



ALBANIA

Highlights

- **The economy is facing a strong recession in 2020 due to the Covid-19 outbreak.** The main channels of influence are tourism, trade with Italy and remittances from Albania's workers abroad, which are all being hit severely.
- **The government has adopted two economic support packages, worth 2.8 per cent of GDP.** The packages consisted mainly of increased government expenditures, sovereign guarantees and one-off social transfers.
- **A contract for a large-scale solar park has been signed.** Besides helping the country in improving the energy mix by diversifying away from hydropower, the Karavasta solar park will also be the largest in the Western Balkans. In addition, Albania secured the lowest solar energy price in the region through a competitive capacity allocation process.

Key priorities for 2021

- **Fiscal adjustment will be needed to ensure public debt sustainability.** The government needs to strengthen public investment management and contain fiscal risks such as those relating to public-private partnership programmes. Simplifying the tax system and making it more transparent would help lead to higher budgetary revenues.
- **Measures should be stepped up to combat informality and level the playing field for private companies.** Key measures in this direction include a simplified tax system and procedures, strengthened capacities in public administration, further support and incentives for micro, small and medium-sized enterprises to formalise their activities, and a more decisive fight against corruption.
- **Further reforms are needed to support credit growth.** Resolution of issues with property rights and the bailiff system, implementation of the insolvency law and enhancement of property rights should all be high on the agenda.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.3	3.8	4.1	2.2	-9.0
Inflation (average)	1.3	2.0	2.0	1.4	1.6
Government balance/GDP	-1.8	-1.4	-1.3	-2.0	-8.5
Current account balance/GDP	-7.6	-7.5	-6.8	-7.6	-11.5
Net FDI/GDP [neg. sign = inflows]	-8.7	-8.6	-8.0	-7.6	-6.0
External debt/GDP	73.5	68.7	65.1	60.4	n.a.
Gross reserves/GDP	27.5	25.9	26.4	24.6	n.a.
Credit to private sector/GDP	36.6	34.8	33.0	34.4	n.a.

Covid-19: macroeconomic implications

The economy is contracting severely in 2020. After the November 2019 earthquake, which caused damage of around €1 billion, the economic outlook was further worsened by the outbreak of the Covid-19 pandemic. The negative effects are being seen mainly in tourism, which normally contributes to more than one-fifth of Albania's GDP, and through the decline in trade with Italy (close to 50 per cent of exports) and remittances from Albanians abroad. Available data show that GDP declined by 6.6 per cent year-on-year in the first half of 2020, on the back of falling exports, investment and consumption. Sectors related to tourism (trade, transport and accommodation services) recorded an overall fall in activity of 16.1 per cent year-on-year. Also, the construction sector was hit strongly as well as manufacturing. In the period of most severe lockdown (March to May 2020), goods exports to Italy fell by 42.7 per cent year-on-year. Overall, total exports of goods in the first seven months of 2020 were lower by 16.8 per cent year-on-year.

Monetary policy responded with policy rate cuts and foreign exchange market

interventions. At the end of March 2020 the Bank of Albania (BoA) lowered the key policy rate by 50 basis points, to a new record low of 0.5 per cent. The Covid-19 crisis also contributed to depreciation pressures on the domestic currency, mainly in the second half of March, when the Albanian lek lost around 7 per cent of its value against the euro. The pressures were eased by the BoA selling €20.4 million on the foreign exchange market at the end of March, and stability has returned since May. The weakening of the currency and a strong increase in food prices caused the inflation rate to pick up from 1.4 per cent in 2019 to 2.0 per cent year-on-year in June 2020, still below the central bank target of 3.0 per cent.

Public debt increased sharply in the first half of 2020, to 80 per cent of GDP. That is 14 percentage points higher than at the end of 2019. The biggest effect came from the seven-year €650 million Eurobond issuance in June 2020. In order to finance measures related to the pandemic and its economic consequences, Albania also borrowed from international lenders such as the European Union (€180 million, under the Macro-Financial Assistance) and the International Monetary Fund (€174 million, under the Rapid Financing Instrument).

A rebound is expected in 2021. GDP is forecast to drop by 9.0 per cent in 2020, and to rebound by 4.5 per cent in 2021. The resumption of normal economic activity and a boost from reconstruction after the November 2019 earthquake is expected in the second half of 2021. However, the forecast is subject to significant uncertainty over the possible return of the pandemic. The downside risks are associated with a potentially stronger impact of the pandemic on remittance inflows and the tourist season both in 2020 and next year.

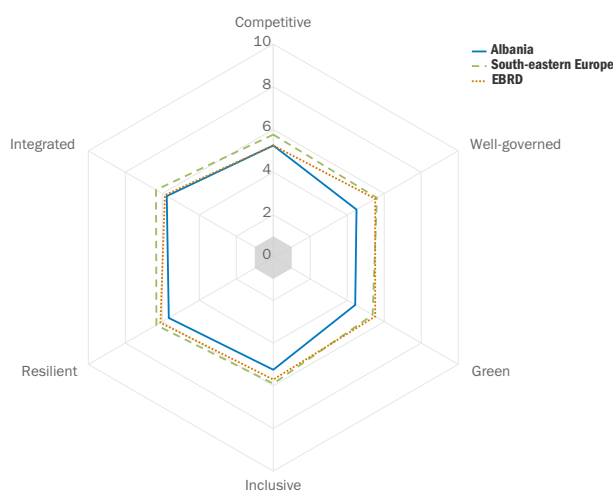
Policy response to Covid-19

The government adopted two support packages to support businesses, healthcare and vulnerable people. The packages included: state aid to companies experiencing difficulties in paying workers' wages; emergency payments for employees in tourism and those dismissed from large companies; income support for micro businesses and the self-employed; cancellation or write-off of penalties on late payments of energy bills for more than 200,000 people; and additional funding for medical personnel. Additional measures adopted in July 2020 were the abolition of value-added tax for small companies with an annual turnover below Lk 8 million (€64,000) from 2021, and a 0 per cent profit tax for small companies with an annual turnover of up to Lk 14 million (€115,000).

Financial measures range from state guarantees to a loan payment moratorium. A sovereign guarantee fund has been established for companies to access overdrafts in the banking system to pay wages for their employees, for up to three months. In addition, a sovereign guarantee was provided for working capital loans for all private companies that were tax-compliant and solvent before the pandemic. Payment holidays for loans, for those applying, were extended until the end of August 2020. In addition, banks have been allowed to restructure loans in 2020 without additional provisioning or downgrades for borrowers. The BoA has temporarily suspended the distribution of dividends for banks until the end of the year, in order to support their capitalisation and lending

potential. The BoA also stated its readiness to provide unlimited liquidity to the banks. In July 2020 the BoA announced that it was setting up a €400 million repurchase agreement line with the European Central Bank, which will be in place until at least June 2021. The line would serve to provide euro liquidity to Albanian banks in case of need.

Assessment of transition qualities (1-10)



Structural reform developments

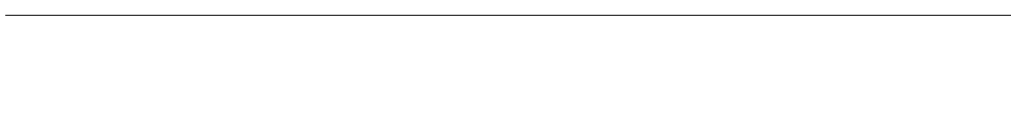
The banking sector remains well capitalised and liquid, but non-performing loans (NPLs) are still relatively high. At the end of June 2020 the capital adequacy ratio stood at 18.1 per cent, and one-third of banks' assets were liquid. The NPL ratio has continued to decline further in the past year, indicating improved asset quality, but at 8.1 per cent at the end of May 2020 it remains the highest in the Western Balkans and is at risk of increasing again once the moratorium on bank loan payments is lifted.

Albania is moving forward in diversifying away from hydro energy. The country has been making efforts to diversify its energy mix, which is dominated by hydropower, and decrease its dependence on weather conditions (rainfall). In August 2020 a contract was signed for the first large-scale solar park in Albania. The Karavasta park would be the largest in the Western Balkans and, through a competitive capacity allocation process, Albania secured the lowest solar energy price in the region. Further solar tenders are expected in the future through the same approach, and wind power will be developed under the same competitive principles. The completion of the offshore Trans Adriatic Pipeline connection between Albania and Italy in June 2020 could also open opportunities for the introduction of gas in the country's energy mix.

The country has narrowed the compliance gap in the electricity sector by reforming the regulatory framework. In May 2020 Albania amended the Power Sector Law with a view to improving compliance with the EU energy legislation and allowing for effective unbundling of the distribution system operator.

The European Council decided to open EU accession negotiations with Albania. In March 2020, the European Council, having assessed that the country fulfilled the conditions identified by the previous councils, decided to open accession negotiations with Albania. It invited the European Commission to prepare the framework for the negotiations, reflecting on the revised methodology (enhanced approach) of the accession process adopted by the council on the same day. Once the

council adopts the negotiating framework, this should be followed “as soon as possible” by the first intergovernmental conference (the formal start of the negotiations). However, the council decided that before the first intergovernmental conference Albania ought to implement a number of specific conditions, including the adoption of electoral reform, continued implementation of judicial reform, and strengthening the fight against corruption and organised crime. Respective key priorities for Albania have been integrated into the draft negotiating framework, which the European Commission presented to member states on 1 July 2020.





BOSNIA AND HERZEGOVINA

Highlights

- **A recession is expected in 2020 due to the Covid-19 pandemic.** Manufacturing sector output fell by 12 per cent year-on-year in the first seven months of the year. Tourism has also been hit hard, with a significant decrease in the number of foreign tourist arrivals.
- **Credit guarantee programmes have been introduced in the two entities.** The programmes help small and medium-sized enterprises (SMEs) access finance during the pandemic.
- **A controversial new coal-fired power plant is under European Union (EU) scrutiny, but energy diversification is slowly advancing.** The state aid case of the Tuzla 7 project has been referred to the highest decision-making body of the Energy Community: the Ministerial Council. A number of small solar and wind projects are under construction or planned, as well as the diversification of gas supply routes.

Key priorities for 2021

- **Reform of state-owned enterprises (SOEs) should be high on the agenda.** The large number of SOEs impose a significant fiscal burden and have negative effects on other businesses and competition. They should be depoliticised and restructured, followed in some cases by a renewed and credible push for privatisation.
- **Further movement towards a single economic area within Bosnia and Herzegovina would help improve the quality of the business environment.** Significant differences in business conditions and procedures in the two entities continue to hinder private sector development. Also, simplifying business registration, licensing and permitting, introducing e-signatures and improving bankruptcy laws would support the post-Covid-19 economic recovery.
- **The authorities should step up their efforts to conduct structural reforms.** The pandemic has exacerbated the structural weaknesses of the economy. In order to improve growth prospects, institutional and socio-economic reforms are needed.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.1	3.2	3.7	2.7	-5.0
Inflation (average)	-1.1	1.2	1.4	0.6	-0.8
Government balance/GDP	1.2	2.6	2.2	1.9	-5.5
Current account balance/GDP	-4.7	-4.3	-3.7	-3.5	-4.5
Net FDI/GDP [neg. sign = inflows]	-1.8	-2.1	-2.5	-2.7	-1.5
External debt/GDP	63.8	72.0	64.5	65.4	n.a.
Gross reserves/GDP	31.9	33.6	34.8	35.7	n.a.
Credit to private sector/GDP	54.3	55.6	55.1	55.8	n.a.

Covid-19: macroeconomic implications

The economy has slowed further due to the pandemic-related lockdown measures. Before the outbreak of Covid-19, economic growth had been falling. A decline of industrial output and a slowdown in the main trading partners resulted in Bosnian GDP growth dropping to 2.7 per cent in 2019 (from 3.7 per cent in 2018). Growth fell further in the first half of 2020 to 3.8 per cent year-on-year, on the back of falling exports, investment and consumption. The crisis has seriously hit the manufacturing sector, with output in this sector falling by 12.3 per cent year-on-year in the first seven months of the year. Certain industries, such as base metals and furniture production, decreased their output by more than 30 per cent year-on-year during the same period. The tourism sector has also been severely affected. In July 2020, foreign tourist arrivals in both entities were more than 80 per cent lower than in July 2019. Because of the pandemic, remittances from the country's large diaspora are also being negatively affected. Available data show that in the first half of 2020 remittances were down by 16.9 per cent year-on-year.

