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From:	General Secretariat of the Council
To:	Delegations
Subject:	Draft Joint Conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans Partners, Türkiye, Georgia, Republic of Moldova and Ukraine

In view of the Economic and Financial Dialogue between the EU and the Western Balkans Partners, Türkiye, Georgia, Republic of Moldova and Ukraine on 14 May 2024, delegations will find attached the draft Joint Conclusions as endorsed by the members of the Economic and Financial Committee and representatives of Albania, Bosnia and Herzegovina, North Macedonia, Kosovo*, Montenegro, Serbia, Türkiye, Georgia, Republic of Moldova and Ukraine on 30 April 2024.

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* This designation is without prejudice to positions on status and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence.

DRAFT

JOINT CONCLUSIONS OF THE ECONOMIC AND FINANCIAL DIALOGUE BETWEEN THE EU AND THE WESTERN BALKANS PARTNERS, TÜRKIYE, GEORGIA, REPUBLIC OF MOLDOVA AND UKRAINE

The Economic and Financial Dialogue between the EU and the Western Balkans Partners, Türkiye, Georgia, Republic of Moldova and Ukraine

Brussels, 14 May 2024

Representatives of the EU Member States, the candidate countries and potential candidates, the European Commission and the European Central Bank, as well as representatives of the central banks of the candidate countries and potential candidates met for their annual economic policy dialogue. Representatives of Georgia, Moldova and Ukraine participated in the dialogue for the first time after becoming candidates for EU membership[1].

The continued economic impact of Russia's war of aggression against Ukraine has confronted EU Member States as well as candidate countries and potential candidates with major economic and social challenges amid an uncertain global outlook. Participants welcomed that the economies of candidate countries and potential candidates continued to show resilience and agreed that the economic and financial dialogue is of continued high importance in view of a common interest to define appropriate policy responses to the recent adverse shocks and future economic and social challenges.

Participants underlined that the economic and financial dialogue also contributes to the wider goals of good governance and economic prosperity. Looking beyond the current challenges, Participants agreed that the dialogue should continue to play a central role in providing jointly agreed policy guidance, where appropriate, to support a sustainable medium-term economic recovery and gradual compliance with the economic criteria for EU accession. Participants emphasised that ownership remains key to a more impactful implementation of the jointly agreed policy guidance and the Economic Reform Programmes. Participants encouraged the Western Balkans to make full use of the Growth Plan for the Western Balkans, including by implementing socio-economic reforms set out in their respective Reform Agendas, to accelerate economic convergence with the EU.

The participants welcome that the new Reform and Growth Facility for the Western Balkans should complement the existing Economic and Financial Dialogue without compromising its scope. From next year, the dialogue will also encompass reporting by Western Balkan beneficiaries of progress made in the achievement of the reform-related part of their Reform Agendas. Participants welcomed the Progress report on the action plan on economic, monetary, and financial statistics for the candidate countries and potential candidates. The dialogue in 2024 represented a transitional year for the process. The dialogue will continue in 2025, taking into account the Reform and Growth Facility for the Western Balkans and the experience with this year's dialogue.

[1] Within the context of the Ukraine Facility where its implementation will be monitored, Ukraine has recently adopted an overarching Ukraine Plan, which outlines its broad-based structural reforms agenda including reforms reinforcing its macroeconomic and financial stability. To avoid duplications and with a view to reducing the administrative burden on Ukraine in these extraordinary circumstances, the country participates in the economic policy dialogue as an observer only.

Albania

Albania submitted its Economic Reform Programme (ERP) 2024-2026 on 15 January 2024. The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of 16 May 2023 has been partial.

Albania's economy expanded by 3.4% in 2023, helped by an exceptional performance of the tourism sector and rising investment. The labour market registered positive developments with increases in employment and wages, which supported household consumption. Helped by the tourism boom, the current account deficit continued to decrease to historically low levels. The ERP projects real GDP growth to accelerate from 3.7% in 2024 to 4% in 2026, reaching its potential growth rate. Domestic demand is expected to be the key driver of growth, with positive contributions from private and public consumption as well as investments. Further support for GDP growth is projected to come from net exports. A higher labour force participation rate is expected to remain the main driver of labour supply, given the decline in population. The growth outlook is subject to domestic and external risks, including higher-than-expected inflation, rising interest rates, and a challenging external environment.

Albania achieved a robust fiscal consolidation in 2023, with the budget deficit narrowing to 1.4% of GDP, which is better than expected, on the back of strong revenue growth and lower than planned public investment. The primary balance turned positive, and the ERP aims to continue realising primary surpluses in the medium term, in line with the fiscal rule. The ERP projects the headline deficit to widen to 2.5% of GDP in 2024 on the back of higher spending on public wages, social insurance and interest costs. In 2025-2026, a lower expenditure-to-GDP ratio is projected to decrease the budget deficit to just above 2% of GDP. The government debt ratio fell by more than expected in 2023, to below 60% of GDP, reflecting a positive primary balance and a favourable snowball effect. Going forward it is projected to continue its downward path, but at a more moderate pace.

In the macro-fiscal area, challenges relate to increasing the revenue-to-GDP ratio, which is low in a regional comparison, and to mitigating fiscal risks, including from arrears and state-owned enterprises (SOEs), particularly in the energy sector. Fiscal consolidation is important in the context of elevated financing needs and should be better underpinned by increasing the tax revenue ratio, including by implementing an updated Medium-Term Revenue Strategy. A higher tax revenue ratio is crucial for supporting much needed investments in both physical and human capital, and for firmly anchoring the downward trend of the public debt ratio. There is also scope for increasing the effectiveness of budget spending by continuing to reform public investment management and execution, including public-private partnerships (PPPs). Contingent liabilities stemming from SOEs, PPPs and ongoing court cases pose risks to public finances and need to be addressed. Increased SOE transparency and higher managerial accountability would increase SOEs' financial performance and, in turn, reduce their reliance on budget support. While the Ministry of Finance stepped up fiscal risk monitoring, further progress in this area remains important. Weaknesses persist in internal control and auditing.

Inflation has peaked at 8.3% in 2022, lower than in Western Balkan peers owing to regulated electricity prices and currency appreciation, falling to 2.3% in March 2024. While domestic price pressures remain elevated due to a tight labour market and strong wage growth, the Bank of Albania (BoA) has slowed the pace of monetary policy tightening, raising the policy rate in two steps by a cumulative 50 bps to 3.25% in 2023. Monetary conditions remain accommodative and credit growth in lek has accelerated, driven by strong growth in mortgage and real estate loans. Strong exchange rate appreciation pressures, explained largely by capital inflows from tourism, remittances and FDI, have prompted the BoA to intervene in the foreign exchange market and it increased pre-announced forex purchases, further strengthening external buffers. The banking sector has remained stable and well capitalised, while profitability has reached record highs, driven by net interest income. Liquidity is ample, but highly concentrated in government securities. The non-performing loan (NPL) ratio has remained stable at historically low levels due to sustained credit growth, but is relatively elevated compared to most other Western Balkan countries while credit risks remain. Some progress has been made in improving the availability of data on real estate, in particular through the adoption of regulations on the reporting of bank lending and investment in real estate. Currency substitution remains high, impeding the transmission of monetary policy and remaining a latent risk to financial stability. It will also be essential going on promoting saving and borrowing in domestic currency, also limiting unhedged lending and the use of foreign currency in the real economy.

Other key challenges are linked to addressing the informal economy, labour shortages and skills, and improving connectivity and energy security. Informality remains widespread, undermining the business climate, fair competition and the tax base. Tackling it requires a multifaceted approach that should also help stem the tide of emigration. Steady emigration flows over the past years are shrinking the workforce. While the labour market registered positive developments with increases in employment and wages, a continued brain drain and labour shortages pose issues. Albania has a very high rate of low-skilled adults and high rates of early school leaving. Furthermore, Albania needs to address the infrastructure gaps and improve connectivity. The energy sector is volatile, with hydro-electricity production dependent on rainfall, and financially reliant on budget support. These challenges as well as the relevant Joint Policy Guidance agreed in 2023 are expected to be addressed through key structural reforms identified in the country's Reform Agenda under the new Growth Plan for the Western Balkans.

Albania made progress in national and regional accounts, excessive deficit procedure notifications, government finance statistics, short-term business statistics, and international trade in goods statistics. Albania does not provide labour market statistics, harmonised indices of consumer prices at constant tax rates and administered prices and monthly balance of payments. Data gaps still remain in the areas of national and regional accounts, excessive deficit procedure and government finance statistics, R&D, supply, use and input-output tables, short-term business statistics, international trade in goods statistics and international investment positions. Albania still needs to align with the new requirements in short-term business statistics.

