Trip Notes

Western Balkans Investor Trip

View of Podgorica

Aktia

Summary

- We visited four countries in the Western Balkans region, Albania, Montenegro, Serbia and North Macedonia .
- The main theme of the trip was EU accession. Each country has been actively working towards joining EU, but progress has stalled due to different reasons.
- Albania and Montenegro are tourist driven economies while Serbia and North Macedonia are industrial economies. As such, countries growth dynamics are different.
- Countries performances economy wise has been and continues to be strong. In general, the macroeconomic fundamentals of these countries are performing better than historic levels.
- Each country is struggling with issues in rule of law and corruption. Discussions were held on how to solve these. Reform momentum in the countries was also a key point due to both EU accession and Western Balkans Growth Plan.

View of Tirana from Pyramid of Tirana

Overview

The primary focus of the trip was EU accession, with each country continuing to strive to join the EU. However, progress had stagnated, partly due to the countries' struggles with implementing reforms and partly due to the EU's conservative stance on expansion. However, the conflict in Ukraine has altered this dynamic, reigniting the EU's appetite for growth, with geopolitical interests now taking precedence.

The path to EU membership is lengthy. Countries must first apply for EU membership. Subsequently, the screening process begins, assessing the alignment of institutions and laws with EU standards. Countries must then undertake reforms to bring their institutions and laws in line with EU standards, organized through clusters and chapters. These clusters cover various topics, such as Fundamentals and Internal Market, with each containing a different number of chapters. There are 35 chapters in total, and each must be approved unanimously by the EU council as satisfactory. However, the process is hindered by the potential for a single country to veto progress, posing challenges, particularly evident in North Macedonia, for instance. Once all chapters are successfully closed, the country can be admitted to the EU.

Discussions have arisen regarding the need to reform the accession process from unanimous to qualified majority, given the ability of a single country to veto membership. This change would likely be necessary for countries like Serbia, Albania, and North Macedonia to join the EU within any reasonable timeframe, if at all. Even with this adjustment, EU membership remains a distant prospect. Gaining membership within the next 10 years seems more realistic than EU’s current 2030 target.

Ukraine, Moldova, and Georgia were granted candidate status due to the war in Ukraine, bypassing the usual slow process for applying for EU accession. In the Western Balkans, this move was perceived as allowing these countries to leapfrog ahead in their EU integration process. To reassure the Western Balkan nations of their importance, the EU signaled a renewed commitment by introducing the Western Balkans Growth Plan (WBGP). This plan is designed to stimulate economic growth, foster convergence with the EU, and enhance regional stability. The WBGP focuses on economic integration, implementing reforms, strengthening regional markets, and increasing financial assistance to familiarize countries with EU-related financing.

