



# Western Balkans: Economic Developments, Outlook and Policy Challenges

2<sup>nd</sup> WBIF Strategic & Operational Board Meetings

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# Outline



Recent Developments and Outlook

Risks and Russia/Ukraine Links

Policy Challenges and Priorities

IMF Relations with the Western Balkan Countries

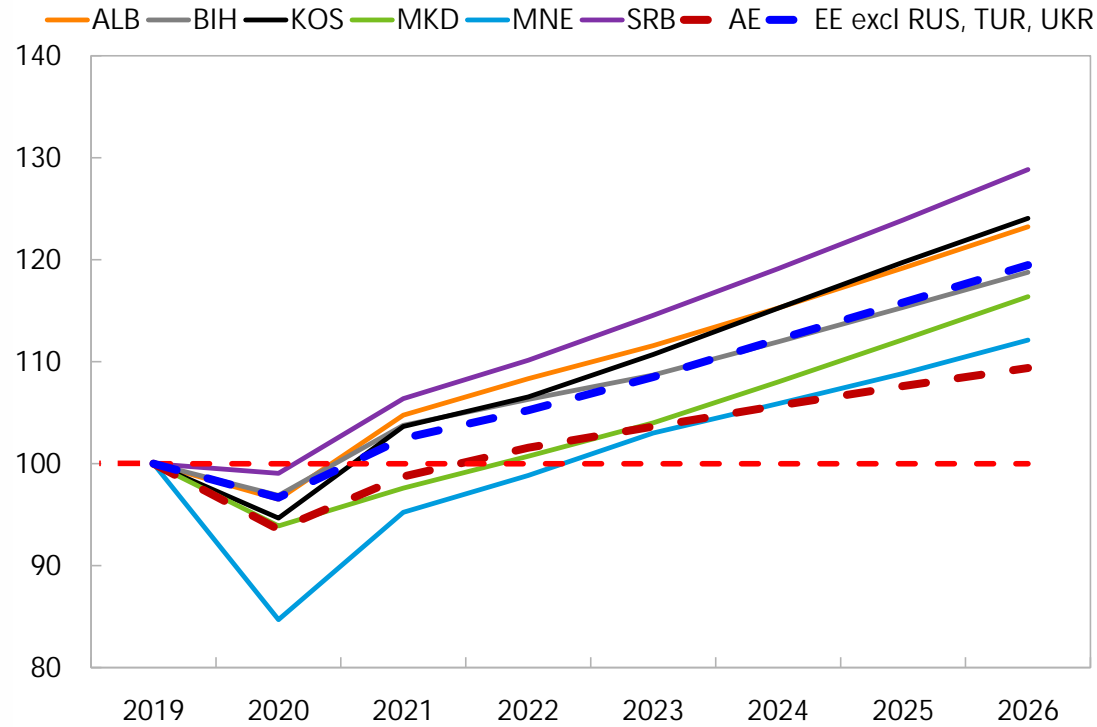
# Key Messages

- **Outlook:** High uncertainty and commodity price hikes have **slowed the post-pandemic recovery** and are adding to **inflation pressures**. Higher **financing costs** will impose constraints.
- **Macroeconomic Policy Mix:** Fiscal policy is better suited to mitigate the negative impact on activity and vulnerable households, while monetary policy should contain additional price pressures, and avert second round effects
  - ❑ **Fiscal policy** should provide temporary support to vulnerable households and firms to mitigate the impact of higher commodity prices. With limited fiscal space this is to be achieved by re-prioritizing spending. Credible medium-term fiscal consolidation strategies are needed in light of increased financing costs.
  - ❑ **Monetary policy needs** to normalize to curb inflation expectations and second-round effects
- **Structural Policies** should address both old (governance, productivity, etc.) and new challenges. Mitigation of energy security risks is an opportunity to accelerate the green transition.