In light of this assessment, Participants hereby invite Albania to:

1. Ensure compliance with the fiscal rules laid down in the Organic Budget Law requiring a non-negative primary balance and a downward path of the public debt-to-GDP ratio, and accelerate the pace of fiscal consolidation in case of better-than-expected economic and revenue performance. Reduce the emergence of new arrears and the overall outstanding stock, ensuring that arrears do not exceed 2% of total expenditure by end-2024. Increase tax revenue as a share of GDP in a growth-friendly way, including by improving tax administration, increasing registrations for VAT, and reducing undeclared work and tax fraud; revise the Medium-Term Revenue Strategy and ensure its implementation.

2. Improve fiscal risk analysis by building capacity in the related new department, establishing a risk management methodology and publishing a comprehensive Fiscal Risk Statement that covers state guarantees, on-lending to public entities and risks stemming from SOEs and PPPs and identifies risk mitigation measures. Increase SOE transparency and accountability by publishing their annual financial performance reports. Facilitate the implementation of the National Single Project Pipeline (NSPP), including by ranking the projects on the list; and advance the integration of PPPs into the NSPP.
3. Ensure a sufficiently tight monetary policy stance as long as necessary to anchor inflation expectations at levels consistent with price stability, underpinned by a thorough assessment of price developments and possible second-round effects and by publishing additional indicators of underlying price pressures. Enhance risk-based supervision in line with best international and European practices, including by further strengthening the reporting framework across the banking system, applying macroprudential measures to mitigate risks and improve data collection to enable a comprehensive assessment of financial sector risks. Continue to promote saving and borrowing in domestic currency, limit unhedged lending and the use of foreign currency in the real economy, with all signatories of the Memorandum of Cooperation taking appropriate action.

Bosnia and Herzegovina

Bosnia and Herzegovina submitted its Economic Reform Programme 2024-2026 on 28 February 2024, i.e. for the third time in a row with a very significant delay. The country's continued non-compliance with agreed submission dates and procedures raises doubts about the commitment of key stakeholders and the country's administrative capacities. The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of 16 May 2023 has been partial.

Weaker external demand and still high inflationary pressures resulted in a slowdown in economic growth to 1.6% in 2023. The ERP projects GDP growth to accelerate to around 3% in 2024 and 2025 and to 3.4% in 2026, benefiting from rebounding exports and increasing private and public investment. In line with expected international price developments, headline inflation is projected to fall to around 1.9% by 2026. Higher foreign demand, especially for tourism exports, and subdued import growth are projected to reduce the current account deficit to 2.8% of GDP by 2026. Risks are on the downside mainly due to the programme's optimistic projections for export growth that may prove elusive given current geoeconomic and geopolitical developments.

The 2023 budget benefited from stronger than anticipated revenue growth, which allowed for a significant increase in current spending, while still meeting the initial fiscal target. The ERP's fiscal framework projects an expenditure-driven fiscal consolidation, leading to a small budget surplus in 2026. On the revenue side, a shift in the growth drivers from private consumption to exports and investment is projected to lower the revenue ratio by 1 percentage point (pp) in 2024-2026. On the expenditure side, mostly unspecified measures and lower investment expenditure are expected to reduce the spending ratio by 1.6 pps. The debt ratio is expected to decline from 26.7% of GDP in 2023 to 23% in 2026 while interest costs are expected to remain at 1% of GDP, benefiting from the low debt level and the high share of concessional lending. Overall, fiscal projections appear optimistic given the lack of detail on spending cuts and the recently adopted permanent measures to increase public wages and social transfers.

The presented fiscal framework is not based on adopted budgets nor on a politically approved medium-term strategy. The country's ability to formulate consistent, country-wide short- and medium-term economic and fiscal objectives and strategies is strongly impeded by a high degree of institutional fragmentation, insufficient cooperation among key stakeholders, in particular the regional entities, and excessively politicised decision-making processes. The reliability of the presented fiscal framework is further diminished by a weak alignment with EU accounting standards. The planned drop in public investment is in contrast to the policy recommendations jointly adopted since 2015. Public investment would rather need a substantial and sustained boost to move the economy onto a higher growth trajectory. Revenue collection is negatively affected by a significant informal economy and insufficient transparency of taxable income.

Having reached a peak at 17.4% in 2022, headline inflation has decelerated to a level of 2.1 % by February 2024. There is no core inflation series published and the late publication of weights in the consumer basket complicates a timely assessment of underlying price trends. Monetary policy has continued to be anchored around the currency board arrangement, which enjoys a high level of credibility with the general public and is a key ingredient of monetary stability, while implying limited scope to address inflationary pressures. After two and a half years, a new governing board of the central bank was formed in January 2024. The entity banking supervisory authorities continued to co-operate smoothly following harmonised approaches, while there is no single resolution fund and the framework for emergency liquidity assistance remains incomplete. Overall, the banking sector appears sound and resilient, with robust capital buffers, high liquidity and profitability. Asset quality indicators remained favourable so far. Downside risks to asset quality result from slowing economic activity. Temporary measures have contained the increase of domestic lending rates potentially affecting market mechanisms in setting interest rates, while data gaps hinder a more comprehensive assessment of financial stability. Removing remaining obstacles to an effective and swift non-performing loan (NPL) resolution, such as further enhancing the possibility to negotiate out-of-court restructurings or securitise and sell NPLs would be beneficial.

Structural challenges lie in the areas of rule of law, the business environment and inefficient public enterprises, the green and digital transition and human capital. A difficult business environment and weaknesses in the country's single economic space are key factors driving poor labour market outcomes, holding back improvements in competitiveness and living standards. There is a need to tackle the high regulatory burden, corruption and informality. Digital transformation is lagging behind in both business and the public administration. Environmental standards are low, with a long-lasting impact on the health and quality of life of Bosnia and Herzegovina's population. These challenges as well as the relevant Joint Policy Guidance agreed in 2023 are expected to be addressed through key structural reforms identified in the country's Reform Agenda under the new Growth Plan for the Western Balkans.

Bosnia and Herzegovina made progress on national accounts, international trade in services statistics, balance of payments and international investment positions, quarterly government finance statistics (GFS) and international trade in goods statistics by invoicing currency. Bosnia and Herzegovina has still not provided harmonised indices of consumer prices, supply, use and input-output tables, foreign direct investment data, labour market statistics and monthly balance of payments. Further data gaps exist in the field of national accounts, excessive deficit procedure and government finance statistics, short-term business statistics and international trade in goods statistics. Bosnia and Herzegovina needs to make further alignment with the new requirements in short-term business statistics, as well as progress in the field of monetary and financial statistics. Efforts should be pursued to improve the coverage and timeliness of all relevant statistics, special emphasis should be given to national accounts, excessive deficit procedure and government finance statistics.

In light of this assessment, Participants hereby invite Bosnia and Herzegovina to:

1. Adopt the Global Fiscal Framework in time so that it provides effective guidance for the budget preparations of all budgetary entities (i.e., the BiH Institutions, the Federation entity, the RS entity and the Brcko district) and ensure the timely adoption of the budgets of all entities. Increase the share of government capital spending in GDP by adopting measures improving public investment management and allowing for an accelerated implementation of those investment projects that have been subject to a clear positive cost-benefit assessment. In order to strengthen the efficiency of tax collection, improve the effective exchange of taxpayer information between the country's tax authorities, and in particular, clarify the constitutional competence for establishing a central (i.e. country-wide) registry of bank accounts of private individuals, in line with the EU acquis.
2. Include in the forthcoming ERP 2025-2027 (i) a first assessment of fiscal risks and contingent liabilities related to publicly owned enterprises, and (ii) concrete policy measures to manage such risks and contain the emergence of new contingent liabilities. With a view to improving the quality of data aggregation and reporting, strengthen the analytical capacities of all institutions responsible for fiscal accounting and planning, and improve the procedures for preparing the ERP in order to ensure a timely submission and compliance with the requirements. Continue to strengthen the country's capacities in the areas of macroeconomic statistics, regional accounts, labour force survey and government finance statistics, in particular by agreeing on the national account sectorisation, and increase efforts to improve the coverage and timeliness of all statistics.
3. Continue to thoroughly assess price developments, supported by the statistical offices through improving price statistics, including a timely publication of CPI weights and developing and publishing core inflation series. Continue to safeguard the integrity of the currency board arrangement and the independence of the central bank. Enhance risk-based supervision in line with best international and European practices, phase out the temporary measures potentially affecting market mechanisms in setting interest rates, initiate the setting up of a single resolution fund and improving data collection to enable a comprehensive assessment of financial sector risks.

