FDI) had increased by 3.4 percent thanks to significant investment in energy and mining in Q1. FDI in real estate, however, decreased by 18.2 percent for H1. Net FDI was up by 64 percent, driven primarily by less repatriation of retained earnings.

Remittance inflows through July 2020 increased by 9.8 percent, with a significant increase of 47 percent arriving through formal channels. This confirms how much remittances contribute to informal social safety nets in Kosovo. By June 2020 compensation of employees working abroad for less than 12 months a year had gone up by 8 percent.

Outlook and Risks

Based on the data available and the course of the pandemic, the 2020 contraction is expected to reach 8.8 percent, and the recovery will be longer. The magnitude of the contraction in 2020 is due to the likely persistence of the pandemic into both Q3 and Q4. While the rigidity of containment measures may be markedly lower than in Q2, international travel restrictions, necessary domestic containment measures, and high investment uncertainty continue to depress economic activity. In 2020, the drop in investment is projected to contribute 4.6 percentage points (pp) to the contraction, and total consumption, despite higher public consumption, will account for another 2.6 pp. Due to the slump in service exports, net exports will subtract another 1.5 pp from growth.

Growth is projected to rebound to 3.7 percent in 2021, and then accelerate to 4.9 percent in 2022. The duration of the pandemic, hence the magnitude of its consequences, economic and social, is still very uncertain. After a marked contraction in 2020, the expected modest recovery of 3.7 percent in 2021 would gain momentum from Q3. The likely main contributors to growth are exports and consumption, which will promote a rebound in imports. Recovery in 2021 and 2022 will also depend on how EU growth rebounds and the successful containment of the pandemic until vaccines are generally available. For Kosovo, international travel restrictions—especially for Germany and Switzerland—and the financial sector response to a prolonged pandemic outbreak are other determinants of recovery. There are also upside risks, including how effectively the government delivers the economic recovery plan it has announced, and an increase in investment that depends on how long it takes to realize the recent agreement on economic normalization between Kosovo and Serbia. Acceleration is assumed in 2022, when economic growth is expected to reach 4.9 percent.

Recovery support measures will widen the fiscal deficit in 2021. The recovery package the government announced for 2020–21 has a fiscal cost of €530 million. Given both the prevalence of the pandemic and delays in approval of the necessary legal changes, much of the spending in this package may be pushed into 2021. Meanwhile, to balance delays in completing IFI-financed public investment projects, including for contracted projects, implementation could accelerate in 2021. However, spending on cash transfers is expected to be lower, bringing total 2021 spending down by close to 2 percent. Also projected are an increase in public revenue by about 7 percent and improvement of the fiscal deficit from 9.5 to 6.7 percent of GDP.

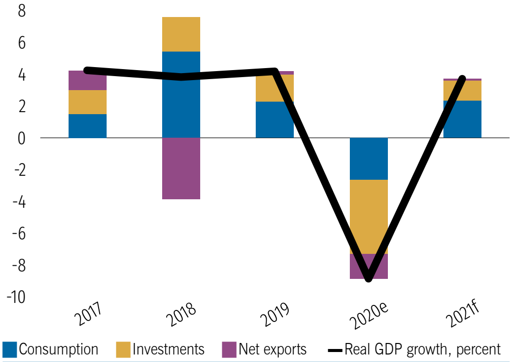
The COVID-19 crisis is expected to have long-term impact on economic activity; depending on its duration, it may cause

permanent business closures and job losses. That would reverse Kosovo's hard-won development gains. According to the BPS, businesses with more than 5 employees expect that by end 2020, as a result of the pandemic, sales will contract by 17 percent and jobs drop by 6 percent.

It will be necessary to advance structural reforms in the medium term to reverse the negative economic impacts of the outbreak and help citizens to become more resilient to future negative shocks. The epidemic has proved the importance of well-functioning social protection mechanisms that can identify and support groups vulnerable to adverse economic shocks while preserving fiscal buffers. Better targeting of social protection spending to the poorest is crucial both for faster poverty reduction and as an automatic stabilizer to prevent steep declines in consumption. To sustain high and inclusive growth, it is also necessary for Kosovo to boost productivity by reducing the administrative burden on firms, e.g., by better coordinating business inspections, investing in human capital, and improving the rule of law so that all firms and citizens are treated fairly.

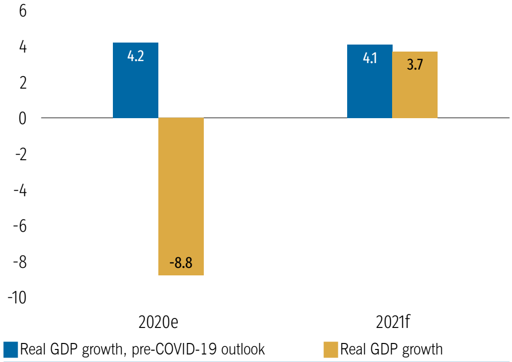
Kosovo's economy is for the first time expected to contract.

Contributions to growth, percent age points



Source: Kosovo Statistics Agency, World Bank staff calculations and projections.

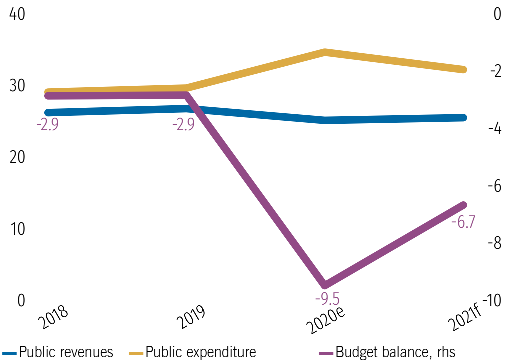
A prolonged COVID-19 outbreak has deepened the contraction in 2020.



Source: Kosovo Statistics Agency, World Bank staff calculations and projections.

A steep revenue decline will widen fiscal deficits.

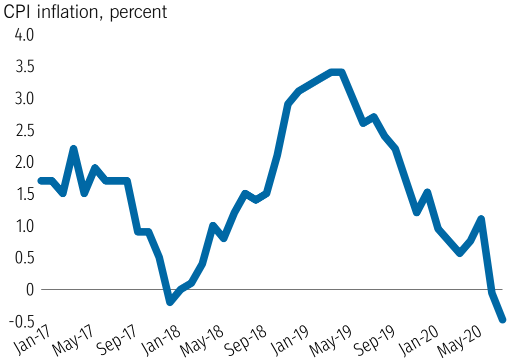
Percent of GDP



Source: Ministry of Finance and World Bank.

Consumer price inflation is easing in 2020.

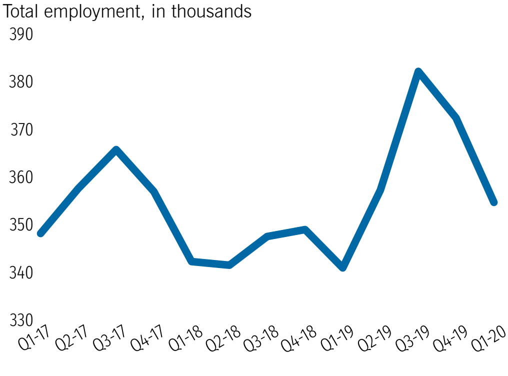
CPI inflation, percent



Source: Kosovo Statistics Agency.

Employment was slipping even before the COVID-19 outbreak.

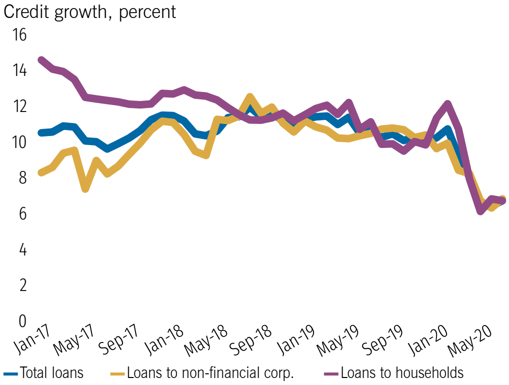
Total employment, in thousands



Source: Kosovo Statistics Agency.

Credit growth slowed after COVID-19 broke out in H1 Q1

Credit growth, percent



Source: Central Bank of Kosovo.

