EUROPEAN COMMISSION

Brussels, 21 April 2020

COMMISSION STAFF'S OVERVIEW OF THE ECONOMIC IMPACT OF THE COVID-19 CRISIS AFTER SUBMISSION OF THE ECONOMIC REFORM PROGRAMMES FOR 2020-2022

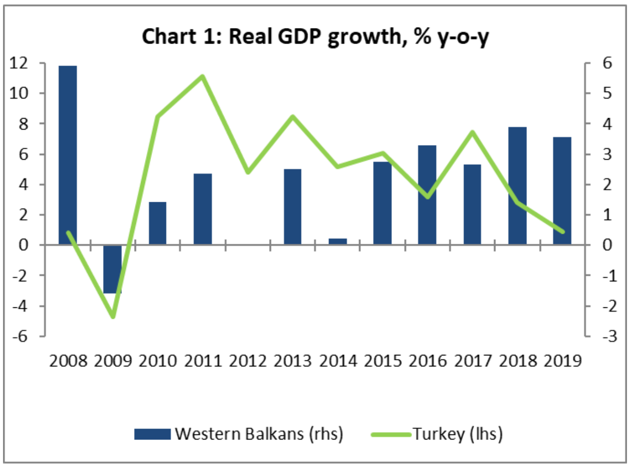
OF

ALBANIA, BOSNIA AND HERZEGOVINA, NORTH MACEDONIA, KOSOVO*, MONTENEGRO, SERBIA AND TURKEY

Information note for the Economic and Financial Committee

* 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.

1. Economic developments and outlook before the onset of the COVID-19 crisis

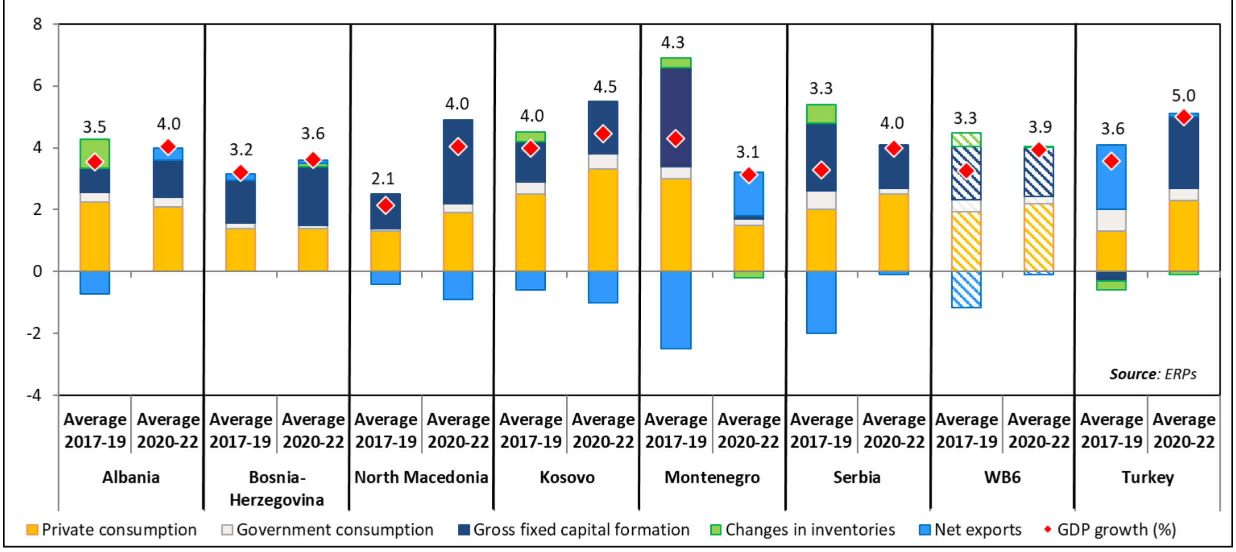


Before the crisis, Western Balkan economies were enjoying several years of relatively robust GDP growth and macroeconomic stability. In 2015-2019, real output grew at an annual average rate of more than 3% across the region, driven by private consumption and investment (see Chart 1). Economic growth in the region peaked at 3.9% in 2018 and decelerated slightly to 3.6% in 2019 due to a less favourable external environment. Sustained economic expansion created jobs and the unemployment rate declined to record low levels in the region; however, at around 14% on average in 2019, it still remained elevated compared to EU peers. Consumer price inflation remained muted throughout this period, reflecting some remaining domestic slack as well as subdued import prices. Inflation decelerated in 2019 in almost all economies of the Western Balkans to levels below 2%, allowing central banks with monetary autonomy to maintain an accommodative monetary policy stance.

Boosted by significant policy stimulus, the Turkish economy was recovering faster than expected from the 2018 currency crisis. Economic performance was volatile and Turkey went through a short but intense recession at the end of 2018, triggered by a loss of investor confidence amid high external and internal imbalances. Competitiveness gains from a sharply depreciated lira, coupled with a strong import retrenchment, brought about a large positive net export contribution to growth in the first half of 2019. Fiscal expansion and increased credit activity by state-owned banks also softened the economic contraction. Monetary policy reacted to the strong depreciation of the lira with a significant tightening but monetary conditions have become more supportive of growth as from the second half of 2019 with a fast and sizeable reduction in official interest rates. Although inflation fell from a very high level, at a double-digit rate it remained well above target. Based on quarterly data, Turkey recorded real GDP growth of 0.9% in 2019.

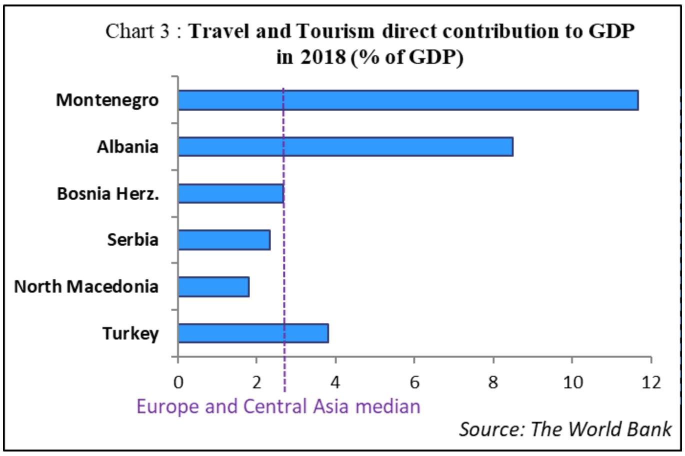
In this pre-COVID-19 context, the Economic Reform Programmes (ERPs) submitted in January 2020 projected economic growth to remain robust and fiscal balances as well as public debt ratios to improve in most cases. While the ERPs' macro-fiscal scenarios were generally plausible and a useful base for policy making at the time of submission (see Chart 2), they have become obsolete following the outbreak of the COVID-19 crisis and the resulting economic fallout.