Georgia

Georgia submitted its Economic Reform Programme 2024-2026 on 15 January 2024. This is the first programme prepared by Georgia since it became an EU candidate country in December 2023. The ERP was endorsed by the Government of Georgia and includes both a presentation of the macro-fiscal framework and of structural reforms; the latter part was this time optional for Georgia.

Georgia's GDP growth continued to be robust in 2023 at 7.5% and was driven primarily by the information technology sector, construction, trade and transport. On the demand side, the expansion was partly on account of temporary factors related to the continued post-pandemic recovery, fast-growing tourism and large inflows of skilled migrants and funds following Russia's full-scale invasion against Ukraine. The latter developments triggered a creation of new businesses, notably in the IT sector, stimulated domestic consumption and wage growth, but also led to a currency appreciation and a spike in the rental market. The inflows of funds have not to date fuelled significant macroeconomic imbalances, however, also thanks to the prudent policy response of the authorities. Looking ahead, economic growth is set to be supported by the expected further easing of monetary policy, low inflation, increasing wages and a continuous inflow of remittances. The ERP expects a still solid growth of around 5% over 2024-2026, with investment and consumption being the main growth drivers. Labour market outcomes are set to continue improving gradually, albeit from a weak initial position. The current account deficit was lower than in previous years at 4.3% of GDP in 2023 and is expected to remain below 5% of GDP over the programme period, but the external balance remains vulnerable. The outlook is subject to a high degree of uncertainty, linked especially to the geopolitical risks affecting the large tourism sector, the significant role of money transfers from abroad and the weak export base amidst dampening global growth.

Similar to 2022, the general government deficit in 2023 (2.2% of GDP) turned out significantly lower than the 3%-of-GDP budget plan, thanks to a stronger-than-projected tax revenue growth and one-off factors. Public debt remained slightly below 40% of GDP at the end of 2023. The ERP projects a gradual decrease in the general government deficit and public debt-to-GDP ratios by 2026 with both remaining well below the respective targets set by the national fiscal rules, allowing for a gradual build-up of buffers in view of the heightened global uncertainty. As the output gap diminishes, the fiscal policy stance is planned to move from a broadly neutral setting in 2024 to a countercyclical stance in 2025. The ERP envisages a decrease in public investments, as key infrastructure projects are reaching completion. Investment is nonetheless expected to remain well above the EU average, similar to regional peers. In a medium-term perspective, Georgia faces the challenge of ensuring sufficient financing for priority outlays to underpin productivity growth and reduce the significant regional disparities. In view of the constitutional constraints on increasing the main taxes, it is relevant to continue to pursue a strategy of broadening the tax base. Despite the already well-developed fiscal governance framework, there is room to make further improvements in the management of public investments and to continue addressing the challenges related to the high share of public debt denominated in foreign currency and a relatively small market for the local currency debt. It would be also appropriate to address the areas for improvement in the functioning of the independent fiscal institution, identified in the self-assessment report. As regards state-owned enterprises, the implementation of the reform strategy has seen delays and needs to be accelerated in order to improve their governance. The authorities are making progress on improving the fiscal oversight over the state-owned enterprises included in the general government sector.

Inflation decelerated sharply last year from its peak of close to 14% in early 2022 and hovered well below target, at around 0.5% in March 2024, driven by lower global commodity prices, a tight monetary policy stance as well as a strong appreciation of the exchange rate. After an early tightening of monetary policy, the decline in inflation has allowed the National Bank of Georgia (NBG) to start cutting interest rates as of May 2023 by a cumulative 275 bps to 8.25% as of mid-March 2024. The parliament passed amendments to the organic law on the national bank in 2023, which changed the institutional balance foreseen for the appointment of the governor that raised concerns about central bank independence. After some initial slowdown, credit activity accelerated in the second half of 2023. Against the backdrop of robust economic performance, the banking sector remained overall sound, liquid and well capitalised. Profitability remained high on the back of solid interest income and low credit losses, helping banks to restore capital buffers released during the pandemic. The ratio of non-performing loans (NPL) continued to decline, also supported by the denominator effect of strong credit growth and efficient NPL resolution. The de-dollarisation strategy launched in 2017 supported a continuous decline in currency substitution, yet it remains high posing potential financial stability risks. The NBG has implemented several measures to promote the use of the domestic currency, including limits to unhedged foreign currency lending. There has been progress concerning the approximation to the EU acquis in payment services and in aligning the national Bank Recovery and Resolution framework to the EU's Bank Recovery and Resolution Directive, including the introduction of Minimum Requirement for own funds and Eligible Liabilities (MREL) requirements for systemically important banks and bail-in clause requirements. The capital market is very small, and the authorities plan to develop it based on the 2023-2028 capital market development strategy. The envisaged reform has two main goals: expanding the quantity and types of securities on the market and deepening of the investor base.

The government's determination and ability to tackle the identified structural challenges will determine the potential for maintaining economic resilience as well as boosting inclusive growth, competitiveness, and job creation ahead. Tackling corruption, reducing political polarisation and advancing deoligarchisation, undertaking judicial reforms and strengthening the rule of law as well as capacity and independence of public institutions is essential in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for a successful transformation of the Georgian economy. These points are also part of the 9 steps set out in the Commission Communication on EU Enlargement of 8 November 2023 as well as in chapters 23 and 24 of the annual country report on enlargement. The European Council decided to grant the status of candidate country to Georgia on 15 December 2023, on the understanding that these steps are taken.

As regards specific structural reforms, the main challenges in terms of boosting competitiveness and long-term and inclusive growth are: (i) addressing key factors behind low competitiveness linked to a dominance of low value-added sectors in the economy and exports, low productivity in agriculture, informality and economic governance, (ii) enhancing connectivity in particular by strengthened energy system, further development of transport infrastructure and digital reforms and (iii) addressing weaknesses in the Georgian labour market by improving the quality and relevance of education and professional skills development, and enhancing the social protection system and health care services. Georgia should also implement other structural reforms necessary to ensure sound socio-economic development, including those agreed with the international financial institutions.

Eurostat and the European Central Bank (ECB) have been undertaking substantial efforts to establish collaboration at working level with Georgia in the fields of economic, monetary and financial statistics. Contacts between Eurostat and Georgia are in early stages. They aim at setting up workplans to initiate data transmissions of economic statistics. Data transmissions have so far been recorded in the field of monthly detailed data on international trade in goods statistics. However, the transmitted data were only partially compliant with the requirements in terms of format and data requested from enlargement countries. Georgia has been invited to send delegates to Eurostat Expert Group meetings since the beginning of 2023. Cooperation in the field of monetary and financial statistics with Georgia is also still at its infancy, with first contacts being made.

In light of this assessment, Participants hereby invite Georgia to:

1. Ensure that the 2024 budget deficit is within the target set in the budget law, and implement the medium-term plan to reduce the deficit with a view to building fiscal buffers. In order to improve efficiency of the tax policy, publish the tax expenditure analysis of the agricultural sector and prepare concrete budgetary recommendations to implement its findings, and continue work on analysing the economic and fiscal impact of all tax expenditures. Adopt and publish the medium-term revenue strategy and make progress on its implementation.
2. With a view to improving the quality of the assessment of public investment projects, further enhance staff skills in preparing these assessments and introduce an electronic system for the management of public investments. In line with the public debt management strategy, continue efforts to develop the government security market, in particular by expanding the range of instruments denominated in local currency as an important step towards further development of capital markets. In order to improve the monitoring framework and cash management, continue the process of improving fiscal oversight over state-owned enterprises (classified as general government units) by bringing the accounts of the largest enterprises under the Single Treasury Account.
3. Ensure a sufficiently tight monetary policy stance as long as necessary to anchor inflation expectations at levels consistent with price stability, underpinned by a thorough assessment of potential second-round effects. Ensure the independence of the central bank, including by adhering to proper appointment procedures and sound central bank governance. Continue to enhance risk-based supervision in line with best international and European practices, as well as to promote the use of the domestic currency and to limit unhedged lending.
4. With a view to strengthening competitiveness and exports in the agricultural sector, finalise the architecture of the land information system and make progress on extending its coverage. Advance with the irrigation sector reform including the revision of water tariffs. With a view to addressing the informal economy in a holistic, government-wide manner, encompassing tax, labour, social and financial policies, undertake steps towards preparing a policy plan, by establishing a dedicated inter-ministerial Working Group and elaborating sectoral and risk assessment.