KOSOVO	2017	2018	2019	2020e	2021f	2022f
Real GDP growth (percent)	4.2	3.8	4.2	-8.8	3.7	4.9
Composition (percentage points):						
Consumption	1.5	5.4	2.3	-2.6	2.4	4.4
Investment	1.5	2.1	1.7	-4.6	1.3	1.0
Net exports	1.2	-3.8	0.2	-1.5	0.1	-0.5
Exports	4.0	1.0	2.8	-8.3	3.5	4.1
Imports (-)	2.8	4.8	2.5	-6.8	3.4	4.6
Consumer price inflation (percent, period average)	1.5	1.1	2.7	0.5	0.6	1.2
Public revenues (percent of GDP)	26.4	26.1	26.7	25.1	25.4	26.4
Public expenditures (percent of GDP)	27.6	29.0	29.5	34.5	32.1	31.1
Of which:						
Wage bill (percent of GDP)	8.6	8.8	8.7	9.8	9.0	8.5
Social benefits (percent of GDP)	6.1	6.1	6.3	8.0	6.8	6.5
Capital expenditures (percent of GDP)	7.3	7.9	7.5	7.0	7.9	7.9
Fiscal balance (percent of GDP)	-1.2	-2.9	-2.9	-9.5	-6.7	-4.6
Primary fiscal balance (percent of GDP)	-0.9	-2.7	-2.5	-9.0	-6.2	-4.2
Public debt (percent of GDP)	15.6	16.3	17.0	22.6	27.3	29.6
Public and publicly guaranteed debt (percent of GDP)	16.3	16.9	17.6	23.3	27.9	30.2
Of which: External (percent of GDP)	6.6	6.2	5.8	8.0	10.6	11.3
Goods exports (percent of GDP)	5.9	5.6	5.6	6.6	6.3	6.0
Goods imports (percent of GDP)	44.3	46.3	45.7	44.7	43.2	43.8
Net services exports (percent of GDP)	12.9	12.7	13.2	6.9	7.9	10.3
Trade balance (percent of GDP)	-25.5	-28.0	-26.9	-31.1	-28.9	-27.5
Remittance inflows (percent of GDP)	11.1	11.3	12.0	14.1	14.1	13.9
Current account balance (percent of GDP)	-5.4	-7.6	-5.5	-7.2	-5.8	-5.3
Net foreign direct investment inflows (percent of GDP)	3.3	3.4	2.8	3.7	4.6	4.6
External debt (percent of GDP)	32.6	30.3	30.4	35.4	37.2	36.7
Real private credit growth (percent, period average)	8.8	10.1	7.8	n.a.	n.a.	n.a.
Nonperforming loans (percent of gross loans, end of period)	3.1	2.5	2.0	n.a.	n.a.	n.a.
Unemployment rate (percent, period average)	30.5	29.5	25.7	n.a.	n.a.	n.a.
Youth unemployment rate (percent, period average)	52.7	55.4	49.4	n.a.	n.a.	n.a.
Labor force participation rate (percent, period average)	42.8	40.9	40.5	n.a.	n.a.	n.a.
GDP per capita (US$)	3,956	4,423	4,486	4,352	4,567	4,842

Sources: Country authorities, World Bank estimates and projections.

Note: Statistical discrepancy contribution is divided at the ratio of 80 percent and 20 percent between Consumption and Investment respectively. Statistical discrepancy contribution is divided at the ratio of 80 percent and 20 percent between Consumption and Investment respectively. Change in inventories is included in Investments.

Montenegro

- The COVID-19 crisis has exposed the limits of Montenegro's fiscal buffers and its general vulnerability to external shocks.
- The economy is projected to contract by about 12 percent in 2020, the deepest recession in two decades.
- The unprecedented crisis has reversed recent employment gains and poverty reduction, though wage subsidies and other crisis mitigation measures have so far prevented even more unemployment.
- The loss of revenues is expected to widen the fiscal deficit in 2020 to about 12 percent of GDP.
- The economy is forecast to grow strongly in 2021 but it will be 2022 before the full loss in GDP will be recovered.

Recent Economic Developments

Montenegro must now deal with its deepest recession in two decades. Economic activity was expected to soften from the 4.1 percent growth in 2019, but in 2020 the COVID-19 crisis has dragged the economy into a recession estimated at 12.4 percent; tourism, the sector most affected, accounts for almost 25 percent of GDP. After growing by 2.7 percent in Q1, GDP fell by 20.2 percent in Q2, primarily driven by a sharp decline in private consumption and investment, while net exports contributed positively to growth. High frequency and sentiment indicators suggest the recovery was slow when the economy reopened: in July, retail trade contracted by 32 percent,[6] and international tourist overnight stays were only 6 percent of last year's, while industrial production recovered and recorded a modest decline of 1 percent. Because of disruptions in international travel and a steep second wave of COVID-19 in the Western Balkans since mid-June, the 2020 tourism season is expected to be the worst on record. Since tourism usually peaks from July to September, tourism receipts in 2020 are expected to drop from 2019 by 75 percent, pushing down exports of goods and services by an estimated 45 percent. As a result, private consumption is estimated to decline by 12.5 percent, though government consumption is expected to rise by 6.6 percent. Meanwhile, the high uncertainty, disruptions in supply chains, and restrictions on worker movement are projected to reduce investment, including construction of the priority section of the motorway, by an estimated 21 percent. Lower investment and consumption and plummeting tourism are expected to cause imports to contract by 32 percent.

The crisis has wiped out recent employment gains. Over 80 percent of jobs in Montenegro are in services, which have been heavily affected by the crisis. The administrative data show that by July employment had plunged 9 percent. While all sectors registered declining employment, the labor-intensive tourism, retail, and construction sectors were hit the hardest. Registered unemployed rose from 34,576 in July 2019 to 42,367 in July 2020. Households are suffering from lost jobs and income. Still larger layoffs were prevented by the government wage subsidy programs for

6 All comparisons are year-on-year unless otherwise stated.

the most affected sectors, which supported over 64,000 employees, almost half of all in formal private jobs. Poverty (income below the standardized upper-middle-income-country poverty line of $5.5/day in 2011 PPP) is estimated to increase by around 2 percentage points to 20.4 percent in 2020.

The government adopted a set of measures to mitigate the impact of the crisis. Its measures included three-month deferrals of taxes and contributions (valued at €45 million); Investment and Development Fund of Montenegro (IDF) loan repayment deferrals (€160 million), IDF credit lines of €150 million, wage subsidies for the most affected sectors (€50 million); support for tourism (€19 million) and agriculture (€8 million); and supplementary cash transfers for the vulnerable (€4.2 million). Though the measures, which tracked most EU policy responses, were well-targeted, a significant share of the vulnerable population depending on the informal sector, may have received little support. Efforts are needed to identify this group of people and help them to maintain their livelihoods. The government has presented an ambitious medium-term investment plan to support post-COVID economic recovery.

The severe demand shock and falling oil prices pushed inflation into negative territory in the second quarter (Q2). By August, inflation averaged -0.1 percent, though it is expected to recover slightly by year-end as demand picks up and oil prices stabilize. Oil, transportation, and utilities led the fall in prices, which went up for food and beverages. Given falling prices and a slight increase in nominal wages (suggesting that mainly low wage workers lost their job), by June real wages were up 2 percent despite the recession. (Since 2011 real wages had been mostly flat.)

The financial sector has been resilient so far. The Central Bank of Montenegro (CBM) issued a 90-day moratorium on loan repayments, initially universal but later extended only to the most affected sectors. To further encourage bank lending, the CBM lowered reserve requirements by 2 percentage points. By August bank lending had grown by 7 percent, driven primarily by loans to households (7 percent) and the private sector (8.59 percent). However, deposits fell by 6 percent, with drawdowns of 6 percent by the private sector, 11 percent by the general government, and 5 percent by households. The loans-to-deposit ratio reached 98 percent, the highest since September 2015. In June, non-performing loans were 5.6 percent of total loans, and the capital adequacy ratio was a healthy 19.6 percent. But bank net profits in the first seven months of 2020 were down by almost 50 percent due to less fee income and higher loan provisioning during the crisis which is expected to lead to rising NPLs, which needs to be attentively monitored. In July, international reserves were €1.1 billion, covering 6 months of merchandise imports.

Imports are falling fast, but the loss of tourism revenue will widen the current account deficit (CAD). In recent years, Montenegro funded CADs through FDI and external debt. The chronically high trade deficit of over 20 percent of GDP will widen; the contraction of imports cannot compensate for the loss of exports, due primarily to the collapse in tourism. Loss of the main tourism season will widen the CAD to an estimated 16.8 percent of GDP. With the EU and US economies deteriorating, net remittances are also expected to decline. Net FDI is expected to fall to 4.5 percent of GDP; the rest of the deficit is being financed by external debt and deposit drawdowns.

The fiscal deficit is expected to widen to 11.7 percent of GDP. In June the revised government budget foresaw a 7.2 percent deficit, but since mid-June, usually the start of the peak tourism season, the second, stronger, COVID-19 outbreak has darkened the fiscal outlook. All revenue categories are projected to narrow, with indirect taxes, primarily VAT, being most affected. By July, central government revenues declined by 12 percent, driven by a sharp decline in VAT (-19 percent) and non-tax revenues (-27 percent). Meanwhile, central government spending was up by 11 percent due to much higher wage spending (17 percent) and transfers to institutions and individuals (35 percent), even though wage subsidies were financed from the budgetary reserve. Before the elections, the Parliament had amended the pension law, increasing the minimum pension to €145, reducing the retirement age, and changing the indexation formula and pension calculations. Without further adjustments, such as removal of some generous early retirement options, the result will be significant additional fiscal costs over the medium term.

Public and publicly guaranteed (PPG) debt is likely to soar to an estimated 97 percent of GDP. It is assumed that the widening deficit will be financed by deposit drawdowns and by new debt. In May, Montenegro secured €250 million in financing with support from a World Bank Policy-Based Guarantee. Initially, the receipts were to repay a Eurobond maturing in March 2021; now they are being used to address the unforeseen financing gap caused by COVID-19. The IMF and the EU provided another €135 million through lending arrangements and €53 million in EU grants. The government also raised funds domestically by issuing T-bills and from bank loans. Given its large fiscal imbalances and financial market conditions worsening in a global recession, Montenegro may need to adjust public spending.