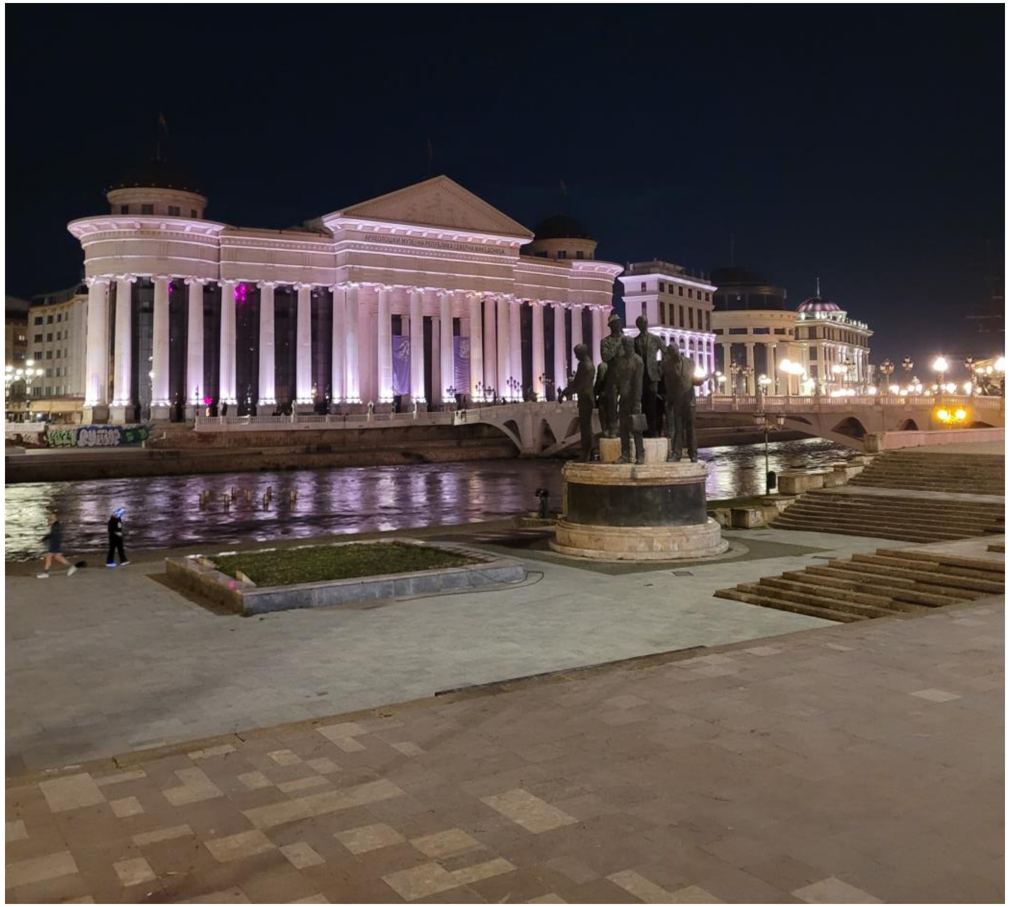
The WBGP comprises a total of 6 billion euros allocated to the region, with 2 billion euros in grants and the remainder in concessional loans. The funding is allocated based on the size of each country's economy. To access the funds, countries must complete specified reforms. Once reforms are successfully implemented, countries can access tranches of their allocated funding. Two tranches are disbursed annually. In cases where a country fails to complete reforms and withdraw funds, the funds may be reallocated to another country based on their progress in implementing reforms. These reforms are aligned with EU accession requirements, providing additional motivation for countries to enact these changes. The WBGP is scheduled to run from 2024 to 2027.

Overview

From an economic standpoint, the four countries can be categorized into two types: industry-driven nations like Serbia and North Macedonia, and service and tourism-oriented countries like Montenegro and Albania. Economic performance across all four nations has been robust, with Albania and Montenegro particularly benefiting from the resurgence of tourism post-COVID due to rising prices in Southern European countries. Conversely, Serbia and North Macedonia rely more heavily on industrial growth in Europe. Despite the slowdown in the EU, most of these countries have experienced record highs in foreign direct investment (FDI) inflows, and these flows are important due to relatively small domestic. Overall, macroeconomic fundamentals are performing above historical levels.

However, all four countries face challenges, albeit to varying degrees. Population decline and a shortage of workforce are prevalent issues, with Albania experiencing the most pronounced effects. There are concerns that the lack of workforce could impede FDI in the long term, as many foreign companies have reported difficulties in finding skilled labor. This has also led to wage growth, reducing the relative attractiveness of these countries. Corruption and rule of law issues are widespread across the region, affecting both the public and private sectors. Discussions in each country often revolve around how to address these issues, with digitalization frequently proposed as a solution. Corruption and rule of law problems not only pose economic challenges but also hinder potential EU accession and impede progress in implementing reforms.

View from Skopje



Albania

The first stop of the trip was in Tirana, the capital of Albania. Albania, in recent years, has experienced many shocks. It began in 2019 with a large earthquake, followed by the Covid crisis, and then by Russia's attack on Ukraine. Despite this, growth has been robust throughout the years, dipping only to -3.3% during 2020, even though tourism is an important part of the economy. Real GDP growth was expected to be around 3.6% by the IMF in 2023. The main driver for growth has been tourism, which reached 2019 levels already in 2022 and then grew by 100% in 2023. This was attributed to the higher cost of travel to countries such as Spain and Italy, leading tourists to seek cheaper alternatives. Tourism growth is expected to moderate to more reasonable levels but still shows signs of strength, with a 30% growth during January and February. The tourism sector contributes around 8% of GDP and is a major source of employment.