5. Adopt a legal framework for supporting Energy efficiency and Renewable Energy roll out, improve the security of energy supply by finalizing and adopting legislation on establishing strategic oil reserves, continue to liberalise the energy market by finalizing and adopting legislation on unbundling of transmission system operators in electricity and ensuring electricity market opening by launching intra-day and day-ahead markets and preparing for the balancing market. To support the country's climate commitments, adopt the Integrated National Energy Climate Action Plan and develop draft legislation to introduce the Monitoring, Reporting and Verification system thus approximating national legislation to the EU legal acts. To support the country's transit potential, continue reforms and ensure implementation of investments in transport infrastructure (ports, railways, road transport), build capacities within relevant transport agencies including through active cooperation with donors. To strengthen digitalisation and productivity of the economy, adopt an overarching digital strategy and enhance coordination among digitalisation governance agencies and relevant ministries.

6. To improve labour market outcomes and social inclusion, adopt and ensure an effective implementation of the Labour and Employment Policy strategy, paying special attention to internally displaced persons and under-represented groups, such as women, people with disabilities, and NEETs, including in remote areas. To strengthen Georgia's human capital and reduce skills mismatches in the labour market, conduct and finalise - with the support of the European Training Foundation - a diagnostic of the education system, including vocational education and training. To reduce regional disparities and social inequalities including through strengthened equity, access and efficiency of health care and the social safety net, extend universal health coverage further.

Kosovo [*]

Kosovo submitted its Economic Reform Programme 2024-2026 on 15 January 2024. The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of 16 May 2023 has been partial.

Kosovo's economic growth slowed down to a still buoyant 3.3% in 2023, mainly due to the negative contribution of the external sector to GDP growth. An acceleration in household consumption growth and the recovery of investment were the key growth drivers. The ERP's baseline scenario optimistically projects GDP growth to accelerate to 4.6% a year on average in 2024-2026. An expected strong increase in investment is seen as a key growth driver, but to realise this ambition, obstacles to public and private investment need to be effectively addressed. There are additional sizeable downside risks to this outlook notably linked to higher-than-expected global energy and food prices, less dynamic growth in the main trading partners, tighter financing conditions and lower-than-expected financial inflows from the diaspora.

Fiscal consolidation continued in 2023 with the headline deficit falling to 0.2% of GDP due to strong revenue performance and despite a surge in public investment spending. The programme projects the headline deficit to widen to 2.7% of GDP in 2024 in light of the planned strong fiscal stimulus, mainly through an investment-driven increase in public spending, which would nonetheless keep the deficit according to the fiscal rule definition (which excludes certain investment categories) at the prescribed ceiling of 2% of GDP. Compliance with the deficit rule is also envisaged for 2025-2026. The public debt ratio is set to increase but remain low at slightly above 20% in 2026. However, financing sources are limited as the domestic public debt investor base remains narrow, and Kosovo does not have access to international debt markets.

Structural fiscal reforms on the budget revenue and expenditure sides are necessary to underpin the envisaged compliance with the 2% deficit ceiling in 2024-2026. Tax collection has recently been increasing by double digits mainly due to improved tax compliance and progress in tackling the informal economy. Kosovo's public finance would benefit from further tax base broadening and a clear identification of tax expenditure. Budget revenue relies on a narrow tax base, which is weakened by tax exemptions, preferential tax rates and special regimes. Budgetary transparency and accountability could be strengthened by further reducing blanket allocations. The significant planned increase in public investment requires comprehensive reforms to improve project planning and implementation. Fiscal risks related to publicly owned enterprises (POEs) could be mitigated by improving their governance and financial oversight and accountability.

[*] This designation is without prejudice to positions on status, and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence.

Since its peak in July 2022 at 14.2%, inflation slowed to 2.3% by March 2024 on the back of the fading energy and food price shock and tighter euro area financing conditions. Core inflation remained stickier, suggesting some second-round effects in prices and wages. Overall, the banking sector remained sound according to headline figures, despite some heterogeneity across the sector. Banks' profitability has slightly declined with robust liquidity and capital buffers at the system level. Lending to the private sector continued to grow strongly in 2023, while decelerating relative to 2022. Interest rates on new loans increased only moderately. The non-performing loan (NPL) ratio remained stable at a historically low level and loan provisioning is adequate. Structural problems to NPL resolution related to the rule of law and the efficiency of the court system persist. Against this background, amending legislation to establish a secondary market for NPLs and address remaining impediments to NPL resolution remains as a medium to long term objective of the CBK. In the wake of a functional reorganisation, the central bank has continued to make improvements in key policy areas. In this regard, ensuring conditions that help to attract and retain skilled staff is key. Data gaps impede a comprehensive analysis and supervision of the financial sector, despite some initial steps taken to improve data availability regarding the real estate sector.

Kosovo faces some key structural obstacles to competitiveness and inclusive growth. The high administrative burden for businesses and citizens, weaknesses in commercial dispute resolution and the lack of easily accessible and affordable credit, especially for SMEs, continue to have a negative impact on the private sector. Despite some progress, the informal economy is still sizeable, hindering the business environment and constraining budget revenues. Given the economic dependency on remittances, it's necessary to transform Kosovo's economy towards more productive and higher value-added activities. Despite some progress on promoting renewable energy sources, the supply of energy is unreliable and insufficient to meet rapidly growing demand, giving rise to significant costs for businesses while also putting pressure on public finance. The education system is not adequately aligned with the needs of the labour market. The latter is characterised by low participation and high unemployment rates, with a noticeable trend of improvement in particular for women and young people. These challenges as well as the relevant Joint Policy Guidance agreed in 2023 are expected to be addressed through key structural reforms identified in Kosovo's Reform Agenda under the new Growth Plan for the Western Balkans.

Kosovo made progress concerning the transmission of national accounts, excessive deficit procedure, government finance and international trade in services statistics. However, Kosovo does not transmit data for regional accounts, short-term business statistics, labour market statistics, R&D, harmonised indices of consumer prices at constant tax rates, administered prices and monthly balance of payments. Efforts should continue also in national accounts, excessive deficit procedure notification tables, government finance statistics and international trade in goods statistics. Data gaps also remain in supply, use and input-output tables and foreign direct investment.

In light of this assessment, Participants hereby invite Kosovo to:

1. Implement the foreseen shift in the 2024 budget spending structure from current to capital expenditure while ensuring compliance with the fiscal rules. Increase budgetary transparency by further reducing blanket allocations. Enhance the revenue side by reducing loopholes and exemptions through amendments to tax legislation, including personal income tax (PIT), corporate income tax (CIT) and value added tax (VAT).

2. Undertake and publish a review of tax expenditure quantifying the size of the revenue forgone from all exemptions, preferential rates and special regimes. Improve the execution rate of capital spending including by establishing the linkages between the e-procurement and Kosovo Financial Management Information System (KFMIS) systems, following the recommendations made under the IMF's updated Public Investment Management Assessment. Improve financial oversight and accountability of Publicly Owned Enterprises (POEs) by approving and publishing their annual performance report; adopt amendments to the POEs' Law to improve their corporate governance.
3. Continue to thoroughly assess price developments and possible second-round effects and stand ready to use the limited tools available under the chosen monetary framework to ensure price stability. Continue efforts to ensure that core areas of the central bank are adequately staffed, particularly by finding ways to attract and retain skilled staff. Enhance risk-based supervision in line with best international and European practices, including by further strengthening the monitoring toolkit and the reporting framework across the banking system and improving data collection to enable a comprehensive assessment of financial sector risks.

Moldova

Moldova submitted its first Economic Reform Programme 2024-2026 on 15 January 2024. Moldova's first ERP submission includes the macro-fiscal framework, while information on structural challenges and reform plans were optional and not included this year. This is Moldova's first ERP after it was granted candidate status in June 2022. The ERP was endorsed by the Inter-ministerial Committee for Strategic Planning on 15 January 2024.

Moldova has been significantly affected by the Russian war of aggression against neighbouring Ukraine and the ensuing energy and food price shocks. These events severely diminished households' purchasing power, eroded investor confidence and undermined export growth. Following five consecutive quarters of contraction, growth returned in the third quarter of 2023, on the back of a strong rebound of the agricultural sector, following the severe drought in the previous year, and notable gains in the IT industry. The ERP projects real GDP growth of 3.5% in 2024 on the back of continued strong agricultural exports and growing private consumption as real wages continue to recover and remittances remain stable, with the recovery accelerating in 2025 and 2026. The outlook suggests continued improvements in labour market outcomes, characterised by a persistently low employment rate and high levels of informal employment. The outlook is subject to significant downside risks related to developments in neighbouring Ukraine and Moldova's continued vulnerability to energy price shocks.