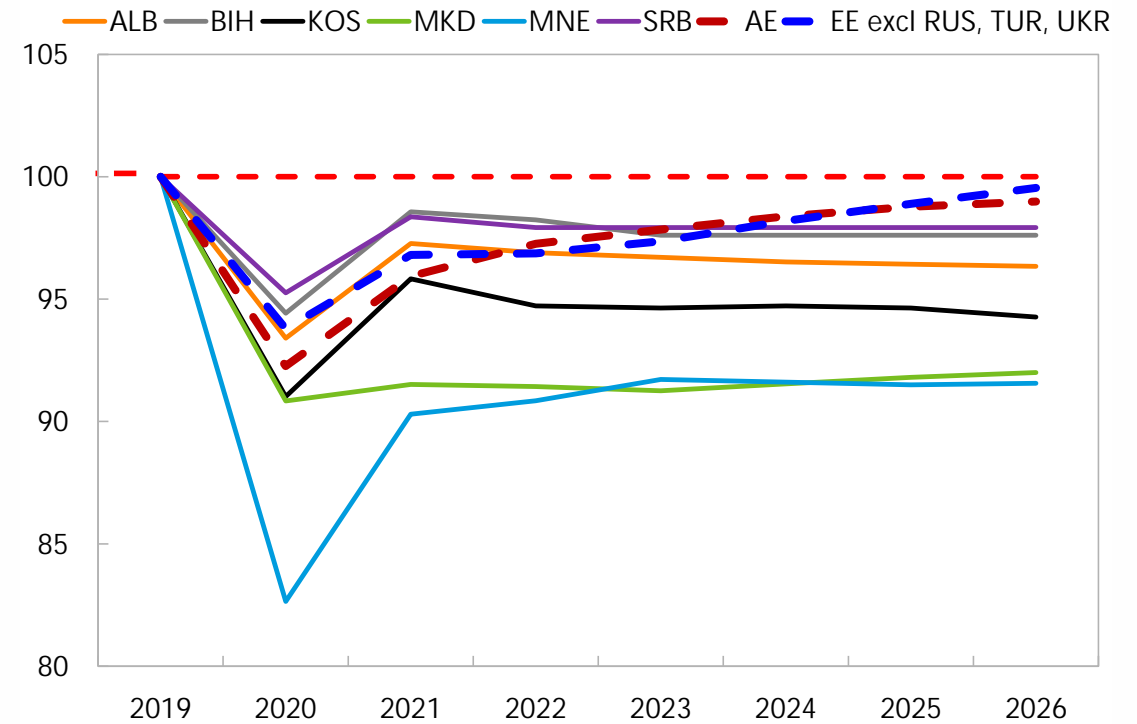
# Recent Developments and Outlook

# The Covid and Ukraine war shocks have resulted in persistent GDP output losses in the Western Balkans

**Cumulative Real GDP Growth**  
(in percent, data as of April/June 2022)



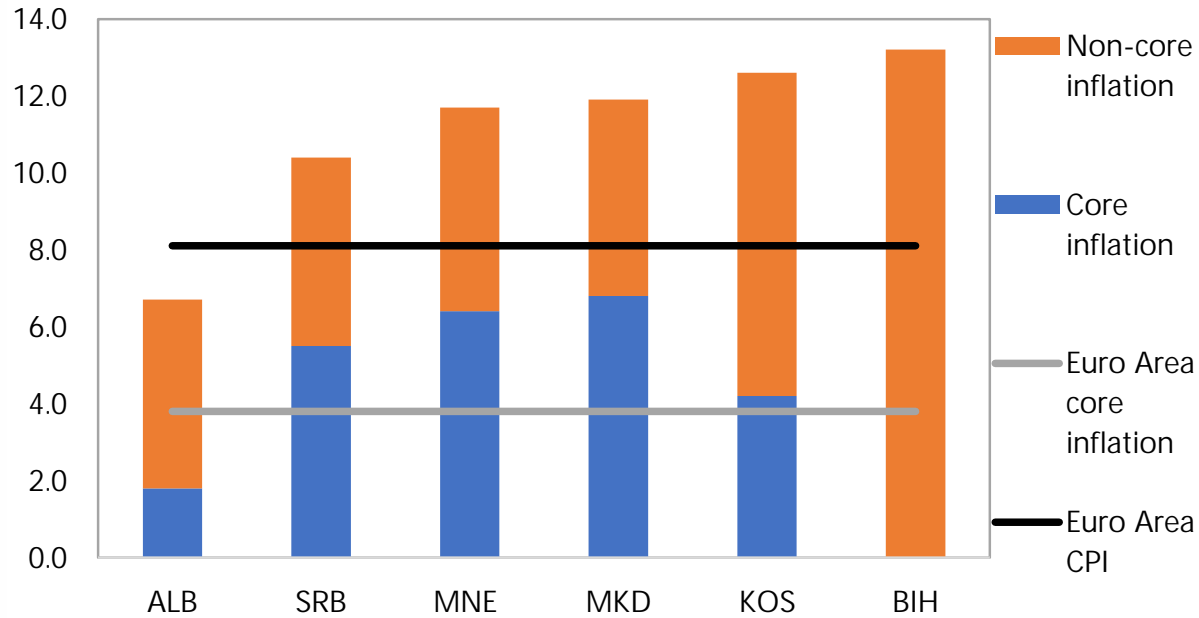
**Cumulative Output Losses**  
(in percent, pre-pandemic real GDP forecasts from January 2020 vs. April/June 2022 forecasts)