Tourism was not the only driver of growth, as the construction sector grew by 18%. This was also noticeable in Tirana, as there were quite a few new hotels being built around the city. This was mainly due to record-high foreign direct investments (around 7% of GDP), mostly originating from Western Europe. Most of the FDI was focused on the real estate and tourism sectors, but some also went into the extraction sector and renewable energy production.

The largest problem Albania is facing is population decline. A 10-year forecast of the Albanian population painted a grim picture, as the population is expected to decline from 2.8 million to 2.4 million. The main driver for this is emigration by young people to Western European countries. It is notable as Albania even imports workforce from Asian countries, but even they tend to use Albania as a stopgap before moving towards EU countries. The problem with youth not wanting to stay in Albania has reached such levels that many young people won't even work as they are waiting for their visas to the EU. To combat these issues, the government has invested in improving education, raised wages in the public sector, and tried to make Albania more attractive for young people. So far, there have not been improvements, as wages are still not on a comparable level to the EU. The government is thinking of introducing rules that would force university graduates to work in Albania for a year after completing their studies.

Partly due to emigration and partly due to strong growth, the unemployment rate has reached historical lows of 10.2%. As employment reaches new highs and young educated people leave the country, there is a large shortage of employees. This has become a significant issue for many companies, leading to increased wages. Foreign companies have noted this as an obstacle for new investments, especially in the industrial sector. Unemployment figures for men and women are split, but this is probably due to most women working in the service sector, where informality is quite high. To address this, the government is investing in digitalization so that more service products, like cleaning services, could be ordered online, which would promote transparency and formality in the sector.

	2024F	**2023F**	**2022**	**2021**	**2020**	**2011 - 2019**
Real GDP (% annual percent change)	3.3%	3.6%	4.8%	8.9%	-3.3%	2.5%
Inflation (% annual percent change)	3.6%	3.8%	7.4%	3.7%	1.1%	1.7%
Overall Fiscal Balance (% of GDP)	-2.8%	-2.5%	-3.7%	-4.6%	-6.7%	-3.1%
Government Debt (% of GDP)	64.2%	62.9%	65.5%	75.2%	75.8%	68.9%
Current Account (% of GDP)	-5.9%	-6.0%	-6.0%	-7.7%	-8.7%	-9.0%

Aktia, IMF and Macrobond

Albania

Due to large-scale emigration, there is a large diaspora of Albanians all over the EU. Many of them send money home in the form of remittances, at the size of 4.4% of GDP. It is expected to grow as more and more Albanians move out of the country. This, along with record high FDI and a tourism boom, have been driving forces for the appreciation of the lek. The lek has appreciated since 2016 from around 136 per euro to around 103 per euro, of which around half of the appreciation came since the start of 2022.

Inflation in the country was an issue in 2022, peaking at 8.3%, but compared to both the EU and the rest of the region, it was under control. Inflation was mainly controlled due to the strong lek appreciation. The central bank believes that the lek will continue to appreciate but more moderately. Exporters in the country feel that this is decreasing their competitiveness, but the central bank will not intervene unless there is significant volatility or if they need to increase their reserves to their target level of 7 months of imports. There are some small risks in the banking sector due to the high euroization of the economy, where all large capital expenditures are made in euros. To mitigate this risk, the central bank does not want high volatility in the exchange rate and has begun taking policy action to decrease euro deposits and loans. However, as long as households can borrow in euros with lek wages, the issue will persist.

The current account balance reached its first positive quarters in 2023, driven by huge service exports (tourism). The trade balance has slightly weakened due to large imports. The central bank sees the medium-term forecast for the current account deficit to be around 4%, which would be sustainable and financed by FDI.

A goal for the government has been to become an energy exporter due to its rich energy resources in renewables and hydrocarbons. There has been a large inflow of FDI into green energy production, supported by IFIs. Albania already produces a lot of hydropower, but during dry seasons, diversifying towards other sources such as solar has been a priority. However, the larger issue right now is the energy grid itself, which needs large-scale upgrades to manage new energy production and support the green transition. Albania also has large oil and gas reserves, and the most recent discoveries in the Shpirag region would further enhance Albania's potential as an energy exporter.

