KEPE, *Greek Economic Outlook,* issue 36, 2018, pp. 20-25

1.5. Recent economic developments in the Western Balkan Region

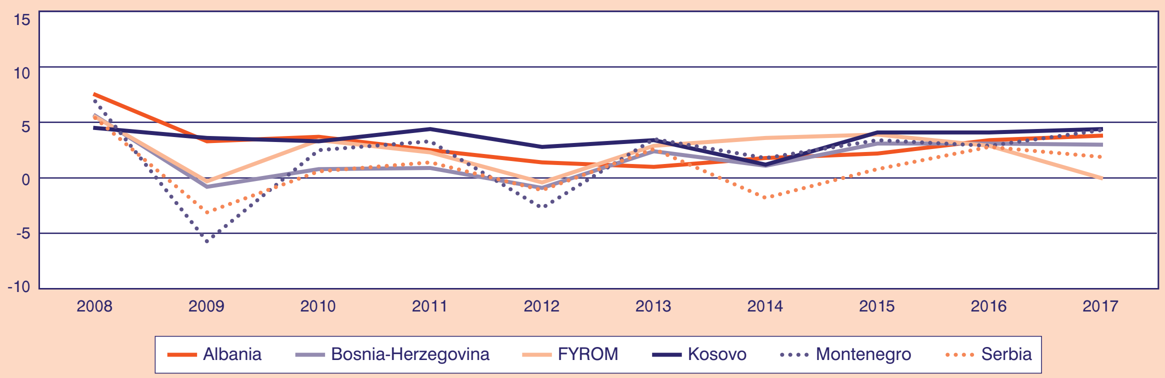
Ritsa Panagiotou

1.5.1. Growth

Real GDP growth in the Western Balkan countries slowed from 3.1 percent in 2016 to an estimated 2.4 percent in 2017, due to weaker growth in Serbia and FYROM (Figure 1.5.1). In Serbia, GDP growth fell from 2.8 percent in 2016 to 1.9 percent in 2017, due to a severe winter and a summer drought that led to a significant decline in energy production as well as in agricultural production (nearly 10 percent). The fast growth of imports –particularly imports of oil and food– was offset by an only modest increase in exports. Although industrial output and services recovered in 2017 –with growth in trade, transport and tourism– this was not enough to compensate for the fall in agricultural production. Private consumption was an important source of growth, spurred by rising employment, growing credit to households and higher wages. In the Former Yugoslav Republic of Macedonia (FYROM), the prolonged political turmoil of 2015-17 led to a steep decline in public and private investment, which contributed to a slowdown of growth to zero, down from 2.9 percent in 2016. Private consumption was the only contributor to growth in 2017, supported –as was the case in Serbia– by higher employment, growing credit to households and higher wages.

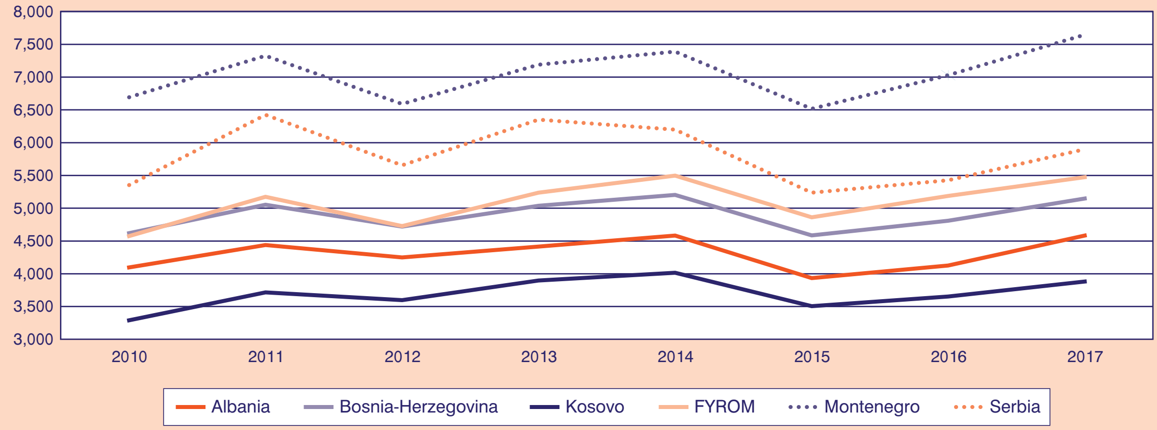
However, Bosnia-Herzegovina, the second largest economy in the region, grew steadily by an estimated 3 percent, and the dynamism of the smaller economies also helped drive regional growth. In Bosnia-Herzegovina growth was driven largely by private consumption, investment and services growth. Albania's real GDP grew by 3.8 percent in 2017, mainly driven by private investment and consumption. Investment dynamics were mainly related to two large energy projects financed by foreign direct investment: the Trans Adriatic Pipeline and the Devoll hydropower plant. A sustained recovery in employment, wages and household credit boosted private consumption. Tourism exports and recovering commodity exports more than compensated for a surge in investment-related imports of machinery and equipment and in drought-related energy imports. Kosovo's GDP grew by an estimated 4.4 percent in 2017, driven mainly by increased public and private investment and a recovery in exports. Exports, building on higher prices for base metals and higher production and higher services exports, added 3.6 pp to growth. Private investment was encouraged by a more attractive business environment, better financing options, and more FDI inflows; public investments contributed 3 pp to growth, up from 2.1. Expansion in services (especially construction, trade, finance and transport) added 2.6 pp to growth, while agriculture and industry contributed only 0.4 pp and 0.7 pp, respectively. Finally, Montenegro's economy grew an estimated 4.3 percent in 2017, stimulated by household consumption and investment: investment contributed 5 pp, as construction of the Bar-Boljare Highway and residential construction accelerated, while consumption also