Chart 2: ERP data and projections on GDP growth and contributions, percentage points



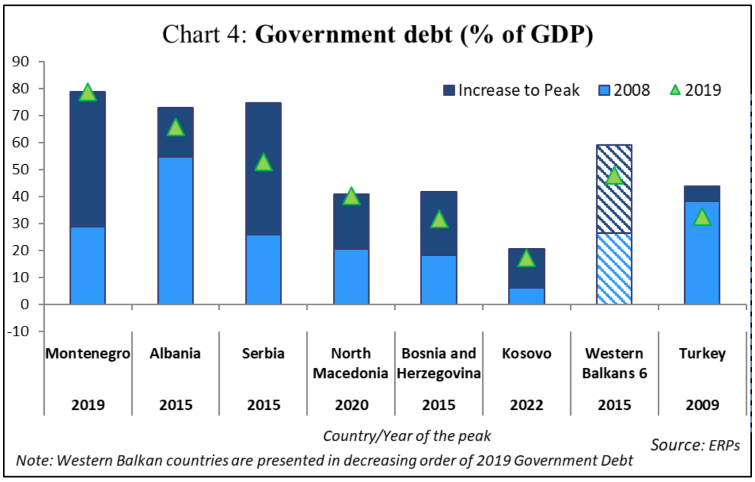
2. Expected economic impacts and transmission channels of the COVID-19 crisis

The pandemic's economic consequences are expected to be severe in the Western Balkans and Turkey due to both external and internal factors. As the Western Balkans and Turkey are closely linked to the EU, the expected sharp downturn in the EU will have strong knock-on effects on their economies that are all expected to fall into recession in 2020. The main external transmission channels are dampened demand for their exports and reduced remittances, which are a particularly important source of external financing in the Western Balkans. This effect may be exacerbated by many expatriates from the region working in the services sector, such as in the hospitality industry, which is especially severely hit by the crisis. In addition, the spread of COVID-19 on their territories has prompted governments across the region to implement containment measures including border closures, social distancing and lockdowns of parts of the economy. These in turn are further supressing trade and domestic demand in the near term. Furthermore, health systems are generally weak and underfunded, which might exacerbate the supply shock from reduced labour availability due to sickness and absenteeism, depending also on the spread of the disease.



The economic weight of the most affected sectors and trade partners varies across the region, which might point to some differences in the severity of the economic fallout. The economic contribution of tourism, one of the most affected sectors, is the biggest in Montenegro and Albania, but it is also high in Turkey (see Chart 3). In addition to the pandemic, Albania is still coping with the economic fallout from the November 2019 earthquake, while many of its expatriates live in EU areas particularly hit by COVID-19, which will negatively affect remittances. Apart from Turkey, which is a manufacturing hub with production oriented both domestically and to the EU market, the manufacturing sector has a relatively large weight in Serbia and North Macedonia, and these countries are also better integrated in global or EU-wide supply chains. The crisis-induced steep fall in global trade flows and the severe disruption to supply chains, for instance in the automotive sector, will therefore affect them to a greater extent.

3. Policy space and measures to mitigate the socio-economic fallout of the crisis



The policy space is constrained by rigid currency regimes, high levels of public debt, and risks to bank balance sheets. In countries that use the euro as their official currency (Montenegro, Kosovo*), have a currency board arrangement (Bosnia and Herzegovina) or a de facto peg to the euro (North Macedonia) the exchange rate is not or insufficiently available as a shock absorbing instrument, although monetary easing in the euro area might benefit them to some extent. Countries with a nominally flexible exchange rate regime (Albania, Serbia, Turkey) have already implemented cuts to the policy rate. However, a large depreciation of their currencies in the context of heightened risk aversion in global markets would create risks for their banking sectors due to the high share of foreign exchange-denominated loans to unhedged borrowers (which are mainly households in Albania and Serbia, and corporates in Turkey). Public debt ratios have mostly fallen from their post-2008 peaks but are generally

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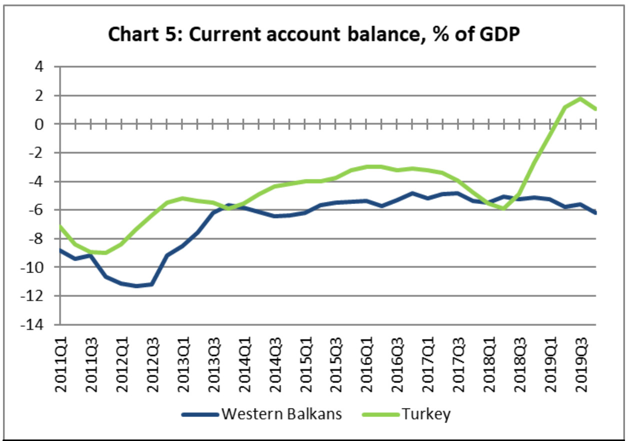
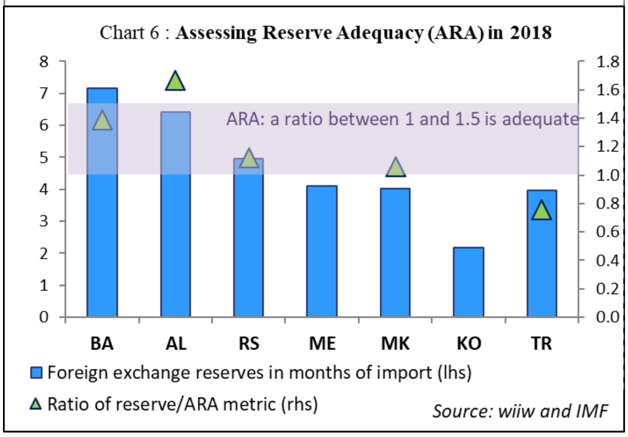
much higher than on the eve of the global financial crisis (see Chart 4), limiting the fiscal headroom to mitigate the socio-economic consequences of the crisis.