On the fiscal side, there have been improvements as well. The budget deficit has been cut, achieving a 1.4% primary surplus, mainly due to decreased fiscal expenditures related to the removal of Covid and earthquake-related spending. Now, the new focus is on revenue mobilization. Tax reforms are much needed to increase revenues and decrease informality. The easiest way right now is to increase digitalization, especially in the service sector. The government is also targeting to remove tax loopholes. A very welcome improvement to fiscal stability is the introduction of a new fiscal rule. The rule states that from 2024 forward, the primary balance must be positive, and the government must aim for a lower debt-to-GDP level. The debt-to-GDP ratio cannot exceed 60%, which was achieved in 2023, if the macro forecast for the last quarter holds.

EU accession in Albania has only recently started to take its first steps. The screening process was completed in November 2023, and no chapters have been opened yet. However, there have been some reforms already completed, with the most notable one being the judicial and corruption reform. The anticorruption reform focused on building an anticorruption task force.

Albania

with autonomy to investigate politicians and public servants for possible corruption. Simultaneously, judges were investigated to ensure they met certain criteria, from competence to integrity. Due to these investigations, 50% of the appointed judges were dismissed, illustrating the depth of corruption in the country.

Albania is still far from the EU, with a realistic timeline closer to 8 years rather than the 2030 goal aimed by the EU. Albania still has not opened or closed a single chapter, and that will take some time. A significant recent change is the Western Balkans Growth Plan, which will provide Albania around 900 million euros in exchange for reforms, serving as a driving force for reform in the country. Albania also benefits from not having any political conflicts with its neighbors or large internal conflicts, as the population is ethnically homogeneous and secular. Additionally, the Prime Minister holds most of the power, and the opposition is weak, allowing the government to drive reforms if it deems it in its best interest. Corruption, the largest obstacle to EU membership and also one of the biggest problems in the country, must be addressed before any realistic chance of joining the EU. Albania, together with Serbia, performs the weakest in corruption indexes in the region, and corruption is widespread in society, not only in small businesses but also prevalent in the government and among politicians.

Our View: Our Emerging Markets Hard Currency strategy currently holds an ~2 percent overweight in Albanian EUR denominated sovereign debt. Albania is not included in the benchmark of the fund. While the EU accession process has been somewhat slower than expected, we view the progress on the fiscal front and continued implementation of reforms as positive. Risk premiums of Albanian sovereign debt have tightened along with other EM sovereign credits during the last 12 months and currently trades in line with other issuers rated B1 / BB-.

View from Dajti Mountain near Tirana

Montenegro

In the past five months, Montenegro has experienced a transition in its government, with the long-time ruling DPS party losing the election and the Europe Now party assuming power through a coalition consisting of 7 parties. This marked a significant shift in Montenegro's direction, sparking hope for change, particularly in addressing corruption and reform momentum. The current government is prioritizing the rule of law, EU accession, and fostering growth through investments and engagement with the EU. Concerns regarding the government's stability are low compared to the country's history, especially as recent positive developments have reinforced support for the main party. Snap elections are unlikely, as any loss of seats within the coalition would only fortify the main party's position. Moreover, most coalition members share pro-EU sentiments, thus minimizing internal differences. The pro-Russian party has moderated its rhetoric and acknowledged the necessity for positive change. Interestingly, only a small percentage of Russians living in Montenegro voted for Putin. The government aims to promote social cohesion by addressing ethnic divisions, with some improvements already noticeable.

The political shift has also led to positive changes in the eyes of international financial institutions (IFI), as the expectation of government stability and a clear motivation for reforms has increased interest from IFIs in working together with clear strategic goals alongside the government. The government has also explicitly stated its interest in enhancing political and economic ties with the West, intending to raise military expenditure to 2% of GDP to meet NATO criteria. Before our visit, the president had resigned from the prime minister's party due to disagreements, but as of now, no signs of a larger party split have emerged. Montenegro follows a parliamentary system where the prime minister holds power, with the president serving as a more ceremonial figure, thus any split should not pose issues in the short to medium term.

Montenegro is the furthest along on the path to EU membership, having already closed three different chapters, albeit the last one in 2017. There are no clear geopolitical obstacles hindering EU membership, and progress has been made in all chapters. From a reform perspective, achieving progress in EU accession hinges on addressing rule of law issues, and the government has initiated reforms in this regard. These reforms include appointing a Supreme Prosecutor with the autonomy to investigate corruption in both judges and high-ranking officials, with assistance from EU professionals. Additionally, efforts have been made to reform the judicial council and establish a new constitutional court. While corruption remains an issue in Montenegro, the country is performing relatively well compared to other Western Balkan countries, with the exception of Croatia.

