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Economic and Financial Affairs

Progress towards Meeting the Economic Criteria for EU Accession

2025 European Commission Assessments

EUROPEAN ECONOMY

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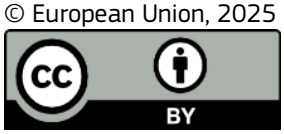

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Directorate-General for Economic and Financial Affairs

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Institutional Paper 329

ABBREVIATIONS

ALL	Albanian Lek
BiH	Bosnia and Herzegovina
CEFTA	Central European Free Trade Agreement
COVID-19	Coronavirus disease 2019
CPI	Consumer Price Index
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
ERP	Economic Reform Programme
ESA 2010	European system of accounts
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
FX	Foreign Exchange
GDP	Gross Domestic Product
GEL	Georgian Lari
GFCF	Gross fixed capital formation
GG	General Government
ICJ	International Court of Justice
ICT	Information Communication Technologies
IDF	Investment Development Fund
IFIs	International Financial Institutions
ILO	International Labour Organization
IMF	International Monetary Fund
INSTAT	Institute of statistics Albania
ISCED	International Standard Classification of Education
LFPR	Labour Force Participation Rate
LFS	Labour Force Survey
MFA+	Macrofinancial Assistance Plus
MoF	Ministry of Finance
Monstat	Statistical Office of Montenegro
NBG	National Bank of Georgia
NBM	National Bank of Moldova
NBU	National Bank of Ukraine
NEET	Not in education, employment or training
NPLs	Non-performing loans
OECD	Organisation for Economic Co-operation and Development

PESR	Public enterprise for state roads of North Macedonia
PFM	Public Finance Management
PIM	Public Investment Management
PISA	Programme for International Student Assessment
PLL	Precautionary and Liquidity Line
POE	Publicly Owned Enterprise
pp.	Percentage point
pps.	Percentage points
PPP	Purchasing power parity
PPS	Purchasing power standard
PRB	Procurement Review Body
RSD	Serbian dinar
SAA	Stabilisation and Association Agreement
SBA	Stand-by Arrangement
SELDI	Southeast European Leadership for Development and Integrity
SMEs	Small and Medium sized Enterprises
SOEs	State-Owned Enterprises
SORS	Statistical Office of the Republic of Serbia
R&D	Research & Development
TRY	Turkish Lira
UK	United Kingdom
UNSCR 1244	United Nations Security Council Resolution 1244
USD	United States Dollar
VAT	Value-added tax
VET	Vocational education and training.
VTC	Voluntary Tax Compliance
WBIF	Western Balkans Investment Framework
WiiW	the Vienna Institute for International Economic Studies
WTO	World Trade Organization
y-o-y	year on year

CONTENTS

INTRODUCTION

In this Institutional Paper the Directorate General for Economic and Financial Affairs brings together into a single document the economic chapters of the European Commission's country reports for the ten enlargement countries Albania, Bosnia and Herzegovina, Georgia, North Macedonia, Kosovo[*], Moldova, Montenegro, Serbia, Türkiye and Ukraine. The annual country reports assess progress achieved in advancing the necessary political and economic reforms as well as the legal transformation in line with the EU accession criteria. The European Commission adopted the country reports on 4 November 2025 as part of its 2025 Enlargement Package.

The purpose of this Institutional Paper is to facilitate the work of those scholars, researchers and analysts who are mainly interested in the economic aspects of the enlargement process. As such, it represents only a part of the overall progress made by the enlargement countries towards meeting the accession criteria. A proper full-fledged assessment of progress made under all examined aspects can be found in the 2025 reports, i.e. the Commission staff working documents[1] for each of the countries.

The accession criteria

In 1993, the Copenhagen European Council identified the economic and political requirements candidate countries will need to fulfil to join the EU. It also concluded that accession could take place as soon as they were capable of fulfilling them.

The criteria are:

- the political criteria - stability of institutions guaranteeing democracy, the rule of law, human rights, and respect for and protection of minorities;

- the economic criteria - the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union;

- the institutional criteria - the ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union, which includes the whole range of policies and measures that constitute the acquis of the Union. Candidate countries must adopt, implement and enforce the *acquis*. This requires the administrative capacity to transpose European Community legislation into national legislation, and to implement and effectively enforce it through appropriate administrative and judicial structures.

The European Commission first assessed progress made by the then candidate countries with respect to these criteria in the 1997 Opinions. Thereafter, the Commission, at the request of the Council, submitted annual Country Reports to the Council assessing the further progress achieved by each country towards fulfilling the criteria. These reports have served as one of the elements for the Council to take decisions on the conduct of negotiations and on the definition of the pre-accession strategy. Since 2005, also the potential candidate countries have been assessed according to the same format and methodology.

[*] This designation is without prejudice to positions on status, and is in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence.

[1] Strategy and Reports - European Commission.

The economic sub-criteria

Regarding the economic criteria, the Commission applies a set of sub-criteria to examine the progress achieved during each year. The compliance with the functioning market economy criterion is thus evaluated against the following five sub-criteria:

- high quality of economic governance;
- macroeconomic stability (including adequate price stability and sustainable public finances and external accounts);
- proper functioning of the goods and services market (including business environment, state influence on product markets, and privatisation and restructuring);
- proper functioning of the financial market (including financial stability and access to finance);
- proper functioning of the labour market;

The capacity to withstand competitive pressure and market forces within the Union is assessed on the basis of the following four sub-criteria:

- a sufficient level of human capital, education, research, and innovation;
- a sufficient amount and quality, at appropriate costs, of physical capital and infrastructure;
- changes in the sectoral and enterprise structure of the economy, including the role of SMEs;
- the degree and the pace of the economic integration with the Union, and price competitiveness.

It is important to note that these conditions do not serve as a simple checklist. First, the interplay and interaction of all conditions, and their mutually reinforcing effects on the economy, are pertinent. Second, there is an important time dimension involved. Meeting the economic criteria requires deep and lasting structural reforms that take time to be accomplished. The issue of track record becomes then very relevant. In this context, the concept of track record means the irreversible, sustained and verifiable implementation of reforms and policies for a long enough period to allow for a permanent change in the expectations and behaviour of economic agents and for judging that achievements will be lasting.

1. ALBANIA

1.1. THE EXISTENCE OF A FUNCTIONING MARKET ECONOMY

Albania has a **good level of preparation** in developing a functioning market economy and made **some progress** in this area. The economy maintained a strong growth momentum in 2024 thanks to robust domestic demand and tourism. Inflation fell below the central bank's target while fiscal consolidation accelerated, and the public debt ratio continued to decline. Despite increases, government revenue as a share of GDP remains low, while spending on public investment is repeatedly under-executed. The labour market situation improved, but structural problems persist. The banking sector remained stable, well capitalised and liquid, while lending to the private sector increased. The business environment remains affected by a weak rule of law, limited access to finance, and shortcomings in the oversight and governance of state-owned enterprises.

The Commission's recommendations from last year were partly addressed and remain largely valid. In the coming year, Albania should in particular:

→ implement the Medium-Term Revenue Strategy and prepare proposals to reduce tax expenditure, prioritising the elimination of exemptions lacking sound policy justification;

→ increase the transparency and accountability of state-owned enterprises, including by publishing their annual financial performance reports;

→ enhance the operationalisation of the public investment management framework, including the National Single Project Pipeline, and ensure that the projects entering the Medium-Term Budget Programme are mature and of good quality, in order to avoid the under-execution of public investments.

Economic governance

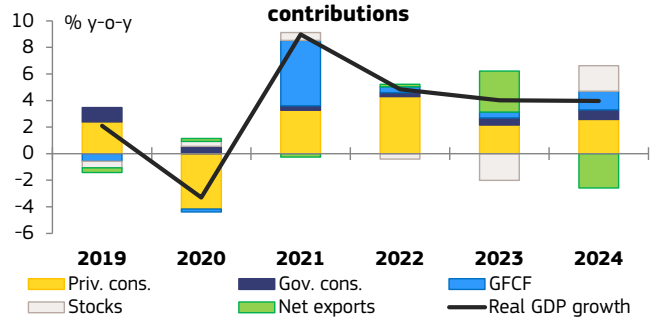
The government remained committed to maintaining macroeconomic stability and boosting growth. In 2024, the fiscal outturn improved compared to previous years and outperformed budget targets, but this was partly the result of under-executed capital spending. The practice of amending the budget via normative acts rather than by using the regular legislative process continued (with three budget revisions in 2024 and two until July 2025). The Medium-Term Revenue Strategy (MTRS) 2024-2027, adopted by the Council of Ministers in December 2024, aims to increase public revenues (by ALL 64.8 billion or about 2.6% of 2024 GDP) mainly by improving tax and customs administration (85% of the expected revenue increase) rather than changing tax policies. Albania submitted its 2025-2027 Economic Reform Programme (ERP) to the European Commission on time in mid-January 2025. The ERP emphasised the government's commitment to maintaining macroeconomic stability, achieving surpluses in the primary balance and abiding to the fiscal rules set out in the organic budget law. Albania also committed to socio-economic and fundamental reforms to accelerate growth and convergence with the EU.

The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2024 has been partial. Albania complied with the fiscal rules on the budget balance and on public debt and stepped up the pace of fiscal consolidation given better-than-expected economic and revenue performance. Arrears continued to build up throughout 2024 and, although the end-of-year target for their reduction was achieved, the reliance on *ex post* clearance through budget reallocations should gradually be phased out. Tax revenue as a share of GDP increased in 2024 and a stand-alone fiscal risk statement has been drafted but not published. The transparency and accountability of state-owned enterprises (SOEs) still needs to be improved. The authorities worked on the public-private partnerships (PPPs) law, but the draft law is pending parliamentary approval. PPPs are not yet integrated into the National Single Project Pipeline.

Macroeconomic stability

The economy maintained a strong growth momentum.

Graph 1.1: **Albania - Real GDP growth and contributions**



Source: WiiW, INSTAT, own calculations

Following 4% GDP growth in 2023, economic expansion remained strong at 4% in 2024, driven by robust domestic demand, good tourism performance and sustained construction activity. The rise in household consumption was supported by increasing real wages amid slowing inflation, and by stronger credit growth. Public consumption growth was elevated on the back of the second phase of the public wage reform. Job creation in the services sector supported employment growth. Exports of services expanded, but goods exports fell significantly due to the appreciation of the lek and an unfavourable external environment. Overall, the contribution of net exports to GDP growth was negative. Most economic sectors recorded positive output growth, but agriculture and industry contracted. Economic activity continued to expand in 2025, with GDP registering an annual growth rate of 3.4% in the first quarter. Albania's GDP per capita in purchasing power standards stood at 37% of the EU-27 average in 2024 compared to 30% in 2019.

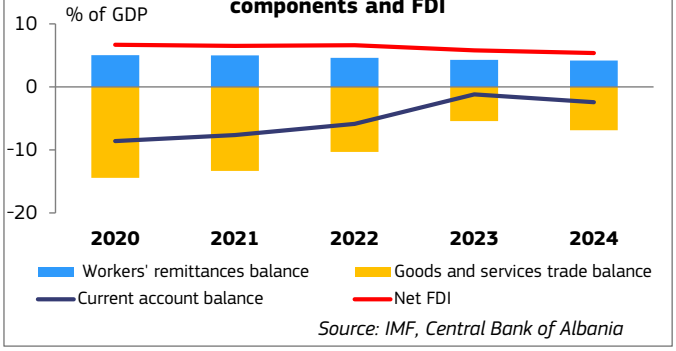
Table 1.1: **Albania - Key economic figures**	**2016-21** average	**2022**	**2023**	**2024**
GDP per capita (% of EU-27 in PPS)[1)]	30	34	36	37
Real GDP growth	3.2	4.8	4.0	4.0
Activity rate of the population aged 15-64 (%), total	68.2	73.2	75.4	75.7
female	*60.0*	*66.8*	*69.8*	*69.3*
male	*76.5*	*80.0*	*81.0*	*82.3*
Unemployment rate of the population aged 15-64 (%), total	13.1	11.3	10.1	9.4
female	*12.7*	*11.7*	*10.3*	*10.0*
male	*13.4*	*10.9*	*9.9*	*8.9*
Employment of the population aged 15-64 (annual growth %)	1.8	4.8	1.6	-1.6
Nominal wages (annual growth %)	3.0	8.2	14.0	9.8
Consumer price index (annual growth %)	1.7	6.7	4.8	2.2
Exchange rate against EUR	128.0	119.0	108.8	100.7
Current account balance (% of GDP)	-7.6	-5.9	-1.2	-2.4
Net foreign direct investment, FDI (% of GDP)	7.6	6.6	5.8	5.4
General government balance (% of GDP)	-3.1	-3.6	-1.3	-0.7
General government debt (% of GDP)	70.7	64.1	57.6	54.2

Notes:
1) Eurostat
Sources: INSTAT, Central Bank of Albania, Ministry of Finance and Eurostat

The current account deficit remained moderate. It increased to 2.4% of GDP in 2024, following a historic low of 1.2% of GDP in 2023. The widening of the deficit in 2024 was primarily driven by a rise in the goods trade deficit, due to a decline in exports and a continued increase in imports driven by the rapid expansion of domestic demand. The services balance remained in robust surplus, driven by tourism. The surplus of the secondary income balance fell, with remittances declining from 4.3% of GDP in 2023 to 4.2% in 2024 (despite their nominal increase). The primary income balance was slightly negative at 0.8% of GDP. In the first quarter of 2025, the current account deficit narrowed, with its rolling 4-quarter total standing at 2.1% of GDP (mainly due to an increase in exports of goods and services). Net foreign direct investments (FDI) inflows remained the primary source of financing

the current account deficit in 2024. They grew by 7% year on year in 2024, but their share of GDP declined to 5.4%, from 5.8% one year earlier. The real estate sector remained the largest recipient of FDI flows. International reserves increased to EUR 6.2 billion in December 2024, covering seven months of imports of goods and services. The external debt-to-GDP ratio has been on a declining trend and fell by 0.7 pps to 46.8% in 2024.

Graph 1.2: **Albania - Current account selected components and FDI**

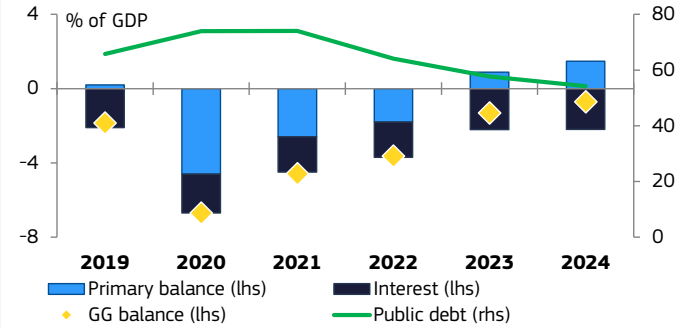


Source: IMF, Central Bank of Albania

Inflation fell below the 3% central bank target. Annual inflation averaged 2.2% in 2024, down from 4.8% in 2023 and a high of 6.7% in 2022. This steady disinflation has been driven by lower food and commodity prices and an appreciating domestic currency. Imported inflation reached historically low levels in 2024 amid exchange rate appreciation. On the other hand, domestic inflationary pressures have moderated more gradually amid strong demand and a tight labour market. Core inflation also fell in 2024. The Bank of Albania implemented two reductions in the key policy interest rate in 2024, lowering it from 3.25% to 2.75%, and a further cut in July 2025, to 2.5%. In the first two months of 2025, inflation recorded a slight decline to 1.9% and then picked up to 2.5% in July 2025.

Fiscal consolidation accelerated in 2024, but the budget deficit is set to increase markedly in 2025. The budget deficit fell from 1.3% of GDP in 2023 to 0.7% of GDP in 2024, significantly undershooting the deficit target of 2.3% of GDP. While revenues performed well, this fiscal outcome was partly the result of public investment under-execution. The primary balance surplus stood at 1.4% of GDP (up from 0.7% of GDP in 2023), supporting the decline in the public debt ratio, which fell by 3.4 pps to 54.2% of GDP in 2024[2]. However, gross financing needs remain elevated. The 2025 budget, adopted in December 2024, projects the deficit to increase to 2.6% of GDP. In the first eight months of 2025, the budget execution showed a fiscal surplus of 1.6% of GDP. Tax expenditures, estimated at 4-5% of GDP[3], and high levels of informality still constrain the revenue base. As part of the MTRS implementation, in June 2025 the government finalised a report on existing tax exemptions, but the assessment has not been made public and concrete proposals to eliminate those exemptions that are not well justified have not yet been developed. In 2025, Albania amended the income tax law and extended its significant tax incentives for luxury hotels[4], which goes against Albania's commitment to reduce tax expenditures. A higher public-revenue-to-GDP ratio is crucial to sustain investments in both physical and human capital while firmly anchoring the downward trend in public debt.

Graph 1.3: **Albania - Fiscal developments**



Source: Ministry of Finance

[2] In February 2025, Albania issued its seventh Eurobond, amounting to EUR 650 million, with a ten-year maturity and a coupon rate of 4.75%. In March 2025, S&P upgraded Albania's sovereign debt credit rating from BB- to BB. The public debt-to-GDP ratio continued to decline in the first half of 2025.

[3] According to national sources, such as the MTRS, which makes references to the 'Tax Expenditures 2021-2022' report.

[4] Under the recently amended income tax law, four- and five-star establishments are exempt from corporate income tax for a 10-year period, provided they meet specific investment thresholds and obtain a special status as defined in the Law on tourism. These hotels also benefit from exemptions on property tax and infrastructure impact tax and enjoy a reduced VAT rate of 6% on all services offered. Parliament extended the deadline for the application period for these tax breaks from 2024 to 2026.

The regulatory framework for public investment management (PIM) has been improved in recent years, but challenges remain. In February 2024, the government updated the PIM guidelines introducing clarifications, including on the role of the Ministry of Finance in certain situations, and that of the Agency for Strategic Planning (SASPAC). Changes to the legal framework were also made in March 2025, when the government approved amendments to the Decision of the Council of Ministers (DCM) No 887/2022 on PIM procedures, including quarterly updates to the National Single Project Pipeline (NSPP) and increased flexibility for feasibility studies. Yet, the planning and execution of public investment projects continues to face significant obstacles in the form of capacity constraints, incomplete project proposals, delays and cost overruns, and an occasional lack of adherence to procedures. The recurrent under-execution in capital spending is a clear indication that shortcomings exist in the operationalisation of the new legal framework and of the NSPP.

Albania implemented an overall appropriate macroeconomic policy mix. It helped sustain macroeconomic stability and supported economic growth. On the fiscal side, the budget deficit narrowed, the surplus in the primary balance increased while the public debt ratio continued its downward path. As disinflation accelerated, with inflation falling below the central bank target, monetary policy was eased. At the same time, bank supervision has been prudent, with the countercyclical capital buffer raised twice amid strong credit expansion.

Functioning of product markets

Business environment

The business environment remains challenging. Businesses welcome the fact that there has been some progress on the justice reform and anti-corruption matters, but lengthy court procedures persist (see Chapter 23 – *Judiciary and Fundamental Rights*). The business environment also remains affected by weaknesses in the rule of law, informality and limited access to finance for SMEs, particularly farmers. Bureaucracy and lengthy licensing procedures, combined with problems of consistency in case law, create burdens for businesses. Clear policies that encourage effective tax compliance and reduce tax evasion would help formalise more businesses and broaden the tax base. Granting of strategic investor status and PPP/concession contracts are often considered non-transparent by businesses. The country also struggles with incomplete and inconsistent property title registration, leading to uncertainty and disputes over ownership which deter investment. Although Albania has made efforts to modernise its property system through cadastre digitalisation, progress has been slow and uneven. Despite efforts towards deregulation and facilitation of business-related services, the responsiveness of public institutions to deliver efficient services is slow, while service delivery remains heavily centralised in Tirana, leaving rural regions underserved. The effectiveness of public consultation processes continues to show room for improvement.

State influence on product markets

The adoption of a unified investment law has been further postponed, while the Law on strategic investment has been extended until 2026. Work on establishing a harmonised legal framework for investments started years ago but progress has stalled. This initiative seeks to replace the existing Law on strategic investment, providing a more cohesive and transparent legal environment for both domestic and foreign investors[(5)]. Meanwhile, in February 2025, Parliament amended the Law on strategic investment, extending its effects until 2026, and included in the strategic investor category investments worth EUR 50 million or more, irrespective of the sector, provided they received prior approval from the line Ministry. While these measures are designed to boost economic activity[(6)], they have also raised concerns about transparency and equitable access, favouritism and lack of competitive processes.

The Bank of Albania introduced an SME financing programme. In early 2025, in collaboration with the government, the central bank launched a financing scheme to improve credit access for SMEs,

[(5)] Under the Reform Agenda, Albania committed to analyse the current legal framework on FDIs, and draft and adopt a unified investment law by December 2026.

[(6)] The measures also strengthen the role of the Albanian Investment Development Agency in scrutinising and vetting investors.

particularly in agriculture, which is a sector that accounts for only 2% of loans to businesses. The Bank of Albania aimed to finance the programme with EUR 250 million, offering loans through commercial banks. It also included a sovereign guarantee covering up to 70% of loan principals. Interest rates are capped at 3.5% or lowered to 2% if the sovereign guarantee applies. The deadline for applications is end of 2025.

Privatisation and restructuring

Regulation allowing for privatisation of public assets, land or movable assets, has been amended. Albania introduced several amendments to the regulation that provides for the privatisation of public assets. Under the revised rules, entities that have secured long-term lease contracts for public assets at symbolic rates (e.g. EUR 1) and used the state-owned assets/land for over a decade can purchase those assets under certain conditions. The implementation of this initiative should ensure equal treatment of investors. The government also adopted regulations to facilitate the transfer of public assets to the Albanian Investment Corporation for further development and revitalisation programmes in partnership with private investors. In March 2025, Parliament adopted the 'Mountain package' legislation. This initiative aims to stimulate economic growth in Albania's mountainous regions by promoting investments in sectors like tourism and agriculture, by providing fiscal incentives and by offering some benefits on land acquisition for those investing in these areas. It is essential to safeguard Albania's ecological and biodiversity values and ensuring full transparency throughout the process.

SOEs pose fiscal risks, and their governance still needs to be improved. SOEs, in particular the state-owned energy utilities, receive loans from the central government but repayment is unpredictable, while the financial viability of some of these companies is weak. Due to the risks posed to the budget, monitoring SOEs is crucial. The Fiscal Risk Unit of the Ministry of Finance expanded the number of monitored SOEs to 12. Technical assistance is also ongoing to improve SOEs' financial reporting practices and the monitoring of their financial performance. The publication of annual financial performance reports by SOEs should become standard practice, while strengthening SOEs oversight remains essential. Weak governance of SOEs contributes to market distortions and unfair competitive conditions[(7)].

Functioning of the financial market

The banking sector remained well-capitalised and profitable, while the non-performing loans ratio decreased. At aggregate level, banks had a capital adequacy ratio of 19.8% in December 2024, which is well above the Albanian minimum requirement of 12%. Following very good performance in 2023, banks' profitability continued to improve in 2024, supported by increasing net interest income, higher income from fees and commissions, and the decrease in loan-loss provisions. The non-performing loans ratio stood at 4% in July 2025, down from 4.7% a year earlier. Driven by higher demand and favourable financing conditions, private sector credit accelerated in 2024. Nevertheless, the level of financial intermediation remained low – the share of private sector loans in GDP stood at 33% in the first half of 2025. The high share of government securities among banks' assets continues to expose them to sovereign risk. Good progress has been made in collecting data on banks' exposure to the real estate sector and in monitoring credit standards for real estate loans. The Bank of Albania took new borrower-based macroprudential measures to address potential risks in the real estate sector. It has also increased the countercyclical capital buffer to 0.5% (effective from December 2025). Efforts to strengthen oversight of non-bank financial institutions should continue.

In March 2025, the law establishing the Albanian Development Bank as a deposit-taking institution was adopted. The law raises major concerns regarding compliance with EU competition and State aid rules in the field of banking. The development bank must have an operational framework that mitigates moral hazards and fiscal risks from state guarantees, and complies with best practices in terms of governance as well as appropriate supervision and regulation applicable to other deposit-

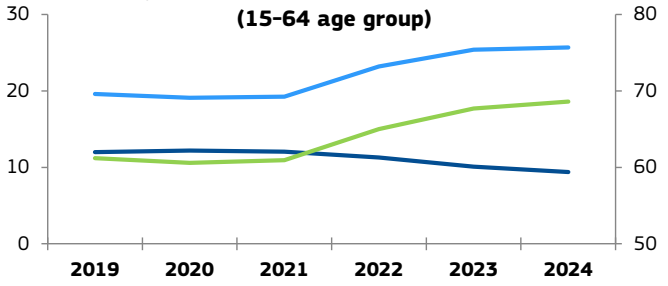
[(7)] More details on key SOE issues and developments can be found in the OECD's Western Balkans Competitiveness Outlook 2024: Albania.

taking institutions, to ensure transparency, sound lending practices, adequate deposit protection and a level playing field in the banking sector.

Functioning of the labour market

The labour market registered positive developments, but it faces structural issues. Albania's labour market exhibited notable improvements in 2024, with an increased employment rate (a 1.5 pps year-on-year increase to 68.3% in Q4-2024) and higher wages, alongside a decline in the unemployment rate (a 0.6 pps year-on-year drop to 9.6% in Q4-2024)[8]. The youth unemployment rate also improved compared to one year earlier, falling from 21.2% to 19.1%, but it remains elevated. The Youth Guarantee Scheme piloting in three municipalities was extended until 2027. Informal employment remains an issue, with many workers lacking formal contracts, social security, and legal protections, while the underreporting of wages is widespread, eroding pensions. Emigration, especially of skilled workers, exacerbates labour shortages in key sectors, contributing to a brain drain. Insufficient active labour market policies hinder workforce adaptability and limit opportunities for higher-quality employment. The coverage of Albania's social assistance system remains inadequate. The tripartite collaboration between the State Labour and Social Services Inspectorate, trade unions and employer organisations remains weak. Albania adopted in June 2025 a policy document on aging and an action plan for 2025-2030.

Graph 1.4: **Albania - Labour market trends (15-64 age group)**



Source: INSTAT

1.2. THE CAPACITY TO COPE WITH COMPETITIVE PRESSURE AND MARKET FORCES WITHIN THE EU

Albania has **some level of preparation** to cope with competitive pressure and market forces within the EU and made **limited progress** in this area. The education system still faces numerous challenges, skills gaps persist, and the youth not in education, employment or training (NEET) rate remains a concern. Transport and digital infrastructure improved, but infrastructure gaps remain. Albania remains competitive as a tourism destination, offering an expanding scope of services, but industry and agriculture remain low-productivity sectors that have been contracting. Manufacturing exports fell due to weak demand, exchange rate appreciation, and businesses' low pricing power.

The Commission's recommendations from last year were partially implemented and remain mostly valid. In the coming year, Albania should in particular:

→ continue to improve and better promote the vocational education and training (VET) system in order to increase the number of graduates from VET schools and ensure that labour skills align with job market demands;

→ improve the quality and inclusiveness of the education system and advance its digital transformation;

→ strengthen infrastructure, including building cyber-resilience.

[8] Data and labour market indicators covering 2023 and 2024 have been revised and calibrated using the updated resident population according to the results of the 2023 population and housing census. A reduced denominator (15-64 year working age population) contributed to the rise in the employment rate. According to the census, the population decreased by 14% between 2011 and 2023, from 2.8 million to 2.4 million residents. Population projections show that Albania is likely to record a large fall in population over the next three decades (see United Nations, Department of Economic and Social Affairs, Population Division (2024). World Population Prospects 2024).

Education and innovation

The education system faces challenges, hindering the build-up of a skilled and competitive workforce. Albania continued to implement the National Education Strategy 2021-2026, which aims to improve quality of education and access and adaptation to the labour market. Nevertheless, the education system is faced with low educational attainment and high dropout rates, particularly in rural areas and among marginalised communities. Albania's not in education, employment, or training (NEET) rate for youth aged 15-29 stands at approximately 24% in 2023, significantly higher than the EU average. The quality of education is often hindered by outdated curricula, insufficient teacher training and outdated infrastructure. Furthermore, there is limited access to early childhood education. The education system also struggles with inclusivity, particularly for children with disabilities and those from disadvantaged backgrounds. The lack of effective vocational education and training (VET) hinders workforce adaptability and limits opportunities for higher-quality employment. Nevertheless, efforts were made to address some weaknesses, by updating curricula, introducing traineeship programmes, and piloting an apprenticeship programme (work-based learning) (See Chapter 26 – *Education*).

Public spending on research and development (R&D) is limited. Albania aims to spend 1% of GDP on R&D in 2030, but currently figures are way below the official target. In December 2024, Albania adopted the **Strategy on Innovative Entrepreneurship.** Besides increasing public R&D expenditure, further efforts are needed to incentivise businesses to increase their R&D expenditure and encourage cooperation between the private sector and universities.

Physical capital and quality of infrastructure

Transport infrastructure development is advancing. Albania continued its public investment in infrastructure, mainly roads, but also railways. Progress has been made on major highways such as the Adriatic-Ionian Highway and Corridor VIII, which are part of the trans-European transport network (TEN-T). The construction of the Tirana–Durrës railway and the railway connection to the airport is ongoing (approx. 80% complete), while the construction of the new airport in Vlora through a concessionary contract is in its final stage. According to the authorities, all transport infrastructure projects that are part of the TEN-T for all modes of transport are included in the Albanian NSPP. While infrastructure projects are advancing, gaps remain, and the recurrent issue of the under-execution of public investment is slowing down the build-up of the capital stock.

Investment in digital infrastructure advanced in 2024. Albania completed the authorisation process for 5G services, granting licences to two mobile operators The number of broadband subscribers grew by 10% compared to 2023, and the mobile broadband penetration rate increased by 15.4%. Several operators reportedly upgraded their networks to deliver faster internet services, primarily through advanced fibre-optic infrastructure capable of supporting high and very high-speed data transmission.

Steps have been taken to improve energy efficiency. In June 2025, Parliament approved a Law on energy performance of buildings. Albania also approved a long-term renovation strategy focusing on improving energy efficiency in buildings and decarbonising the energy sector, including also measures to reduce greenhouse gas emissions, integrate renewable energy and improve energy security (see Chapter 15 – *Energy*).

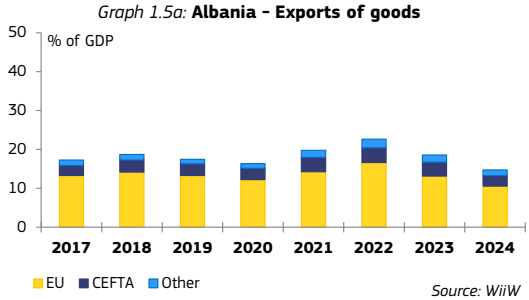
Sectoral and enterprise structure

The structure of the economy remains similar to the previous year. The structural survey of enterprises shows that, in 2023, micro, small, and medium-sized enterprises dominated Albania's economy, comprising 99.9% of all enterprises. These businesses employed 82.5% of the total workforce and contributed 78.2% of the total value added by non-agricultural sectors. According to the 2023 data on the trade in goods by enterprise characteristics, SMEs accounted for 65% of total goods exports, marking a decline of 8.9% compared to 2022. The number of newly registered foreign companies (with 100% foreign ownership) reached 1 423 in 2024, reflecting an 11% increase compared to the previous year.

Economic integration with the EU and price competitiveness

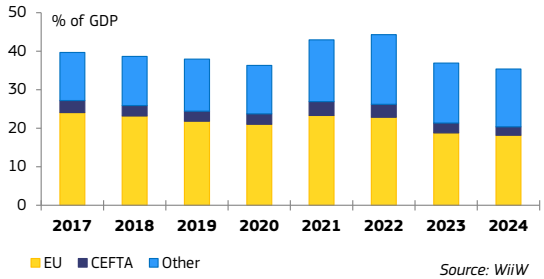
The EU remains Albania's main trading and investment partner. Trade openness (the sum of total exports and imports as a share of GDP) declined from 82.4% in 2023 to 79.5% of GDP in 2024, as exports of goods fell. The EU remained Albania's main trading partner. In 2024, the EU accounted for 57.4% of Albania's goods trade, absorbing 71.7% of Albania's merchandise exports and providing 51.5% of its goods imports. Italy (43.7%), Kosovo (9.9%), Greece (6.3%), and Germany (5.9%) were the leading export destinations. The country's main import partners were Italy (21.1%), China (10.9%), Türkiye (10.8%) and Greece (7.6%). The EU also remains the main source of FDI inflows, while the EU's share of FDI stocks stood at 54.1% (from 54.4% in 2023). Albania's price competitiveness deteriorated, as reflected in the appreciation of the real effective exchange rate, the increase in nominal wages and lower goods exports. Manufacturing exports are sensitive to exchange rate appreciation, due to their low value added and businesses' low pricing power. They are outweighed by services exports (in particular travel services, which more than doubled in value between 2019 and 2024), which provide some 80% of Albania's total exports. SMEs accounted for 69% of total goods exports, marking a decrease of 10.3% compared to 2023.