In general, domestic banks hold a significant share of government securities, thus adverse feedback loops could emerge should government finances come under pressure. On the positive side, banks are generally well capitalised and liquid, and their asset quality has improved considerably since the heights of the financial crisis. Subsidiaries of EU-based parent banks rely mostly on domestic deposits for funding, thus deleveraging pressures, should they materialise, might have less of an impact in the domestic economies than during the global financial crisis. However, limited financial inclusion (i.e. lack of access to banking services), coupled with high informality excludes many firms and individuals most in need from liquidity measures channelled through banks.





Although external positions have improved in recent years, balance-of-payment pressures have emerged as the crisis weighs on capital flows and rollover plans. In the Western Balkans, large merchandise deficits are only partially offset by surpluses in the services and secondary income accounts, and the current account deficit for the region averaged around 5-6% of GDP in recent years, narrowing from its level in the early 2010s (see Chart 5). The deficits were largely financed by net foreign direct investment inflows. In Turkey, the current account adjusted sharply in the wake of the 2018 currency crisis as the sharp depreciation of the lira boosted price competitiveness while weak domestic demand compressed imports. However, balance-of-payment positions have now come under pressure as the COVID-19 crisis is having a large negative impact on revenues from exports and remittances, while also adversely affecting FDI inflows and rollover plans. Most Western Balkan partners[2] have turned to the International Monetary Fund and the EU for emergency balance-of-payment assistance, notwithstanding relatively high levels of foreign exchange reserves in most cases that provide some buffer in the face of highly uncertain market conditions (see Chart 6).

While important measures have already been taken in a timely manner, the lack of fiscal space may limit their size in some cases. A series of measures have already been

[2] See annex for country-specific information.

announced and taken by all countries in March and early April. These have typically included in a first step monetary easing for all countries with nominally flexible exchange rate regimes, additional support for the health system, moratoriums on loan repayments, deferred tax payments or liquidity support through banks. In many economies, the initial measures have been complemented by direct income support measures to employees and self-employed in sectors most affected by the shutdown measures (such as payment of minimum salaries), special support schemes targeting workers in the informal economy, one-off lump-sum payments to certain groups such as pensioners, the setting up of additional liquidity support schemes through state guarantees or development banks etc. The size of the measures in relation to GDP however varies, also depending on the available financing capacity.

Mitigating the effects of the crisis on households and businesses and creating room for increased health spending remain key short-term priorities. In addition to the discretionary measures already taken, allowing automatic fiscal stabilisers to operate fully appears crucial for short-term mitigation efforts. Further additional discretionary measures to cushion the short-term impact of the crisis on growth and employment may also become appropriate, depending on the duration of the containment measures and reassessment of their economic impact. All short-term fiscal measures to mitigate the crisis should be managed in a transparent and well-targeted manner with a view to maximising their impact and making the best use of the limited fiscal room for manoeuvre.

In the short term, it is important to take new or continue implementing existing measures to preserve jobs through short-time work schemes, where possible in combination with training once the pandemic subsides. Adequate income support needs to be ensured to laid off workers and it would be advisable to extend social protection coverage to informal employees, who tend to be hit first by the economic slowdown and may be left without any support. It also appears important to increase the coverage of means-tested social assistance to vulnerable groups.

In many cases, external assistance, including from the EU, will play an important role in addressing the crisis. The initial EU financial assistance package for the Western Balkans amounts to EUR 706.5 million (see Joint Communication on the Global EU Response to COVID-19[3]). This package is divided into immediate relief funding (EUR 38 million) to manage the emergency and a short- to medium-term assistance (EUR 373.5 million) to further strengthen health systems and to support the economic and socioeconomic recovery efforts. This will be further complemented by a medium term regional economic assistance package post-COVID-19 (EUR 295 million), which is being elaborated in close cooperation with international financial institutions. Balance-of-payment support through the Macro-Financial Assistance instrument is also being considered.

[3] JOIN(2020) 11 final, available at:
https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020JC0011&from=EN

4. Medium-term challenges for securing a sustained recovery

To reduce fiscal risks, it will be crucial in the medium-term to rebuild fiscal buffers, improve the composition of spending and strengthen rules-based fiscal governance. While fiscal policy should play its full role in alleviating the impact of the crisis, sharply increasing fiscal deficits and depressed economic activity will take a toll on public finances. Therefore, medium-term measures should focus on strengthening debt sustainability while improving the growth-friendliness of public budgets, thereby ensuring a sustained recovery after the crisis. From this perspective, containing current spending, especially on public wages and pensions, appears important, as their level as a percent of GDP is relatively high in most Western Balkan countries, crowding out more productive expenditure. Supporting a strong recovery also necessitates shifting budgets further towards a more growth-oriented composition, by increasing capital investment expenditure based on a well-designed public investment management framework. Moreover, reforms to address fiscal risks stemming from contingent liabilities (in particular from often opaque public-private partnerships and from still sizeable state-owned enterprises) should also contribute to a sustainable recovery, in particular trough a more efficient use of public resources. Revenue mobilisation is often negatively affected by widespread informality, weak tax administrations and costly tax expenditures; addressing these challenges could also contribute to the recovery by raising financial resources to fund much-needed spending. Finally, strengthening fiscal governance through the adoption of new or improved fiscal rules and frameworks, also supported by independent fiscal bodies, could contribute to better fiscal policy planning and to the rebuilding of fiscal buffers that will be significantly depleted as a result of the crisis.

To help laid off workers find employment, it will be necessary to increase the capacity of public employment services and to step up the provision of active labour market policies, especially reskilling/upskilling. The outreach and coverage of support services for jobseekers are limited. The staffing of public employment services in terms of number of jobseekers per officer is at times very low and will be further undermined by the already increasing numbers of registered unemployed. Active labour market policies (ALMPs) are generally underfunded and only a small range of measures is on offer. The share of ALMPs with training/upskilling content vis-à-vis ALMPs based on pure job subsidies without on-the-job-training element would need to be increased to prepare unemployed people for work in sectors in demand once growth bounces back. It will also be important to invest in capacities for analysis of current and anticipation of future skills demand in order to target well training/upskilling ALMPs. While generalised support will be necessary, it should not be forgotten that before the crisis some groups, such as women, young people and less represented ethnic groups, were less integrated into the labour market and that they would need specific support.