FIGURE 1.5.1
Western Balkans, GDP (% change)



Source: IMF, *World Economic Outlook,* April 2018.

FIGURE 1.5.2
Western Balkans, GDP per capita (US$)



Source: IMF, *World Economic Outlook,* April 2018.

grew, supported by employment and wage growth, adding 3.7 pp to GDP growth.

After contracting sharply in 2015, GDP per capita grew steadily in all Western Balkan countries over the following two years: in Albania, GDP per capita grew from USD 3,935 in 2015 to USD 4,582 in 2017; in Bosnia-Herzegovina, from USD 4,586 to USD 5,148; in FYROM, from USD 4,860 to USD 5,474; in Kosovo, from USD 3,506 to USD 3,880; in Montenegro, from USD 6,517 to USD 7,647 (the highest in the region); and in Serbia, from USD 5,237 to USD 5,899 (Figure 1.5.2).

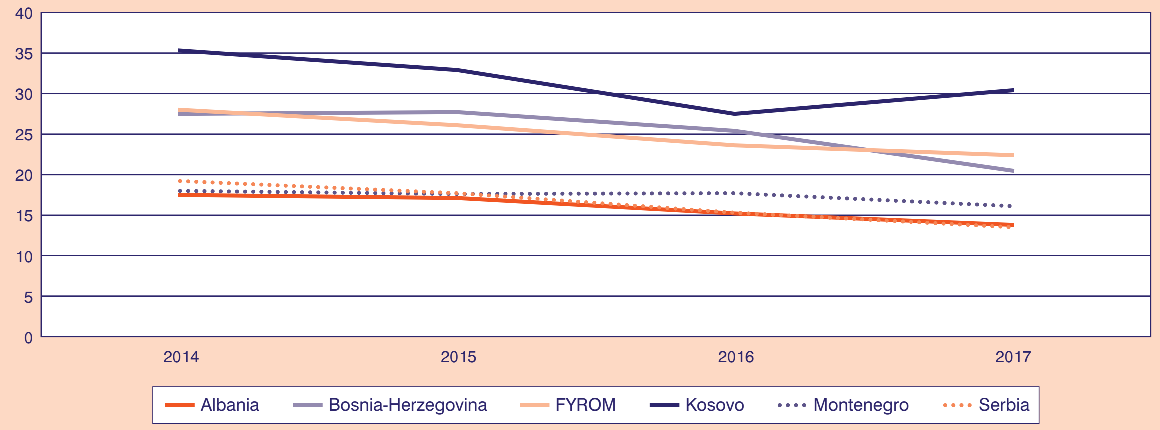
1.5.2. Employment

Unemployment declined in all countries in the region except Kosovo (Figure 1.5.3). As of September 2017, there were 1.24 million people unemployed – 5.6 percent fewer than a year earlier. During the same period, about 190,000 new jobs were created in the Western Balkans, with employment going up in all countries. The average employment rate in the Western Balkans has been increasing by 1.2 pp annually, reaching 44.2 percent in September 2017. In all the Western Balkan countries –except Kosovo– services accounted for over 80 percent of new jobs in 2017 (most of which were in wholesale and retail trade). Youth unemployment in the Western Balkans declined to 31.5 percent in September 2017 (307,000 fewer young people unemployed), 6 pp below the September 2016 rate.

