

86th East Jour Fixe: All about COVID-19? Geopolitical, economic and macrofinancial perspectives for the Western Balkans

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The OeNB's most recent East Jour Fixe² on September 28, 2020, was both a time-honored event – the 86th East Jour Fixe organized to discuss CESEE-related topics since 1991 – and a first: the first purely virtual event ever hosted by the OeNB. More than 80 registered participants followed the workshop online and gave the organizers credit for the new format, including the virtual coffee breaks, which enabled participants to have a personal online exchange in small groups with the speakers and panelists.

In his welcome remarks, *OeNB Governor Robert Holzmann* reviewed the COVID-19 situation in the Western Balkans, virus-induced vulnerabilities as well as the potential macro- and microeconomic impact. He voiced expectations that the macroeconomic impact of the coronavirus crisis is likely to be less severe in the Western Balkan region than in other CESEE countries as the latter are more integrated in global value chains. At the same time, countries highly reliant on tourism will be hit most harshly. In addition, he pointed to the expected sharp decline in remittances and its implications for the fiscal and external balances as well as for the private and banking sectors in the region. Governor Holzmann closed his speech with a broad call for action which should focus above all on (1) providing (orchestrated) liquidity support for the region, especially from international financial institutions, (2) adjusting trade policies to facilitate cross-border commercial exchanges and (3) reducing transaction costs of remittances and, last but not least, (4) avoiding brain drain and population shrinkage. Most of these topics were picked up and discussed in greater depth by the subsequent speakers.

Session 1 was devoted to policy options and challenges ahead for the Western Balkan countries and was chaired by *Doris Ritzberger-Grünwald*, *Director of the OeNB's Economic Analysis and Research Department*. In his keynote speech, *Wolfgang Petritsch*, *President of the Austrian Marshall Plan Foundation*, addressed the autocratic, populist tendencies toward illiberal democracy that have been gaining momentum in the region, fueling legitimate concerns among EU enlargement skeptics such as France. Add to this the widespread phenomenon of corruption and clientelism, which has been long ignored or even tacitly accepted by the European Commission. Unfortunately, prospective EU membership has not produced a sustainable drive to embark on reforms; much rather, the status quo has been cemented into a “stabilocracy.” Given changing geopolitical conditions, the EU is no longer the only major stakeholder in the region. Old and new players, particularly China, Russia and Turkey, have been expanding their role and pursuing their own objectives. Russia, for instance, may benefit from a prolonged instability of the region, while China has been increasing its influence in the Western Balkans through infrastructure investments

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² The presentations and the workshop program are available at: <https://www.oenb.at/Termine/2020/2020-09-28-east-jour-fixe-86.html>

while eyeing the EU market. Petritsch also addressed the rather gloomy demographic projections for the region. He concluded by saying that the EU would need to shape a more strategic view vis-à-vis the Western Balkans and double down on its investments while engaging with China as a partner. In the ensuing discussion he elaborated further by calling for a combination of more accountability and greater openness and for a more sincere discussion from both the EU and the Western Balkan countries. He also advocated interim solutions that would allow the EU candidate countries to participate in different projects before entering the EU.

In the following panel discussion, *Marcus How*, *Head of Research and Analysis at ViennEast*, picked up on the enlargement skepticism in the region to which the EU has contributed. Yet, rather than subscribing to the general tendency to victimize EU candidates in the Western Balkans because of the enlargement standstill, How believes that the region's state of limbo about EU accession provides room for competition among other players. This may be beneficial for further development and may in fact be seen positively by foreign investors, who honor above all predictability, whereas the usual narrative pictures the rule of law and functioning democratic institutions as a prerequisite for successful economic development. That is, even if the rules of the game are rigged, investors can cope with the situation if the rules are predictable. As a case in point, FDI in Serbia – 60% of which comes from EU-based firms that like to use Serbia as a gateway to Russia – has been increasing despite eroded checks and balances and a deteriorated rule of law. Moreover, the assets invested by foreign investors contribute to the accumulation of resources which may ultimately serve to support the organic development of institutions. Finally, How expects the current COVID-19-crisis to boost existing trends rather than creating new ones. At the same time, as socioeconomic indicators deteriorate as a result of the crisis, opposition toward ruling elites may emerge very fast.

Adding to these views, *Othon Anastasakis*, *Director of South East European Studies at Oxford (SEESOX)*, argued that the geopolitical agenda in the region has been growing in the sense that themes go beyond the strictly ethno-national, post-Yugoslav post-conflict issues and include other important global issues such as the environment, migration, religious radicalization, energy, cybersecurity, misinformation or organized crime. This makes the region more vulnerable globally. Anastasakis stressed that despite the predominance of the transatlantic impact, the latter is not always uniform. There are some disagreements among EU countries and more so between the EU and the United States as far as the region's progress is concerned. Regarding external geopolitical actors that have become increasingly visible and seek to de-westernize the region, Anastasakis pointed out that these players have their own agendas which are not necessarily compatible with each other and that their influence is usually opportunistic and short-term. According to Anastasakis we observe an instrumentalization of these geopolitical influences with local rulers who play external actors off against each other. He cautioned against overestimating the influence exerted by non-European actors: they tend to get more prominence than they deserve. To conclude, Anastasakis urged participants to see the biggest threat arising from internal vulnerabilities of the Western Balkan countries in terms of their problematic rule of law, institutional weaknesses, illiberal elites and democratic backsliding.