Inflation dropped below zero. After falling to 0.6 per cent in 2019 (from 1.4 per cent in 2018), the inflation rate continued to trend downwards in 2020 and became negative in April, averaging -0.7 per cent year-on-year in the first seven months of the year. The deflationary pressures came from several factors: a fall in transport prices (related to the decline of oil prices globally); the continuing decline of clothing and footwear prices; and the entity governments' decisions to restrict margins on oil products and prices of basic food, hygiene products, medicines and protective equipment during the pandemic emergency.

Public debt is at a moderate level but is expected to increase. As a response to the crisis, the entity governments have adopted a set of measures to mitigate the economic consequences of the pandemic (see below). Public debt was 33.0 per cent of GDP as of the first quarter of 2020, but is on a rising path as a result of falling GDP, new loan arrangements with international institutions (including €333 million under the International Monetary Fund's Rapid Finance Instrument and €250 million under the European Commission's (EC's) Macro-Financial Assistance, which is currently under discussion), and increased borrowing by governments in the domestic financial market.

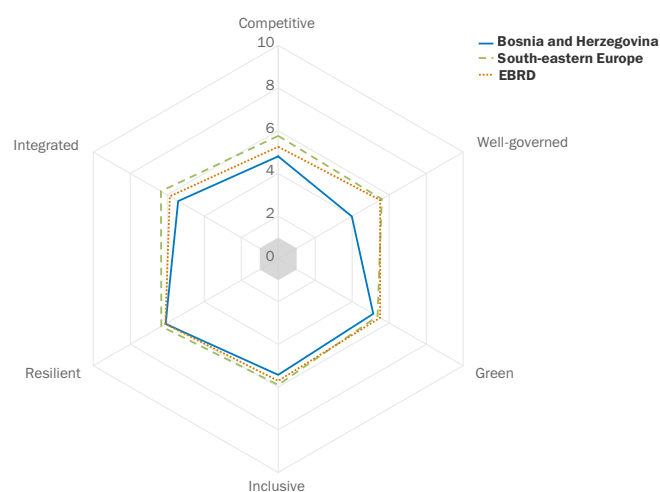
After the recession in 2020, a recovery is expected in 2021. GDP is forecast to fall by 5.0 per cent in 2020 and grow by 3.0 per cent in 2021. Risks to the projection are on the downside, related to the potential return of the pandemic, slow recovery in the main eurozone export markets and uncertainty about progress in the country's reform agenda.

Policy response to Covid-19

Support measures mitigating the effects of the crisis were introduced in both entities.

In the Federation of Bosnia and Herzegovina (FBiH), a Stabilisation Fund helps cover minimum wages and social contributions in affected companies, while the FBiH Development Bank set up a guarantee fund to maintain and improve the liquidity of companies. Other measures include extra funds for cantons and municipalities in the Federation, exemptions from para-fiscal fees for affected businesses, and the cancellation of advance corporate income tax payments. In the Republika Srpska (RS), a Solidarity Fund was established to support businesses, corporate income tax payments were deferred, and a fixed pricing margin for certain staple products was temporarily introduced. In addition, the RS government covered gross minimum wages for April, along with income taxes and contributions for March wages for affected businesses, and the RS Investment Development Bank deferred overdue payments. Credit guarantee programmes for SMEs have also been introduced in both entities. In August 2020 the FBiH Banking Agency and RS Banking Agency extended the moratorium on loan repayment by a further six months. Both agencies introduced the moratorium initially in March 2020 and then prolonged it by two more months. In August 2020 the RS Banking Agency also banned banks in the entity from paying dividends from 2019 profits.

Assessment of transition qualities (1-10)



Structural reform developments

The authorities are discussing a new arrangement with the International Monetary Fund (IMF). The previous Extended Fund Facility arrangement with the IMF (€553.3 million) officially expired in September 2020 but, because of the lack of economic reforms, only two tranches were disbursed. It is expected that talks between the country's authorities and the IMF on a new arrangement will start in November 2020. The new arrangement, if agreed, is likely to focus on reforms to the health sector and response to the Covid-19 crisis, and SOEs.

There has been little progress in EU accession negotiations over the past year. The country submitted an EU membership application in February 2016. In May 2019 the EC issued the Opinion on the application, which was subsequently endorsed by the Council in December 2019. The Opinion identifies 14 key priorities for the country to fulfil in order to be recommended for the status of EU candidate country. These priorities lie in the areas of democracy and functionality of institutions, rule of law, fundamental rights and public administration reform. The Commission encouraged the authorities to agree and implement socio-economic reform measures, in line with the Economic Reform Programme policy guidance, and to continue engaging in regional cooperation and strengthening bilateral relations with neighbouring countries.

The state footprint in Bosnia and Herzegovina remains large. Around 550 SOEs in Bosnia and Herzegovina employ 80,000 people or about 10 per cent of the total workforce. Many of them are loss-makers, characterised by weak transparency, accountability and performance, and suffer from political influence. Over the past year, there has been little progress in reforming these companies.

Construction of a controversial new coal-fired power plant is advancing. Initially, the project was planned to begin in March 2020, but was delayed by the pandemic. The new 450 MW unit (Tuzla 7) at the country's largest power plant is expected to produce around 2,750 GWh of electricity annually. The project, worth around €720 million, is to be implemented by a Chinese consortium and financed mainly by a loan from China's Exim Bank. Besides posing environmental concerns, the project is also controversial because of a potential breach of EU state aid rules, related to the loan guarantee for Tuzla 7 approved by the Federation government. After terminating negotiations related to the construction of the unit with FBiH representatives without having reached an agreement in late 2019, the Energy Community Secretariat referred the Tuzla 7 state aid case to the highest decision-making body of the Energy Community, the Ministerial Council, in June 2020.

Steps have been taken to diversify the energy portfolio towards more renewables. One of the three state-controlled power producers Elektroprivreda BiH has started the construction of a 48 MW wind park Podveležje, worth €83 million and with an expected annual output of 130 GWh. The RS power utility (ERS) has submitted to the government of RS an offer to build a solar power plant Trebinje 1, a project worth around €50 million, but with somewhat lower installed capacity (73 MW) and power output (101.5 GWh annually) than initially planned. The company is also developing a project for a 48 MW wind farm Hrgud in eastern Herzegovina, whose construction should start by the end of the year. Other projects are in the process of receiving energy permits for their construction. In June 2020 the Federation parliament adopted conclusions calling for a prohibition of the construction of small hydropower plants on the territory of the Federation of Bosnia and Herzegovina.

Banking sector non-performing loans (NPLs) are down and regulatory reforms in the sector have progressed. The capital adequacy ratio of the banking sector stood at 18.4 per cent at the end of June 2020, well above the regulatory minimum of 12.0 per cent. Still, some (primarily local) banks have insufficient capital endowments and unfavourable credit portfolios. At the same time, the NPL ratio of the banking sector stood at 6.7 per cent (down from 8.0 per cent a year ago). The NPLs are concentrated in domestically owned banks and are largely a legacy issue. The new banking laws adopted in 2017 should support the soundness of the banking sector, but banking sector supervision is hampered by fragmented competences. In June 2020 the new Law on Deposit Insurance in Banks was adopted. The law envisages mandatory membership of banks in the deposit insurance programme, a shorter deadline for payout to depositors (20 days from the day the bank's licence is revoked, rather than the earlier 90 days) and use of funds of the Deposit Insurance Fund for bank resolution.



BULGARIA

Highlights

- **The Bulgarian economy has been negatively affected by the coronavirus crisis.** The economy is experiencing recession in 2020 after recording growth of 3.7 per cent in 2019, but a bounce-back is expected in 2021.
- **The government has taken crisis response measures similar to those in other peer countries, although somewhat smaller.** The focus has been on preserving jobs, helping vulnerable groups and providing support to firms.
- **Bulgaria has joined the European Union (EU)'s Exchange Rate Mechanism (ERM II), paving the way for euro adoption.** Bulgaria has also joined the Banking Union, and therefore the European Central Bank (ECB) will be in charge of supervision of the major banks in the country.

Key priorities for 2021

- **Supporting firms' liquidity and preserving jobs from crisis through recovery is needed.** Providing liquidity to the economy, particularly small and medium-sized enterprises (SMEs), and revenue support to vulnerable individuals affected by the crisis are important measures for a quicker post-Covid-19 recovery.
- **The authorities should focus on the key structural reforms required to improve the country's competitiveness.** While important reforms have been taken in recent years, as reflected by the country's entry into ERM II and the Banking Union, further progress is needed with regards to improving the overall quality of institutions and governance.
- **Further work is needed to improve the rule of law and strengthen anti-corruption efforts.** Progress under the EU's Cooperation and Verification Mechanism (CVM) has been praised in the previous years' reports. Nevertheless, proving the irreversibility of the reforms will be key to fulfilling the country's commitments to the EU.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.8	3.5	3.1	3.7	-5.5
Inflation (average)	-1.3	1.2	2.6	2.5	1.0
Government balance/GDP	0.1	1.1	2.0	1.9	-2.8
Current account balance/GDP	3.2	3.5	1.4	4.0	1.9
Net FDI/GDP [neg. sign = inflows]	-1.1	-2.5	-1.3	-1.3	-0.5
External debt/GDP	67.1	67.8	58.1	55.7	n.a.
Gross reserves/GDP	46.9	47.4	43.1	40.6	n.a.
Credit to private sector/GDP	51.5	49.5	49.7	49.3	n.a.

Covid-19: macroeconomic implications

The coronavirus pandemic has hit the economy. Following growth of 3.7 per cent in 2019, which was driven mainly by private consumption, the country is experiencing a recession in 2020. The state of emergency, declared in mid-March, imposed tough restrictions on travel and economic activity, resulting in a sharp decrease in economic activity in March and April. Economic activity started to gradually recover from May onwards amid the lifting of most restrictions. In the first quarter of 2020, the economy was still expanding by 1.2 per cent year-on-year, and growth was broad-based. The full impact of the crisis was seen in the second quarter, when real GDP dropped by 8.7 per cent year-on-year. This resulted in a decline of 4.2 per cent year-on-year in the first half of the year, with private consumption decreasing by 2.4 per cent year-on-year and investments by more than 8 per cent year-on-year. The mitigating factor came from the government crisis response package of about 4 to 5 per cent of GDP, the focus of which was on preserving jobs and providing support to firms.

Exports and tourism have declined. Exports of goods, which account for about 50 per cent of GDP, making Bulgaria only moderately dependent on trade, decreased by about 3 per cent year-on-year in the first half of 2020. A more important impact on the balance of payments, as well as on the decline in economic activity, was the enormous disruption to the important tourism sector, which in normal times accounts for about 10 per cent of GDP. Foreign arrivals stopped almost completely in April and May 2020 and have been slow to recover since, declining by 75 per cent year-on-year in June and 65 per cent year-on-year in July. The government expects a decline of tourism revenues for the year as a whole of more than 50 per cent compared with last year.

The government redrafted the budget to accommodate a higher deficit. After four consecutive years of budget surpluses, and with public debt at 20 per cent of GDP, Bulgaria is among the least indebted countries in the EU. Notwithstanding the pandemic-induced economic slowdown, budget execution data up to mid-year show a cumulative surplus of 1.3 per cent of GDP in the first half of 2020. However, the Covid-19 crisis is putting great pressure on the fiscal account, and with a deterioration expected in the second half on the back of lower tourism receipts and government support measures employed, in April 2020 the government projected a new deficit at -2.9 per cent of GDP for the year as a whole (assuming a recession of 3 per cent), compared with a previously planned balanced budget. In April and May 2020, respectively, Fitch and Standard & Poor's maintained the BBB rating on Bulgaria's sovereign credit but downgraded the outlook from positive to stable on the back of Covid-19 related risks.

Economic activity is expected to recover in 2021. We project GDP to fall by 5.5 per cent in 2020 and bounce back with a 3.0 per cent growth rate in 2021. This is based not only on the assumption of a gradual normalisation of economic activity in Bulgaria in the second half of 2020, but also among its main economic partners. The main risks to the outlook are on the downside and are associated with a possible prolonged Covid-19 crisis, both in Bulgaria and elsewhere.

