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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 and Turkey

In view of the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey of 19 May 2020, delegations will find attached the Draft Joint Conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey, which were endorsed by the members of the EFC and representatives of Albania, Bosnia and Herzegovina, the Republic of North Macedonia, Kosovo*, Montenegro, Serbia and Turkey on 4 May 2020.

* 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.

JOINT CONCLUSIONS OF THE ECONOMIC AND FINANCIAL DIALOGUE BETWEEN THE EU AND THE WESTERN BALKANS AND TURKEY

The Economic and Financial Dialogue between the EU and the Western Balkans and Turkey, Brussels, 19 May 2020

Representatives of the EU Member States, the Western Balkans and Turkey, the European Commission and the European Central Bank, as well as representatives of the central banks of the Western Balkans and Turkey[1] met for their annual economic policy dialogue[2]. The dialogue aims at preparing the Western Balkans and Turkey for the future participation in the European Semester.

The outbreak of the Covid-19 pandemic confronts EU Member States, the Western Balkans and Turkey with similar unprecedented major public health, economic and social challenges. Participants agreed that it is crucial to maintain the economic policy dialogue in these exceptional circumstances in view of a commonly coordinated response to the crisis. Participants acknowledged the strong solidarity between the EU and the Western Balkans and Turkey they have been demonstrating by providing medical and financial assistance to fight the Covid-19 pandemic and contributing to address its socio-economic impact in the region. Participants welcomed the measures adopted by the Western Balkans and Turkey to limit the spread of the Covid-19 virus. They also acknowledged that the adoption of temporary emergency measures should be done in a transparent manner and should not undermine the principles of rule of law, democracy and fundamental rights. Participants fully supported the Western Balkans and Turkey in their decisions to allow automatic fiscal stabilisers to accommodate crisis-induced economic fall-outs in 2020. They also considered appropriate to take additional discretionary measures to cushion the negative impact on growth and employment in the short-term. Looking ahead beyond the short-term impact of the crisis, participants agreed that the economic policy dialogue should continue to play a central role for policy coordination in view of the medium-term recovery after the crisis. The macro-fiscal scenarios and part of the structural analysis presented in the Economic Reform Programmes have been strongly impacted by the Covid-19 crisis fallout. Therefore, participants concluded that this year's policy guidance will focus on measures providing an immediate fiscal, economic and social policy response to mitigate the impact of the pandemic as well as on the transition from these short-term to more structural measures to foster the medium-term recovery. In order to build up economies' resilience in the longer term, these measures should duly take into account the digital transformation and the green transition, in line with international commitments. It is important to duly integrate gender equality perspective in all the measures taken to foster employment, social protection and health care. Strong ownership will be key to achieve the successful implementation of the jointly agreed policy guidance.

Overall, Participants underlined their commitment to this surveillance process and encouraged the Western Balkans and Turkey to foster strong recovery via further improvement of their macroeconomic, budgetary and structural policies in a medium-term perspective. The dialogue will continue in 2021, including on the implementation of these conclusions.

[1] Montenegro, Serbia, the Republic of North Macedonia, Albania and Turkey are candidate countries for EU accession.
[2] The conclusions of this dialogue are without prejudice to EU Member States´ positions on the status of Kosovo.

Turkey

Turkey submitted its Economic Reform Programme 2020-2022 on 10 February 2020. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2019 has been implemented to a limited extent.

The economy recovered faster than expected from the recession triggered by the 2018 sharp depreciation of the lira thanks to a strong policy stimulus and favourable external financing conditions. However, the growth momentum was interrupted abruptly by the Covid-19 pandemic, which stifled global economic activity and rendered the ERP’s macroeconomic and fiscal scenarios obsolete. As other major emerging market economies, the Turkish economy is affected by the global slowdown due to its high integration in global value chains and, additionally, because of its dependence on tourism and transport – two of the most heavily affected sectors. In this context, preserving the recent significant improvement in the external balance, which is key to sustaining macroeconomic stability, has become challenging, especially in the short run, notwithstanding accommodative policies by major world economies, low oil prices and a competitive exchange rate.

Despite a limited policy space, the authorities took timely and targeted measures to cushion the impact of the pandemic on the local economy and employment. Although delaying plans to improve general government balance, fiscal measures could be expanded beyond the operation of automatic fiscal stabilisers to further enhance direct transfers to the most vulnerable groups and increase active labour market policies. A post-crisis fiscal strategy should be developed as well and, once the temporary shock dissipates and the economy has stabilised, fiscal policy should be geared towards winding down one-off and temporary measures and improving the structural balance, while simultaneously boosting productive expenditure. Improving fiscal transparency and governance would be an important step towards enhancing policy credibility.

The easing cycle of monetary policy that started in July 2019 brought the ex-post real policy rate further into negative territory, while leaving the ex-ante real policy rate slightly positive up to April 2020, yet much below that of other large emerging and developed economies. Elevated global uncertainty, trade and geopolitical tensions, as well as concerns about central bank independence weighed on the local currency. The central bank has taken a wide set of liquidity measures in response to the coronavirus pandemic. As inflation and inflation expectations remain above the target, monetary policy space to further ease financing conditions seems relatively limited.

Regarding financial stability, subdued economic activity, coupled with declining but high inflation and a weaker lira, has put some pressure on the debt repayment capacity of corporates, and to a lesser extent of households, resulting in a deterioration of the banking sector’s asset quality. Overall, non-performing loan ratios still remain relatively low in international comparison; however they are likely to increase amid the coronavirus pandemic as in many other countries. In this context, measures introduced earlier by the government, especially with respect to improvements in the financial restructuring legislation, are welcome but could be broadened. Overall, the banking sector appears to have sound buffers, with capitalisation well above internationally accepted minimum standards. Profitability has declined, relatively more in state-owned banks, which have led the broad-based credit recovery. The build-up of indirect credit risk stemming from the high share of corporate forex lending and external debt denominated in forex has slowed in 2019, thanks to macro-prudential measures and heightened awareness of foreign exchange risks, but given the high accumulated levels of forex debt this remains a key vulnerability.