Graph 1.5a: **Albania - Exports of goods**



Source: WiiW

Graph 1.5b: **Albania - Imports of goods**



Source: WiiW

2. BOSNIA AND HERZEGOVINA

2.1. THE EXISTENCE OF A FUNCTIONING MARKET ECONOMY

Bosnia and Herzegovina is at an **early stage of preparation** – and there was **no progress** during the reporting period – in establishing a functioning market economy. Economic activity remained resilient despite a deteriorating political situation, with GDP growth slowing down to 2.6% in 2024, and to about 1.7% in the first half of 2025. Employment growth decelerated further, while a significant outflow of workers from the country continued to result in labour shortages and created upward pressure on wages. Economic and fiscal governance deteriorated as a result of politically motivated blockages in policy implementation, a very short-term-oriented policy approach and a deteriorating cooperation. The business environment continues to suffer from a highly fragmented internal market and a deterioration in the rule of law. Political stalemate continued to delay necessary decisions and structural reforms that would have been needed to improve the functioning of the market economy.

Last year's Commission recommendations remain valid. In the coming year, Bosnia and Herzegovina should in particular:

→ improve the business environment by both: (i) simplifying business registration and licencing procedures; and (ii) harmonising and mutually recognising licences and certificates between entities;

→ strengthen countrywide regulatory and supervisory institutions, bolster analytical and policy formulation capacity and publish complete and consistent countrywide data in a timely manner, in particular on public finances;

→ increase the transparency and efficiency of the public sector, in particular by putting in place a framework for better and depoliticised governance; and clarify the constitutional competence for setting up a registry of bank accounts of private individuals, in line with the EU *acquis*.

Economic governance

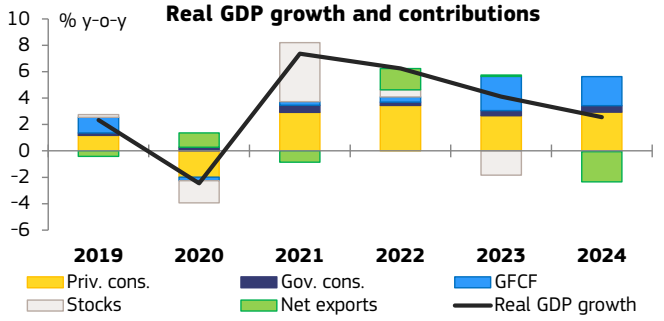
Economic governance deteriorated in 2024 due to resurfacing political tensions. Policy formulation and implementation continued to be impeded by highly politicised decision-making processes, institutional fragmentation and insufficient cooperation among key stakeholders, in particular from the *Republika Srpska entity*. The notorious delays in agreeing on the budget for State-level institutions continues to impede their functioning and to erode their capacities. The quality and credibility of fiscal policy has further deteriorated in 2024, mainly due to its focus on short-term objectives, such as raising social transfers and wages well beyond productivity increases. Longer-term challenges (such as stemming brain drain and increasing the country's growth potential), or upcoming economic issues, such as the impact of the introduction of the EU's carbon border adjustment mechanism (CBAM), are not adequately addressed. Progress on overdue structural reforms has remained very limited. The Economic Reform Programme (ERP) was again submitted with a significant delay in 2024, for the fourth time in a row. The programme's quality continues to suffer from a lack of both internal consistency and cooperation between the various stakeholders.

Implementation of the policy guidance jointly adopted at the May 2024 Economic and Financial Dialogue with the EU has remained limited. Limited progress has been made since then to improve the country's statistics, especially in the area of public finance. The 2025-2027 global fiscal framework was not adopted in time, and no steps were taken to clarify the constitutional competence for setting up a central (countrywide) registry of bank accounts of private individuals. The bank resolution framework is not fully operational. The Central Bank continued to ensure full convertibility of the domestic currency, while its governing board is complete and functioning.

Macroeconomic stability

Economic activity was resilient in 2024 but weakened in early 2025[9]. Real GDP growth decelerated from 4.1% in 2023 to 2.6% in 2024. This was largely driven by weaker exports, while import growth held up, reflecting stronger domestic demand. In the first half of 2025, output growth slowed down to about 1.7%, driven mainly by weakening domestic demand. The process of catching up with EU living standards has remained slow, with GDP per capita in purchasing power standards at 35% of the EU average in 2024, one percentage point (pp) lower than in 2023 and only 3 pps higher than in 2019.

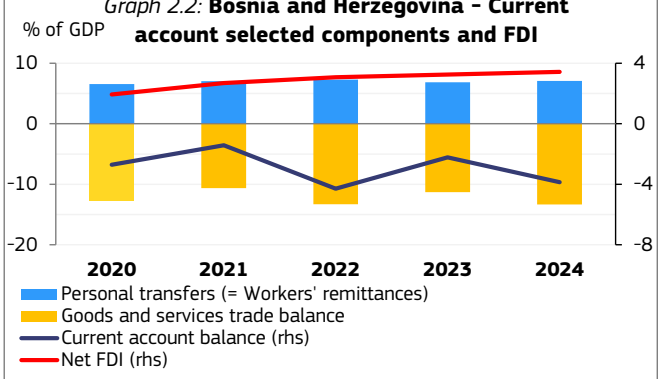
Graph 2.1: **Bosnia and Herzegovina – Real GDP growth and contributions**



Source: Agency for statistics, own calculations

A weak export performance during the reporting period led to a marked deterioration of the current account deficit. Deficit increased from 2.2% of GDP in 2023 to 3.9% in 2024, mainly due to a reduction in goods exports (which fell by 1.5% of GDP) and an increase in imports (which rose by 0.9 % of GDP), leading to an increase in the goods trade deficit from 19.7% of GDP in 2023 to 21.3% in 2024. The weak export performance was broad-based, but in particular affected mineral products, base metals and footwear, while exports of military materials and transport vehicles performed significantly better. The services trade surplus stood at around 8% of GDP in 2024, benefitting from strong tourism revenues. The surplus in the secondary income balance, primarily consisting of remittances, increased slightly from 9.6% of GDP in 2023 to 9.8% in 2024. Net foreign direct investment (FDI) inflows rose slightly from 3.3% of GDP in 2023 to 3.4% in 2024, financing the bulk of the external deficit. About 40% of those inflows were reinvested earnings.

Graph 2.2: **Bosnia and Herzegovina – Current account selected components and FDI**



Source: Central Bank of Bosnia and Herzegovina, Agency for statistics

Headline inflation picked up from 1.7% in 2024 to 3.8% on average in the first seven months of 2025. The main drivers for this recent increase were strong price increases for food (+8.8%), health and restaurants (+6.5% each). The measurement of inflation suffers due to the lack of disaggregated data from the *Republika Srpska* entity. The country's statistics office does not yet publish data on core inflation, while the Central Bank has started to publish its own estimates. These methodological shortcomings greatly impede the analysis of inflationary dynamics.

A strong rise in public spending led to an increase in the fiscal deficit from 1.2% of GDP in 2023 to 1.9% in 2024, despite strong economic growth and significantly higher revenues. Higher than expected revenues were largely used to finance additional spending, primarily for higher wages, pensions and increased social transfers. The main reasons behind the improved revenue performance were: (i) indirect tax revenues being boosted by strong household consumption; and (ii) higher revenues from social contributions due to higher wages. On the spending side, social transfers and collective consumption rose by 0.7% of GDP from 32.9% of GDP in 2023 to 35.2% of GDP in 2024. Public investment rose slightly from 3.5% of GDP in 2023 to 3.9% in 2024. General government

[9] GDP growth figures in this paragraph reflect the data released on 30 September 2025 by the Agency for Statistics of Bosnia and Herzegovina (BHAS).

Table 2.1: **Bosnia and Herzegovina - Key economic figures**	**2016-21** average	**2022**	**2023**	**2024**
GDP per capita (% of EU-27 in PPS)[1)]	32	34	36	35
real GDP growth [2)]	2.9	6.2	4.1	2.6
Activity rate of the population aged 15-64 (%), total	56.0	59.1	59.8	61.8
female	*43.9*	*46.3*	*47.0*	*49.3*
male	*67.8*	*71.8*	*72.3*	*74.0*
Unemployment rate of the population aged 15-64 (%), total	19.3	15.5	13.3	12.8
female	*22.7*	*19.9*	*16.7*	*16.7*
male	*17.2*	*12.7*	*10.9*	*10.2*
Employment of total population (annual growth %)[3)*]	2.4	2.3	1.4	0.5
Nominal wages (annual growth %)	3.0	11.7	13.0	9.8
Consumer price index (annual growth %)	0.5	14.0	6.1	1.7
Exchange rate against EUR	1.96	1.96	1.96	1.96
Current account balance (% of GDP) [2)]	-3.1	-4.3	-2.2	-3.9
Net foreign direct investment, FDI (% of GDP) [2)]	2.2	3.1	3.3	3.4
General government balance (% of GDP)	0.3	-0.4	-1.2	-1.9 [3)]
General government debt (% of GDP)	35.0	29.3	26.4	27.4

Notes:

1) Eurostat

2) Expenditure side GDP, Agency for statistics data revision 30 Sept.2025

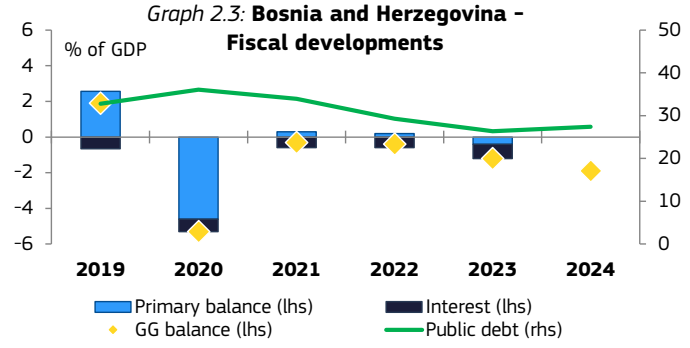
3) Agency for statistics, Central Bank of Bosnia and Herzegovina

** There is no comparable time series for the age group 15-64*

Sources: Agency for statistics, Central Bank of Bosnia and Herzegovina and Eurostat

debt rose from 26.4% of GDP at end-2023 to 27.4% at end-2024. The recent increases in current spending in response to a temporary inflation-driven revenue increase have structurally weakened the country's fiscal position. Adopted budgets for 2025 suggest a further increase in the fiscal deficit towards 2.5% of GDP. Overall, any assessment of the country's budgetary position and public debt is severely constrained by: (i) a lack of timely, countrywide fiscal data; (ii) weak compliance with EU accounting standards; and (iii) a significant level of payment arrears and contingent liabilities.

Graph 2.3: **Bosnia and Herzegovina - Fiscal developments**



Source: Central Bank of Bosnia and Herzegovina, Agency for statistics

The macroeconomic policy mix has deteriorated and does not adequately address the country's main challenges. Bosnia and Herzegovina's currency board regime, which is an anchor of stability, limits the country's room for monetary policy. For this reason, fiscal policy is the key macroeconomic policy tool to manage aggregate demand. However, there is *de facto* no countrywide fiscal planning or *ex ante* coordination of fiscal planning between the State and the entities, as existing legislation requiring this is not being complied with. In June 2025, the Federation entity adopted legislation to issue Eurobonds without State-level approval and to increase borrowing limits from local banks. In the *Republika Srpska entity* a similar practice is already in place. This further impedes the country's ability to pursue a coordinated, countrywide fiscal policy. The country's fiscal stance and its structural fiscal position have worsened in 2024 and 2025 with procyclical spending increases in 2024 and further spending increases in 2025, largely consisting of additional expenditure on consumption and transfers. At the same time, public

investment remains low, failing to increase the country's growth potential. This short-term-oriented fiscal stance fails to address the country's structural challenges, such as: (i) the overall low speed of convergence with the EU; (ii) a poor business environment; (iii) insufficient domestic and foreign investment; and (iv) significant labour market issues due to skill mismatches and a persistent and substantial brain drain.

Functioning of product markets

Business environment

The institutional and regulatory business environment has further weakened. Although property rights are largely well established, implementing these rights remains cumbersome in some areas, such as in real estate registration. The backlog in civil and commercial litigious cases at first instance has increased slightly (by about 1%) in 2024. The long duration of court cases impedes contract enforcement, in particular for the settling of commercial disputes. Doing business across the entire country continues to be impeded by technical and administrative obstacles, such as: (i) the need to obtain the same licences or permits in each entity or local government area; (ii) locally diverging rules and standards such as for construction permits; or (iii) the need to pay a range of some 3 500 different local taxes and fees. This prevents competition and deters both domestic and foreign investors. Not surprisingly, the number of foreign 'green field' investors and the growth of medium-sized companies has remained very limited. The economic and social dialogue between the authorities, social partners and academia further declined during the reporting period. This has a negative impact on the quality of adopted legislation, as in the case of the poorly prepared increase of the minimum wage in both entities.

The informal economy and the level of corruption remain sizeable. Despite some efforts to increase employment registration, the informal sector continues to be large, accounting for up to one third of GDP. Undeclared work provides substantial employment and income but distorts competition and erodes the tax base. Together with under-reported wages, this results in lower pension benefits, increases the risk of poverty for older people, and adds to an already significant fiscal burden on registered labour. Transparency International's country-corruption index for 2024 shows a drop by 2 points compared with 2023 and a further fall in the country's ranking by six places, to 114th out of 180, indicating an increase in perceived corruption.

State influence on product markets

State influence in the economy remains large. About one third of total employment is in public administration, health, education and publicly owned enterprises. Many of these public enterprises remain unreformed despite ongoing poor performance. Public procurement procedures continue to be complex, and administrative capacities remain low. This facilitates corruption and leads to a preference for domestic suppliers, which is incompatible with the EU *acquis* (*see also Chapter 5 – public procurement*). There is still a wide range of regulated prices in the economy. The official level of State aid is relatively low (at 1.1% of GDP in 2022), although significant indirect State support continues to undermine the level playing field. Monitoring and control of State aid is still hindered by both (i) the only partial legal alignment with the EU State aid framework; and (ii) the lack of consistent enforcement of State aid rules throughout the country. The State Aid Council's powers and capacities remain limited.

Privatisation and restructuring

No progress was achieved during the reporting period on the restructuring of publicly owned companies. Some 540 companies are owned or controlled by different levels of government, accounting for about 10% of total employment and about one quarter of public-sector employment. The debt of those public companies is substantial, amounting to nearly 30% of GDP, with a high share of short-term liabilities. Contingent liabilities with a high risk of realisation account for about 5% of GDP. Monitoring and management of those debt risks is often insufficient. Close to half of those companies require both explicit and implicit budgetary support, which is a heavy burden on the public finances. Although legislation partially provides for open and transparent selection procedures, in practice appointments to boards of public companies are highly politicised. Some of the public

enterprises benefit from a less strict collection regime when it comes to paying taxes and social contributions, accumulating payment arrears. This also allows them to pay wage premiums, which puts them in an advantageous position when compared with private companies. Actual steps to restructure, dissolve or privatise public enterprises remained very limited. However, there have been some steps in the *Republika Srpska* entity towards strengthening the management and oversight of the entity's publicly owned enterprises. Functional mechanisms and capacities for effective oversight and governance of public enterprises are still lacking. While the *Republika Srpska* entity has started publishing a consolidated report on the financial performance of publicly owned enterprises, a countrywide report is still missing. This represents a significant gap in transparency and accountability. The *Republika Srpska* entity still lacks an updated single register of public companies, and the Federation entity has not yet put in place units to oversee and manage public companies.

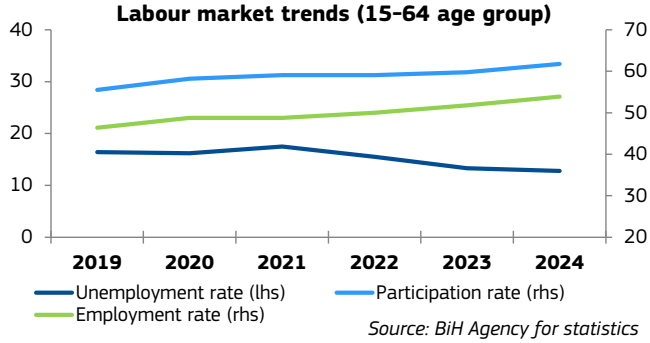
Functioning of the financial market

The financial sector remained stable and asset-quality indicators remained solid during the reporting period, although some weaknesses remain. Banks have robust capital and liquidity buffers, while bank profitability remained solid in the reporting period. Bank deposits grew robustly (by 7.6% in 2024 and 7.8% in the first seven months of 2025) while nominal credit growth accelerated to 9.0% in 2024, and 10% in the first seven months of 2025. Bank lending as a share of GDP rose from 46.2% in 2023 to 48% in 2024. The ratio of non-performing loans continued to decline, from 3.5% in the second quarter of 2024 to 2.9% in the second quarter of 2025. However, credit risks appear markedly higher in some smaller, domestically owned banks. During the reporting period, the entity-level banking supervisory authorities extended measures to contain the increase in domestic lending rates. They did this to preserve households' repayment capacity and discourage higher-risk lending. A comprehensive assessment of financial-sector risks is hampered by both: (i) gaps in data availability, particularly in the real-estate sector and on private debt; and (ii) the overall fragmentation of the domestic financial market. Bosnia and Herzegovina does not have a countrywide financial safety net, such as a single resolution framework. The size of the non-bank financing sector and of the capital markets remained small, with a stock market capitalisation of about 22.5% of GDP at the end of 2024. For many micro and small companies, gaining access to credit remained difficult.

Functioning of the labour market

Recent labour market improvements have slowed down, but high levels of youth and long-term unemployment, low labour participation, and labour shortages all point to persistent structural weaknesses. Registered employment growth slowed down to 0.1% in the first seven months of 2025, compared to 0.4% the year before. There were job losses in manufacturing, while the construction, trade, tourism and health sectors registered moderate employment growth. The unemployment rate according to the labour force survey rose from 12.7% on average in 2024 to 13.3% in the first half of 2025. Youth unemployment (those aged 15-24) rose from an average of 29.9% in 2024 to 34.6% in the first half of 2024. Plans to establish the EU Youth Guarantee scheme have been further delayed. A relatively high inactivity rate among women contributes to an overall rather low activity rate. The level of informal employment remains high. Significant numbers of workers continued to leave the country during the reporting period, leading to labour shortages and damaging the country's medium-term growth potential. In response, the authorities have increased available quotas for foreign employment permits. Long-term unemployment as a share of total unemployment slightly declined but was still a very high 73.2% in 2024. The key causes of this are skills mismatches, insufficient job opportunities and a high tax wedge on labour. The impact on the labour market of the recent reduction of the tax wedge might

Graph 2.4: **Bosnia and Herzegovina – Labour market trends (15-64 age group)**



Source: BiH Agency for statistics

be observable only at a later stage. Measures to address the high youth and structural unemployment and skill mismatches have remained limited and fragmented at cantonal and entity level. Official real wages grew by 8.1% in 2024 and some 10% in the first seven months of 2025, while labour productivity growth during this period was significantly lower, at around 2-2.5% annually. Such above-productivity wage increases could fuel inflationary pressures and hamper the country's external competitiveness.

2.2. THE CAPACITY TO COPE WITH COMPETITIVE PRESSURE AND MARKET FORCES WITHIN THE EU

Bosnia and Herzegovina is **between an early stage of preparation and having some level of preparation** in its capacity to cope with competitive pressure and market forces in the EU. It made **no progress** in this area during the reporting period. The overall quality of education remains inadequate. The country continues to lag behind in the energy and digital transitions. Economic integration with the EU remains high, but overall trade with the EU is below potential.

The implementation of last year's recommendations has remained limited, and therefore last year's recommendations remain valid. To support long-term growth, Bosnia and Herzegovina should in particular:

→ improve the quality of education and training, in particular by accelerating the modernisation of curricula to better match skills with labour market needs;

→ increase government capital spending as a percentage of GDP, in particular by focusing on transport and energy infrastructure and improving environmental standards;

→ improve the management of public investment and accelerate the implementation of investment projects that have undergone a clear, positive cost-benefit assessment.

Education and innovation

Measures to develop the country's human capital have remained insufficient. Despite a large number of local-level education and research strategies, efforts to coordinate these activities in a highly fragmented institutional set-up have remained limited. As a result, despite sizeable public spending on education (some 4% of GDP), the education system does not sufficiently provide the workforce with the required skills and knowledge, in particular in view of the upcoming green and digital transitions. The insufficient coordination among the many stakeholders in the education sector leads to both a lack of common standards in education and differences in the quality of teachers' training and performance evaluation, both of which impede labour mobility. In 2020, the country stopped participating in the Programme for International Student Assessment (PISA) evaluation, abandoning an important source of information for education policy. Some measures have been taken at local level to modernise education curricula and increase available funds. In a positive development, Bosnia and Herzegovina joined the European Alliance for Apprenticeships (EafA) in October 2024, showing its commitment to improve its systems for vocational education and training and to take measures to increase youth employment. Investment in research and development has remained low, while the lack of coordination in this area results in overall poor spending efficiency. No progress was made during the reporting period in improving the functioning of science and technology parks.

Physical capital and the quality of infrastructure

Bosnia and Herzegovina's fixed capital endowment continues to remain insufficient for reaching a higher growth potential. Ongoing political deadlock and uncertainties, along with inadequate progress in improving public investment management procedures, have negatively affected public and private investment. This has prevented the country from reaching a higher growth trajectory. Net FDI inflows continue to remain significantly lower than in other countries of the region, at 3.4% of GDP in 2024 and 3.3% in the first quarter of 2025. Some progress has been made – largely with foreign financing – in improving road infrastructure, and there are local initiatives aimed at attracting investment. The energy sector relies heavily on lignite coal with a high level of CO_2 emissions per unit of energy production. Efforts to improve the energy mix by allowing solar-generated electricity to

access the country's energy grid are insufficient. The absence of a unified regulatory framework hampers investments in renewable energy sources. While the country has begun drafting a national energy and climate plan (NECP), this has yet to be adopted. Environmental standards remain low and are frequently neglected. This is detrimental to the health (and thus productivity) of the labour force.

The degree of digitalisation of government services remains relatively low. Insufficient coordination, cooperation and data exchange between administrations slow down progress. An important example in this respect is the failure to agree on a countrywide harmonisation of e-signature systems. Furthermore, appropriate legislation and countrywide institutions in line with European standards are missing.

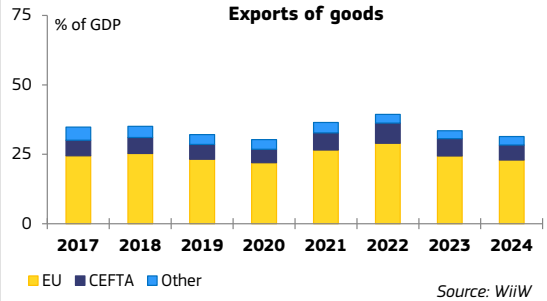
Sectoral and enterprise structure

Bosnia and Herzegovina's production structure is gradually shifting towards services. The share of production-oriented sectors (manufacturing, electricity production, water management) in total value added declined between 2019 and 2024 (from 35.2% of gross value added to 30.3%) while the share of trade and tourism, IT and administrative services increased (from 33.1% of gross value added to 37.2%). The number of registered active companies has increased in recent years. However, this has mostly been driven by micro companies (0-9 employees) in the trade sector. Some 90% of all companies are small and micro businesses (i.e. with less than 50 employees).

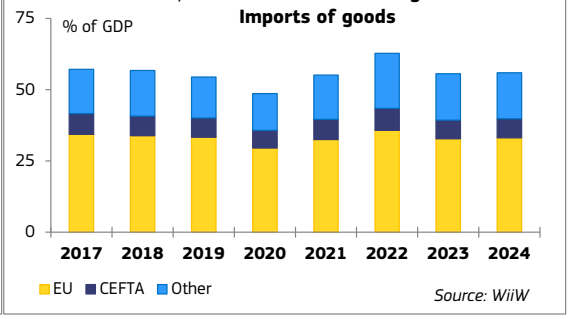
Economic integration with the EU and price competitiveness

Trade and investment integration with the EU remained high, despite weak demand in 2024 from key EU trading partners. In 2024 and the first half of 2025, Bosnia and Herzegovina's external trade experienced a slight diversification away from the EU, mainly due to weaker exports to key EU trading partners, such as Germany and Italy and stronger trade with non-EU neighbours such as Serbia. As a result, the share of trade with the EU remained at some 73% of total trade, while trade with the CEFTA countries rose from 15.9% in the first 7 months of 2024 to 16.9% in January–July 2025. Bosnia and Herzegovina's openness to trade (exports and imports as a percentage of GDP) stood at 97.4% of GDP in 2024, largely back to its pre-COVID-19 level. This remains relatively low given the small size of its economy. The composition of the country's exports is not very diversified, relying strongly on basic metals, machinery and chemical products. About two thirds of the FDI stock originates from EU countries.

Graph 2.5a: **Bosnia and Herzegovina - Exports of goods**



Graph 2.5b: **Bosnia and Herzegovina - Imports of goods**



Domestic wage pressures affect the country's external competitiveness. Significant increases of nominal wages in 2023 and 2024 risk to negatively affect the country's export industries. The nominal effective exchange rate of the domestic currency appreciated in 2024 due to its peg to the euro, which appreciated against the currency of key third-country trading partners, in particular the Turkish Lira. However, when using the consumer price inflation (CPI) as a deflator, Bosnia and Herzegovina's real effective exchange rate depreciated in 2024 as a consequence of higher average inflation rates in key export destinations, such as Türkiye, Serbia and Croatia. In the first half of 2025, both indicators appreciated, again mainly due to the appreciation of the EUR exchange rate against the country's main trading partners.

3. GEORGIA

3.1. THE EXISTENCE OF A FUNCTIONING MARKET ECONOMY

Georgia is **moderately prepared** and made **limited progress** in establishing a functioning market economy. The authorities' course of action and the decision not to pursue EU accession negotiations until 2028 created high uncertainty for businesses. While growth remained strong, it is subject to downside risks reflecting heightened political instability and the developments regarding Russia's war of aggression against Ukraine. The macroeconomic policy mix was broadly appropriate. Despite improvements in the labour market, the structural weaknesses remain unaddressed. While the authorities continued with selected public finance reforms, the reform of state-owned enterprises advanced slowly. No progress was made on strengthening the legislation related to independence of the central bank, although the vacancies at the NBG board were filled.

The Commission's recommendations from last year were only partially implemented and therefore remain mostly valid. In the coming year, Georgia should in particular:

→ strengthen the legislation towards ensuring the independence of the central bank, enhance and implement the medium-term revenue strategy and the reform of public investment management, streamline tax expenditures, and further improve fiscal oversight and governance of state-owned enterprises;

→ address the main weaknesses of the labour market, such as the low employment rate and significant regional differences, adopt and start implementing the new Labour Market Strategy, and prepare a programme to reduce informal economy in a comprehensive manner;

→ further develop the non-banking segments of the financial sector, including by implementing the capital market development strategy, and strengthening the insurance sector.

Economic governance

The authorities' course of action and the decision not to pursue EU accession negotiations until 2028 has created considerable uncertainty. Progress on economic reforms was limited and concerns about central bank independence remain. The authorities advanced with selected public finance reforms, for instance by publishing the medium-term revenue strategy, albeit with a limited scope of planned reforms and without their quantification and timeline. They also started a new phase of modernisation of the Revenue Service and published a report assessing the economic impact of existing tax expenditures in agriculture. The implementation of the 2023-2026 Public Finance Management strategy based on the public expenditure and financial accountability (PEFA) assessment continued, with some specific dimensions considered as requiring further efforts, such as annual financial consolidated reporting, public asset management, and municipal finances. No progress was made on strengthening the legislation related to independence of the central bank, although the vacancies at the NBG board were filled. The three-year stand-by arrangement with the IMF had been suspended since mid-2023 and expired in June 2025.

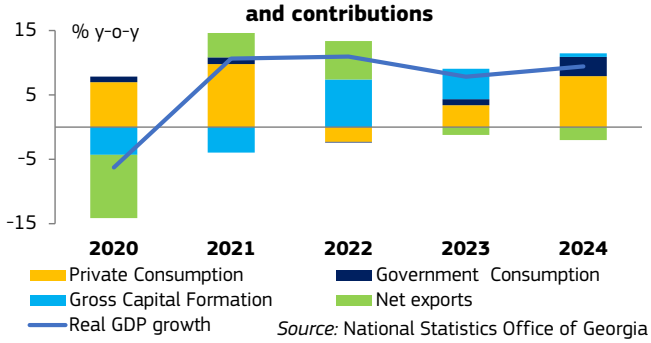
Macroeconomic stability

Georgia recorded strong growth, driven by private and government consumption, continuing to benefit from the recovery in tourism, high- skilled migrants from Russia and the reallocation of certain services and trade routes away from Russia following its full-scale war of aggression against Ukraine. GDP growth reached 9.4% in 2024. Private and government consumption were the most important growth factors, stimulated by strong wage increases, employment growth and fast-growing consumer loans. Investment also continued to rise in the same period, supported by higher business lending, good financial results of enterprises and strong public investment. The contributions of net exports of goods and services and of inventories to growth were

negative. On the supply side, the value added increased most in ICT, construction, tourism, transport, education and other services.

Growth appeared resilient, but it is subject to downside risks, reflecting in particular the heightened political instability and uncertain international environment. According to preliminary figures, growth continued in the first half of 2025, reaching 8% year-on-year in the first seven months of the year. However, Georgia's economy is subject to a high degree of uncertainty. The deterioration of the domestic political situation and the *de facto* halt of the EU accession process may adversely affect the confidence of investors and consumers, discourage tourism and put renewed pressure on the Georgian currency, the lari.

Graph 3.1: **Georgia - Real GDP growth and contributions**

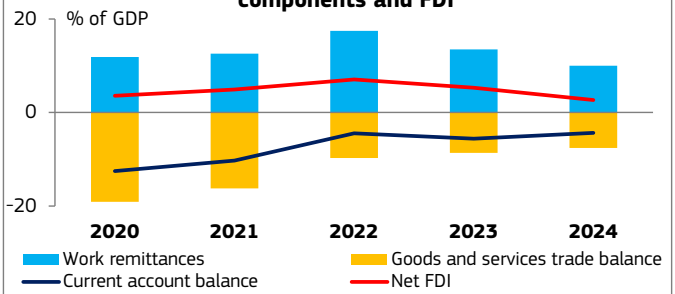


Source: National Statistics Office of Georgia

The current account deficit narrowed to 4.4% of GDP in 2024 from 5.6% of GDP in 2023. Goods exports increased by 6% in USD terms, thanks to a rebound in demand for metallurgical products and re-exported cars. Imports increased by 7%, due to higher domestic demand for investment and consumer goods and despite lower prices of imported oil. The merchandise trade deficit deteriorated in 2024. A stronger surplus in services, especially in tourism which benefited mainly from arrivals from Russia, Türkiye and the EU, and a lower net outflow of investment income have helped reduce the current account deficit. On the other hand, lower inflow of remittances reflecting the reduction in money transfers from Russia, had the opposite effect.

Foreign direct investment (FDI) inflows and international reserves decreased in 2024. FDI inflows decreased from 6.3% of GDP in 2023 to 4.6% of GDP in 2024. The drop was particularly noticeable in equity investment. Georgia has a strongly negative net international investment position and relatively high external debt. However, both decreased in the last three years, mainly due to nominal GDP growing faster than external debt. As of December 2024, they stood at -89% and 75% of GDP respectively. The level of gross official foreign reserves dropped from USD 5 billion at the end of 2023 to USD 4.1 billion in November 2024, which was caused by foreign exchange interventions of the central bank, aimed at stabilising the lari in view of domestic uncertainty. Since then, the central bank has replenished its reserves to USD 5.2 billion in August 2025, which is still below the authorities' desirable range of 120-130% of the IMF's Assessing Reserve Adequacy metrics.

