



Western Balkans Key Trends in the Economic Environment

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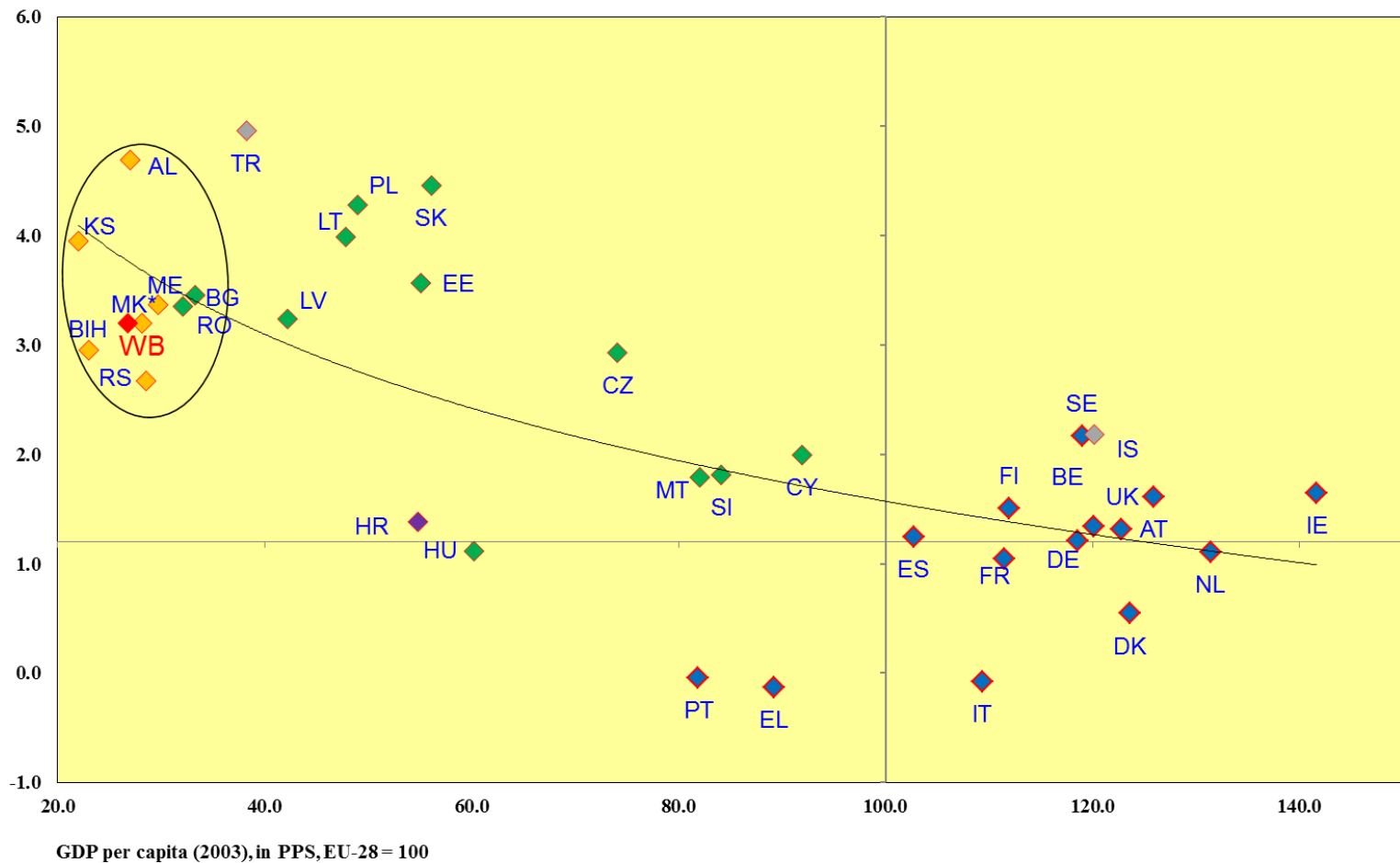
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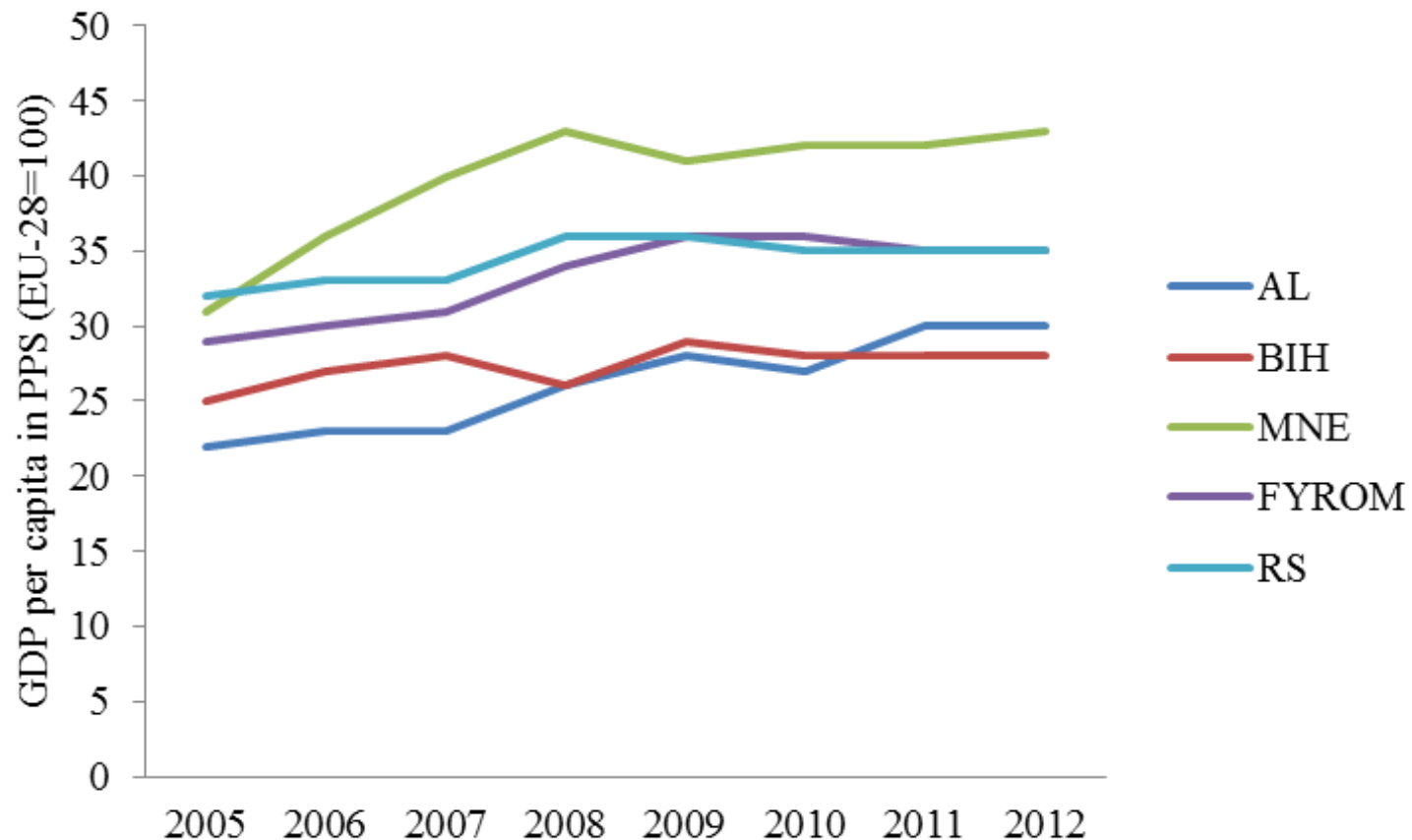
**10th Meeting of the WBIF Steering Committee
Berlin, 11-12 June 2014**