In the parliamentary elections held on August 30, opposition-led coalitions won a majority. A new majority coalition announced it would form a technical government. The new government will face the unprecedented challenge of mitigating the economic and social impacts of the crisis and facilitating an economic recovery with fiscal and external imbalances high and still rising

Outlook and Risks

Uncertainty is high, and Montenegro faces both fiscal and external risk. The outlook depends heavily on the trajectory of the COVID-19 pandemic. Assuming that new outbreaks will be restricted to the upcoming winter and spring, Montenegro's economy is expected to rebound briskly in 2021 with estimated GDP growth of 6.9 percent driven by a recovery of tourism receipts from the very low 2020 base. The total output loss due to the crisis is projected to be fully recovered only in 2022, when the economy is projected to grow 4.2 percent. Tourism is expected to recover in 2021 to 80 percent and in 2022 to 95 percent of its 2019 levels, which would support export and consumption growth. The expected completion of the motorway priority section is projected to push investment in 2021 but attenuate total investment in 2022. External imbalances are expected to remain elevated in 2021, but in 2022 completion of the motorway section and stronger tourism exports would reduce the CAD to 11 percent of GDP. Moreover, the high import dependence of investment in Montenegro is expected to decline with completion of major projects. The outlook for employment is highly uncertain, depending as it does on recovery of labor-intensive sectors. The speed of recovery of low-skill jobs will partly determine how fast poor and vulnerable households can regain their income. Addressing long-standing job challenges is critical for robust welfare improvements.

The large fiscal deficit will likely push public debt to a new peak in 2021, after which it is forecast to resume declining. With current policies, the fiscal deficit is expected to decline to 5.2 percent of GDP in 2021 and 1.6 percent in 2022, as capital expenditures plunge after the competition of the highway and revenues recover. The crisis has diverted Montenegro from its debt reduction path and brought debt sustainability issues to the forefront, given higher debt service costs. PPG debt is projected to peak at 98 percent of GDP in 2021 and then recede to 93 percent. Vigilant debt management and a tighter fiscal stance will be needed to place Montenegro on a firm and accelerated debt reduction trajectory as a recovery takes hold.

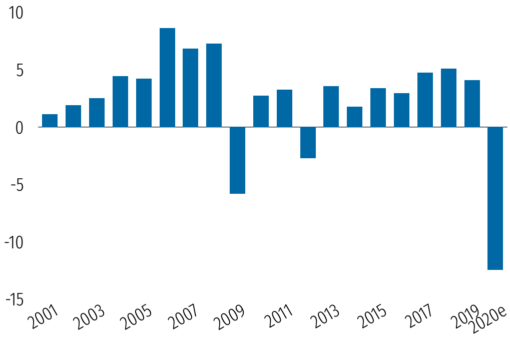
Downside risks dominate, among them a protracted pandemic, more financial upheaval, and worsening global and regional trade. Duration of the pandemic and the speed with which a vaccine becomes widely available will determine the speed of recovery. Given its dependence on regional and EU economies, one major risk is a weaker than expected recovery in these countries. Most worrisome is the possibility that a new COVID-19 wave in summer of 2021 will lead to travel restrictions that will again cost the country most of the tourism season.

Medium-term fiscal risks and vulnerabilities are also significant. Given global recession and uncertainties, external funding may tighten and in 2021–22 amortization of €745 million in public debt (15 percent of 2021 GDP) is still sizable. Only careful fiscal management can mitigate those risks. Proceeding with the second section of the highway is a risk to the sustainability of public debt. Although most risks are negative, the governance and economic management reforms announced by the new parliamentary majority could give positive momentum for a speedier economic recovery.

Montenegro must become more resilient to shocks. To achieve this means addressing its internal and external imbalances and enhancing productivity growth to support a strong and sustainable recovery. Current inefficiencies in public spending leave room for expenditure adjustments that could accelerate debt reduction by, e.g., speeding up public administration reform, strengthening public investment management, and continuing reform of public procurement. It may also be necessary in the medium term to adjust the pension law to Montenegro's fiscal capacities and make the pension system more sustainable. In addition to responsible fiscal management, strong, independent and accountable institutions such as competition and anti-corruption agencies, an independent and efficient judiciary, and a public sector administration based on merit are fundamental to ensuring the accountability of public spending and enabling a private sector level playing field which will foster entrepreneurship, innovation, and broad-based growth. Concomitantly, boosting human capital with better education focused on learning outcomes will support sustainable growth. Intensifying efforts to strengthen the rule of law and the effectiveness of public services will not only support private sector–led growth but will also lessen fiscal vulnerabilities and help create much-needed fiscal space to weather future shocks.

Montenegro must now deal with the deepest recession in decades…

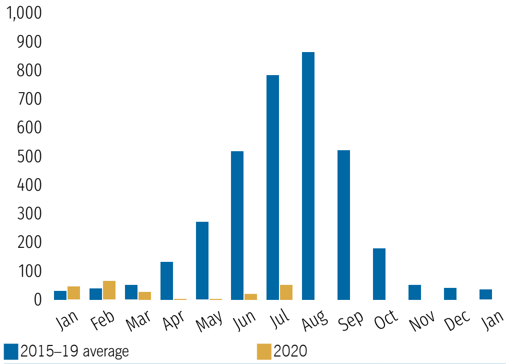
Real GDP growth, percent



Source: MONSTAT data, World Bank staff calculations.

…mainly because the COVID-crisis has halted tourism.

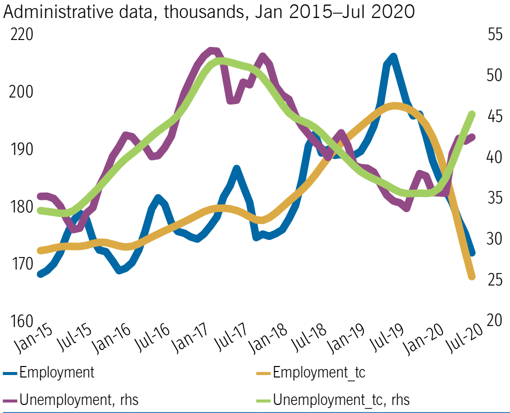
International tourists overnight stays, in thousands



Source: MONSTAT data, World Bank staff calculations.

Employment fell in all sectors…

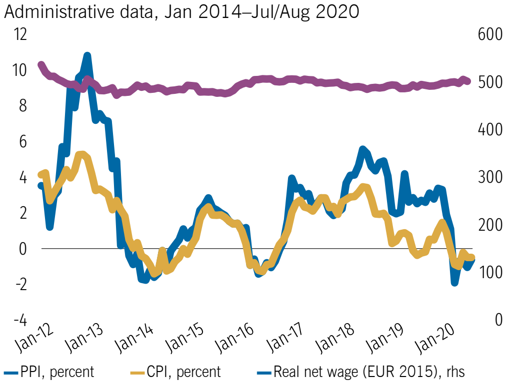
Administrative data, thousands, Jan 2015–Jul 2020



Source: MONSTAT data, tc = trend cycle.

…and inflation plunged into negative territory.

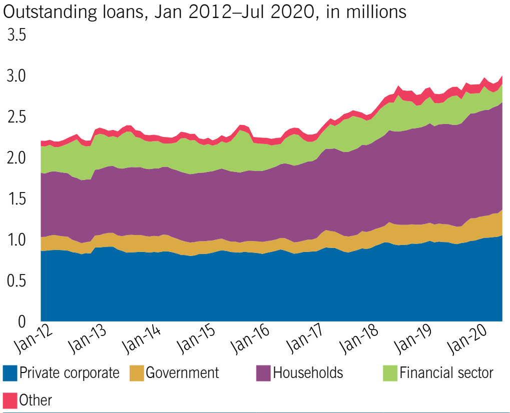
Administrative data, Jan 2014–Jul/Aug 2020



Source: MONSTAT data, World Bank staff calculations. Last obs. (CPI and PPI - Aug 2020, Real net wage - Jul 2020)

Bank lending is still solid…

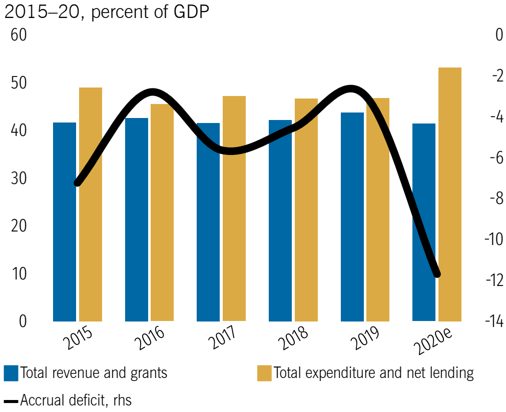
Outstanding loans, Jan 2012–Jul 2020, in millions



Source: Central Bank, World Bank staff calculations.

…but the fiscal position has deteriorated.

2015–20, percent of GDP



Source: MoF, World Bank staff calculations.