Structural weaknesses have been exacerbated by the Covid-19 pandemic, highlighting the strong need for structural reforms. Effective and well-coordinated structural reforms will contribute to mitigating the impact of the pandemic and accelerate the post-crisis economic recovery. The government's policy response will be critical to shape the economy in the post crisis context. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges posed by Covid-19 are linked to strengthening the public health sector, preserving employment and improving social protection, and improving the regulatory and institutional environment affecting businesses and providing support to the private sector. The pandemic is putting the health system under stress, and highlights the importance of covering the whole population by health insurance. In a situation of already increased unemployment levels over 2019, the pandemic is putting jobs at further risk, including in the informal sector. Social assistance and unemployment benefit schemes are further stretched due to the pandemic and are limited in providing coverage and adequate benefits to those in need.. Businesses, in particular SMEs, self-employed and small family enterprises are considerably affected by the pandemic and are in need of further urgent support, such as liquidity and further easing the regulatory and tax burdens. The effectiveness of support measures depends on good governance, coordination and inclusiveness, taking into consideration the large informal sector.

Participants take note that Turkey improved compliance with respect to annual national accounts by sending population data and in balance of payments, sending quarterly international investment positions series. Turkey has also made progress in other statistical areas such as Europe 2020 indicators, annual international trade in services statistics, foreign direct investment, research and development which is fully compliant and harmonised indices of consumer prices. Turkey should give priority to the transmission of excessive deficit procedure notifications, government finance statistics and further improve annual and quarterly national accounts, by also improving agricultural statistics that serves as a data source for national accounts.

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

1. Increase in a transparent manner fiscal transfers to households and companies with the view to limiting the fall-out in employment. Increase growth-enhancing capital expenditure above budget plans in 2020 and in the medium term. To reinforce the medium-term sustainability of public finances, prepare an exit strategy to lower the use of one-off and temporary measures over the medium term,.

2. Conduct spending reviews and implement performance budgeting as planned, in order to create space for more productive expenditure and to increase budgetary transparency and accountability. Publish the regular audited reports of the Sovereign Wealth Fund. Take preparatory steps towards publishing higher-than-annual frequency data by sub-sector on general government budget execution.

3. Implement an appropriate monetary policy stance at the central bank's own discretion to contain inflation broadly in line with the target and anchor inflation expectations, increase trust in the local currency and boost investor confidence, in particular amid the global risk-off environment evoked by the Covid-19 pandemic. Closely monitor financial stability challenges arising as a result of the Covid-19 pandemic and take appropriate action if needed. Ensure the transparency of measures taken to provide liquidity for the banking sector and support the flow of credit to the private sector. Enhance confidence in the banking sector by conducting transparent asset quality reviews, and explore further measures to mitigate the likely build-up of new NPLs.

4. With the aim to improving the business environment, further strengthen the rule of law and the regulatory environment and improve consultation mechanisms with business organisations and social partners on relevant new legislation. In order to mitigate the impact of the Covid-19 pandemic, target state aid and small and medium-sized enterprises support programmes in a transparent manner to sectors with strong potential for economic recovery. Implement additional measures helping viable businesses to avoid insolvency.
5. Extend social protection coverage and provide incentives for businesses and employees in the informal economy sector to register and to facilitate their transfer to the formal economy. Revise the Action Plan for reducing the informal economy taking into account the specific situation of migrant workers and those under temporary protection as well as the impact of Covid-19 pandemic.
6. Take measures to preserve jobs including through short-time work schemes and other employment flexibility schemes, step up VET training, reskilling and upskilling, and redesign and upscale targeted employment incentives, in particular for recently unemployed workers and young people. Ensure adequate income support and social assistance for the unemployed and those at risk of poverty and social exclusion.

Montenegro

Montenegro submitted its Economic Reform Programme 2020-2022 on 31 January 2020. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2019 has been partially implemented.

The maturing of the investment cycle had a dampening effect on economic output in 2019. The economy grew by robust 3.6% y-o-y, albeit decelerating from the 5.1% expansion recorded a year before. GDP growth was driven by a record-breaking tourist season, boosting private consumption and exports of services. However, the economic performance is set to deteriorate in 2020 due to the negative effects of the coronavirus (COVID-19) outbreak. Montenegro's economy is strongly dependent on tourism, a key source of foreign exchange, GDP growth, and fiscal revenues. However, tourism has been paralyzed with knock-on effects on other related sectors like retail sales, transport and catering.

Despite a very constrained fiscal space and modest effect from automatic fiscal stabilisers, the authorities reacted rapidly, adopting a series of measures to limit the impact of the pandemic on growth and employment, such as increasing healthcare spending, deferring the payment of taxes and social contributions and providing a credit line to help companies to improve their liquidity. The fiscal costs of the policy response together with a deteriorating economy is likely to undermine temporarily the ERP's plan for public debt reduction. Once the temporary shock dissipates, fiscal policy should be geared towards debt reduction based on earlier plans. Improving fiscal governance and transparency would be an important step towards enhancing long-term sustainability. Montenegro lacks an independent body to ensure not only the implementation of the fiscal rules but also their transparency. Moreover, the tax administration would require designing new tools to help improving fiscal performance.

The resilience of the banking system has strengthened, also on the back of some consolidation in the sector. To safeguard the progress achieved in 2019, the central bank should closely monitor financial stability challenges that may arise as a result of the coronavirus pandemic and take appropriate action where needed. Efforts in this regard should be supported by additional investment in the central bank's supervisory capacity, by duly operationalising the bank resolution framework as well as by pursuing measures to facilitate the resolution of existing and potential future non-performing debts. Equally, the central bank should diligently work towards completing the asset quality review, apply equal standards to all banks to assure its credibility, publish its findings in a transparent manner and promptly take any measures that its results may call for.