The longer-term perspective: convergence in 2003-2012

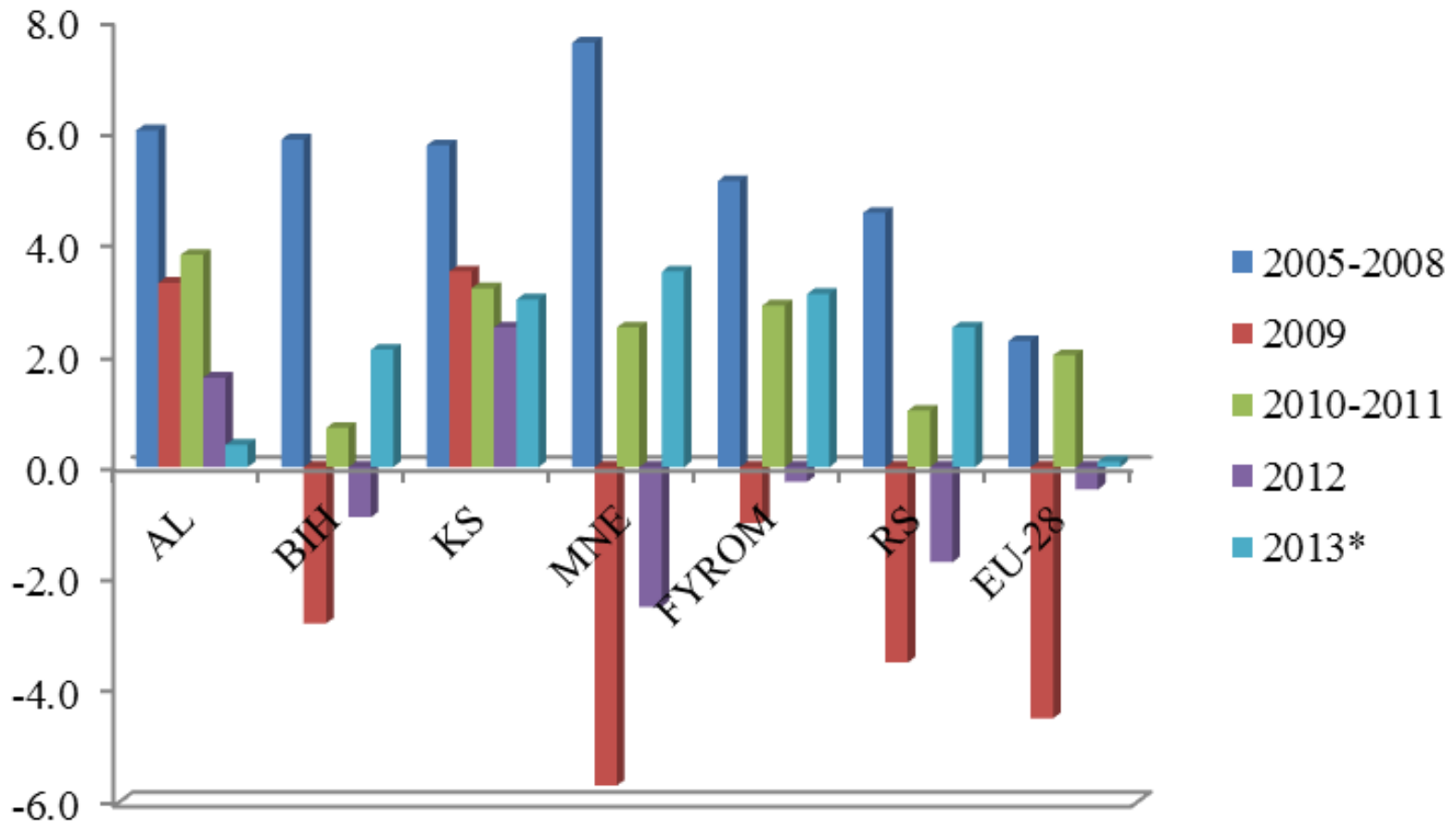
Average growth (2003-2012)