Policy response to Covid-19

Crisis response measures mainly focused on preserving jobs. The overall measures taken so far by the government are estimated at 4 to 5 per cent of GDP, and are similar to those in other countries. Government support during the pandemic mainly focused on sustaining employment. One of the key measures has been the coverage of 60 per cent of salary costs in the crisis-affected sectors, which has been extended until the end of the year. The government also introduced wage subsidies for hiring the unemployed, as well as for retaining jobs in the tourism and transportation sectors (a monthly subsidy of BGN 290 [€148] per employee for up to six months), and provided support for the self-employed (such as freelancers working in the cultural sector). Additional remuneration was provided to those in the ministries of health, interior and defence, as well as one-off transfers to parents forced to be on unpaid leave.

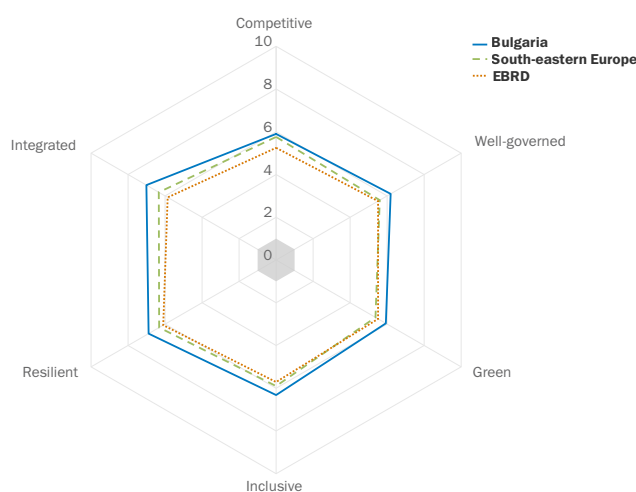
Several measures were taken to support firms. In April 2020, the government announced that the payment of corporate taxes would be deferred until 30 June, and the value-added tax rate reduced from 20 per cent to 9 per cent for certain categories including restaurant services, tourist operators, sports facilities, wine and beer, as well as books and baby food, until the end of 2021.

In terms of direct firm liquidity support, the government increased the capital of the state-owned Bulgarian Development Bank (BDB) by BGN 700 million (€357 million) so that it could provide BGN 500 million (€255 million) of support for portfolio guarantees to commercial banks for the extension of corporate loans, and the remaining BGN 200 million (€102 million) for interest-free loans to employees on unpaid leave. The government also reallocated about BGN 350 million (€179 million) of EU funds to directly support companies affected by the Covid-19 crisis through grants, and an additional BGN 1,024 million (€532 million) to the state-owned company “The Fund of Funds” for further on-lending, particularly to SMEs.

Further measures were adopted in July 2020 under an additional crisis support package. Key measures, effective from 1 August, include additional payments to personnel involved in activities to contain the spread of the pandemic, an increase in subsidies to hospitals, extra payments for children’s healthcare, and more money for social assistance and pensioners. In the tourism sector, state subsidies of €35 per seat for charter flights are provided, as well as BGN 210 (€105) worth of tourism vouchers for people involved in addressing the pandemic. The minimum amount of unemployment benefit was also increased (from BGN 9 to 12 [€4.6 to €6.1] per day) as well as the minimum payment period (from four to seven months), in effect since October.

The Bulgarian National Bank took measures to increase the liquidity of the banking sector. Key policy measures introduced during the Covid-19 crisis included: (i) capitalisation of 2019 profit in banking system (BGN 1.6 billion, 1.4 per cent of GDP); (ii) reduction of foreign exposures of commercial banks (BGN 7 billion, or 5.8 per cent of GDP); and (iii) cancellation of the increase of the countercyclical capital buffer planned for 2020 and 2021, in effect amounting to BGN 0.7 billion (0.6 per cent of GDP). In addition, the central bank, following guidance from the European Banking Authority, and after consultation with the Association of Banks in Bulgaria, approved the deferral of loan payments for up to six months for impacted firms and individuals. It also established a €2 billion swap line with the ECB until the end of 2020 or as long as necessary to ensure liquidity.

Assessment of transition qualities (1-10)



Structural reform developments

Bulgaria’s eurozone membership has advanced following ERM II accession. In July 2020 the ERM II parties, that is, the ECB together with the eurozone member states and Denmark, decided to include the Bulgarian lev in the ERM II, following the request sent by Bulgaria in July 2018, at the central rate set at 1 euro = 1.95583 leva, the same rate Bulgaria has had under its currency board arrangement since 1997. After two years, a new assessment of the country’s readiness for eurozone membership will be taken; if positive, Bulgaria would join the eurozone.

The decision followed the introduction of a number of important reforms in the financial sector, which strengthened institutional quality and governance. In the same month, Bulgaria joined the Banking Union and therefore, from 1 October 2020, the ECB is in charge of the direct supervision of the major banks in Bulgaria, as well as the oversight of others.

Liberalisation and diversification of the gas market have advanced. Amendments to the Energy Act were adopted in October 2019 towards the liberalisation of the gas market, including rules on gas balancing and the setting up of an organised trading point, as well as those regarding the functioning of the public supplier. The new rules will allow for a gradual transition from a regulated market to one based on freely negotiated prices. The gas supply is also being diversified, following progress in the development of new transmission links with neighbouring countries. The construction of the gas pipeline connecting the country's existing gas transmission system with Turkey and with Serbia, with the aim of carrying gas from the Turkish Stream, is progressing. Moreover, the construction of the gas connection with Greece advanced with financial support from the European Investment Bank (EIB), and one with Serbia is also planned. In addition, in August 2020 Bulgartransgaz acquired a 20 per cent interest in a Greek liquefied natural gas terminal in Alexandroupolis.

Transport infrastructure development is progressing. Road infrastructure works have continued at the Hemus motorway (linking Sofia with the Black Sea port of Varna through the northern part of country), while the contract for the last pending section of 89 km between Veliko Tarnovo and Buhovtsi-Belokopitovo, was awarded to the state-owned Avtomagistrali in December 2019, with full completion expected in 2024. The Gabrovo bypass, part of the I-5 road (linking the Danube port Russe to the Greek border) including Bulgaria's longest concrete bridge, was finalised in June 2020. Contracts for railway modernisation, including the Plovdiv node, as well as the EIB-funded Elin Pelin-Kostenets railway line (part of the Sofia-Plovdiv route), were signed in July. Also in late July, the government and SofConnect, a consortium of the French-registered Meridiam Eastern Europe Investments, the Austrian construction company Strabag, and the Munich Airport operator, signed a deal on a 35-year concession of Sofia airport.



CYPRUS

Highlights

- **The economy is being severely hit by the Covid-19 pandemic.** A deep recession is under way in 2020 as key sectors such as tourism, shipping and construction are particularly affected by the pandemic and associated restrictions.
- **The authorities have responded to the crisis with a significant package of support.** Key measures introduced so far include value-added tax (VAT) deferrals, payment holidays and subsidies, along with enhanced use of European Investment Bank instruments to support enterprises.
- **The digitalisation agenda has advanced.** Measures have been introduced to accelerate and improve the level of access to digital services, both within the government and between the government, the public and businesses.

Key priorities for 2021

- **Targeted support for businesses will be needed as Cyprus enters the recovery phase.** The challenge will be to provide support to the most affected businesses and vulnerable groups without endangering the hard-earned stability of public finances.
- **Renewed efforts are needed to reduce non-performing loans (NPLs) once the economy picks up.** NPLs have come down steadily in recent years but remain well above average European Union levels. Further reductions will require the pursuit of existing plans as soon as the market environment permits, along with support to the banking sector via the Central Bank of Cyprus (CBC) where needed.
- **Accelerating reforms to improve the governance of state-owned enterprises (SOEs) and public administration remain a priority.** The pandemic has accelerated the reforms on digitalisation, such as the implementation of the e-justice system, but a number of reforms regarding the governance of SOEs and public administration have advanced only slowly in recent years and need to be accelerated.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	4.8	4.2	3.9	3.2	-7.5
Inflation (average)	-1.2	0.7	0.8	0.5	-0.5
Government balance/GDP	0.1	1.7	-4.4	2.7	-1.8
Current account balance/GDP	-4.2	-5.1	-4.4	-6.7	-10.6
Net FDI/GDP [neg. sign = inflows]	-10.7	-6.9	-34.5	-14.1	-13.2
External debt/GDP	1,147.8	1,074.5	990.9	972.2	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	218.3	194.4	139.6	114.0	n.a.

Covid-19: macroeconomic implications

The robust economic performance of recent years has been halted by the pandemic. Strong GDP growth over several years, including 3.2 per cent in 2019, has shifted in 2020 into a deep recession. In the first quarter of 2020 GDP grew by just 0.8 per cent year-on-year as the effects of the virus started to take hold. The severe lockdown (schools and all non-essential businesses shut) implemented between March and May 2020 to limit the spread of the virus affected virtually all sectors of the economy, and GDP fell by 11.9 per cent year-on-year in the second quarter of 2020. Economic sentiment plummeted from 111.7 points in January 2020 to 72.9 points in May 2020 (the lowest point since 2013) and has increased to just 80.6 points since then (September 2020). However, government measures have supported household income and unemployment so far has remained close to pre-Covid-19 levels, at 6.9 per cent in July 2020.

Tourism has been particularly affected by the crisis. In 2019, the travel and tourism sector accounted for 13.8 per cent of GDP, according to estimates from the World Travel and Tourism Council. During January to May 2020, overnight stays in Cyprus were down by more than 80 per cent relative to the same period a year previously, as lockdown and quarantine measures in key source countries took a major toll on the sector. The shipping sector (7 per cent of GDP) has also been hit by the crisis.

Public finances are being stretched by the pandemic. Recent years have seen major improvements in the public accounts after the financial and economic crisis in 2013; in 2019, the headline government budgetary balance recorded a surplus of 1.7 per cent of GDP, and the ratio of public debt to GDP fell below 100 per cent of GDP (at 95.5 per cent) by the end of 2019. However, a substantial budget deficit in 2020, along with a corresponding rise in public debt, is inevitable in light of falling GDP and government revenues and rising spending to mitigate the negative effects of the pandemic. Access to funding is not an issue so far, as the government retains investment-grade level among the main international sovereign credit rating agencies.

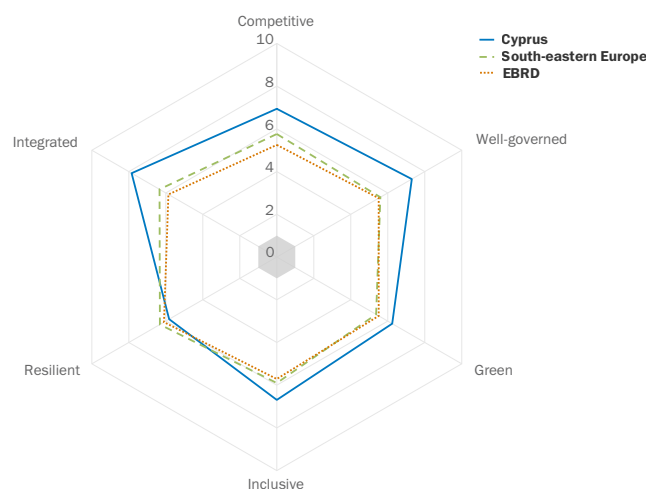
The recession in 2020 should be followed by a partial recovery. We forecast GDP to fall by 7.5 per cent in 2020, followed by growth of 4.0 per cent in 2021 on the back of a general pick-up of economic activity next year and a return of tourism to something closer to normal levels. However, risks are weighted to the downside, with any recovery likely to be delayed if there is a resurgence of the pandemic.

Policy response to Covid-19

The authorities have responded to the crisis with a significant package of support. Since March 2020, the government introduced a set of financial support measures worth €899 million (4.5 per cent of GDP), including specific support to the health sector, tourism and shipping. The package includes a VAT deferral for most companies until November 2020, a general nine-month payment holiday on loans for those who have been affected by the Covid-19 pandemic, and the introduction of subsidies, especially targeted at micro- and small- and medium-sized enterprises (MSMEs). Households are also being supported by leave allowances, and workers by unemployment allowances. The government package also includes financing and guarantees/financing of credit facilities (up to €1.7 billion) via the Pan-European Guarantee Fund.