Structural weaknesses have been exacerbated by the Covid-19 pandemic, highlighting the strong need for structural reforms. Effective and well-coordinated structural reforms will contribute to mitigating the impact of the pandemic and accelerate the post-crisis economic recovery. The government's policy response will be critical to shape the economy in the post crisis context. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, enhance transperancy and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges posed by Covid-19 are linked to strengthening the public health sector, preserving employment and improving social protection, enhancing the business environment and providing support to the private sector. The pandemic is putting the health system under stress, revealing persistent under-funding and weak capacities to cope with the crisis. Despite improvements in the labour market in the past few years, the pandemic is now putting jobs at risk, including in the informal sector. Underfunded, inadequate and insufficiently targeted social assistance and unemployment benefit schemes become further stretched. The crisis has also highlighted the need to review the social protection system with the aim of improving its coordination with employment activation and its capacity to reduce social exclusion and poverty. Businesses, in particular SMEs, self-employed and small family enterprises are considerably affected by the pandemic and are in need of urgent support, such as provision of liquidity and further easing the regulatory and tax burdens. The effectiveness of support measures depends on good governance, coordination and inclusiveness, taking into consideration the large informal sector.

Participants take note that Montenegro made progress in several statistical areas, namely in balance of payments (with start of compilation of the international investment position), energy statistics, harmonised indices of consumer prices, foreign direct investment and short-term business statistics. However, serious gaps still remain in national accounts. Montenegro should also give priority to the transmission of excessive deficit procedure notifications and government finance statistics and aim for a full implementation of the European System of Accounts 2010.

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

1. Use fiscal policy to mitigate the crisis-induced impact on growth and employment. While allowing for due reinforcement of healthcare spending during the crisis, reinforce the medium-term sustainability of public finances by limiting overall spending on wages, also by taking concrete steps towards implementing the public administration optimisation plan. Establish a fully-fledged centralised public sector employment payroll system.

2. To support economic recovery, make sound cost-benefit analysis an integral part of public investment management. Take steps towards the establishment of a fiscal council, following consultation of the related options paper with stakeholders, including the EU. Introduce the electronic fiscal invoice system (e-fiscalisation).

3. Closely monitor financial stability challenges arising as a result of the coronavirus pandemic and take appropriate action if needed, while developing further the supervisory capacity of the central bank. Identify and prioritise the removal of obstacles for the swift and successful resolution of non-performing debts, particularly by improving legal, judicial and institutional procedures. Ensure the participation of all banks in the asset quality review on equal terms, transparently publish its findings and promptly take remedial action where needed.

4. Ensure smooth and effective support to the private companies and their employees affected by the crisis, in particular micro, small and medium-sized enterprises and self-employed. Extend social protection coverage and provide incentives for businesses and employees in the informal economy sector to register and to facilitate their transfer to the formal economy. In order to ensure a swift recovery, focus on simplifying tax legislation and reducing the diversity of para-fiscal charges affecting businesses.

5. Maintain continuous dialogue with social partners, business organisations and civil society on all decisions taken in response to the Covid-19 pandemic. Provide an active feedback from this dialogue to the public domain. Ensure close cooperation between central and local authorities on all crisis mitigation and economic recovery measures, including through joint and coordinated actions.

6. Take measures to preserve employment including by ensuring short-time work schemes and flexible working arrangements, as well as through increased provision of active labour market policies to facilitate transition to work and support workers at risk of job loss. Ensure adequate income support and social assistance for the unemployed, and for those at risk of poverty and of social exclusion. Strengthen the healthcare system's resilience and capacity to improve access and quality provision of health care services.

The Republic of Serbia

Serbia submitted its Economic Reform Programme 2020-2022 on 31 January 2020. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2019 has been partially implemented.

Serbia maintained a robust pace of economic growth of 4.2% in 2019 due to strong domestic demand, in particular from investment. The ERP projected the economy to continue expanding steadily, supported by solid growth in private consumption, investment and exports. It also expected the public debt ratio to continue falling based on a broadly balanced budget. However, the growth momentum was interrupted abruptly by the Covid-19 pandemic, which stifled global economic activity and turned the ERP's macroeconomic and fiscal scenarios obsolete. The Serbian economy is strongly exposed due to its relatively high trade openness and its reliance on FDI inflows to modernise productive capacities, especially in view of the particularly strong Covid-19 impact on its main trading partners. On the other hand, the relatively low share of tourism in gross value added may attenuate the impact as compared to some neighbouring countries.

In addition to allowing a significant effect of automatic stabilisers mostly on the revenue side, the authorities took major discretionary fiscal and monetary measures to cushion the impact of the pandemic on the local economy and employment. The adopted 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 loan guarantees will increase the general government deficit and delay the reduction of government debt. To reinforce the medium-term sustainability of public finances, the overall spending on public wages should be contained while simultaneously increasing growth-enhancing capital expenditure. Improving fiscal governance would be essential to durably anchor fiscal policy after the crisis. Increasing transparency on fiscal risks and further restructuring of state-owned enterprises would also be important steps towards enhancing medium-term policy credibility.

The National Bank of Serbia conducted monetary policy in 2019 in line with the inflation targeting regime. The key policy rate was cut to 2.25% through the year, and a further cut by 75 bps to 1.5% was implemented in March and April 2020 as a response to the coronavirus pandemic. Headline inflation hovered mostly within the lower part of the tolerance band in 2019.

The banking sector remains well capitalised and liquid according to several metrics. The ratio of non-performing loans to total loans has declined considerably since 2015 and credit growth appears to have resumed for both corporates and households. The central bank adopted prudential measures to prevent a build-up of risks stemming from excessive lending at long maturities in the household sector. Continued vigilance is warranted, in particular in light of the financial stability challenges that may arise from the coronavirus pandemic. The measures introduced so far to foster the use of the local currency are welcome. While the dinarisation of bank deposits has been gradually increasing, enhancing lending dinarisation has proved more difficult, with foreign currency use overall remaining the highest in the region. A number of factors weigh on the ability to progress further, including the remaining, albeit decreasing, interest rate differentials between dinar and euro denominated lending and limited long-term funding sources in dinar for banks. The measures adopted by the central bank at the end of 2019 to improve the currency structure of lending to corporates and provide more favourable dinar financing for SMEs are appropriate steps in this regard.