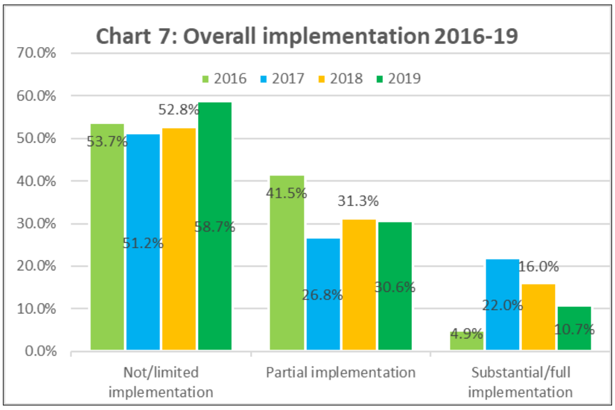
The level and structure of social spending is not addressing the needs of the poorest segments of the population and there are gaps in public health insurance coverage as well as in access to and quality of health care. Despite continuing positive economic trends in recent years, high levels of poverty and social exclusion remain a problem in all partners from the region. This issue will be further exacerbated by the crisis. Social assistance schemes are under-funded and do not cover those most in need; the low support levels are ineffective in reducing poverty, thus further increasing income inequality, which is still high in most cases. On the other hand, relatively generous non-means tested social benefits, for instance to war veteran categories, might create disincentives to work. It is recommended to improve the adequacy of social assistance benefits and to make them more targeted to the categories in need. Social care services are not yet provided everywhere, especially in rural areas, thus hindering social inclusion of vulnerable people. The current crisis also highlights some structural issues in the public health sector. It would be important to close the gaps in public health insurance coverage, reduce the large share of out-of-pocket payments, improve access to health care and increase the quality of health services provided.

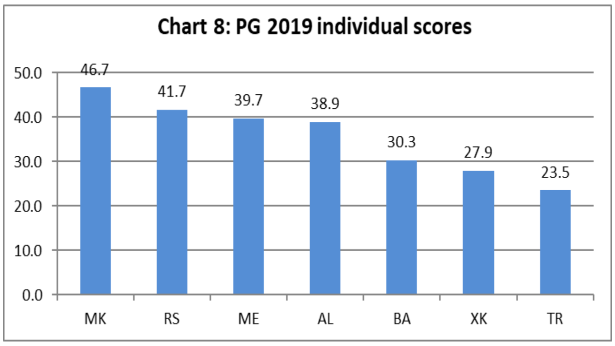
In all seven economies, the COVID-19 crisis is severely affecting businesses, in particular SMEs, compounding structural weaknesses in the business and institutional environment. For most, the regulatory environment remains insufficiently flexible to respond to the crisis when it comes to triggering automatic stabilisers or reducing administrative burdens. The unpredictability of the regulatory and legislative environment represents an additional burden on private sector development. In most, the weak level of administrative capacity hinders a quick, transparent and well-coordinated response to the crisis. Still sizeable and unprofitable state-owned enterprises generally represent a problem, creating unfair competition for private companies. All seven economies struggle with corruption and a weak rule of law, which can undermine the effectiveness of the introduced measures to fight the pandemic and to stimulate economic recovery. In order to overcome these challenges, there is a need for extensive structural reforms to improve the business environment and the investment climate, including significant efforts to strengthen the rule of law and institutions and to fight corruption.

Informality is very high in all seven economies, ranging between 25% and 35% of GDP. The large informal sector creates unfair competition, hinders the efficient allocation of public and private resources, and reduces tax revenues. Due to the current crisis, informality poses an additional challenge to the governments' policies aimed at alleviating the effects of the crisis for businesses and households as the support measures usually address the needs of formal economic operators. There are many underlying causes of high informality, in particular the low level of trust in government, a complex regulatory environment (red tape) and the perceived low quality of public services. Effective government support to businesses and measures to preserve employment should stimulate the formalisation of the economy.

5. Implementation of the policy guidance adopted in 2019

Every year since 2015, the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey has adopted targeted policy guidance (PG) for all the authorities. The guidance represents the participants' shared view on the short-term policy measures that should be implemented to address macro-fiscal vulnerabilities and structural obstacles to growth. The underlying rationale of the PG is similar to that of the country-specific recommendations adopted under the European Semester for EU Member States. Implementation of the PG is evaluated by the Commission in the following year's ERP assessments[4].





Assessment of the implementation of last year's policy guidance points to persistent difficulties in implementing reform commitments. The average score across the Western Balkans and Turkey has declined for the second consecutive year, from 41 out of 100 in 2018 to 35.5 this year[5]. Well over half (59%) of the PG adopted last year saw no or only limited implementation, which is the highest share so far (see Chart 7). Only around 11% of the PG has been substantially or fully implemented. In terms of individual performances, the scores display some variation, but none of them is higher than 50, which happens for the second time after 2019 (see Chart 8).

[4] The detailed evaluation of individual PG items can be found in Section 5 of the Commission's ERP assessments.

[5] For a detailed description of the methodology used to assess policy guidance implementation, see Section 1.3 of the Commission's Overview and Country Assessments of the 2017 Economic Reform Programmes available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en

Annex: Country-specific assessment

Albania

Albania is particularly vulnerable to the economic fallout from the pandemic due to its close economic relations with some highly affected EU Member States, the importance of the tourism sector and its high refinancing needs. The damages from the November 2019 earthquake, which already absorbed a large part of both public and private reserves for the emergency response, and the limited capacity of the health sector aggravate the situation. Faced with the spread of COVID-19, the government has put in place strong social-distancing measures since 8 March and announced the state of emergency on 28 March. Albania faces a recession with the IMF forecasting real GDP to decrease by 5% in 2020, driven by a drop in private consumption and in goods and services (tourism) exports. Albania has close economic relations with EU Member States highly affected by the COVID-19 crisis, such as Italy, which receives half of Albania's merchandise exports (textiles) and is the largest source of its remittances (amounting to 5.2% of GDP). Furthermore, Albania strongly depends on travel and tourism, which accounts for 9% of GDP and about 23% of employment. The annual peak of tourism revenue is usually in the third quarter, much of which is at risk this year. The IMF expects the current account deficit to widen to 11.2% of GDP in 2020. Foreign reserves are covering over 6 months of imports, providing some buffer, but external financing needs are high. In particular, the government needs to refinance foreign debt amortisation of EUR 545 million (3.8% of GDP) in 2020, partly by issuing a EUR 500-600 million Eurobond. The government postponed the Eurobond issuance from May to October, the latest possible date, but the conditions will certainly be less favourable than the 3.4% interest of the 2018 Eurobond – if it can be placed at all.