...But real convergence has come to a halt



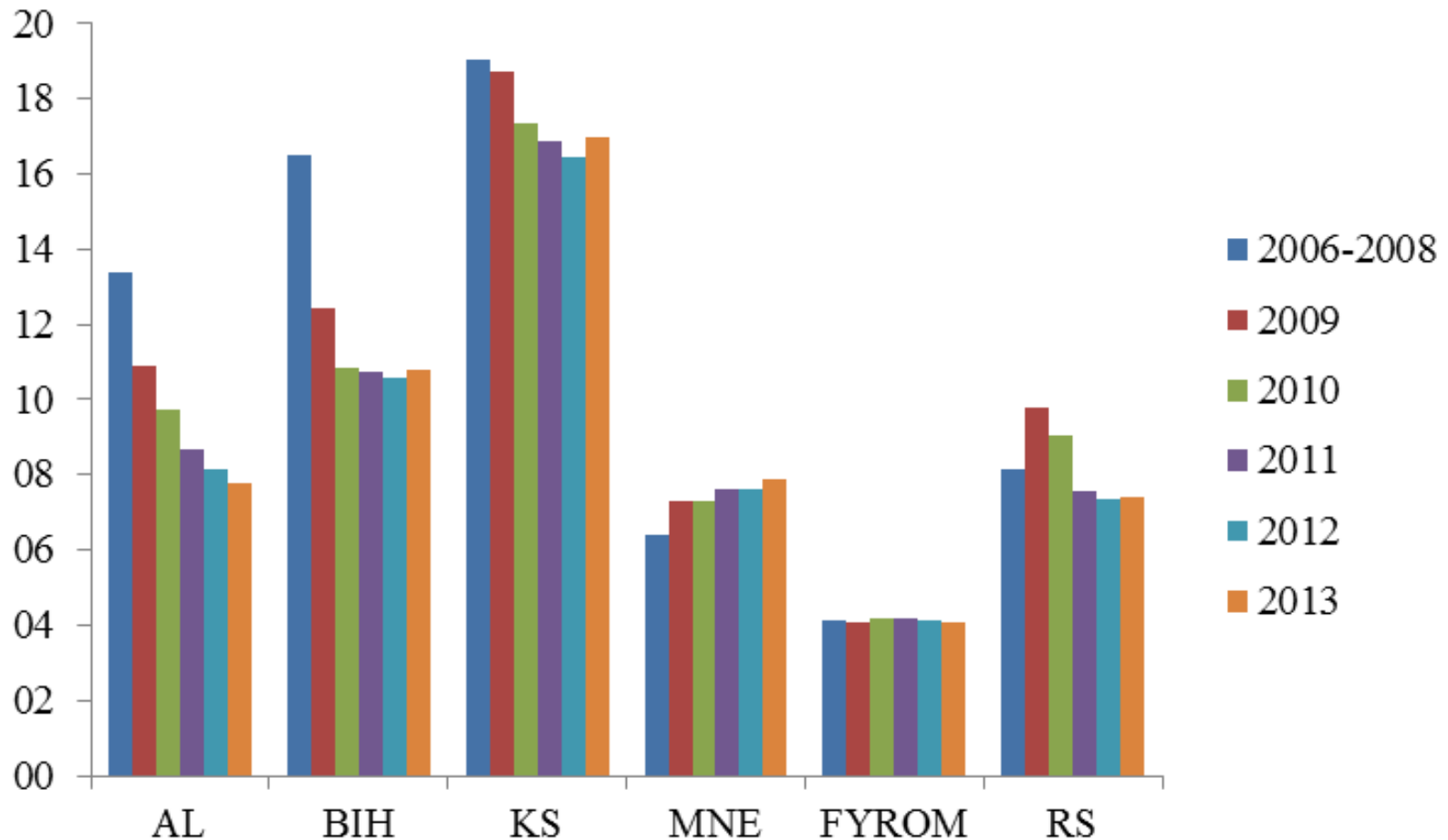
Slow recovery in 2013 followed a double-dip recession