Further crisis-response measures are supported by the CBC. In March 2020 a set of additional measures was announced, including: a release of capital and liquidity buffers for banks directly supervised by the CBC (up to €100 million), the simplification of documentation requirements for new short-term loans and other credit facilities, and the simplification of approval processes for loan restructuring. Applying favourable interest rates to new loans and newly restructured loans is also encouraged by the central bank.

Assessment of transition qualities (1-10)



Structural reform developments

NPL reduction has slowed. In recent years, Cyprus had managed to improve significantly its banking system, after a deep crisis in the sector erupted in 2013. NPLs at one point accounted for more than half of all loans, but efforts to reduce the total have brought down the level significantly, to 27.8 per cent of total loans as of the end of April 2020. The banking sector was also significantly strengthened in 2019, with operations aiming at improving the balance sheets of the two major banks of the country (Cyprus Cooperative Bank and the Bank of Cyprus) and transferring NPLs to the state-owned management company KEDIPES. However, further sales envisaged in 2020 have had to be postponed given the challenge to determine the value of assets as well as the uncertainty about investors' appetite in the current pandemic. KEPIDES is not yet fully operational as the organisation set-up and governance framework have not been finalised, and the implementation of a business plan has not yet started. In addition, the take-up of ESTIA – the state support scheme for NPLs collateralised by primary residences – has been lower than expected.

The pace of digitalisation reforms has increased. In March 2020, a new Deputy Ministry on Research, Innovation and Digital Policy was established with the goal of improving digital access both within the government and between the government and the public and businesses. Some initiatives are focused on responding to the lockdown challenges of public administration and tracking. The implementation of digital services and electronic tools for the submission of applications by citizens, workers and SMEs regarding the support measures and grants announced by the government, has been introduced by the Ministry of Labour, Welfare and Social Insurance. Similarly, e-Banking credentials can now be used by citizens to access the government's systems and transact with the government. Existing initiatives have been accelerated, with for example the start of the tendering of the e-Justice system. Lastly, other initiatives are at the early stages of development, such as support to the development of e-Health initiatives and a new information system for the Cyprus Tax Department.

Reforms to the governance of SOEs and public administration are advancing slowly. Regarding the governance of SOEs, draft legislation pending since April 2015 was withdrawn in 2019, although a number of provisions were integrated in measures adopted by the government such as the application of the Code of Public Governance by SOEs. A new Action Plan for Better Regulation (2019-22), proposed in November 2019 and focusing on the reduction of administrative burdens and improved public sector efficiency, includes a number of ambitious objectives such as the modernisation of the tax department.



GREECE

Highlights

- **The pandemic has abruptly interrupted economic recovery.** Modest but steady GDP growth in recent years was brought to a halt by the outbreak of Covid-19 in March 2020 and the introduction of strict containment measures, pushing the economy into a deep recession.
- **A comprehensive fiscal response to the crisis is being implemented.** One-off fiscal measures to mitigate the impact of the crisis amount to more than 9 per cent of GDP and include deferral of tax obligations, enhanced liquidity for businesses, increased spending on public healthcare and extra support for the unemployed.
- **Important reforms are advancing.** Despite the pandemic the government is pushing ahead with important reforms in a range of areas, such as insolvency, public administration, pension reform, land reform, public procurement and digitisation – all anchored within the post-programme enhanced surveillance procedure.

Key priorities for 2021

- **Strong support for the economy is needed for a fast recovery.** Although the stock of public debt remains one of the highest (relative to GDP) in the world, long maturities and a strong fiscal position will allow for further targeted support to local businesses and individuals affected by the pandemic.
- **Ensuring the soundness of the financial system is crucial.** The pandemic has put additional strains on the banking system, which still suffers from high levels of non-performing loans (NPLs), and new NPLs are likely to arise in the short term. Schemes to reduce NPLs are now in place and implementation will need to be stepped up once the economic recovery is well under way.
- **Energy sector reform should be pursued vigorously.** Greece has strong potential in renewables, and has an ambitious programme to close coal mines by 2023. This programme should be accompanied by a comprehensive package, in cooperation with international partners, to support the development of new energy sources and the retraining and upskilling of workers displaced by the closure of existing energy sources.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	-0.2	1.5	1.9	1.9	-9.5
Inflation (average)	0.0	1.1	0.8	0.5	-0.5
Government balance/GDP	0.6	1.0	0.9	0.4	-9.0
Current account balance/GDP	-2.3	-2.5	-3.5	-2.1	-7.7
Net FDI/GDP [neg. sign = inflows]	-2.4	-1.5	-1.6	-1.7	-1.8
External debt/GDP	236.1	227.2	222.4	219.3	n.a.
Gross reserves/GDP	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	107.3	99.0	89.1	79.2	n.a.

Covid-19: macroeconomic implications

The Covid-19 pandemic has abruptly interrupted a steady economic recovery. Before the pandemic, all economic indicators were moving in the right direction: positive growth (1.9 per cent in 2019), steadily falling unemployment, strong fiscal surpluses and economic sentiment at a 12-year high in early 2020. The lockdown (schools and all non-essential businesses closed) imposed from 23 March to 4 May 2020 severely affected local business and economic activity, as well as consumption levels. Nominal (real) disposable income of households declined by 0.4 per cent year-on-year in the first quarter of 2020, reflecting the impact of the Covid-19 pandemic mainly from mid-March 2020 onwards, when restrictions were put in place. The full effect of the crisis was seen in the second quarter, when GDP contracted by 15.2 per cent year-on-year. The halt of virtually all travel to Greece from March until 1 July heavily affected the tourism sector, which normally represents more than a fifth of GDP. Revenues from foreign tourism in August 2020 amounted to between 30 and 35 per cent of those in August 2019, and the industry expects heavy losses in 2020.

Fiscal targets have been temporarily relaxed. For several years, Greece has been running primary fiscal surpluses, meeting the target of 3.5 per cent of GDP in 2018 and 2019 in line with commitments made to international creditors. By agreement with the European Commission the same target for 2020 was suspended because of the Covid-19 crisis, and the government has responded to the pandemic with a major support programme amounting to more than 9 per cent of GDP (see below for more details). However, the stock of general government arrears remains large at €2.6 billion as of the end of August 2020, significantly above the target adopted in October 2019.

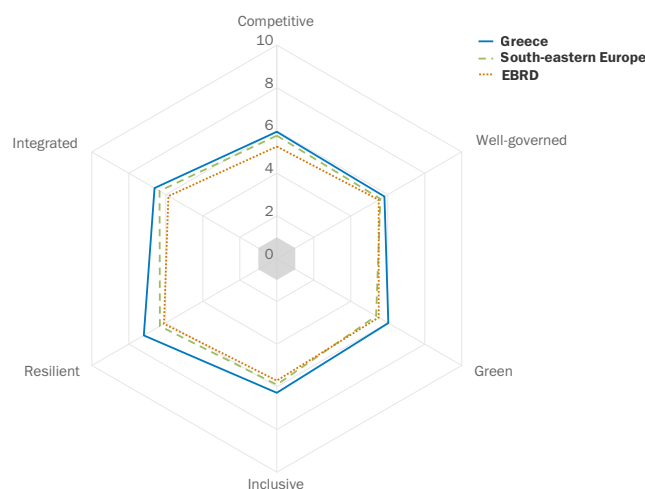
Sovereign access to capital remains on favourable terms. Greece's inclusion in the European Central Bank's emergency Pandemic Emergency Purchase Programme (PEPP) asset purchase scheme has reduced the previous risk premium on Greek government bonds and made access to capital markets easier. On 2 September 2020 the sale of €2.5 billion of 10-year Greek bonds was heavily oversubscribed, with a yield of 1.187 per cent, the lowest of any Greek bond transaction. However, as of October 2020 Greece's sovereign rating is still at least two notches below investment grade status.

A deep recession in 2020 should be followed by a partial recovery in 2021. We project GDP to fall in 2020 by 9.5 per cent, with a bounce-back of 4.0 per cent growth in 2021 as confidence returns, businesses reopen and tourism numbers start to recover to something closer to pre-pandemic levels. Risks are tilted to the downside amid extreme uncertainty about the future path of the pandemic and associated economic and social restrictions.

Policy response to Covid-19

A strong Covid-19 response is being implemented. The government has introduced a set of one-off fiscal measures estimated at around €15.6 billion (9.1 per cent of GDP), financed from national and EU resources. The measures focus on supporting vulnerable individuals and businesses affected by the pandemic. For vulnerable individuals, there is income support (extension of regular unemployment benefits, 40 per cent reduction in rent for primary residence or €800 allowance for the self-employed and freelancers affected by the crisis). For businesses facing a drop in demand, the government is injecting liquidity into the economy via tax deferrals and guarantees to commercial banks by way of new loans (including a sovereign guarantee scheme of €2 billion in total for working capital loans from the Hellenic Development Bank). Enterprises can defer principal payments up to the end of 2020, while individuals affected by the crisis can receive a state subsidy of up to nine months of instalments (backed by primary residence as collateral). The package also includes strong budgetary support for the health sector and value-added tax reductions for goods needed for protection against Covid-19.

Assessment of transition qualities (1-10)



Structural reform developments

Reforms under the post-programme enhanced surveillance procedure remain largely on track. Following the conclusion of the third economic adjustment programme in August 2018, Greece entered a post-programme enhanced surveillance framework, with regular reports by the European Commission (EC) including contributions from the European Central Bank, International Monetary Fund and European Stability Mechanism. In the seventh enhanced surveillance report, published by the EC in September 2020, Greece was deemed to have made significant progress on a number of major reforms, notably in insolvency, investment licensing, energy policy and public administration, despite the difficult circumstances caused by Covid-19. However, the crisis has led to delays in some areas, including clearance of public sector arrears, public revenue administration, healthcare, land reform and privatisation.

A new insolvency framework is being prepared. In late October, parliament passed the relevant legislation. The new code is based on best international practice in terms of simplifying requirements for effective restructuring, thus helping to preserve viable businesses. Scheduled to enter into force in January 2021, it introduces a unified code for bankruptcy and the restructuring of individual and corporate debt. The new code will be combined with other mechanisms, including the new “Hercules” asset protection scheme introduced in early 2020, to tackle the persistent problem of non-performing loans which, as of June 2020, amounted to 36.7 per cent of total loans in the banking system. E-auctions were temporarily suspended during the pandemic but they resumed in September 2020.

The pace of privatisation has slowed but the commitment to make progress remains intact. The Hellenic Corporation of Assets and Participations, which is in charge of maximising the value of major public corporations through privatisation and other means, has prepared a new business plan for the period 2020-22. The Covid-19 pandemic has adversely affected previous plans, but work is ongoing to bring major assets to sale in the coming months and years. Among other developments, closure of the financial transaction for Hellinikon (the former Athens airport) depends on the resolution of certain legal cases. A concession agreement was signed in May 2020 for Alimos Marina (one of the largest marinas in the south-eastern Mediterranean) and the tenders for the infrastructure and commercial parts of the Public Gas Corporation, DEPA, were launched in late 2019 and early 2020, respectively.

The energy sector is undergoing a number of reforms. The government remains committed to reforming the governance of the loss-making public energy provider, PPC, which continues to dominate the retail market, and introduce further competition by allowing other providers access.

A number of energy market reforms have already been implemented, including the launch of a forward market for electricity. There are also ambitious targets to phase out lignite and promote renewables. Greater energy efficiency is also being targeted; in August 2020 the government launched a new €1 billion programme to improve the energy efficiency of buildings and develop additional infrastructure via state subsidies of up to 85 per cent of the cost of small-scale works to improve energy inefficiencies in residential properties and introduce electric car charging stations.

The digital agenda is advancing. A new national digital strategy is being prepared, which will set out a lengthy pipeline of projects designed to move Greece towards being an advanced digital economy. A public portal for government services (gov.gr) offers more than 600 services (as of September 2020), with further services in the pipeline. The digital agenda is part of a broader public administration reform, which is progressing despite the challenges of the pandemic. Important steps have been taken in the past year in the recruitment of public officials and codification of the rules relating to the recruitment of public officials. Judicial reform continues, with the completion of a mandatory mediation framework in March 2020 and progress in the e-justice system. Cutting red tape remains a priority for the authorities, with a focus on improving the investment licensing regime.