Table 1: Selected macroeconomic indicators for Albania

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, % year-on-year	1.8	2.2	3.3	3.8	4.1	2.2
Consumer price inflation, %, end of period	0.7	1.9	2.2	1.8	1.8	1.1
Key monetary policy rate, %, end of period	2.3	1.8	1.3	1.3	1.0	1.0
Unemployment rate, %	17.5	17.1	15.2	13.7	12.3	11.5
General government balance, % of GDP	-5.2	-4.1	-1.8	-2.0	-1.6	-1.9
Public debt, % of GDP	70.1	72.7	72.4	70.2	67.7	66.3
Current account balance, % of GDP	-10.8	-8.6	-7.6	-7.5	-6.8	-7.6
International reserves, USD billion	2.5	2.9	2.9	3.3	3.7	3.5
International reserves, months of imports	5.2	7.4	6.8	7.0	6.8	6.5
Gross external debt, % of GDP	69.5	74.4	73.5	68.8	65.2	60.5
Foreign direct investment, % of GDP	8.4	8.3	9.3	8.8	8.5	8.1

Sources: Eurostat, WIIW, IMF

With the adopted measures, which only cover the most urgent needs for about 2 months, the fiscal deficit is set to reach 4% of GDP and public debt could increase from 66.3% of GDP to over 69% of GDP, according to the very optimistic budget amendment of the government (the IMF projects the fiscal deficit to widen to 5.4% of GDP in 2020). Despite the very limited fiscal space, the government swiftly adopted policy support measures of about 2% of GDP for affected businesses and households, and additional funding for the health sector. The government issued a moratorium on loan repayments together with the central bank, which has lowered its already low policy rate to 0.5% and releases liquidity. Before the corona crisis, the share of foreign debt had increased to about 46% of total public debt and overall interest payments were estimated to reach 2.1% to 2.3% of GDP. Future debt sustainability is likely to weaken with higher interest on the foreign-owned part of the debt, a depreciating exchange rate and the increasing domestic debt, which has usually been of shorter maturity and bore higher interest. The government requested and the IMF Executive Board approved on 10 April emergency liquidity assistance under the Rapid Financing Instrument (RFI) of about EUR 172 million. The EU announced a reallocation of IPA funding of EUR 50 million. In addition, the World Bank and the Agence Française de Développement have been asked to frontload planned loans of approximately EUR 130 million. On 9 April, Albania requested Macro-Financial Assistance from the EU.

Bosnia and Herzegovina

Having already been on a decelerating growth path, Bosnia and Herzegovina now faces a major recession. During 2019, economic growth decelerated to 2.6% from 3.3% in 2018, largely reflecting deteriorating external demand and a continued political stalemate, delaying necessary structural reforms and negatively affecting investment. Brain drain has gained substantial momentum in recent years, undermining the country's growth potential. The outbreak of the COVID-19 pandemic sharply exacerbated the already ongoing slowdown, in particular affecting transport and tourism, but also workers' remittances, accounting for some 10% of GDP and providing an important lifeline, in particular for lower income households. The latest IMF WEO projects a 5% drop in economic activity in 2020.

Table 2: Selected macroeconomic indicators for Bosnia and Herzegovina

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, % year-on-year	1.2	4.1	3.4	3.0	3.3	2.6
Consumer price inflation, %, end of period	-0.4	-1.3	-0.5	0.7	1.6	0.2
Key monetary policy rate, %, end of period*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Unemployment rate, %	27.5	27.7	25.4	20.5	18.4	15.7
General government balance, % of GDP	-2.0	0.7	1.2	2.6	2.3	1.0
Public debt, % of GDP	41.6	41.9	40.4	36.1	34.2	31.7
Current account balance, % of GDP	-7.2	-5.1	-4.7	-4.3	-3.7	-3.6
International reserves, USD billion	4.8	4.7	5.0	6.3	6.6	7.0
International reserves, months of imports	5.5	6.6	7.0	7.6	7.3	7.0
Gross external debt, % of GDP	53.4	54.3	54.8	54.2	54.1	55.6
Foreign direct investment, % of GDP	3.0	2.2	2.1	2.5	2.3	2.8

** Banks use the Euribor as a reference*

Sources: Eurostat, WIIW, IMF, Bosnia & Herzegovina Agency for Statistics

Despite rather sound fiscal headline numbers, the country's fiscal space is very limited. The health sector is poorly equipped for coping with the virus-related strong increase in the demand for intensive care and requires substantial spending. The economic slowdown and announced measures to alleviate the COVID-19 related shock will lead to a large drop in revenues and a sharp increase in transfers, which will severely worsen the budget balance. Given the country's currency board regime with the euro as it anchor currency, the room for monetary policy is very limited. As the crisis is expected to hit exports and remittances, the IMF projects the current account deficit to widen to 7.5% of GDP in 2020, resulting in a strong increase in external financing needs. Due to Bosnia and Herzegovina's poor credit ratings, access to international financial markets is very limited, while the country's financial markets are too shallow to accommodate these financing needs. Against this background, the authorities have already requested emergency financing from the IMF amounting to up to EUR 330 million (2% of GDP). On 14 April, Bosnia and Herzegovina also requested Macro-Financial Assistance from the EU.