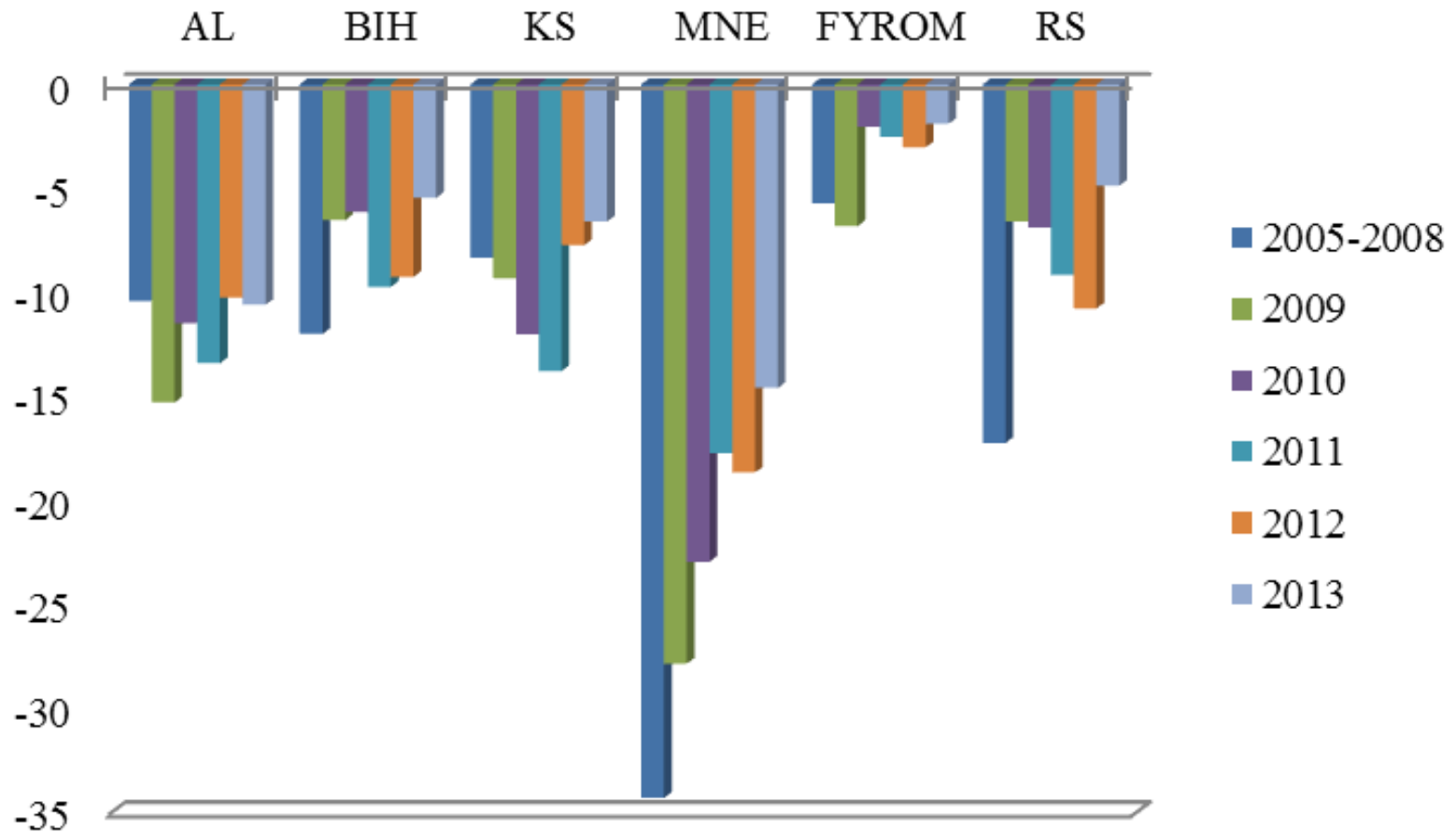
The recovery is still narrow-based

- Net exports drove economic recovery in 2013
- Domestic demand contracted (~ -1%)
 - Investment stayed on a low level
 - Depressed private consumption
 - Stagnating remittances
- In the first months of 2014 - slowdown of growth dynamics