MONTENEGRO	2017	2018	2019	2020e	2021f	2022f
Real GDP growth (percent)	4.7	5.1	4.1	-12.4	6.9	4.2
Composition (percentage points):						
Consumption	3.2	5.2	2.9	-9.7	5.8	4.7
Investment	8.0	4.9	0.8	-9.3	3.2	-1.6
Net exports	-6.5	-5.0	0.4	6.7	-2.2	1.1
Exports	0.9	3.4	2.7	-23.1	17.7	4.4
Imports (-)	7.4	8.4	-2.3	-29.8	19.9	3.4
Consumer price inflation (percent, period average)	2.4	2.6	0.4	-0.2	1.5	1.4
Public revenues (percent of GDP)	41.4	42.0	43.3	41.3	42.9	42.3
Public expenditures (percent of GDP)	47.0	46.6	46.2	53.0	48.0	43.9
Of which:						
Wage bill (percent of GDP)	11.8	11.2	11.0	13.2	12.5	11.9
Social benefits (percent of GDP)	12.5	11.7	11.2	13.6	12.5	12.1
Capital expenditures (percent of GDP)	7.8	8.5	8.7	6.0	6.3	4.4
Fiscal balance (percent of GDP)	-5.7	-4.6	-3.0	-11.7	-5.2	-1.6
Primary fiscal balance (percent of GDP)	-3.3	-2.4	-0.8	-9.2	-2.4	0.9
Public debt (percent of GDP)	64.2	70.1	76.5	92.9	94.2	89.7
Public and publicly guaranteed debt (percent of GDP)	69.1	74.1	80.0	97.0	97.9	93.2
Of which: External (percent of GDP)	57.9	64.6	68.1	83.5	86.2	83.0
Goods exports (percent of GDP)	8.9	9.4	9.4	9.2	9.5	9.7
Goods imports (percent of GDP)	52.2	53.3	51.1	42.0	48.1	47.0
Net services exports (percent of GDP)	19.8	20.1	20.6	10.0	18.9	20.3
Trade and services balance (percent of GDP)	-23.5	-23.9	-21.1	-22.7	-19.7	-17.0
Remittance inflows (percent of GDP)	3.9	4.0	4.0	3.6	3.8	4.0
Current account balance (percent of GDP)	-16.1	-17.0	-15.0	-16.8	-13.8	-11.0
Net foreign direct investment inflows (percent of GDP)	11.3	6.9	7.0	4.5	6.5	6.5
External debt (percent of GDP)	160.1	163.9	n.a.	n.a.	n.a.	n.a.
Real private credit growth (percent, period average)	4.4	5.9	6.7	n.a.	n.a.	n.a.
Nonperforming loans (percent of gross loans, end of period)	8.4	7.4	5.1	n.a.	n.a.	n.a.
Unemployment rate (percent, period average)	16.1	15.2	15.1	n.a.	n.a.	n.a.
Youth unemployment rate (percent, period average)	31.7	29.4	25.2	n.a.	n.a.	n.a.
Labor force participation rate (percent, period average)	54.7	56.0	57.4	n.a.	n.a.	n.a.
GDP per capita, PPP (current international $)	19,627	21,236	22,989	19,362	21,071	22,605

Sources: Country authorities, World Bank estimates and projections.

North Macedonia[7]

- The pandemic hit the economy hard: a lockdown, disrupted supply chains, and a prolonged adverse epidemiological situation since summer darkened an already dim outlook.
- Government support programs somewhat alleviated the impact on workers and firms, but fiscal space narrowed as debt approached 60 percent of GDP.
- The near-term outlook beyond 2020 is positive but with heightened downside risks: the containment phase has not yet finished, and a longer period of social distancing policies will affect firms, household incomes, and spending on health.
- While economic and social measures to remedy the crisis will be the main priority, it will be important to continue with the necessary medium-term reforms (fiscal, competition, environment and governance) for a sustainable recovery and EU accession.

Recent Economic Developments

North Macedonia is coping with its deepest recession since 2001. The robust 3.6 percent growth of 2019 was reversed by mid-2020 as the pandemic unfolded. By June growth was down by 6.4 percent: manufacturing had dropped by 16.1 percent[8] with growth in only a handful of areas. Trade, tourism, and transport, which have been driving growth for several years, together fell by 12.3 percent—tourism simply came to a halt. The decline in private construction was offset by public investment in roads, contributing positively to growth. Growth was also robust in agriculture and ICT. Net taxes dropped by 15.3 percent, in part because of reduced compliance. There was also a severe contraction on the demand side as private consumption plunged by 5.6 percent and gross investment by 11.3 percent; exports, 80 percent of which was related to foreign investments, fell by 18.8 percent. The related drop in imports alleviated pressure on the trade balance, which was largely unchanged from 2019. High frequency and sentiment indicators suggest the recovery of trade will be very slow; industrial production is still down some 9 percent.

Although government support cushioned the impact of the crisis on the labor market, for the first time since 2011 the unemployment rate increased, to 16.7 percent. By June, 17,690 people had lost their jobs since March[9]. Most of these losses were because short-term contracts were discontinued. Bigger job losses were prevented by an emergency subsidy scheme to retain jobs by covering minimum salary and social contribution payments in the most affected sectors. At the peak of the crisis in April, subsidies saved some 128,000 jobs. By June the number had declined only slightly, to over 101,000, for which government spent 0.7 percent of GDP. Male employees were more affected than female because they are more active in the labor market. Since peaking in Q1 2020 the male employment rate dropped by 1.5 percentage points (pp); most remained inactive rather than registering with the

7 This Country Note reflects the data available as of September 30; therefore, it excludes recent changes to the 2020 budget and the historical national accounts and balance of payments account data. Implications that these changes might have for projections have not been taken into account.

8 All comparisons are year-on-year unless otherwise stated.

9 According to the Labor Force Survey.

unemployment bureau. The largest employment losses were in services, manufacturing and energy; in ICT, construction, and the financial sector employment grew. But both employment and participation rate gains from 2019 were wiped out.

At the height of the crisis, a severe demand shock and falling oil prices brought inflation down to negative territory. By August, however, consumer price inflation averaged 0.8 percent; it is expected to increase slightly by yearend because of stronger demand and electricity prices that have gone up 7.4 percent. Producer prices have recovered less, standing at 0.6 percent. Despite the severe recession, real wages increased by 7.3 percent, led by rises in public sector and minimum wages.

So far, the banking sector has withstood the crisis well. The capital adequacy ratio is 17 percent, double the mandatory 8 percent.[10] Liquid assets represent 29.5 percent of all banking sector assets, supporting credit through the peak of the crisis. In Q2 the liquid assets increased, with Treasury securities and cash and deposits in the Central Bank having the largest contribution in the quarterly growth. This has given banks space for more lending, which by June was up by 6.6 percent y-o-y—and by 2.6 percent compared to Q1. More important is that the increase is the result of higher lending to both businesses and households. In Q2 total deposits increased by 8.4 percent, with private corporate deposits up 13.7 percent and household deposits up 8.7 percent. Nonperforming loans held steady at 4.6 percent. While the loan repayment moratorium granted by banks could be extended through March 2021, the loan reclassification moratorium[11] (reclassification toward non-performing loan) granted by the central bank bylaw is valid until September.

External imbalances widened as exports and transfers tumbled. A steep fall in exports was followed by a similar contraction in imports, which kept the trade deficit at about the 2019 level. Yet transfers through cash exchanges (a proxy for remittances) halved despite increased use of official channels to transfer remittances. The current account deficit is projected to widen slightly, to 2.9 percent of GDP. Net FDI is expected to slow as some investments previously announced are delayed. A government strategy to secure financing for emergency support and for refinancing in early 2021 will push up external debt considerably.

By yearend the fiscal deficit is expected to triple to 6.3 percent of GDP;[12] by August, it had already grown to 5.2 percent. The more than 14 percent drop in VAT and excise revenues was somewhat cushioned by social contributions, which rose because of the government subsidies. Spending went up more than 11 percent because of health care costs and subsidies to retain jobs. Because of policy changes in 2019, spending on wages was up 8 percent and up on pensions by 4 percent; capital spending only began to increase in July.

10 In August one small bank declared bankruptcy procedure, as it did not manage to resolve issues with its capital adequacy for over a year.

11 The amendments to the Credit Risk Management Bylaw provide a temporary relaxation (until end-September) only for clients that are late over 90 days but not more than 150 days not to be reclassified as NPLs. For others, banks are obliged to measure expected credit losses as usual.

12 With the October 2020 budget revision budget deficit has further increased to 8.4 percent of GDP as it incorporates the Fourth Support Package adopted by the government for firms and households to mitigate the crisis impact.

Public and publicly guaranteed (PPG) debt nearly reached 60 percent of GDP. The government was able to refinance payments due and secure financing to mitigate the COVID-19 crisis through a package of measures amounting to about 2.5 percent of GDP. Net borrowing in Q2 amounted to almost 9 percent of GDP, which by June resulted in PPG debt rising to 59.5 percent of GDP. In June the government issued a 7-year Eurobond worth €700 million with an interest rate of 3.675 percent. The IMF disbursed a Rapid Financing Instrument of €176.7 million, the World Bank approved a €140 million emergency response package, and the EU approved Macro-Financial Assistance of €160 million and grants of €60 million.

Early parliamentary elections on July 15, 2020, retained the previous coalition. The government is now confronted by the unprecedented challenge of mitigating the social and economic impacts of the crisis while restoring fiscal sustainability and supporting recovery. Given the global recession, its large fiscal imbalance, and worsening financial market conditions, North Macedonia will need to reinforce its resilience. This will require broadening the tax base and adjusting public spending to reduce the deficit and financing needs.