Structural weaknesses have been exacerbated by the Covid-19 pandemic, highlighting the strong need for additional structural reforms,. Effective and well-coordinated structural reforms will contribute to mitigating the impact of the pandemic and accelerate the post-crisis economic recovery. The government's policy response will be critical to shape the economy in the post crisis context. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges posed by Covid-19 are linked to strengthening the public health sector, preserving employment and improving social protection, enhancing business environment and providing support to the private sector. The pandemic is putting the health system under stress, revealing persistent under-funding and weak capacities to cope with the crisis. Despite improvements in the labour market in the past few years, the pandemic is now putting jobs at risk, including in the informal sector. The high tax wedge on low-wage earners acts as a disincentive to formal employment. Social assistance and unemployment benefit schemes, which are underfunded, are further stretched and do not provide sufficient coverage and adequate benefits. Businesses, in particular SMEs, self-employed and small family enterprises are considerably affected by the pandemic and are in need of urgent support, such as liquidity and further easing the regulatory and tax burdens. The effectiveness of support measures depends on good governance, coordination and inclusiveness, taking into consideration the large informal sector.

Participants welcome that Serbia has increased its efforts in the area of national accounts and has completed the implementation of the benchmark revision of its GDP back data to eliminate the breaks in series. Serbia transmits the entire set of monthly MFI Interest Rate Statistics and has had a good level of compliance with regard to short-term business statistics and balance of payments. Further progress is expected regarding adherence to the excessive deficit procedure methodology and government finance statistics. The missing data series in the area of annual and quarterly national accounts should also be addressed.

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

1. Allow automatic fiscal stabilisers to accommodate crisis-induced economic fall-outs and further mitigate the impact on growth and employment by appropriate discretionary fiscal measures. To reinforce the medium-term sustainability of public finances, contain overall spending on wages as a percentage of GDP, while allowing for due reinforcement of healthcare spending during the crisis, also by taking concrete steps towards implementing an appropriately designed public sector wage system reform. Adopt a credible and binding system of fiscal rules underpinning fiscal sustainability. I

2. To support economic recovery, further increase growth-enhancing capital spending as a share of GDP in 2020 and over the medium term. Increase the transparency of the fiscal impact of state-owned enterprises by reinforcing fiscal risk analysis and by publishing quarterly reports on SOEs' financial performance. To reduce fiscal risks, improve the governance of state-owned enterprises including via further restructuring.

3. Closely monitor financial stability challenges arising as a result of the coronavirus pandemic and take appropriate action if needed. Further implement the measures included in the 2018-2020 NPL strategy and related action plan, including those aimed at preventing the accumulation of new non-performing loans such as reforms of the bankruptcy frameworks. Enhance further the use of the local currency by fostering the development of secondary markets for government and corporate dinar securities, and support the use of hedging instruments.

4. With a view of mitigating the economic consequences of Covid-19 pandemic and stimulating economic recovery, ensure effective, transparent and non-discriminatory support to businesses affected by the crisis, in particular micro, small and medium-sized enterprises and self-employed. Extend social protection coverage and provide incentives for businesses and employees in the informal economy sector to register and to facilitate their transfer to the formal economy. Include monitoring and evaluation of measures introduced and further improve the public consultation process by consulting businesses and social partners on the adoption and implementation of all new legislation concerning their operations.
5. Ensure cross-sectoral coordination within the government and across public administration to effectively respond to Covid-19. Take measures to preserve employment including through short-time work schemes and ensure increased provision of effective active labour market policies to the unemployed. Provide adequate unemployment compensation schemes for laid off workers in order to mitigate the social impact of the economic downturn.
6. Step up social transfers to ensure adequate income support for people at risk of poverty and social exclusion. Reduce the tax wedge considerably for low wage earners to ensure living wages and to incentivise the formalisation of employment. Ensure adequate and sustainable funding to strengthen the health care sector with an aim to improve access to quality public health care for all citizens.

The Republic of North Macedonia

North Macedonia submitted its Economic Reform Programme 2020-2022 on 03 February 2020. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2019 has been partially implemented.

Economic growth strengthened in 2019, driven by firming domestic demand and supported by expansionary policies. Investment rebounded, while the external balance detracted from growth amid slowing export growth. The ERP expected the outlook to remain positive based on further strengthening household and investment spending, while it projected public debt to stabilise partly as a result of a gradually decreasing primary deficit. However, the growth momentum was interrupted abruptly by the Covid-19 pandemic, which stifled global economic activity and rendered the ERP's macroeconomic and fiscal scenarios obsolete. North Macedonia's economy is exposed to developments in the EU, its main trading partner, due to its high reliance on exports, in particular automobile supplies, for growth. Transport, tourism and trade are important sectors of the economy likely to be severely impacted by the pandemic. Moreover, although the current account deficit is moderate, the expected hit to remittances from abroad is likely to narrow external financing sources.

The authorities should allow automatic fiscal stabilisers to accommodate potential major economic fall-outs from the coronavirus in the short term and take additional measures to soften its impact on growth and employment. Despite limited fiscal policy space, the authorities reacted in a swift and bold manner to assist those sectors most affected by liquidity shortages, by, inter alia, exempting companies from corporate tax advances, providing SMEs with interest-free loans, subsidising employer contributions, wage subsidies, allowances for vulnerable families in the informal economy, and establishing a tourism support fund and a solidarity COVID-19 fund. The fiscal costs of the policy response, together with a slowing economy are likely to delay temporarily the implementation of public debt reduction envisaged in the ERP. Once the temporary shock dissipates, fiscal policy should be geared towards re-building fiscal buffers and debt reduction with a view to enhancing long-term sustainability. Improving fiscal governance and transparency would be important supporting steps.

In 2019, robust economic growth, subdued inflation and a sustained balance of payments surplus enabled the central bank to fulfil its primary goal of price stability with relative ease. Going forward, policies should be consistent with maintaining the exchange rate peg, using all available instruments within that framework to mitigate the economic fallout from the coronavirus pandemic. In this context, the central bank cut its main policy rate, provided additional liquidity, reintroduced the non-standard measure which allows for reducing the banks' base for reserve requirements by the amount of newly approved and restructured loans to companies that will be most affected by the pandemic, eased conditions for the restructuring of loans, and allowed for additional regulatory flexibility.