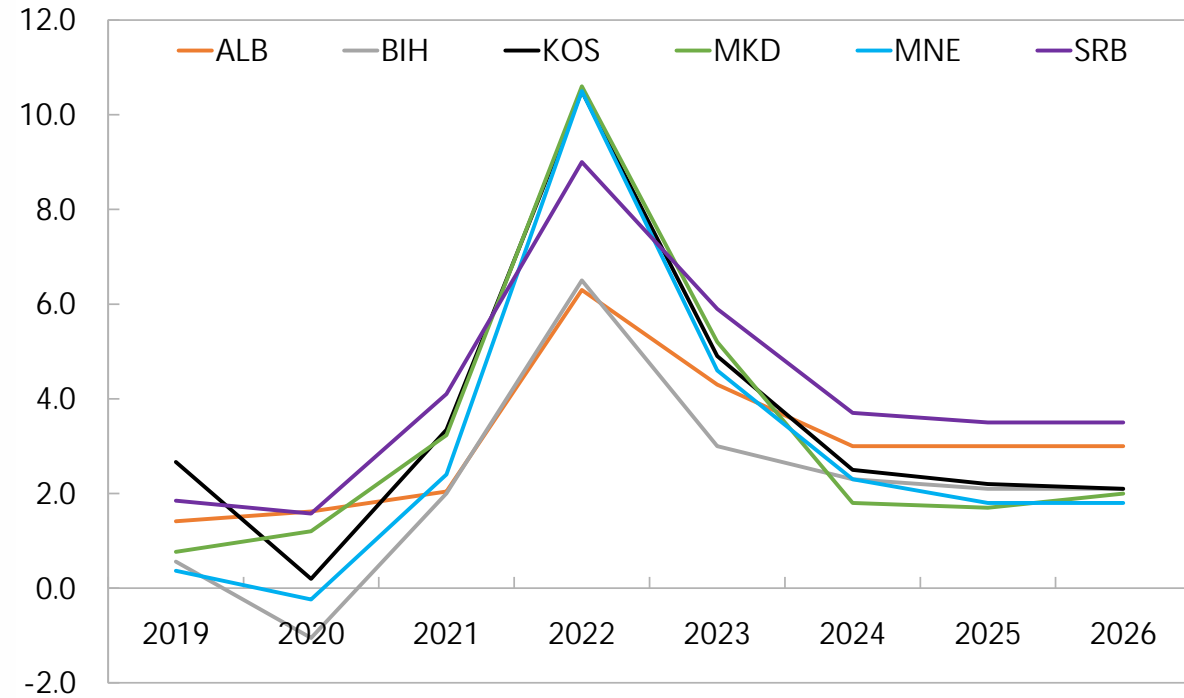
Sources: IMF WEO January 2020 vs. WEO April 2022 (for MNE, AE and EE excl. RUS, TUR, UKR) and IMF forecasts as of June 2022 for ALB, BIH, KOS, MKD, SRB, and staff calculations.

# Inflation has been high, with a large share of energy & food in the CPI baskets, and is expected to remain elevated in 2022

**Actual Inflation**  
(CPI in percent, data as of May 2022)



**Inflation Forecast**  
(Average CPI in percent, data as of June 2022)



Sources: Eurostat, national statistics offices, Haver, IMF forecasts as of June 2022, and IMF staff calculations.  
Notes: BIH inflation as of April 2022 with no published core inflation. SRB and MNE core inflation as of April 2022.

# Fiscal space has reduced as public debt rose following sizable fiscal policy support to households and firms

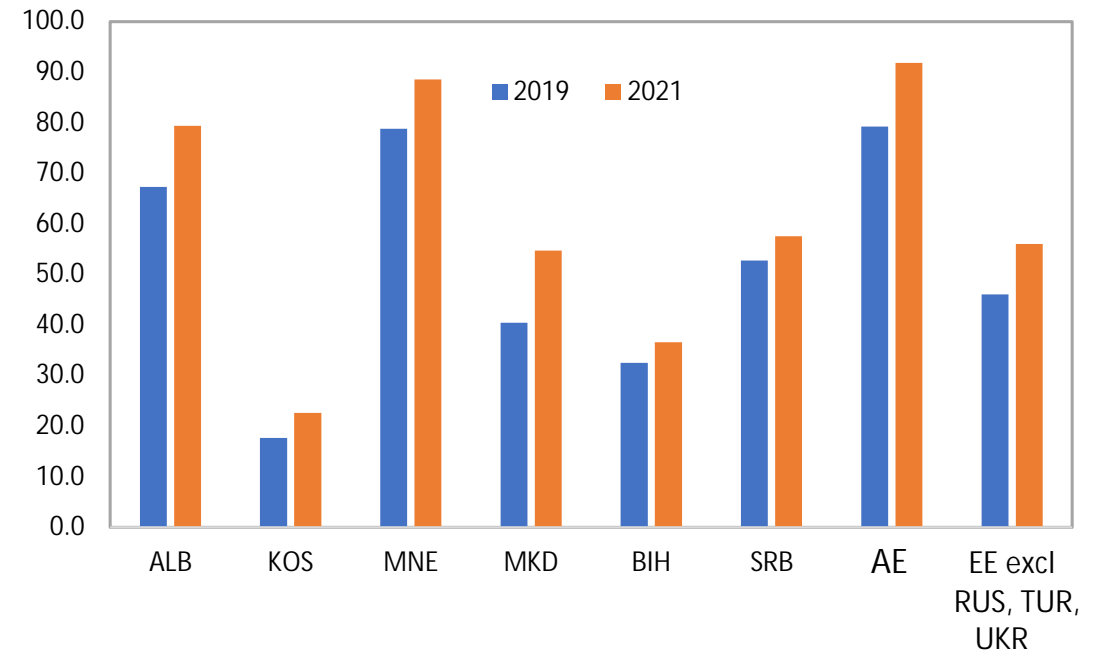
## Fiscal Balances

(in percent of GDP, data as of April/June 2022)