Outlook and Risks

The economy is facing its deepest recession since 2001. The demand contraction and supply chain disruptions caused by the prolonged COVID-19 pandemic and its containment measures have been worse than earlier projected. Since June, a second, COVID-19 outbreak has darkened the outlook because it has disrupted a full recovery of production and social distancing is limiting consumption. The growth contraction in 2020 is now expected to reach 4.1 percent.[13] Unemployment is set to grow despite government support schemes, and private investors are struggling with supply disruptions, liquidity shortages, and general uncertainty. Services are being affected by the travel bans still in place. Without the government response, lower labor incomes and remittances would increase poverty in 2020 to pre-2015 levels of about 23 percent; but government support programs will alleviate the impact of COVID-19 on poverty.

Over the medium term, growth is expected to return as the pandemic loses force. The political stability after the general elections and launch of the EU accession negotiations should boost both reforms and investor confidence so that once the crisis is over, growth rebounds faster. Assuming that new COVID-19 outbreaks are contained through winter and spring, there are no new lockdowns, and the first vaccine successfully completes Phase 3 trials in early 2021, a gradual recovery of growth to 3.6 percent is projected for 2021. Restoration of consumer and investor confidence would boost personal consumption, exports, and private investment. However, the total output loss will not be fully recovered until 2022.

Although the economy is projected to rebound, downside risks dominate, and the duration of the pandemic and its impacts are highly uncertain. The containment phase is not yet finished, and a longer period of social distancing policies will affect household income and health expenditures. Increased employee absenteeism, disrupted supply chains, lower

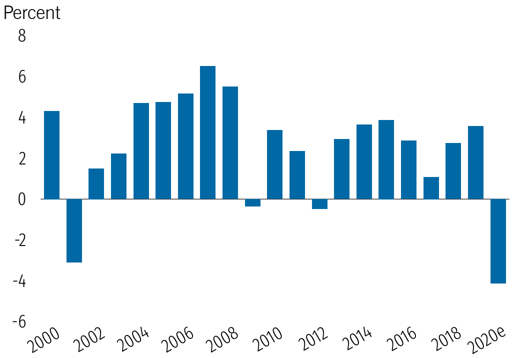
13 This does not take into account the October changes to historical GDP data which will likely lead to further decline in GDP in 2020.

domestic and external demand, and liquidity shortages could lead to further layoffs and increase poverty, stretching already tight public finances, in particular after the Fourth Support Package adopted by the Government in October 2020 (amounting to additional 4.2 percent of GDP). Dependence on regional and EU economies if recovery is again delayed would further dampen North Macedonia's growth prospects. Tightening financial conditions globally may affect financing options for North Macedonia as well. More positively, the launch of EU accession negotiations and the political stability after the July elections may provide the impetus for structural reforms that would boost productivity and strengthen investor confidence. Also, nearshoring within the European supply chains may be an opportunity for North Macedonia, which already hosts a number of car-supply FDIs.

Over the medium term it will be necessary to bring public finances back onto a sustainable path. The large fiscal deficit is likely in 2021 to push public debt to a new peak of 59.8 percent of GDP, though it is later expected to resume a declining trend. The new peak for public debt will require North Macedonia to reprioritize spending for longer-term recovery and boost revenues by cutting exemptions, improving compliance, and enhancing public investment management to maximize its efficiency and its impact on growth. With current policies, the fiscal deficit (road agency finances included) is expected to narrow to 4 percent of GDP in 2021 and 2.6 percent in 2022, mainly due to lower subsidies and higher revenues as the economy recovers. The debt reduction trajectory launched in 2017 should resume. The process would be aided by avoiding creation of long-term liabilities in the pension system that erode its sustainability, improving management of state-owned companies, and broadening the tax base. Finally, although state aid is triple that in EU peers, only 16 percent of it is horizontal; North Macedonia's reliance on sectoral aid (40 percent) compared with the EU's (6 percent) suggests considerable scope to rationalize and reform state aid to EU standards.

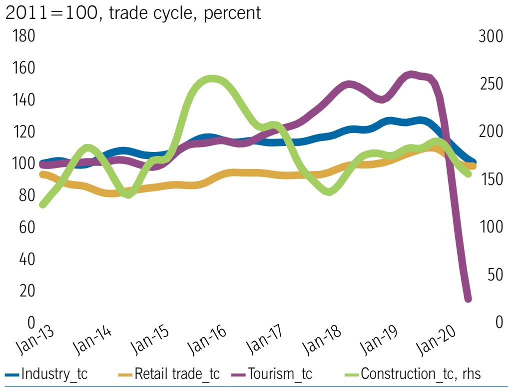
While mitigating the near-term impact of the crisis is the main priority, to boost its potential North Macedonia needs to focus on structural reforms. The priorities are addressing low and declining human capital, weak competition policy and an inadequate court system, and declining productivity. For better governance, reforming public administration and streamlining management of state-owned companies would directly support private sector productivity while also supporting fiscal prudence. Strengthening such independent and accountable institutions as the competition protection agency and reforming network sectors is critical to enable the private sector to compete fairly and eliminate unfair practices. A substantial growth dividend of 0.23 percentage points a year could be gained through reforms of just the energy, water, transport, and telecommunications sectors.

The economy is in the worst recession since 2001…



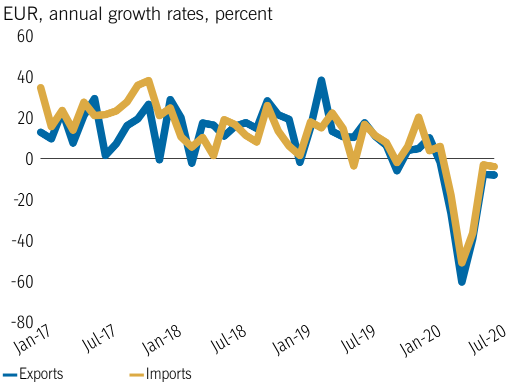
Source: State Statistics Office.

…and recovery was delayed beyond Q2.



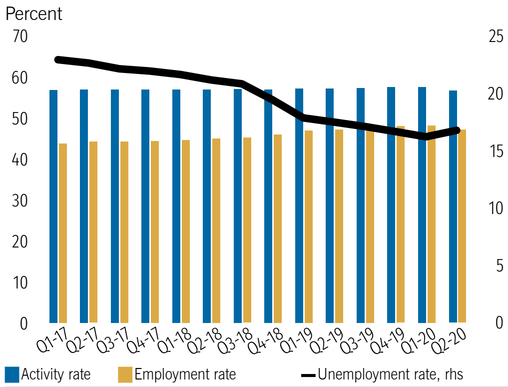
Source: State Statistics Office and World Bank calculations.

Exports and imports both dropped.



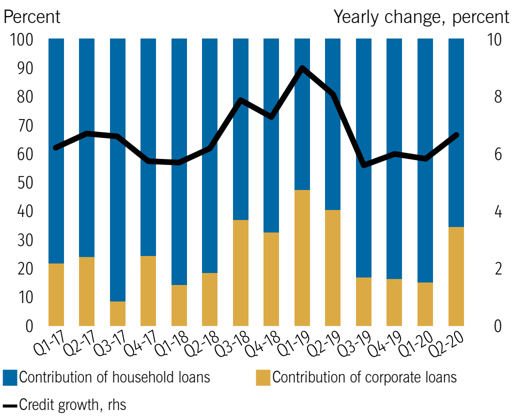
Source: National Bank.

Unemployment increased for the first time since 2011.



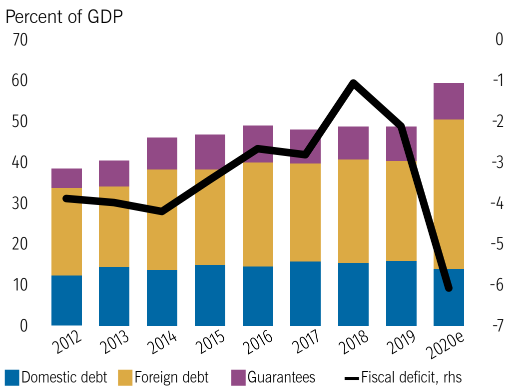
Source: State Statistics Office.

As monetary policy relaxed, lending to corporations rose.



Source: National Bank.

Fiscal performance deteriorated in support of firm and household survival.



Source: Ministry of Finance and World Bank estimates.