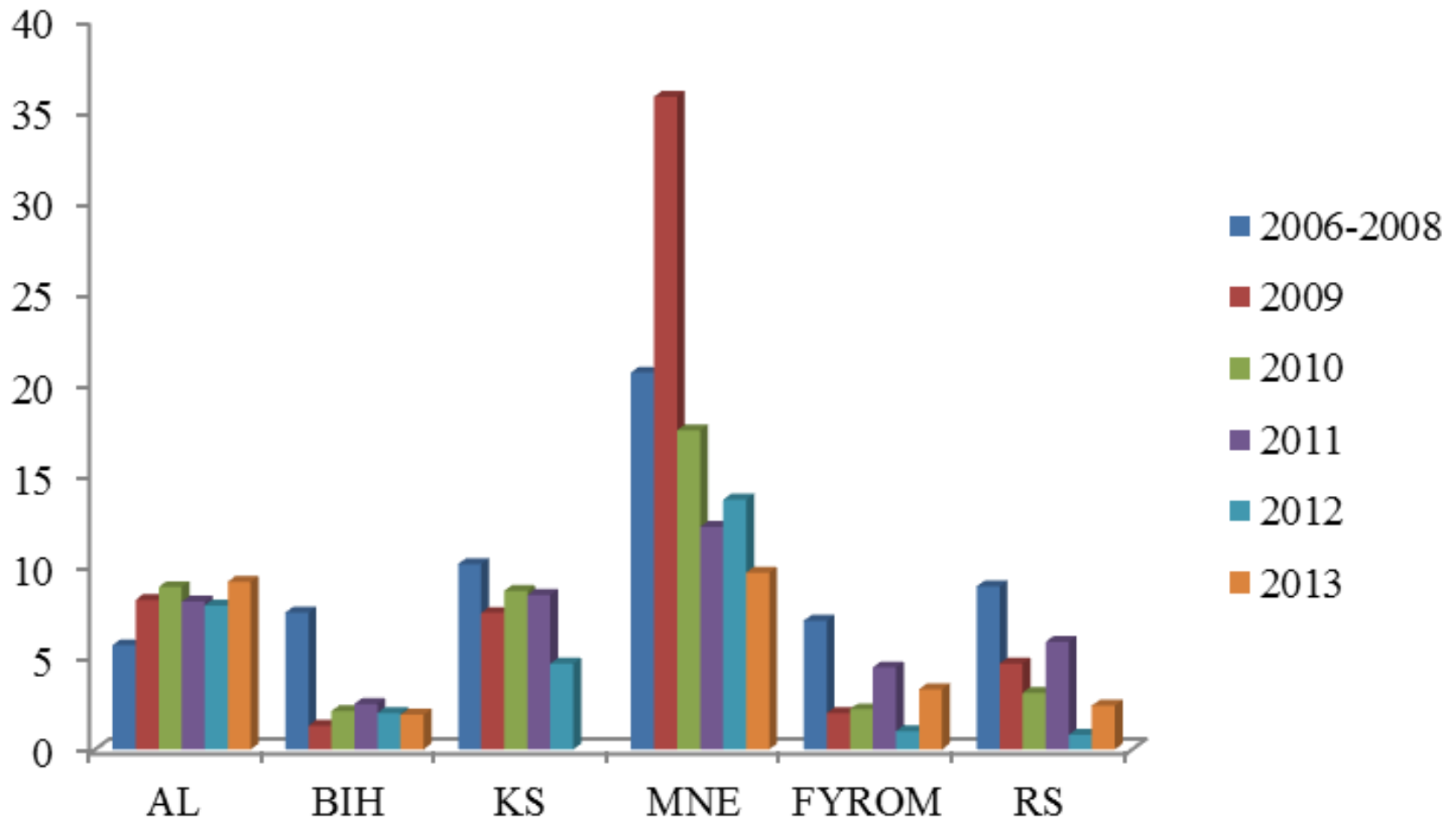
Remittances broadly unchanged



External imbalances narrowed substantially



...but so did FDI inflows, albeit with exceptions



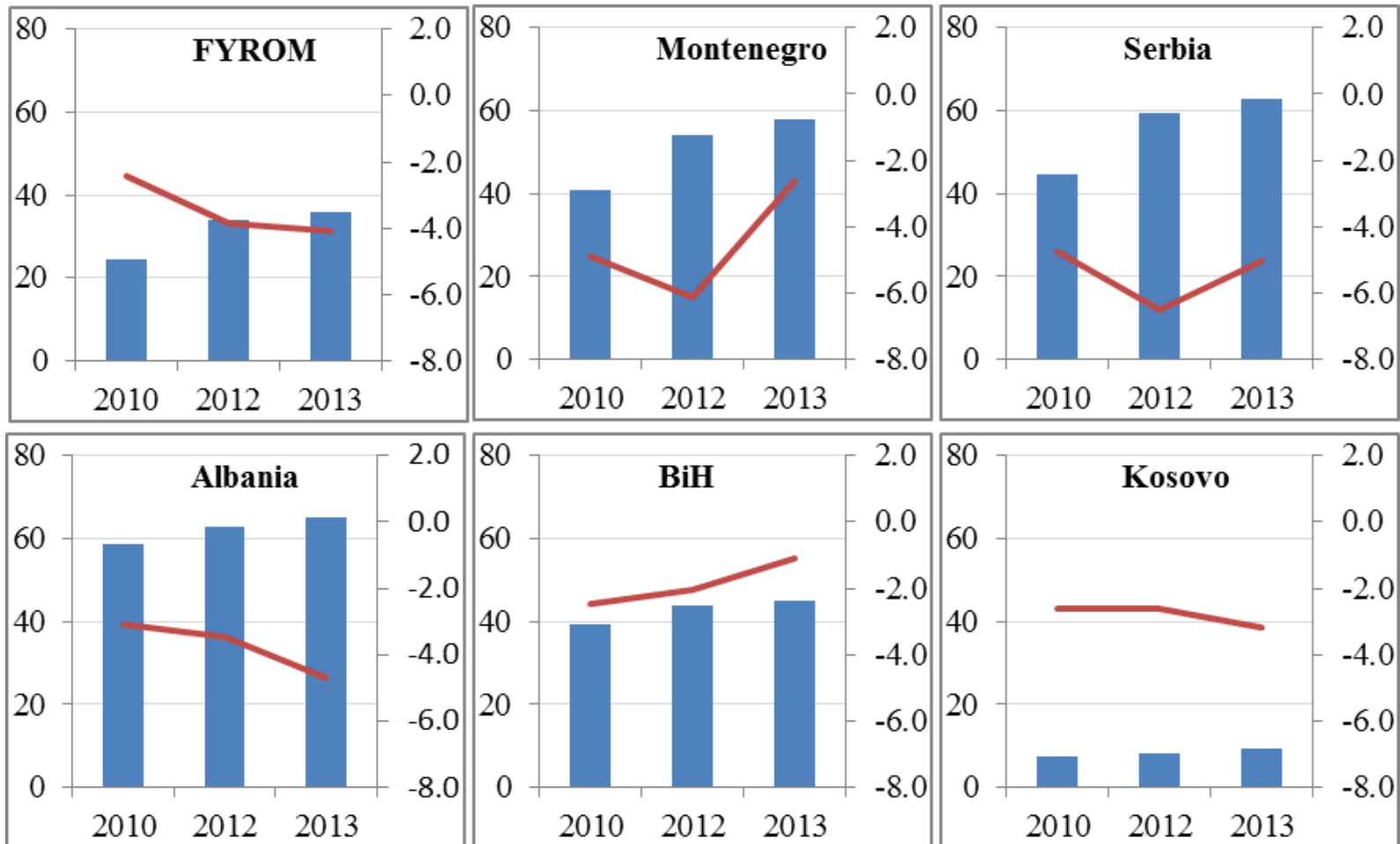
Balance of risks tilted to the downside

- Growth of EU partners
- Delayed resolution of crisis legacy problems
- Pace of structural reforms
- (Geo)political tensions
- Floods in Bosnia and Herzegovina and Serbia

Domestic weaknesses contribute most to a feeble growth

- Fiscal pressures increased
- Slow credit growth, high NPLs
- Persistently high unemployment
- Weaknesses in business environment
- Broadly stalled structural reforms