## Public Debt

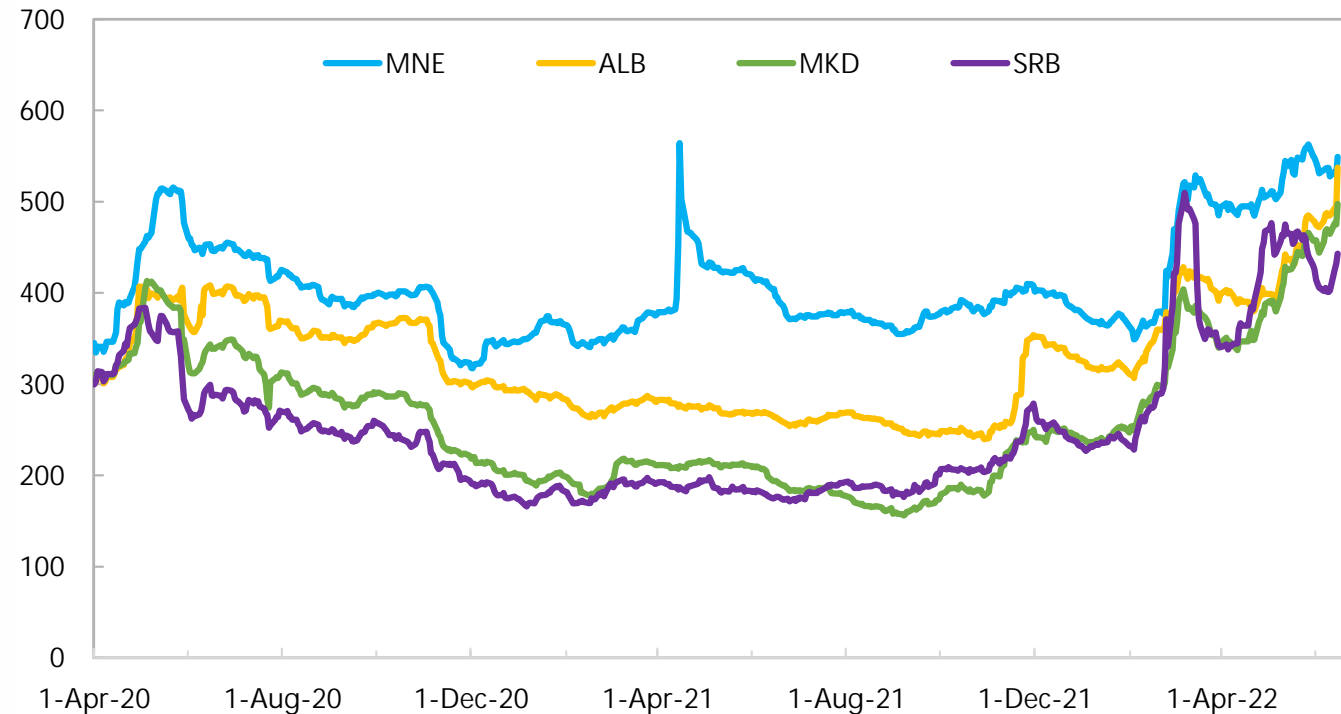
(in percent of GDP, data as of Dec-2019 and Dec-2021)



Sources: IMF WEO April 2022 (for MKD, MNE, AE and EE excl. RUS, TUR, UKR) and IMF forecasts as of June 2022 for ALB, BIH, KOS, SRB, and IMF staff calculations.

# Interest rates have significantly increased with increased uncertainty and global monetary policy tightening

**Bond Spreads**  
(in basis points, data as of June 15, 2022)



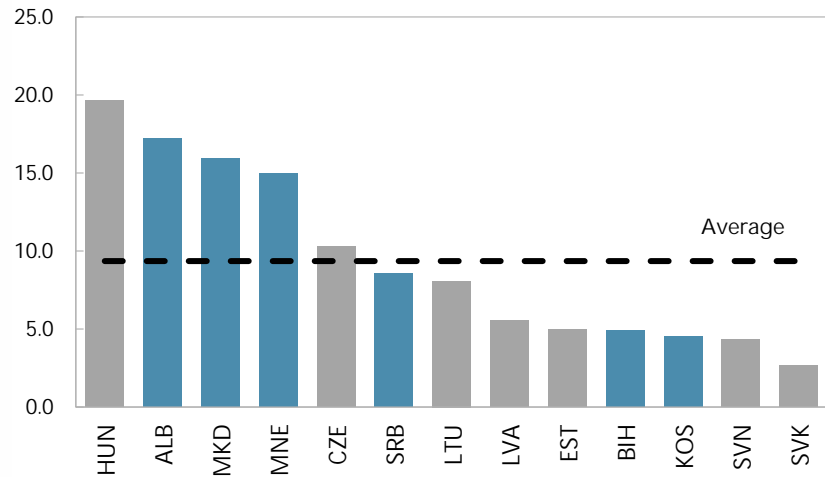
Sources: IMF Sovereign Spread Monitor; and IMF staff calculations.

Note: Weighted spread across all of a country's bonds with more than one year remaining maturity. Average remaining maturity may differ across countries and hence affect spread comparability.

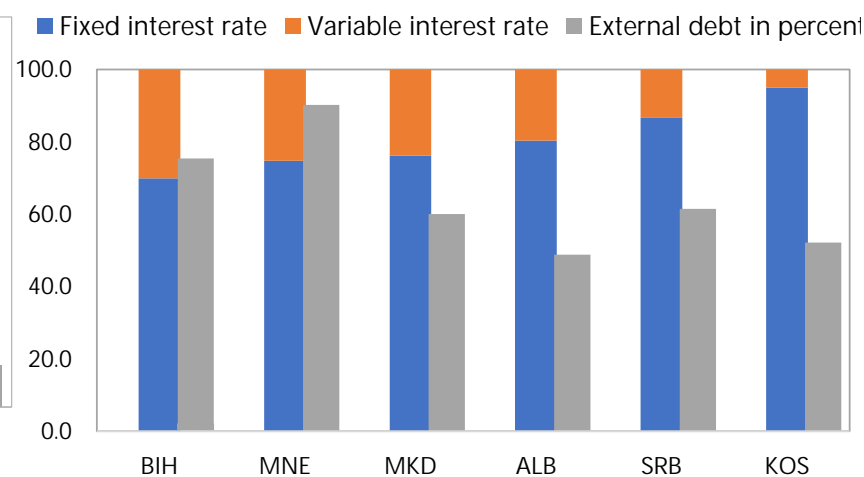


# GFN are significant in some WBCs, but most debt is fixed rate; reserves have increased, supported by Eurobond and IFI financing