Graph 3.2: **Georgia - Current account selected components and FDI**



Source: National Bank of Georgia

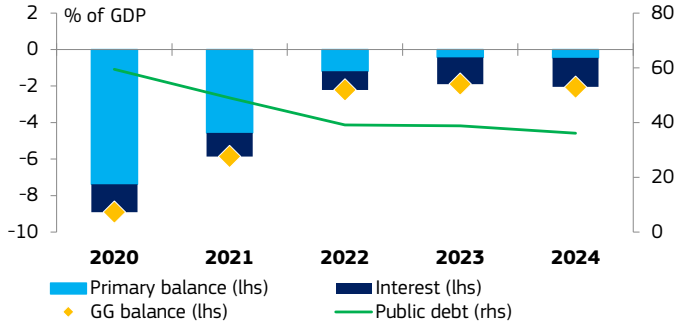
Average consumer price inflation slowed to 1.1% in 2024 thanks to low imported inflation and the central bank's prudent monetary policy, but in 2025 it gradually picked up to 4.6% in August. The acceleration of consumer prices can be attributed to the pass-through from wage increases and rising food prices, as well as to base effects. Core inflation, excluding food and energy, reached 3% in August. The central bank has kept its policy rate unchanged at 8% since May 2024.

Table 3.1: **Georgia - Key economic figures**	**2016-21** average	**2022**	**2023**	**2024**
GDP per capita (% of EU-27 in PPS)	33	39	41	45
Real GDP growth	2.9	11.0	7.8	9.4
Economic activity rate of the population aged 20-64 (%), tota	61.7	65.9	68.7	70.8
Unemployment rate of the population aged over 15 (%), total	21.1	17.3	16.4	13.9
Employment of the population aged 20-64 (annual growth %)	0.3	5.4	4.0	5.1
Nominal wages (annual growth %)	6.5	18.3	20.4	16.5
Consumer price index (annual growth %)	4.1	11.9	2.5	1.1
Exchange rate against EUR	2.9	3.1	2.8	2.9
Current account balance (% of GDP)	-9.5	-4.4	-5.6	-4.4
Net foreign direct investment, FDI (% of GDP)	7.2	7.1	5.3	2.7
General government balance (% of GDP)	-2.3	-2.2	-1.9	-2.1
General government debt (% of GDP)	43.4	39.2	38.9	36.1

Sources: National Statistics Office of Georgia, IMF, National Bank of Georgia, Ministry of Finance of Georgia, own calculations

General government revenue in 2024 was much stronger than expected, although current expenditure grew even faster. Public revenue increased by 18% compared to 2023, boosted by economic expansion, in particular wage increases stimulating personal income tax revenues, as well as by discretionary measures, such as increases in gambling fees and a tax reform in the banking sector. Current expenditure increased by 20% in the same period, mainly due to rising public sector salaries and interest expenditure. The already high capital expenditure rose by 10%. The general government deficit stood at 2.1% of GDP in 2024, below the initially planned 2.5% of GDP. General government debt fell from 38.9% of GDP in 2023 to 36.1% of GDP in 2024, largely due to the debt-reducing effect of high nominal GDP growth.

Graph 3.3: **Georgia - Fiscal developments**



Source: Ministry of Finance of Georgia

The macroeconomic policy mix was broadly appropriate. While the rise in current expenditures by 20%, and especially of public sector salaries by 30% over the previous year, was high, this one-off adjustment could help public sector compete with private sector for qualified staff. The monetary policy of the central bank was sufficiently tight to anchor inflation expectations in the situation of high domestic and global uncertainty. The key risks to macroeconomic stability include, among others, domestic political developments, which may adversely affect business and consumer sentiment, the developments regarding Russia's war of aggression against Ukraine, as well as the slowdown in global trade.

Functioning of product markets

Georgia has a fairly dynamic business fabric, but many structural weaknesses still hamper the business environment, and there was very limited progress in addressing them last year. Georgia's business environment has been liberalised and the barriers to market entry are low. Georgia has one of the highest firm birth rates and one of the lowest company survival rates in Europe. There is evidence of weak productivity growth in individual companies and a continued reliance on low-sophisticated markets, while companies face high costs to enter the EU market (including lack of standardisation and the associated infrastructure). The main obstacles for businesses include political instability, an inadequately educated workforce, court inefficiency and exchange rates fluctuations.

There is scope to further reduce the share of the informal economy. Informality in Georgia is closely linked to the country's economic structure which is dominated by agriculture, construction and tourism, a lack of unemployment benefits, a large share of self-employment and a high share of cash payments. In October 2024, the authorities established an inter-ministerial working group to prepare a programme for reducing the informal economy in a holistic, government-wide manner. The working group launched cooperation with the International Labour Organisation (ILO) with a request to conduct a comprehensive assessment of the informal economy in Georgia, including its size and structure, to serve as a basis for the further analysis of employment, revenue generation, and other key issues related to informal economy. areas. The working group and the ILO organised workshops with employers' and workers' organisations to gather their insights on the root causes of informality.

Progress on the reform of state-owned enterprises (SOEs) has been slow, while the financial oversight has improved. The state footprint in the economy remains limited: SOEs accounted for 4.2% of Georgia value added and 8% of employment in 2024. The authorities piloted a shared ownership of three SOEs by ministries of economy and finance, appointed independent supervisory boards at several SOEs, established SOE performance targets. However, no agreement on strengthening the exercise of the ownership function has been found yet. The Ministry of Finance continues to gradually enhance financial oversight by bringing the accounts of 114 SOEs into the single treasury account to better monitor contingent fiscal risks. The revenues from privatisation and sales of state property amounted to 0.26% of GDP in 2024. The total amount of state aid issued by public bodies in Georgia was very low at 0.01% of GDP but the reporting methodology is not aligned with the EU *acquis* requirements. The extent of price regulations remains very limited in Georgia. Public funds for business development have increased in the last few years, especially those provided by the agency Enterprise Georgia in three areas: co-financing of business loans, investment promotion and export support.

Functioning of the financial market

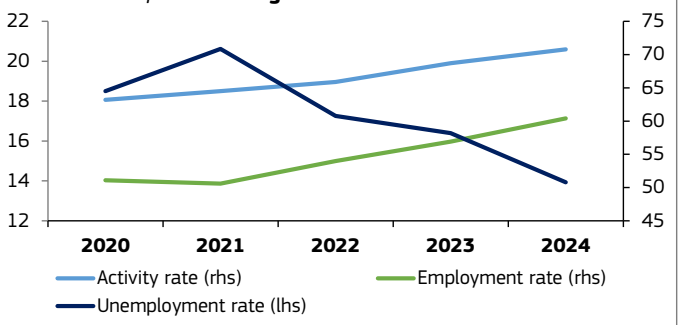
The Georgian banking sector remains sound, although it is exposed to foreign exchange risks. According to data from the National Bank of Georgia, the banking system's capital adequacy ratio stood at 23% in July 2025. Most lenders remained very profitable, reaching an aggregate 22.1% return on equity. The asset quality of the sector as a whole remains strong, with the ratio of non-performing loans to total loans broadly unchanged at a low 2.6%. The high dollarisation of both assets and liabilities remains a structural weakness of the banking system although, from a financial stability perspective, banks have ample foreign exchange buffers. The share of loans in foreign currencies remained broadly stable in the reporting period and amounted to 40% in July 2025. The level of dollarisation for deposits is higher compared to loans and slightly increased in the last months of 2024 to 51.5% reflecting the heightened uncertainty, before decreasing to 50.0% in July 2025. Credit growth remained strong at 14.9% in July 2025 (excluding the effect of exchange-rate fluctuations) for both corporate and retail loans. Access to finance is still perceived as a major obstacle for many small businesses, although the situation has improved in the recent period.

The insurance sector and the capital market are still underdeveloped. The local securities market is characterised by its small size, low liquidity and dominance of government securities, as well as an inactive secondary market. Some improvements have been achieved thanks to the implementation of the 2023-2028 capital market development strategy. For instance, the Capital Market Support State Programme was significantly revised in September 2024 to co-finance the costs of issuance of bonds by Georgian companies and of their credit ratings, with a view to improving businesses' access to finance. In June 2025, amendments were made to the law on investment funds.

Functioning of the labour market

The situation on the labour market has further improved, supported by the economic expansion, but weaknesses remain. The employment rate among the population aged 20-64[10] rose from 56.9% in 2023 to 60.4% in 2024, but is still well below the Member States with the lowest employment rate (67%). The unemployment rate among the population aged over 15 decreased from 16.4% in 2023 to 13.9% in 2024. The capacities of the State Employment Support Agency continued to develop, with an extension of its network in municipalities. A new national strategy of labour and employment policy still needs to be adopted. Some structural labour market weaknesses persist, including the persistent mismatch between labour skills and business needs, high youth unemployment, significant gender disparities and regional differences. Following a dynamic rise in 2023, real wages increased strongly again in 2024, by 15%. This reflects several factors: the spillover effects from wages of high-skilled migrants from Russia, in particular in the IT sector, strong demand allowing Georgian companies to compensate rising living costs, especially of housing rents in the main cities, labour shortages in some production sectors.

Graph 3.4: **Georgia - Labour market trends**



Source: National Statistics Office of Georgia, own calculations

3.2. THE CAPACITY TO COPE WITH COMPETITIVE PRESSURE AND MARKET FORCES WITHIN THE EU

Georgia has **some level of preparation** and has made **some progress** in coping with competitive pressure and market forces within the EU. It continued to upgrade its education framework and adopted a vocational education and training (VET) strategy. Spending on research and innovation remains very low. The level of public investment continued to be high, with a focus on transport infrastructure. The structure of the economy is dominated by low-skilled services, and economic integration with the EU remains limited, with a decreasing value of exports from Georgia to the EU.

The Commission's recommendations from last year were only partially implemented and therefore remain mostly valid. In the coming year, Georgia should in particular:

→ further improve the quality of education and training to ensure that their outcomes align with labour market needs, in particular through further VET reforms, enhancing cooperation between the educational institutions and business and improving teachers' professional development;

→ continue efforts to develop the necessary transport, connectivity and energy infrastructure and to increase the share of renewables in the energy mix;

→ stimulate innovation and make efforts to increase exports of higher value added goods and services, in particular by facilitating certification, compliance with sanitary and phytosanitary standards, export promotion, logistics and the development of the necessary infrastructure for exports.

Education and innovation

Georgia continued to upgrade its education framework but the mismatch between skills and business needs remains an issue. Government expenditure on education in 2024 increased to 3.9% of GDP but was still below the EU average; there is also potential to enhance spending efficiency of

[10] Eurostat's employment indicators are calculated among the population aged 20-64, while Geostat uses indicators based on International Labour Organisation definitions covering the population aged 15 years or older. Therefore, according to Geostat definitions, the employment rate in Georgia was 47.1% in 2024.

current education resources. Reform efforts focused on the vocational education and training (VET) system, which included the adoption of the VET strategy in September 2024, the development of occupational and educational standards for VET, the upgrading of teachers' qualifications and the development of their networks. The compulsory general education age was increased from 15 to 16 years and a reform of pre-school education was implemented. Despite the ongoing reforms, the mismatch between skills and private sector needs persists, largely due to outdated teaching methods, insufficient cooperation between businesses and educational institutions, and a lack of clearly defined skill requirements from businesses. The private sector's participation in skills development programmes is low despite significant external support. Sectoral skills organisations are being developed as a way to bridge the gap between industry and education, although they face challenges like limited sectoral cooperation and capacity.

Georgia is making efforts to improve its innovation environment but spending on research and development is still very low, at 0.3% of GDP. Georgia ranked 57th (out of 133 economies) in the 2024 Global Innovation Index, an improvement from 63rd in 2022. The Georgia Innovation and Technology Agency continued to support innovative start-ups and training, with a focus on the ICT sector. The authorities also decided to build a Technology Hub in Kutaisi, including a technology park, industrial innovation laboratory, an IT and technology school and other facilities.

Physical capital and quality of infrastructure

Public investment has remained high (over 8.5% of GDP in 2024), with a focus on transport infrastructure. In line with Public Investment Management (PIM) reform, all new larger investment projects are selected in accordance with the new PIM methodology before being included in the relevant budget. In the reporting period, significant progress was made with the completion of several sections of the East-West Highway, as well as with upgrading of the secondary road network. The recent railway modernisation project is nearing completion, but large parts of the rail network and rolling stock are still obsolete. The development of a new deep-water port in Anaklia started in 2024 as part of the Middle Corridor connecting China and Central Asia with Europe, bypassing Russia. A Chinese consortium was selected as an investor in this port, but an investment agreement has not been finalised yet. In October 2024, the construction of a new runway at Kutaisi airport also began. In the energy sector, the government is focused on expanding the transmission network and on securing private investment for new wind, solar and hydropower plants. Following two big auctions for renewable power generation in 2024, the authorities assessed the applications received for further renewable projects, to be granted via direct contracting. Preparatory activities continued for the Black Sea Submarine Cable project, intended to link Georgia with Romania by electricity and fibre-optic submarine cable interconnections. In the area of information and communications technology, the penetration of fixed broadband internet subscribers among households increased and reached 99%. The authorities continued to invest in fibre networks in more remote regions. However, issues such as relatively high prices of high-speed fixed broadband, insufficient digital skills and weak international digital connectivity persist.

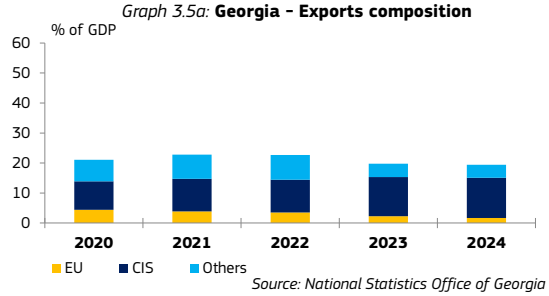
Sectoral and enterprise structure

The economy is increasingly based on services, with a diminishing role of agriculture and manufacturing. Services increased their share in GDP to 71.9% in 2024, with the biggest gains recorded last year by the information and communication technology, education and tourism sectors. The share of construction is relatively high at 8.4%, thanks to a residential construction boom in big cities and substantial investment in public infrastructure. The share of manufacturing, at 9.3%, is relatively low in Georgia compared to peer countries and diminishing. Agriculture, a traditionally important sector but characterised by low productivity, declined to 6.2% of GDP in 2024, but still accounts for 16% of total employment. SMEs accounted for 54% of the value added of the enterprise sector and the same share in employment.

Economic integration with the EU and price competitiveness

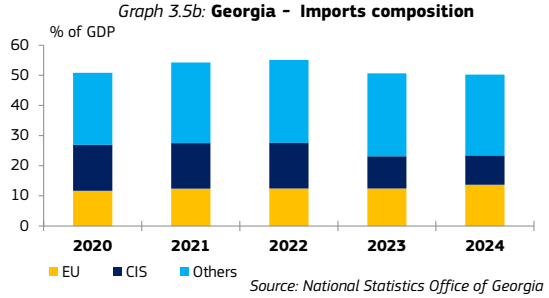
Economic integration with the EU is limited. The EU share in Georgia's exports fell from 11.6% in 2023 to 8.7% in 2024. This reflected a decline in the value of exports to the EU by 19%, but also a surge in re-exports of cars from Georgia to Central Asia. Georgia's imports from the EU rose in 2024 by 2.7 percentage points to 27.2% of the total. As a result, Georgia's trade deficit with the EU increased to over USD 4 billion, or 12% of GDP. In contrast, Georgia had a positive, albeit much smaller, balance in trade services with the EU (equal to 1% of GDP). In 2024, the EU remained the biggest source of remittances to Georgia (43% of the total, or 4.5% of GDP) and the second source of foreign direct investment after the UK (23% of the total, 1% of GDP).

Graph 3.5a: **Georgia - Exports composition**



Source: National Statistics Office of Georgia

Graph 3.5b: **Georgia - Imports composition**



Source: National Statistics Office of Georgia

The real effective exchange rate of the lari depreciated by 4% in twelve months until July 2025. The real exchange rate of the Georgian currency weakened especially against the euro and Turkish lira, while it strengthened against the US dollar and Russian ruble. As regards nominal exchange rates, the effective rate of lari remained broadly stable over the last twelve months, while it weakened against the euro, strengthened against the lira and remained stable against the US dollar.

4. KOSOVO

4.1. THE EXISTENCE OF A FUNCTIONING MARKET ECONOMY

Kosovo has **some level of preparation** and made **some progress** in developing a functioning market economy. Economic growth picked up on the back of stronger private consumption and a surge in public investment. Despite a strong increase in public spending, the 2024 budget remained close to balance, due to robust revenue performance. Fiscal challenges persist given the narrow tax base, weaknesses in public investment management, insufficient targeting of social benefits and poor financial oversight of publicly-owned enterprises (POEs). Despite employment gains, the labour market continues to face challenges, such as low participation and high unemployment rates as well as a significant gender gap. The banking sector continues to be sound and resilient. Some progress was made in reducing the size of the informal sector and improving the business environment, notably through a speedier settlement of commercial disputes.

The Commission's recommendations from last year were partially implemented and remain largely valid. To improve the functioning of the market economy, Kosovo should, in particular:

→ strengthen the revenue base by reducing loopholes and exemptions, including by amending tax legislation;

→ improve the quality of public spending by addressing remaining weaknesses in public investment management and better targeting social benefits;

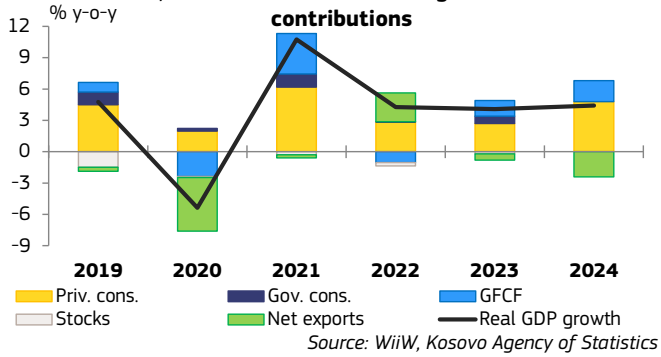
→ reduce fiscal risks by improving financial oversight and accountability of POEs.

Economic governance

Overall, Kosovo's macro-economic policies remained prudent. The budget was nearly balanced in 2024, despite surging capital and social spending[(11)]. Government initiatives to improve public investment management resulted in stronger execution rates. Kosovo's performance under the two-year Stand-By-Arrangement (SBA), as well as the Resilience and Sustainability Facility with the International Monetary Fund (IMF), was strong, and both programmes were successfully concluded.

The policy guidance set out in the conclusions of the Economic and Financial Dialogue of 14 May 2024 has been partially implemented. The spending structure slightly improved compared to 2023, with a small increase in the share of public capital spending. Tax revenue grew robustly, partly due to improved tax compliance and some formalisation gains. Financial oversight of POEs has been strengthened but amendments to the POEs' law to improve their corporate governance are still pending. For 2025-2027, Kosovo's Economic Reform Programme (ERP) aims to maintain stable public finances while complying with fiscal rules and supporting economic growth through higher public investment.

Graph 4.1: **Kosovo - Real GDP growth and contributions**



Source: WiiW, Kosovo Agency of Statistics

Macroeconomic stability

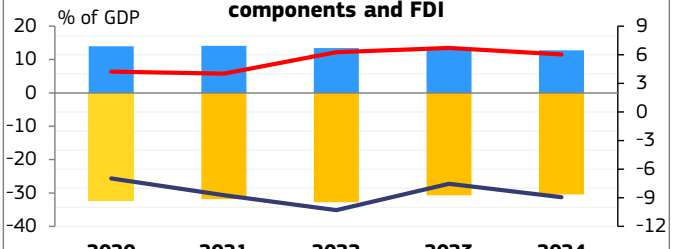
Kosovo's economic growth accelerated in 2024 on the back of stronger private consumption and public investment. Real GDP growth picked up to 4.4%, up from 4.1% in 2023, and slightly above the

(11) Social transfers surged by 22% year-on-year, reflecting government measures ahead of the 9 February parliamentary elections, including higher child benefits and non-contributory pensions.

average growth rate of 4% in 2016-2021. Private consumption growth accelerated on the back of growing bank lending and rising real disposable incomes, boosted by increasing wages and social transfers. Furthermore, a surge in gross fixed capital formation resulted from a strong increase in public investment. Public consumption growth slowed markedly, partly due to the high base in 2023. Net exports had a negative contribution to growth, mainly due to an acceleration in real imports growth. Economic activity slightly slowed in the first quarter of 2025, with real GDP growth easing to 3.6% y-o-y, from 4.1% in the preceding quarter. Kosovo's per capita GDP remains the lowest in the Western Balkan reg ion, standing at 30% of the EU average in 2024, but higher than the average of 22% in 2016-2021.

Kosovo's external position deteriorated in 2024. The current account deficit rose to nearly 9% of GDP, up from 7.5% in 2023. The key drivers were a notable decline in the secondary income surplus, partly due to the moderate fall of remittances as a share of GDP, coupled with a slight increase in the merchandise trade deficit. This more than offset the rise in the services trade surplus by 0.6 pps., to 17.4% of GDP. The primary income surplus remained broadly stable at 2.1% of GDP. Further unofficial services exports and remittances were reflected in large errors and omissions (2.5% of GDP) in the balance of payments. In the first quarter of 2025, the current account deficit deteriorated, with its rolling 4-quarter total widening to 9.1% of GDP. In 2024, this deficit was mainly financed by net foreign direct investment (FDI) inflows, which decreased by 0.7 percentage points (pps.) to 6% of GDP, with the bulk directed to real estate as well as financial and insurance services. At end-2024, official reserve assets amounted to 2 months of imports of goods and services.

Graph 4.2: **Kosovo - Current account selected components and FDI**



Source: IMF, Central Bank of Kosovo

Table 4.1: **Kosovo - Key economic figures**	**2016-21** average	**2022**	**2023**	**2024**
GDP per capita (% of EU-27 in PPS)	22	24	27	30
Real GDP growth	4.0	4.3	4.1	4.4
Activity rate of the population aged 15-64 (%), total	40.1	38.6	40.7	43.3
female	*20.2*	*22.0*	*24.2*	25.9
male	*59.9*	*55.5*	*57.8*	60.6
Unemployment rate of the population aged 15-64 (%), total	22.8	12.6	10.9	10.8
female	*27.6*	*16.5*	*18.2*	18.0
male	*21.2*	*11.0*	*7.7*	7.7
Employment of the population aged 15-64 (annual growth %)	4.5	5.4	5.4	-2.6
Nominal wages (annual growth %)	2.6	7.6	9.4	12.1
Consumer price index (annual growth %)	1.5	11.6	4.9	1.6
Exchange rate against EUR*	1.0	1.0	1.0	1.0
Current account balance (% of GDP)	-7.1	-10.3	-7.5	-8.9
Net foreign direct investment, FDI (% of GDP)	3.4	6.3	6.7	6.0
General government balance (% of GDP)	-2.8	-0.5	-0.2	-0.3
General government debt (% of GDP)	18.2	20.0	17.5	16.9

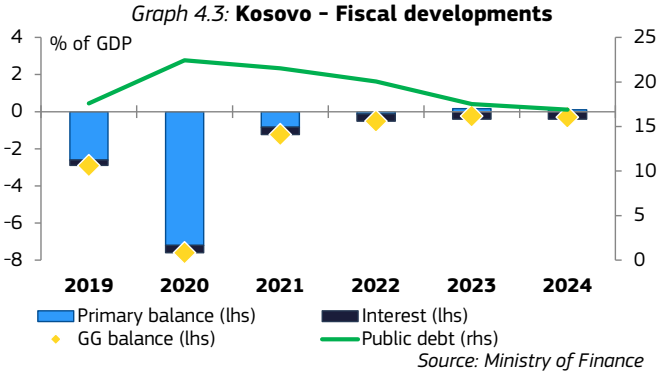
** The euro is used as a de facto domestic currency*
Sources: Kosovo Agency of Statistics, Central Bank of Kosovo, Ministry of Finance, World Bank and IMF

Annual inflation slowed to an average of 1.6% in 2024, well below the 4.9% rate registered in 2023, mainly driven by lower commodity prices in international markets. However, consumer price inflation picked up to an average of 2.8% y-o-y in the first half of 2025 and further to

4.3% and 4.5% y-o-y in July and August respectively, mainly due to accelerating prices for electricity, food and non-alcoholic beverages. On 16th April, the Energy Regulatory Office Board had approved a linear electricity tariff increase of 16.1% for all consumer categories, which came into force on 1st May.

Robust tax revenue growth and surging capital and social spending resulted in the budget remaining close to balance in 2024. The headline fiscal deficit marginally rose to 0.3% of GDP in 2024 (from 0.2% in 2023), which corresponds to a surplus of 0.5% of GDP under the fiscal rule's definition[12]. This outcome resulted from an 8.2% increase in public revenues, partly due to improved tax compliance and some formalisation gains, that was slightly outpaced by budget expenditure growth (8.4%). Public capital spending rose strongly by 16.7% y-o-y; however, it only reached around 75% of the budget allocation, reflecting remaining weaknesses in implementation capacity. Roughly in line with the budget plan, current expenditure grew by 6.4% y-o-y, mainly on the back of increased spending on goods and services (8.2%), transfers and subsidies (3.2%) and wages (10%). The latter increase was due to the implementation of the law on public-sector wages and the rise in the amount paid from court rulings[13]. Government deposits slightly increased to 4.1% of GDP.

Graph 4.3: **Kosovo - Fiscal developments**



Source: Ministry of Finance

Public debt is low and falling, while the domestic investor base for government debt remains narrow. On the back of a marginal primary surplus and high nominal GDP growth, the public debt-to-GDP ratio fell to 16.9% of GDP at end-2024, the lowest level since 2017, and down from 17.5% one year earlier. It further declined to 16% of GDP at end-June 2025. In 2024, domestic debt, which is held by a narrow investor base, fell marginally by 0.8% year-on-year. In March 2025, the share of domestic debt held by the KPST stood at 46%, while the Central Bank of Kosovo and commercial banks held a further 24% and 21%, respectively. Foreign debt, owed mostly to international donors, rose by 12% in 2024. This includes loans from the International Monetary Fund, the World Bank, and the European Investment Bank. However, the political deadlock has hindered the ratification of new external financing agreements with international financial institutions. In May 2025, Fitch Ratings reaffirmed its 'BB-' sovereign credit rating, with a stable outlook, that Kosovo had obtained for the first time in April 2024, improving the prospects of accessing international financial markets in future.

There has been some progress in fiscal governance. The 2025 budget includes slightly lower blanket allocations compared with the previous year's one, improving fiscal transparency. A stand-alone annual fiscal risk analysis for POEs, limited to high-risk POEs, was published in October 2024. The distribution and supply of electricity in northern Kosovo were normalised in 2024 as the electricity supply company *Elektrosever* has started bill collections, thus generated savings and reduced fiscal risks. In 2024, there was a strong increase in public capital spending even though the recurring under-execution of the capital budget points to remaining weaknesses in the planning and implementation of public investment projects. The spending overrun on war veterans' pensions has not been resolved, due to the absence of a reclassification of beneficiaries.

[12] The fiscal rule places a cap on the fiscal deficit of 2% of forecast GDP, excluding capital projects financed by privatisation proceeds and donors ('investment clause'). This exemption for donor-financed investment can be invoked until 2026, provided the public debt ratio remains below 30% of GDP. A further rule stipulates that the increase in the public wage bill cannot exceed the nominal GDP growth rate of the latest calendar year available at the time the consolidated budget is being prepared. Government deposits used as fiscal buffers are legally required to stay at 4.5% of GDP as long as the government uses privatisation proceeds. The debt rule requires that public and publicly guaranteed debt cannot exceed 40% of GDP.

[13] The law came into force in February 2023 setting the value of the wage coefficient at EUR 105 for 2023 and EUR 110 for 2024. Most of the rulings concerned unbudgeted allowances obtained by teachers, doctors, and other public employees through collective agreements.

A track record of prudent fiscal policies created space for a planned strong fiscal impulse in 2025. The 2025 budget expects the headline deficit to widen significantly to 2.8% of GDP, mainly through an arguably very ambitious further surge in public investment. Nevertheless, the budget appropriately aims to keep the deficit (according to the fiscal rule's definition) at the prescribed ceiling of 2% of GDP, maintaining the credibility of Kosovo's well-functioning set of fiscal rules.

Functioning of product markets

Business environment

Some progress was made in improving the business environment. In September 2024, the new Law on sustainable investment came into force, following a review by the Constitutional Court. The purpose of the Law is to create a comprehensive legal framework to protect and promote sustainable investment in Kosovo. In November 2024, the Assembly adopted the law on the Register of Beneficial Owners, which was an important step in combating money laundering and terrorist financing, by identifying the ultimate beneficial owners of businesses. The government also adopted a new administrative burden prevention and reduction programme (2025-2028) and its action plan for 2025-2026. There was an acceleration in settling commercial disputes. In 2024, 4 276 first-instance judgments and 2 693 second-instance judgments by the Commercial Court were published.

Efforts to further reduce the informal sector continue. In the reporting period, the Tax Administration of Kosovo (TAK) made progress in upgrading its compliance risk management techniques, using information from financial and tax databases to better identify tax evasion, and supporting further formalisation of the economy. Under the new law on the administration of tax procedures, TAK started establishing data-sharing arrangements with commercial banks, the CBK and other government agencies, to enable systematic access to bulk third-party data for better compliance monitoring.

State influence on product markets

The State aid policy framework is partially aligned with EU rules and principles while steps were taken to fully liberalise the electricity market. The existing framework lacks a unified approach to State aid as well as a comprehensive strategy and cost-benefit assessments for the aid and subsidies granted. The Assembly has still not appointed the State Aid Commission, the institution ensuring State aid control and adopting decisions on State aid schemes. The liberalisation of electricity prices for businesses with an annual turnover of more than EUR 10 million or employing more than 50 employees became effective on 1 June 2025.

Privatisation and restructuring

The creation of a sovereign fund has been delayed. The law on the establishment of a sovereign fund was adopted by the Assembly in mid-December 2023, but it is being reviewed by the Constitutional Court. The fund is expected to take over socially owned enterprises[(14)] and assets currently managed by the Privatisation Agency of Kosovo (PAK) as well as some POEs overseen by the Ministry of Economy, once their financial performance improves. However, establishing the fund will not be sufficient to resolve the persistent problems related to poor financial performance and management of POEs. In the reporting period, the comprehensive review of the assets of PAK continued, identifying assets suitable for transferring to the sovereign fund.

Functioning of the financial market

The banking sector continued to expand robustly while maintaining adequate capitalisation and liquidity buffers. The average return-on-equity ratio remained high, although it fell to 17.6% in July 2025 from 19.9% at end-2024. The non-performing loans ratio stood at a historically low level of 1.9% at end-2024, while it slightly increased to 2.1% at end-July 2025. The ratio of banks' regulatory capital to risk-weighted assets rose to 16.2% at end-2024 and further to 17.4% at end-July 2025, comfortably exceeding the regulatory minimum of 12%. Bank loan growth slightly accelerated to an

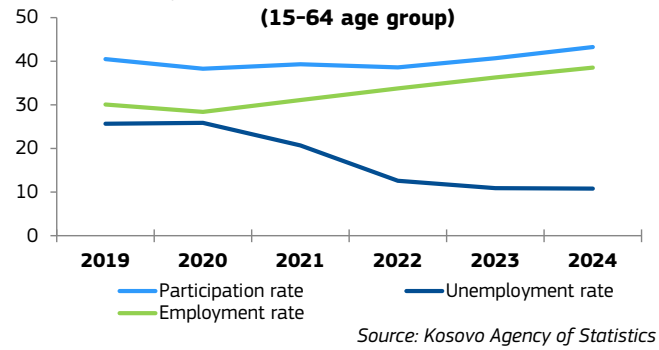
[(14)] Socially owned enterprises were considered to be shared social property in the former Yugoslavia.

average of 14.3% in 2024 from 14.1% a year before, and further to 19.9% year-on-year in the first half of 2025, largely due to a faster pace of credit growth to households, including for consumption purposes. Bank deposits' average growth slowed to 10% in 2024 from nearly 14% one year earlier, before accelerating to 14.3% year-on-year in the first half of 2025. Data gaps, in particular in the area of private sector indebtedness and the real estate sector, hinder analysis and financial sector supervision.

Functioning of the labour market

Despite significant employment gains, the labour market is characterised by still very low participation, high unemployment and large gender gaps. Labour force survey results continue to be published in Kosovo with large delays with the latest available data referring to 2024 as a whole. In line with the robust economic activity, the employment rate increased to 38.6%, up from 36.3% in 2023. Meanwhile, the unemployment rate declined by 0.1 pp. to 10.8%, despite the increase in the labour force participation rate to 43.3% from 40.7% in 2023. The gap between male and female employment rates (55.9% and 21.2%, respectively) widened. In 2024, the share of young people (aged 15-24) not in employment, education or training (NEET) decreased to 31.4%, from 33.4% a year before. Weak labour market outcomes contribute to continuously high emigration rates.