Deficit and debt levels have increased



Fiscal discipline has been relaxed

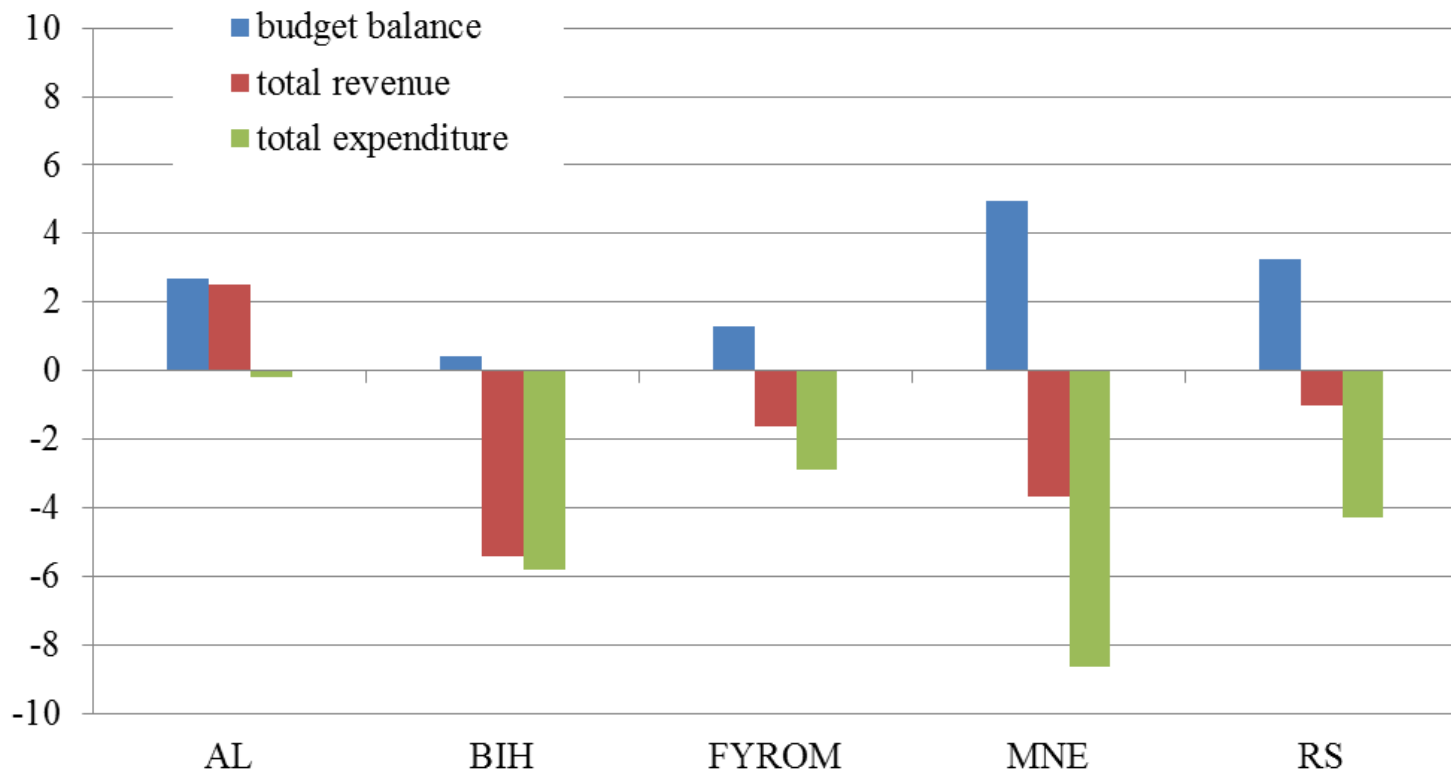
- Short-term + ad-hoc budget decisions
- Statutory debt ceilings breached
- Short-term bias of public debt
- Huge contingent liabilities
- Public sector arrears

Concerns about quality and sustainability of public finances

- Rigid expenditure structure, spending inefficiencies
- Lack of growth-enhancing spending

Fiscal consolidation in the pipeline

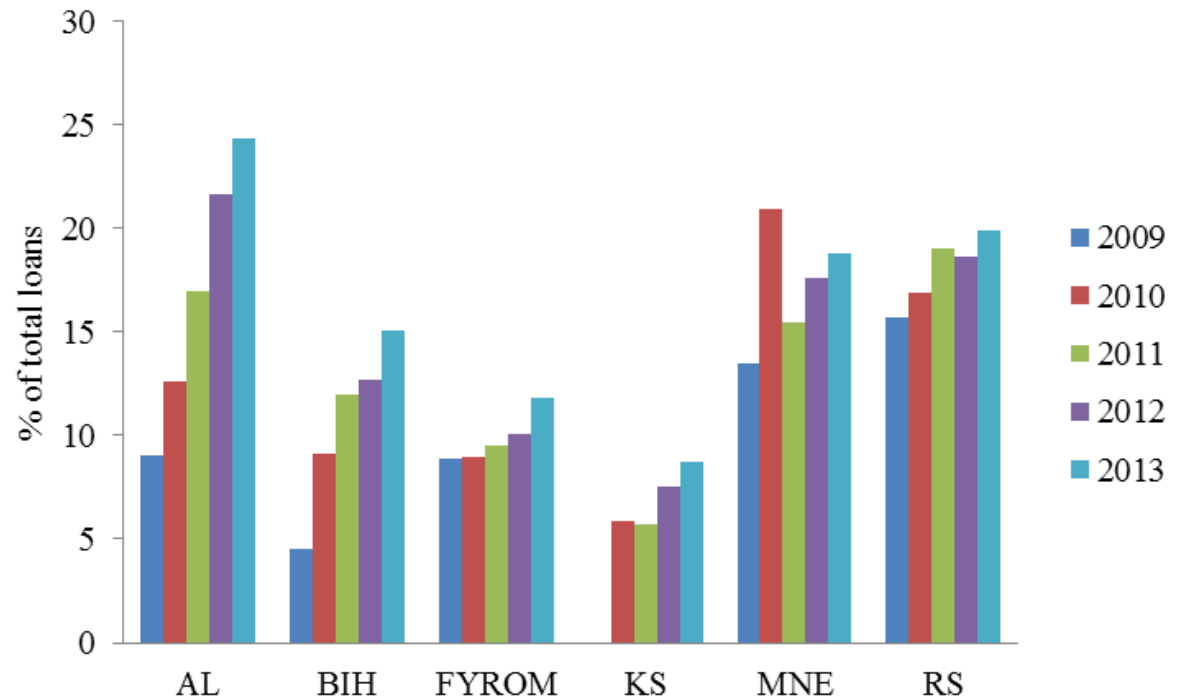
Fiscal adjustment 2014-16, change in % of GDP