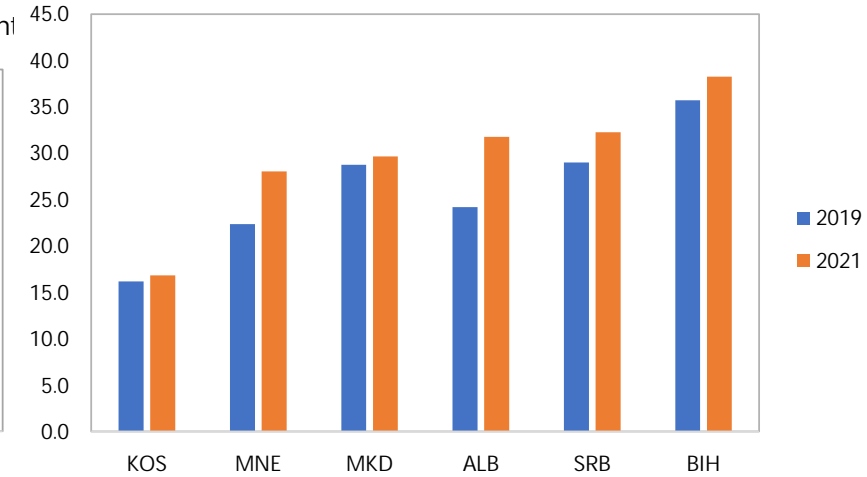
**Gross Financing Needs (GFN)**  
(in percent of GDP, data as of 2021)



**Fixed rate/External Public Debt**  
(in percent of public debt, data as of December 2021)



**Reserve Assets**  
(in percent of GDP, data as of Dec-2019 and Dec-2021)

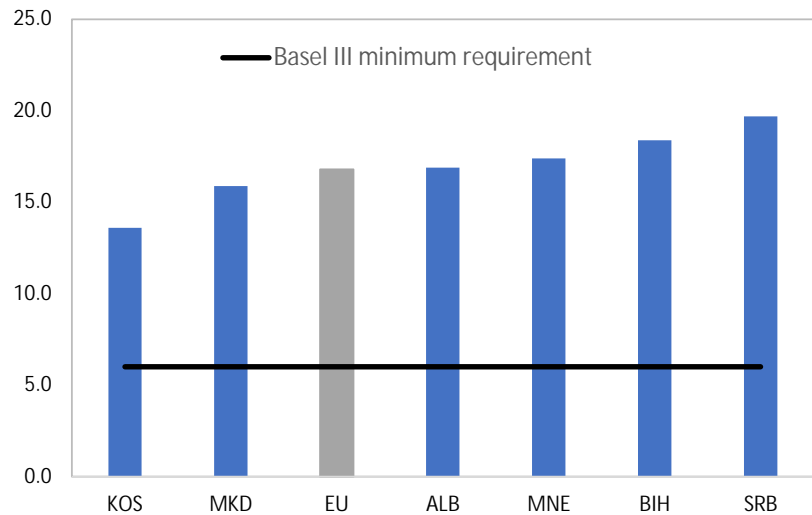


Sources: IMF WEO April 2022, IMF Vulnerability Exercise database, national finance ministries and staff calculations.

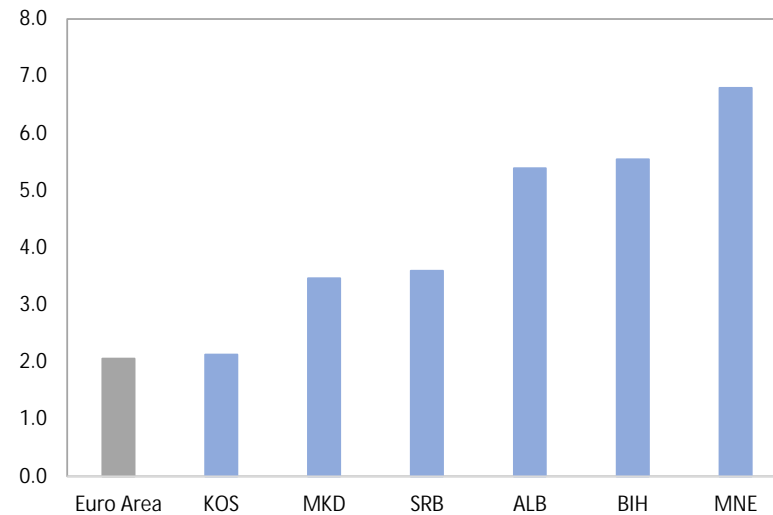
Notes: MNE reserve asset data refers to 2020 instead of 2021. MNE fixed rate/external public debt levels refer to central government.

