Croatia

Highlights

- **Economic growth in 2024 remains robust, outperforming regional peers.** Real gross domestic product (GDP) growth expanded by 3.6 per cent year on year in the first half of 2024, driven by rebounding private consumption and strong investments.
- **Improving economic fundamentals and progress in integration are supporting credit rating upgrades.** Since late 2023, Croatia has a positive outlook from all three main rating agencies, with Fitch the first to upgrade the rating to A-, further driving down financing costs as Croatia continues to deepen its integration in the eurozone.
- **Croatia is a frontrunner in implementing the Recovery and Resilience Plan (RRP).** The authorities submitted the fifth payment request in April 2024, which led to a swift disbursement by the European Commission in July 2024. Croatia has already received €4.5 billion out of the planned €10.5 billion.

Key priorities for 2025

- **Improvements in the state-owned enterprise (SOE) sector could bring productivity gains.** SOE performance remains weak despite recent progress and commitments related to RRP implementation and Organisation for Economic Co-operation and Development accession. A new single law on SOEs to strengthen corporate governance is expected to be adopted by the end of 2024, and implementation will be key to boosting productivity.
- **Labour market tightness requires additional reforms to improve labour supply.** While recent reforms aim to address skills mismatches via improved vocational education, the private sector increasingly relies on foreign workers.
- **The government needs to address barriers to renewables.** Despite strong investor interest, the failure to approve a grid connection fee and the often lengthy procedures needed to enable investments continue to hamper the pace of installing renewables.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-8.3	12.6	7.3	3.3	3.6
Inflation (average)	0.0	2.7	10.7	8.4	3.5
Government balance/GDP	-7.2	-2.5	0.1	-0.7	-2.1
Current account balance/GDP	-1.0	1.0	-2.8	1.1	0.4
Net FDI/GDP [neg. sign = inflows]	-1.4	-5.1	-5.3	-1.9	-1.8
External debt/GDP	81.1	80.2	72.9	83.7	na
Gross reserves/GDP	37.2	42.5	44.8	na	na
Credit to private sector/GDP	57.8	51.1	49.1	47.4	na

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Macroeconomic developments and policy response

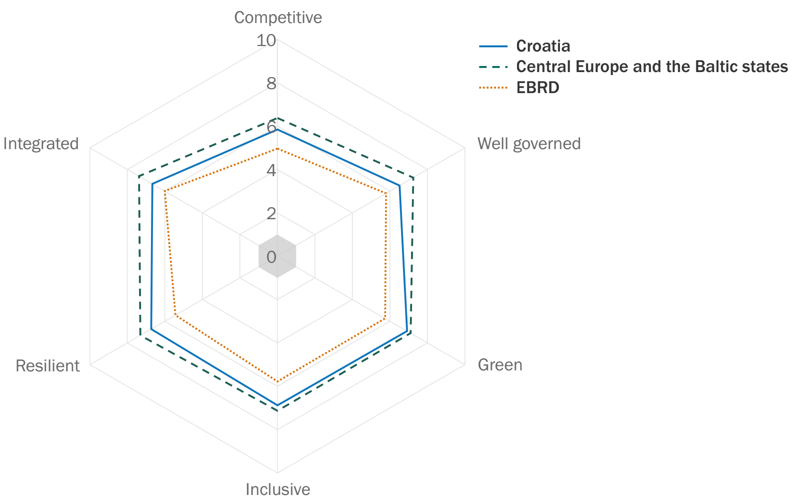
Economic growth remains robust, outperforming regional peers. While real GDP growth slowed to 3.3 per cent in 2023, the economy was still among the best performers in the European Union (EU). Strong domestic demand contributed to 3.6 per cent growth year on year in the first half of 2024. Private consumption accelerated to 5.8 per cent growth year on year in this period, and investment rose by 12.0 per cent over the same period, reflecting the accelerated pace of post-earthquake reconstruction and the implementation of EU funds. External trade remained weak, however; goods exports expanded by 3.0 per cent year on year, albeit coming from a drop in 2023, but service exports were 6.2 per cent lower in the first half of 2024, leading to an increase in the trade deficit. The country is enjoying another excellent tourism season in 2024, with arrivals up 8 per cent year on year in the first half and revenues boosted by price increases.

Despite strong real wage growth, inflation is close to target. After peaking in November 2022 at 13.5 per cent, inflation steadily declined and reached 2.2 per cent by July 2024. Real wage growth averaged 12.0 per cent in the first half of 2024, almost double the average recorded in 2023, posing upside risks to inflation via stronger consumption. The latter was mainly driven by the 20 per cent boost in the minimum wage, alongside higher public-sector wages. Housing prices increased by 12 per cent in 2023, the highest growth rate in the EU, posing challenges to housing affordability.

Increased spending and tax cuts require offsetting fiscal measures. The public budget recorded a deficit of just 0.7 per cent of GDP in 2023, much lower than the EU average. The deficit target was revised to 2.6 per cent of GDP in mid-2024, driven by further decreases of the tax base, the adoption of public pay reform and higher social spending. Proposed offsetting measures include a new property tax and potential spending adjustments, particularly the phasing-out of cost of living crisis support measures. The budget deficit is expected to stay within the limit of 3 per cent of GDP in the medium term, although the level of public debt relative to GDP will decline at a slower pace than in the past three years.