NORTH MACEDONIA	2017	2018	2019	2020e	2021f	2022f
Real GDP growth (percent)	1.1	2.7	3.6	-4.1	3.6	3.5
Composition (percentage points):						
Consumption	1.3	3.3	3.6	-1.6	3.3	2.5
Investment	-0.8	-2.6	2.1	-1.0	1.8	2.0
Net exports	0.6	2.0	-2.1	-1.5	-1.5	-1.1
Exports	4.6	9.2	5.5	-4.2	4.2	5.0
Imports (-)	4.0	7.3	7.6	-2.7	5.8	6.1
Consumer price inflation (percent, period average)	1.4	1.5	0.8	0.5	1.6	2.0
Public revenues (percent of GDP)	31.0	30.5	31.2	28.9	31.4	32.1
Public expenditures (percent of GDP)	33.8	31.6	33.3	35.0	34.9	34.5
Of which:						
Wage bill (percent of GDP)	6.6	6.3	6.3	7.0	6.7	6.4
Social benefits (percent of GDP)	15.3	15.3	15.5	17.2	16.4	16.2
Capital expenditures (percent of GDP)	4.2	2.5	3.4	2.2	3.4	3.7
Fiscal balance (percent of GDP)	-2.8	-1.1	-2.1	-6.1	-3.5	-2.4
Overall Fiscal Balance with the Public Enterprise for State Roads*	-3.5	-1.7	-2.4	-6.3	-4.0	-2.6
Primary fiscal balance (percent of GDP)	-1.5	0.1	-1.0	-4.9	-2.1	-1.1
Public debt (percent of GDP)	39.4	40.6	40.2	50.8	51.3	50.9
Public and publicly guaranteed debt (percent of GDP)	47.7	48.6	48.8	59.1	59.8	59.2
Of which: External (percent of GDP)	31.7	33.1	32.7	38.4	38.3	37.2
Goods exports (percent of GDP)	40.6	45.6	47.0	42.9	43.7	44.8
Goods imports (percent of GDP)	58.4	61.8	64.3	60.0	61.0	61.4
Net services exports (percent of GDP)	3.7	3.4	3.0	2.6	2.8	3.0
Trade balance (percent of GDP)	-14.1	-12.8	-14.3	-14.5	-14.5	-13.6
Remittance inflows (percent of GDP)	1.9	1.9	1.7	1.7	1.6	1.5
Current account balance (percent of GDP)	-0.9	-0.1	-2.8	-2.9	-3.0	-2.3
Net foreign direct investment inflows (percent of GDP)	1.8	5.6	2.6	1.2	4.2	4.3
External debt (percent of GDP)	73.4	73.3	73.9	84.7	83.4	81.7
Real private credit growth (percent, period average)	1.1	5.0	6.5	n.a.	n.a.	n.a.
Nonperforming loans (percent of gross loans, end of period)	6.1	5.0	4.6	n.a.	n.a.	n.a.
Unemployment rate (percent, period average)	22.4	20.7	17.3	n.a.	n.a.	n.a.
Youth unemployment rate (percent, period average)	39.2	37.1	30.5	n.a.	n.a.	n.a.
Labor force participation rate (percent, period average)	56.8	56.9	57.2	n.a.	n.a.	n.a.
GDP per capita, PPP (current international $)	15,529	16,518	17,815	17,084	17,699	18,319

Sources: Country authorities, World Bank estimates and projections.
Note: Youth unemployment rate is for labor force aged 15–29.

Serbia

- After solid growth of 4.2 percent in 2019, in 2020 Serbia must now deal with a COVID-19-related recession of 3 percent.[14]
- Despite the economic slowdown, unemployment rate hit a historic low of 7.3 percent in Q2 2020, thanks to the government fiscal stimulus program.
- However, keeping the economy afloat during the pandemic had a high cost: the fiscal stimulus measures now account for nearly 13 percent of GDP, leading to a projected fiscal deficit of a record-high 7.6 percent.
- The deficit might even be worse if some contingent liabilities materialize, which would drive up public debt significantly.
- The recovery is expected to start in 2021, with a return to the previous growth path over the medium term.

Recent Economic Developments

After several years of solid growth, the Serbian economy will enter recession in 2020. The year began well—GDP in Q1 was up by 5.1 percent—but growth turned negative as government measures to control the spread of the COVID-19 pandemic took a toll. Preliminary estimates suggest that in Q2 GDP fell 6.4 percent—though this is better than neighboring countries, where a drop in GDP averages about 11.5 percent. The extended summer COVID-19-related crisis, the elections, the slowdown with legislative activities and economic developments globally will all affect this year's growth. Another reason for slower recovery in the second half (H2) of 2020 is the high base set in H2 2019.

Services and industry led the decline in value-added in Q2, but agricultural growth was positive. On average, value-added in services shrank by 6.6 percent in real terms, but it is important to note that some services grew even in Q2: ICT was up 5.4 percent and financial services up 3.8 percent in real terms. Contrary to expectations, construction also continued to grow in Q2: value added was up by 0.1 percent. Agricultural output grew by 2.2 percent.

Both labor market participation and unemployment fell during the pandemic. According to Labor Force Survey data, in 2019 unemployment fell to an estimated 10.4 percent (annual average, population age 15 and over) and employment reached a record-high 49 percent. This improvement continued through H1 2020. Pandemic-related lockdowns prevented numerous workers from finding jobs, leading them to leave the labor market; as a result, in Q2 active labor market participation was lower than in 2019 by 183,000, and of these, 132,000 had been previously employed informally. This brought unemployment rate down to a record low of 7.3 percent. But the real impact on the labor market may not be clear until the wage subsidy program expires in September.

Although its fiscal consolidation efforts in recent years allowed Serbia to enter the COVID-19 crisis in a strong fiscal position,

14 All comparisons are year-on-year unless otherwise stated.

the pandemic still had significant impact. The massive fiscal package introduced early on—the total value so far is now nearing 13 percent of GDP—helped to limit the negative impact on growth and protect jobs. About 40 percent of the package consists of soft loans and guarantees, 30 percent tax deferrals (personal and corporate income taxes [PIT and CIT]), 20 percent a variety of cash supports to businesses. and 10 percent support for individuals. Meanwhile, in Q2 fiscal revenues fell 14 percent in nominal terms, due to the decision to defer CIT payments. This led to a record high deficit of 4.8 percent of annual GDP in Q2, and a 6.1 percentage point rise in public debt since December 2019, to reach 59 percent of GDP by the end of June 2020.

For now the impact on poverty seems to have been mitigated. The package is simulated to increase household income (which suffered due to the COVID-19 crisis), by close to 9 percent, on average, compared to the scenario with no fiscal package. That helped to prevent an immediate surge in poverty. However, same simulations show that more targeted interventions would have achieved a similar impact (in terms of poverty alleviation) at a significantly lower fiscal cost.

Similarly, the impact of the fiscal package on firms was positive but a similar impact could have been achieved at a lower fiscal cost. Recent World Bank analysis suggests that the impact of the support measures on firms was positive, but that with better targeting, a less generous package could have had similar effect and the firms most affected could have received more generous support, which would have reduced the pandemic impact even further while reducing fiscal costs of the program.

Low inflation and a strong National Bank of Serbia (NBS) position provided a solid foundation for monetary policy responses to the pandemic. Inflation in 2019 was low and stable, as it was through August 2020, with prices up 1.9 percent. To stimulate the economy, the NBS continued to lower the key policy rate—in March by 50 bps to 1.75 percent, in April to 1.5 percent and in June to 1.25 percent. The NBS also significantly increased the money supply: in July, M1 was 42.5 percent higher than a year ago.[15] As a precaution, the NBS and the European Central Bank agreed to set up a repo line arrangement worth EUR 1 billion for Serbian financial institutions to address possible euro liquidity needs caused by markets disrupted by the COVID-19 shock.[16] After a small appreciation in 2019, the dinar held steady in 2020, primarily thanks to NBS interventions in the foreign exchange market; through August it had sold foreign currencies equaling EUR 1.5 billion. At that point, NBS had official foreign currency reserves of EUR 13.4 billion, about the same as at yearend 2019.

The pandemic has changed the challenges to the banking system. As part of the response to the pandemic, the NBS twice issued a moratorium on debt repayment for both individuals and businesses, which intensified liquidity pressures on banks. Moreover, as the economy entered recession and uncertainty about the recovery rose, credit activity slowed: The total value of new business loans went down 24.2 percent in Q2 compared to Q2 2019, and the amount of new company loans for investment projects went down 47.1 percent. However, nonperforming loans continued

15 M2 was also higher, by 34.6 percent.

16 The repo line is to expire on June 30, 2021, but can be extended.

to decline, from 4.1 percent in December to 3.7 percent in June.

Financing of the current account deficit (CAD) has become a concern, as the external debt started to rise in 2020. Even though in H1 2020 the CAD in euro terms was 11 percent lower than a year earlier, as a share of GDP it had reached 2.9 percent. The trade deficit continued to widen, up by 4.5 percent in H1 to €2.6 billion. Exports of goods dropped by 9.4 percent and imports by 6.7 percent. The surplus in trade in services increased as import of services dropped by 11 percent. The deficit in primary income went down by 37 percent and the secondary income surplus by 16 percent, mainly because remittances plunged by some 27 percent. Financing the CAD is not a problem, however, although net FDI was down 19 percent in H1 and within that foreign equity inflows dropped by 44 percent. However, external debt increased -61.9 percent of GDP at the end of 2019, to 69.9 percent at the end of June 2020.

Outlook and Risks

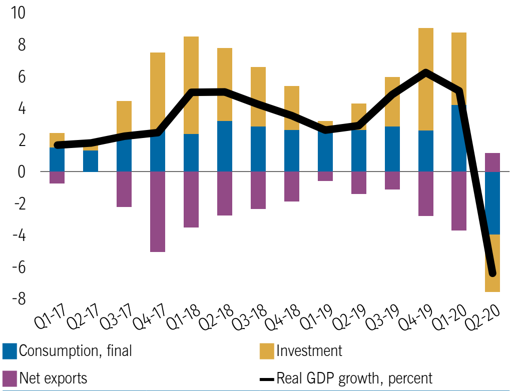
Based on the latest data, in the baseline scenario Serbian GDP will drop by 3 percent in 2020—slightly less than in the rest of the region. The baseline assumes that the number infected by the coronavirus will be kept under control and, despite likely pressure on the health care system, there will not be major effects on the economy, as seen in Q2, since new lockdowns are not expected. However, business travel, exports of services, remittances, and FDI will be affected. The recovery in H2 will also be slower since last year the economy expanded significantly due to Serbia's one-off investment in the new gas pipeline.