Graph 4.4: **Kosovo - Labour market trends (15-64 age group)**



Source: Kosovo Agency of Statistics

4.2. THE CAPACITY TO COPE WITH COMPETITIVE PRESSURE AND MARKET FORCES IN THE EU

Kosovo **is between an early stage and some level of preparation** and made **some progress** in terms of its capacity to cope with competitive pressure and market forces in the EU. The education system does not adequately equip students with the skills demanded by the labour market. Limited progress was made in improving transport infrastructure while some progress was made in promoting renewable energy sources and digitalising the economy. The economy remains highly reliant on small and micro firms, which cannot compete internationally. Trade openness increased significantly compared with 2019.

The Commission's recommendations from last year were partially implemented. To improve competitiveness and sustain long-term growth, Kosovo should, in particular:

→ align education with labour market needs, including by revising the legal framework on vocational education and training (VET) and adult education;

→ develop transparent and competitive procedures for deploying renewable energy;

→ facilitate private-sector investment and improve mechanisms to attract FDI in strategic sectors, promoting the adoption of higher value-added products and services and innovation.

Education and innovation

Inadequate quality of education and misalignment with labour market needs remains a key structural obstacle. Kosovo ranked 81st and last in the 2022 cycle of the OECD Programme for International Student Assessment (PISA), while unemployment among tertiary education graduates is still high. This is due to inadequate quality and relevance of education, which are undermined by an absence of quality learning materials in schools, a lack of initial training and continuous professional development for teachers, and an insufficient number of inspectors for teachers' assessment. On teacher development, in December 2024, an advanced teaching license examination was launched. The

12 dual education profiles piloted over the last two years continue to be implemented facilitating the transition from school to the labour market.

Little progress has been achieved in improving Kosovo's research and innovation system. Budget allocation for research and development, at 0.1% of GDP, is far below the 0.7% required by law. Participation in the Horizon Europe programme has further potential. Since its launch, Kosovo has submitted 171 project applications, of which 15 were considered successful, receiving total EU funding of EUR 1.59 million and resulting in a very low success rate of 9.36%. The Law on Innovation and Entrepreneurship aims to encourage innovative activities in Kosovo as well as establish the Innovation Fund, but its adoption by the Assembly is pending.

Physical capital and quality of infrastructure

Large infrastructure gaps limit Kosovo's full economic potential and output. There has been no progress on the Pristina – Merdare motorway or the 'Peace Highway', as Kosovo has not yet negotiated the loan agreements for the project with supporting international financial institutions. The rehabilitation works for Rail Route 10 continued at a slow pace. The tendering of signalling systems and telecommunications, which is of utmost priority, is still delayed, due to lack of financing. The feasibility study for the railway connection between Durrës and Pristina has been finalised. The transport system continues facing significant challenges related to safety, inadequate maintenance, and limited administrative capacity of regulatory institutions.

Despite recent efforts to diversify the energy supply and increase efficiency, the energy sector remains a key obstacle to economic growth. Over 90% of electricity is produced by two outdated, highly unreliable and polluting lignite power plants, posing serious health and environmental risks. Kosovo also suffers from major technical and commercial losses in the distribution and transmission grids due to poor infrastructure (nearly 22% of electric power output in 2023)[(15)]. The lack of energy security gives rise to significant costs for business and represents one of the biggest obstacles to attracting FDI. In December 2024, Kosovo inaugurated its intra-day electricity market coupling with the Albanian power exchange (ALPEX). Kosovo has launched its first tender for up to 100 MW of wind energy, with bids received in late February. The second phase of the tender procedure, where three qualified companies bid with technical and financial proposals is under way.

The **digital transformation of the economy is advancing gradually.** Although Kosovo is the leader in the Western Balkan region with 98.6% of households having some form of internet access in 2023 (OECD, 2024), and with 100% broadband coverage, challenges remain in developing high-speed broadband infrastructure, including limited private sector investment capacities, an outdated cable network, and delays in 5G development. The e-commerce sector is still in its early stages. Progress in public sector digitalisation has been slow, with only 10% of all public services currently offered online, most of which are merely informational (OECD, 2024). However, Kosovo made some progress in the area of digital services with 230 online services now available on the e-Kosova platform. In the reporting period, the government launched the piloting phase of the national electronic identification (eID) system.

Sectoral and enterprise structure

The services sector continued to dominate economic activity in 2024, providing almost 46% of gross value added (GVA). The sectoral structure of GVA shows a gradual increase in the share of wholesale and retail trade, to 14.3% in 2024, up from less than 13% in 2019, while the share of construction remained broadly unchanged at around 8% in this period. Industry represented 18.5% of gross value added in 2024, but Kosovo's manufacturing base remains narrow, relying mainly on mineral mining and processed metal products. The share of agriculture in GVA remained virtually unchanged at around 7% in 2024, compared to 5 years before. At the same time, the share of real estate activities fell by 1.3 pps. to 5.6% compared to 2019.

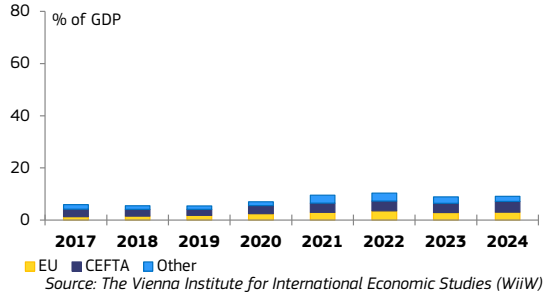
[(15)] Kosovo's Energy Regulatory Office (2024), *Annual Report 2023.*

The private sector is dominated by small firms which still facing difficult access to finance. SMEs and family-run businesses account for 81.3% of employment in non-financial businesses and generate 81% of Kosovo's total value added. Kosovo's Reform Agenda aims at supporting the creation and scaling-up of start-ups and micro, small and medium-sized enterprises (MSMEs) specialised in ICT and green and circular economies, by establishing an Innovation Fund and business incubators. Some progress was made with various financing options available through the Kosovo Credit Guarantee Fund (KCGF), but access to finance is overall still limited, affecting mostly smaller businesses.

Economic integration with the EU and price competitiveness

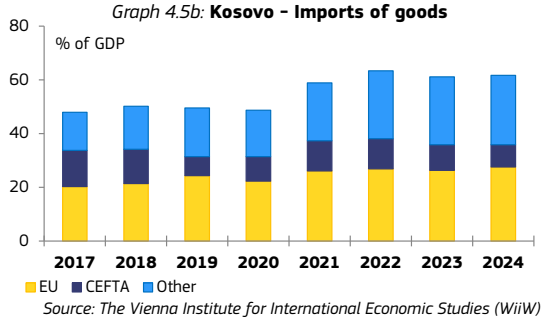
The EU remained Kosovo's largest trading partner while services exports have expanded rapidly. In 2024, the EU accounted for 44.7% of Kosovo's total imports of goods, lower than in 2019 (49.1%), while the CEFTA partners' share decreased by 1 pp. to 13.4%. In early October 2024, Kosovo started lifting restrictions on imports of Serbian goods, imposed in mid-June 2023. The EU's share in Kosovo's merchandise exports remained unchanged in 2024 compared to 2019, at 33.2% while the CEFTA countries' share rose to 45.2%, up from 43%. Trade openness (i.e. the total value of exports and imports) stood at 114.3% of GDP in 2024, significantly higher than in 2019 (85.8%), on the back of a much higher value of both goods and services trade. Kosovo's services exports are significantly larger than its goods exports, and are dominated by travel services (mainly related to diaspora tourism from Western Europe), followed by ICT service exports, which have been growing rapidly in recent years.

Graph 4.5a: **Kosovo - Exports of goods**



Source: The Vienna Institute for International Economic Studies (WiiW)

Graph 4.5b: **Kosovo - Imports of goods**



Source: The Vienna Institute for International Economic Studies (WiiW)

The EU remains the main investor in Kosovo. Net FDI inflows fell by around 4% in 2024. The bulk of inflows was on the back of significant diaspora investment in real estate, followed by financial and insurance activities. Substantial concentration in these sectors (93.5% of FDI inflows) does little to improve Kosovo's export capacity. The EU's share in Kosovo's net FDI stock reached 43.8% in 2024, up from 34.6% in 2019. The shares of Germany and Switzerland (two countries with large diasporas from Kosovo) increased to 19.4% and 18.7%, respectively, in 2024, up from 13% for each of them in 2019. Concerns over external competitiveness have increased as real wages grew by 12.7% in 2024[16], supported by a raise in the minimum wage effective from 1 October 2024.

[16] IMF (2025), Republic of Kosovo, Fourth Reviews Under the Stand-By Arrangement and the Arrangement Under the Resilience and Sustainability Facility, No 25/112.

5. MOLDOVA

5.1. THE EXISTENCE OF A FUNCTIONING MARKET ECONOMY

Moldova has **some level of preparation** and has made **good progress** in creating a functioning market economy. Despite a challenging external environment, the authorities remain committed to pursuing macroeconomic stability and submitted the second economic reform programme in January 2025. The adoption of a law on strengthening economic governance is still pending. Economic growth in 2024 has stalled, with the current account deficit experiencing a significant widening as it continues to be affected by structural vulnerabilities. Moldova has continued advancing fiscal structural reforms, notably to improve public investment management and spending efficiency, while no decisive steps have been taken to consolidate tax expenditures. The banking sector remains well capitalised and stable, and credit growth expanded; however, financial intermediation remains low. A large informal economy and slow progress on the reform of state-owned enterprises limits the quality of the business environment. Employment growth started to lose steam due to economic slowdown, while reforms to support female participation helped to mitigate the effect on female employment.

The Commission's recommendations from last year were partially implemented and remain valid. In the coming year, Moldova should, in particular:

→ pursue fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while increasing public investments, notably through the Growth Plan, broadening the tax base including through reducing the scope of tax expenditures and improving spending efficiency;

→ ensure a timely implementation of economic policy reforms, with the support of international financial organisations, encompassing all Growth Plan, EU enlargement and other economic policy commitments, reduce vulnerability to external shocks including through efforts to extend and diversity the export base and improve business regulations and competition in key sectors while speeding up the state-owned enterprise reform including by finalising the digitalisation of the public property registry, selecting independent board members and launching the preparations for the privatisation of selected SOEs to implement the triage;

→ continue efforts to address informal employment, including by identifying ways to incentivise formal employment.

Economic governance

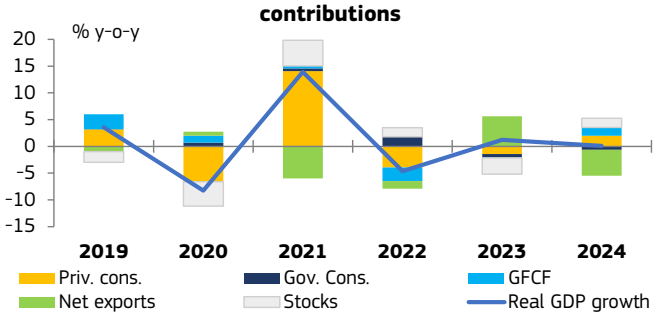
The authorities are taking some steps in implementing reforms supported by international partners, but adoption of laws critical to strengthening economic governance is still outstanding. Moldova completed an EU macro-financial assistance operation worth EUR 295 million with the final disbursement in December 2024, following the successful implementation of all policy conditions. On 17 December 2024, the IMF completed the sixth review under the ECF/EFF, and the second review under the resilience and sustainability facility (RSF) with Moldova. The programme expired in October 2025 with two reviews not completed in 2025. In response to concerns about the independence of the central bank following the abrupt dismissal of the Governor of the National Bank of Moldova, additional amendments to the central bank law have been drafted to strengthen the institutional setup of the National Bank of Moldova. However, their adoption by Parliament remains pending.

Moldova participated in the economic and financial dialogue with the EU in May 2025, following the submission of its second economic reform programme. Implementation of the 2024 policy guidance was partial, with progress on fiscal consolidation, some steps taken to advance fiscal structural reforms and significant efforts in the area of monetary policy.

Macroeconomic stability

The economic recovery, which started in 2023, came to a halt in the second half of 2024. Real GDP growth stagnated as a result of Russia's war of aggression against neighbouring Ukraine, a sharp drop in agricultural output due to a severe drought and decline in agricultural exports and mineral re-exports. The impact remained contained thanks to a rebound in private consumption underpinned by a nearly 10% increase in real wages. Strong private investment growth driven by looser monetary policy in 2024 and a support programme for real estate investments also supported economic activity. Net export remained a drag on growth (down by 3.7 pps. as share of GDP), due to a decrease in exports amidst strong import growth, particularly during the second half of 2024.

Graph 5.1: **Moldova - Real GDP growth and contributions**

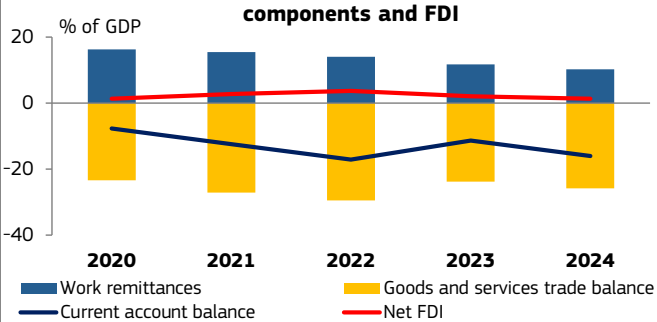


Source: WiiW, National Bureau of Statistics

Real GDP growth is set to slowly recover in 2025 and 2026 as the drag on growth stemming from the weak harvest in 2024 fades, agriculture partly recovers and domestic demand remains strong. Moldova's income per capita is just under a third of that of the EU, having increased by more than 10 percentage points over the previous decade, although the crises in recent years have slowed the pace of convergence. This trend also contributed to slower reduction in poverty levels. The recently adopted EU Reform and Growth Facility is expected to advance key structural reforms and increase much needed investment to support Moldova's economic convergence.

Moldova's current account balance continues to be structurally affected by its heavy reliance on volatile agricultural exports and vulnerability to imported energy price fluctuations. By end 2024, the current account deficit increased to 16% of GDP, up from 11.4% in 2023, reflecting falling re-exports to Ukraine (mostly minerals) and a sharp drop of agricultural exports – a trend that is projected to persist through 2025. While goods exports as share of GDP dropped services exports registered a modest increase., largely supported by growth in the IT sector. At the same time, imports remained strong supported by robust private consumption. The widening current account deficit has been primarily financed by net inflows of currency and deposits, as well as loans from multilateral and bilateral donors. Remittances continued to play a significant role but fell in 2024 to 10.3% of GDP. Similarly, the inflows of foreign direct investment as a share of GDP declined from 2.2% in 2023 to 1.8% in 2024 partly reflecting persistently weak investor confidence due to Russia's war of aggression against Ukraine.

Graph 5.2: **Moldova - Current account selected components and FDI**



Source: WiiW, National Bank of Moldova

After successful disinflation following the 2022/2023 energy shock, inflation rebounded in the second half of 2024 before slightly easing in 2025. Average annual inflation dropped from 13.4% in 2023 to 4.7% in 2024, but inflationary pressures re-emerged in mid-2024 due to rising food prices partly driven by the 2025 summer drought and increased gas prices. The National Bank of Moldova paused interest rate cuts in May 2024, maintaining a 3.6% base rate while easing reserve requirements to counteract declining private consumption toward the end of 2024. However, as

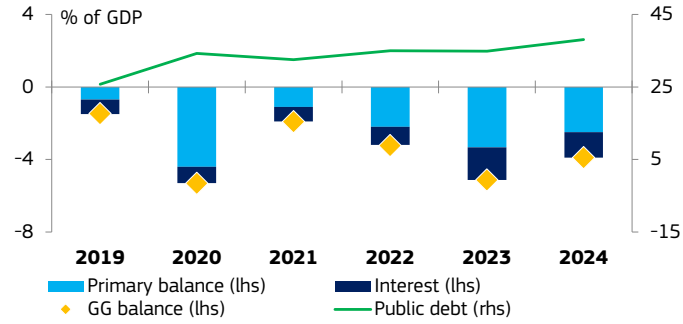
inflation peaked at 9.1% in January 2025 due to a sharp increase in electricity prices following the cut-off of Russian gas to the Transnistrian region, the Central Bank increased its key policy rate. The righting of monetary policy contributed to stabilising inflation at around 8% in the first half of 2025. In the summer 2025, the NBM reduced the base rate in two steps, to 6%.

Table 5.1: **Moldova - Key economic figures**	**2016-21** average	**2022**	**2023**	**2024**
GDP per capita (% of EU-27 in PPS)[1)]	27	28	29	30
Real GDP growth	3.7	-4.6	1.2	0.1
Activity rate of the population aged 20-64 (%), total	n/a	53.7	58.4	59.1
female	*n/a*	*50.0*	*55.3*	*57.5*
male	*n/a*	*57.8*	*61.9*	*60.9*
Unemployment rate of the population aged 20-64 (%), total	n/a	3.1	4.6	4.0
female	*n/a*	*2.6*	*4.2*	*4.1*
male	*n/a*	*3.5*	*5.0*	*3.8*
Employment of the population aged 20-64 (annual growth %)	n/a	2.0	1.8	-3.3
Nominal wages (annual growth %)	12.1	16.3	16.9	
Consumer price index (annual growth %)	5.0	28.7	13.4	4.7
Exchange rate against EUR	20.5	19.9	19.6	19.3
Current account balance (% of GDP)	-8.4	-16.6	-11.4	-16.0
Net foreign direct investment, FDI (% of GDP)	2.1	3.7	2.2	1.8
General government balance (% of GDP)	-3.4	-3.2	-5.2	-3.9
General government debt (% of GDP)	34.2	35.0	34.9	38.2

Sources: WiiW, IMF, National Bureau of Statistics, Ministry of Finance, National Bank of Moldova

Although Moldova's public debt-to-GDP ratio remains relatively low compared to regional peers, the country has run large fiscal deficits in recent years. The fiscal deficit fell to 3.9% of GDP in 2024 (compared with 5.2% of GDP in 2023), primarily due to stronger-than-expected revenues, an under-execution of public investments and improved targeting of support measures to mitigate the impact of high energy prices on households. The 2025 budget, as amended in April and June 2025, projects the deficit to widen to 5.1% of GDP, on the back of additional expenditure in road and rail infrastructure, energy efficiency and other projects for regional development and environmental protection. It also provides for other increases in current expenditure including subsidies to agricultural producers, support to SMEs, an increase in public salaries and one-off support payments to selected groups such as students and vulnerable households. This higher spending is supported by additional funding from the Reform and Growth Facility. Additional spending to mitigate the impact of higher energy prices for households, businesses and the public sector is financed by EU grant support (as part of the Energy Package). In 2024, the public debt-to-GDP ratio increased by 3.3 percentage points, reaching 38.2% of GDP by the end of the year.

Graph 5.3: **Moldova - Fiscal developments**



Source: WiiW, Ministry of Finance of Moldova, IMF

Moldova has made efforts in advancing fiscal structural reforms, notably through improvements of public investment management, spending efficiency, while steps have been taken to consolidate tax expenditures. Nevertheless, total public investments fell from 1.3% of GDP in 2023 to less than 1% of GDP in 2024, while steps were taken to strengthen public investment management.

The single project pipeline was successfully applied to all new investment projects in the 2025 budget. The full impact of this reform will become evident over time, once the ongoing projects (not included in the pipeline) are completed. Moldova also took steps in broadening the tax base and enhancing tax compliance, with some tax expenditures eliminated. However, a cost-benefit analysis of tax expenditures did not result in a general consolidation of tax expenditures. Instead, new tax expenditures were introduced in 2025. In terms of public spending efficiency, Moldova completed a spending review in the health sector and has begun implementing its results. A spending review on social protection is underway. However, a key challenge remains the lack of a regulatory framework that makes the implementation of spending reviews a legal requirement, as well as limited capacities in the line ministries and in the Ministry of Finance to undertake such spending reviews.

The macroeconomic policy mix has contributed to sustaining macroeconomic stability amidst several crises, yet public investment levels remain low while the recent energy price increase and the 2024 drought exposed the country's vulnerability to external shocks. The government responded swiftly to rising energy prices and increased energy support spending, supported by EU grants, to mitigate the impact on businesses and households. A new electricity compensation has been put in place for 2025 to mitigate the effects of the price shock due to the abrupt transition towards market electricity prices. The package, which compensates up to 80% of average electricity consumption provides support to all households. This support is to be phased out with energy vulnerability reduction fund remaining the main instrument to support vulnerable households. Further implementation of the public investment reform as well as improved budget planning and execution are required to increase the much needed public investments, also facilitated by the EU Reform and Growth Facility. Monetary policy remains adequate and sufficiently tight to respond to recent inflationary pressures. The key risks for macroeconomic stability include the impact of Russia's war of aggression against Ukraine, further energy price hikes given the country's large dependency on energy imports, Moldova's weak export base and a low level of preparedness to adapt to climate change as well as weaker growth among key trading partners amid a volatile global trade environment.

Functioning of product markets

Business environment

Moldova has made some progress in improving its business environment but remains affected by Russia's war of aggression against Ukraine and structural challenges. The government adopted several deregulation packages aimed at reducing administrative costs for firms imposed by outdated or overly complex regulation. In addition, access and use of digital public services significantly increased. Despite some progress during the reporting period, weaknesses in the rule of law continue to undermine the business environment. According to the 2024 World Bank Enterprise Survey, nearly one fifth of firms identify corruption as a major or very severe constraint, slightly above the regional average. Based on the World Bank methodology, results suggests that only 43% of surveyed firms view the courts as independent and impartial in resolving commercial disputes, while slightly less than half consider alternative dispute resolution mechanisms to be reliable. Both figures are significantly below the regional average, where approximately 75% of firms report confidence in judicial independence and the reliability of alternative dispute resolution. Despite some legal amendments, weaknesses in the insolvency and bankruptcy framework persist. In addition, a shortage of both high and low-skilled labour, regulatory uncertainty and political instability remain limiting factors to the potential for entrepreneurship and FDI. Informal employment decreased slightly in 2024, largely due to a decline in agriculture[(17)]. The reform of the State Labour Inspectorate has yielded some positive results, with a significantly higher number of inspections and successful cases of formalised

[(17)] According to World Economics (2024), which uses an average of the latest estimates from economists around the world, Moldova's informal economy represents about 37.1% of GDP, a decrease by almost 4 pps. compared to 2023. Any estimations need to be taken with caution given the variety of methodological approaches.

employment, though the increase remains limited given the large size of the informal economy. Furthermore, Moldova has advanced the implementation of the programme to combat undeclared work by launching an online platform that allows individuals to anonymously and formally report suspected cases of undeclared work. A review of major taxes found personal income taxpayers concentrated in low-income brackets, potentially incentivising informal employment. However, no steps were taken to address this and to identify avenues to incentivise formalisation.

State influence on product markets

State-owned enterprises (SOEs), including those with partial state ownership, continue to dominate some competitive sectors in Moldova's economy, including transport and manufacturing. While the number of SOEs has declined by around 20% since 2019, primarily due to liquidation and restructuring efforts, their productivity remains significantly lower than that of private sector firms. Notably, around one third of SOE operations are still concentrated in competitive sectors such as transport services and manufacturing. Price controls and state production in the food sector continue to be in place, albeit for a limited range of food products. Prices of pharmaceuticals are regulated at the wholesale level. The amount of State aid granted in Moldova has been declining in recent years, reaching 1.35% of GDP in 2023 – still slightly above EU levels (1.09% in 2023). In 2024, important steps were taken to bring the regional State aid scheme in line with the EU *acquis*.

Privatisation and restructuring

Progress on the ongoing SOE reform remains limited, with the most important steps still pending implementation. In November 2024, the government adopted the programme on administration of state public property for 2024-2027, which outlines a roadmap to implement the results of the triage exercise and pursue corporate governance reform until 2027. Following the triage exercise, 5 out of the 55 SOEs identified for restructuring have been transformed into other legal forms of organisation such as public institutions. Efforts are underway to digitalise the public property register, providing more transparency and a basis for the implementation of the triage results. The number of SOEs that have adopted a corporate governance code increased by 13, reaching 43 SOEs. However, the implementation at company level often lags behind. Three SOEs set up audit committees, bringing the total number to 11; however, they do not yet publicly report on their activities Steps are being taken to amend the regulatory framework governing the management and privatisation of public property assets with the adoption by Parliament still pending.

Functioning of the financial market

The mainly foreign-owned banking sector remains stable as capital adequacy, liquidity, and profitability remained strong in 2024. In 2024, the high capital adequacy ratio decreased slightly, primarily due to increased lending activity. The liquidity coverage ratio remains well above the levels before the Russian full-scale invasion of Ukraine in 2022 and significantly exceeds the 100% regulatory threshold. The upward trend in profitability slowed in 2024 due to a lower interest income, but profitability remained strong.

Lending to households and businesses increased strongly in 2024, supported by looser monetary policy and government support programmes, but remains relatively low with credit to the economy accounting for 25.6% of GDP in 2024. Credit growth in local currency reached pre-crisis levels, at around 16% y-o-y, largely driven by higher real estate lending supported by the Prima Casă PLUS support programme and lower interest rates. This contributed to rising property prices in major cities, further driven by supply constraints and suggesting increased credit risks. Non-bank lending growth slowed due to stricter lending rules. The non-performing loans (NPL) ratio fell from 5.6% at the end of 2023 to 4.2% in December 2024. The banking sector remains relatively concentrated, with the three largest banks holding more than 60% of total assets. The government continued to support access to finance, notably through interest rate subsidies and guarantee programmes while also initiating the development of its first National Financial Inclusion Strategy. Nevertheless, the effectiveness of access to finance programmes appears to be undermined

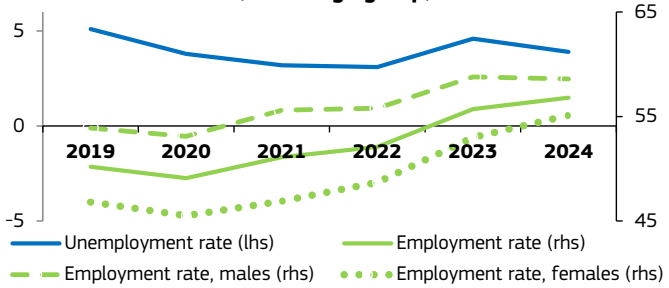
by insufficient coordination among existing programmes and a limited focus on supporting value added activities calling for enhanced monitoring and evaluation.

Moldova's integration into the EU financial system is progressing. On 2 January 2025, the NBM switched to using euro from US dollars as the reference currency for the official exchange rate of the Moldovan leu, reflecting the increasing role of the euro in external trade, remittances and FDI flows.

Functioning of the labour market

Improvements in the labour market slowed down, primarily driven by the economic downturn during the second half of 2024. While both the employment and labour participation rate for men aged 20-64 years edged down in 2024, mainly in rural areas as well as industry and agriculture, female employment maintained a positive trajectory, albeit weaker than in 2023. Moldova's overall labour market participation rate increased by 0.7 in 2024 but remains significantly lower than the EU average, standing at just 59.1% compared to nearly 76% in the EU. However, at the beginning of 2025, the employment rate for both men and women (15 years and older) was significantly below the same period of the previous year. The unemployment rate decreased to 3.9% in 2024 thanks to measures such as increased vocational education and training (VET) support and higher start-up subsidies. The simultaneous decline in both unemployment and employment is likely explained by greater participation in VET, persistently high emigration rates and seasonal work abroad. The share of young people not in employment, education, or training aged 19-25 (NEET) continued its downward trend of recent years and declined by 2.1 percentage points compared to the end of 2023. This improvement likely reflects expanded active labour market measures and efforts to enhance VET. However, the NEET rate remains high at 26%, significantly above the EU average of 11.2% in 2023.

Graph 5.4: **Moldova - Labour market trends (20-64 age group)**



Source: National Bureau of Statistics

5.2. THE CAPACITY TO COPE WITH COMPETITIVE PRESSURE AND MARKET FORCES WITHIN THE EU

Moldova is **between an early stage of preparation and having some level of preparation** and has made **some progress** to cope with competitive pressures and market forces within the EU. The government has taken steps to improve the quality of education and expand vocational and educational training offers; however, the shortage of both low and high skilled labour, low levels of FDI and innovation negatively affect the country's competitiveness. Significant efforts were made to improve energy security, particularly through domestic renewable energy production, and digitalisation levels continue to increase. However, investment needs, notably in quality infrastructure, remain significant. Integration with the EU continues to deepen but Moldova's trade performance continues to be affected by its narrow export base.

The Commission's recommendations from last year were partially implemented and remain valid. In the coming year, Moldova should, in particular:

→ address the skills mismatch, notably by advancing on the curriculum and dual-education reform and setting up regular public-private dialogues to better assess labour market needs;

→ increase public investment, including through the Growth Plan, especially in infrastructure, to further improve energy security, climate resilience and to facilitate domestic and cross-border trade;

→ step up measures to promote foreign direct investment, especially in the tradable sectors, and

increase efforts to promote innovation, including by technology transfers.

Education and innovation

Despite comparatively high spending on education and some improvements to address the skills mismatch, outcomes remain low. According to the 2024 World Bank Enterprise Survey, almost 35% of firms in Moldova identified an inadequately educated workforce as a major or very severe constraint, compared to 25% on average in the region. Nevertheless, the share of employers rating graduates as well-prepared rose from 28% in 2021 to 36% in 2024 according to the annual Labour Market Survey. To address the skills mismatch, the authorities expanded dual VET, which has shown significantly better labour market outcomes compared to traditional VET programmes, and advanced the internationalisation of higher education. However, little progress was made to establish a regular dialogue between the business sector and policy makers to overcome the skills mismatch.

Moldova has stepped up efforts to strengthen research and innovation, but progress remains limited. R&D spending remains low at 0.22% of GDP in 2024. The share of firms that introduced a new product or services in the last three years or use a foreign licensed technology remains far below the regional average. In March 2025, the National Fund for Innovation and Technology Transfer was launched to support innovation and technology transfer projects between research and businesses and to attract domestic and foreign investment under the 2024-2027 National Programme for Research and Innovation and the Smart Specialisation Strategy.

Physical capital and quality of infrastructure

Public investments as a share of GDP continue to decline, but steps are being taken to address structural gaps through strategic infrastructure projects and public investment management reform. While the average public investment in the EU stood at around 3.5% of GDP in 2024, it fell to below 1% in Moldova. Transport infrastructure remains underdeveloped, particularly in the railway sector, but the Mobility Strategy 2030 adopted in 2024 aims to modernise the network and strengthen cross-border connectivity with the EU. The country continues to make major efforts to enhance the energy infrastructure, particularly as a response to the recent energy crisis, including through investments in domestic production including for renewable energy. Moldova approved its first National Energy and Climate Plan aimed at advancing a sustainable energy transition. Work is also progressing on two key electricity interconnection projects with Romania to support the integration of Moldova's grid into the EU market and circumventing the Transnistrian region for electricity imports. Moldova's infrastructure, including transport and energy, remains highly vulnerable to climate related shocks, in particular floods and heat waves. According to the World Bank, Moldova is projected to face an average annual disaster preparedness and response funding gap of USD 146 million.

Digitalisation is steadily advancing, supported by improved access to the internet and expanded access to public e-services, while regional disparities persist. High-speed broadband coverage improved significantly, reaching 57% of the population by mid-2024. The share of public services available online significantly increased to 64% for businesses and 54% for individuals in 2024. Progress in e-commerce and digital payments, such as the expansion of online trade platforms and the launch of the Moldova Instant Payments system, is also helping lower transaction costs and support small entrepreneurs through digitalisation.

Sectoral and enterprise structure

Moldova's economic structure continues to slowly shift away from agriculture, with labour gradually reallocating towards higher-productivity sectors. Agriculture's share of GDP has steadily decreased over the past decade, declining from 14.1% in 2014 to 7.1% in 2024. The ICT sector has emerged as a significant contributor, with its share in GDP increasing from 4.8% in 2018 to 7.1% in 2024, driven largely by the growth of the Moldova Innovation Technology Park, whose resident companies generate approximately 73% of the IT industry's revenue. Exports of higher value-added

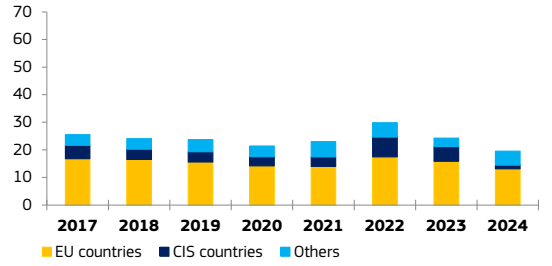
agricultural products have declined in 2024 due to the drought and a temporary licensing regime for grain and oilseed imports. While this measure aims to protect local farmers from low-cost competition, it has disrupted the model of importing cheap inputs for processing and exporting products such as sunflower oil and alcohol. Consequently, the export of unprocessed locally grown grain and oilseeds became more viable, reducing value added exports.