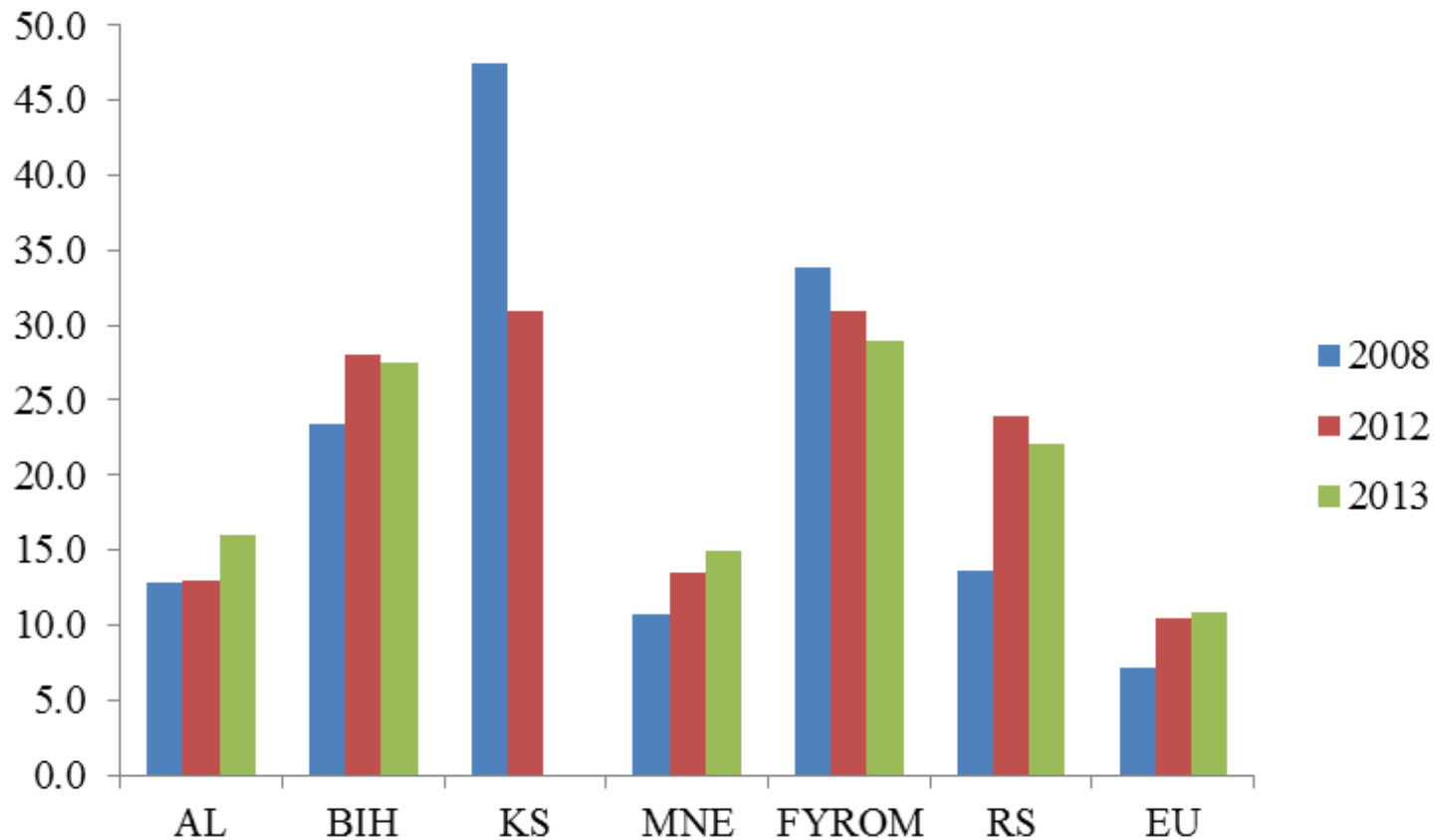
Source: Countries' 2014 medium-term economic programmes

High NPLs are a legacy of the crisis, constraining credit supply in the present

- Banks well-capitalised and liquid, but...
- ...deteriorating asset quality weighs on credit supply
- Falling bank profitability
- Decelerating or negative credit growth