Public finances significantly deteriorated in 2023, reflecting weak growth and the high cost of household support measures. Nevertheless, the budgetary outcome (a deficit of 5% of GDP) was better than the planned 5.9% of GDP, on account of expenditure under-execution, revenue overperformance due to high inflation and an overestimated impact of a sizeable tax relief measure, which did not materialise (yet) and constitutes a risk for 2024. After a slight reduction in 2024, the ERP sees the deficit fall significantly further to 3.8% in 2025 and 3.4% in 2026. Fiscal policy in 2024 and 2025 aims to increase much-needed public investment to support the nascent economic recovery and at the same time ensure fiscal sustainability via a fiscal adjustment that improves the efficiency and targeting of public expenditure. Crucial growth-enhancing public capital expenditure continued to be under-executed in 2023, though by less than in previous years, and a promising public investment management reform underpins the ERP's projections of increased investment in 2025 and 2026. After peaking at 37.2% of GDP in 2023, the public debt ratio is expected to fall throughout the programme's horizon. A large share of debt (60%) is denominated in foreign currency, which exposes public finances to exchange rate risks. However, a large part of the debt has been extended by multilateral creditors at highly favourable terms.

In view of the limited fiscal space and competing spending priorities, the authorities plan to continue to pursue progress on the Public Finance Management Strategy 2023-2030, in particular through measures to improve tax compliance and to broaden the tax base. This is particularly relevant in light of the envisaged changes to the tax regime for cars and a new tax expenditure to support investment, which may undermine revenue growth towards the end of the forecast horizon. Spending reviews have seen uneven progress in recent years, though the authorities are currently finalising a review of healthcare spending. Similarly, assessing the efficiency of programmes which support businesses' access to finance would ensure that they are more effective in addressing the persistently low credit-to-GDP ratio. Last but not least, Moldova grapples with a large and loss-making sector of state-owned enterprises. The authorities have embarked on an ambitious reform of the sector in 2023. Progressing with further implementation steps in 2024 would help mitigate fiscal risks and creating a level playing field for all businesses.

Inflation decelerated faster than anticipated from its peak in 2022 at close to 35%, reaching 3.9% in March 2024 driven by lower energy and food prices and tight monetary conditions. The National Bank of Moldova (NBM) in December 2022 started cutting the policy rate from 21.5% to 3.75% in March 2024. After strong depreciation pressures following Russia's invasion of Ukraine, the leu strengthened in 2023 on the back of strong foreign currency inflows, including due to significant international assistance, interest rate differentials and improved market confidence. Currency substitution in deposits is elevated but has declined since a peak in 2022. Following the 2014 banking fraud, the banking system has been strengthened, but tight credit standards and a buffer held by one bank due to a related ongoing litigation continue to limit credit extension. The overall indicators on capital adequacy, liquidity and profitability remained sound despite headwinds from large external shocks. The non-performing loan (NPL) ratio has declined markedly since 2018 to below 6% but remains elevated. As the NBM took over the supervision of the non-bank financial sector in July 2023, it is crucial not only to adequately monitor the risks of the transferred entities but also to harmonise the regulatory and supervisory landscape with the banking sector, enhancing systemic risk supervision. Central bank independence should be ensured. This encompasses safeguarding the independence of decision-makers in light of the recent dismissal of the NBM governor, which raised concerns about due process, and enhancing the NBM's autonomy through the planned amendments to grant operational control over its assets, to define more explicitly its mandate for financial stability and macroprudential policy, to amend certain administrative procedures and to stagger non-executive board member mandates.

Moldova is facing a number of structural challenges as it seeks to promote inclusive growth, competitiveness and convergence with EU income levels. Firstly, persistently low levels of public investment remain a major obstacle that prevents the country from meeting its large investment and infrastructure needs. In addition, labour force participation remains very low, and the shortage of skilled labour and skills mismatches, along with a large informal sector, represent a major bottleneck for businesses and foreign investors. Despite impressive efforts to mitigate the implications of the recent energy crisis, the developments in the energy sector continue to pose significant risks to public finances. Finally, following a short but strong recovery after the pandemic, Russia's war of aggression against Ukraine has had a strong negative impact on investment sentiment in Moldova, compounding pre-existing challenges linked to corruption, the rule of law, the lack of skilled work force, low levels of economic diversification and low-quality public services.

Eurostat and the European Central Bank (ECB) have been undertaking substantial efforts to establish collaboration at working level with Moldova in the fields of economic, monetary and financial statistics. Contacts between Eurostat and Moldova are in early stages. They aim at setting up workplans to initiate data transmissions of economic statistics. Data transmissions have so far been recorded in the field of monthly detailed data on international trade in goods statistics. However, the transmitted data were only partially compliant with the requirements in terms of format and data requested from enlargement countries. Moldova has been invited to send delegates to Eurostat Expert Group meetings since the beginning of 2023. Cooperation in the field of monetary and financial statistics with Moldova is also still at its infancy, with first contacts being made.

In light of this assessment, Participants hereby invite the Republic of Moldova to:

1. Gradually reduce the fiscal deficit as the economic recovery takes hold, while building fiscal buffers to mitigate risks to the public finances; to that end, prepare an analysis on the fiscal impact of a possible interruption of natural gas supply used for electricity generation. Increase public investment as planned in the ERP, while applying the new single project pipeline framework covering all investment projects regardless of financing source. Improve the capacity to produce macroeconomic and fiscal forecasts, in particular of the cyclically adjusted fiscal balance.

2. Continue to broaden the tax base and improve tax compliance in line with the Public Finance Management Strategy 2023-2030. Finalise and publish the ongoing spending review of the health sector and undertake further reviews in the most significant areas of expenditure such as social protection. Review the main programmes supporting businesses' access to bank finance such as the '373 interest subsidy programme', the Fund for Entrepreneurship and Economic Growth Investments and the 'Credit Guarantee Facility' with a view to improving their effectiveness in addressing the bottlenecks to provision of credit, and assessing their potential to support the implementation of Environmental, Social and Governance (ESG) principles. Take steps to implement the results of the state-owned enterprise 'triage' exercise and ensure the implementation of recent governance reforms related to the professionalisation of boards and the establishment of audit committees at state-owned enterprises.
3. Ensure a sufficiently tight monetary policy stance as long as necessary to anchor inflation expectations at levels consistent with price stability, underpinned by a thorough assessment of potential second-round effects and developing an inflation expectations survey. Ensure the independence of the central bank, including the personal independence of decision-makers. Enhance risk-based supervision in line with best international and European practices, including by further strengthening the reporting framework across the banking system, harmonising the regulatory and supervisory landscape between the banking and the non-bank financial sector, and improving data collection to enable a comprehensive assessment of financial sector risks.

Montenegro

Montenegro submitted its Economic Reform Programme 2024-2026 on 12 January 2024. The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of 16 May 2023 has been partial.

Montenegro continued to record high economic growth in 2023, which is set to slow down in 2024-2026. A successful tourism season and strong private consumption, supported by a large inflow of foreign nationals, were the key drivers of economic growth in 2023, which reached 6%. The main headwind came from high albeit moderating inflation, while tighter financing conditions weighed on investment. The baseline ERP scenario projects real GDP growth to slow to an annual average of 3.2% in 2024-2026, driven by domestic demand. Net exports are projected to provide only a marginal contribution to GDP growth as tourism services, which exceeded their 2019 level already in 2023, are expected to decelerate from double-digit growth. The balance of risks is tilted to the downside as inflation might fall less than projected, eroding disposable income, while higher financing costs could negatively affect investment. Imports may increase by more than expected if investment plans, in particular the construction of the Bar-Bojare highway, are realised.

The 2023 budget performed much better than expected and recorded a surplus, estimated at 0.5% of GDP, driven by strong growth in indirect taxes, one-off revenues and lower-than-budgeted spending. The ERP's fiscal scenario projects a sizeable deterioration of the budget balance in 2024 and a gradual deficit reduction in the following two years. The 2024 deficit is largely driven by strong increases in social transfers and capital spending. Budgetary adjustment in 2025-2026 is expected to rely on a sharp deceleration in public spending, which is projected to lead to a 2.3 pps drop in the spending ratio and a small primary surplus in 2026. However, the envisaged spending restraint should be better underpinned by concrete measures. The public debt ratio, which has fallen very substantially in recent years, is set to continue declining but only slowly, to 61% of GDP in 2026. Debt refinancing needs remain large, peaking at 11% of GDP in 2025.

High mandatory spending and a weak revenue base, together with upcoming large debt repayment needs raise concerns and call for a comprehensive medium-term fiscal plan with concrete consolidation measures and a commitment to bring the debt ratio below 60% of GDP as prescribed by the fiscal rule. Broadening the tax base and streamlining tax exemptions would contribute to rebuilding fiscal buffers. Further fiscal space could be gained by reviewing and streamlining spending on public sector wages and social transfers. Large infrastructure projects need better management and prioritisation given the limited fiscal space available. While fiscal rules are in place, they are weak and lack a strong enforcement mechanism. Establishing an independent fiscal institution would contribute to strengthening the costing of new initiatives and improving fiscal discipline. Improving the oversight and risk management of state-owned enterprises (SOEs) would over time alleviate their burden to the budget.