SMEs contribute over half of GDP. While a significant share continues to operate in trade, construction, and agriculture, the SME structure is gradually diversifying, supported by targeted public programmes under the National Strategy for Economic Development. About 75% of all SMEs operate in the services sector, with nearly one third active in high value-added sectors such as ICT, business services or financial services.

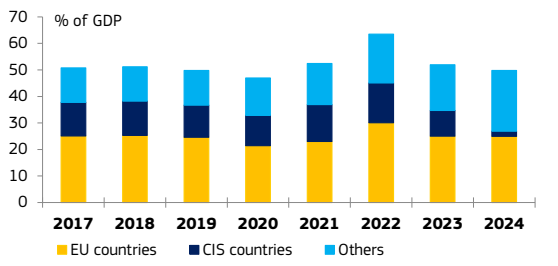
Economic integration with the EU and price competitiveness

Despite deeper trade integration with the EU, Moldova's trade performance continues to be affected by its narrow export base. The trade-to-GDP ratio declined in 2024, primarily due to a drop in goods exports. In 2024, the EU remained Moldova's dominant trading partner, accounting for 67.3% of total goods exports and over half of goods imports. However, trade flows continue to be heavily concentrated, with a handful of EU countries receiving most of Moldova's exports and supplying most of its imports. While the composition of exports is gradually shifting, with ICT services gaining traction, the export base still largely relies on labour-intensive, low-productivity goods from the primary and manufacturing sectors.

Graph 5.5a - **Moldova Exports composition**



Source: National Bureau of Statistics, National Bank of Moldova



Source: National Bureau of Statistics, National Bank of Moldova

External price competitiveness weakened further in 2024 as the real effective exchange rate continued to appreciate over the year although at a slower pace than in 2023. In addition, real wages increased across all sectors by 9.5% in 2024. The continued erosion of price competitiveness combined with renewed trade volatility in 2024 underscores the need for export diversification and enhanced value-added production, including in traditional sectors such as agriculture and food processing.

6. MONTENEGRO

6.1. THE EXISTENCE OF A FUNCTIONING MARKET ECONOMY

Montenegro has made **some progress** and is **between a moderate and a good level of preparation** in developing a functioning market economy. Economic growth slowed down amid weaker tourism exports in 2024 and the first half of 2025. The budget deficit increased in 2024 but was in line with the revised target; however, fiscal vulnerabilities remain given the high debt rollover needs and recent measures that weakened the government's revenue base and raised social spending. The labour market situation continued to improve, but structural problems persist, such as high youth and long-term unemployment rates. The banking sector remained well capitalised and liquid. Some progress was made in improving the business environment and preparing the reform of state-owned enterprises (SOEs).

The Commission's recommendations from last year were addressed to some extent but remain mostly valid. To improve the functioning of the market economy, Montenegro should in particular:

→ design and implement measures that limit public spending and raise revenue, ensuring compliance with the fiscal rules;

→ implement the Law on budget and fiscal responsibility to set up the Fiscal Council in time for it to review the 2026 budget proposal;

→ prepare a comprehensive fiscal risk statement, including the analysis of SOE-related fiscal risks, and advance the SOE governance reform.

Economic governance

The government adopted a new fiscal strategy and the Europe Now 2 Programme. The main element of the fiscal strategy is the reduction of the labour tax wedge, resulting in a sizeable revenue loss that is only partially offset by compensatory measures. The Europe Now 2 Programme, adopted in September 2024 and effective since October 2024, introduced two major changes: (i) a significant increase in minimum wages, from EUR 450 to either EUR 600 or EUR 800 a month, depending on the level of education; and (ii) changes to pension contributions. Employee contributions to the Pension and Disability Insurance Fund were reduced from 15% to 10%, and employer contributions (5.5%) were abolished. The resulting fiscal impact is mitigated by introducing a third VAT rate (including for tourism, accommodation services and catering).

Policy guidance set out in the conclusions of the Economic and Financial Dialogue with the EU of May 2024 was partially implemented. Progress was made in improving financial supervision and meeting the revised budget target, but the fiscal strategy does not anticipate compliance with the numerical rules for the general government deficit (3% of GDP) and debt (60% of GDP) in 2025-2027. The Fiscal Council has not been set up yet, and structural reforms aiming to improve SOE governance have only been partially implemented.

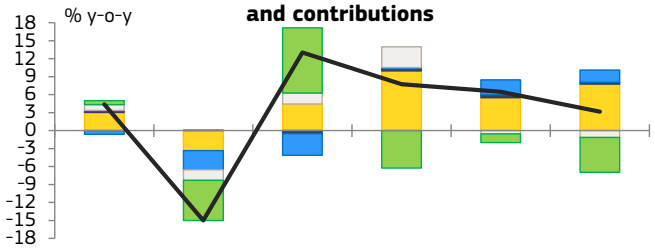
There were some political setbacks that affected adherence to the principles of central bank independence, including to the country's commitments under the economic fundamentals and Chapter 17 of the accession negotiations (economic and monetary policy). The appointments of two central bank vice-governors have been pending since September 2024, with Parliament rejecting the candidates proposed by the governor in May 2025 without any explanation. The appointments of four members to the Central Bank Governing Board have also been significantly delayed. Montenegro needs to ensure a transparent selection of the Board's members, including vice-governors, based on candidates' skills and in compliance with the central bank law.

Macroeconomic stability

Following a strong expansion in 2022-2023, economic growth decelerated due to a weak

performance of exports. GDP growth stood at 3.2% in 2024 and at 3.1% y-o-y in the first half of 2025, down from 6.5% in 2023. Economic expansion was mainly driven by recovering investment and private consumption, underpinned by growing disposable income and credit. Further support came from government consumption. The performance of exports was disappointing due to a contraction in goods exports, while the growth in tourism-related services decelerated sharply after strong increases in previous years. Overall, the contribution of net exports to GDP growth was negative. Montenegro's per capita GDP in purchasing power standards stood at 54% of the EU-27 average in 2024 compared with 52% in 2023 and 44% in 2020.

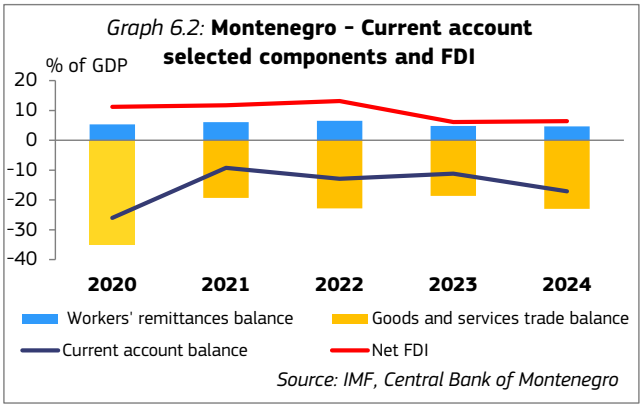
Graph 6.1: **Montenegro - Real GDP growth and contributions**



Source: WiiW, MONSTAT

External imbalances widened over the reporting period. The current account deficit increased from 11.4% of GDP in 2023 to 17.1% in 2024 and further to 17.7% in the second quarter of 2025, owing to a contraction in exports. The decline in exports was broad-based, with services and merchandise exports contracting by 3% and 8% in 2024, respectively. The fall in merchandise exports was caused by unfavourable weather conditions and weak exports of electricity. The secondary income surplus declined to 5.6% of GDP in 2024 due to lower remittances. The primary income balance turned negative, at 0.3% of GDP, due to higher dividend payments. Less than half of the current account deficit was financed by net foreign direct investment (FDI) inflows, with the remainder covered by new debt[18]. Net FDI inflows, with a substantial share going to real estate, increased slightly from 6.3% in 2023 to 6.4% of GDP in 2024, due to a combination of higher inflows of equity investment and inter-company debt and lower outflows. In Q2 2025 net FDI inflows declined slightly to 6.1% of GDP[19] while international reserves stood at EUR 1.5 billion in Q2 2025, equivalent to 3.5 months of imports of goods and services. In Q2 2025 net FDI inflows declined slightly to 6.1% of GDP[20] while international reserves stood at EUR 1.5 billion in in Q2 2025, equivalent to 3.5 months of imports of goods and services.

Graph 6.2: **Montenegro - Current account selected components and FDI**



Source: IMF, Central Bank of Montenegro

Average inflation declined to 3.6% in 2024 on the back of lower import prices, while domestic price pressures persisted. Year-on-year Inflation reached the lowest point of 1.4% in September 2024 but reaccelerated to 4.6% in August 2025. The reduction in headline inflation in 2024 took place on the back of lower prices for food and energy, while core inflation hovered around 5%.

The 2024 budget recorded a deficit in line with the revised target, while the budget balance is set to deteriorate somewhat in 2025. The 2024 budget deficit stood at 3.2% of GDP[21], which is a substantial deterioration compared with the small surplus seen in 2023. The deterioration is mainly explained by a large increase in public spending (18%). This included: (i) a 23% rise in social transfers driven by a hike in the minimum pension[22]; (ii) a 26% surge in capital spending; and (iii) a 16%

[18] Errors and omissions stood at 1.3% of GDP in 2024.
[19] The four-quarter moving net FDI.
[20] The four-quarter moving net FDI.
[21] The general government budget deficit stood at 3.2% of GDP in 2024, which is slightly better than the target of 3.3% adopted in the revised budget in September.
[22] The government increased the minimum pension by 52% to EUR 450 from 2024 onwards.

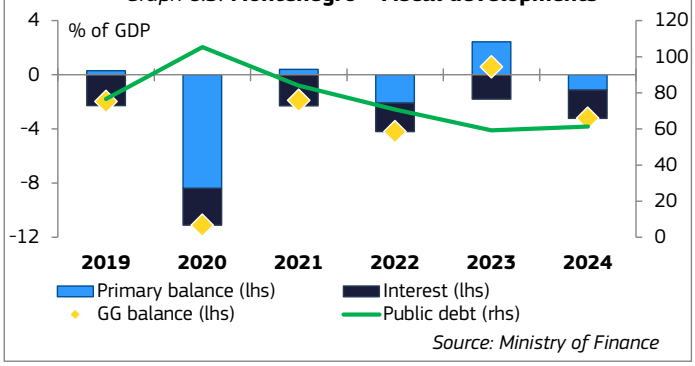
increase in transfers to institutions, including for health, as well as a 40% decrease in one-off revenues. Parliament adopted the 2025 budget law with a delay in February 2025. It projects the budget deficit to rise to 3.5% of GDP, driven by the full implementation of the Europe Now 2 Programme for the whole year. In January-July, the budget deficit stood at 1.2% of projected GDP compared to a surplus of 0.6% of GDP in the same period of 2024.

Table 6.1: **Montenegro - Key economic figures**	**2016-21** average	**2022**	**2023**	**2024**
GDP per capita (% of EU-27 in PPS)[1)]	46	48	52	54
Real GDP growth	2.3	7.7	6.5	3.2
Activity rate of the population aged 15-64 (%), total	63.1	67.7	71.7	72.6
female	*56.2*	*61.4*	*66.3*	*66.4*
male	*70.0*	*73.9*	*77.0*	*78.6*
Unemployment rate of the population aged 15-64 (%), total	16.7	15.1	13.4	11.6
female	*16.8*	*13.1*	*14.3*	*12.4*
male	*16.7*	*16.6*	*12.6*	*11.0*
Employment of the population aged 15-64 (annual growth %)	-0.6	17.2	10.5	2.9
Nominal wages (annual growth %)	1.5	11.2	11.8	9.7
Consumer price index (annual growth %)	1.3	11.9	8.7	3.6
Exchange rate against EUR	1.0	1.0	1.0	1.0
Current account balance (% of GDP)	-16.5	-12.9	-11.2	-17.1
Net foreign direct investment, FDI (% of GDP)	9.5	13.2	6.1	6.4
General government balance (% of GDP)	-4.6	-4.2	0.6	-3.2
General government debt (% of GDP)	77.1	70.8	59.3	61.3

Notes:
1) Eurostat
Sources: MONSTAT, Central Bank of Montenegro, Ministry of Finance and Eurostat

Recent measures weakening the revenue base and raising current spending, coupled with large upcoming repayment needs, point to significant fiscal vulnerabilities. At the end of 2024, the public debt ratio increased to 61.3% of GDP, up from 60.3% of GDP a year earlier. The increase was partially driven by borrowing to accumulate reserves for the Eurobond repayment due in 2025 [(23)].

Graph 6.3: **Montenegro - Fiscal developments**



Source: Ministry of Finance

Debt rollover needs, including of Eurobonds, are particularly substantial in 2025 and 2027, amounting to 10.3% and 11.1% of GDP, respectively[(24)]. The Medium-Term Debt Management Strategy for 2025-2027, adopted at the end of 2024, aims (i) to secure sufficient financing for debt repayment and fiscal buffers for 2025 and 2026 by issuing bonds on foreign and domestic markets, (ii) extend the debt maturity, (iii) smoothen its repayment profile and (iv) avoid peaks in every two years[(25)]. In March 2025, Montenegro made progress in meeting financing needs by selling a record-high EUR 850 million Eurobond (around 10.7% of projected GDP in 2025) with a seven-year maturity and an interest rate of 4.875%. The

[(23)] In autumn 2024, the authorities also secured an EUR 180 million loan facility provided by the World Bank, the French development agency (AFD) and the OPEC Development Fund.
[(24)] The surge in 2025 (EUR 821 million) is driven by a maturing Eurobond (EUR 500 million), and the peak in 2027 (EUR 972 million) is due to the repayment of a Eurobond issued in 2020 (EUR 750 million).
[(25)] Montenegro has more large debt repayments in 2029 and 2031.

public debt to GDP ratio increased to 61% in Q2 2025. Montenegro also plans to issue a first retail bond of around EUR 50 million, tapping into the large deposit base held by banks and yielding low interest rates. To stabilise the debt ratio below 60% of GDP as prescribed by the fiscal rule, additional measures might be needed, which would offset adverse fiscal dynamics resulting from high mandatory spending and a narrow revenue base, which was further weakened by cuts in pension contributions.

Fiscal policy is the main tool to manage aggregate demand and support disinflation in Montenegro's 'euroised' economy. Newly adopted policy measures weakened the fiscal position, and they do not ensure compliance with the fiscal rules or the building of fiscal buffers that would strengthen the economy's resilience to adverse shocks.

Functioning of product markets

Business environment

Work on improving the regulatory business environment continued. In March 2024, the Competitiveness Council adopted an Action Plan aiming to eliminate 11 key barriers to business. Following this, a technical secretariat was tasked in December to revise the Action Plan and align it with the timelines in the Reform Agenda. The revised document focuses on four action areas: (i) suppressing the grey economy; (ii) improving the business environment; (iii) advancing legislative work; and (iv) making the public administration more efficient. However, progress so far is slow, with just 4 out of 37 of the plan's activities completed. In July 2025, Montenegro adopted the Law on companies and the Law on registration of business and other entities, which introduced fully electronic procedures for company registration, improved legal certainty and the overall business environment. A new e-government portal was launched in December 2024 and is expected to serve as a central access point for public administration services. However, consolidating digital services into a single e-government portal and improving interoperability and data exchange among institutions remains a challenge. The integration of all public registers into the Unified System of Electronic Data Exchange has yet to be completed.

Progress in tackling the informal economy remains slow and harms Montenegro's competitiveness. Undeclared work is particularly harmful to small and medium-sized enterprises (SMEs) and microenterprises in the services sector that operate legally. It is driven by shortcomings in the institutional and regulatory environment, weaknesses in the labour market, insufficient enforcement capacity of public authorities, corruption and tax non-compliance. In January 2025, the government adopted political guidance and support to help implement the Action Plan for eliminating the informal economy. This plan aims to strengthen institutional coordination and trust between public and private sectors and provide support to the monitoring committee.

State influence on product markets

Although the government continued to apply measures to contain price increases, ensuring State aid is transparent and efficient remains a challenge. The government extended a price cap programme in cooperation with the country's largest supermarket chains, which was launched in March 2024, to mid-May 2025. This effort aims to contain surging prices for staple food items (such as flour, sugar, oil and salt) and support domestic producers. In December 2024, the Agency for Protection of Competition (APC) issued a decision on unlawful State aid to Montenegro Airlines, which should be repaid. While Montenegro made progress in ensuring the transparency of State aid decisions, further work is needed to raise more awareness of State aid rules among aid grantors and increase the number of APC staff.

Privatisation and restructuring

The privatisation of state-owned enterprises (SOEs) has not made progress, but some steps were taken to improve SOE governance and profitability. In February 2025, the Ministry of Finance set up an updated register of national and local SOEs, aiming to collect data, help monitor SOEs and report on the related fiscal risks. Based on the analysis of SOE legal and regulatory frameworks, the government prepared draft laws on the governance of state-owned enterprises, and state ownership policy. Improving SOE governance is a major feature of Montenegro's Reform Agenda. The ambition is to boost SOEs' financial performance by transforming their management structures

and eliminating political patronage.

Functioning of the financial market

The banking system remained well-capitalised, liquid and profitable in 2024 and the first half of 2025. Banks continued to fund themselves mainly through domestic deposits, although deposit growth decelerated significantly to 3.4% in 2024, down from 15.1% in 2023. In the first half of 2025 deposit growth pick-ed up to some 6% y-o-y. The returns on assets and on equity declined from 2.8% and 19% in Q4-2024 to 2.2% and 15.2%, in Q2-2025, respectively. The non-performing loan ratio continued declining from 4.0% at the end of 2024 to 2.9% in Q2-2025, compared with 5% in 2023. The capital adequacy ratio of the banking sector (regulatory capital to risk-weighted assets) was stable around 19.5% from Q4-2024 to Q2-2025. As a precautionary measure to ensure financial stability, the Central Bank of Montenegro requires banks to keep capital buffers between 3.4% and 3.9% of the total risk exposure amount.

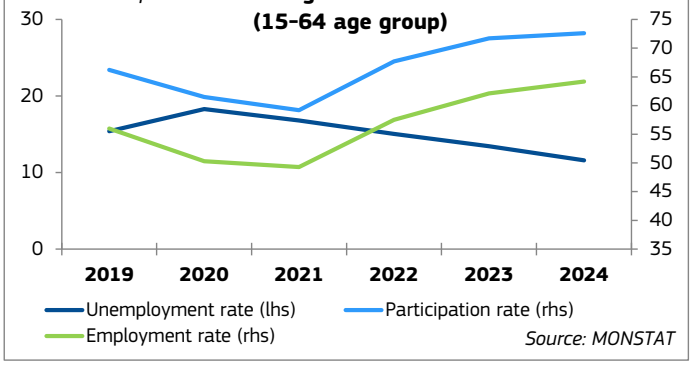
Following the adoption of the Law on the development bank in October 2024, the Investment Development Fund of Montenegro was officially transformed into the Development Bank of Montenegro in December. The law is not aligned with several EU legal acts in the field of banking, regulation of credit institutions and payments and raises strong concerns about the law's compliance with EU competition and State aid rules.

Credit activity continued to grow despite higher lending rates. Credit growth accelerated to 13.3% in 2024 and further to some 15% y-o-y in the first half of 2025, up from 10.8% in 2023. Compared with 6.1% in early 2024, borrowing costs, measured by nominal weighted average lending rate, increased to6.5% by the end of 2024 and moderated to 6.3% in July 2025. The nominal weighted average rate on deposits stood at only 0.26% over this period. The large spread between lending and deposit rates supported the increased profitability of the banking sector in 2024.

Functioning of the labour market

Economic growth supported further labour market improvement, but structural labour market challenges persisted. According to the labour force survey, the average unemployment rate fell from 13.4% in 2023 to 11.6% in 2024 and further to 10.7% in Q2 2025. The number of people in employment increased by 2.9%, bringing the employment rate to 64.2% in 2024. In Q2 2025 the employment rate climbed to 65.7% The average net wage, supported by the cut in pension contributions, rose by 24.3% year-on-year to EUR 1 012 at the end of 2024. During 2025 the net average wage remained roughly stable, reaching EUR 1 014 in July. Regional disparities persisted in 2024, with the unemployment rate varying from 2% in the coastal region to 8.4% in the centre and 25.7% in the poorer northern region. The gender gap also persisted with the activity rate of women (68.4%) significantly below that of men (78.7%) in Q2 2025. Other major structural challenges to be tackled are youth unemployment (aged 15-24), which rose from 23.3% in 2023 to 26% in 2024 and 31.3% in Q2 2025, and long-term unemployment, with 74.5% of all unemployed people having been looking for a job for more than 12 months in 2024, which declined to 64% in Q2 2025. Ongoing reform efforts aimed at improving administrative capacities and the digitalisation of the Employment Agency (EA) are expected to result in more targeted and effective employment activation measures. There was some progress in digitalising the EA's services, which led to the launch of the pilot phase of the Youth Guarantee in three municipalities.

Graph 6.4: **Montenegro - Labour market trends (15-64 age group)**



Source: MONSTAT

6.2. THE CAPACITY TO COPE WITH COMPETITIVE PRESSURE AND MARKET FORCES WITHIN THE EU

Montenegro has made **some progress** and is **between a moderate and a good level of preparation** to cope with competitive pressure and market forces in the EU. The education system still faces numerous challenges, which are being gradually addressed by the authorities. Efforts to advance the green and digital transitions have continued at a slow pace. Further efforts are needed to diversify Montenegro's narrow production base. The economy's high reliance on services, in particular tourism, together with the small size of local companies and their low level of participation in exports are obstacles to increasing the productivity and competitiveness of local firms.

The Commission's recommendations from last year were implemented to a limited extent and remain mostly valid. In the coming year, Montenegro should in particular:

→ continue implementing digital public services for the public and businesses and prioritise the development and implementation of an interactive e-government platform for transactional electronic services;

→ improve the implementation of programmes for dual vocational education and training and post-secondary education in close cooperation with business associations and provide work-based learning;

→ improve the institutional and regulatory environment for the green transition and increase energy resilience by adopting the national energy and climate plan and implementing energy efficiency legislation.

Education and innovation

The quality of education and skills mismatches in the vocational education and training system are still long-standing challenges. In April 2025, the government adopted a comprehensive multiannual education sector strategy (2025-2035) aiming to improve the alignment of educational outcomes with the market's needs.

A newly opened technology park is expected to strengthen the national innovation system. The Science and Technology Park of Montenegro was opened in mid-2024, aiming to facilitate the commercialisation of research and boost cooperation between business and academia. The links between academia, research institutes and business are weak, with research staff mostly working for the government or in the higher education sector. The Innovation Fund continued to play a vital role in implementing the national innovation policy through managing seven innovation support programmes in 2024. These programmes aim to encourage cooperation between the private sector and research institutions in developing innovative projects and products.

Physical capital and quality of infrastructure

Some progress was made in improving energy infrastructure. While the use of renewable energy sources is high, there is a lack of diversification of renewable sources and insufficient focus on environmental standards in energy infrastructure projects. Electricity production mainly relies on hydropower, accounting for more than 40% of electricity production in 2024. To advance diversification, the national electric power company started to run two solar projects in June 2025 and started building a new wind-power plant in November 2024. Montenegro is planning for the thermal (lignite) power plant in Pljevlja to remain in service until 2041. This is vital for security of supply and the stability of the country's power system, but the plant remains the main polluter. The Pljevlja plant produced around 40% of Montenegro's electricity in 2024, but it was temporarily closed for renovation and ecological upgrades in spring 2025. The national energy and climate plan has yet to be adopted.

Investment in digital infrastructure continued over the reporting period. In December 2024, the government adopted a decision to establish the Cybersecurity Agency and started initial work. The 5G spectrum had been activated in all municipalities as of the end of 2024, covering more than 90% of the population with a 5G network signal. Despite the integration of various government systems and

portals into the centralised e-government portal, there was no noticeable improvement in the quality and the number of e-services available as of the end of 2023.

Modernising the transport sector requires a strategic approach and close partnership with the EU. In July Montenegro adopted the Law on railways, which establishes an independent Railway Agency and meets the EU standards for market opening and fair competition in the rail sector**.** After significant delays, the EU-funded update to the feasibility study of the Bar-Boljare highway was completed in November 2024. Improving road transport connections, in particular the corridor linking the major port of Bar to Boljare at the border with Serbia, is a national priority for Montenegro. Following the relaunch of a technically updated tender, which includes European Bank for Reconstruction and Development (EBRD) and EU financing (EUR 500 million), 5 consortia, from 10 bids submitted, were selected to progress to the second round of the tender for the design and construction of the Matesevo–Andrijevica highway section. Work on upgrading the Bar-Vrbnica railway, the EU-funded core network corridor, continued despite significant delays during the reporting period, indicating a limited absorption and management capacity of the country's administrative bodies. The procedure for the concession award for the country's two main airports (in Podgorica and Tivat) is not yet finalised, pending an appeal by one of the two bidders.

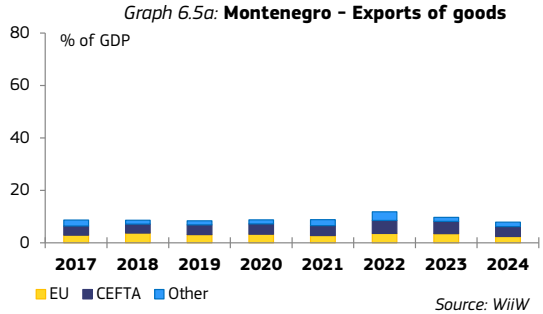
Sectoral and enterprise structure

The structure of the economy remains dominated by the services sector. Micro, small and medium enterprises (MSMEs) accounted for nearly 53% of total employees in 2024. The share of microenterprises stood unchanged at 95% of all MSMEs. Across sectors, the distribution of employment remained broadly stable in 2024: the services sector accounted for 76.6% of total employment, while the shares for industry and construction (19%) and agriculture (4.3%) were much lower. The share of agriculture and industry in gross value added[26] continued to decline to 6.5% and 10.9% in 2024, down from 9.1% and 13.5% in 2020, respectively. The share of services rose to 78.8%, up from 70% in 2020.

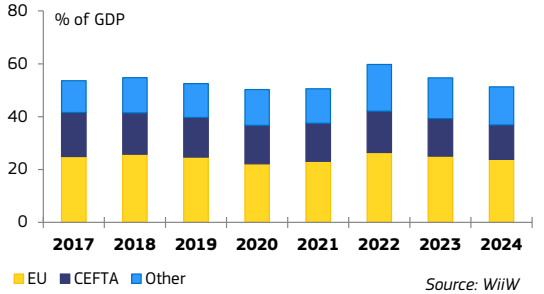
Economic integration with the EU and price competitiveness

Import growth drove the increase in merchandise trade amid weak exports. Montenegro's foreign trade in nominal terms expanded by 4.5% year-on-year, with exports of goods shrinking by 7% and imports increasing by 6.7% in 2024. The export base therefore remained very narrow. Despite a small decline of 1.7% in bilateral trade with the EU, the EU remained Montenegro's main trading partner, accounting for 30% and 46% of merchandise exports and imports, respectively. The share of Central European Free Trade Agreement (CEFTA) countries was also substantial, accounting for 48% and 26% of Montenegro's total exports and imports of goods, respectively. The EU is also the main source of FDI inflows, accounting for 28% of total FDI inflows in 2024, followed by Serbia, Russia and Türkiye.

Graph 6.5a: **Montenegro - Exports of goods**



Graph 6.5b: **Montenegro - Imports of goods**



[26] Eurostat data.

7. NORTH MACEDONIA

7.1. THE EXISTENCE OF A FUNCTIONING MARKET ECONOMY

North Macedonia has made **limited progress** and is at a **good level of preparation** in developing a functioning market economy. Real GDP growth accelerated in 2024, driven by private consumption and public investment. The external position deteriorated and inflation, after falling substantially, has surged again since September 2024. The 2024 fiscal deficit exceeded the initial plan as a result of rising public sector wages and pensions, delaying fiscal consolidation and adherence to the fiscal rules. The execution of planned capital expenditure continues to suffer from weak public investment management. Efforts to formalise the informal economy have stalled. The central bank started to cautiously ease monetary policy and the macroprudential framework was strengthened. The banking sector remained resilient amidst a solid rise in credit growth. The labour market situation improved, but structural problems persist, including low participation rates, substantial emigration and a large gender gap.

The Commission's recommendations from last year were only partially implemented and therefore remain largely valid. In the coming year, North Macedonia should in particular:

→ adopt the remaining implementing legislation for the organic budget law and ensure compliance with the fiscal rules, including by adopting further revenue-enhancing measures and controlling current spending;

→ accelerate the implementation of the public investment management action plan and adopt the Law on public-private partnership;

→ adopt and implement a revised action plan for formalising the informal economy.

Economic governance

The government did not progress on key reforms. The government delayed fiscal consolidation plans and postponed full implementation of the 2023 organic budget law (OBL)[27], originally planned for 2025. A new department for public investment management (PIM) was set up in 2024, and the decree governing PIM procedures was adopted in April 2025 after significant delay. The government suspended direct subsidies to the domestic electricity producer, ESM, but replaced them with large guarantees for commercial bank loans and took on new spending commitments that required a supplementary budget. Regarding the EU's macro-financial assistance (MFA), the government has not expressed an interest in implementing the second and final tranche and the related reforms. In November, the IMF's two-year precautionary and liquidity line (PLL) expired. In line with PLL commitments, the country progressed on fiscal and structural reforms, bolstered fiscal governance through the adoption of the OBL and reduced external imbalances during the PLL period. However, it did not fulfil some other commitments, in particular regarding timely assessment of fiscal risks from public works on Road Corridors VIII and Xd as well as a budget revision that substantially lifted the planned budget deficit against the PLL target.

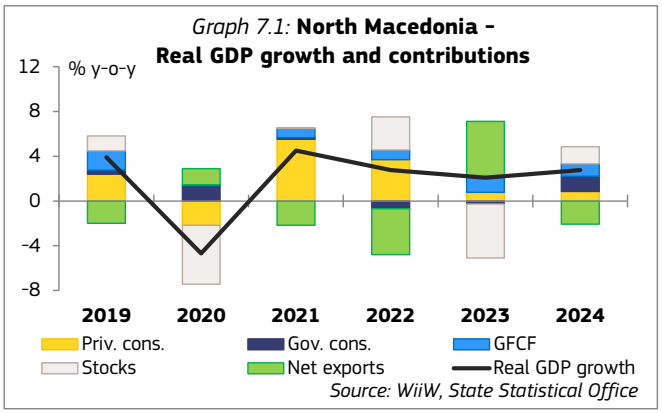
Implementation of the policy guidance agreed at the May 2024 Economic and Financial Dialogue has been limited. The government did not meet the original fiscal target in 2024. Public-sector wages were raised in the course of the year beyond the original budgeted funds, and pensions were raised in September 2024 and again in March 2025, in a linear way rather than by indexation. The 2025 budget does not comply with the new deficit rule, the application of which has been postponed to 2027, one year later than originally planned. The government did not initiate any

[27] The OBL, passed by Parliament in September 2022 and supposed to enter into force in its entirety by 1 January 2025, introduces fiscal rules and a Fiscal Council, and strengthens the medium-term budget procedure.

measures eliminating tax exemptions. It has not yet adopted the draft law on public-private partnerships.