	2024F	2023F	2022	2021	2020	2011 - 2019
Real GDP (% annual percent change)	3.7%	4.5%	6.1%	13.0%	-15.3%	2.9%
Inflation (% annual percent change)	3.1%	5.1%	17.2%	4.7%	-0.9%	1.8%
Overall Fiscal Balance (% of GDP)	-5.0%	-1.7%	-4.2%	-1.7%	-10.9%	-5.0%
Government Debt (% of GDP)	67.6%	65.8%	72.1%	85.6%	107.3%	64.4%
Current Account (% of GDP)	-11.3%	-10.7%	-13.2%	-9.2%	-26.1%	-14.3%

Aktia, IMF and Macrobond

Montenegro

To combat corruption, particularly in the tourism sector, the government has introduced QR codes on invoices. If an invoice lacks a QR code, the buyer is not obligated to pay. Additionally, the government has ramped up efforts to tackle money laundering, leveraging data from Europol on crypto transactions and receiving assistance from Italian financial inspectors. Montenegro narrowly avoided being placed on the FATF grey list, thanks to the implementation of new anti-money laundering measures.

On the economic front, Montenegro's government is heavily focused on reform activities. However, due to the country's small economy and population size, coupled with a limited budget, numerous capacity constraints persist, posing long-term challenges. Governance efficiency has also been criticized by many officials we met, citing a lack of accountability in the public sector. Many employees simply receive their jobs, perform minimal tasks, and collect their paychecks. The government aims to address this behavior but has thus far only expanded the public workforce.

The fiscal situation remains uncertain, with the fiscal surplus in 2023 largely attributed to one-time income resulting from terminating a loan agreement with China to build a highway that will connect Montenegro and Serbia and cancelling the loan hedge. The World Bank and IMF predict a deficit increase for 2024, although this deficit could potentially turn into a surplus depending on the outcome of negotiations surrounding the deal to build a new airport in Podgorica. Moreover, a significant portion of concessional financing, such as the Western Balkans Growth Plan and World Bank Development Policy Loan, is contingent upon reforms. Delays in reform progress would necessitate seeking financing from alternative sources. The EU's Western Balkans Growth Plan could potentially allocate 500 million to Montenegro, with 90 reforms tied to the funding, including crucial CEPA reforms.

View from Podgorica

Montenegro

Despite the establishment of fiscal rules in 2014, these rules were breached as early as 2015 and have not been consistently upheld since then. Efforts are underway to reduce the debt-to-GDP ratio below the maximum threshold of 60%. The government has implemented tax cuts to stimulate spending, which surprisingly resulted in increased revenues due to heightened consumption.

The reduction in government debt represents a significant success story. In 2020, government debt surged to 107.3% of GDP due to both the economic downturn, driven by loss of tourism, and an increase in the fiscal deficit. However, with the economy rebounding and fiscal stability being restored, the debt-to-GDP ratio has now dropped to approximately 63%, as reported by officials (IMF 65.8%). The public debt ratios are still vulnerable to economic shocks and lack of fiscal discipline but the outlook is showing positive signs. However, a worry that persists is the major highway project that will connect Montenegro to Serbia. There are still loans left to repay China, as well as a need to finance the last part of the project. Nevertheless, officials assert that the debt is not a major concern due to the favourable terms of the loan. Nevertheless, it remains a substantial burden, with around 65 million in principal payments per year.

Capital expenditure investments are not a major concern from a fiscal point of view, as most major projects, such as airports and ports, are undertaken by foreign investment companies. For example, the airport construction project involves a tender with three foreign companies, with the state receiving a portion of the revenues and onetime payment of 100 million. These aspects are not included in budget forecasts.

Tourism continues to be a vital contributor to Montenegro's revenue, accounting for approximately 40% of its GDP. During the summer season, around 50 thousand seasonal workers come to Montenegro for employment in the tourism sector. However, this reliance on tourism renders the country highly vulnerable to fluctuations in tourism flows, as evidenced during the COVID-19 pandemic, when GDP plummeted by 15.3%. Consequently, Montenegro has been striving to diversify its economy, with particular emphasis on sectors such as energy, tourism, and agriculture. Nonetheless, progress in this endeavor has been limited, despite some investments in renewable energy. One sector experiencing growth is the ICT sector, mostly attributed to an influx of migrants from Ukraine and Russia.