# The financial systems are well-capitalized, NPLs in check, and liquid but deposit growth is slowing

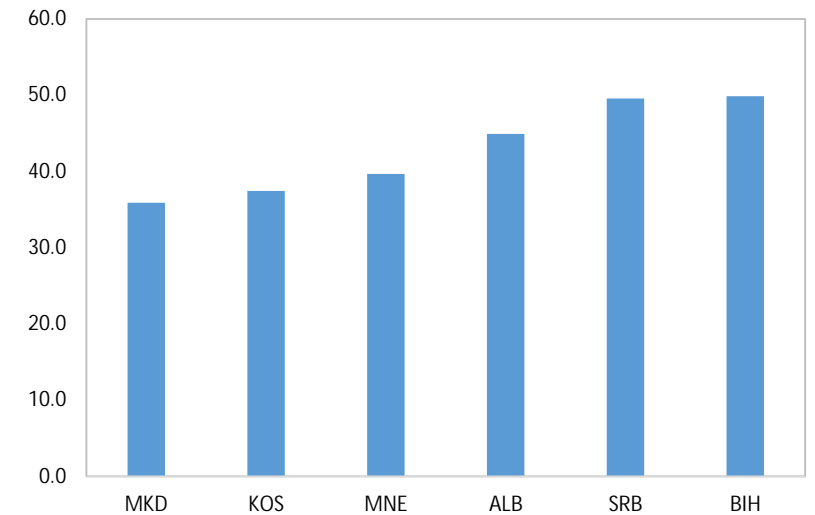
**Regulatory Tier 1 Capital to Risk-weighted Assets**  
(in percent, data as of Q4 2020)



**NPL to Total Gross Loans**  
(in percent, data as of Q4 2020)



**Liquid Assets to ST Liabilities**  
(in percent, data as of Q4 2020)

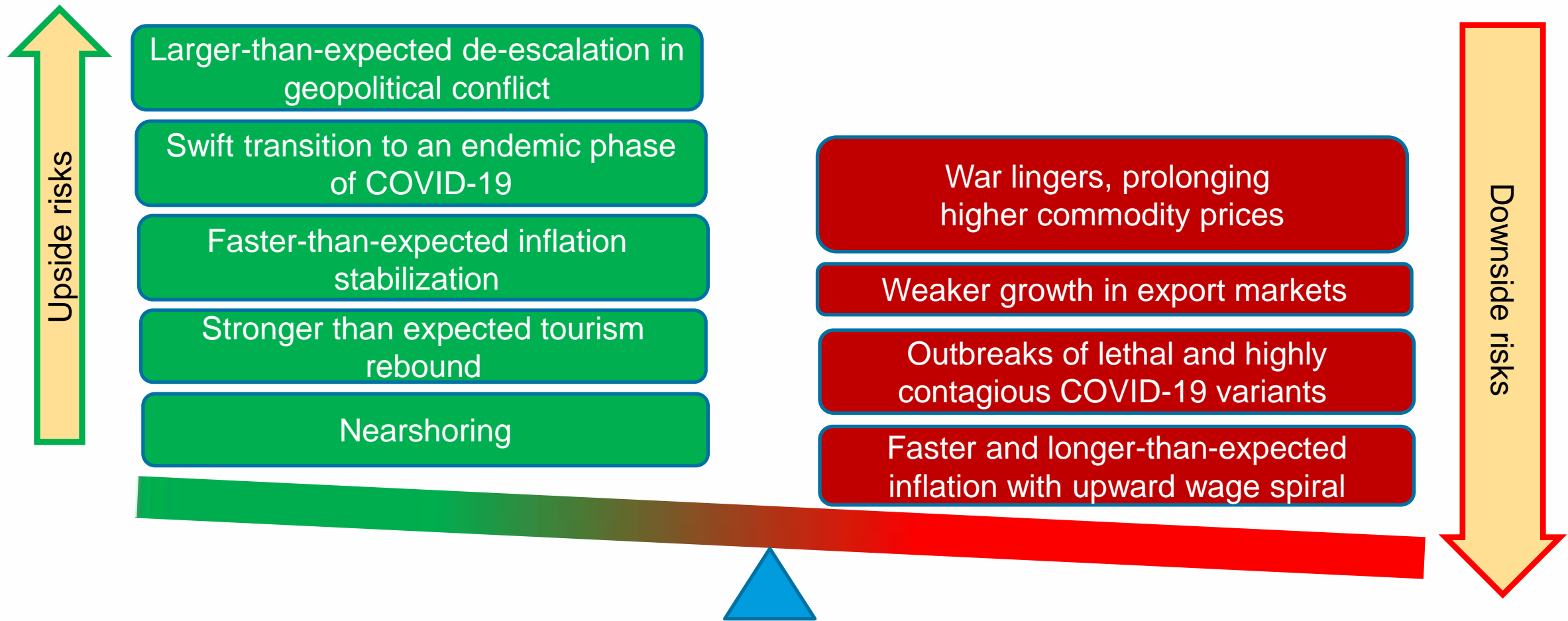


Sources: Haver, national central banks, ECB and IMF staff calculations.