Inflation has come down from its 2022 peak at 17.5%, reaching 5.5% by March 2024, but risks remain for further disinflation absent fiscal restraint under the chosen monetary framework. While the recent inflation surge was driven predominantly by imported and food-related inflation which have since normalised, domestic wage pressures also played a role. The banking system has remained sound, also bolstered by the strong economic backdrop. Liquidity continued to benefit from the massive influx of deposits since 2022, including from non-residents, with large excess liquidity reflected in low loan-to-deposit ratios. Bank profitability increased strongly, while capital buffers rose further, and non-performing loan (NPL) ratios declined. Alignment of financial sector laws and regulations to EU frameworks is progressing with work on the implementation of secondary legislation for the Law on Credit Institutions and the Law on Resolution of Credit Institutions. Real estate prices have continued to rise, which warrants vigilance and the potential use of macroprudential tools to curb emerging risks. Further strengthening the forward-looking monitoring of bank's asset quality and monitoring and carefully evaluating the banking sector's growing exposures to foreign securities is also warranted, as well as further progress on the broad legal, judicial and regulatory framework to expedite NPL resolution, which involves inter-agency collaboration beyond the central bank.

Improving the business environment to foster private sector development, strengthening the governance and monitoring of state-owned enterprises, advancing the green and digital transition and developing human capital are among the key structural challenges Montenegro is facing. The country's energy transition plans are in line with the European Green Deal, implying further development of the energy sector through investments in green energy and decarbonization. Digitalisation focuses on developing digital services and improving cyber-security. Addressing structural labour market challenges, including persistently low rates of labour market activity and high unemployment, especially among women, young people and the low-skilled, would contribute to boosting potential growth and improving living standards. These challenges as well as the relevant Joint Policy Guidance agreed in 2023 are expected to be addressed through key structural reforms identified in the country's Reform Agenda under the new Growth Plan for the Western Balkans.

Montenegro made improvements in national accounts, including supply and use tables, international investment position, international trade in services statistics, international trade in goods statistics and short-term business statistics. Montenegro does not provide input-output tables, excessive deficit procedure and government finance statistics, Labour Cost Survey 2020 datasets, harmonised indices of consumer prices at constant tax rates, trade by enterprise characteristics data and monthly balance of payments. Montenegro needs further improvements in supply and use tables, short-term business statistics, national accounts, research and development (R&D), labour market statistics, short-term business statistics and foreign direct investment. Montenegro should also give further attention to monetary and financial statistics.

In light of this assessment, Participants hereby invite Montenegro to:

1. Adopt an appropriately tight fiscal stance in 2024 to comply with the budget target and support further disinflation, and use revenue overperformance for deficit reduction and accumulation of government deposits. Adopt a medium-term fiscal strategy, including concrete consolidation measures supporting the achievement of a non-negative primary balance and the public debt ratio not exceeding 60% of GDP by 2026. Elect and appoint members of the fiscal council, and ensure and make publicly available a proper costing of new fiscal initiatives.

2. Based on an analysis of the economic and fiscal impact of all tax expenditures to be shared with the Commission, prepare concrete budgetary recommendations to reduce tax expenditure (such as exemptions, deductions, credits, deferrals). Improve SOE oversight by producing and publishing the related fiscal risk assessments. Implement the public investment management assessment (PIMA) recommendations, prioritising key public infrastructure works within the available fiscal space while avoiding exceptions regarding project selection.
3. Continue to thoroughly assess price developments and possible second-round effects, and stand ready to use the limited tools available under the chosen monetary framework to ensure price stability. Progress with the implementation of secondary legislation for the Law on Credit Institutions and the Law on Resolution of Credit Institutions and transpose the Bank Recovery and Resolution Directive II. Further enhance risk-based supervision in line with best international and European practices, including by improving data collection to enable a comprehensive assessment of financial sector risks.

North Macedonia

North Macedonia submitted its Economic Reform Programme 2024-2026 on 18 January 2024. The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of 16 May 2023 has been partial.

Coping with the repercussions of the cost-of-living crisis and weak external demand, the post-pandemic economic recovery remained weak in 2023. Annual GDP growth fell to an estimated 1%, mainly reflecting a steep decline in inventories and fixed investment while private consumption benefited from higher remittances, real wages and solid private sector credit growth. The ERP projects real GDP growth to strengthen to an annual average of 4.4% in 2024-2026, mainly as increased public infrastructure spending would support domestic demand. External demand is also set to pick up, but net exports would have a negative contribution to growth, albeit gradually less so over the programme's horizon. There are sizeable downward risks to this scenario, stemming from weaknesses in public investment management and in the regulatory framework for attracting private co-financing, in addition to geopolitical uncertainties, including potential trade disruptions and global commodity price developments.

The fiscal deficit widened to 4.9% of GDP in 2023, mainly as social transfers and public sector wages increased, and notwithstanding revenue-increasing tax measures and the phasing out of some energy support measures. The ERP projects a gradual fiscal consolidation, with the deficit falling by 1.6 pps between 2023 and 2026. The primary deficit would fall to its pre-COVID level (0.9% of GDP) by 2026. Fiscal consolidation is projected to be driven entirely by savings in current expenditure, notably in government consumption as well as subsidies and social transfers. Public debt, which reached 62% of estimated GDP in 2023, is projected to remain above 60% of GDP also in 2024, partly due to the financing needs of major transport infrastructure projects (Road Corridor 8 and 10d), and to decline thereafter.

Fiscal consolidation needs to advance to restore fiscal space and ensure compliance with the fiscal rules as set by the Organic Budget Law and the medium-term fiscal strategy. Envisaged consolidation measures, in particular the reduction of energy subsidies, need to be rigorously adhered to, and sizeable fiscal slippages in an election year should be avoided. On the revenue side, ongoing implementation of the 2020 tax reform package is important and could usefully be complemented by further tax base-broadening measures. There is scope for strengthening fiscal governance. The newly established Fiscal Council should be fully equipped to take up its functions. The new Public Investment Management (PIM) department in the Ministry of Finance still needs to become fully operational, for which the Government should adopt legal acts, methodologies and criteria for the appraisal, selection and monitoring of investment projects applicable to all public sector entities. An increase in fiscal risks, partly stemming from construction projects carried out by state-owned enterprises, require the centralisation and improvement of their monitoring. The fiscal authorities should take measures to avoid further accumulation of arrears by the central and local governments.

Inflation, peaking in October 2022 at 19.8% (year-on-year rate), has receded gradually over 2023, due to the normalisation of food and energy prices and monetary policy tightening, and stood at 4% in March 2024 (year-on-year rate). Core inflation, which reached 11.1% at end-2022 also partly due to the pass-through from high food and energy prices, has been also slowing during 2023, but more gradually, and recorded 5.1% in March 2024, amidst high nominal wage growth. Denarisation also restarted in 2023, although currency substitution remains above the pre-crisis level. To curb inflation and inflation expectations, and to underpin denarisation, the National Bank of the Republic of North Macedonia (NBRNM) has withdrawn liquidity, increased reserve requirements, and raised policy rates, maintaining a substantive interest rate differential to the euro area in support of the peg. The banking sector has remained sound, with overall indicators on capital adequacy, liquidity and profitability favourable despite the fallout from the energy crisis in 2022. Non-performing loans (NPLs) remain stable at low levels. Counter-cyclical capital buffer requirements are being gradually raised. The Bank Resolution Law was passed in October 2023 that transposed the EU's Bank Recovery and Resolution Directive, with implementation in 2025. To mitigate vulnerabilities from real estate price increases, the authorities introduced a range of borrower-based macroprudential measures to curb potential risks in mortgage lending and in general lending to households in an environment of rising interest rates. The amendments to the national bank law, excluding the NBRNM from the scope of the administrative servants and public sector employees, were adopted by the Parliament on 28 March 2024. It is, however, necessary that the draft laws on administrative servants and public sector employees are also adopted, in order to safeguard central bank independence, in particular as regards decisions about employment conditions for central bank staff. If adopted, this would resolve a longstanding issue.