Kosovo

The risk of economic contraction is very high in Kosovo. Before the outbreak of corona crisis, the economy was undergoing a cyclical upswing in 2015-2019, with real GDP increasing by 4% annually. The key growth drivers were services exports, gross-fixed capital formation and private consumption, the latter boosted by large remittances from abroad, and by robust wage and credit growth. Services exports (tourism) and private investment were also to a large extent supported by the diaspora. The outbreak of the COVID-19 pandemic and the related shutdown are disrupting Kosovo's trade and financial flows with a drastic impact on the economy. A further vulnerability of Kosovo's economy is the fragile private sector, dominated by micro enterprises with limited liquidity buffers or access to finance. Due to the large informal sector (accounting for around 30% of GDP) and the already high unemployment rate (26% in late 2019), the most likely scenario is a rapid increase in poverty and unemployment. The IMF projects real GDP to contract by 5% in 2020, while it expects the current account deficit to widen to 7.4% of GDP as exports and remittances will fall, while financing flows, including FDI, will diminish significantly.

Table 3: Selected macroeconomic indicators for Kosovo

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, % year-on-year	1.2	4.1	4.1	4.2	3.8	4.2
Consumer price inflation, %, end of period	-0.4	-0.2	1.3	0.5	2.9	1.1
Key monetary policy rate, %, end of period	9.3	7.7	7.2	6.8	6.0	6.4
Unemployment rate, %	35.3	32.9	27.5	30.5	29.6	25.7
General government balance, % of GDP	-2.2	-2.0	-1.2	-1.3	-3.0	-2.9
Public debt, % of GDP	10.7	13.1	14.4	16.6	16.9	17.5
Current account balance, % of GDP	-6.9	-8.6	-7.9	-5.4	-7.6	-5.8
International reserves, USD billion	0.7	0.7	0.6	0.7	0.8	0.9
International reserves, months of imports	2.4	2.6	2.0	2.1	2.2	2.4
Gross external debt, % of GDP	31.2	33.3	33.2	32.6	30.3	30.3
Foreign direct investment, % of GDP	2.7	5.3	3.6	4.0	4.0	3.8

Sources: Eurostat, WIIW, IMF, ERP, Ministry of Finance Kosovo

Despite moderate deficit and debt-to-GDP levels in 2019, fiscal space is limited. Headline budget deficit and public debt stood at 2.9% and 17.5% of GDP, respectively, in 2019. Kosovo's tax-revenue base is constrained by the large informal economy, while public spending is burdened by costly spending on social transfers for specific groups. As Kosovo has no access to international financial markets (due to the lack of credit rating), nearly two-thirds of its total debt is held by a narrow investor base, with the Kosovo Pension Security Trust and the Central Bank accounting for around 38% and 23%, respectively, of the total. A further 35% of domestic debt is held by commercial banks. The IMF and IBRD hold nearly one third of Kosovo's international debt each while the remaining part is mainly with foreign banks. Due to the unilateral adoption of the euro, there is no scope for an independent monetary policy.

Plummeting public revenue combined with large basic payments and the crisis response measures constitute an acute liquidity risk. The IMF estimates that government revenues will fall by 50-60% year-on-year in April-June and projects an annual decline of up to 12.5%. This would lead to a widening of the budget deficit to almost 5% of GDP. The key drivers are related to a severe contraction in economic activity and the postponement of tax payments. The caretaker government approved an emergency package worth EUR 180 million containing 16 measures, mainly to support affected businesses, reinforce social protection of the most vulnerable households, protect formal and informal employment and support public organisations working in the front-line of the fight against the pandemic. The government bank balance, which has already fallen below the legally prescribed 4.5% of GDP, is expected to decline further to 2.5% of GDP in 2020. Kosovo has requested and the IMF Board approved on 10 April emergency IMF liquidity assistance of EUR 51.6 million through the RFI. On 8 April, Kosovo also requested Macro-Financial Assistance from the EU.

Montenegro

Montenegro is particularly exposed to the economic fallout from the pandemic due to its very strong reliance on the tourism sector as well as its high external financing needs. Montenegro faces a deep recession in 2020, with the IMF forecasting a steep 9% real contraction of the economy. Tourism, one of the most affected sectors, accounts for more than 20% of GDP and is a key source of foreign exchange, employment and fiscal revenues. However, COVID-19 containment measures brought tourism and travel to a standstill at a time when these activities were about to enter the high season. Official reserves amounted to some 5 months of imports in 2019, providing some buffer, but external financing needs are sizeable. The IMF expects the current account deficit to increase to 17.9% of GDP. The government needs to refinance maturing foreign debt of about 1.6% of GDP in the remainder of 2020, while an additional 6.8% of GDP worth of foreign debt will need to be refinanced in 2021. The government is currently negotiating a syndicated EUR 250 million loan, backed by a EUR 80 million loan from the World Bank in order to meet some of the rollover needs. In addition, the government requested emergency liquidity assistance from the IMF under the Rapid Financing Instrument (RFI), and the EU announced a reallocation of IPA funding of EUR 50 million. On 15 April, Montenegro also requested Macro-Financial Assistance from the EU.

Table 4: Selected macroeconomic indicators for Montenegro

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, % year-on-year	1.8	3.4	2.9	4.7	5.1	3.6
Consumer price inflation, %, end of period	-0.6	1.7	1.0	2.9	1.5	1.2
Key monetary policy rate, %, end of period	8.4	7.7	6.7	6.2	5.8	5.5
Unemployment rate, %	18.0	17.6	17.4	16.1	15.2	14.6
General government balance, % of GDP	-2.9	-8.3	-3.6	-5.3	-2.9	-2.3
Public debt, % of GDP	59.9	66.2	64.4	64.2	70.1	69.0
Current account balance, % of GDP	-12.4	-11.0	-16.2	-16.1	-17.0	-15.2
International reserves, USD billion	0.6	0.7	0.8	1.0	1.2	1.5
International reserves, months of imports	2.9	3.4	3.7	3.7	4.1	5.1
Gross external debt, % of GDP	45.2	53.5	50.6	51.5	59.2	53.8
Foreign direct investment, % of GDP	10.8	17.2	5.2	11.5	8.9	8.2

** Gross external public debt*

Sources: Eurostat, WIIW, IMF

The government has adopted a first package of emergency economic measures. In March, the government adopted measures to deal with the health-related and economic consequences of the COVID-19 pandemic. Despite limited fiscal space, these measures amount to some 2% of GDP and concern in particular deferred payments of taxes and social contributions, a moratorium on loan repayments and on rent payments for the lease of state-owned property, as well as subsidies for businesses and workers. A second set of measures is currently being discussed with social partners and should be adopted in April. Preliminary estimates from the Ministry of Finance expect the fiscal deficit to rise to more than 7% of GDP and public debt to increase by an additional 2.6 pps. to 82% of GDP in 2020, the highest in the region. Montenegro's unilateral adoption of the euro as its official currency means that it has no monetary policy autonomy.