The second session was designed to shed light on the threats to macrofinancial stability due to the COVID-19 crisis with two kick-off presentations. It was chaired by *Helene Schuberth, Head of the OeNB's Foreign Research Division*.

Regarding key macrofinancial stability issues that are likely to be affected by the COVID-19 crisis, *Antje Hildebrandt, Senior Economist in the OeNB's Foreign Research Division*, singled out financial deepening and the de-euroization process. Financial deepening may be slowed down by lower credit growth, and de-euroization may be decelerated by the economic fallout from the pandemic, because a high degree of uncertainty or a severe economic crisis are after all major drivers of euroization. Additionally, but more in the short run, a high degree of euroization makes economies with a flexible exchange rate more vulnerable in case of sizable currency depreciation. Regarding the impact of the crisis on nonperforming loans, Hildebrandt pointed out that this impact will depend on measures implemented (e.g. loan moratoria) to support households as well as on the economic recovery path.

Regarding the financial vulnerability of households in the Western Balkans due to the COVID-19 crisis, *Aleksandra Riedl, Senior Economist in the OeNB's Foreign Research Division*, shared research data collected with the OeNB Euro Survey. Specifically, she presented debt service-to-income (DSTI) ratios estimated for individuals covered by the survey and found the median DSTI ratio to be relatively high in the Western Balkan region. While households' wealth position is rarely known, the income situation points to little room for maneuver. In a second step, Riedl assessed the impact of job losses due to the COVID-19 slump on DSTI ratios and found that a significant share of households in Bosnia and Herzegovina as well as in Serbia may end up having trouble repaying their loans. Offsetting factors include, to some extent, unemployment benefits as well as the fact that the countries facing the highest impact from job losses are not the ones with the highest share of vulnerable households in the region.

These two kick-off presentations were followed by a discussion among three high-ranking panelists. First, *Stephanie Eble, the IMF Regional Resident Representative for the Western Balkans*, gave an overview of economic developments and challenges of the Western Balkan region. Accordingly, all countries have been heavily hit by the crisis, particularly Montenegro, Albania and Kosovo. These countries are strongly dependent on tourism, which almost came to a standstill following the lockdown in March. Overall, she sees risks to economic growth on the downside, and projections surrounded by a high degree of uncertainty. Inflation in the Western Balkan countries has remained rather subdued, and financial packages to support the economy have been smaller than in advanced countries with the notable exception of Serbia. Furthermore, foreign currency reserves have remained stable and deposits have increased due to precautionary savings. Informal remittances have declined in the course of the crisis, but there was some mitigation due to higher formal transfer payments. Eble pointed out that the Western Balkan countries are in a better situation regarding cross-border exposure than during the global financial crisis. Furthermore, not only foreign-owned banks but also domestic banks are exposed due to lower capital inflows (tourism remittances).

Second, *Sokol Havolli, Deputy Governor of the Central Bank of the Republic of Kosovo*, gave a broad picture on how the pandemic has affected the Kosovar economy. Travel restrictions by European countries are one of the major drags on the country, as travel exports, which are an important source of income, have declined significantly.

Havolli emphasized that quick and creative measures, such as loan moratoria, the lifting of regulatory requirements and other unorthodox regulatory measures, were implemented to overcome economic difficulties and to preserve liquidity in the economy. Other measures such as a government support package were put in place as well. According to Havolli, the future is surrounded by many uncertainties, given the uncertainty about the evolution of the pandemic. A worsening of the current situation would certainly imply a further deterioration of economic conditions, and additional measures would be needed. In his view, such measures can only be in place for a limited period without compromising the main objective of the Central Bank of Kosovo, which is safeguarding financial stability.

Finally, Ana Mitreska, *Vice Governor of the National Bank of the Republic of North Macedonia*, pointed toward stronger fundamentals and smaller vulnerabilities in the current COVID-19 crisis compared to the global financial crisis of 2008. This is reflected in a more resilient banking sector, stronger external positions and a higher level of foreign reserves. According to Mitreska, the economy has been affected via several channels: private consumption and investment have been negatively affected by lower confidence and more pessimistic expectations, exports by lower foreign demand. However, the opening of the economy was immediately followed by a rebound. Mitreska also referred to monetary policy and regulatory changes adopted by the National Bank of the Republic of North Macedonia, including interest rate cuts, the provision of additional liquidity and regulatory flexibility to support corporates and households. Mitreska emphasized the unusually high degree of uncertainty which requires close monitoring of all economic developments.

Issues touched upon in the ensuing general *discussion* included the impact on the de-euroization process. Overall, the pandemic has been observed to have changed the structure of the portfolio toward more liquid forms of assets and toward more savings in foreign currency in highly euroized countries. Another question touched upon global value chains, particularly in the automotive sector, in North Macedonia. Ana Mitreska explained that global value chains have been interrupted severely by the crisis. During the complete lockdown, exports of the automotive sector declined by around 60%. By the end of September, capacity utilization had reached about 70%. In her *concluding remarks*, Helene Schubert summarized the main points: There are potential risks for macrofinancial stability in the Western Balkan countries – and not only there but also in more advanced countries – due to the COVID-19 crisis. She emphasized the importance of detecting risks as early as possible and of reacting in an appropriate way. She concluded by saying that macroprudential measures and other supportive action can help to mitigate negative effects of the crisis on the real economy.