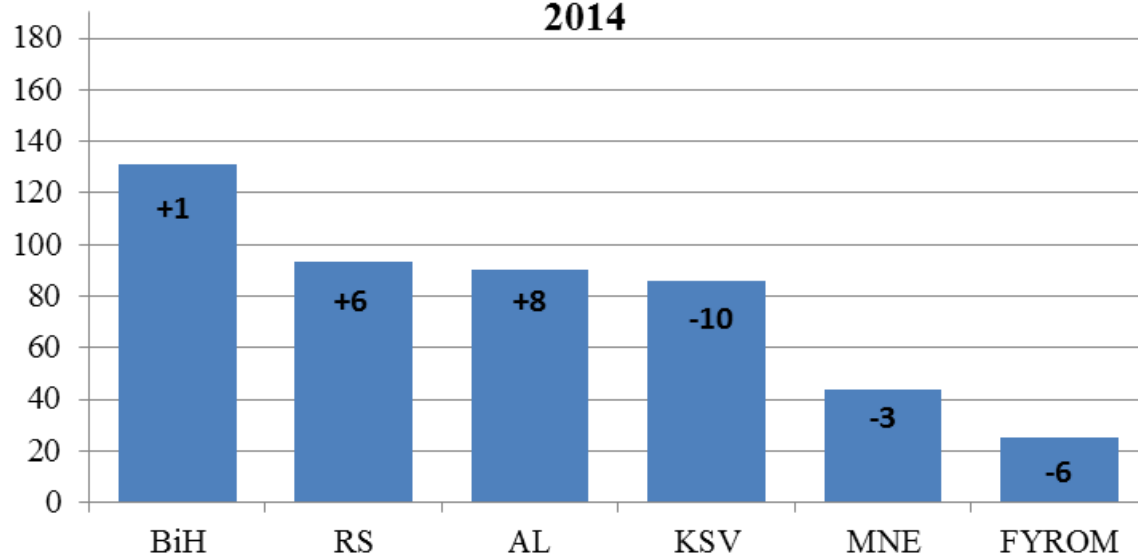


Persistently high unemployment reflects structural problems



Business environment remains difficult

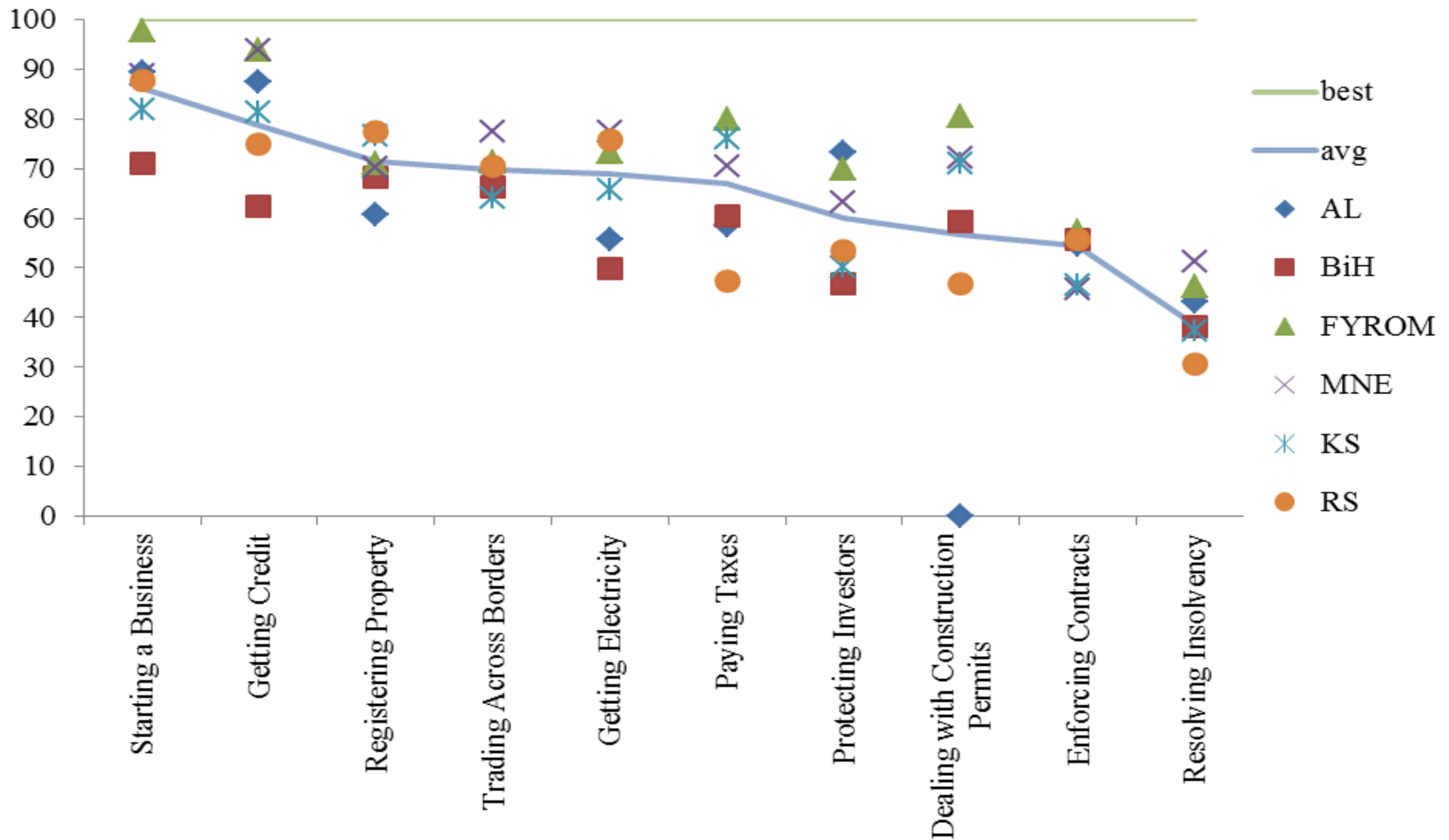
Ease of Doing Business, rank out of 189 countries,
2014



- Limited progress to improve business environment (MNE, KS, FYROM)
- Weaknesses persist (market entry and insolvencies, contract enforcement, investor protection, property rights)

Distance to Frontier, Doing Business Survey

Distance to Frontier, % points (100 = Best Performer), 2014



Structural reforms need to gain momentum

- Little progress with structural reforms to improve competitiveness and long term prospects for growth
- Unfinished agenda of enterprise restructuring and setbacks in privatisation
- Need to put public budgets on sound footing
- Low quality of education and labour market problems
- Inadequate institutional capacity and infrastructure bottlenecks (e.g. energy)

Conclusions

- Gradual convergence with EU is not automatic, but conditional on supportive domestic policies
- Current enlargement countries face significant economic challenges (macro-fiscal, business environment, obstacles to long-term job-rich growth)
- EU accession process has remained catalyst for reforms
- What next? -> Stronger focus on economic governance to support enlargement's countries' reform efforts (e.g. more targeted policy guidance)
- Close cooperation with IFIs

Thank you for your attention