KOSOVO

Highlights

- **Growth has slowed and a recession is expected in 2020.** After growing by 4.2 per cent in 2019, the economy contracted by 4.8 per cent year-on-year in the first half of 2020 due to a severe drop in investment and exports.
- **The government adopted an emergency relief package.** The package, adopted in April 2020, supports employment, municipalities and people in need, and has since been followed by a medium-term economic recovery package and a plan for implementing the latter.
- **Kosovo removed the 100 per cent tariff imposed on goods imported from Serbia and Bosnia and Herzegovina.** Also, the requirement of “reciprocity”, including requesting the use of the name of the Republic of Kosovo on documents on imported goods, has been withdrawn.

Key priorities for 2021

- **Governance and economic performance of state-owned enterprises (SOEs) should be improved.** Updating the state ownership policy, clarifying further the responsibilities of the board of directors and improving the legal and institutional framework for measuring and monitoring SOE performance can help raise their economic performance, which was weak even before the pandemic and has worsened further since then. Also, the new Law on Publicly Owned Enterprises should be adopted.
- **Acceleration of reforms in the business environment would enable a swifter recovery.** Decreasing the (widespread) informality and tax evasion, which would also facilitate access to finance for small and medium-sized enterprises (SMEs), could improve the growth outlook.
- **Raising competitiveness and economic diversification through smart specialisation is warranted.** This would enable the economy to build further capacity and enhance the value-added content of exports. In addition, accelerating sustainable investments in infrastructure and energy would enable Kosovo to speed up its green transition.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	4.1	4.2	3.8	4.9	-5.0
Inflation (average)	0.3	1.5	1.1	2.7	0.3
Government balance/GDP	-1.7	-1.4	-2.9	-2.8	-7.0
Current account balance/GDP	-7.9	-5.4	-7.6	-5.5	-6.0
Net FDI/GDP [neg. sign = inflows]	-2.9	-3.3	-3.4	-2.9	-3.0
External debt/GDP	33.2	32.6	30.3	31.0	n.a.
Gross reserves/GDP	10.0	10.7	11.4	12.2	n.a.
Credit to private sector/GDP	36.5	38.6	40.8	42.5	n.a.

Covid-19: macroeconomic implications

The solid economic growth of previous years has disappeared because of the pandemic.

GDP grew by 4.2 per cent in 2019, driven by investment and consumption. Strong exports (at over 10 per cent) and subdued imports growth (below 5 per cent) helped reduce the current account deficit from close to 8 per cent of GDP in 2018 to below 6 per cent in 2019. Higher growth in 2019 resulted in some employment gains, as the employment rate increased in 2019 by one percentage point (to 30 per cent). Despite falling somewhat, the unemployment rate stayed high, at 25.7 per cent, especially for youth (49.4 per cent). With the onset of the pandemic, the economy contracted by 4.8 per cent year-on-year in the first half of 2020. Investments and exports declined sharply, by 28.3 and 21.0 per cent year-on-year, respectively. Available figures for the second quarter show that manufacturing output declined by 16.9 per cent year-on-year and was accompanied by a fall in the number of employees in the sector (3.3 per cent year-on-year).

Inflation has slowed in 2020. Inflation in 2019 picked up to 2.7 per cent from 1.1 per cent in 2018. Prices, especially those of food, rose significantly, possibly reflecting the imposition of a 100 per cent tax on goods imported from Serbia and Bosnia and Herzegovina in November 2018. However, year-on-year inflation started to decelerate from the second half of 2019, dropping below zero in July 2020, in part due to the negative demand effects of the lockdown measures.

The fiscal stance is being loosened significantly. Budgetary revenues, especially taxes, are on track to fall by more than 10 per cent in 2020, as household and corporate revenues decline. Expenditures may stay constant but the internal structure is set to change, with current spending (mostly subsidies and grants to companies and individuals) increasing and capital spending decreasing. As a result, the overall fiscal deficit is forecast to rise to 6.5 per cent of GDP (according to the amended 2020 budget) from 2.8 per cent in 2019. Public debt may increase from below 18 per cent of GDP in 2019 to close to 21 per cent in 2020. The additional public financing needed is mainly covered by funding from international institutions, including the International Monetary Fund (IMF) and the European Union.

A relatively fast recovery is possible. After a forecast recession of -5.0 per cent in 2020, a rebound of 4.0 per cent GDP growth is expected in 2021, with domestic demand continuing to be the main growth driver. The risks to the projection are on the downside as the pandemic and associated economic disruption may last longer than expected. Further risks are in the weak public investment management and the potential slow recovery of European Union (EU) countries and main trading partners. Regarding the former, a swifter recovery would be helped by the acceleration of the hitherto-slow implementation of key infrastructure projects.

Policy response to Covid-19

The government has put in place a Covid-19 emergency relief package. The package, adopted in April 2020, amounted to nearly €180 million (more than 2.5 per cent of GDP). The measures included support to affected sectors through liquidity provision, wage subsidies and corporate and personal income tax deferrals. Health expenditures were also increased, as well as assistance to socially vulnerable people (for example, double payment of the value of the social assistance for three months, and monthly assistance to vulnerable groups and those who lost their job for two to three months). In addition, the package envisaged the provision of interest-free loans to publicly owned enterprises (with a maturity period until the end of 2020) and financial support to municipalities. Companies could benefit from support to salaries of €170 per month, lasting for two months, and to pension contributions, and SMEs became entitled to a rent subsidy of up to 50 per cent of the rent value. Micro enterprises and the self-employed could receive credit guarantees through the Kosovo Credit Guarantee Fund of up to €10,000. Grants and subsidies to increase agricultural production and to support exporters and sports and cultural activities have also been envisaged. Furthermore, the central bank allowed the submission of loan restructuring applications until the end of September 2020 for borrowers with payment difficulties due to the pandemic.

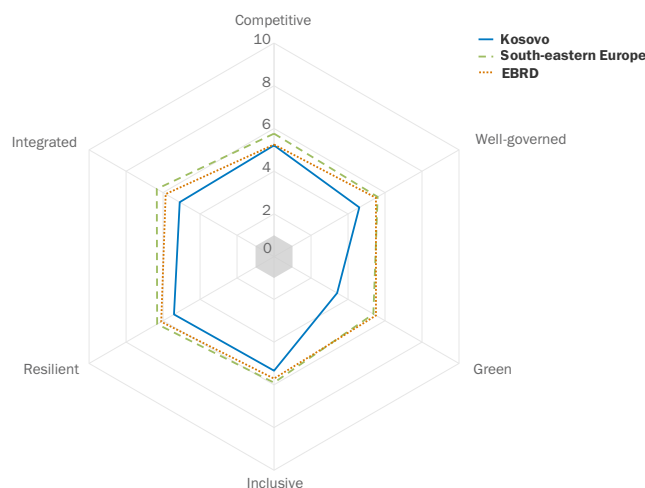
The government has adopted a medium-term economic recovery package. The new package, adopted in June 2020, is worth €1.2 billion and covers the period 2020-23. The package aims

to facilitate access to finance, reduce the tax burden, and support employment in the agriculture sector and public enterprises. In August 2020 it was followed by a plan to implement the package, totalling €365 million. The plan contains 15 measures and among other things envisages supporting the Kosovo Credit Guarantee Fund, covering the minimum operating costs of publicly owned enterprises and providing financial support for youth employment.

Kosovo is receiving significant international assistance to help cope with the Covid-19 crisis.

Since the outbreak of the pandemic, the EU, the IMF and other international financial institutions provided special assistance to finance the additional costs of the pandemic. The Macro-Financial Assistance from the EU amounted to €100 million, while the IMF’s Rapid Financing Instrument was €51.6 million. Other international organisations and some countries also offered financial support to the country.

Assessment of transition qualities (1-10)



Structural reform developments

There has been little progress in EU accession negotiations over the past year. Kosovo signed the Stabilisation and Association Agreement (SAA) with the EU in October 2015 and it formally entered into force on 1 April 2016. While the European Commission has repeatedly stressed that Kosovo shares the European perspective of the Western Balkans, the question of its integration into the EU remains contentious due to the fact that five member states do not recognise Kosovo bilaterally. Although the European Commission confirmed that Kosovo fulfilled outstanding visa liberalisation benchmarks, the decision for visa liberalisation is pending in the European Parliament and the council, and citizens of Kosovo remain the sole among Western Balkans countries unable to travel without a visa to the Schengen area.

The 100 per cent tariff on goods from Bosnia and Herzegovina and Serbia has been revoked.

The government of Kosovo originally introduced the tariff in November 2018 as a response to what it called Serbia’s “aggressive campaign” to revoke Kosovo’s international recognition. In April 2020 the previous government revoked the 100 per cent tariff imposed on goods imported from Bosnia and Herzegovina and Serbia, but imposed reciprocity measures from May, consisting of trade restrictions and customs requirements. This included requesting the use of the name of the Republic of Kosovo on documents on agricultural and industrial products, as well as an entry permit for vehicles transporting goods to Kosovo from the Liaison Office of the Republic of Kosovo in Serbia. In June 2020 the incoming new government revoked the reciprocity measure.

Kosovo has joined the newly formed Kosovo-Albania Control Block within the European transmission network. Accession to the network took place in May 2020. Kosovo has left the SMM (Serbia, Montenegro and North Macedonia) block. This formation of a new link with Albania may increase electricity transmission between the two countries and improve the stability of supply. On the green agenda, work has now started in cooperation with the Energy Community to introduce an auctions scheme to allocate licences for renewables as a successor to feed-in tariffs.





MONTENEGRO

Highlights

- **The Covid-19 pandemic is weighing strongly on growth in 2020.** The economy relies heavily on tourism, and foreign tourist arrivals declined by over 80 per cent year-on-year in the first half of 2020, contributing to a sharp fall in GDP.
- **The government adopted three packages of economic support measures as a response to the coronavirus crisis.** The packages are worth over €1.5 billion (more than 30 per cent of GDP) and aim to maintain the liquidity of companies, saving jobs and supporting vulnerable groups.
- **The country is progressing on greening energy generation.** The decarbonisation agenda of the state electricity company (EPCG) relies on an extensive renewable investment plan.

Key priorities for 2021

- **Fiscal adjustment should be resumed as soon as Covid-19 concerns recede.** Besides maintaining a primary surplus over the medium term, further strengthening of budgeting procedures, public investment management and public and tax administration is needed. Construction of further sections of the major cross-country highway should be preceded by a careful cost-benefit analysis.
- **Informality needs to be tackled through further measures.** Unfair competition from the informal sector weighs primarily on local micro, small and medium-sized enterprises. Government measures should be focused on underlying causes such as the regulatory burden, weak enforcement capacity and corruption, and simplifying tax legislation and reducing para-fiscal charges would also be beneficial.
- **The bank asset quality review should be completed.** This would help give a clear picture of the underlying strengths and weaknesses of the banking sector. In addition, the central bank should closely monitor financial stability and issues arising from the Covid-19 crisis.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.9	4.7	5.1	4.1	-9.0
Inflation (average)	-0.3	2.4	2.6	0.4	-0.1
Government balance/GDP	-6.2	-6.9	-6.2	-2.4	-10.0
Current account balance/GDP	-16.2	-16.1	-17.0	-15.2	-14.0
Net FDI/GDP [neg. sign = inflows]	-9.4	-11.3	-6.9	-7.0	-5.0
External debt/GDP	162.6	160.6	164.7	170.2	n.a.
Gross reserves/GDP	18.1	20.8	21.9	27.9	n.a.
Credit to private sector/GDP	48.8	48.7	49.6	49.4	n.a.

Covid-19: macroeconomic implications

The economy has entered a strong recession in 2020. GDP growth slowed to 3.6 per cent in 2019, primarily due to large investment projects approaching completion (the Bar-Boljare highway) or being completed (power link to Italy), although the tourist season was the strongest on record. In Montenegro, around one-fifth of GDP normally comes from tourism, and most tourists visit the country in the summer months. In June 2020, the government announced that the Covid-19 virus had been eliminated on the territory, but in mid-July the government acknowledged that new cases had emerged throughout the country. In the first half of 2020 GDP contracted by 10.3 per cent year-on-year, while foreign tourist arrivals declined by over 80 per cent year-on-year. Exports recorded a fall of 35.5 per cent. The economy also entered deflation in the second quarter, with year-on-year inflation averaging -0.7 per cent in April to June 2020.