In Albania, employment grew by 3.3 percent in 2017, following its impressive expansion of 6.5 percent in 2016. Labour force participation increased to 58.3 percent. In 2017 the unemployment rate declined by 1.4 pp to 13.6 percent –an historical low for the country. At 26 percent, youth unemployment in Albania is the lowest in the region. Unemployment in Bosnia-Herzegovina fell from 25.4 percent in 2016 to 20.5 percent in 2017, which was the largest decline in unemployment in the region during that period. However, this was due, to a large extent, to declining labour force participation as people emigrated or stopped searching for work. Moreover, although long-term unemployment in Bosnia-Herzegovina decreased by nearly 3.4 pp in 2017, at 82 percent it is still a very high percentage of the unemployed. Employment in 2017 stood at a low 33.9 percent. Most of the expansion in employment originated in agriculture and the services sector, while industrial employment went down in absolute terms.

In FYROM, employment grew by 2.4 percent in 2017, partly helped by subsidies in the first half of the year that facilitated the creation of more than 5,000 jobs (the policy was discontinued by the new government after July 2017). However, at 44.5 percent, the employment rate is still low. Most of the jobs created were in wholesale and retail trade, transport and storage and manufacturing –the sectors most linked to the FDI projects that benefit from tax exemptions and other government support. The unemployment rate fell to an historical low in 2017, 22.4 percent –of which 81 percent is long term– while youth unemployment declined by 1.5 pp to 46.7 percent. In Kosovo, higher growth fostered job creation in 2017. Labour force participation increased by 3.8 pp, and employment grew by 1.7 pp, although unemployment also increased (by 3.3 pp) reaching 30.4 percent as more people,

FIGURE 1.5.3
Western Balkans, Unemployment (% change)



Source: IMF, *World Economic Outlook,* April 2018.

particularly youth, entered the labour force at a faster pace than that of the creation of new jobs. Over 70 percent of unemployment is long term, and employment is still only 29.7 percent. Employment went up in information, manufacturing, agriculture wholesale and retail trade, communications, and administrative activities and support services. Youth unemployment dropped from 52.4 in 2016 to 51.6 percent. Kosovo was the only country in the region where industry –and not services– was the most important factor in employment growth, and a major impetus came from greater demand for Kosovar metal from the EU.

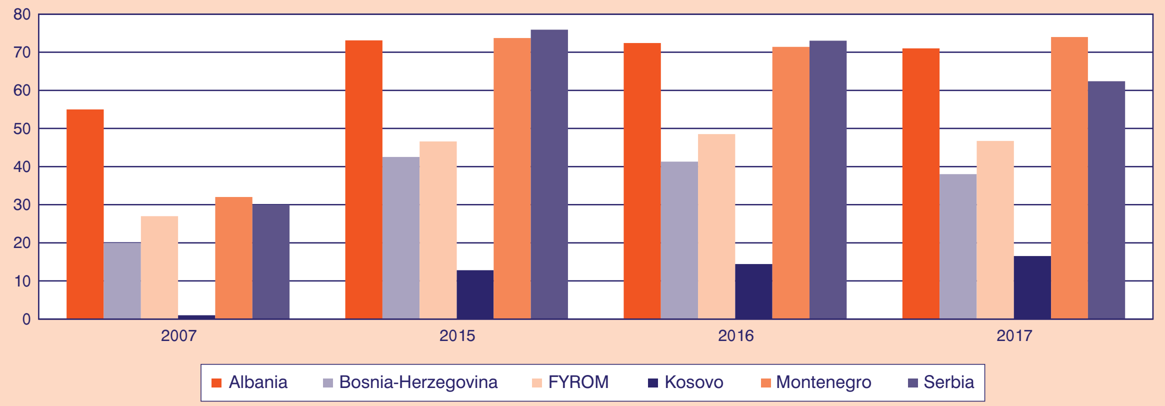
In Montenegro, employment increased by 2.3 percent, reaching 45.9 percent in 2017. The unemployment rate declined from 17.7 percent in 2016 to 16.1 percent in 2017 and youth unemployment decreased from 36.1 percent to 32 percent during the same period. In Serbia, despite the negative impact of the weather on agricultural activity, employment increased by about 3 percent in 2017 compared to the previous year. The average 2017 employment rate reached a record high of 46.7 percent, led by services, which created 33,000 new jobs (a quarter of them in wholesale and retail trade) spurred by higher consumption and fast-growing services exports. Manufacturing created another 23,700 jobs (a 6 percent increase in employment in this sector). Additional impetus came from greater demand from the EU for Serbian automotive products. Moreover, the number of registered entrepreneurs went up by 5.9 percent in 2017. Unemployment fell from 15.3 percent in 2016 to 13.5 percent in 2017, which was the lowest rate in the region. Youth unemployment also fell from 35.0 percent to 32.0 percent in the same period.