There are concerns regarding the sustainability of the current account, given its structural dependence on imports for consumption and investments. Inflation peaked in November 2022 at 17.5% but has otherwise remained relatively low and well managed. Much of this stability can be attributed to Montenegro's use of the euro as its currency, with no indications of policy shifting away from the euro.

Our View: Our Emerging Markets Hard Currency strategy currently holds an ~2.5 percent overweight in a combination of EUR and USD denominated sovereign debt issued by Montenegro. We view the solid progress on growth and fiscal fronts, together with the lower exposure to geopolitical tensions as positives for the sovereign credit. Risk premiums of Montenegro’s sovereign debt have tightened along with other EM sovereign credits during the last 12 months and currently trades in line with other issuers rated B1 / BB-. Montenegro does however offer a pickup (20-30 bps) compared to Albania and Macedonia.

Serbia

The situation in Serbia presents a complex narrative, with impressive economic progress compared against heightened geopolitical tensions in the region. While the country's macroeconomic indicators are performing at historical highs, geopolitical risks remain a significant concern, particularly regarding Serbia's aspirations to join the EU.

Serbia is navigating a delicate balance, seeking to improve its relationship with the EU, its most crucial economic partner, while also keeping lines of communication open with Russia and China, and ensuring that Kosovo does not gain international recognition. The most pressing issue currently revolves around the status of Kosovo. Interestingly, according to US officials, Serbia has shown more flexibility in recent negotiations, likely driven by its desire to join the EU. Conversely, Kosovo's Prime Minister, Albin Kurti, has taken drastic measures aimed at marginalizing Serbians in Kosovo, such as ceasing payments in Serbian dinars, effectively halting funding to Serbian schools in the region. Serbia remains committed to preventing Kosovo's international recognition as long as there are no guarantees for the rights of Serbs in the region.

The relationship between Serbia and Russia is nuanced, as evidenced by its provision of ammunition to Ukraine. However, as long as the Kosovo issue persists and Serbia maintains its strong ties with Russia, EU membership seems unlikely without changes to voting procedures within the EU. Nevertheless, there were hopes in Serbia, particularly fueled by the Western Balkans Growth Plan, that the country could join the EU free market without voting rights, which would still be considered a success. Officials in Serbia do not seem overly concerned about the prevalence of pro-Russian sentiments and somewhat tepid pro-European views, attributing it mainly to weak use of public relations and media control by President Vučić, as well as disappointment with the lack of progress from the EU.

From a macroeconomic perspective, Serbia is performing well. The government has prioritized economic development and maintaining robust fiscal metrics. Serbia's fiscal deficit remains low, and public debt has decreased to 52.3%. Large cash reserves and record-high central bank reserves further bolster the country's economic stability. Growth prospects are promising, with expected real growth of around 3%. In meetings with officials, there were complaints about rating agencies’ strictness in giving them an investment grade rating.

Serbia is also keen on completing reforms for the Western Balkans Growth Plan, which aims to enhance economic integration in the region and with the EU. Majority of FDI originates from Western Europe, reaching record highs, and exports are increasing as well. The current account deficit has reached its lowest point since early 2000s, supported by growing exports and moderated imports, standing at just 2.3% of GDP.

	2024F	2023F	2022	2021	2020	2011 - 2019
Real GDP (% annual percent change)	3.0%	2.0%	2.3%	7.6%	-0.9%	2.1%
Inflation (% annual percent change)	4.0%	8.2%	15.1%	7.9%	1.3%	3.7%
Overall Fiscal Balance (% of GDP)	-1.8%	-1.8%	-0.1%	-3.3%	-7.2%	-2.6%
Government Debt (% of GDP)	49.6%	51.3%	53.5%	56.3%	56.9%	57.8%
Current Account (% of GDP)	-3.2%	-2.3%	-6.9%	-4.3%	-4.1%	-6.0%

Aktia, IMF and Macrobond

Serbia

Belgrads old train station

The central bank has focused on controlling inflation and decreasing the euroization of the economy. Although inflation peaked in 2022 at 16.2%, it has since moderated, nearing the central bank's target. The unemployment rate, although historically low, is expected to continue to decline, alleviating wage pressures. Unlike Albania, Serbia is not experiencing significant emigration to the EU and has benefited from an influx of Russians and Ukrainians. The central bank has intervened in the foreign exchange market to accumulate reserves and stabilize the dinar, resulting in significant FX reserve growth. Dinar deposits have expanded substantially, indicating a shift towards the national currency in financial transactions. To promote dinar usage, the central bank has enforced lower interest rates on dinar loans compared to euro loans, albeit at some cost to banks.