Public debt will likely reach a record high level in 2020. As in other countries, economic support measures (described below) aimed at mitigating the negative effects of the coronavirus pandemic, combined with falling revenues, will lead to an increased budget deficit in 2020. According to the government, the deficit will be 7.3 per cent of projected GDP in 2020, but other estimates suggest it could be as high as 10 per cent of GDP. Besides coronavirus-related measures, the previous government announced a pension hike (raising minimum pensions by around 13 per cent retroactively from 1 January 2020) ahead of the parliamentary elections at the end of August.

The current account deficit declined only marginally in the first half of 2020. Montenegro has run high current account deficits for many years, reaching 15 per cent of GDP in 2019. In the first half of 2020, it declined by only one percentage point, as the fall in goods imported was more than compensated for by the decline in tourism exports.

A sharp recession in 2020 is expected to be followed by a recovery in 2021. GDP is forecast to fall by 9.0 per cent in 2020 as the tourist season was significantly affected by the crisis. Provided the pandemic loses its power both locally and globally in the second half of 2021, the economy should return to growth in 2021, which is projected at 5.0 per cent. The downside risks are associated with potentially longer duration and stronger impact of the pandemic on the economy than envisaged, and further deterioration of the fiscal position.

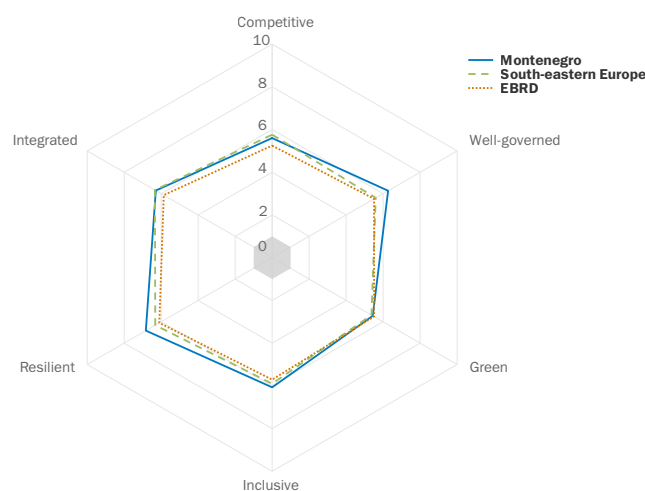
Policy response to Covid-19

The government adopted three packages of economic measures between mid-March and August 2020. The overall aims were to maintain the liquidity of companies and citizens, save jobs and support the vulnerable. While the government spent around €320 million on the first two packages, the third is far larger, estimated at €1.2 billion, and will span over four years. Fiscal measures ranged from deferral of wage taxes and social contribution payments, to wage subsidies for employees in troubled sectors (such as tourism, hospitality and transport) and for new employment, to assistance to the agricultural and fisheries sectors. The government provided farmers with access to soft loans worth up to €20,000 and announced it would purchase and store surplus agricultural products as well as assist producers to transport those products to public institutions. Measures also included shorter value-added tax (VAT) refund deadlines, financial aid to pensioners and the unemployed, power subsidies for vulnerable groups, and higher wages for healthcare workers and police officers. Among the latest actions was a one-year reduction of VAT for catering activities (from 21 to 7 per cent), additional support for the tourism sector as well as incentives for the agriculture, fisheries and information technology sectors.

Financial measures ranged from loan payment holidays to soft loans. In March 2020, a 90-day moratorium on the repayment of bank loans for citizens and companies was announced. In May 2020, the central bank of Montenegro (CBCG) allowed a new 90-day moratorium for troubled borrowers and doubled its repurchase agreement line with the Bank for International Settlements to €100 million. In order to support banks' liquidity and lending potential, the CBCG reduced reserve requirement rates for banks by two percentage points (to 5.5 per cent for deposits with a maturity of less than one year and to a 4.5 per cent for deposits with a maturity longer than one year). In order to strengthen the capitalisation of banks, in April 2020 the central bank temporarily prohibited

commercial banks from paying dividends to shareholders. In addition, the CBCG allowed banks to raise their exposure to a single entity beyond the regulatory limit of 25 per cent of the bank's own funds, under certain conditions. Lastly, a credit line has been opened by the state-run Investment-Development Fund, offering help to affected companies with soft loans of up to €3 million per beneficiary (two-year grace period, 1.5 per cent interest rate).

Assessment of transition qualities (1-10)



Structural reform developments

Government measures have been financed by the previous Eurobond issuance and external borrowing. The €500 million Eurobond issuance from September 2019 has helped the government secure a part of the budgetary funding need for 2020. The rest of the financing mainly comes from external borrowers. Among the rest, the government secured a €250 million syndicated loan from commercial banks with an €80 million World Bank guarantee in May 2020. In addition, the International Monetary Fund provided a €74 million loan under the Rapid Financing Instrument, the European Commission approved €60 million in macro-financial assistance, and further loans have been granted by other international financial institutions.

Montenegro opened the last negotiating chapter with the European Union (EU). The year 2020 saw the opening of the last remaining chapter of the EU accession negotiating framework, bringing the number of opened chapters to 33 in total. The focus will now be on closing the chapters — only three chapters have been provisionally closed since the opening of accession negotiations in June 2012. According to the council and European Commission (EC), further progress in negotiations will depend on meeting the interim benchmarks set in the rule-of-law chapters (23 and 24).

The government has provided support to some troubled state-owned enterprises. In December 2019 a *lex specialis* on Montenegro Airlines was adopted, allowing the government to provide support to the national air carrier so that it could pay its debt. The Agency for the Protection of Competition was not able to assess the compliance of the law with state aid rules. According to the EC, this may have long-lasting negative effects on the perception of the regulatory environment and unfairness of the state as a regulator. As a consequence of Covid-19, Montenegro Airlines has accumulated losses worth several million euros since halting its operations in mid-March 2020.

In May 2020, the government approved €0.5 million support to the company. In addition, in March 2020, it was announced that the government will take over debt worth €5.5 million from the state railway infrastructure operator ZICG and the railway transport operator ZPCG.

Works on transport infrastructure continue, with some delays. Due to Covid-19-related factors, the deadline for completing the first section of the Bar-Boljare highway has been changed from the end of September 2020 to June 2021. The construction of the 41-kilometre long first section is estimated to cost €895 million (or around 18 per cent of 2019 GDP).

Energy linkages and renewables are advancing. In November 2019, the 455-kilometre power link between Montenegro and Italy was launched, marking the completion of one of the largest investment projects in recent years. In August 2020 the state electricity company (EPCG) started a one-month overhaul of one of two main hydropower plants (the 307 MW Perucica). The works are part of EPCG's investments aiming to improve the safety and efficiency of its power plants and ensure the stable functioning of the power system in the country. In June 2020, EPCG signed a €54 million deal for the ecological revamp of the Pljevlja thermal power plant, which will allow it to keep operating in line with the Paris Agreement and the Green Deal. In December 2019, the government completed the acquisition of the Italian A2A company's shares in EPCG, raising its stake in EPCG to 88.6 per cent, and in February 2020, it launched the first CO₂ emissions trading scheme in the Western Balkans. Its decarbonisation agenda includes an extensive renewable investment plan for EPCG. In August 2020, the government signed a contract worth over €100 million for the construction of a 70 MW wind farm. The farm will be located in the coastal area and will produce 220 GWh of electricity per year.



NORTH MACEDONIA

Highlights

- **The economy has entered recession in 2020.** After expanding by 3.6 per cent in 2019, GDP is falling sharply as a result of the Covid-19 pandemic, with industry, trade, transport and tourism being particularly affected.
- **Sizeable and targeted support packages are mitigating the impact of the crisis.** The government is supporting individuals and companies, and protecting employment and poor households through targeted measures including temporary payments of minimum wages in coronavirus-affected companies and loan repayment holidays.
- **The country has stepped up its green economy transition.** A comprehensive law on energy efficiency in line with EU directives has been adopted, and the government is seeking investors to transform an abandoned coal mine into a 100 MW solar park.

Key priorities for 2021

- **Raising the level and quality of public investment is key to increasing productivity and economic convergence.** There are still significant infrastructure and private sector productivity gaps that could be narrowed through higher public investments in transport, energy, education and sustainable environmental infrastructure (for example, water and wastewater treatment, and solid waste management), along with improved planning and implementation.
- **Fiscal sustainability should be prioritised as the short-term crisis response measures expire.** The government should create fiscal buffers, raise the efficiency of tax collection and execute capital expenditures in a timely manner. An enhanced fiscal governance framework would strongly support debt sustainability.
- **Better quality of education is needed to reduce skills mismatches in the labour market.** The persistently high level of youth unemployment indicates that the education system does not meet the needs of businesses. Ongoing reforms in education, if stepped up, can help improve the situation.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	2.8	1.1	2.7	3.6	-5.0
Inflation (average)	-0.2	1.4	1.5	0.8	0.9
Government balance/GDP	-2.7	-2.7	-1.8	-2.0	-7.5
Current account balance/GDP	-2.9	-1.0	-0.1	-3.3	-4.5
Net FDI/GDP [neg. sign = inflows]	-3.3	-1.8	-5.6	-3.2	-1.5
External debt/GDP	74.7	73.4	73.3	71.9	n.a.
Gross reserves/GDP	27.1	23.3	26.8	28.8	n.a.
Credit to private sector/GDP	49.0	49.9	50.5	50.9	n.a.

Covid-19: macroeconomic implications

Economic recovery has been halted by the pandemic. Growth of 3.6 per cent in 2019 was driven mainly by domestic demand, while exports were also robust, growing by 9 per cent, although offset by similar growth in imports. In the first half of 2020 GDP declined by 6.4 per cent year-on-year, with sharply falling activity in industry and trade, transport and tourism. On the expenditure side, only government consumption recorded growth, while private consumption, investments, exports and imports all contracted strongly. Unemployment increased slightly in the second quarter of 2020, to 16.7 per cent, reflecting the impact of the pandemic on the economy, but youth unemployment continued to decline, albeit remaining high at 33.8 per cent. Year-on-year inflation remains low at 0.7 per cent in January to July 2020.

Fiscal deficits and public debt are rising. After a marginal increase in 2019, to 2.0 per cent of GDP, the general government deficit is expected to reach close to 7 per cent of GDP in 2020 due to the combination of falling GDP and revenues and rising costs as a result of the measures adopted to mitigate the effects of the crisis. Lockdown measures and lower external demand have reduced economic activity, resulting in revenue shortfalls, while current spending on health, economic subsidies and social transfers are higher than budgeted, and only partially offset by lower capital expenditure. General government debt is increasing significantly in 2020. In June 2020, general government debt stood at 50.7 per cent of GDP (10.5 percentage points higher than at the end of 2019), while the guaranteed debt accounted for another 8.4 per cent of GDP. Financing for the crisis response measures is mostly external, including funding from the International Monetary Fund (IMF), the European Union (EU), international financial institutions and a €700 million Eurobond issuance in May 2020.

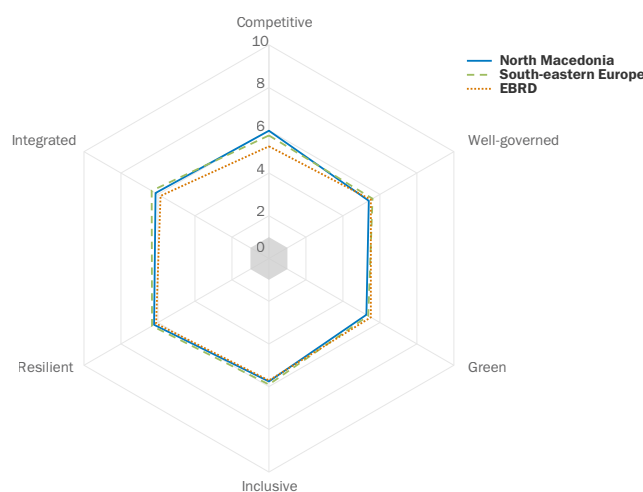
After recession in 2020, a recovery is expected in 2021. GDP is projected to drop by 5.0 per cent in 2020 and recover by 3.0 per cent in 2021. However, risks to the projection are weighted to the downside, and any recovery will be much more protracted if the pandemic persists, both in North Macedonia and among its main trading partners.