1.5.3. Fiscal balances

Although most countries took in more revenue (mostly through improved tax collection), few used the opportunity to improve fiscal balances: in most cases, higher revenue led to higher spending and higher deficits in the region, except in Serbia and Bosnia-Herzegovina, where continued consolidation efforts combined with lower subsidies to state-owned enterprises led to fiscal surpluses in 2017. By contrast, Montenegro recorded the largest increase ever in its deficit –2.3 percent of GDP– driven by extra spending on the construction of Bar-Boljare highway. However, in 2017 it introduced reforms to contain current spending, abolish untargeted social benefits and reduced spending on public wages. Albania increased public investment activity (public infrastructure and energy subsidies), FYROM chanelled extra spending on health, pensions, subsidies and social assistance, while Kosovo chose to increase pensions and benefits to war veterans, as well as public investment, e.g. on the Route 6 motorway.

Countries that undertook fiscal consolidation saw public debt ease (Figure 1.5.4). A combination of economic growth, fiscal discipline and active debt management in 2017 brought down the share of public and publicly-guaranteed (PPG) debt in Serbia, Albania, FYROM and Bosnia-Herzegovina. Between 2016 and 2017, PPG debt fell from 73.0 percent to 62.4 percent of GDP in Serbia, 72.4 percent to 71.0 percent in Albania, 48.5 percent to 46.7 percent in FYROM, and 41.3 percent to 38.0 percent in Bosnia-Herzegovina. On the contrary, Montenegro's PPG debt increased from 71.4 percent of GDP to 74.0 percent, and Koso-

FIGURE 1.5.4
Western Balkans, Public debt (% of GDP)



Source: IMF, *World Economic Outlook,* April 2018.

vo's PPG debt, while still the lowest in the region (16.5 percent of GDP in 2017), has been on a continuing upward trend since 2014.

1.5.4. Credit

In 2017, credit outstanding increased everywhere in the region, except in Albania. In Kosovo, the growth of credit to the private sector was particualrly strong, over 11 percent in 2017, as private demand grew with better market conditions and lower interest rates. In Montenegro, accelerating private sector credit growth exceeded 6 percent in December 2017, as confidence improved and there was a vigorous growth in deposits, a major source of funding for local banks. At 3 to 7 percent, lending remained robust in Bosnia-Herzegovina and FYROM, while credit growth was almost zero in Albania, mostly because of loan write-offs.

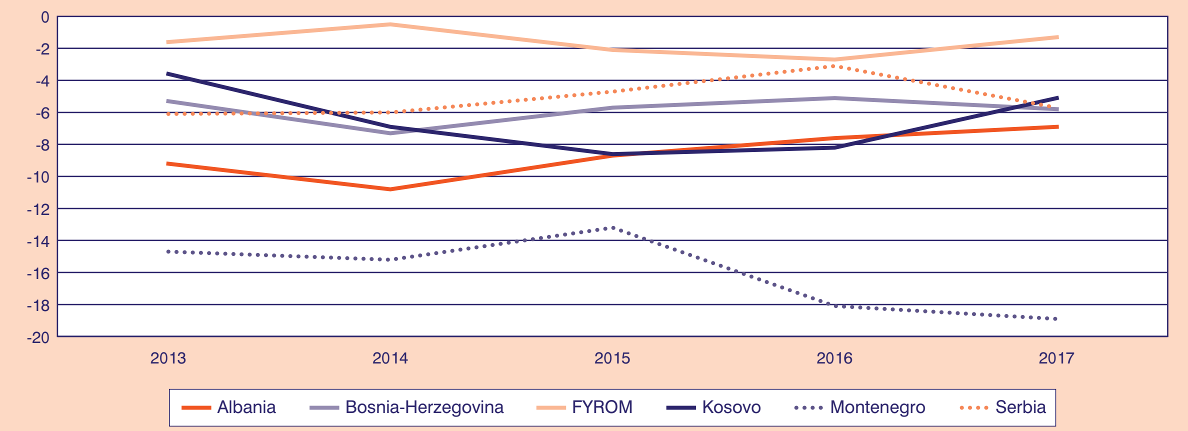
Banks in the region are liquid and well-capitalized. At the end of 2017, bank capital adequacy averaged 17.5 percent and the ratio of liquid to total assets was about 29.6 percent. Profitability, though low, has held firm, with a regional average return on assets of 1.7 percent. However, the sector is still dealing with the aftershocks of the financial crisis: despite improvements in the banking system as a whole, the vulnerabilities of domestic banks have renewed concerns about asset quality and the health of specific banks, especially in Bosnia-Herzegovina, Serbia and Montenegro. Further structural changes are likely after the planned sale of some foreign-owned subsidiaries as parent banks realign country exposures and smaller domestic institutions merge in Albania, Bosnia-Herzegovina and Serbia.