Key structural challenges are linked to the skills mismatch in the labour market, the informal economy, a large infrastructure investment gap, and the need to progress with the green transition. The education system does not adequately equip young people with the key competences that they need to actively participate in the regular labour market. Persistent structural problems of the labour market, such as low participation rates, especially for women, and high youth unemployment dampen potential growth. Combating informality and corruption could partially address the issues of emigration among young, educated, and entrepreneurial populations. Managing the green transition and meeting targets for greenhouse gas reductions set under the European Green Deal requires large-scale investments and regulatory and legal adjustments. North Macedonia's economy relies heavily on coal-fired electricity production, and the shift towards renewable energy sources, as well as improvements in energy efficiency, are likely to be costly. These challenges as well as the relevant Joint Policy Guidance agreed in 2023 are expected to be addressed through key structural reforms identified in the country's Reform Agenda under the new Growth Plan for the Western Balkans.

North Macedonia complies with transmission requirements for harmonised indices of consumer prices. It made progress in national and regional accounts and excessive deficit procedure notifications and government finance statistics, but further progress is needed in all three areas. North Macedonia also improved labour market statistics, short-term business statistics and international trade in services statistics. Gaps still remain in the areas of supply, use and input-output tables, international trade in services, R&D, labour market statistics, short-term business statistics and international investment positions. North Macedonia still needs to align with the new requirements in short-term business statistics.

In light of this assessment, Participants hereby invite the Republic of North Macedonia to:

1. Implement the 2024 budget as adopted and ensure the fiscal target is met, in particular by controlling wage spending and reducing energy subsidies (as foreseen under the current IMF programme); adopt the budget for 2025 in a timely manner and in line with the fiscal rules. Strengthen the administrative capacity for the regular preparation and publication of the tax expenditure report and explore all options to further broaden the tax base. Introduce an integrated approach for reducing the build-up of arrears of public sector entities, through putting in place an Integrated Financial Management Information System and by setting up an effective system for monitoring of fiscal risks in the Ministry of Finance, including the fiscal risks stemming from SOEs and arrears.
2. Ensure timely implementation of the new Organic Budget Law (OBL) in its entirety by 2025, by adopting the necessary by-laws, in particular on budget classification and on the statement on fiscal policy; and by updating the manual on macro-fiscal projections. To improve public investment management, adopt a methodology/guidelines for appraisal of projects, in line with the recommendations of the IMF and the World Bank, and ensure sufficient training of staff in the new PIM department of the Ministry of Finance. To enhance private sector financing of public infrastructure projects based on a suitable regulatory framework, adopt the Law on Public Private Partnership.
3. Ensure a sufficiently tight monetary policy stance as long as necessary to anchor inflation expectations at levels consistent with price stability and support the peg, underpinned by a thorough assessment of potential second-round effects. Safeguard the independence of the central bank in its key statutory tasks, including in staffing and wage issues, by excluding the national bank from the scope of all related laws on administrative servants and public sector employees. Further enhance risk-based supervision in line with best international and European practices, including by operationalising the Bank Resolution Law by amending by-laws and building capacity ahead of implementation, upgrading the deposit insurance law, further implementing measures to promote the role of the domestic currency and improving data collection, notably on real estate, to enable a comprehensive assessment of financial sector risks.

Serbia

Serbia submitted its Economic Reform Programme 2024-2026 on 15 January 2024. The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of 16 May 2023 has been partial.

Serbia's economy remained resilient in 2023. GDP growth picked up speed in the second half of the year, reaching an estimated 2.5% for the year as a whole, helped by strong FDI inflows and decelerating inflation (averaging 12.1% in 2023). The ERP projects economic growth to gradually pick up to 3.5% in 2024 and about 4.0% in 2025-2026, broadly returning to its potential growth rate. Relatively buoyant exports and lower energy import volumes and prices contributed to the substantial reduction in the current account deficit, from 6.9% of GDP in 2022 to 2.6% in 2023. The external deficit is expected to widen again in the coming years, to about 4% of GDP, as imports are set to pick up in line with rising investment and private consumption. The growth outlook is, as elsewhere, subject to a series of downside risks primarily associated with geopolitical tensions and global trade disruptions.

The general government deficit fell to 2.2% of GDP in 2023, which is a better-than-expected outcome despite ad-hoc measures to raise pensions, social transfers and public sector wages. Revenue growth outperformed projections and fiscal support to state-owned energy utilities was lower than planned. The 2024 budget targets a moderate further deficit reduction (compared to the ERP-estimated 2023 outcome) because of robust labour income growth and expenditures increasing at a rate below GDP growth, helped by lower energy-related subsidies. Further gradual expenditure-based fiscal consolidation is projected to bring the budget deficit down to 1.5% of GDP in 2025-2026, in compliance with the new deficit rule. The debt-to-GDP ratio decreased to 52.3% in 2023 and the ERP projects it to moderately decline further to reach 50% of GDP in 2026. There has been substantial progress on fiscal reforms in 2023, but some significant fiscal risks, including those related to state-owned enterprises (SOEs), persist.

In the macro-fiscal area, challenges relate to the budgetary framework and building up the credibility of the new fiscal rules, as well as to state-owned enterprises and public sector wage reform. Medium-term fiscal targets need to be better anchored by a strict application of the new framework of fiscal rules and backed up by credible medium-term fiscal planning, including public investment planning. The budget is also lacking a detailed overview of tax expenditures. Fiscal risks might still arise from state-owned enterprises, although the fiscal burden related to SOEs in the energy sector is reduced by increase in tariffs on gas and electricity in 2023. In spite of recent progress linked to the new SOE management law, several actions are still to be completed in the coming years, such as adopting related by-laws, restructuring companies, ensuring sound corporate governance and improving transparency. Public finances would benefit from further capacity strengthening in the Ministry of Finance for fiscal risk analysis and reporting. A public sector wage reform is crucial to attract and retain talent in the public sector, which is indispensable to progress with many of the ongoing reforms.

Inflation dropped from over 16% in March 2023 to 5% in March 2024. The National Bank of Serbia (NBS) continued to tighten monetary policy, by increasing the key policy rate to 6.5% by July 2023. The average reverse repo rate, which de facto determines the monetary stance, stood at about 5.6% in March 2024. Monetary tightening has been largely transmitted to financial conditions, notwithstanding a cap on mortgage interest rates, contributing to a further moderation of lending growth and supporting disinflation and a decline in inflation expectations. The NBS expects inflation to return within the tolerance band of 3% ±1.5 pp towards mid-2024 and to reach the target midpoint towards the end of the year. In order to keep the exchange rate stable amid strong FDI and remittance inflows the NBS has continued to intervene in the foreign exchange market. As a result, foreign exchange reserves increased significantly. The banking system remained resilient with favourable indicators on solvency, liquidity, profitability and asset quality (with the non-performing (NPL) ratio at about 3%). The resolution framework for non-performing loans still has margins for improvement. The positive momentum in dinarisation which had come to a halt in the first half of 2022 has resumed since late 2022. While the authorities are committed to further increase dinarisation and have continued fostering the development of local bond markets and dinar-denominated deposit and loan growth, currency substitution remains high and continues to represent a potential tail risk for financial stability and limits monetary policy choices.

Key areas for reforms to boost competitiveness and long-term and inclusive growth are related to the business environment and private sector development, the green and digital transition as well as labour market and education. Strengthening the rule of law, including further efforts in the fight against corruption, would improve the business environment. The development of a strong corporate sector is also challenged by the informal economy and the significant share of SOEs, while some of them are characterized by a low level of efficiency. Overreliance on coal and inefficient infrastructure characterize the energy sector, which is dominated by SOEs. There is still room to raise employment to EU average levels, reduce skills mismatches, and improve education and training. Serbia has made good progress on digital transformation across the economy and intends to tackle some of the remaining gaps, in areas such as digital infrastructure and cyber security, public sector e-services and education. These challenges as well as the relevant Joint Policy Guidance agreed in 2023 are expected to be addressed through key structural reforms identified in the country's Reform Agenda under the new Growth Plan for the Western Balkans.

Serbia has reached a good level of compliance in many areas of statistics. It fully complies with transmission requirements in the areas of harmonised indices of consumer prices, supply, use and input-output tables, R&D, balance of payments and international investment positions. However, further efforts are needed in the areas of government finance statistics (GFS) and excessive deficit procedure (EDP) notifications. Serbia needs to address data gaps in the areas of national and regional accounts, international trade in services statistics, international trade in goods statistics, labour market statistics, short-term business statistics, and further progress is needed in the alignment with the new requirements in short-term business statistics.

In light of this assessment, Participants hereby invite Serbia to:

1. Keep an appropriately tight fiscal stance in 2024 to help disinflation and strictly adhere to the new fiscal rules in order to enhance their credibility. Implement the action plan for 2023-2026 to strengthen medium-term budgeting, inter alia by developing tools and methodology for a stable strategic fiscal planning. Appoint members of the Fiscal Council following the recent expiry of some of their mandates.