Policy response to Covid-19

Four economic packages were introduced to lessen the negative impact of the crisis. The total size of the packages was above €1 billion (around 9.0 per cent of GDP). The first two sets of actions, implemented between March and May 2020, mitigated the impact of the crisis on the economy and the population, while the third package focused on economic recovery and incentivising consumption and industrial production, starting from May 2020. Measures adopted included: the government paying minimum wages of workers between April and June in coronavirus-affected companies and subsidising 50 per cent of social contributions; exempting from tax advances firms and the self-employed until July 2020; providing interest-free loans (€3,000 to €90,000 per company, six-month grace period and two-year repayment period) and soft loans (at a 1.5 per cent interest rate) through the Development Bank of North Macedonia and commercial banks to companies; and increasing value-added tax (VAT) refunds for buying domestic products. The fourth package, adopted in late October 2020, introduced some novelties such as payment cards for vulnerable citizens and a reduction of VAT on the products and services of artisans and restaurants. The central bank has cut its policy rate three times so far in 2020 (from 2.25 to 1.5 per cent). It has also allowed banks to change loan terms faster and through more straightforward procedures, and it extended the time to classify a loan as non-performing from 90 to 150 days by the end of September 2020. In addition, the central bank has set up a €400 million repurchase agreement line with the European Central Bank to provide euro-denominated liquidity to the country's financial sector. The line is to stay in place at least until June 2021.

International institutions are helping to finance the additional costs due to the pandemic. Macro-Financial Assistance from the EU amounted to €160 million, while the IMF's Rapid Financing Instrument was €176.5 million. Other international organisations and some countries also offered financial support to the country.

Assessment of transition qualities (1-10)



Structural reform developments

The European Council decided to open EU accession negotiations with North Macedonia. In March 2020 the European Council decided to open accession negotiations in light of the progress achieved in comprehensive reforms and the fulfilment of the conditions identified by the June 2018 Council. It invited the European Commission to prepare the framework for the negotiations, reflecting on the revised methodology (enhanced approach) of the accession process adopted by the council on the same day. Once the council adopts the negotiating framework, this should be followed “as soon as possible” by the first intergovernmental conference (the formal start of the negotiations). The European Commission presented to member states a draft of the negotiating framework on 1 July 2020.

Implementation of the law on inspection supervision has advanced. The law, adopted in May 2019, aims to streamline the inspection procedure and make it more business friendly, including through warnings for minor breaches, and it provides grace periods for corrective actions. The law entered into force at the end of 2019 and the Inspection Council has in the meantime overseen the completion of checklists and risk-based inspection methodologies for each Inspectorate. This will create the conditions for more transparent and less intrusive inspections for legal businesses. The full implementation of the law, including proper procedural rules, may significantly enhance the quality of the business environment.

The authorities have taken some steps towards improving the energy mix. To diversify the country’s energy mix away from coal, increase the share of renewables and fight air pollution, North Macedonia has initiated plans to develop a solar park on the site of an abandoned coal mine in the western part of the country. In February 2020 the government launched a public tender for investors to construct two photovoltaic units of up to 100 MW in total. In the same month, the country also adopted a comprehensive Law on Energy Efficiency, transposing the relevant EU directives.

The banking sector has remained resilient. At the end of March 2020, liquid assets of the banking sector made up around 30 per cent of total assets, while capital adequacy was at 16.5 per cent, exceeding the regulatory minimum. Lending growth picked up from 5.8 per cent year-on-year in March 2020 to 8.2 per cent in July, on the back of faster lending to the corporate sector. Non-performing loans (NPLs) have declined from 5.4 per cent in June 2019 to 4.7 per cent in March 2020, but may increase as the measure allowing banks to extend the time to classify a loan as an NPL from 90 to 150 days expires at the end of September. Foreign currency (euro) lending has stayed high, at over 40 per cent of total lending in July 2020. In August 2020 the central bank revoked the licence of a small bank without any systemic impact on the sector.



ROMANIA

Highlights

- **The economy is being hit hard by the coronavirus crisis.** GDP grew by a robust 4.2 per cent in 2019, but the economy is experiencing a sharp recession in 2020 with the export-dependent manufacturing sector being severely affected.
- **The government has introduced a support package similar to those in other peer countries, although somewhat smaller.** Adopted measures include employment support schemes, as well as loan guarantees to small and medium-sized enterprises (SMEs), on top of fiscal relief measures.
- **Structural reforms have been hampered by parliamentary fragmentation and the Covid-19 crisis.** Not only has there been limited progress in reforms, but there have also been some reversals in the past year, including in the areas of privatisation and the banking sector.

Key priorities for 2021

- **Further actions to strengthen good governance should be undertaken.** Public administration and governance reform, and improvements in policymaking processes, including through digitisation, and in strengthening corporate governance of state-owned enterprises, should remain priorities.
- **Investments in infrastructure should be stepped up.** Given significant infrastructure gaps, the positive trend of public capital spending in the past year should continue. Ensuring administrative capacity, including for absorbing the allocated European Union (EU) funds, is critical.
- **Medium-term fiscal sustainability is important for the country's further transition.** The additional crisis-related fiscal stimulus in 2020 and curbed revenues, on top of an already unbalanced budget, will require the authorities to devise a medium-term fiscal strategy to reduce the deficit.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	4.7	7.3	4.5	4.2	-5.0
Inflation (average)	-1.1	1.1	4.1	3.9	2.5
Government balance/GDP	-2.6	-2.6	-2.9	-4.3	-9.2
Current account balance/GDP	-1.4	-2.8	-4.4	-4.6	-5.3
Net FDI/GDP [neg. sign = inflows]	-2.6	-2.6	-2.4	-2.4	-1.2
External debt/GDP	52.0	55.4	49.1	48.5	n.a.
Gross reserves/GDP	21.2	20.7	17.3	16.6	n.a.
Credit to private sector/GDP	28.1	26.3	25.6	24.7	n.a.

Covid-19: macroeconomic implications

Romania is being severely affected by the coronavirus crisis. After robust growth of 4.2 per cent in 2019, on the back of expanding domestic demand, Romania is experiencing a recession in 2020. Key transmission channels are lower consumption and a drop in exports. A domestic lockdown and state of emergency were introduced in mid-March 2020, lasting until mid-May and severely affecting travel, economic activity and consumer and business sentiment. The lockdown heavily affected private consumption: retail sales dropped by almost one-fifth in April on a year-on-year basis, although some recovery has taken place in the following months. Industrial production collapsed in April by almost 40 per cent year-on-year, causing, among other things, exports of goods to drop. GDP fell in the first half of 2020 by 4.6 per cent year-on-year, with private consumption expenditure falling by 5 per cent and exports by 15 per cent. The unemployment rate has risen to 5.4 per cent in July 2020 (up from 3.7 per cent in January 2020), with further job losses likely in the coming months, as government support schemes are phased out. Inflation has picked up to 2.2 per cent year-on-year in June, which is within the central bank's target of 2.5 per cent +/- 1 percentage point.

The fiscal position has deteriorated further, requiring a budget revision. Romania entered the Covid-19 crisis with a significant fiscal deficit (4.3 per cent of GDP in 2019). The combination of a declining economy and revenues, a fiscal stimulus programme amounting to around 4 per cent of GDP, and another increase in pensions (on top of that in 2019) in September 2020, is expected to raise the fiscal deficit in 2020 to an estimated 8.6 per cent of GDP, as per the August 2020 revised budget. However, market access to funding on favourable terms remains strong. Romania still has a relatively moderate level of public debt of 35 per cent at the end of 2019, which is another mitigating factor, although this ratio is rapidly increasing. Because of the widening budget deficit, Fitch and Moody's downgraded their outlook on Romania's sovereign credit rating to negative in April 2020, but the country remains in investment-grade territory with all of the main credit ratings agencies.

The National Bank of Romania (NBR) has reacted promptly to loosen monetary policy. In a first reaction to the pandemic, the NBR reduced the monetary policy rate by a total of 1 percentage point to 1.5 per cent through three cuts (the latest in August 2020), and narrowed the related interest rates corridor to ± 0.5 percentage points from ± 1.0 percentage points, thus lowering further the lending facility rate. It also provided liquidity to credit institutions via repo transactions (repurchase of government securities). The NBR has also agreed with the European Central Bank to establish a repo (repurchase agreement) line for euro liquidity of up to €4.5 billion, to address possible euro liquidity needs in the event of market failures, in exchange for high-quality euro-denominated collateral. The repo line was first meant to be in place until the end of 2020, but in late August was renewed until 30 June 2021. The NBR also intervened in the foreign exchange markets to stabilise the Romanian leu-euro rate, given the high depreciation pressures.

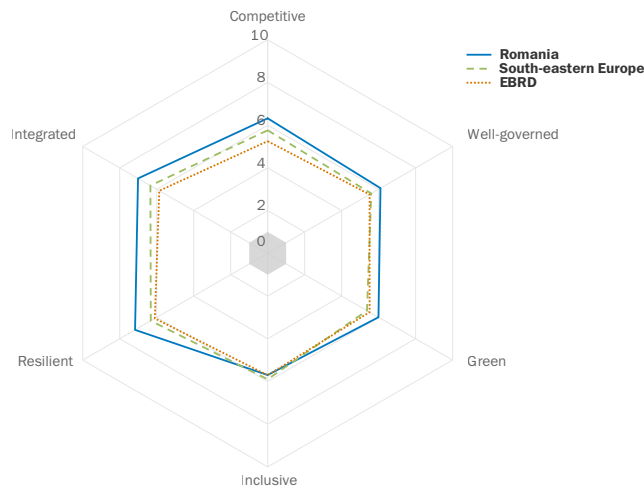
Economic performance is expected to recover in 2021. Currently we forecast GDP to drop in 2020 by 5 per cent but rebound in 2021 by 3 per cent. The recovery is contingent on a gradual normalisation of economic activity in both Romania and its main economic partners, and a resumption of structural reforms. However, this would be hard to achieve should other major Covid-19 outbreaks emerge later in 2020 or early 2021.

Policy response to Covid-19

The government intervened to support liquidity and preserve jobs. The announced fiscal package in March 2020 of about 3 to 4 per cent of GDP includes: (i) additional funds for the healthcare system; (ii) partial coverage of wages for individuals who are technically unemployed (up to 75 per cent of the average gross wage), as well as for parents staying at home; and (iii) guarantees for supporting lending to SMEs, and a separate mechanism for large companies. Other measures include a deferral of loan payments for both firms and citizens of up to nine months (until the end of 2020), faster reimbursement of value-added tax, suspending foreclosures on overdue debtors, and postponement of property tax by three months. In June 2020 the government introduced a temporary measure to cover up to 45 per cent of the average gross wages for employees who return to work from technical unemployment, while firms employing people over 50 or under 30 years of age will receive subsidies of up to RON 2,500 (€515) per month for a year. In addition, a *Kurzarbeit*

scheme, where the employer pays part of the wage proportional to the work hours, and the state tops up the payments to employees up to 75 per cent, was approved by the government. The government has also further relaxed procedures to smooth state-guaranteed loans to SMEs, under the IMM Invest programme, with the aim of accelerating the processing of loan requests. On top of the state-guaranteed lending from banks, the government decided also to directly finance SMEs from unused EU funds.

Assessment of transition qualities (1-10)



Structural reform developments

The government has unveiled an Economic Relaunch Plan focused primarily on public investments. In July 2020 the government unveiled the National Investment and Economic Relaunch Plan, which includes €100 billion worth of public investments and improved social protection over the next 10 years. The government envisions setting up a sovereign investment fund and a national promotional bank as the institutions in charge of implementing the plan. Investments in transport infrastructure remain a priority, but the plan also includes financial support to companies and sizeable state aid to greenfield investments that will contribute to regional development. The overall aim of the plan is to raise the country's GDP per capita, at purchasing power parity, to 87 per cent of the EU average by 2025, from the current 69 per cent.

Progress under the EU's Cooperation and Verification Mechanism (CVM) continues to be uneven. The latest CVM report, published in October 2019, noted reversals on Romania's progress in the areas of the rule of law and the fight against corruption. However, the European Commission welcomed the fact that the new government expressed a wish to reset the approach.