The more significant recovery is projected to start in 2021, but it is likely to be slower than expected. Investment will not soon return to previous levels, and consumption will be subdued because the real impact on both employment and wages will only be felt late in 2020 or early in 2021. As the economy recovers, the public sector will need to make major adjustments to unwind the fiscal stimulus in 2020. Lower government spending and its impact private consumption and investment may slow down the recovery in 2021, with GDP growth currently projected at 2.9 percent.

Numerous risks remain. Besides the uncertainty that hovers over the global economy, there are internal risks to the baseline scenario. Contingent liabilities that affect public finances could materialize, particularly those related to the deterioration in performance of state-owned enterprises, (including as of recently Telekom Srbija and Air Serbia, in addition to those that have long been troubled by financial challenges, such as the railways and Srbijagas). Political developments, especially as related to the Kosovo talks, could distract the government from undertaking necessary reforms, most important from the growth perspective being those related to improving the business environment. There are also factors that could lead to a lower decline of GDP this year and faster recovery going forward, primarily related to recovery of exports; FDI and domestic consumption. Those in turn crucially depend on the pace of structural reforms, EU accession process and developments on global markets.

In Q2 the COVID-19 pandemic, caused GDP to contract.

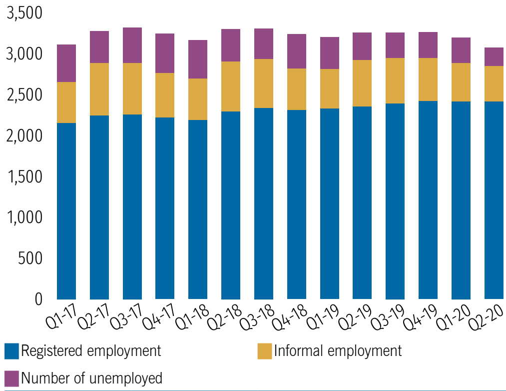
Contribution to growth, percentage points



Source: Statistics Office of Republic of Serbia.

Active population shrank significantly in Q2.

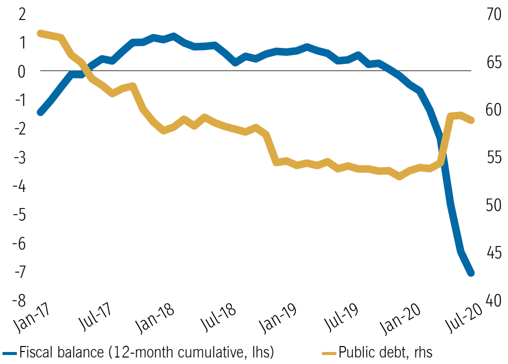
Employed and unemployed, thousands



Source: LFS - Statistics Office of Republic of Serbia.

A major increase in budgetary deficit, already reflected in the increase in public debt.

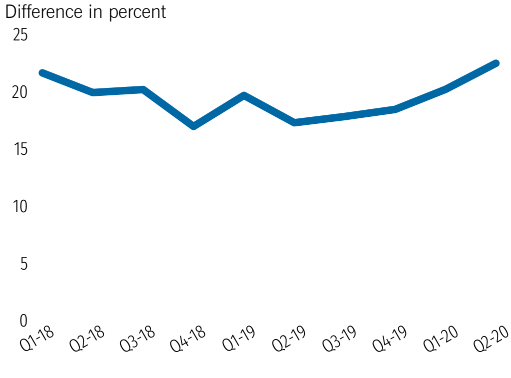
Share in GDP



Source: Ministry of Finance.

Public sector wages are again growing faster than private.

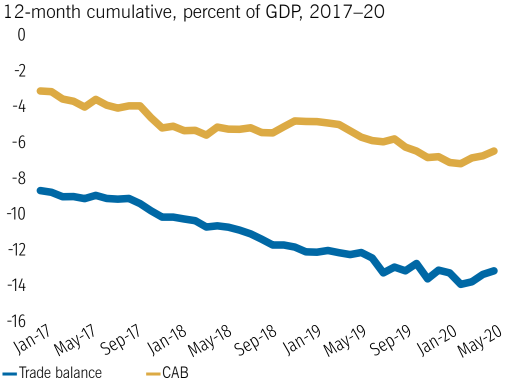
Difference in percent



Source: Statistics Office of Republic of Serbia.

The trade deficit and the CAD have begun to decline.

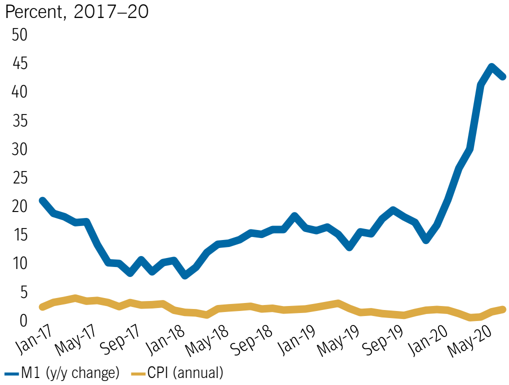
12-month cumulative, percent of GDP, 2017–20



Source: National Bank of Serbia.

Inflation is low, although the money supply has grown.

Percent, 2017–20



Source: National Bank of Serbia.

SERBIA	2017	2018	2019	2020e	2021f	2022f
Real GDP growth (percent)	2.0	4.4	4.2	-3.0	2.9	3.3
Composition (percentage points):						
Consumption	1.9	2.8	2.7	-1.6	2.2	2.8
Investment	2.2	4.2	3.0	-1.4	0.9	1.1
Net exports	-2.1	-2.6	-1.5	0.1	-0.3	-0.6
Exports	4.0	4.3	4.6	-5.7	4.1	4.6
Imports (-)	6.1	6.9	6.0	-5.8	4.3	5.2
Consumer price inflation (percent, period average)	3.2	2.0	1.9	2.0	2.2	3.2
Public revenues (percent of GDP)	41.5	41.5	42.1	39.4	42.8	44.0
Public expenditures (percent of GDP)	40.4	40.9	42.3	47.0	44.9	44.5
Of which:						
Wage bill (percent of GDP)	9.0	9.2	9.5	10.6	10.1	10.2
Social benefits (percent of GDP)	15.1	14.7	14.5	15.7	15.3	15.2
Capital expenditures (percent of GDP)	2.8	3.9	4.9	3.9	5.0	5.2
Fiscal balance (percent of GDP)	1.1	0.6	-0.2	-7.6	-2.1	-0.5
Primary fiscal balance (percent of GDP)	3.6	2.8	1.8	-5.6	-0.1	1.4
Public debt (percent of GDP)	55.6	50.8	49.7	55.3	54.8	52.7
Public and publicly guaranteed debt (percent of GDP)	58.7	54.4	52.9	59.8	58.8	56.2
Of which: External (percent of GDP)	35.5	31.4	30.3	36.5	37.0	38.0
Goods exports (percent of GDP)	35.9	35.2	35.8	35.0	35.7	38.4
Goods imports (percent of GDP)	46.1	47.1	48.0	46.2	47.5	48.8
Net services exports (percent of GDP)	2.4	2.3	2.3	2.4	3.8	2.1
Trade balance (percent of GDP)	-7.8	-9.5	-9.9	-8.8	-8.0	-8.3
Remittance inflows (percent of GDP)	5.2	6.4	5.8	4.2	5.2	5.3
Current account balance (percent of GDP)	-5.2	-4.8	-6.9	-6.4	-6.4	-6.7
Net foreign direct investment inflows (percent of GDP)	6.2	7.4	7.8	4.8	5.2	5.4
External debt (percent of GDP)	68.9	61.3	61.9	67.1	67.6	68.6
Real private credit growth (percent, period average)	1.9	3.7	6.9	n.a.	n.a.	n.a.
Nonperforming loans (percent of gross loans, end of period)	9.8	5.7	4.1	n.a.	n.a.	n.a.
Unemployment rate (percent, period average)	13.5	12.7	10.4	n.a.	n.a.	n.a.
Youth unemployment rate (percent, period average)	31.9	29.7	27.5	n.a.	n.a.	n.a.
Labor force participation rate (percent, period average)	54.0	54.5	54.6	n.a.	n.a.	n.a.
GDP per capita, PPP (current international $)	16,363	17,552	18,564	18,420	20,182	n.a.

Sources: Country authorities, World Bank estimates and projections.