The soundness of the banking sector is underpinned by comfortable levels of capital, liquidity and profitability. However, the coronavirus pandemic may pose a challenge for financial stability, calling for a close monitoring of developments and, if warranted, the adoption of remedial measures at an early stage. In this regard, the swift establishment of the Financial Stability Committee with the aim to formalise the collaboration of all supervisory authorities appears crucial, with the legal clarification of the central bank's macro-prudential mandate providing added benefit. Likewise, swift operationalisation of the resolution strategy for non-performing loans will prepare the banking sector for better dealing with the adverse consequences of economic contraction. To strengthen the resilience of the financial system in the longer term, the denarisation strategy should be further implemented to reduce risks from currency mismatches on the balance sheets of borrowers and banks.

Structural weaknesses have been exacerbated by the Covid-19 pandemic, highlighting the strong need for continued structural reforms. Effective and well-coordinated structural reforms will contribute to mitigating the impact of pandemic and accelerate the post-crisis economic recovery. The government's policy response will be critical to shape the economy in the post crisis context. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges posed by Covid-19 are linked to strengthening the public health sector, preserving employment and improving social protection, enhancing the business environment and providing support to the private sector. The pandemic is putting the health system under stress, revealing persistent under-funding and weak capacities to cope with the crisis. Despite improvements in the labour market in the past few years, the pandemic is now putting jobs at risk, including in the informal sector. Social assistance and unemployment benefit schemes are further stretched due to the pandemic and are limited in providing coverage and adequate benefits to those in need. The crisis has also highlighted the need to continuously review the social protection system with the aim of improving its coordination with employment activation to improve its capacity to reduce social exclusion and poverty. Businesses, in particular SMEs, self-employed and small family enterprises are considerably affected by the pandemic and need urgent support, such as provision of liquidity, further easing of para-fiscal charges and of other regulatory and tax burdens. The effectiveness of support measures depends on good governance, coordination and inclusiveness, as well as the ability to take into consideration the large informal sector.

Participants welcome that North Macedonia made progress concerning annual international trade in service statistics, research and development, harmonised indices of consumer prices, and short-term business statistics. Further progress is expected regarding adherence to the excessive deficit procedure methodology. Efforts on government finance statistics should be intensified and the data gaps in annual and quarterly national accounts should be addressed.

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

1. Use fiscal policy to mitigate the crisis-induced impact on growth and employment. Adopt the Tax System Reform Strategy 2020-2023 and improve revenue collection capacities in line with the strategy. Further improve the transparency of public finances by publishing regular fiscal reports on public enterprises and taking steps towards incorporating them in the general government statistics in line with the excessive deficit procedure methodology.

2. To support the economic recovery, improve public investment management to mitigate technical obstacles to implementation of capital spending. Establish a comprehensive registry of state aid and review firm-level subsidies based on their cost-effectiveness. Take initial legal and operational steps to establish fiscal rules and a fiscal council with a view to strengthening fiscal sustainability in the medium term.

3. Closely monitor financial stability challenges arising as a result of the coronavirus pandemic and take appropriate action if needed. Operationalise the reconstituted Financial Stability Committee and ensure the legal clarification of the central bank's macro-prudential mandate. Work towards a further implementation of the denarisation and NPL resolution strategies, ensuring the effectiveness of the measures taken and making any adjustments deemed necessary.

4. Ensure a whole-of-government approach and a cross-sectoral coordination across public administration to effectively respond to Covid-19. Maintain continuous dialogue with business organisations, social partners and civil society on all measures in response to the crisis. Take necessary actions to ensure easy access to digital public services for citizens and businesses.

5. With a view to mitigate the economic consequences of Covid-19 pandemic and to stimulate economic recovery, establish an effective and transparent mechanism to support the businesses affected by the crisis, in particular micro, small and medium-sized enterprises and self-employed. Extend social protection coverage and provide incentives for businesses and employees in the informal economy sector to register and to facilitate their transfer to the formal economy. Create a register of para-fiscal charges to streamline their use and further decrease the administrative and regulatory burden of companies.
6. Continue taking measures to preserve employment including by ensuring short-time work schemes and flexible working arrangements. Increase the capacity of and cooperation between the Employment Agency and Centres for Social Work to provide integrated services and measures for inclusion in the labour market including training upskilling and reskilling. Ensure adequate and sustainable funding to strengthen the health care sector with an aim to improve access to quality public health care for all citizens.

The Republic of Albania

Albania submitted its Economic Reform Programme 2020-2022 on 31 January 2020. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2019 has been partially implemented.

Following an economic slowdown in 2019, caused by weak electricity production amid low rainfall and aggravated by the November earthquake, Albania's ERP projected economic growth to rebound in 2020-2022 driven by exceptionally high public investment for post-earthquake reconstruction and a recovery of exports, and later by private consumption. The earthquake-related rise in expenditure was set to temporarily increase the fiscal deficit and slow down the pace of reducing the high public debt. The outbreak of the Covid-19 pandemic renders the macroeconomic and fiscal projections of the ERP obsolete. Its intensive economic relations with the strongly hit Italy and the importance of the tourism sector for its economy, make Albania particularly vulnerable to the economic fallout from the pandemic. The limited capacity of the health sector adds to Albania's vulnerability in this situation.

The Albanian government swiftly imposed restrictions on mobility and social contacts to contain the pandemic and put in place measures to buffer their socio-economic impact. Despite limited policy space, the government announced as immediate support for businesses postponements of tax declarations and financial guarantees for wages in addition to financial support for the health sector, and for SMEs and households in need. The central bank reduced its policy rate, increased liquidity injections and introduced temporary provisions to allow for delays in loan repayments of viable businesses affected by the crisis. The implementation of these measures challenge the already stretched administrative capacity. Albania's existing social protection system covers only a small part of the population, while the large informal sector might not benefit from state support. The likely loss of a whole tourism season this year dampens the expectations for a beginning recovery in the second half of the year. The economic and fiscal impact of the crisis is likely to overturn public debt reduction, which however should remain a medium-term priority in light of the high debt burden and the need to rebuild fiscal buffers.