1.5.5. Current accounts

In 2017 external deficits widened in Bosnia-Herzegovina, Montenegro and Serbia, and narrowed in Albania, Kosovo and FYROM (Figure 1.5.5). The current account deficit in Serbia rose markedly –from 3.1 percent of GDP in 2016 to 5.7 percent in 2017– as supluses in trade in services failed to compensate for the 27.8 percent rise in the widening goods trade deficit and a 27.1 percent deficit in primary income. However, remittances grew robustly –by 10.1 percent, reaching 5.9 percent of GDP– and a net increase of 27.1 percent in FDI was enough to finance the current account deficit. Montenegro's high external imbalances worsened in 2017: the current account deficit widened to 18.9 percent of GDP in 2017, up from 18.1 percent the previous year. Imports of goods increased by 11.7 percent, led by the high import-dependence of investments in infrastructure and tourism. As EU demand rose, exports –led by metals and mineral ore sales– grew by 13.9 percent, and exports of services also rose by 8 percent. However this was not sufficient to offset the more than 2 pp widening of the trade deficit. Net FDI inflows increased to 11.2 percent of GDP, financing two thirds of the current account deficit. Bosnia-Herzegovina's current account deficit increased slightly in 2017, to 5.8 percent, driven mainly by increased imports needed for public investment projects. The services surplus from transport, travel, construction, and remittances was enough to finance a significant part of the trade deficit, while the rest was financed through FDI.

In contrast, a lower trade deficit and higher remittances contributed to the narrowing of current account deficits in Albania, Kosovo and FYROM. Specifically,

FIGURE 1.5.5
Western Balkans, Current account balance (% change)



Source: IMF, *World Economic Outlook,* April 2018.

Albania's current account deficit fell from 7.6 percent of GDP in 2016 to 6.9 percent in 2017, driven by an increase in exports of commodities, tourism and manufacturing-related services that pushed up total exports by 44.9 percent. Increased demand in the EU, Kosovo's main trading partner, led to a surge in exports of goods and services –by 23.1 percent and 17.7 percent, respectively– and contributed to the decrease in the current account deficit from 8.2 percent of GDP in 2016 to 5.1 percent. Higher remittance inflows also helped offset the rise in investment –and consumption– related imports. Finally, FYROM's current account deficit narrowed to 1.3 percent of GDP in 2017, down from 2.7 percent in 2016, driven by a solid export performance in iron and steel, furniture and tobaco.

Steady FDI inflows helped finance current account deficits: total FDI inflows to the region were relatively steady in 2017, supported by remittance inflows. In Montenegro, net FDI inflows went up 1.8 pp, to 11.2 percent of GDP as tourism and real estate investments resumed, but only financed 60 percent of the current account deficit. In Albania, net FDI inflows were associated with large investment projects, and in Kosovo diaspora investments in real estate were supported by the highest remittances in the region, 11.2 percent of GDP. In Serbia and FYROM, FDI inflows continued to fully finance the current accout deficit, but in Bosnia-Herzegovina, where FDI is significantly less than in other countries, they finance only about 30 percent of it. Although the Western Balkans have enjoyed substantial support to growth from FDI inflows, investment remains lower than recommended for sustainable growth.