Key Economic Indicators

Key Economic Indicators	**2016**	**2017**	**2018**	**2019**	**2020e**	**2021f**	**2022f**
Real GDP growth (percent)							
Albania	3.3	3.8	4.1	2.2	-8.4	5.0	3.9
Bosnia and Herzegovina	3.1	3.2	3.7	2.6	-3.2	3.0	3.5
Kosovo	4.1	4.2	3.8	4.2	-8.8	3.7	4.9
North Macedonia	2.8	1.1	2.7	3.6	-4.1	3.6	3.5
Montenegro	2.9	4.7	5.1	4.1	-12.4	6.9	4.2
Serbia	3.3	2.0	4.4	4.2	-3.0	2.9	3.3
WB6	*3.3*	*2.7*	*4.0*	*3.6*	*-4.8*	*3.5*	*3.6*
Consumer price inflation (percent, period average)							
Albania	1.3	2.0	2.1	1.4	2.0	2.5	2.8
Bosnia and Herzegovina	-1.6	0.8	1.4	0.6	0.7	0.5	0.5
Kosovo	0.3	1.5	1.1	2.7	0.5	0.6	1.2
North Macedonia	-0.2	1.4	1.5	0.8	0.5	1.6	2.0
Montenegro	-0.3	2.4	2.6	0.4	-0.2	1.5	1.4
Serbia	1.1	3.2	2.0	1.9	2.0	2.2	3.2
WB6	*0.4*	*2.2*	*1.8*	*1.5*	*1.4*	*1.7*	*2.3*
Public expenditures (percent of GDP)							
Albania	29.6	29.8	29.4	29.3	35.1	32.6	30.9
Bosnia and Herzegovina	41.5	41.4	40.2	41.5	46.6	44.0	42.3
Kosovo	27.7	27.6	29.0	29.5	34.5	32.1	31.1
North Macedonia	33.2	33.8	31.6	33.3	35.0	34.9	34.5
Montenegro	45.3	47.0	46.6	46.2	53.0	48.0	43.9
Serbia	41.9	40.4	40.9	42.3	47.0	44.9	44.5
WB6	*36.5*	*36.7*	*36.3*	*37.0*	*41.8*	*39.4*	*37.9*
Public revenues (percent of GDP)							
Albania	27.6	27.7	27.6	27.4	26.6	27.0	27.6
Bosnia and Herzegovina	42.7	43.8	42.7	43.3	42.3	43.6	43.0
Kosovo	26.3	26.4	26.1	26.7	25.1	25.4	26.4
North Macedonia	30.6	31.0	30.5	31.2	28.9	31.4	32.1
Montenegro	42.5	41.4	42.0	43.3	41.3	42.9	42.3
Serbia	40.8	41.5	41.5	42.1	39.4	42.8	44.0
WB6	*35.1*	*35.3*	*35.1*	*35.7*	*33.9*	*35.5*	*35.9*

Source: World Bank calculations and projections on data from national authorities and World Economic Outlook.

	2016	2017	2018	2019	2020e	2021f	2022f
Fiscal balance (percent of GDP)							
Albania	-1.8	-2.0	-1.8	-1.9	-8.5	-5.6	-3.4
Bosnia and Herzegovina	1.2	2.4	2.5	1.9	-4.2	-0.4	0.7
Kosovo	-1.4	-1.2	-2.9	-2.9	-9.5	-6.7	-4.6
North Macedonia	-2.7	-2.8	-1.1	-2.1	-6.1	-3.5	-2.4
Montenegro	-2.8	-5.7	-4.6	-3.0	-11.7	-5.2	-1.6
Serbia	-1.2	1.1	0.6	-0.2	-7.6	-2.1	-0.5
WB6	*-1.4*	*-1.4*	*-1.2*	*-1.4*	*-8.0*	*-3.9*	*-2.0*
Public debt (percent of GDP)							
Albania	68.7	67.8	64.6	63.5	76.2	76.2	74.2
Bosnia and Herzegovina	42.4	36.1	34.2	33.1	38.0	38.2	38.3
Kosovo	14.1	15.6	16.3	17.0	22.6	27.3	29.6
North Macedonia	39.9	39.4	40.6	40.2	50.8	51.3	50.9
Montenegro	64.4	64.2	70.1	76.5	92.9	94.2	89.7
Serbia	62.8	55.6	50.8	49.7	55.3	54.8	52.7
WB6	*48.7*	*46.4*	*46.1*	*46.7*	*56.0*	*57.0*	*55.9*
Public and publicly guaranteed debt (percent of GDP)							
Albania	72.3	71.9	69.7	68.0	81.3	81.3	79.3
Bosnia and Herzegovina	43.8	37.7	35.6	34.6	38.6	39.8	39.9
Kosovo	14.4	16.3	16.9	17.6	23.3	27.9	30.2
North Macedonia	48.8	47.7	48.6	48.8	59.1	59.8	59.2
Montenegro	70.4	69.1	74.1	80.0	97.0	97.9	93.2
Serbia	68.6	58.7	54.4	52.9	59.8	58.8	56.2
WB6	*53.0*	*50.2*	*49.9*	*50.3*	*59.9*	*60.9*	*59.7*
Goods exports (percent of GDP)							
Albania	6.7	6.9	7.7	6.8	6.0	6.0	6.0
Bosnia and Herzegovina	25.7	29.8	31.2	29.0	27.5	27.4	26.6
Kosovo	5.1	5.9	5.6	5.6	6.6	6.3	6.0
North Macedonia	36.5	40.6	45.6	47.0	42.9	43.7	44.8
Montenegro	8.9	8.9	9.4	9.4	9.2	9.5	9.7
Serbia	34.9	35.9	35.2	35.8	35.0	35.7	38.4
WB6	*26.2*	*27.8*	*28.5*	*28.4*	*27.3*	*27.7*	*28.8*

Source: World Bank calculations and projections on data from national authorities and World Economic Outlook.

	2016	2017	2018	2019	2020e	2021f	2022f
Trade balance (percent of GDP)							
Albania	-16.8	-15.1	-13.8	-13.8	-19.4	-17.5	-16.9
Bosnia and Herzegovina	-16.6	-16.2	-15.0	-15.2	-14.2	-14.6	-15.5
Kosovo	-27.2	-25.5	-28.0	-26.9	-31.1	-28.9	-27.5
North Macedonia	-15.2	-14.1	-12.8	-14.3	-14.5	-14.5	-13.6
Montenegro	-22.5	-23.5	-23.9	-21.1	-22.7	-19.7	-17.0
Serbia	-6.0	-7.8	-9.5	-9.9	-8.8	-8.0	-8.3
WB6	*-12.8*	*-13.1*	*-13.6*	*-13.8*	*-14.2*	*-13.4*	*-13.3*
Current account balance (percent of GDP)							
Albania	-7.6	-7.5	-6.7	-7.6	-11.9	-10.1	-8.7
Bosnia and Herzegovina	-4.7	-4.4	-3.9	-3.7	-3.9	-4.0	-4.6
Kosovo	-7.9	-5.4	-7.6	-5.5	-7.2	-5.8	-5.3
North Macedonia	-2.6	-0.9	-0.1	-2.8	-2.9	-3.0	-2.3
Montenegro	-16.2	-16.1	-17.0	-15.0	-16.8	-13.8	-11.0
Serbia	-2.9	-5.2	-4.8	-6.9	-6.4	-6.4	-6.7
WB6	*-4.8*	*-5.4*	*-5.1*	*-6.2*	*-6.8*	*-6.4*	*-6.2*
External debt (percent of GDP)							
Albania	73.5	68.7	64.5	60.5	67.4	62.0	56.1
Bosnia and Herzegovina	72.2	68.5	66.8	66.5	70.9	68.8	67.0
Kosovo	33.2	32.6	30.3	30.4	35.4	37.2	36.7
North Macedonia	74.7	73.4	73.3	73.9	84.7	83.4	81.7
Montenegro	162.5	160.1	163.9	n.a.	n.a.	n.a.	n.a.
Serbia	72.1	68.9	61.3	61.9	67.1	67.6	68.6
WB6	*81.4*	*78.7*	*76.7*	*58.6*	*65.1*	*63.8*	*62.0*
Unemployment rate (period average, percent)							
Albania	15.2	13.7	12.3	11.5	n.a.	n.a.	n.a.
Bosnia and Herzegovina	25.4	20.5	18.4	15.7	n.a.	n.a.	n.a.
Kosovo	27.5	30.5	29.5	25.7	n.a.	n.a.	n.a.
North Macedonia	23.8	22.4	20.7	17.3	n.a.	n.a.	n.a.
Montenegro	17.7	16.1	15.2	15.1	n.a.	n.a.	n.a.
Serbia	15.3	13.5	12.7	10.4	n.a.	n.a.	n.a.
WB6	*20.8*	*19.5*	*18.1*	*15.9*	*n.a.*	*n.a.*	*n.a.*

Source: World Bank calculations and projections on data from national authorities and World Economic Outlook (2017)

WORLD BANK GROUP

Western Balkans
Regular Economic Report
No.18 | Fall 2020

View this report online:
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Coins
by Faton Dermaku (Kosovo)

Faton Dermaku is a young Prishtina-based visual artist, with a prolific portfolio of abstract graphic art. He completed his graduate and post-graduate studies in fine arts at the University of Prishtina Academy of Arts (the Graphics Department) in 2008 and 2010, respectively. Faton has showcased his work in various collective exhibitions and organized personal exhibitions in Kosovo and Switzerland. Faton experiments with his imagination of history through modern art, with an emphasis on cultural intersections in historic imagery.

People forge ideas, people mold dreams, and people create art. To connect local artists to a broader audience, the cover of this report and following editions will feature art from the Western Balkan countries.