FTSE Russell has upgraded Romania's equity market to (Secondary) Emerging market status. The upgrade is effective from September 2020. This is a significant change and should have a positive impact on market development, investor sentiment and overall investment inflows. This move could give a boost to the privatisation process for state-owned enterprises, which has stalled and even reversed in the past year (see below). More recently, Nuclearelectrica and Banca Transilvania met the FTSE Global All Cap Index eligibility requirements as of the end of June 2020.

A new law temporarily freezing the sale of state assets has been adopted. Initiated by the opposition, the "Bill on certain measures to protect national interests in the economic sector" (or "anti-privatisation law") was passed by parliament in June 2020. It bans any sale of state-owned assets for two years, as well as stalling current privatisation procedures. The intention of the law was to postpone the privatisation for the period after the Covid-19 crisis, as those backing the law claimed that sales carried out now (or in the near future) would be at low prices because of the effects of the crisis. The government appealed the bill and the Constitutional Court is expected to review it.

Several bills targeting consumer credit, with a potential negative impact on the banking sector, have been adopted. One bill, approved by parliament in May 2020, sets interest rate caps on mortgage and consumer loans. The law states that in the case of mortgage loans, the effective interest rate cannot exceed the policy rate by more than 2 percentage points, and in the case of consumer loans by more than 15 percentage points. The Giving in Payment Law, also adopted in May 2020, allows a debtor to be discharged of any obligations towards their creditor by handing over the property subject to the mortgage loan. Another new law is aimed at limiting the value of claims that can be recovered in the case of banks selling a claim to a distressed credit manager. On a more positive note, the bank tax on total assets introduced in December 2018 by Government Emergency Ordinance 114/2018, was removed, effective from the beginning of 2020.



SERBIA

Highlights

- **The effects of the Covid-19 pandemic are intensifying.** After a robust first quarter in 2020 (5.0 per cent growth year-on-year), GDP fell by 6.4 per cent year-on-year in the second quarter, as a consequence of the coronavirus-related lockdowns and disruptions in supply chains.
- **Work on a state-ownership policy (SOP) is advancing.** The SOP, which is designed to improve the governance of state-owned enterprises (SOEs), is expected to be adopted soon.
- **The government approved two economic support packages as a response to the pandemic.** Overall, the packages are worth around 12.5 per cent of GDP, with measures aimed primarily at preserving employment and increasing liquidity for businesses.

Key priorities for 2021

- **To ensure the sustainability of public finances, fiscal risks should be contained.** Public debt may exceed 60 per cent of GDP by the end of 2020. The government should decrease the budget deficit significantly in 2021, control wages and pensions and improve the structure of public expenditures towards more productive infrastructure investments and increase their value for money.
- **Public sector reforms need to progress.** In addition to adopting the SOP to improve the governance of SOEs and making necessary legal changes for its implementation, the government should proceed with the public administration reform, including the introduction of a new public sector pay grade system, and further professionalisation and de-politicisation of the administration.
- **Further improvements of the business environment are necessary in order to increase domestic private investments.** The focus should be on levelling the playing field for small and medium-sized enterprises (SMEs), strengthening the rule of law, implementing the legislation consistently and fighting corruption. In addition, the private sector should be properly involved in public consultations regarding new business legislation.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.3	2.1	4.5	4.2	-3.5
Inflation (average)	1.2	3.0	2.0	1.9	1.5
Government balance/GDP	-1.1	1.4	0.8	0.0	-8.0
Current account balance/GDP	-2.9	-5.2	-4.8	-6.9	-6.5
Net FDI/GDP [neg. sign = inflows]	-5.2	-5.9	-7.3	-7.8	-5.0
External debt/GDP	72.0	65.1	62.2	61.9	n.a.
Gross reserves/GDP	27.8	25.4	26.3	29.1	n.a.
Credit to private sector/GDP	41.0	40.3	41.4	42.1	n.a.

Covid-19: macroeconomic implications

After solid growth in 2019, the economy is facing a recession in 2020. GDP expanded by 4.2 per cent in 2019, driven by domestic demand, primarily investments, among which the building of the TurkStream gas pipeline stood out. GDP also rose strongly in the first quarter of 2020, at 5.0 per cent year-on-year, driven by consumption, government expenditures (related to increased spending in the early stages of Covid-19 and a hike in wages) and investments. At the same time, exports growth slackened to 3.1 per cent year on year, which was the slowest quarterly rate since 2014. The second quarter of 2020 saw a fall in economic activity of 6.4 per cent year on year, as the impact of stringent lockdowns was felt by the economy.

Public debt has started to rise due to government measures to fight the effects of Covid-19.

According to International Monetary Fund (IMF) estimates, the budget deficit in 2020 will reach 8.6 per cent of GDP. To finance it, Serbia raised €2 billion through a seven-year Eurobond issuance in May 2020 and stepped up domestic borrowing. In June 2020 the debt stood at 58.1 per cent of GDP, around five percentage points higher than at the end of 2019, and some further rise in the ratio is expected by the end of 2020.

Inflationary pressures have remained subdued. The average inflation rate in the first seven months of 2020 was 1.5 per cent year-on-year, which is exactly at the lower bounds of the central bank's target band (3 ± 1.5 per cent). After three cuts of 25 basis points each in 2019, the central bank lowered the key policy rate by another 100 basis points between March and June 2020, to an historical low of 1.25 per cent. The latest cuts are helping to mitigate the economic effects of the pandemic. The exchange rate against the euro has remained stable. The central bank has intervened in the foreign exchange market, mainly by selling euros (€1.4 billion net in the first seven months of 2020).

A recovery is expected in 2021. Overall, GDP is expected to decline by 3.5 per cent in 2020. Although the economy is being affected through several channels (lockdown measures, disruption in supply chains, lower inflow of foreign direct investment and remittances), the contraction in 2020 is smaller than in many neighbouring countries because the structure of the economy, with production of basic products accounting for an important share, is less vulnerable to the effects of the pandemic. In addition, the government has continued capital investments throughout the crisis period. Assuming a return to normal economic activity by mid-next year, GDP growth is forecast to resume at 3.0 per cent in 2021.

Policy response to Covid-19

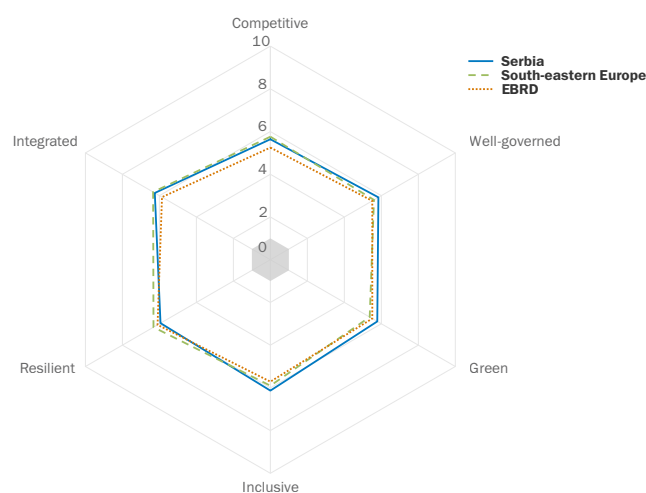
The government is implementing a large aid package to mitigate the impact of Covid-19.

The initial package, announced at the end of March 2020, amounts to €5.1 billion (or 11 per cent of GDP). Measures include: direct private sector support (payment of three minimum wages to entrepreneurs and micro, small and medium-sized enterprises and a subsidy at 50 per cent of the minimum net wage to large businesses that had to suspend activity); fiscal measures (postponed payment of social security contributions and payroll tax; delayed advance corporate income tax payments for the second quarter of 2020); and liquidity enhancement (primarily state guarantees for €2 billion new loans). Under the second package, adopted in July 2020, the state covered 60 per cent of minimum wages for August and September, deferred payment of social security contributions and payroll tax for one month, and continued to subsidise large companies. The condition for companies to obtain state aid was not to lay off more than 10 per cent of the workforce three months after receiving the last payment. In addition, the government set aside around €22 million for farmers and approved one-off aid to pensioners of RSD 4,000 (€35), one-off assistance to all adults (€100) and a 10 per cent wage hike of health workers. In August 2020, a programme of subsidies for city hotels in difficulties was adopted. The hotels would be entitled to one-off subsidies of €350 per single bed and €150 per room.

Financial measures have also been adopted as part of the crisis response. The measures ranged from loan repayment moratoria to possible inclusion of corporate bonds into monetary operations. In mid-March 2020, the National Bank of Serbia (NBS) introduced a 90-day loan

repayment moratorium for all debtors willing to use that option, which was later extended until the end of September. In addition, the central bank provided additional local currency and foreign exchange liquidity to banks through additional foreign exchange swaps and repurchase agreement (repo) auctions. To meet possible future euro liquidity needs, it also established a €1 billion repo line with the European Central Bank, which will remain in place until at least June 2021. In May 2020, the NBS announced inclusion of corporate bonds in conducting monetary operations. The NBS can buy dinar bonds from commercial banks, issued by the end of 2020 and with a maximum maturity of five years, provided the bonds have at least a B rating assigned by the national Business Registers Agency. In June 2020, the NBS passed a regulation lowering the downpayment for first home-buyers to 10 per cent of the sought loan amount, and in August it adopted measures in support of lending. However, the latter are rather narrow in scope (targeting mostly the construction sector and housing loans) and not mandatory for banks.

Assessment of transition qualities (1-10)



Structural reform developments

EU accession negotiations are advancing, albeit slowly. So far 18 chapters (out of 35) have been opened since the start of negotiations in January 2014, of which two are provisionally closed. According to the European Commission's country reports, the future speed of negotiations will depend on the pace of reforms regarding the rule of law as well as on progress in the normalisation of relations with Kosovo.

The government is taking steps to develop the capital market. In February 2020 the government announced drafting of the strategy for capital market development with the support of international institutions. At the same time, the law on capital markets was amended to allow greater availability of domestic securities for foreign investors. In May 2020 the Securities Commission enacted by-laws needed for the implementation of the law on alternative investment funds and law on open investment funds with public offerings, adopted in October 2019. The laws are intended to harmonise Serbian law with EU legislation, including on venture capital and private equity funds, and provide a more predictable environment for investors.

A new state ownership policy (SOP) is being developed. According to the IMF programme, the new policy, which should contribute to better corporate governance of SOEs, is to be adopted by the end of October 2020. The SOE sector in Serbia is relatively large and typically performs worse than it does in other countries or in the private

sector. The government agreed to adopt a SOP as part of the IMF Policy Coordination Instrument programme, and to provide a strategic vision of state ownership, including ownership objectives, financial and public policy targets, reporting and monitoring guidelines and procedural guidelines for boards of directors.

Two important state-owned companies face severe difficulties. Air Serbia, the national air carrier, is facing a major financial crisis. In August 2020 the government announced it would provide financial assistance of €56.5 million to pay off the company's debt. Meanwhile, after a series of takeovers of domestic cable operators in 2018 and 2019, the debt of the telecommunications company Telekom Srbija rose from under €400 million at the end of 2017 to €1.2 billion at the end of 2019. There are claims that the takeovers were significantly overpriced. In September 2020 the company issued €200 million worth of five-year corporate bonds, stating the need to refinance its current liabilities and advance its operations. Previous attempts by the government to sell Telekom Srbija (the last time in 2015) were unsuccessful.

The third largest bank in the country has been privatised. Following the November 2019 purchase of the 34.6 per cent stake in Komercijalna Banka from international investors, the state sold its whole share in the bank (83.2 per cent) to Slovenian bank NLB in February 2020. The transaction is expected to be closed in the last quarter of 2020.

A special law to accelerate infrastructure development may jeopardise transparency and competitive tendering. In February 2020 the government adopted a law on special procedures for implementation of linear infrastructure projects (such as highways and the underground) deemed to be of special importance for the country. This *lex specialis* allows the government to exempt "strategic" projects from the application of public procurement rules and thus might not ensure value for money.

An important step has been made in tackling air pollution. At the end of January 2020 the government adopted the country's National Emissions Reduction Plan (NERP), shortly after the Energy Community Secretariat opened a dispute settlement procedure against the country for not adopting the Plan. (The draft NERP of Serbia was approved by the Secretariat in 2016.) The adoption of the NERP is an important step in reducing emissions from large combustion plants into the air.