Monetary policy continued to be accommodative in 2019, with inflation still below the target. In response to the Covid-19 crisis, the central bank reduced its policy rate and released liquidity. The banking sector remained well capitalised and liquid, while the authorities made further progress in supervisory and regulatory convergence. Banking sector consolidation continued in 2019, with the number of active banks decreasing to twelve. Asset quality continued to improve on account of a further decline in non-performing loans (NPLs) facilitated by the ongoing implementation of measures foreseen in the NPL action plan, including amendments to the regulation on out-of-court restructuring and credit risk management. However, the level is the highest in the region and likely to increase again as a result of the economic fallout from the coronavirus pandemic. Against that background, it is essential that the remaining obstacles to NPL resolution are addressed as soon as possible, e.g. resolving the legal deadlock around the private bailiffs and developing a credit scoring system. With currency substitution at high levels, indirect credit risk continues to pose a significant challenge to financial stability.

Structural weaknesses have been exacerbated by the Covid-19 pandemic, highlighting the strong need for structural reforms. Effective and well-coordinated structural reforms will contribute to mitigating the impact of pandemic and accelerate the post-crisis economic recovery. The government's policy response will be critical to shape the economy in the post crisis context. The recovery would also benefit from further efforts to tackle corruption and money laundering , improve the rule of law, enhance transparency and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges posed by Covid-19 are linked to strengthening the public health sector, preserving employment and improving social protection, enhancing business environment and providing support to the private sector. The pandemic is putting the health system under stress, revealing persistent under-funding, low public health insurance coverage and weak capacities to cope with the crisis. Despite improvements in the labour market in the past few years, the pandemic is now putting jobs at risk, including in the informal sector. Income support to registered unemployed and to socially vulnerable groups is very limited. Only a very small share of registered unemployed are eligible to unemployment benefits, while the allowances under the social assistance scheme are low and very far from the at-risk-of-poverty threshold. The crisis has also highlighted the chronic lack of social care services. Businesses, in particular SMEs, self-employed and small family enterprises are considerably affected by the pandemic and are in need of urgent support, such as providing liquidity and further easing the regulatory and tax burdens. The effectiveness of support measures depends on good governance, coordination and inclusiveness, taking into consideration the large informal sector.

Participants welcome that Albania made progress concerning annual national accounts, excessive deficit procedure notifications, annual government finance statistics, energy statistics and short-term business statistics. However, significant progress is still needed in the domains of the excessive deficit procedure and national accounts, including quarterly national accounts and government finance statistics. Harmonised indices of consumer prices, balance of payments, research and development, and labour market statistics also need attention.

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

1. Keep the increase of fiscal deficit and public debt temporary while accommodating the fiscal costs of post-earthquake reconstruction and addressing the pandemic impact in a transparent and cost-effective manner. Set time-limits for tax-relief measures, while paying all VAT refunds in time. Adopt the medium-term revenue strategy, with a particular focus on reviewing tax expenditures.

2. Publish on a regular basis a break-down of all arrears of public expenditure and prevent any increase of their stock above the level of end-2019. Assess and approve all investments, which involve public funds, through the same approval process, based on the same minimum quality and fiscal affordability criteria. Increase the institutional capacities for monitoring and containing fiscal risks stemming from public-private partnerships, concessions and state-owned enterprises.

3. Closely monitor financial stability challenges arising as a result of the coronavirus pandemic and take appropriate action if needed. Resolve remaining legal impediments to NPL resolution in the realm of the government, especially the bailiff deadlock that lingers on collateral execution, also in order to mitigate a potential renewed build-up of NPLs as a consequence of the coronavirus pandemic. Develop the market for forex hedging instruments, taking into account international expert advice, in the context of strengthening the use of the national currency.

4. With a view to mitigating the economic consequences of Covid-19 pandemic and stimulating economic recovery, establish an effective and transparent mechanism to support the businesses affected by the crisis, in particular small and medium-sized enterprises and self-employed. Extend social protection coverage and provide incentives for businesses and employees in the informal economy sector to register and to facilitate their transfer to the formal economy. Ensure transparency and predictability of measures, by consulting new legislation with businesses and social partners.

5. Considering the big investments to be made for the post-earthquake reconstruction, speed up the adoption the secondary legislation for the laws on energy efficiency and energy performance of buildings and provide incentives for energy efficiency measures in the private sector and households. Increase access to healthcare and public health insurance coverage while reducing the share of out-of-pocket payments on total health expenditure.
6. Take short-term measures to preserve employment including through short-time work schemes, and once the Covid-19 pandemic subsides, ensure an increased provision of active labour market policies, especially training, upskilling and reskilling. Improve the adequacy of social assistance benefits and set up an objective mechanism for their regular update, taking into account the data from the Survey of Income and Living Conditions. Take more effective steps to increase availability of social care services through enhancing ability of municipalities to identify needs for social services and to prepare social care plans.

Bosnia and Herzegovina

Bosnia and Herzegovina submitted its Economic Reform Programme 2020-2022 on 31 January 2020. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2019 has been implemented to a limited extent.

Economic activity slowed down during 2019 largely reflecting decelerating private consumption and investment growth and weaker external demand for commodities, partly compensated by increasing tourism revenues. Employment benefitted from active labour market measures, while increasing emigration created an upward pressure on nominal wages. However, thanks to low import prices, inflation had remained low. The outbreak of the Covid-19 pandemic is sharply exacerbating the already ongoing slowdown, in particular affecting transport and tourism as well as remittances, rendering the ERP's macroeconomic and fiscal projections obsolete.