2. Adopt the necessary by-laws to fully implement the new SOE law and strengthen SOE governance, reducing the associated fiscal risks. Reinforce fiscal risk analysis and management capacity, fully implement the risk methodology and publish comprehensive fiscal risk reports. Building on progress with the electronic public wage and employment registry, implement the preparatory steps towards an appropriately designed public sector wage system reform.
3. Ensure a sufficiently tight monetary policy stance as long as necessary to anchor inflation expectations at levels consistent with price stability, underpinned by a thorough assessment of possible second-round effects. Further enhance risk-based supervision in line with best international and European practices, including by further strengthening the reporting framework across the banking system, phase out temporary measures affecting market mechanisms in setting mortgage interest rates and foster NPL resolution including by further developing the secondary market for NPLs. Continue efforts to promote the use of the domestic currency, including by enhancing long-term financing in domestic currency, further encouraging forex hedging and raising awareness of risks related to forex lending.

Türkiye

Türkiye submitted its Economic Reform Programme 2024-2026 on 15 January 2024. The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of 16 May 2023 has been limited.

The economy continued expanding in 2023, with real GDP growth at 4.5%, slightly above the ERP projection but somewhat lower than in the previous year. Economic growth is projected to slow to 4.0% in 2024, before rebounding to 5.0% in 2026. The strong deceleration of household consumption growth is seen as the main driver of economic rebalancing and curbing excess demand. Public consumption and investment are envisaged to support this process as well, albeit to a lesser extent. As a result, net exports' contribution to growth is forecast to turn slightly positive in 2024-2026. Managing the projected steep deceleration of domestic demand while durably reducing external imbalances and solidifying the ongoing disinflation process is a key policy challenge.

Corrective measures helped contain the 2023 central government budget deficit to 5.2% of GDP, below the ERP target. The deficit was, however, much higher than in the previous year due to large one-off earthquake-related costs and ad- hoc spending in 2023. On current projections, the 2024 central government budget deficit is likely to be significantly below the planned deficit of 6.4% of GDP due to better revenue performance. The ERP expects the general government primary balance to improve significantly and to reach a surplus of 1.2% of GDP in 2026. The fiscal adjustment relies heavily on the expiration of the earthquake-related expenditure (around 3% of GDP), while increasing tax revenue. The general government debt ratio declined to 29.5% of GDP in 2023, below the ERP estimate, and is expected to remain moderate, helped by inflation, strong economic growth and the projected primary surplus. Türkiye has the fiscal space to manage fiscal risks, which have become more noticeable in recent years. At the same time, introducing a strong fiscal anchor could help strengthen fiscal discipline.

Inflation increased to 68.5% by March 2024 on the back of a sharp depreciation of the lira since June 2023 and increases in indirect taxes and administered prices as well as a sharp rise in minimum wages. The CBRT projects inflation to peak in May 2024, before declining to its intermediate targets of 36% by end-2024 and 14% by end-2025. In a significant policy shift, interest rates have been raised substantially, from 8.5% in May to 50% in March 2024, and important steps have been taken to strengthen monetary transmission and to reinstate the policy rate as the primary instrument of monetary policy. While accumulating international reserves continues to be among the CBRT's aims, amid still low foreign exchange buffers, balance of payments dynamics and external financing conditions have improved, supporting the exchange rate, which is a key channel for disinflation. Inflation expectations have also improved, but remain well above the medium-term and intermediate targets with upside risks to the inflation outlook. Confidence has improved on the back of upside surprises in multiple successive policy rate decisions amid some persisting concerns about central bank independence among market participants. The banking system has remained resilient, with adequate capitalisation and low non-performing loan ratios. Credit risk has increased as growth decelerates, financial conditions tighten and still high inflation weighs on the repayment capacity of retail borrowers. The operating environment for banks has improved as progress has been made in unwinding and simplifying the complex macroprudential and regulatory framework, although some regulations that constrain market-based risk pricing and capital allocation remain in place with the aim to insure against high credit growth and ensure that policy rate hikes are transmitted to Turkish lira deposit rates.

Despite the welcome shift towards more conventional economic policies in the second half of 2023, several structural barriers remain for the Turkish economy. The main challenges in terms of boosting competitiveness and long-term and inclusive growth are: (i) raising the skills level to increase employment, in particular of women and young people; (ii) improving transparency and predictability in the regulatory and institutional environment affecting businesses; and (iii) pursuing climate neutrality, energy security and the economy's green transition, in particular by boosting energy efficiency. The timely implementation of the reform measures announced by the government against well-defined targets should play a pivotal role in shaping the economy and maximising investments, which are especially needed to tackle the socio-economic consequences of the earthquakes.

Considering high-risk indicators and an uncertain geopolitical climate, advancing the business environment will require improvements in the rule of law by enhancing transparency and predictability, strengthening the legal framework for state intervention and reinforcing cooperation with private sector, and strengthening the independence of regulatory authorities. Implementing structural reforms to improve the business environment and reach climate neutrality will require good governance, coordination, and inclusiveness. The green transition, and the timely adoption of the Climate Law, needs to be incorporated and mainstreamed by the government. The labour market has improved, with gradually increasing rates of employment and decreasing rates of unemployment. The share of young people not in employment, education or training (NEET) has declined, but remains structurally high, especially for young women. Despite some improvements, female labour market participation remains structurally low and continues to be an impediment for further economic growth. This should be addressed as a matter of priority. Lifelong learning measures also remain crucial to master the green and digital transitions of the labour market.

Türkiye made progress in national and regional accounts. A Memorandum of Understanding has been signed between TURKSTAT, the Central Bank and the Ministry of Treasury and Finance for improving the availability and timeliness of data for excessive deficit procedure notifications. Türkiye needs to make improvements in the areas of national and regional accounts, supply, use and input-output tables, excessive deficit procedure notifications and government finance statistics, international trade in services and labour market statistics, and to undertake further efforts to fully align with the new requirements in short-term business statistics as well as international trade in goods statistics. Türkiye does not provide harmonised indices of consumer prices at constant tax rates and administered prices.

In light of this assessment, Participants hereby invite Türkiye to:

1. Maintain a tight macroeconomic policy mix until the disinflation process is firmly established. Use any revenue overperformance as well as fiscal buffers on the expenditure side to lower the 2024 budget deficit compared to the ERP target. Present a medium-term fiscal strategy that includes specific consolidation measures to support the envisaged gradual return to a primary surplus of at least 1% of GDP.

2. Reduce fiscal risks by – inter alia – gradually phasing out the FX value guarantees on lira time deposits. Expand the tax base by streamlining tax exemptions and reductions and reducing informality. Take gradual steps to phase out subsidies on fossil fuels.

3. Ensure a sufficiently tight monetary policy stance to entrench further disinflation and anchor inflation expectations, continue the simplification of the complex macroprudential measures and the regulatory framework to strengthen monetary transmission while maintaining financial stability. Underline central bank independence as the institutional basis for sustainably achieving price stability and underpinning monetary policy credibility. Enhance risk-based supervision in line with best international and European practices, including by further improving the transparency and efficiency of the regulatory framework by removing regulations that hamper market-based credit allocation and loan pricing, and enhance confidence by conducting transparent asset quality reviews and publish its methodology and outcomes.
4. Implement legislation and enhance transparency, accountability, and predictability regarding state aid to maximise the benefit of the EU-Türkiye economic and trade relationship, as well as to achieve a meaningful level-playing field. Adopt effective measures to further strengthen the rule of law, ensure adequate and timely contract enforcement and improve the availability and functioning of dispute settlement mechanisms. Track the implementation process of the action plan for the fight against the informal economy (2023-2025).
5. Adopt the Climate Law focusing on enhancing climate governance, fair transition and the establishment of an Emission Trading System (ETS) aligned with the EU ETS. In the context of "Climate Change Mitigation Strategy and Action Plan (2024-2030)" and "Climate Change Adaptation Strategy and Action Plan (2024-2030)", effectively implement a long-term low-emission development strategy and address the energy-intensive and hard-to-abate sectors also using alternative fuels such as renewable hydrogen. Increase the resilience against climate change and disaster-related risks, including to ensure sustainable urban development.
6. Facilitate school-to-work transitions for young people who are not in education, employment or training (NEET) by ensuring the quality and inclusivity of the school, tertiary, and vocational training system. Address the labour market gender gap – the difference between men and women – through the establishment of affordable childcare infrastructure beyond the big urban centres of Türkiye, and through raising the level of skills for women by facilitating their participation in on-the-job training. Continue increasing the participation of adults in lifelong learning, aimed at the development of a skilled labour force fit for the green and digital transitions.