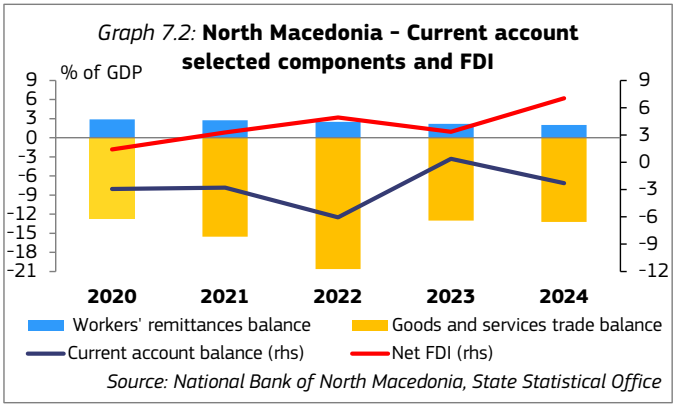
Macroeconomic stability

Economic growth strengthened in 2024, despite muted external demand. After a significant growth slowdown in 2023, annual real GDP growth picked up in 2024, from 2.4% in the first half to 3.1% in the second half. For the year as a whole, real GDP increased by 2.8%, compared with an average growth rate of 1.7% over 2019-2023. Economic activity was largely driven by investment and public consumption, with the latter partly reflecting a strong rise in public-sector wages. Gross capital formation increased by 8.9% in 2024, following a steep decline in 2023, signalling the end of a prolonged drawdown of inventories. Household consumption growth picked up too, helped by an increase in real disposable incomes. The contribution of net exports to growth turned negative due to slowing exports, largely reflecting the weakness in the main European trading partners. Convergence with EU income levels remained very slow, with real GDP per capita in purchasing power standards increasing from 40% of the EU-27 average in 2017 to 43% in 2021 and then dropping to 42% in 2024.



Graph 7.1: **North Macedonia - Real GDP growth and contributions**
Source: WiiW, State Statistical Office

The country's external position deteriorated somewhat. After a small surplus in 2023 driven by the decline in energy prices, the current account balance slipped back into deficit during 2024 (to 2.3% of GDP), on the back of a deterioration in the merchandise trade deficit (down 3 pps to 20.1% of GDP) and a lower surplus in the secondary income balance. The primary income deficit widened. This together more than offset the increase in the services trade surplus, which is increasingly driven by the contribution of professional, technical and scientific services. Foreign direct investment rose by 4.2 pps to 7.1% of GDP in 2024, well above its average in the preceding five years (4.0%), and hence exceeding the current account deficit by a large margin. The economy remains vulnerable to a potential renewed surge in energy prices, given its high energy intensity and heavy reliance on imported energy. Foreign reserves were boosted by two large government loans from Hungary of EUR 1 billion, half of which was earmarked for refinancing a Eurobond maturing in January 2025. Foreign reserves stood at 4.8 months of prospective imports of goods and services at the end of June. Gross external debt increased by 3.3 pps in 2024, to 79.8% of GDP. The increase was due to a rise in both general government foreign borrowing and intercompany lending. The structure of gross external debt, dominated by long-term and fixed-rate financing, posed limited risk.



Graph 7.2: **North Macedonia - Current account selected components and FDI**
Source: National Bank of North Macedonia, State Statistical Office

Inflation surged again in late 2024. Inflation slowed to 3.5% on average in 2024, down from 9.4% in 2023. This reflected mainly the drop in global commodities prices, and a gradual, albeit slow, abatement in second-round effects of high energy and food prices on other domestic sectors. However, headline inflation has been rebounding since September 2024, driven by rising food prices, despite the government's temporary price controls which include limits on gross profit margins of basic food products. Headline inflation stood at 4.4% in August 2025. Core inflation remained sticky amid rising labour costs.

Table 7.1: **North Macedonia - Key economic figures**	**2016-21** average	**2022**	**2023**	**2024**
GDP per capita (% of EU-27 in PPS)[1)]	41	42	41	42
Real GDP growth	1.8	2.8	2.1	2.8
Activity rate of the population aged 15-64 (%), total	65.4	66.4	65.4	66.0
female	*52.8*	*54.4*	*54.7*	*55.7*
male	*77.6*	*78.4*	*76.0*	*76.2*
Unemployment rate of the population aged 15-64 (%), total[2)]	19.6	14.5	13.2	12.5
female	*19.1*	*12.6*	*11.4*	*11.2*
male	*19.9*	*15.9*	*14.4*	*13.4*
Employment of the population aged 15-64 (annual growth %)[2]	1.1	-0.1	-0.2	0.6
Nominal wages (annual growth %)	4.9	11.1	15.3	12.9
Consumer price index (annual growth %)	1.3	14.1	9.4	3.5
Exchange rate against EUR	61.58	61.62	61.56	61.53
Current account balance (% of GDP)	-2.0	-6.1	0.4	-2.3
Net foreign direct investment, FDI (% of GDP)	3.1	4.9	3.3	7.1
General government balance (% of GDP)	-3.6	-4.3	-4.6	-4.4
General government debt (% of GDP)	43.7	49.7	49.8	53.8

Notes:

1) Eurostat

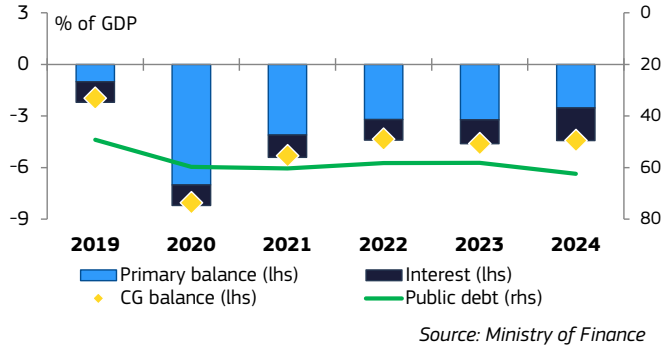
2) In 2023, the implementation of a new regulation caused changes in the survey affecting the scope and definition of employment and unemployment.
This caused an interruption of the time series of data, restricting comparability with previous data.

Sources: State Statistical Office, National Bank of North Macedonia, Ministry of Finance and Eurostat

The central bank started to ease monetary policy. The central bank lowered the key policy rate in several steps as of September 2024, from 6.30% to 5.35% in February 2025. Nevertheless, the overall monetary policy stance remained cautious, acknowledging that domestic risks to inflation are increasing, in particular from high nominal wage growth.

Fiscal consolidation has been delayed. The 2024 fiscal deficit turned out at 4.4% of GDP, higher than the initial plan[(28)] but lower than the revised projection (4.7%), on the back of a large budget revision and subsequent additional rebalancing which cut funds for capital expenditure. Capital expenditure was reduced by 17.3% and current expenditure was raised by 9% to fund: (i) the repayment of arrears; (ii) public-sector wage increases; (iii) higher than anticipated transfers to the health fund and to local government units; and (iv) new spending priorities, in particular the linear pension increase. The wage bill therefore rose by 0.5 pps year-on-year to 4.6% of GDP, while transfers to the pension fund increased by 1 pp. to 11% of GDP. Capital expenditure implementation remained significantly below the revised target

Graph 7.3: **North Macedonia - Fiscal developments**



Source: Ministry of Finance

[(28)] The original fiscal deficit for 2024 was projected at 3.4% of GDP, in line with the previous government's plan for fiscal consolidation, which was to achieve a deficit of 3% in 2026 in line with the new fiscal rules.

(77%), amounting to 3% of GDP[29]. The government expects a boost to revenue in 2025 and beyond from measures to formalise the informal economy and the expected increased effectiveness of the Public Revenue Office (PRO) through digitalisation. A budget revision, adopted by the Parliament in July, did not raise the 2025 deficit target (4% of GDP), but lifted projections for both revenue and spending, the latter to account for, in particular, further linear increases in pensions, a rise in public sector wages, and additional projects by municipalities.

Progress on bolstering the fiscal framework has been mixed. Against the backdrop of the postponement of full implementation of the 2022 OBL and of the new deficit rule, which weakened the fiscal framework, the new Fiscal Council, in line with the OBL provisions, published its opinion on the October 2024 Medium-term Fiscal Strategy. The government published a fiscal policy statement in September 2024, also as required by the OBL, and in April 2025 it adopted the Fiscal Strategy 2026-2030. Fiscal governance suffers from a deterioration in the quality of statistical data. Revisions of national accounts data have increased in number and in size. Moreover, fiscal data remains partial, with large parts of public entities excluded, and does not reflect the ESA2010 standards.

The cumulative rise in public debt levels over the last five years raises concerns. Public debt increased by 4.3 pps y-o-y to 62.4% of GDP in 2024, significantly above its level of five years earlier (49.2%). While the share of external debt in public debt has been declining over the past five years (-5.7 pps), it remains high, at 55.6%. Overall, foreign currency debt made up 66% of total debt. 91% of the foreign currency debt is in euro, which is significantly above the threshold set in the public debt strategy (80%). However, risks stemming from exchange rate depreciation are mitigated by the 'de facto' currency peg to the euro.

The policy mix was not fully aligned to meet current challenges arising from inflation and fiscal consolidation needs. Monetary policy started to ease cautiously as of autumn 2024, standing ready to tighten again if necessary. However, monetary policy is constrained by the peg and weakened by excess liquidity, leaving fiscal policy as the main stabiliser. Yet expansionary fiscal policies have reduced fiscal space and risk raising domestic price pressures. Furthermore, through its temporary price ceilings for key food categories and caps on retailers' profit margins, the government contributed to inflation volatility.

Functioning of product markets

Business environment

Long-standing obstacles to doing business persist. The large informal economy, accounting for as much as 38% of GDP according to some estimates[30], undermines the competitiveness of domestic companies. In 2024, the share of the workforce employed in the informal sector rose by 1.6 pps to 12.3%, according to the State Statistical Office. Implementation of the government's 2023 Action Plan to formalise the informal economy slowed, partly because of a reorganisation of responsibilities in the new government. Furthermore, legal certainty in the business environment is hampered by an increase in fast-track parliamentary procedures, as well as by inconsistent application of regulations.

State influence on the product market

Caps on profit margins have only a temporary impact on prices, and State aid control remains weak. The government continued to impose temporary price ceilings for key food categories as well as caps on retailers' profit margins. Since 2023, the government has introduced these measures on four occasions, linking them with public holidays when consumption spikes[31]. The latest

[29] Including the Public Enterprise for State Roads (PESR), which by the ESA2010 rules should be accounted for under the general government, capital spending was around 6.6% of GDP in 2024.

[30] Kelmanson, Kirabaeva, Medina, Mircheva, and Weiss (2019) "Explaining the shadow economy in Europe: size, causes and policy options," Working Paper No. 19/278, International Monetary Fund.

[31] There were two price control mechanisms introduced in the second half of 2024. While both limit retailers' margins, the latest imposes a price cap on some 700 products (at least 10% discount over the lowest price of the previous month). The gross profit margin caps also affect producers.

measure expired on 30 April 2025[32]. However, the impact on price levels was not lasting and the capacity of the two institutions responsible for monitoring proved insufficient. The transparency and effectiveness of State aid continues to be affected by the high number of State aid providers, the lack of an updated registry, and the still limited powers of the Commission for the Protection of Competition (CPC) in State aid supervision. The procurement of a management information system connecting different institutions as part of setting up a State aid registry has been postponed to 2026.

Privatisation and restructuring

The public sector's stake in the economy is low. In 2024, the number of companies in full state ownership remained unchanged compared with the preceding year, at 14. The number of companies in partial ownership remained at 38, most of these with a state ownership share of below 1% of issued capital[33]. The total value of state ownership in enterprises declined, from about 10% of GDP in the preceding years to 7.7% in 2024. While the state ownership is relatively small, economy-wide it has large implications as it is mostly contained in the network industries which are critical for well-functioning of the rest of the economy. SOE governance remains weak, while energy, railways, posts, utilities companies keep on creating losses and are the source of large fiscal risks.

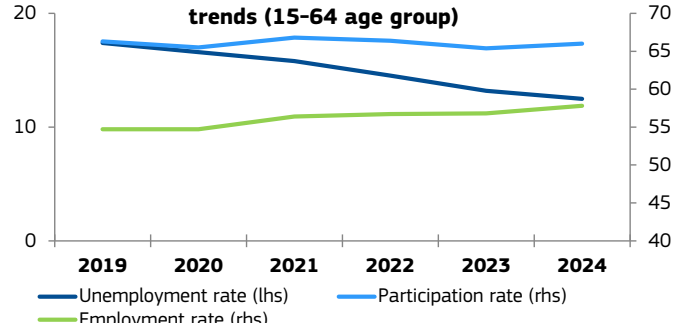
Functioning of the financial market

The banking sector proved resilient and the macroprudential toolkit was bolstered. Financial intermediation is still relatively weak in North Macedonia, with financial sector assets at some 87% of GDP at the end of 2024. This is, however, above the level of five years earlier (79%). Diversification is progressing slowly, with banks accounting for 78% of total financial sector assets at the end of 2023 (2019: 81.4%). Banks' capital adequacy ratio increased further to 18.8% in the first quarter of 2025, supported by the gradual rise in the central bank's countercyclical capital buffer throughout 2024, amidst solid bank profitability. Banks' return on equity dropped, compared to one year earlier, to 16.6% (-1.6pps). Liquidity in the banking sector is high. At the end of the first quarter the share of liquid to total assets, at 21.4%, was above its level of one year earlier. The central bank increased reserve requirements to absorb excess liquidity. The ratio of non-performing loans in total loans to the non-financial sector dropped to a record low of 2.7% in 2024. The annual growth in both deposits and bank lending to the private sector picked up, in particular to companies.

Functioning of the labour market

The labour market remained resilient, although structural challenges persist. Over recent years, there have been steady improvements in key labour market indicators. The unemployment rate (age group 15-64) dropped gradually, to 12.5% on average in 2024, compared with 17.1% five years earlier. The employment rate also improved (57.8%, compared with 47.5% in 2019). High emigration continues to take its toll on the labour force, even though in 2024 the labour force decreased by much less (0.2%) than in 2023 (2%). Labour market participation rose to 66% (2019: 57.3%). Unemployment among young people (age group 15-24)

Graph 7.4: **North Macedonia - Labour market trends (15-64 age group)**



Source: State Statistical Office

[32] Following a temporary limit in autumn 2024 and a one-month cap from mid-December to mid-January 2025, the government on 17 February 2025 introduced graduated caps of 5%, 10% and 15% margin limits in both retail and wholesale trade for basic food products until 30 April.

[33] The figures are based on information from the government. A new harmonised and internationally standardised global database of state-owned enterprises (SOEs) by the World Bank shows that there are 88 SOEs in North Macedonia, with the government holding a 100% stake in 35 of them.

remains high, at 29%. The labour market continues to suffer from structural shortcomings such as low participation rates, in particular for women, and skills mismatches. These are a large obstacle to economic growth. Wage growth remained high, fuelled by public sector wage agreements and a rise in minimum wages. Average gross nominal wages rose by 12.9% in 2024, somewhat less than in the preceding year, with annual increases further slowing down to 8.5% in June 2025, Real wage growth accelerated to 8.8% in 2024 (+3.7 pps y-o-y), winding down to reach 3.8% in June 2025.

7.2. THE CAPACITY TO COPE WITH COMPETITIVE PRESSURE AND MARKET FORCES WITHIN THE EU

North Macedonia has made **some progress** and is **moderately** prepared to cope with competitive pressure and market forces within the EU. A new Law on vocational education and training includes some measures to address significant skills mismatches. The digitalisation of the economy is advancing, and new school curricula provide for better teaching of IT skills. Sizeable investment needs in transport and energy infrastructure persist. Projects to improve road and rail infrastructure and to digitalise public services have progressed somewhat but need to be strengthened to have a positive impact on the competitiveness of domestic companies. The share of energy production from renewable sources increased further. Integration with the EU in trade and investment, as well as overall trade openness, remained high in 2024.

The Commission's recommendations from last year were not fully implemented and therefore remain valid. In the coming year, North Macedonia should in particular:

→ increase financial and human resources to speed up the vocational education and training system reforms and implement the Law on secondary education;

→ complete key projects in transport infrastructure, such as on Road Corridors VIII and X;

→ increase the use of renewable energy sources, including by adopting a new law on renewable energy sources.

Education and innovation

The reform of vocational education and training is progressing, while higher education still suffers from outdated curricula and skills mismatches persist. Foundational learning outcomes are weak and worsening. The OECD's latest Programme for International Student Assessment (PISA) results for North Macedonia shows declines across all subject areas. The number of people with higher educational attainment has increased, but curricula fail to equip graduates with the necessary skills to match labour demand. Parliament adopted the new Law on vocational education and training (VET) in December 2024. The law introduces several key innovations such as formalising dual education partnerships between vocational institutions and employers, increasing the number of practical training hours in VET and setting the legal framework for establishing a network of regional VET centres. On the digital transformation of the education system, under the new curriculum for primary education, the subject of technical education and IT will be studied in grades 4-9. In April 2025, Parliament also adopted amendments to the Law on secondary education, providing for an updated curriculum for secondary education, including digital and green skills. The new financing formulas for primary and secondary education have been adopted. Public spending on education and training decreased slightly to 3.2% of GDP in 2024 (2023: 3.7%), remaining below the EU average of 4.7%. The education budget decreased as a share of the overall state budget from 11.7% in 2023 to 9.2% in 2024. Spending is often inefficient, focused on wages and goods and services rather than infrastructure maintenance and investment. Overall investment in research and innovation in the country remains very low (2022: 0.38% of GDP) and the private sector's participation in research continues to be marginal.

Physical capital and quality of infrastructure

The need to modernise transport infrastructure remains substantial, but investment is limited. Works on the key transport project, sections of Trans-European Road Corridors VIII and Xd, started after long delays, but their completion has been postponed by two years, to 2029. Railway

construction on Corridor VIII, which would link North Macedonia with Albania and Bulgaria and provide an alternative export option via ports in these two countries, has stalled due to contractual difficulties. Completing these and other vital transport projects is essential to boost productivity growth and the competitiveness of the domestic economy. Public investment as a share of GDP, after spiking in 2023, has dropped again. Overall investment, at 28.4% of GDP in 2024, also dropped compared with 2023 (31.9%), but remained above the average for the preceding five years.

The digitalisation of the economy is advancing slowly. The share of households with internet access at home increased by 11.4 pps between 2020 and 2024, to 90.8%. There was some progress in ICT infrastructure development – fixed broadband was available to 79.6% of households (2019: 70.9%) at the end of 2023, below the EU average (EU 2024: 93.1%). Digital adoption among SMEs in North Macedonia has accelerated in recent years, but remains uneven and largely focused on basic technologies. Smaller companies and rural areas still face significant obstacles in obtaining access to broadband. Several laws were adopted by the government in May 2025 to spur digitalisation, in line with the Roadmap for Digital Transformation from late 2023.

Measures to improve energy efficiency are delayed. The Energy Efficiency Fund is not yet operational, even though its legal basis was created in 2023. Key operational documents and the setting up of a joint Steering Board need to be agreed between the Ministry of Finance and the Development Bank. In September, Parliament adopted the new Energy Efficiency Law, which provides for a range of measures to improve energy efficiency and cut greenhouse emissions, such as a requirement for the renovation of at least 3% of public buildings per year and financial support for private energy efficiency investment.

The government increased renewable energy capacities. While the economy continues to rely heavily on coal-fired electricity production, the installed capacity of power plants from renewable energy sources increased to 55.7% of total capacity in 2024, up from 17% in 2021. Renewables accounted for 41% of total electricity production in 2024, up from 22.8% in 2021. However, progress on climate change abatement policies is lagging. Adoption of the Law on climate change, which would introduce carbon pricing mechanisms, is delayed. A newly adopted energy law harmonises legislation in North Macedonia with the recently adopted Energy Community legislation, providing a legal basis for electricity market integration and coupling with the EU. The law also provides for further development of energy storage.

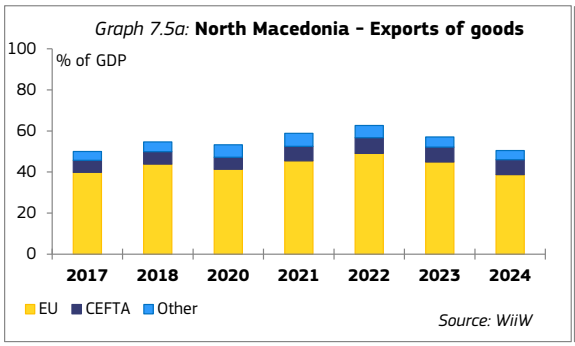
Sectoral and enterprise structure

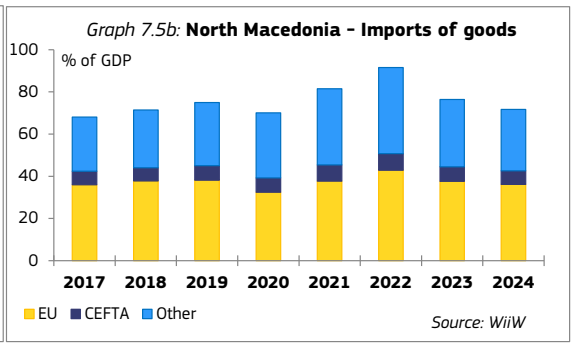
Trade and services are becoming more important for the economy. The economy's output structure relies increasingly on services and trade (67.4% of total value added in 2024, about the same as in 2023, compared with 60% in 2019). The contribution of manufacturing (15.3% of value added) and construction (6.6%) remained relatively steady over the past five years. ICT is becoming an increasingly important sector for output and employment. Its contribution to value added rose from 4.1% in 2019 to 5.6% in 2024, while the IT sector contributed 3.5% of employment in 2024, compared with 1.9% in 2019. The share of agriculture has declined both in terms of value added (from 9.4% in 2019 to 6.8% in 2024) and employment (from 13.9% to 9% in the same period). On employment, the services sector, including trade, accounted for 36.8% of total employment (compared with 31.7% in 2019), followed by manufacturing (19.8%, the same as five years earlier) in 2024. The share of agriculture declined over the period 2019 to 2024 by 4.9 pps to 9.0%.

Economic integration with the EU and price competitiveness

Trade openness decreased but is still at historically high levels. Exports and imports of goods and services as a share of GDP dropped further in 2024, to 138.5% (2023:148.7%), due to a decrease in both import and export values, but trade openness remains above its five-year pre-COVID average of 120%. The share of higher value-added products in the export structure rose further in 2024, including chemicals (39% of total goods exports) and machinery and transport equipment (37%). The EU is the country's main trading partner, accounting for 61.4% of its total trade in goods (2023: 61.8%). 76.9% of North Macedonia's total goods exports went to the EU, while 50.5% of its imports derived from there. CEFTA, the country's second biggest trading partner, accounted for 11.1% of trade

(2023:10%). EU countries are also still the biggest investors in North Macedonia, accounting for 44% of total foreign direct investment inflows in 2024, after a record high of 69.7% in 2022. The EU-27 share in the total stock rose to 67% in 2024, up from 64.2% in 2021.





External price competitiveness decreased slightly. The consumer price index-deflated real effective exchange rate (REER), as a measure of external competitiveness, depreciated by 0.1% in 2024, following an average appreciation of 1.8% between 2019 and 2023. Nominal unit labour costs rose starkly in 2024, reflecting the strong rise in nominal wages in a context of subdued productivity growth.

8. SERBIA

8.1. THE EXISTENCE OF A FUNCTIONING MARKET ECONOMY

Serbia has a **good level of preparation** and has made **limited progress** in developing a functioning market economy. In 2024, economic activity was robust, but slowed markedly in the first half of 2025 while external imbalances increased. The budget deficit turned out lower than planned in 2024 and monetary policy remained relatively tight, which helped inflation return to the target band. The banking sector remained stable, and the labour market improved further. Serbia postponed the full application of some fiscal rules and the reform of the public sector wage system faced further delays. State aid rules are not always implemented due to strong political pressure to provide financial assistance to state-owned enterprises (SOEs) and large foreign investors. SOEs continue to have an outsized presence in many structurally important sectors. The business environment is hampered by red tape, weaknesses in the rule of law and limited efficiency and transparency of the public administration. The government has interfered significantly in the goods market by instituting on a very short notice a 20% margin cap for a wide variety of goods from 1 September 2025 for the following 6 months. While it is intended to benefit consumers through lower inflation, the measure risks causing market distortions and having a negative impact on investment.

Last year's recommendations were implemented to a limited extent and therefore remain largely valid. To improve the functioning of the market economy, Serbia should in particular:

→ keep an appropriately tight policy stance to maintain price stability, including by containing current spending;

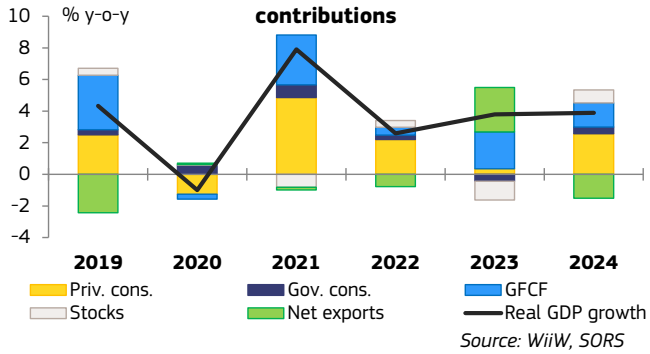
→ swiftly advance the reform of the public sector wage system;

→ adopt implementing legislation to fully implement the SOE law and strengthen SOE governance to reduce the associated fiscal risks.

Economic governance

Serbia remained committed to maintaining macroeconomic stability. Serbia's 24-month stand-by arrangement with the International Monetary Fund (IMF) was successfully concluded in December 2024. It was replaced by a 36-month Policy Coordination Instrument (PCI), under which Serbia commits to continue to implement important reforms regarding SOE governance, the public-sector wage system, fiscal transparency, public investment management and energy sector reforms. The government's current fiscal strategy (2025-2027) targets an increased deficit of 3.0% of GDP in every single year, which is higher than the ceiling set in the fiscal rules.

Graph 8.1: **Serbia - Real GDP growth and contributions**



Source: WiiW, SORS

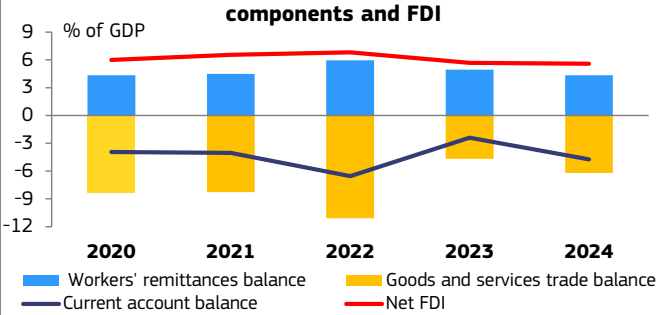
Serbia has partially implemented the policy guidance set out in the conclusions of the May 2024 Economic and Financial Dialogue. Serbia has achieved good progress notably in achieving a sufficiently tight monetary policy stance, continuing action to promote the use of the domestic currency and creating a bank resolution fund. However, only partial progress was made on the public-sector wage reform, fiscal risk analysis and reporting, implementation of the new SOE Law and on strengthening medium-term budgeting.

Macroeconomic stability

Following last year's strong growth, economic activity slowed down at the beginning of 2025. In 2024, GDP growth reached 3.9%, slightly higher than the average growth rate of 3.6% between 2019 and 2023, driven by buoyant investment and rising consumer spending. Consumer spending was supported by higher real disposable income resulting from rapid real wage growth, while investment was boosted by strong inflows of foreign direct investment (FDI) in 2024 and an ambitious public investment programme. In line with the strong increase in domestic demand, the contribution of net exports to GDP growth was negative as import growth far exceeded exports. However, the ongoing domestic political turmoil, weak demand from main EU trading partners, and intensified global trade tensions dampened economic sentiment, notably in the first half of 2025, and resulted in GDP growth decelerating to only about 2% in the first two quarters of 2025. The income gap with the EU average continued to narrow slightly in 2024, with GDP per capita in purchasing power standards reaching 51% of the EU average, up from 42% in 2019.

In line with surges in investment and spending, the current account deficit widened considerably in 2024. After falling to 2.4% of GDP in 2023, the external deficit rose to 4.7% of GDP in 2024 as both the trade and the primary income balance deteriorated notably. In the second quarter of 2025, the current account deficit rose further to 6.3% of GDP due to the large negative goods trade balance only partly offset by the surplus in trade in services, supported by ICT and business service exports. At the same time, the growing stock of FDI resulted in higher outflows of dividend and interest payments, while remittances decreased. The current account deficit was fully offset by net FDI inflows in 2024, reaching 5.6% of GDP. However, FDI fell by over half in the first six months of 2025 compared with the same period in 2024, but the fall is from record-high levels. Official foreign exchange reserves peaked at the end of 2024 at 35.6% of GDP, covering 7.3 months of goods and services imports, before subsiding in early 2025. External debt remained stable at 60.6% of GDP in 2024, slightly below the average of 62.6% between 2019 and 2023.

Graph 8.2: **Serbia - Current account selected components and FDI**

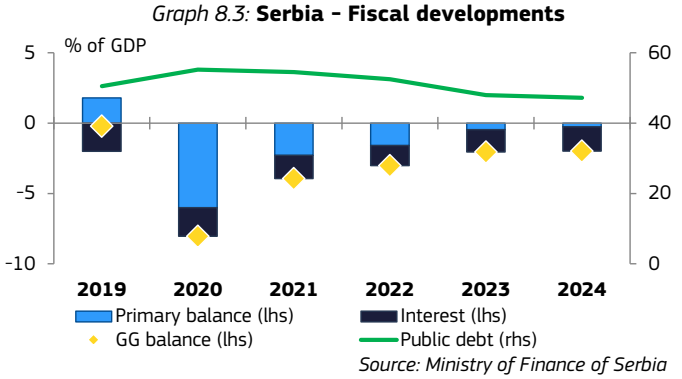


Source: IMF, Eurostat

Monetary policy remained relatively tight in 2024, which helped inflation return to within the central bank's target band (3±1.5%) in mid-2024. Down from 12.1% in 2023, inflation averaged 4.7% in 2024 but continued to hover around the upper bound of the target band in the second half of 2024. It bottomed at 3.8% in May 2025, but has since accelerated to 4.7% in August, notably driven by food prices. After lowering the key policy rate in the second half of 2024 in three steps to 5.75%, the National Bank of Serbia (NBS) has refrained from further easing of monetary conditions as domestic price pressures remain high. The NBS maintained exchange rate stability but switched to being a net seller on the local FX market in the first half of 2025 due to the deteriorating external position.

The general government deficit turned out lower than planned in 2024, at 2.0% of GDP. Compared with 2023 figures, both revenue and expenditure increased by 1.5 percentage points (pps) of GDP, resulting in a minor improvement of the deficit vis-à-vis 2023 and a continuation of the positive trend in the balance since the outbreak of the COVID-19 pandemic in 2020.

Graph 8.3: **Serbia - Fiscal developments**



Source: Ministry of Finance of Serbia

Revenues were mostly boosted by social contributions and personal income tax, driven by rises in wages and employment. Capital spending increased by 0.9 pps to 7.3% of GDP, while current spending on pensions (up 0.8 pps) and wages (up 0.6 pps), also saw notable increases. However, these were in line with the special fiscal rules capping pension and wage expenditure at 10% of GDP each. The level of subsidies remained relatively high at 2.5% of GDP. The primary balance was slightly negative. The public debt-to-GDP ratio declined to 47.5% from 48.4% in 2023. In October 2024, S&P Global Ratings upgraded Serbia's short- and long-term foreign and local currency credit rating, which resulted in the country's first-ever investment grade rating.

Table 8.1: **Serbia - Key economic figures**	**2016-21** average	**2022**	**2023**	**2024**
GDP per capita (% of EU-27 in PPS)[1)]	42	46	49	51
Real GDP growth	3.5	2.6	3.8	3.9
Activity rate of the population aged 15-64 (%), total[1)]	67.7	70.9	71.7	72.7
female	*60.1*	*64.0*	*65.6*	*66.9*
male	*75.3*	*77.8*	*77.8*	*78.6*
Unemployment rate of the population aged 15-64 (%), total[1)]	12.5	9.8	9.7	8.9
female	*13.3*	*10.3*	*10.2*	*9.1*
male	*11.9*	*9.4*	*9.3*	*8.8*
Employment of the population aged 15-64 (annual growth %)	2.1	2.3	0.8	2.0
Nominal wages (annual growth %)	6.9	13.8	14.7	14.4
Consumer price index (annual growth %)	2.3	11.9	12.1	4.6
Exchange rate against EUR	119.3	117.5	117.3	117.1
Current account balance (% of GDP)	-4.5	-6.6	-2.4	-4.7
Net foreign direct investment, FDI (% of GDP)	6.3	6.8	5.7	5.6
General government balance (% of GDP)	-1.9	-3.0	-2.1	-2.0
General government debt (% of GDP)	55.8	52.5	48.0	47.2

Notes:
1) Eurostat
Sources: Statistical office of Serbia, National Bank of Serbia, Ministry of Finance of Serbia and Eurostat

The fiscal governance framework, while well-designed, risks being undermined by the decision to postpone the full application of the fiscal rules. Serbia adopted a new set of fiscal rules in December 2022, with the deficit component set to enter into force in 2025. However, in late 2024, specific new deficit targets were agreed with the IMF under the PCI. The fiscal deficits are thereafter in practice anchored by the IMF program, as the application of the deficit rule will be *de facto* postponed until 2029, while the fiscal rule component on pension and public wage growth is still in place. Budgetary practices need improvements, notably as regards the budget procedure, including for amending budgets. Serbia used the fast-track procedure again to adopt the 2024 supplementary budget. Similarly, the contingency reserve (which is relatively high against an international comparison) allows for substantial ad hoc spending decisions during the year. The reserve lacks clearly defined restrictions on the use of ad hoc decisions and is often spent in an untransparent way. The Fiscal Council continued to monitor fiscal policies, producing independent reports and recommendations.