One significant area of dependence on Russia is gas supply. However, the government has taken steps to diversify gas sources by building interconnectors with Bulgaria and working on one with North Macedonia, crucial for reducing reliance on Russia in hopes of EU accession and stability.

Our View: Our Emerging Markets Hard Currency strategy currently holds an ~2.5 percent overweight in EUR denominated sovereign debt issued by Serbia. The country has a 0.4 percent weight in the strategy benchmark. Strong fiscal and reform progress is, in our view, counterbalanced by a high exposure to geopolitical tensions and, most likely, indefinite EU accession timeline. Risk premiums of Serbian have tightened during the last 12 months, but still offer some value relative to similarly rated peers. Serbian local rates remain quite low, in line with Serbian hard currency bonds, and we have therefore no investments in Serbia in our local currency strategies.

North Macedonia

The upcoming elections in North Macedonia have cast uncertainty over the country's future trajectory. Criticisms of the previous government's performance have been widespread, with the opposition viewed as somewhat opposed to EU membership and inclined towards rising nationalism. Polls indicate that the opposition is likely to win, but the percentage of seats they secure could pose challenges in driving reforms.

North Macedonia, the first country to apply for EU membership from the Western Balkans, has faced obstacles in opening chapters and has so far not opened nor closed a single chapter. Domestically and geopolitically, issues have arisen, particularly concerning relations between Bulgaria and North Macedonia. The dispute revolves around Bulgarians' perception of Macedonians as "confused" regarding their identity, where Macedonians are just Bulgarians with a wrong identity. Bulgaria demands constitutional changes in North Macedonia to recognize and grant full rights to Bulgarians, despite their small population of 3500 people in the country. The opposition party, which previously held power, invested heavily in fostering nationalism to counter this view, evident by the number of statues of famous Macedonians in Skopje.

The opposition, while privately supportive of EU membership, opposes the constitutional changes demanded by Bulgaria, fearing further extortion from Bulgaria in future negotiations (at worst, during each chapter of EU accession). Their proposition suggests making constitutional changes legally binding only upon North Macedonia's EU membership. The opposition does recognize that other issues, such as corruption and the rule of law, remains as more pressing issues for EU accession.

Implementation of the Western Balkans Growth Plan faces challenges, including political will and government passivity due to election year. North Macedonia's agreed share amounts to 850 million. The first reforms should already be completed this year to receive the first tranches of financing. If the new government is slow to negotiate the coalition, reforms might be delayed to next year which would delay money from the Western Balkans Growth Plan. Right now, all government offices are waiting for election results. The elections are held in May, and due to summer holidays, the realistic timeline for the new government to start working is in early autumn. This combined with strong signals of both inefficient decision making and rule of law issues does not paint an optimistic picture that the reforms would be successful this year.

North Macedonia has the most open economy in the Western Balkans, heavily reliant on European Foreign Direct Investments (FDIs) and exports to Western Europe. Particularly, car parts constitute a significant export product. To incentivize investments, the country has established economic free zones where foreign companies enjoy tax exemptions and receive.

	2024F	2023F	2022	2021	2020	2011 - 2019
Real GDP (% annual percent change)	3.2%	2.5%	2.1%	3.9%	-4.7%	2.6%
Inflation (% annual percent change)	2.3%	5.7%	18.7%	4.9%	2.3%	1.3%
Overall Fiscal Balance (% of GDP)	-3.4%	-4.7%	-4.5%	-5.4%	-8.0%	-3.0%
Government Debt (% of GDP)	50.4%	51.6%	52.1%	53.4%	50.8%	36.8%
Current Account (% of GDP)	-3.3%	-3.3%	-6.0%	-3.1%	-2.9%	-1.7%

Aktia, IMF and Macrobond

North Macedonia

subsidies for constructing factories. Consequently, the country's growth is closely tied to that of Europe, raising concerns about future growth prospects, especially amid expectations of a slowdown in Germany's growth. However, FDI has performed admirably, contributing to 3.8% of GDP and projected to stay there in the medium term. The imperative to enhance infrastructure has been recognized, with numerous projects aimed at constructing transit corridors to neighboring countries.