In order to compensate for the negative effects of the Covid-19 crisis, the authorities of Bosnia and Herzegovina took measures to address the liquidity squeeze by allowing households and businesses to defer loan repayments and tax payments. Along with other measures to provide financial assistance to alleviate the economic impact of the crisis, this will inevitably lead to a temporary worsening of the fiscal position. However, the public debt ratio is currently still rather low (at around 30% of GDP) and interest costs are quite favourable, resulting from a high share of concessional financing. Once the temporary shock dissipates, efforts should be undertaken to accelerate the economic recovery and the country's shock resilience by improving the quality of public finance by shifting public spending towards a more growth-supporting pattern and improving the targeting of social spending. Moreover, country-wide medium-term planning capacities as well and the quality of statistical data should be significantly improved.

Monetary policy has continued to be anchored around the currency board arrangement, which enjoys the confidence of the general public and provides stability within the complex institutional environment.

Regarding financial stability, the banking system as a whole exhibits robust capital and liquidity buffers, but the legal framework should be strengthened further. Authorities have adopted a set of legislative reforms, but a final law on deposit insurance is still pending, which is a crucial element of the bank resolution framework. Approving the complete legal package entailing the establishment of a comprehensive bank resolution framework would buttress the legal underpinnings of the financial system. Ensuring sufficient coordination among bodies entrusted with resolution is essential. Notwithstanding improvements in asset quality, non-performing loans are still sizeable, which impacts banks' profitability and constitutes an obstacle for credit extension. The dynamic rise of general-purpose consumer loans poses a potential financial stability risk and warrants close monitoring. The coronavirus pandemic aggravates the situation, as both consumers and firms may be adversely affected by containment measures and a looming economic downturn.

Structural weaknesses have been exacerbated by the Covid-19 pandemic, highlighting the strong need for structural reforms. Effective and well-coordinated structural reforms will contribute to mitigating the impact of pandemic and accelerate the post-crisis economic recovery. The government's policy response will be critical to shape the economy in the post crisis context. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges posed by Covid-19 are linked to strengthening the public health sector, preserving employment and improving social protection, enhancing business environment and providing support to the private sector. The pandemic is putting the health system under stress, revealing lack of adequate and sustainable funding, issues with access and weak capacities to cope with the crisis. Despite some improvements in the labour market in the past few years, the pandemic is now putting jobs at risk, including in the informal sector. Social assistance and unemployment benefit schemes, which are underfunded, are further stretched and do not provide sufficient coverage and adequate benefits. In addition, a major part of non-contributory social benefits are grants to war veterans and only a small part is spent on disabled and on means-tested social assistance and family benefits. Businesses, in particular SMEs, self-employed and small family enterprises are considerably affected by the pandemic and are in need of urgent support, such us providing liquidity and further easing the regulatory and tax burdens. The effectiveness of support measures depends on good governance, coordination and inclusiveness, taking into consideration the large informal sector.

Participants welcome that Bosnia and Herzegovina made visible progress concerning excessive deficit procedure notifications, balance of payments and the international investment position. Progress in other statistical areas such as regional accounts, foreign direct investment, labour market statistics and harmonised indices of consumer prices was, however, limited. While efforts should be pursued to improve the coverage and timeliness of all statistics, priority should be given to national accounts and government finance statistics, and putting in place adequate infrastructure for data transmissions to Eurostat and the ECB.

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

1. Take the necessary fiscal measures to alleviate the economic shock of the COVID-crisis, in particular protecting the most vulnerable groups. In order to support the recovery, improve analytical, planning and coordination capacities to strengthen country-wide macroeconomic policy formulation and its implementation. Improve the provision of timely, exhaustive and country-wide statistics and its transmission to Eurostat and the ECB, in particular on national accounts, the labour market and government finance, in line with Eurostat recommendations.
2. To accelerate the economic recovery, increase growth-enhancing public investment as a share of GDP, based on a comprehensive investment strategy. Improve the targeting of social transfers by increasing the share of means-tested benefits in total social spending.
3. Closely monitor financial stability challenges arising as a result of the coronavirus pandemic and take appropriate action if needed, while addressing the remaining obstacles to NPL resolution and ensuring the proper coordination of supervisory activities. Strengthen the bank resolution framework by adopting the law on deposit insurance. Safeguard the integrity of the currency board arrangement and the independence of the central bank, while enhancing its analytical capacity by establishing macroeconomic projections.
4. With a view to mitigating the economic consequences of Covid-19 pandemic and stimulating economic recovery, establish an effective, coordinated and transparent mechanism to support the businesses affected by the crisis, in particular small and medium-sized enterprises and self-employed. Extend social protection coverage and provide incentives for businesses and employees in the informal economy sector to register and to facilitate their transfer to the formal economy. With a view to a swift recovery after the Covid-19 crisis, simplify business registration, licensing and permit procedures country-wide.

5. Ensure adequate and sustainable funding to strengthen the health care sector with an aim to improve access to quality public health care for all citizens. Identify scope for and implement centralised procurement of pharmaceuticals and medical equipment, especially for high-cost and high-volume medications. Adopt and implement a credible and relevant countrywide Public Finance Management strategic framework with a performance based monitoring and reporting system.
6. Take measures to preserve employment including through short-time work schemes, strengthen without delay the capacity and human resources of employment offices to ensure more active support to registered jobseekers including an increased provision of active labour market policies, especially training, upskilling and reskilling. Complete in the whole country the discharge of public employment services from administrative duties related to health insurance for registered unemployed. Ensure increased coverage of unemployment and needs-based social benefits and in the medium term, map non-contributory social benefits in the whole country and rebalance the social assistance system from status-based to needs-based benefits while increasing their adequacy and coverage.

Kosovo*

Kosovo submitted its Economic Reform Programme 2020-2022 on 22 January 2020. The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2019 has been implemented to a limited extent.

Relatively robust economic growth continued in 2019, supported by private investment and consumption. Despite the failure to implement the reclassification of war veteran pension beneficiaries, which has led to cost overruns, the 2019 budget deficit was lower than planned, due to a large under-execution of capital spending. The ERP projected GDP growth to strengthen further in 2020-2022 to above the historical trend, on the back of a planned strong pick-up in public investment and continuously robust private consumption. The fiscal strategy was envisaged to be frontloaded with the 2020 budget deficit projected to reach the ceiling of 2% of GDP prescribed by the fiscal rule (which excludes certain investment categories from the deficit). The projected rise in expenditure was expected to be driven by a steep rise in capital spending, while the envisaged current spending only partially takes into account the potentially substantial impact of the law on salaries.