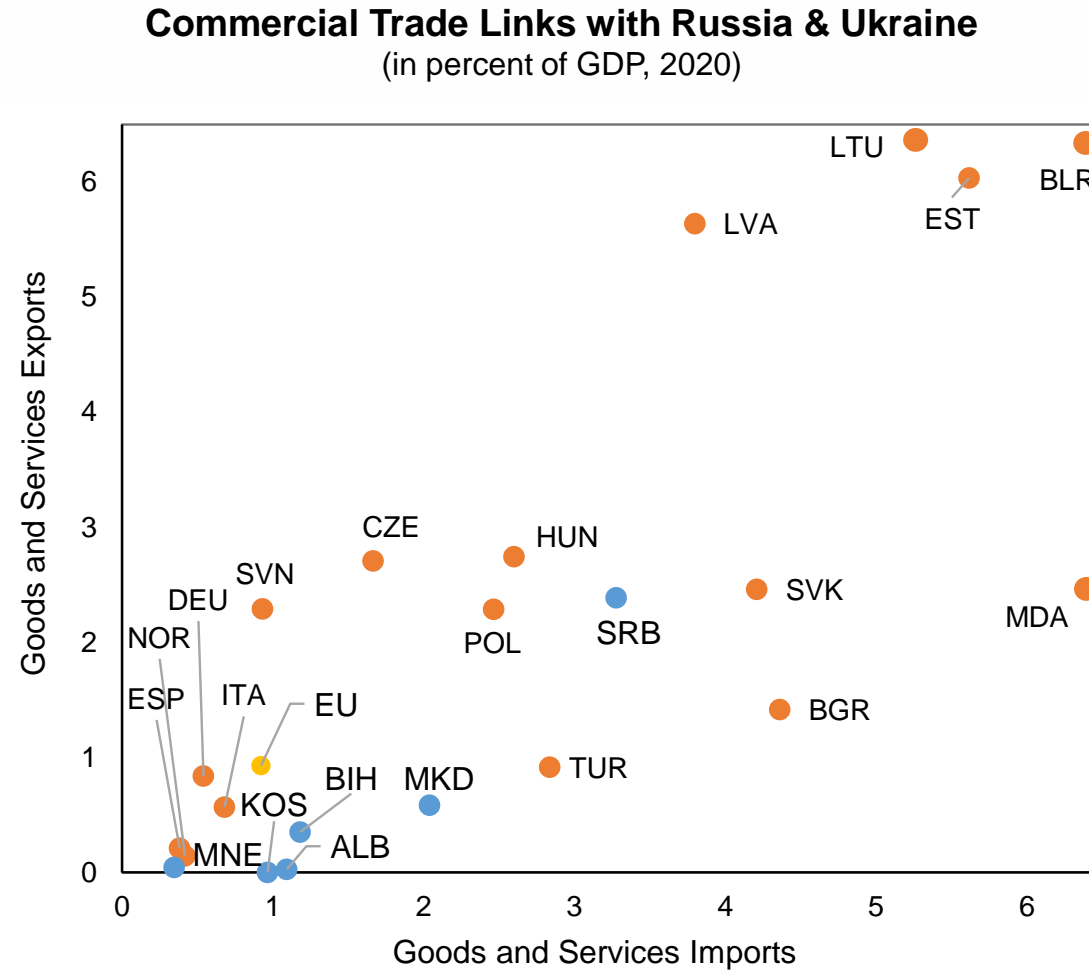
Notes: BIH ratios refer to Q3 2020. EU and Euro Area data refers to ECB supervised banks.

# Risks and Russia/Ukraine Links

# The balance of risks is to the downside, on war-related uncertainty and an incomplete exit from the pandemic...



# Even though direct links to Russia/Ukraine are relatively limited...

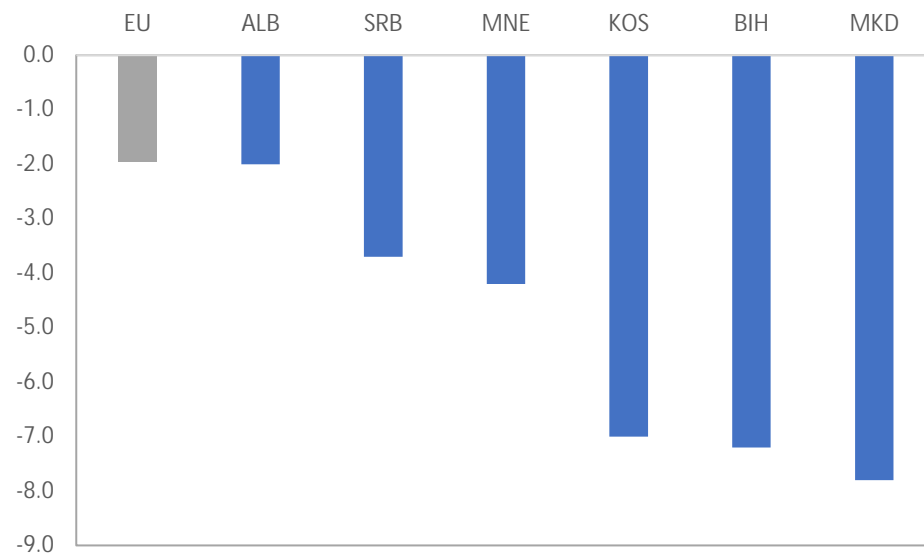


Sources: UN Comtrade, Eurostat, national authorities, and IMF staff calculations.