Similarly to Albania, North Macedonia faces a concerning issue of population decline. Foreign companies have lamented the scarcity of workforce, exemplified by a joke one of the officials expressed, suggesting that individuals seeking employment at factories may be detained by security guards until they sign the necessary papers. While humorous, this anecdote underscores the workforce scarcity prevalent in the country.

The fiscal rule in North Macedonia has proven relatively successful, setting limits on public debt at 60% and fiscal deficit at 3%. This rule is overseen by the fiscal council. Although the rule was breached due to COVID-19-related spending, public debt had already decreased below the threshold in 2022.

The monetary policy in North Macedonia underwent tightening measures in response to surging inflation, which peaked close to 19.8%, largely influenced by energy shocks. Starting in April 2022, interest rates increased from 1.25% to 6.3%. However, inflation has since stabilized around 3%, with forecasts indicating it will remain between 3 to 4% in the medium term. In terms of the external sector, there was a significant improvement in the current account last year, resulting in a surplus for the second time in history. This improvement was attributed to enhancements in the trade balance due to decreases in energy prices. Looking ahead, the medium-term forecast for the current account stands at 2.4%. Foreign reserves, amounting to 4.3 months of imports, are considered adequate by the central bank, supported by a repo line with the ECB. Approximately 15% of reserves were sold during the most significant shock to maintain the peg.

Similarly to Albania and Serbia, euroization of the economy is an issue, and the central bank is actively managing it. The spread differential between euro and Macedonian dinar (MKD) deposits has been containing this issue. Despite questions about switching to the euro due to a large share of debt nominated in foreign currency (euro), officials deemed maintaining the peg as the right strategy.

On the financial innovation front, North Macedonia has been proactive. Citizen bonds, successfully initiated last year, are planned for quarterly issuances this year. Additionally, exploration into green bonds in the domestic market is underway, aligning with global trends towards sustainable financing.

Efforts to decrease reliance on gas, with Gazprom as the largest provider, have been actively pursued. Investments in green energy are growing, although the outdated energy grid requires updating to accommodate renewable sources.

Our View: Our Emerging Markets Hard Currency strategy currently holds an ~2.7 percent weight in EUR denominated sovereign debt issued by North Macedonia. The country is not part of the strategy benchmark. Similar to Albania, the EU accession process has been somewhat slower than expected but we view the progress on the fiscal front and continued implementation of reforms as positive. Risk premiums of North Macedonian sovereign debt have tightened along with other EM sovereign credits during the last 12 months and currently trades in line with other issuers rated BB.

Investments always involve financial risks. The customer bears the responsibility for the financial impact of his investment decisions. The investment may fail to yield a profit, or the invested capital may even be lost. The customer may be debited the costs for financial services irrespective of the investment results. It is always advisable to study the investment market and alternative investments in detail before making the decision to invest. Aktia cannot give assurance to the materialisation of the expected yield presented. The information is based on assumptions based on the historic yield from different financial instruments, but it is no guarantee for future development of yield or value. This presentation is part of Aktia's marketing material, and therefore not necessary put together in accordance with the rules for independent investment analysis. Trade restrictions concerning investment analysis is not applied on the financial instruments presented. This presentation is not based on the customer's individual data, and it is not intended to be investment advice. The aim is to present the financial instruments, and their characteristics, included in the quotation. We would be happy to set a date for preparation of an individual investor profile and to give you individual investment advice. The customer may be obliged also to pay taxes and official charges other than those debited by Aktia. The customer should be aware that investments and investment property are subject to taxation, the impact of which was not necessarily taken into consideration in this presentation. Future performance is subject to taxation which depends on the personal situation of each investor, and which may change in the future. The customer is responsible for the gathering of necessary information regarding taxation of his investments and his decisions concerning these.

Aktia