North Macedonia

The economic recovery is disrupted by the external shock. The pace of economic expansion in North Macedonia accelerated in 2019 (+0.9pp. to 3.6%) on the back of firming domestic demand, including a recovery of investment and supported by a sizeable fiscal stimulus, accommodative monetary policy, and solid increases in bank lending. Labour-market conditions improved continuously and the current-account deficit remained contained. The economic upswing is projected to be reversed this year, as the extended lockdown measures are having a severe impact on output and employment, and trade activity is hit. Current IMF projections expect an economic contraction of 4% in 2020.

The main economic impact from the crisis is through the trade channels. Exports are an important pillar of growth, amounting to 62% of GDP in 2019 (goods and services). The main trading partner is Germany (49% of total goods exports). Over half of exports are derived from foreign companies established in the country. Their production largely depends on imported intermediate inputs, capital goods and commodities, which exposes them to the risk of supply-chain disruptions as well as lower global demand from third countries. Producers of automotive supplies have already faced a shortage of components imported from China since January, due to COVID-related factory closures there. On the domestic side, the production and internal trade lockdown has already led to a massive drop in output and large layoffs and pay cuts in the workforce. In comparison with regional peers, tourism assumes a less important role in the country's economy, but it is severely hit by the crisis, with strong repercussions on activity and employment in transport and trade.

Table 5: Selected macroeconomic indicators for North Macedonia

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, % year-on-year	3.6	3.9	2.8	1.1	2.7	3.6
Consumer price inflation, %, end of period	-0.6	-0.3	-0.3	2.4	0.8	0.4
Key monetary policy rate, %, end of period	3.3	3.3	3.8	3.3	2.5	2.3
Unemployment rate, %	28.0	26.1	23.7	22.4	20.7	17.3
General government balance, % of GDP	-4.2	-3.4	-2.7	-2.8	-1.1	-2.1
Public debt, % of GDP	45.7	46.6	48.7	47.6	48.6	48.8
Current account balance, % of GDP	-0.5	-2.0	-2.9	-1.0	-0.1	-2.8
International reserves, USD billion	2.7	2.2	2.5	2.5	3.0	3.3
International reserves, months of imports	4.9	4.9	4.0	4.2	4.2	4.5
Gross external debt, % of GDP	70.0	69.3	74.7	73.4	73.3	72.2
Foreign direct investment, % of GDP	2.4	2.4	3.5	1.8	5.7	1.8

Sources: Eurostat, WIIW, IMF

The authorities have taken swift and decisive action to mitigate the socioeconomic impact of the crisis. After the central bank lowered the key policy rate and adopted measures to ease credit extension, the government followed with two packages of economic support measures. A first set targets the most impacted sectors, and includes interest-free loans for SMEs totalling EUR 100 million; subsidies to employee benefits for April to June, by up to 50% of the average salary paid in 2019 totalling EUR 120 million; and, exemptions from personal and corporate income tax, for April, May and June. A second set of measures, totalling EUR 200 million, includes financial support for private firms affected by the crisis; delay of loan repayments; and a further EUR 8 million in interest-free loans to SMEs.

Fiscal space to accommodate the economic fallout from the crisis is limited. The government expects a revenue shortfall of between 20-40% this year, compared to the original budget. It plans to reallocate budgeted expenditure towards the health sector and the new economic measures, without increasing the expenditure ceiling. The IMF expects the headline fiscal deficit to widen to 6.5% of GDP in 2020. In general, fiscal space for discretionary measures to cope with the multiple shocks is limited. Low tax rates, a large array of tax expenditures, and persistent shortcomings in revenue collection have contributed to a decline in public revenue ratios in recent years, adding to fiscal risks from a rising pension deficit and high indebtedness of public enterprises. The share of transfers in total public expenditure of the general government has risen from 51% in 2014 to 57% in 2019. Moreover, particularly high refinancing needs are arising in 2020-2021, including for the amortisation of two maturing Eurobonds, part of a World Bank Policy-Based Guarantee, and large commercial loans of the Public Enterprise for State Roads, which is tasked with the implementation of major road transport infrastructure. North Macedonia has requested emergency assistance from the IMF under the Rapid Financing Instrument (RFI), which amounts to EUR 177 million and was approved by the IMF Board on 10 April. On 15 April, North Macedonia also requested Macro-Financial Assistance from the EU.

Serbia

Serbia's economic situation before the outbreak of the Covid-19 crisis was rather positive. GDP growth in 2019 exceeded 4% for the second consecutive year, price stability appeared well anchored at an inflation rate of 1.7% in 2019 and the current account deficit, while deteriorating to 6.9% of GDP in 2019, continued to be fully covered by large FDI inflows. The financial sector performance has been sound with the NPL ratio declining to 4.1% in 2019. As regards public finances, the strong revenue performance in 2019 allowed for high increases in current and capital spending while maintaining a general government deficit close to balance (-0.2% of GDP in 2019). The public debt to GDP ratio has also continued its gradual decline to 52% of GDP. GDP growth was expected to remain robust in 2020 (around 4%) thanks to strong domestic demand supported by further large infrastructure projects, while public accounts were set to remain broadly balanced with a gradual further decline of the debt-to-GDP ratio. As regards the current account deficit, its evolution appeared mainly linked to and covered by strong FDI inflows.