The fallout from the coronavirus has made the ERP's macroeconomic and fiscal projections obsolete. The key vulnerabilities stem from a potential fall of service exports to diaspora, foreign investment and remittances. In the context of coronavirus, the authorities of Kosovo have postponed the deadline of payments of tax (VAT, PIT, CIT, etc) liabilities and adopted the emergency package, while the central bank has postponed all credit payments. Fiscal measures aim to soften the impact on growth and employment, but without access to international credit markets, the fiscal space is rather limited. Beyond mitigating the economic shock in 2020, public spending should better support medium-term growth potential. Social spending should focus on poverty reduction and should not discourage work. Prioritisation, planning and coordination between policies are essential, while new initiatives should be properly evaluated and costed before adoption.

The banking sector continues to be characterised by capitalisation and liquidity ratios that are well above the regulatory minima. Credit activity remained buoyant in 2019, spurred by lower interest rates, increased competition among banks, ample liquidity in the banking sector and improved quality of the credit portfolio. Micro-financial institutions have boosted their short-term lending to households, capturing a market segment not necessarily tapped by bank lending, at much higher borrowing costs. A thorough analysis of household indebtedness is hampered by the absence of a comprehensive measure that combines a single borrower's debt to all bank and non-bank financial institutions. Non-performing loans continue to be low by peer standards, but significant scope remains for deepening financial intermediation. Lengthy court and contract enforcement procedures, high informality, the low degree of audited financial statements and corporate governance shortcomings constitute bottlenecks to SME lending. Progress has been limited in identifying factors hampering access to finance for SMEs in 2019. Going forward, the authorities should closely monitor challenges arising as a result of the coronavirus pandemic, and adopt pre-emptive measures if warranted. For this purpose it is essential that the central bank has adequate staffing capacity in the areas of financial stability and banking supervision. For temporary difficulties in SME's access to finance arising from increased uncertainty related to the coronavirus, the authorities could consider expanding the capacity of the Kosovo Credit Guarantee Fund if necessary.

[*] 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.

Structural weaknesses have been exacerbated by the Covid-19 pandemic, highlighting the strong need for structural reforms. Effective and well-coordinated structural reforms will contribute to mitigating the impact of pandemic and accelerate the post-crisis economic recovery. The authorities' policy response will be critical to shape the economy in the post crisis context. The recovery would also benefit from further efforts to tackle corruption, improve the rule of law, enhance transparency and strengthen institutions and social dialogue.

As regards specific structural reforms, the main challenges posed by Covid-19 are linked to strengthening the public health sector, preserving employment and improving social protection, enhancing business environment and providing support to the private sector. The pandemic is putting the health system under stress, revealing persistent under-funding, low public health insurance coverage and limited capacities to cope with the crisis. The pandemic is putting jobs at risk, including in the informal sector, in a situation of already very low employment levels, especially for women and young people. The capacity of the Employment Agency is also weak. Social assistance and unemployment benefit schemes, which are underfunded, are further stretched and do not provide sufficient coverage and adequate benefits. Moreover, social benefits are not sufficiently targeted at categories in need. Businesses, in particular SMEs, self-employed and small family enterprises are considerably affected by the pandemic and are in need of urgent support, such as liquidity and further easing the regulatory and tax burdens. The effectiveness of support measures will largely depend on transparency, good coordination and inclusiveness, taking into consideration the large informal sector.

Participants take note that Kosovo has made progress regarding international trade in goods statistics, foreign direct investment, balance of payments and the international investment position. However, data for several statistical domains such as the excessive deficit procedure, short-term business statistics and research and development are missing. Although small progress was made in 2019, further efforts should continue towards a complete set of annual and quarterly national accounts and government finance statistics.

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

1. Create fiscal space and undertake well-targeted measures to address the socio-economic consequences of the crisis, including by containing spending on the public wage bill and on war veterans pensions through progress with the reclassification of beneficiaries. To reinforce the medium-term sustainability of public finances, improve tax revenue collection by reducing informality.

2. To support economic recovery, improve the execution of capital spending by strengthening institutional capacities at central and local government levels for multiannual investment planning and investment project management. Improve the financial oversight and accountability of publicly owned enterprises. Prepare an options paper on the establishment of an independent body for fiscal oversight for further consultations with stakeholders, including the EU.

3. Closely monitor financial stability challenges as a result of the coronavirus pandemic and take appropriate action if needed, while developing a more integrated framework for measuring household indebtedness. Undertake an in-depth analysis of the staffing and competence requirements in the central bank's key policy areas, especially financial stability. Continue with the inflation expectations survey and publish the time series once more data points become available.

4. With a view to mitigating the economic consequences of Covid-19 pandemic and stimulate economic recovery, establish an effective and transparent mechanism to support the private sector and employees affected by the crisis, in particular micro, small and medium-sized enterprises and self-employed. Extend social protection coverage and provide incentives for businesses and employees in the informal economy sector to register and to facilitate their transfer to the formal economy. In order to ensure a swift recovery, further implement relevant business environment measures, in particular the simplification, merging and abolishment of licences and permits.
5. Strengthen the health sector in order to provide adequate and accessible primary health services for all citizens. In the short term, ensure increased coverage of unemployment benefits and needs-based social benefits for the groups most affected by the Covid-19 crisis. In the medium term, review social assistance schemes, in particular the category-based pensions, to ensure that they are targeted at groups most in need and focused on poverty reduction.
6. With a view to minimising the impact of Covid-19, take measures to preserve employment including through short-time work schemes and upgrade the capacity of the Employment Agency to ensure an increased provision of active labour market measures. With the aim of increasing the integration of youth in the labour market, conduct a feasibility study for a Youth Guarantee scheme.