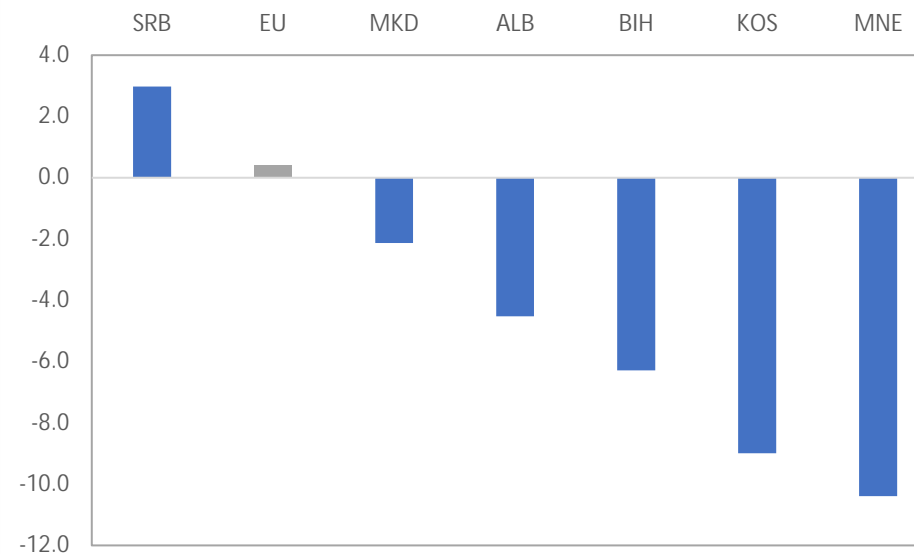
Notes: Services Imports data is of 2019, the latest available in UN Comtrade. LTU, LVA, and EST include re-exports.

# ...the WBCs are impacted through global price effects and EU trade partners

**Energy Trade Balances**  
(in percent of GDP, data as of 2021)



**Food, live animals, beverages and tobacco trade balances**  
(in percent of GDP, data as of 2021)



Sources: Eurostat, national statistics offices, and IMF staff calculations.

Notes: Energy trade balances refer to mineral fuels, lubricants and related materials (incl. electric current). ALB data refers to the trade balance of minerals, fuels, electricity.

# Policy Challenges and Priorities

# Reduced fiscal space means that there is a need for well-targeted fiscal support

## Macroeconomic Policy Mix

Fiscal policy is better suited to mitigate the negative impact on activity and vulnerable households, while monetary policy should contain additional price pressures, and avert second round effects, ensuring inflation and inflation expectations remain anchored.

## Fiscal Policy

### Fiscal stance:

With limited fiscal space, **relocation and re-prioritization of spending**. Support needs to be in the form of temporary and well-targeted measures to the vulnerable. Tax cuts should be avoided. Energy tariff adjustments to reduce budgetary costs and incentivize energy savings.

In the medium term, **fiscal consolidation** needs to continue to rebuilt policy buffers and in light of increased in financing costs. Credible fiscal consolidation plans should be communicated.

### Structural fiscal reforms:

- Increase tax revenue to cover priority spending needs in infrastructure, health and education:
  - Implementation of MTRS (tax policy/administration reforms, no tax amnesties)
- Improve spending efficiency and reduce spending risks:
  - PFM, procurement, public investment frameworks (including for PPPs)



# Monetary policy needs to be normalized, while banks need to be closely monitored and regulated

## **Monetary Policy**

Monetary accommodation needs to be withdrawn and monetary policy normalized by raising interest rates to anchor inflation expectations and avoid second-round effects.

Clearly communicate policy stance on inflation.

## **Financial Sector Policies**

Central banks will need to closely monitor financial sector vulnerabilities.

Take supervisory and regulatory measures as needed, and ensure continued building/preservation of capital buffers.

# Structural policies should focus on addressing both old and new transitional and long-term challenges

## Transitional Challenges

Inflation impacts on the vulnerable and economic activity

Mitigate **Energy Supply** Downside Risks

Foster Factor Reallocation

## Policies

Provide **targeted temporary support** to the vulnerable

Allow **price signals** to operate; prepare contingency plans

Active and passive **labor and education** policies

Market regulations and bankruptcy and solvency framework

## Long-term challenges

Boost **productivity**

Promote **energy transition**

Facilitate move to a **digital green** economy

Enhance **human capital and Infrastructure**

Strengthen **governance**

## Policies

Product market and education reforms

Improve energy networks, increase energy efficiency and diversify supply

Labor market reforms

Actionable long-term climate and digital strategies; infrastructure investment

Enhancement of institutions

# IMF Relations with the Western Balkans

# IMF Relations with the Western Balkan Countries

	RFI (2020)	SDR allocation (2021) and usage so far	Programs / Program Requests	Latest Article IV	Share of IMF Europe Capacity Development spending \1
<b>Albania</b>	100% of quota EUR 174mn	EUR 161mn Central bank reserves		Dec-21	6%
<b>Kosovo</b>	50% of quota EUR 52mn	EUR 95mn Central bank reserves		Jan-22	6%
<b>Montenegro</b>	100% of quota EUR 74mn	EUR 70mn Central bank reserves		Feb-22	5%
<b>North Macedonia</b>	100% of quota EUR 177mn	EUR 162mn Budget financing	PLL requested in April 2022	Feb-22	8%
<b>Bosnia and Herzegovina</b>	100% of quota EUR 333mn	EUR 305mn Budget financing		Jun-22	8%
<b>Serbia</b>	No request	EUR 754mn Budget financing	30-month successor PCI approved in June 2021	end-Jun-22	6%
<b>WB total</b>	<b>EUR 810mn</b>	<b>EUR 1,546mn</b>			<b>40%</b>

Note:\1 Share of IMF Europe Department Budget on Capacity Development.



Thank you