Overall, the macroeconomic policy mix was appropriate, although the plan to loosen the fiscal stance in 2025 somewhat contradicts the efforts to combat inflation. Under current projections, the more expansionary fiscal policy is still set to result in a sustainable fiscal position as public debt is projected to decline gradually. However, the decision to weaken the fiscal targets appears pro-cyclical in the context of a projected economic upswing in the coming years. Maintaining fiscal discipline would be important to manage inflationary risks. Monetary policy has been appropriately tight, given the persisting domestic inflationary pressure.

Functioning of product markets

Business environment

Despite progress in reducing the regulatory and administrative burden on businesses, there are still weaknesses that affect small and medium-sized enterprises (SMEs) in particular. The business environment is hampered by red tape, political interference, weaknesses in the rule of law and limited efficiency and transparency of the public administration. The Law on foreign exchange transactions is too restrictive and not applied consistently. Serbia ranked 105th out of 180 countries in the 2024 corruption perception index by Transparency International, continuing the negative trend since 2016. Efforts to reduce the size of the informal economy continued, but several factors favour its persistence: high taxes and social security contributions on the lowest salaries, parafiscal (non-tax) charges, red tape and shortcomings in addressing corruption. In addition, there is insufficient capacity in key inspection departments. Further efforts are needed to improve the quality, independence and efficiency of the justice system.

State influence on product markets

The state has significantly intervened in the product markets. The government announced in August 2025 a major new intervention into the domestic trade of many basic goods, taking effect abruptly on 1 September 2025 for the following 6 months, with no meaningful prior consultation with stakeholders. The measure caps margins for the largest retailers, wholesalers and distributors to a maximum of 20% of purchase price for a large number of products, such as most food categories and household cleaning and personal hygiene products, cosmetics, etc. While it is intended to benefit consumers and contain inflation, the measure risks disrupting the business operations of retailers and the whole supply chain and could negatively impact investment and business climate. The legal framework for competition and State aid is broadly in line with the EU *acquis*, but greater alignment is needed with implementing legislation and to make implementation systematic. The Commission for Protection of Competition (CPC) and the Commission for State Aid Control (CSAC) are legally independent bodies. However, the operational independence of the CSAC needs to be demonstrated. State aid rules are not always implemented due to strong political pressure to provide financial assistance to SOEs and large foreign investors, which has a significant impact on competition. State aid is not sufficiently transparent, including in the 2025 budget. In addition, temporary ad hoc trade restrictions continue to be brought in at very short notice and without clear justification, with negative impacts on both local and foreign companies. Public investment management and public procurement procedures still use exemptions from standard procedures, undermining the attainment of a unified and transparent system for investment planning and management and preventing fair competition.

Privatisation and restructuring

The state still plays a major role in the economy, which hampers competition and the development of the private sector. Serbia's SOEs still operate in many structurally important sectors including energy, transport, manufacturing, telecommunications and finance, and employ a large share of Serbia's workforce. Their outsized presence affects resource allocation and impedes overall competitiveness while also posing a major risk for public finances. Steps have been taken to improve SOE governance through the 2021-2027 strategy on state ownership and management of SOEs and the Law on SOE governance, which entered into force in September 2024, and a number of related secondary laws. However, practical improvements have so far been limited. Many SOEs still do not apply proper corporate governance rules and continue to operate inefficiently. They often rely on direct or indirect government subsidies and are subject to strong political influence. The issue of appointing temporary managers for extended periods (against the rules) has yet to be addressed in practice. It is critical to finalise and operationalise the implementing legislation without delay, to ensure its application in practice, and make sure that the institutions responsible for doing so have sufficient administrative capacity.

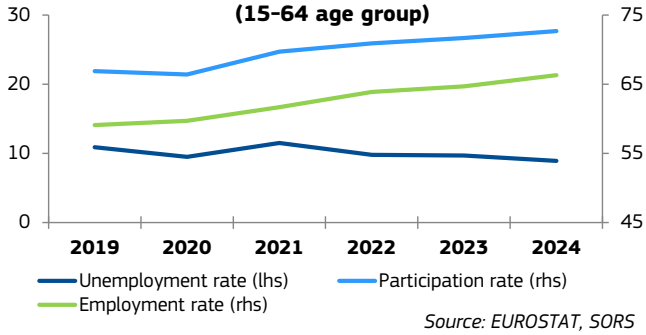
Functioning of the financial market

The banking sector remained stable in the reporting period**.** The sector's capital adequacy was 21.3% at the end of 2024, well above the 8% minimum set by the central bank. Sector-wide liquidity remained high. Profitability increased, with the return on assets increasing to 2.8% in 2024 from 2.5% in 2023. The non-performing loan ratio decreased to 2.9% at the end of 2024 from 3.2% at the end of 2023. Bank lending to the non-financial sector amounted to around 36.5% of GDP in 2024. Bank financing remained the dominant form of lending, with non-banking financial institutions still underdeveloped. The Central Bank has intervened in the consumer and 'first residential property' loan market by issuing supervisory guidance for commercial banks to offer more favourable interest rates and lending conditions specifically for low-income employees and pensioners. While the objective is to improve the accessibility of banking services for all categories of the population, this measure risks distorting the credit market, creates incentives for loan uptake beyond market-driven conditions and raises loan default risks. A legal framework for microfinance institutions is yet to be drawn up. Backed by the capital market development strategy, Serbia is working to further develop the domestic corporate bond capital market. The availability of venture capital in Serbia is very limited, but the adoption of the Draft Law on Amendments and Supplements to the Law on Alternative Investment Funds in 2024 is a step in the right direction.

Functioning of the labour market

The labour market continued to improve. The overall unemployment rate fell to 8.6% in the fourth quarter of 2024. The activity rate of the population aged 15-64 continued to increase in 2024 and reached 72.7%. Net salaries increased by 13.9% in nominal terms, which due to lower inflation in 2024 translated into a 9.2% growth in real terms. Despite the increase in the activity rate of women, their participation in the labour force lags significantly behind that of men (66.9% and 78.6% respectively in 2024). The youth unemployment rate (15-24) was 23% in 2024, down from about 50% a decade ago. Emigration and the brain drain is a long-standing problem which has a negative impact on the growth and skills level of the labour force. Companies' access to skills is an increasing issue in various sectors. Despite notable unemployment, local labour shortage is a common issue for larger investments. Unemployment benefits and subsidised job seeker measures are low compared with the EU average. The budget allocated to active labour market measures has stagnated at around 0.1% of GDP in recent years. Undeclared work, especially in the agricultural sector, is a long-standing issue that has yet to be fully addressed. However, legislation on temporary agency employment and seasonal work has gradually lowered the rate of people working in the informal economy.

Graph 8.4: **Serbia - Labour market trends (15-64 age group)**



Source: EUROSTAT, SORS

8.2. THE CAPACITY TO COPE WITH COMPETITIVE PRESSURE AND MARKET FORCES WITHIN THE EU

Serbia is **between a moderate and a good level of preparation** and has made **some progress** in coping with competitive pressure and market forces in the EU. The manufacturing and service sectors are well-developed, benefiting from close economic integration with the EU. Serbia has made some progress in facilitating the school-to-work transition. Educational outcomes are below the OECD average and public spending on education and research remains below the EU average. There are wide infrastructure gaps, especially in certain sectors, despite higher government investment. Digital transformation is well advanced. SMEs still face obstacles, including an uneven playing field compared with large companies and foreign investors.

The Commission's recommendations from last year have been partially implemented. Over the coming year, Serbia should in particular:

→ improve education outcomes and skills, including by increasing enrolment rates, modernising vocational education and training, and stepping up lifelong learning;

→ further strengthen public investment management, including by putting in place a single, comprehensive and transparent system for prioritising and selecting all public investments, regardless of the type and source of financing and in line with the best international standards;

→ further advance green transition reforms, connectivity and diversify sources of energy imports.

Education and innovation

Despite the ongoing implementation of the 2030 education strategy, the quality of education and training has yet to meet labour market needs. Public spending on education remains below the EU average (3.2% in 2023[34]). According to the Programme for International Student Assessment (PISA) 2022, Serbia's learning outcomes are below the OECD average, but at the top in the Western Balkans. Serbia made progress in facilitating the school-to-work transition, as evidenced by the 11 pps increase in employment rates of recent graduates over the past five years (reaching 73.1% in 2024) and the relatively low rate of young people not in education, employment or training (NEET) (15.2% in 2023 for people aged 15-29 and 15.9% in the fourth quarter of 2024). The modernisation of vocational education and training (VET) is ongoing. The quality of education needs to be improved to meet labour market needs and limited exposure to practical work-place training remains a challenge even for VET students. Participation rates in lifelong learning remained low. To remedy this, the offer could be diversified and better promoted, while reskilling and upskilling should be facilitated. The legal framework for lifelong learning lacks detailed implementation guidance, including standards for programme content, certification requirements and links to the National Qualifications Framework. Investment in research remained low at 0.88% of GDP in 2023 (against the EU average of 2.24%). The share of private-sector investment remained unchanged at 43.7% of total financing. The share of researchers in the labour force has steadily increased over the last 10 years to above the EU average. Implementation of Serbia's smart specialisation strategy, the strategy for development of start-up ecosystem and the law on innovation activity are ongoing.

Physical capital and quality of infrastructure

The level of government investment is high, concentrated in road and rail infrastructure, but infrastructure gaps remain. In 2024, Serbia invested a total of 23.6% of its GDP. The economy also attracted significant FDI inflows of EUR 4.6 billion, or 5.6% of GDP in 2024, largely directed to manufacturing, mining and construction. Government investment was relatively high at over 7.3% of GDP in 2024, concentrated in railways, roads, energy infrastructure and environmental investments. Continuous monitoring of transport investment compliance with European standards is a challenge. Energy infrastructure is largely outdated, and coal remains the main source of energy. However, recent auctions were successful in attracting bidders for new renewable sources. The regulatory and green transition reforms are progressing but at too slow a pace. Serbia remains highly dependent on Russia for gas and oil, although steps have been taken to diversify import sources. Work is progressing on transport connectivity with neighbouring countries. The authorities are committed to extending the 'green lanes' to neighbouring Member States, in line with the Growth Plan for the Western Balkans. Serbia's digital transformation is well under way. Digital connectivity infrastructure is well developed in urban areas but underdeveloped in rural areas where commercial operators do not see any economic interest. However, some progress on rural broadband connectivity has been made in recent years. Digital government services are well developed, already reaching the EU average in many dimensions. Businesses are relatively active in e-commerce, but digital uptake among SMEs remains constrained mainly due to insufficient support mechanisms to translate regulatory improvements into business practice.

[34] Latest available data.

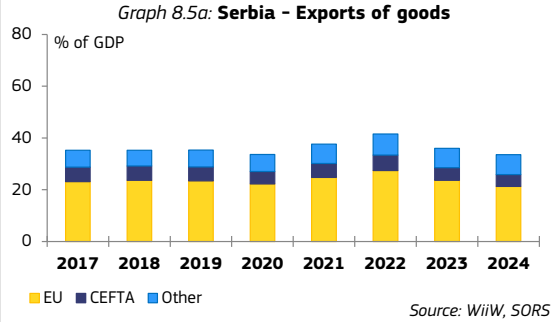
Sectoral and enterprise structure

Services dominate the economy, providing more than two thirds of the value added. Industry continued to be the single largest sector in terms of its share of GDP, at 21.5% in 2024 although on a declining trend for several years. The share of the agricultural sector fell to 3.7% of GDP, while the share of the construction sector in GDP increased to 5.8% in 2024, supported by investments in infrastructure. SMEs provided close to 60% of total employment and turnover in the economy and around 50% of the value added in 2023[35]. SMEs are particularly active in construction, housing and food services, retail and real estate. Serbia is implementing several programmes to support SME development, although the budget allocation remains modest and prone to ad hoc changes and cuts. Loans to SMEs consistently account for some two thirds of total corporate loans, but SMEs' borrowing costs are significantly higher than the costs faced by large companies. Policies to compensate for SMEs' lack of collateral, such as public credit guarantee schemes, are lacking. SMEs often face an uneven playing field as large companies and foreign investors often have direct lines of communication to the government and are much more likely to receive state subsidies.

Economic integration with the EU and price competitiveness

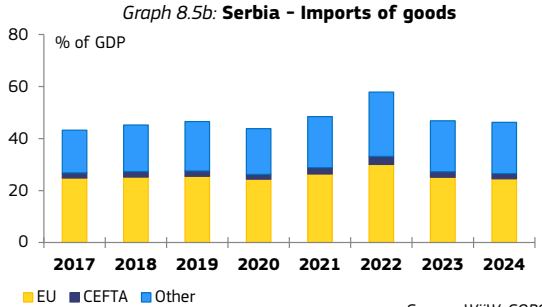
Economic integration with the EU is high. The EU is Serbia's biggest trading and investment partner, accounting for 58.3% of all trade and 37.6% of FDI inflows in 2024. Serbia's other main trading partners in 2024 were China (10%), the Central European Free Trade Agreement (CEFTA) countries (9%) and Türkiye (4.5%). China has become an increasingly important source of both imported goods and FDI inflows, accounting for around a third of the FDI inflow in 2024. There are still significant bottlenecks at border crossing points with neighbouring EU countries, despite continued efforts in various fora to address these.

Graph 8.5a: **Serbia - Exports of goods**



Source: WiiW, SORS

Graph 8.5b: **Serbia - Imports of goods**



Source: WiiW, SORS

The real effective exchange rate (REER) has steadily appreciated in recent years. The dinar–euro nominal exchange rate was broadly stable, as the central bank successfully managed both appreciation (in 2024) and depreciation (in the first quarter of 2025) pressure on the dinar. The Consumer Price Index (CPI)-based REER appreciated by 4.6% cumulatively between 2020 and 2022, edged down slightly by 0.3% in 2023, and then rose again by 0.4% in 2024. This reflects persistent inflation differentials between Serbia and its main trading partners. Similarly, the unit labour cost (ULC)-based REER continued to appreciate in 2024, rising by 13.4% over the year, mostly due to continued strong wage growth in the private sector.

[35] Last available data.

9. TÜRKIYE

9.1. THE EXISTENCE OF A FUNCTIONING MARKET ECONOMY

Türkiye is **well advanced** in creating a functioning market economy and made **some progress** over the reporting period. Faced with the economic fallout of domestic political turmoil, the authorities tightened their policy stance further. Economic growth moderated amid weakening domestic demand, while the external position strengthened. Tight monetary policy was instrumental in bringing down inflation and inflationary expectations, although both remained elevated. The banking sector remained stable. Fiscal consolidation advanced largely due to the winding-down of earthquake reconstruction spending. The labour market was strong in 2024, but still faces major structural challenges, such as large labour underutilisation, a high youth unemployment rate, and a low female participation rate. The authorities took limited steps to improve the business environment, which were mostly related to the functioning of the judiciary and specialised courts. State aid control remained weak, and transparency declined.

The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2024 was partially implemented, but implementation improved markedly in comparison with previous years. To improve the functioning of the market economy, Türkiye should in particular:

→ maintain a tight economic policy stance to support disinflation;

→ reduce the budget deficit as planned;

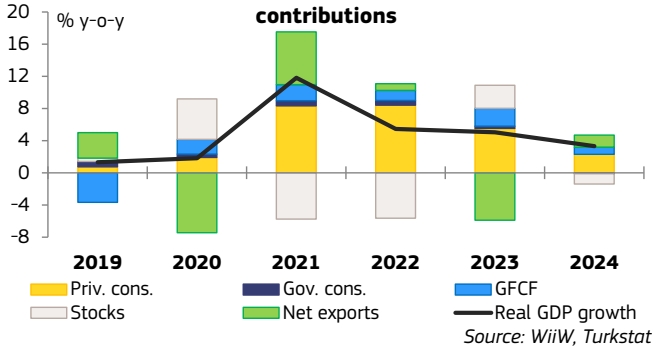
→ further improve the business environment by increasing institutionalised and inclusive stakeholder consultation, reducing state interference in price-setting mechanisms, preventing State aid that distorts competition, and ensuring State aid transparency.

Economic governance

Faced with the economic fallout of domestic political turmoil, the authorities further tightened their policy stance. Domestic political tensions following the arrest of the mayor of Istanbul in March 2025 triggered financial turmoil and large capital outflows. The authorities took action to stem the fall of the lira, restore investor confidence, and preserve financial stability, although market interventions led to a sizeable decrease of official reserves. The central bank interrupted its rate-cutting cycle and raised its key policy rate in April, before resuming monetary easing in July. It also took macroprudential measures to strengthen the monetary transmission mechanism and manage liquidity. In support of disinflation efforts, the 2025 budget sets a much lower deficit target, mostly reflecting the winding down of earthquake reconstruction spending. However, the target was revised upwards in early September, softening consolidation efforts.

The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2024 was only partially implemented, yet the rate of implementation improved markedly from previous years. In line with the recommendations, the authorities maintained an overall tight macroeconomic policy mix and reduced the budget deficit significantly beyond initial plans, while reconfirming their commitment to sound fiscal policy over the medium-term. They also reduced fiscal risks by rapidly winding down the stock of foreign exchange (FX) guaranteed deposits and terminated the opening and renewal of such accounts in

Graph 9.1: **Türkiye - Real GDP growth and contributions**



Source: WiiW, Turkstat

August. Tax exemptions were curtailed only marginally and the government continued to subsidise fossil fuels.

Macroeconomic stability

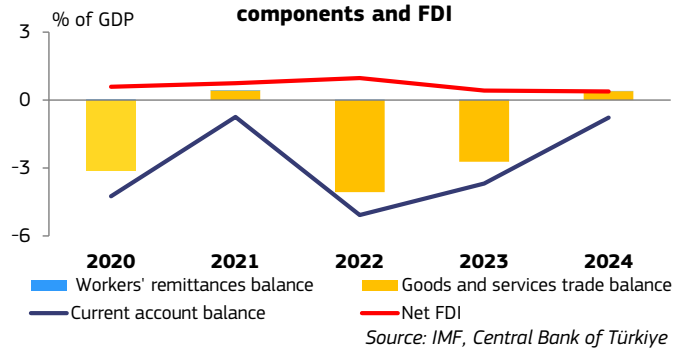
Economic growth moderated amid weakening domestic demand. Real gross domestic product (GDP) increased by 3.3% in 2024, compared with 5.0% in 2023 and the 5-year average of 5.1% (2019-2023). Household consumption and investment growth decelerated strongly, while net exports contributed positively to real GDP growth, largely due to a fall in imports. Economic activity contracted in industry and weakened in services but remained robust in agriculture and construction. Tight economic policies curtailed domestic demand and growth decelerated further to 2.3% year-on-year in the first quarter of 2025. However, domestic demand rebounded somewhat in the second quarter on stronger household consumption, investment and rising stocks, driving economic growth up to 4.8%. Türkiye's per capita GDP in purchasing power standards slightly declined to 71% of the EU average in 2024, down from its peak of 72% in 2023.

Table 9.1: **Türkiye - Key economic figures**	**2016-21** average	**2022**	**2023**	**2024**
GDP per capita (% of EU-27 in PPS)[1)]	62.0	68.0	72.0	71.0
Real GDP growth	4.9	5.4	5.0	3.3
Activity rate of the population aged 15+ (%), total	52.0	53.1	53.3	54.2
female	*33.1*	*35.1*	*35.8*	*36.8*
male	*71.3*	*71.4*	*71.2*	*71.9*
Unemployment rate of the population aged 15+ (%), total	12.0	10.5	9.4	8.7
female	*14.7*	*13.5*	*12.7*	*11.8*
male	*10.7*	*9.0*	*7.7*	*7.1*
Employment of the population aged 15+ (annual growth %)	1.5	6.7	2.9	3.1
Nominal wages (annual growth %)	18.7	73.1	106.3	91.8
Consumer price index (annual growth %)	13.7	72.3	53.9	58.5
Exchange rate against EUR	6.3	17.4	25.7	35.5
Current account balance (% of GDP)	-1.9	-5.1	-3.7	-0.8
Net foreign direct investment, FDI (% of GDP)	0.9	1.0	0.4	0.4
General government balance (% of GDP)	-2.4	-1.1	-5.1	-4.8
General government debt (% of GDP)	32.5	30.2	28.7	24.0

Notes:
1) Eurostat
Sources: Turkstat, Central Bank of Türkiye, Turkish Ministry of Treasury & Finance and Eurostat

Türkiye's external position strengthened, yet vulnerabilities remain. External imbalances declined faster than expected and the current account deficit fell to 0.8% of GDP in 2024 and to 1.3% of GDP in the first half of 2025, down from 3.7% in 2023. Higher capital inflows helped rebuild official FX reserves, which reached record-high levels in early 2025 before falling in early spring amid domestic financial turbulences. However, already by end-July 2025, the central bank reserves had largely recovered. Foreign direct investment (FDI) inflows were subdued at below 1% of GDP in 2024, pointing to Türkiye's untapped potential to attract FDI. The country risk premium declined, the lira strengthened in real terms, and external debt declined to around 38%

Graph 9.2: **Türkiye - Current account selected components and FDI**



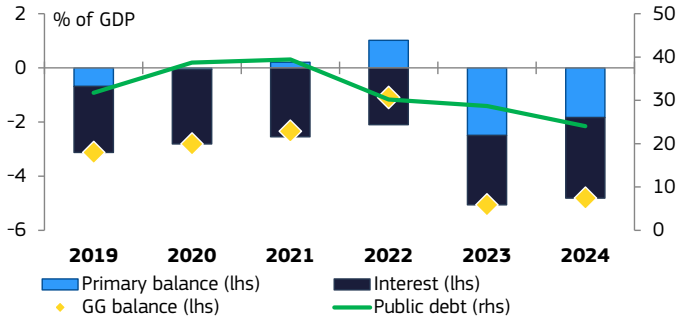
Source: IMF, Central Bank of Türkiye

of GDP in 2024. The improved external position was also instrumental in the upgrades of Türkiye's sovereign credit rating last year. However, the domestic political tensions in the spring weakened the lira, increased the country risk premium, and triggered large capital outflows. Türkiye's 5-year credit default swap spread increased from around 250 basis points in mid-March to 375 basis points in mid-April. However, in September it fell below 250 basis points, a five-year low.

The central bank remained hawkish, fighting both elevated inflation and domestic financial turmoil. The central bank kept its policy rate at 50% for most of 2024. It started its rate-cutting cycle in December (250 basis points), followed by two cuts (250 basis points each) in January and March 2025. The authorities also tightened the caps on the growth of certain credit categories to help curb domestic demand and support disinflation. To stem market turmoil and reduce exchange rate volatility triggered by the arrest of the mayor of Istanbul in March, the central bank increased its overnight lending rate by 200 basis points to 46% and took macroprudential measures to strengthen the monetary transmission mechanism, support the tight monetary stance, and manage lira and FX liquidity. In April, the bank tightened its policy further by increasing its 1-week repo auction rate (the key policy rate) to 46%, its overnight lending rate from 46% to 49%, and the overnight borrowing rate from 41% to 44.5%. The monetary policy stance has remained tight even after the central bank resumed its easing cycle in July, with the key policy rate at 40.5% in September. This stance was instrumental in bringing down inflation and inflation expectations, and in markedly improving the FX position of the central bank. However, annual inflation remained elevated at 33.0% in August. Inflation expectations of market participants (12-month ahead) fell to 22.8%, but expectations of the real sector (37.7%) and households (54.1%) remained very high.

Fiscal consolidation advanced due to the winding-down of earthquake reconstruction spending. The 2024 accrual-based government deficit was 4.8% of GDP, broadly in line with the revised target but markedly below the initial budget plan. While the deficit also decreased in comparison to the previous year, due to lower earthquake-related spending, net of it the underlying budget deficit increased in 2024. The 2025 central government budget targets a sizeable reduction of the budget deficit to 3.1% of GDP, supporting the fight against inflation, again largely driven by lower earthquake reconstruction expenditure. However, this target was revised upwards to 3.6% of GDP with the new medium-term economic programme (2025-2028) adopted in September, leaving the underlying budget deficit broadly unchanged in 2025. In 2024, the government debt ratio declined to 24.0% of GDP, helped by the strong denominator effect from the very high inflation.

Graph 9.3: **Türkiye - Fiscal developments**



Source: Turkish Ministry of Treasury & Finance

The authorities remained committed to lowering inflation, relying mostly on a tight monetary policy stance. A response to the financial turmoil that occurred in the spring of 2025, monetary policy was tightened further. The key policy rate was increased significantly above current and expected inflation, while macroprudential measures additionally tightened financing conditions. However, fiscal consolidation plans were relaxed with the medium-term programme update in September.

Functioning of product markets

Business environment

The authorities took some limited steps to improve the business environment. Insufficient transparency and predictability, along with a large informal economy, remain concerns. In January 2025, Türkiye adopted a judicial reform package, which includes measures to increase the efficiency of the judiciary and strengthen the role of specialised courts. The results of the action plan to improve the

business environment adopted in 2024 were not disclosed in the reporting period. A new action plan for 2025 was adopted in July 2025 consisting of 39 actions, including measures on data protection, improving the functioning of judiciary mainly through alternative dispute settlement, alignment with international standards on public procurement, and actions on green and digital transition, largely mirroring the measures of the 12th Development Plan. Türkiye still lacks a mechanism for systematically consulting business organisations and social partners when preparing new legislation. Even though alternative dispute resolution mechanisms have been promoted, commercial judicial processes are slow, and a large backlog of commercial court cases remains. Market exit remains costly and time -consuming due to complicated insolvency procedures. Nevertheless, due to the deteriorating economic conditions, the number of liquidated companies increased by 12.1% and the number of closed companies went up by 21.4% compared with 2023. The number of newly set up businesses dropped by 10.2% in 2024. Meanwhile, the acquisition and management of companies under the trusteeship of the Savings Deposit Insurance Fund is still conducted in a non-transparent manner. In June 2025, the trusteeship of the Fund was still managing 654 companies based in 42 provinces across Türkiye, with a total asset value of TRY 328 billion (EUR 8.3 billion) and 23 838 employees. Problems in enforcing intellectual property rights persist (*see Chapter 7 – Intellectual property law*). The government continued to implement its action plan to fight against the informal economy (2023-2025), yet the lack of performance indicators hinders the monitoring and transparency of the implementation progress. The informal sector's share in the economy remains structurally high and well above the OECD and EU averages.

State influence on product markets

Price-setting interventions persist, and State aid transparency and control remains weak. The authorities introduced various import tariff quotas (e.g. for corn) and export restrictions (e.g. for eggs and oil). As part of the efforts to support households, residential properties consuming less than 417 kWh per month are receiving a subsidy as of 1 April 2025. Furthermore, the government covers 65% of the cost related to natural gas consumption of these properties. Regulatory authorities continued to carry out extensive price audits to investigate allegations of unfair pricing and stockpiling. The State aid law cannot be enforced due to the lack of implementing legislation and an operational institutional framework. In May 2025, Türkiye adopted a new State aid incentive scheme focusing on strategic sectors, the green transformation, and regional development. Türkiye did not formally establish a comprehensive State aid inventory or implement an action plan to align all State aid schemes with the EU *acquis* (*see Chapter 8 – Competition policy*).

Privatisation and restructuring

The scope of privatisation remains limited. This is partly because Türkiye has already privatised many of its state-owned enterprises. The Turkish Wealth Fund (TWF) has a portfolio of assets consisting of 31 companies from the financial (including state-owned banks, Borsa Istanbul and consolidated public insurance companies), telecommunications, petrochemicals, real estate, mining and iron/steel, agriculture and transport/logistics sectors. At the end of 2024, the TWF completed its first Sukuk issuance and signed an Islamic financing agreement worth USD 150 million with Dubai Islamic Bank, indicating Türkiye's growing participation in Islamic finance markets. The TWF's total assets increased to TRY 9.4 trillion in terms of value in 2023, up from TRY 5.6 trillion in 2022, yet its share in GDP declined from 37.3% to 35.2%.

Functioning of the financial market

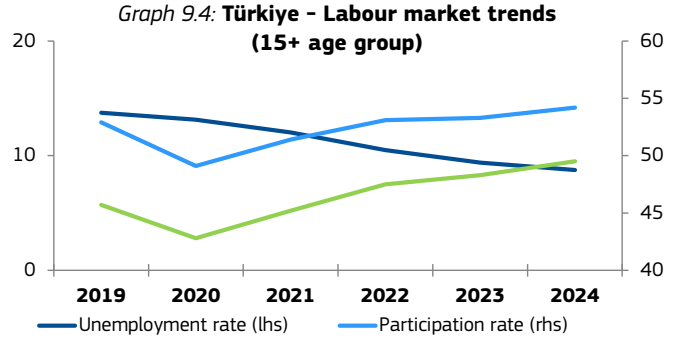
The banking sector remained stable. The pace of decline of bank loans –slowed down, and by April, real lending started growing again. Lending activity was relatively weaker in the corporate and housing loan segments. The authorities took steps to gradually simplify the complex regulatory environment. They terminated the securities maintenance regulation and took further steps to wind down other disruptive macroprudential measures in 2024. However, in July 2025 the central bank introduced a new macroprudential package to support the lira. The share of FX -protected lira deposits declined rapidly from more than a quarter of the total deposit stock at their peak in 2023 to less than 2% in September 2025, removing a key source of financial sector vulnerability, the central bank terminated the opening and renewal of such accounts in August. Commercial banks' capitalisation, still favourably affected by forbearance measures, increased to 19.7% in 2024 (19.1% in 2023). Both profitability and

capitalisation remained lower in state-owned banks. The non-performing loan ratio was 2.2% in July 2025 (1.7% in state banks) – increasing slowly since early 2024. In 2024, the central bank recorded a significant loss for a second year in a row. High inflation and subdued lending activity caused banking system assets to decline from 87% of GDP in 2023 to 73% in 2024. The share of foreign-owned banks in total banking sector assets declined slightly to 24.4%.

Functioning of the labour market

Labour market indicators improved further, but structural challenges remain. Türkiye's labour market remained robust. The participation rate (15+ age group) increased from 53.3% on average in 2023 to 54.2% in 2024, and remained elevated at 54.3% in July 2025. The employment rate also increased from to 48.3% on average in 2023 to 49.5% in 2024, and 49.8% in July 2025. The unemployment rate fell further, reaching 8.3% in July. The gap between the male and female employment rate is still very large (66.9% for men against 32.5% for women in 2024), and the unemployment rate for women stood at 11.8% in 2024. Women's participation in the labour force is still restricted by barriers in certain occupations, traditional gender roles and gender gaps in education, limited quality and affordable childcare facilities (largely inaccessible in the countryside), and insufficient skills. To tackle this restriction, the expansion of affordable care services and adoption of more effective active labour market programmes is pertinent. The composite measure of labour underutilisation increased from 22.8% in 2023 to 26.7% in 2024 (from 30.6% to 35.3% for women), and further to 31.6% (40.1% for women; highest on record) in the second quarter of 2025, as time -related underemployment increased. Young people still have difficulties entering the labour market. The youth unemployment rate (15-24) declined from 17.4% in 2023 to 16.3% in 2024, before increasing again to 17.3% in July 2025. The share of young people not in employment, education or training remained unchanged at 22.1% in the second quarter of 2025. Regional labour market disparities continued to decline, with unemployment rates across different provinces ranging from 4.0% to 18.3% in 2024. With a view to lowering inflationary pressures, the gross minimum wage was raised only once in 2024, and again by 30% (below the inflation rate) at the beginning of 2025.

Graph 9.4: **Türkiye - Labour market trends (15+ age group)**



Source: Turkstat

9.2. THE CAPACITY TO COPE WITH COMPETITIVE PRESSURE AND MARKET FORCES WITHIN THE EU

Türkiye has a **good level of preparation** and made **limited progress** in increasing its capacity to cope with competitive pressure and market forces within the EU.