1.5.6. Outlook and risks

In the medium term, real GDP growth in the western Balkans is projected to recover, reaching 3.2 percent in 2018 and 3.4 percent in 2019. (Table 1.5.1). FYROM's economy is projected to gain momentum in 2018 and grow at 2.3 percent, from zero in 2017, as investment and consumption recover after the resolution of the political crisis. In Serbia, a recovery in investment is projected to support growth of 3 percent in 2018 and 3.5 percent in 2019. Kosovo is projected to grow at 4.8 percent in 2018-19, led by higher capital spending and investment, while growth in Bosnia-Her-

TABLE 1.5.1 GDP growth (% change)

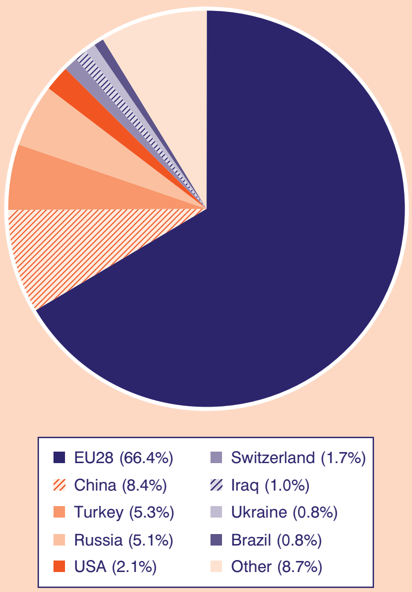
	2016	2017	2018*	2019*
Albania	3.4	3.8	3.6	3.5
Bosnia-Herzegovina	3.1	3.0	3.2	3.4
FYROM	2.9	0.0	2.3	2.7
Kosovo	4.1	4.4	4.8	4.8
Montenegro	2.9	4.3	2.8	2.5
Serbia	2.8	1.9	3.0	3.5
WB6	**3.1**	**2.4**	**3.2**	**3.5**

Source: IMF, *World Economic Outlook*, April 2018.

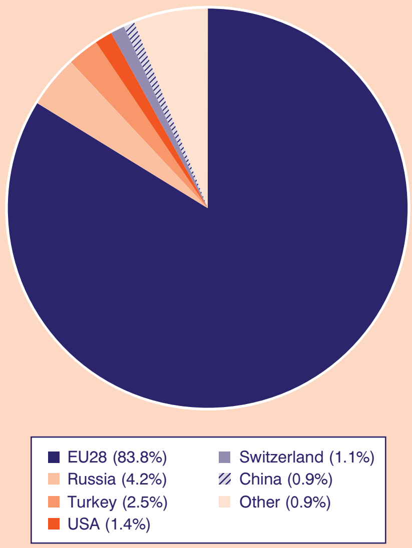
* Forecast.

FIGURE 1.5.6

Top trading partners Imports 2017



Top trading partners Exports 2017



Source: European Commission, Directorate-General for Trade, April 2018.

zegovina is also expected to pick up, supported by more investment in energy, construction and tourism. On the other hand, growth in Albania and Montenegro is expected to be moderate in 2018-19, as large FDI projects wind down and the necessary fiscal consolidation moves forward in Montenegro.

The projections for growth in the Western Balkans are closely linked to favourable external conditions: higher growth in global trade flows, favourable financing conditions and continued growth in the EU –the most important trade and investment partner of the Western Balkan countries (Figure 1.5.6). Implementation of structural reforms are also necessary for sustainable growth: these include reforming the complex tax administration, accelerating the privatisation agenda, improving the opaque business environment, dealing with clientelism and corruption.

Finally, a prerequisite for sustainable economic growth is political stability and ethnic reconciliation, an ever-elusive goal in the region. In this context, the Western Balkan regimes have to address the low quality of institutions and the electoral process, the protection of human rights and the freedom of the press. They must also push back againt the recent increase in instances of ethnic tensions and populist/nationalist rhetoric. The European Union has a very important role to play in the economic, political and ethnic stability of the region: the EU's "Credible enlargement perspective for the Western Balkans" –launched in February 2018– aims at injecting fresh momentum into EU enlargement, speeding up the homework the six countries need to do and giving a concrete framework and timeline for achieving this.

References

EBRD, *Transition Report 2017-2018,* Country Assessments.

European Commission, Directorate-General for Trade, *Western Balkans,* April 2018.

IMF, *World Economic Outlook,* April 2018.

United Nations Conference on Trade and Development, *World Investment Report,* 2017.

World Bank, *Migration and Remittances Factbook*, 2017.