Table 6: Selected macroeconomic indicators for Serbia

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, % year-on-year	-1.6	1.8	3.3	2.0	4.4	4.2
Consumer price inflation, %, end of period	1.8	1.6	1.5	3.0	2.0	1.8
Key monetary policy rate, %, end of period	8.0	4.5	4.0	3.5	3.0	2.3
Unemployment rate, %	18.9	17.7	15.3	13.5	12.7	10.4
General government balance, % of GDP	-6.2	-3.5	-1.2	1.1	0.6	-0.2
Public debt, % of GDP	66.2	70.0	67.8	57.9	53.7	52.0
Current account balance, % of GDP	-5.6	-3.5	-2.9	-5.2	-4.8	-6.9
International reserves, USD billion	11.5	10.7	10.0	11.0	12.0	13.4
International reserves, month of imports	6.6	6.7	6.2	5.4	5.3	5.4
Gross external debt, % of GDP	72.4	73.5	72.1	65.1	62.2	61.9
Foreign direct investment, % of GDP	4.2	5.9	5.8	6.5	8.2	8.7

Sources: Eurostat, WIIW, IMF

The COVID-19 crisis is expected to lead to a recession due to external and internal factors. The IMF expects the economy to contract by 3% in 2020. On the external side, due to its relatively high trade openness (exceeding 110% of GDP), the Serbian economy is set to be strongly hit by a slump in external demand. This concerns in particular export-oriented firms in the manufacturing industry, which is closely integrated in international supply chains, especially in the automotive industry. The relatively low share of tourism in Serbian GDP, of around 2%, should attenuate the impact of the crisis on exports of services. As regards financial and capital flows, there appears to be a risk of a certain reduction in workers remittances due to the slump in economic activity in major emigration countries such as Germany, but also due to the return of some migrant workers to Serbia before the closure of the borders. FDI inflows are also likely to drop considerably in the short term. However, the negative shock on FDI inflows and domestic demand is expected to lead to a short-term improvement in the current account balance that is also set to benefit from lower oil prices.

On the domestic side, the economic shock is both supply- and demand-driven. Many companies, in particular SMEs, are obliged to completely or partially halt their activities due to the shutdown and curfew measures taken by the Government. An immediate reduction of household income particularly affects informally employed workers. Depending on the duration of the state of emergency, private investment can be expected to be strongly impacted by confidence effects (wait and see), disruption in supplies and sanitary limitations to the activities still allowed to be pursued. There do not appear to be any major short-term risks to the financial sector that is well capitalised and faces a low level of NPLs.

The authorities have already adopted a sizeable package of discretionary fiscal and monetary policy measures to cushion the impact of the pandemic on the local economy and employment. In addition to allowing a significant effect of automatic stabilisers mostly on the revenue side, the authorities have adopted a major package of fiscal measures, such as deferred tax payments, direct income support to employees in SMEs and laid off workers, increased healthcare spending, one-off payments to pensioners and all citizens and liquidity-enhancing loan guarantees. The package has a total volume of around 6% of GDP of direct budgetary impact and another 5% in liquidity-enhancing measures. In view of the good starting position of public accounts close to balance, Serbia appears in a position to accommodate the resulting substantial increase in the general government deficit. While public debt would increase accordingly, its strong reduction over the last five years to close to 50% of GDP has created a relatively more favourable starting position. The National Bank of Serbia has also lowered its key policy interest rate in two steps by a total 0.75% to 1.5% and has taken a series of additional measures to provide dinar and forex liquidity to the market.

Turkey

The Turkish economy ended 2019 with a strong growth momentum but remained inherently vulnerable to external shocks. Economic growth accelerated in the fourth quarter, supported by base effects, to 6.0% year-on-year, up from 1.0% in the preceding quarter. Household consumption, boosted by consumer lending and pent-up demand, was the main growth driver, while investment activity rebounded from its slump. Despite its growth momentum, the economy remained inherently vulnerable. It had not yet recovered from the disruption caused by the 2018 recession when the COVID-19 pandemic started. As a result, the labour market recovery was still subdued and unemployment high at the beginning of 2020. In addition, vulnerabilities from the large open net foreign currency position of the non-financial sector and expansionary policies prior to the current crisis limit the policy space to mitigate the COVID-19 related effects.

Table 7: Selected macroeconomic indicators for Turkey

Indicator	2014	2015	2016	2017	2018	2019
Real GDP change, % year-on-year	5.2	6.1	3.2	7.5	2.8	0.9
Consumer price inflation, %, end of period	8.2	8.8	8.5	11.9	20.3	11.8
Key monetary policy rate, %, end of period	8.3	7.5	8.0	8.0	24.0	12.0
Unemployment rate, %	9.9	10.3	10.9	10.9	10.9	13.7
General government balance, % of GDP	-0.8	-1.0	-1.1	-1.5	-2.0	-2.9
Public debt, % of GDP	28.8	27.6	28.3	28.2	30.2	32.0
Current account balance, % of GDP	-4.7	-3.7	-3.8	-5.5	-3.4	0.2
International reserves, USD billion	106.9	91.4	90.6	81.6	70.9	76.3
International reserves, month of imports	5.9	6.0	6.0	5.2	4.7	5.6
Gross external debt, % of GDP	47.7	47.5	49.7	50.2	59.4	57.8
Foreign direct investment, % of GDP	1.4	2.2	1.6	1.3	1.7	1.1

Sources: Eurostat, WIIW, IMF, Turkish Ministry of Treasury & Finance

The COVID-19 crisis is likely to affect the Turkish economy through multiple channels. The economy is particularly exposed to pandemic effects due to its high integration in global value chains and strong dependence on tourism and transport – two of the most heavily affected sectors. Negative demand effects from the crisis, both on investment and private consumption, are expected to be very strong in view of further declines in confidence and very high uncertainty. The IMF expects the economy to contract by 5% in 2020. Financial market stress was quite pronounced already in early 2020, with country default swap spreads rising to multiyear highs in April and the Lira losing more than 13% against the U.S dollar since the beginning of the year. Capital outflows continued and dollarization pressures intensified amid concerns about refinancing the large short-term external debt and dwindling central bank reserves.

Despite a limited policy space, the authorities took a number of measures to cushion the impact of the pandemic on the local economy. However, the measures were mostly focused on boosting liquidity and providing favourable credit conditions, while fiscal transfers, beyond the operation of automatic stabilisers, remained limited. In view of the economy's vulnerabilities and significant exchange rate pressures, addressing external financing needs and arresting the decline in international reserves will be crucial in order to allow a stronger policy reaction to cushion the dramatic social and economic consequences of the COVID-19 crisis.