The economy is diversified, with a well-developed service sector and strong manufacturing and agriculture sectors. Investment activity decelerated slightly in 2024. While efforts to boost human capital and the innovation system continued, skills mismatches and insufficient innovation persist. Economic integration with the EU remained high.

The Commission's recommendations from 2024 were only partially implemented. To improve competitiveness and support long-term growth, Türkiye should in particular:

→ further tailor education and training to labour market needs, improve the quality of and access to vocational education and training, and support the school-to-work transition;

→ continue efforts to diversify energy supplies and further increase the share of renewables in the energy mix, while ensuring stability and reliability of the grid;

→ improve small to medium-sized enterprises' access to long-term finance.

Education and innovation

While efforts to improve human capital continue, skills mismatches remain a significant challenge. Expenditure on education was 4.3% of GDP in 2023, up from 3.9% in 2022. Government spending was 3.6% of GDP in 2023, increasing by 0.5 percentage points from 2022. In the 2023/2024 school year, net enrolment rates increased at the primary level and slightly at the lower secondary level, while declining marginally for preschool and significantly for upper-secondary and higher education (*see Chapter 26 – Education and culture*). Addressing skills mismatches remains a key challenge in making the economy more competitive. In the 2022 Programme for International Student Assessment (PISA) survey carried out by the OECD, students in Türkiye performed below the OECD average in mathematics, reading and science. Türkiye also continues to score poorly in educational attainment in the Global Gender Gap Index calculated by the World Economic Forum, ranking only 127th out of 146 countries in 2024. While the share of students in vocational and technical secondary education increased by 4 percentage points to 30.1% in 2024, further measures are needed to improve the quality of and access to vocational education and training (VET).

Innovation outcomes improved, but are still lagging behind the EU average. After dropping to 1.3% of GDP in 2022, the research and development (R&D) expenditure ratio rose marginally to 1.4% in 2023. However, the gap from the EU average of 2.2% remains significant. The private sector is the primary driver of R&D, accounting for 65.1% of R&D expenditure in 2023, reflecting an increase of 3.7 percentage points from 2022. In March 2025, Türkiye announced its Industry and Technology Strategy for 2030, which aims to increase the share of R&D expenditure to 2.2% of GDP by 2030. In the Global Innovation Index 2024, Türkiye ranked 37th out of 133 countries, a significant improvement over the last decade. However, the performance of the innovation system lags behind that of its European peers, with Türkiye being an emerging innovator, with its performance at 51.7% of the EU average in 2024. In 2024, the total number of granted patents increased by 15.9% in comparison with 2023, and was close to its 5-year average. The number of domestic patents granted in Türkiye increased by 33.7% and the number of international patents increased by 9.8% in 2024 in comparison with 2023.

Physical capital and quality of infrastructure

Investment activity decelerated slightly amid tight financial conditions. Total gross capital formation accounted for 31% of GDP in 2024, down by 0.9 percentage points from 2023. The decline was particularly pronounced for machinery and equipment investment, while the share of construction in total investment increased to 45.2% in 2024, mostly due to reconstruction efforts in the aftermath of the February 2023 earthquakes and urban transformation plans. Türkiye retains its ambition of becoming a regional energy hub, investing heavily in expanding its liquified natural gas import and regasification capacity as well as natural gas storage capacity. The share of renewable energy continued to increase, reaching 60% of the installed power in operation in April 2025 and 45% of energy generation in 2024. Türkiye continues its efforts to accelerate the digitalisation process by extending the scope of e-government services, regulating and monitoring e-commerce markets, and supporting the digitalisation of small to medium-sized enterprises (SMEs). Türkiye ranks 10th out of 35 countries (EU, European Free Trade Association, and enlargement countries) in the latest e-government benchmark report (2022-2023), with an overall score of 83% in e-government maturity, which is above the EU average (76%). Digitalisation efforts in businesses continued, with 96% of companies having internet access in 2024, while the proportion of individuals using the internet for buying or ordering goods or services for private use increased from 49.5 % in 2023 to 51.7% in 2024.

Sectoral and enterprise structure

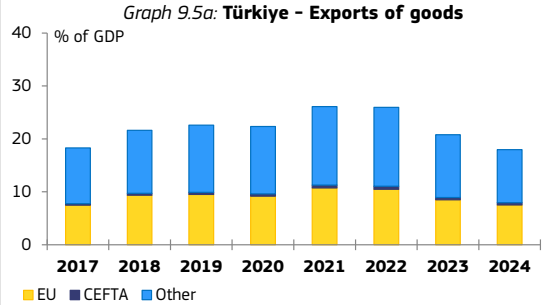
The economy is diversified, with a well-developed service sector and strong manufacturing base. The share of services in GDP increased to 57.5% in 2024, up 3.2 percentage points from 2023. The industry's share declined from 22.8% in 2023 to 19.7% in 2024. Driven mostly by earthquake reconstruction efforts, the construction sector's share in GDP rose from 5.4% in 2023 to 5.8% in 2024, but it remained significantly below its pre-2019 levels. Facing productivity challenges, the agriculture sector's share fell further to 5.8% of GDP in 2024. SMEs are the backbone of the economy, accounting for 70.5% of employment in 2023 and 40.1% of the total value added in 2023, increasing by around 4 percentage points compared with 2022. Approximately 55.6% of SMEs in the manufacturing sector

operated in low technology sectors in 2023. Türkiye continued to implement various economic support schemes that target SMEs, yet access to and the cost of long-term finance remain a problem.

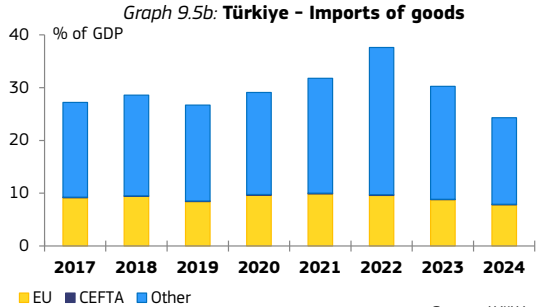
Economic integration with the EU and price competitiveness

Economic integration with the EU is high. Türkiye is the EU's fifth largest trading partner, representing 4.2% of the EU's total trade in goods with non-EU countries in 2024, compared with 4.1% in 2023, while the EU is Türkiye's largest trading partner. The EU's share of Turkish goods exports increased to 41.4% in 2024, up from 40.8% in 2023. The share of Turkish goods imports originating from the EU increased from 29.3% in 2023 to 32.1% in 2024, but it is still below its long-term average. Russia's share in Turkish merchandise exports fell to 3.3% in 2024, down from a historic high of 4.3% in 2023. The nominal value of imports of goods from Russia declined in 2024, largely influenced by lower international energy prices, but Russia's share remained significant at 12.8% of total goods imports.

Graph 9.5a: **Türkiye - Exports of goods**



Graph 9.5b: **Türkiye - Imports of goods**



The EU's share of FDI inflows into Türkiye was 55% in 2024. Trade openness significantly declined to 55% in 2024 mainly due to lower deflators of both exports and imports of goods and services. Türkiye took steps to address some of the trade barriers with the EU, reducing their number from 26 in early 2021 to 14 in early 2025.

10. UKRAINE

10.1. THE EXISTENCE OF A FUNCTIONING MARKET ECONOMY

Ukraine is at **some level of preparation** and has made **good progress** in establishing a functioning market economy. The Ukrainian authorities remain committed to macroeconomic stability and the implementation of reforms. While the pace of recovery has slowed, the economy continues to demonstrate resilience, underpinned by sound policymaking, strong international support, and the adaptability of the private sector. Despite the challenging wartime context, progress has been made on fiscal structural reforms, while efforts to strengthen the tax administration and increase domestic revenues have continued, which have led to a slight reduction in the fiscal deficit in 2024 despite strong expenditure pressures. The roll-back of emergency measures introduced at the beginning of Russia's war of aggression has progressed, with the National Bank of Ukraine gradually easing foreign exchange restrictions and maintaining a managed float for the hryvnia. The business environment has benefited from steps to make it easier to do business, supported by ongoing deregulation efforts. The banking sector has remained resilient, with credit activity showing signs of recovery.

The Commission's recommendations from last year were well implemented. In the coming year Ukraine should, in particular:

→ advance the implementation of the National Revenue Strategy and domestic revenue mobilisation, take steps to improve the sustainability of the pension system, and improve fiscal transparency through the timely publication of general government data; continue pursuing policies supporting macroeconomic and financial stability, including by implementing the Financial Sector Development Strategy roadmap;

→ continue improving the business environment and market competition; accelerate deregulation and reduce administrative burdens, particularly those associated with tax compliance; advance the corporatisation of state-owned enterprises and the appointment of supervisory boards with a majority of independent members, while safeguarding their independence in line with OECD standards;

→ take steps to facilitate the labour market integration of displaced persons and war veterans, while intensifying efforts to reduce informality and promote formal employment.

Economic governance

Despite the significant challenges imposed by Russia's continued war of aggression, Ukraine remains committed to implementing reforms agreed with both the EU and International Monetary Fund, although the pace of implementation has recently slowed. All policy conditions for the first three regular payments under the Ukraine Plan were met, while there are delays in the implementation of a subset of measures linked to the fourth and fifth payments. Reform conditionality under the exceptional macro-financial assistance loan provided through the G7's Extraordinary Revenue Acceleration (ERA) initiative – fully aligned with the Ukraine Plan – was fully met, unlocking EUR 18.1 billion in urgent budget support. The IMF's eighth programme review was successfully completed at the end of June, despite delays in the implementation of reforms relating to customs, the financial sector and governance. Implementation of the National Revenue Strategy advanced with initial steps taken to boost revenue mobilisation and strengthen the State Tax Service, although progress on some areas has been slower than anticipated. Around 75% of the measures scheduled for 2024 have been completed so far. In August 2025, a medium-term reform plan for the State Customs Service was adopted, aiming to accelerate digitalisation, strengthen EU alignment, improve governance and transparency, and reduce corruption risks.

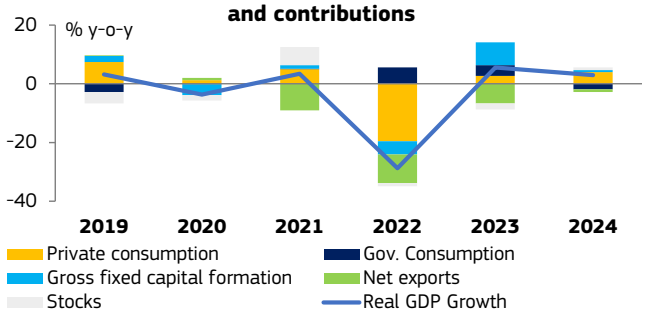
Economic governance has further improved, with progress in key areas. In October 2024, a

law on public consultations was passed, creating a formal framework for stakeholder engagement in policymaking, aimed at improving transparency, accountability, and regulatory quality. Medium-term budget planning has resumed. On 30 June 2025, the Cabinet of Ministers approved the budget declaration for 2026-2028, which showed progress towards alignment with the EU *acquis* on medium-term budgetary frameworks. A new state debt management strategy for 2026–2028 is being prepared, setting debt sustainability targets and measures to deepen the domestic bond market. In April, the government launched a spending review of the 2025 budget, covering 31 policy areas. The National Bank of Ukraine (NBU) has continued the gradual easing of foreign exchange restrictions, while maintaining a managed float for the hryvnia and pursuing its medium-term inflation target of 5%. The NBU has refrained from monetary financing since the beginning of 2023.

Macroeconomic stability

Ukraine's economy has demonstrated significant resilience, but signs of a slowdown have emerged. After robust growth extending into early 2024, momentum weakened noticeably from mid-year. Real GDP growth slowed from 6.8% year-on-year in the first quarter of 2024 to a slight contraction of 0.1% by the fourth quarter. This deceleration reflected a weaker agricultural harvest, alongside persistent labour shortages and ongoing attacks on critical infrastructure, which weighed on economic activity. As a result, real GDP growth fell to 2.9% in 2024, down from 5.5% in 2023, leaving output at 23% below pre-war levels. Economic weakness has persisted into 2025: real GDP grew by 0.9% year-on-year in the first quarter, while goods exports declined by 2.3% year-to-date in July compared to the same period in 2024, driven by poor performance in metallurgy and agriculture.

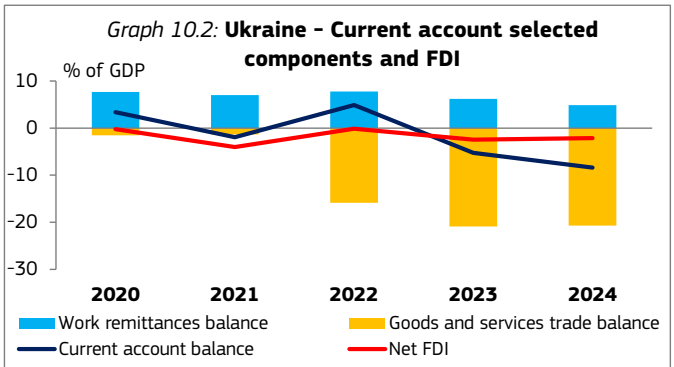
Graph 10.1: **Ukraine - Real GDP growth and contributions**



Source: WiiW, State Statistics State of Ukraine

The current account deficit widened over 2024, rising from 5.3% of GDP in 2023 to 8.4% in 2024. This deterioration was driven by a further weakening of the investment income balance and a decline in international grants, which were increasingly replaced by loans. The former reflected both lower income receipts from abroad and higher income payments to foreign investors – notably in the form of distributed earnings – following a partial relaxation of capital controls. At the same time, elevated import needs, related defence and repair, kept the trade balance firmly in deficit, at approximately -20% of GDP, despite some export recovery supported by the effective use of Black Sea and Danube routes. Strong external financing inflows from international partners continued to underpin reserve accumulation, with gross international reserves reaching USD 46.0 billion in August 2025, equivalent to approximately 5 months of imports.

Graph 10.2: **Ukraine - Current account selected components and FDI**



Source: WiiW, IMF, Central Bank of Ukraine

Inflation accelerated visibly, prompting the NBU to tighten monetary policy. Inflation rose from a low of 3.3% in May 2024 to 14.1% in July 2025, driven by higher electricity and labour costs, rising food prices, and depreciation of the hryvnia. In response, the NBU halted its monetary easing cycle and has raised the key policy rate by a cumulative 2.5 percentage points since end-2024, bringing it to 15.5% in March 2025. Nonetheless, inflation expectations – particularly among households – have increased and remain above the NBU's target. After depreciating from 38 UAH/USD

to 42.1 UAH/USD over 2024, the hryvnia stabilised in early 2025, supported by foreign exchange interventions.

Table 10.1: **Ukraine - Key economic figures**	**2016-20** average	**2021**	**2022**	**2023**	**2024**
GDP per capita (% of EU-27 in PPS)	28.8	34.6	28.2	28.7	28.4
Real GDP growth (% change)	-0.3	3.4	-28.8	5.5	2.9
Activity rate of the population aged 15-70 (%), total[1)]	62.3	61.8	57.7	56.7	
Unemployment rate of the population aged 15-70 (%), total[1)]	9.1	9.9	25.0	20.0	14.0
Employment of the population aged 15-70 (annual growth %)	-0.6	-0.9	-21.5	4.8	
Nominal wages (annual growth %)	22.5	20.9	6.0	17.4	
Consumer price index (annual growth %)	16.4	9.4	20.2	12.9	6.5
Exchange rate against EUR	29.1	32.3	34.0	39.6	43.5
Current account balance (% of GDP)	-0.6	-1.9	4.9	-5.3	-8.4
Net foreign direct investment, FDI (% of GDP)	-2.3	-3.8	-0.1	-2.5	-1.8
General government balance (% of GDP)	-2.4	-3.4	-16.1	-20.1	-17.6
General government debt (% of GDP)	67.2	49.0	77.8	83.3	91.2

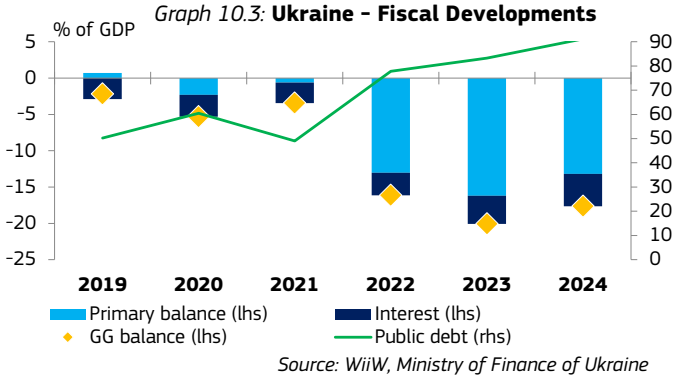
Notes:

1) For the period 2022-2024, data are estimated

Sources: WiiW, State Statistics of Ukraine, National Bank of Ukraine, Ministry of Finance

The fiscal deficit narrowed slightly in 2024 but remains very high, and its financing is heavily reliant on external support. Revenue measures – including higher excise duties, a military tax, and a windfall tax on banks – helped lower the general government deficit to 17.6% of GDP (23.5% excluding international grants) in 2024, down from 20.1% of GDP in 2023 (26.6% excluding international grants). However, expenditures remain elevated as the war continues: military personnel costs reached 18% of GDP in 2024, while defence procurement, including ammunition, represented 9% of GDP. The deficit of the pension fund, estimated at around 4% of GDP, is set to increase in the absence of pension reform. As a result, public debt rose to 91.2% of GDP in 2024, from 83.3% in 2023. Ukraine continues to rely on very concessional external financing and more costly domestic borrowing. The very concessional terms of external financing and, specifically, the financing under the G7's ERA initiative (representing up to EUR 45 billion until 2027), which is expected to be repaid from windfall revenues linked to immobilised Russian Central Bank assets, are essential for ensuring debt sustainability in a forward-looking manner.

Graph 10.3: **Ukraine - Fiscal Developments**



Source: WiiW, Ministry of Finance of Ukraine

Ukraine has made progress in advancing reforms to improve the efficiency and effectiveness of its revenue administration and the tax system, but weaknesses remain. In September 2024, the Ministry of Finance adopted a new methodology for evaluating tax expenditures. Benchmark systems for the four main tax types (corporate income tax, personal income tax, value added tax, and excise tax), which will serve as reference to identify tax expenditures, have been established. A comprehensive inventory of all tax expenditures, detailing all exemptions, deductions and credits, is planned for inclusion in the 2027 budget. The State Tax Service advanced towards a risk-based compliance approach, supported by the adoption of a digital development plan, improved capacity for international information exchange, and the launch of a pilot project for tax risk management. Still, revenue collection continues to be weakened by high levels of informality, complex and burdensome tax compliance processes, tax fraud and a broadly applied and distortive presumptive tax regime. Additionally, the publication of fiscal data at the general government level remains limited, and access to this data is restricted.

The macroeconomic policy mix remains appropriate and has helped sustain macroeconomic stability despite substantial challenges linked to Russia's ongoing war of aggression. Fiscal policy will need to focus on strengthening domestic revenue mobilisation, where the National Revenue Strategy should remain a key anchor, reducing reliance on external financing in the medium-term, and ensuring long-term fiscal sustainability, while prioritising the efficient use of public funds to support recovery and reconstruction. Monetary policy remains adequately calibrated and sufficiently tight to contain inflationary pressures. The key challenge to macroeconomic stability includes a potential intensification of Russia's war of aggression against Ukraine, which could lead to further destruction of productive capacity and trigger additional outward migration and further weaken the current account balance.

Functioning of product markets

Business environment

Despite ongoing reform efforts, Ukraine's business environment remains constrained by structural and wartime challenges. Business surveys show that war-related disruptions, labour shortages and inflation are the top three impediments to business activity. In addition, cumbersome procedures – particularly inefficiencies in tax administration, such as excessive documentation requirements and processing delays – increase compliance costs and place a disproportionate burden on smaller firms. High market concentration and low dynamism of young businesses point to weak market competition. Nonetheless, some progress has been made to improve the business climate, with firms increasingly expressing confidence in the legal system's ability to enforce contracts and protect property rights. In September 2024, Ukraine adopted a comprehensive Action Plan on Deregulation aimed at simplifying permitting procedures, introducing risk-based supervision, and advancing digitalisation through the e-permit system, in line with EU standards. In line with this plan, new laws adopted in September and November 2024 introduced cost-free notifications for most economic activities – so that permits are not required except in high-risk areas – and aligned licensing rules with general administrative procedures. Deregulation efforts, coordinated by an inter-ministerial working group, led to the repeal of 200 approvals and permits in April 2025. Reforms of the insolvency framework were also advanced to streamline procedures and improve restructuring options. At the same time, informality remains a major structural challenge, driven by weak enforcement of legislation, limited institutional capacity, high fiscal burdens, and disruptions linked to the war.

State influence on product markets

The state footprint in the economy remains high. Although the public sector's share of gross value added declined slightly to 21% in 2024, it remains well above the pre-war level of 6%. State-owned enterprises (SOEs), including state-owned banks, continue to play a major role in the economy, employing around 568 000 people (4% of total employment), holding 14% of national business assets, and generating net income equivalent to 15% of GDP. Although some are profitable, SOEs underperform compared to private firms, reflecting operational inefficiencies. Administered prices cover 22.1% of the consumer price index basket, compared to around 9% in the EU. Energy price liberalisation has made little progress. In June 2024, household electricity tariffs were raised from UAH 2.64/kwh to UAH 4.32/kwh, but still cover only half the cost of supply, while small businesses in Kyiv pay UAH 8.96/kwh.

Privatisation and restructuring

Some progress was made in the privatisation and restructuring of SOEs, though there have been some setbacks on corporate governance reform. Privatisation auctions generated an historical high of UAH 19.7 billion (around EUR 492 million) for state and local budgets in 2024, including UAH 6.5 billion (EUR 162 million) from large-scale and over UAH 4 billion (EUR 100 million) from small-scale privatisation. On 29 November 2024, the government adopted a new policy on state ownership, setting out the criteria for keeping SOEs in state ownership, setting out improved corporate governance standards (aligned with OECD principles), and requiring regular performance reviews of state assets. In December 2024, the Cabinet of Ministers approved the triage of SOEs, classifying companies into three categories: those to remain under state ownership, those to be privatised or liquidated, and those for which privatisation is temporarily suspended under martial law. In April 2024,

the authorities adopted an action plan setting out steps to ensure a mandatory structural separation of accounts between public service obligation (PSO) activities and non-PSO activities in the biggest SOEs. These steps aim to streamline the state's portfolio and improve the efficiency, transparency and accountability of SOE management. In May 2025, the authorities amended the statutes of key SOEs in the energy sector, as well as the transport sector, introducing a *de facto* power of veto for state representatives on their supervisory boards on key strategic decisions including the appointment and dismissal of CEOs. This undermines the independence of supervisory boards, which is a key component of recent reforms adopted as part of the Ukraine Plan, in line with OECD corporate governance principles. In addition, the supervisory boards of several SOEs remain incomplete, and procedures for the selection of state representatives do not follow a merit-based competitive process, negatively affecting the SOEs' independence and stable governance.

Functioning of the financial market

The Ukrainian banking sector remains resilient. Liquidity levels are around three times the regulatory minimum, and despite the retroactive increase in the tax rate on bank profits to 50% for 2024, the sector continued to generate sizeable profits, though this largely reflects banks' exposure to sovereign risk. The National Bank has resumed the annual resilience assessment of Ukrainian banks, with a detailed report expected to be published in the first quarter of 2026. The first results were issued on 1 September 2025. As part of the strategy to reduce non-performing loans (NPLs), banks have started applying since January 2025 an updated methodology for calculating NPL ratios, aimed at improving statistical comparability and bringing practices closer to EU standards, although a formal assessment of compliance has not yet been conducted. The NPL ratio fell by 6.6 percentage points over the year but remained high at 30% in March, with stark differences by ownership: 42.9% for state-owned banks, 12.6% for private Ukrainian banks, and 10.9% for foreign-owned banks, which can be partially explained by legacy factors. Provisioning remains robust, with a 95.6% NPL coverage ratio. The share of state-owned banks in total assets declined slightly to 53.5%.

Lending to households and businesses increased markedly in 2024, but overall credit penetration remains low. Lending growth reached 22% for business loans and 38% for household credit, supported by public and international financial institution (IFI)-backed guarantee and support schemes, lower interest rates, and stabilising real estate prices. Still, the loan-to-GDP ratio is just 11%, compared to around 80% in the EU. The NBU has started implementing significant measures under its Lending Development Strategy, including transitional provisions for EU regulatory alignment. Capital markets remain underdeveloped, and the National Securities and Stock Market Commission (NSSMC) remains under-resourced, impacting its capacity to supervise market participants effectively and enforce compliance with international standards. In line with IMF programme requirements, work is ongoing to develop a roadmap to guide the implementation of the updated Financial Sector Development Strategy, setting out concrete reform measures for strengthening financial market infrastructure.

Functioning of the labour market

War-related labour shortages have become a growing structural constraint on the economy. Around 38% of businesses reported difficulties in finding qualified workers, and estimates suggest that labour shortages reached 16% of total labour demand in 2024. The problem is particularly acute for skilled blue-collar professions, especially in the transport and construction sectors. While shortages have contributed to a rise in the labour market participation of women, traditionally underrepresented in Ukraine's workforce, the gender gap in the labour force participation remains notable. On 15 October 2024, the government adopted a medium-term labour market forecast to better align vocational education and training with projected labour needs. In addition, in November 2024, the Cabinet of Ministers approved an action plan to operationalise the Strategy for the Demographic Development of Ukraine until 2040, which seeks to counterbalance workforce shortages linked to external and internal population displacement induced by Russia's war of aggression. Legislative amendments submitted to Parliament in May 2025 introduced tax reporting obligations for digital platform operators, with the aim of improving tax compliance and formalising employment in the platform economy. Work is ongoing on a new Labour Code, designed to align with EU best practices, remove impediments to labour mobility, and raise labour market participation.

10.2. THE CAPACITY TO COPE WITH COMPETITIVE PRESSURE AND MARKET FORCES WITHIN THE EU

Ukraine is **between an early stage of preparation and having some level of preparation** and has made **good progress** to cope with competitive pressures and market forces within the EU. Ukraine has continued to strengthen the foundations for long-term competitiveness. Reform efforts in education have progressed, including the continued implementation of the New Ukrainian School Reform and the entry into force of a new law on preschool education. Additional steps were taken to align the education and training system with the needs of Ukrainians abroad, while reforms undertaken under the Ukraine Plan are set to strengthen 10 vocational education and training. Ukraine approved a new Global Innovation Development Strategy, which seeks to boost innovation through better infrastructure, regulation and access to funding. In parallel, Ukraine restored and expanded its energy generation capacity, advanced its digital connectivity and reformed public investment management.

The Commission's recommendations from last year were well implemented. In the coming year Ukraine should, in particular:

→ continue taking measures to support the repair, rehabilitation and building of infrastructure, in particular related to energy generation capacity, including from decentralised renewable sources;

→ continue implementing the commitments in the Roadmap for Public Investment Management, in particular by adopting sectoral strategies that include the main goals and priorities for investments by sector;

→ continue taking steps to improve the quality of education and training to ensure that outcomes align with the needs of the labour market, including the skills required for reconstruction.

Education and innovation

The authorities continue to take steps to improve the quality of education. Public spending on education as a share of GDP has remained steady and similar to that in the EU. Results from the most recent PISA (Programme for International Student Assessment) study in 2022 showed a decline in performance compared to the previous round in 2018, likely due to the combined effects of the pandemic and the war[36]. Ukraine has continued its ongoing reform efforts, including through a new law on preschool education which entered into force in January 2025 and aims to achieve universal coverage and improve educational outcomes. The implementation of the New Ukrainian School Reform of Curricula and the Pedagogical Approach has continued, with the launch of the pre-pilot project in upper secondary education starting from September 2025. The authorities have also continued to take steps to prepare the education and training system to meet the needs of Ukrainians currently living abroad. These include accelerated curricula, modified distance-learning courses on Ukrainian language and history, recognition of education received abroad, and allowing university applicants to use temporary exam centres abroad to qualify for entrance to Ukrainian bachelor's and master's programmes. In addition, the Ukraine Plan contains a number of measures and investments to improve human capital, in particular through improvements to vocational education. Spending on research and development remains low at 0.37% of GDP in 2024, though Ukraine approved a new Global Innovation Development Strategy to 2030 aimed at boosting innovation by improving infrastructure, reducing regulation, improving access to funding and creating centres of excellence in areas such as defence and healthcare.

[36] The PISA study was conducted in October 2022 in 18 of Ukraine's 27 regions. The results are thus not entirely comparable with those from 2018. Nevertheless, the authorities themselves do make the comparison (in their contribution to the enlargement report) and conclude that 'the educational loss of Ukrainian 15-year-olds in reading can be estimated to be about two years of schooling.'

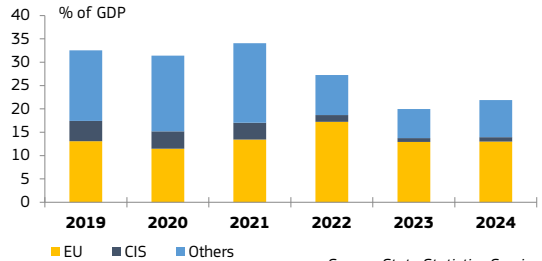
Physical capital and quality of infrastructure

Amidst tight budgetary conditions, Ukraine has continued to address urgent reconstruction needs, in particular for energy generation, where 4 GW of generation capacity was restored and 830 MW built in 2024 (together worth over a quarter of peak winter demand), but also for housing and roads. The Ministry of Economy has commissioned 600 MW of additional distributed generation in 2025. The NBU and 17 commercial banks signed a memorandum to increase financing for energy needs, with the total financed generation capacity above 1 GW since June 2024. In addition, the Ministry for Development of Communities and Territories and the Ministry of Energy have introduced 'energy independence passports' for each region of Ukraine to assess the potential for the development of distributed generation in each region, and to allow for regions to develop detailed actions plans. Procedures for building and reconstructing gas transport and power lines have been simplified. Ukraine has made strong progress in reforming public investment management, creating the strategic investment council and the single project pipeline, using the DREAM digital platform, developing much of the regulatory framework for the new public investment management system and amending the budget code to better embed public investments in the budget cycle, in line with the Ukraine Plan. Ukraine has also made notable progress in maintaining and expanding household internet access with a 1.2% increase in fixed access points overall and a 6.3% increase in rural areas.

Sectoral and enterprise structure

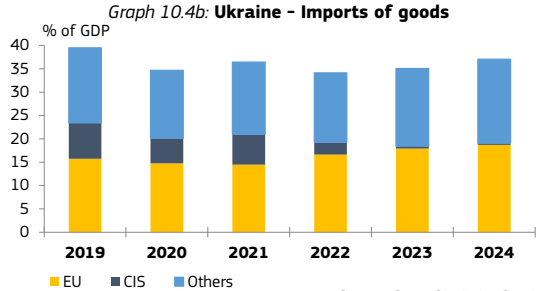
The ongoing war continues to impact the structure of the economy. Agriculture's share of GDP fell from over 12% in 2021 to around 8% in 2024, following a 30% decrease in total agricultural production in 2022, from which Ukraine has only partially recovered. However, Ukraine's exports continue to rely heavily on agricultural products, which account for 63% of all exports, despite major challenges, including supply-chain disruptions, loss of farmland, risks from mines, destruction of machinery, and soil damage. Industry has seen a similar decline to around 17% of GDP in 2024, the share of construction nearly halved, while the relative size of the service sector grew to around 70% of GDP. Industrial production is dominated by energy, basic metals, mining and other lower value-added industries. The information and communication technology sector, where Ukraine had been developing a comparative advantage, maintained its relative share of output at 5.2% of GDP, and digital services made up 12% of total exports.

Graph 10.4a: **Ukraine - Exports of goods**



Source: State Statistics Service

Graph 10.4b: **Ukraine - Imports of goods**



Source: State Statistics Service

Economic integration with the EU and price competitiveness

The overall openness of the economy, as measured by the trade-to-GDP ratio, declined from about 87% in 2022 to 78% in 2024, where it has since stabilised as a result of disruptions related to the war. The EU remains Ukraine's largest trading partner, accounting for over half of Ukraine's exports and imports of goods and services. The EU is also the largest source of foreign direct investment (FDI) in Ukraine, accounting for over three quarters of FDI inflows in 2023 and 2024. However, much of this reflects reinvested earnings, driven by capital controls that restrict the repatriation of dividends. The real effective exchange rate again appreciated slightly in 2024, driven by higher inflation and a slower exchange rate depreciation of the hryvnia as a result of the NBU's managed floating exchange rate policy.

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