Growth will remain robust in the short term. Considering the positive dynamics in the first half of the year, real GDP is forecast to grow by 3.6 per cent in 2024, with risks tilted to the upside as robust domestic demand will likely offset the weaker demand of key trading partners. In 2025, accelerated implementation of absorbed EU funds will support overall investment and thus growth, while further income and labour tax easing will continue to support consumption. We therefore forecast real GDP growth at 3 per cent in 2025.

Assessment of transition qualities (1-10)



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Structural reform developments

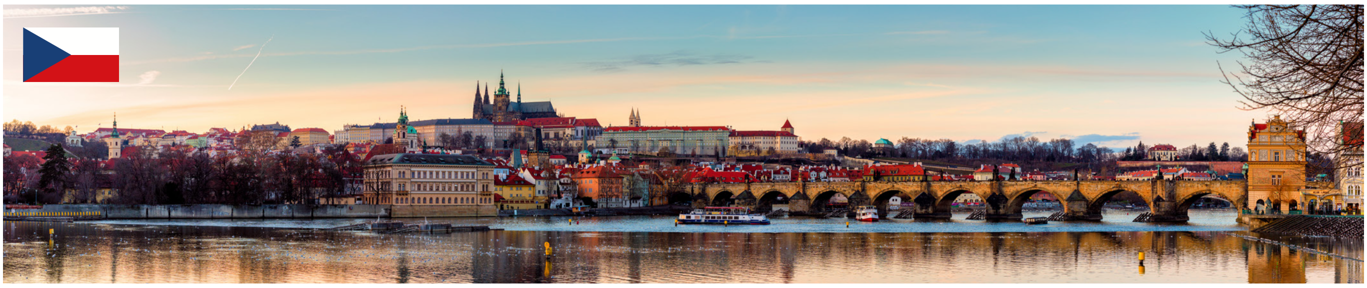
Croatia is among the EU frontrunners in its implementation of the Recovery and Resilience Plan. As of May 2024, 28 per cent of deliverables under the RRP had been implemented, with another 28 per cent in progress. According to the authorities, €5.6 billion has been disbursed or is being absorbed through various tenders, calls, direct awards and financial instruments, with an additional €2.4 billion in preparation. Most of the investments in the Croatian RRP are concentrated in the later stages, and making sure there is sufficient capacity to deliver them on time will be a challenge. Croatia has an allocation of close to 25 per cent of GDP from the RRP and the new cohesion policy budget.

The authorities are continuing fiscal reforms to ease the burden on the private sector. A process that began in 2016 has continued in 2024, with further increased deduction thresholds and income tax rates being replaced with new two-bracket rates set by local authorities within prescribed ranges. In addition, the city surtax on income has been abolished. Future potential changes announced by the authorities include tax relief for Croatians returning from abroad and the introduction of a value-based property tax, which was long recommended by international partners. Rental taxes were raised from 10 per cent to 12 per cent in 2024.

Public pay reform was adopted, resulting in a sizeable fiscal cost. One of the key reforms in the RRP is the reform of the salary-setting mechanism in the public sector, which entered into force in April 2024. After a period of preparation and negotiation with unions and stakeholders, which included strikes, the government adopted a law increasing public-sector wages by an average of 13.5 per cent, with some segments of the workforce receiving much higher raises. The entire reform cost around 2 per cent of GDP. The reform simplified the salary-setting formula, replacing it with 16 pay grades and increasing performance bonuses. The government also increased the base pay for state officials by 83 per cent in July 2024, as it had been unchanged since 2016.

Changes to the labour law target the recent surge in temporary employment. Croatia's labour market has tightened significantly in recent years, largely on the back of increased temporary employment. This followed deregulation efforts aimed at making the labour market more flexible and imposing measures against informal employment. Following pressure from trade unions, the government updated the legislation to limit the circumstances for offering fixed-term employment, with higher penalties for breaches of the new rules. Aside from certain cases, fixed-term contracts will not be able to exceed three years.

Renewable-energy installations are accelerating, but administrative issues remain. Croatia has historically underperformed in installing solar capacity, with the share of solar in electricity production one of the lowest in the EU. Recent reforms are starting to bear fruit, including the use of market support mechanisms, streamlining procedures, regulating energy communities and the introduction of auctions in 2020. In 2023, installed solar capacity more than doubled, while in July 2024, the Croatian energy market operator awarded premiums for 420 MW of solar and hydropower projects. Around 800 MW of mostly small-scale solar capacity has been installed so far in 2024, according to the authorities. Still, relevant associations point to the lengthy administrative procedures that delay construction, with the main issue being the grid connection fee, which is yet to be set despite an original deadline of December 2022. Another issue concerns the powers granted to the transmission system operator to disconnect capacity, which is undermining investor interest in large-scale projects.



Czechia

Highlights

- **A modest economic recovery is under way.** Real gross domestic product (GDP) growth was just 0.4 per cent year on year in the first half of 2024, with ongoing normalisation of the inventory cycle, weak fixed capital investments and a decline in value added in the manufacturing sector holding back the economy.
- **Major floods brought significant damage and fiscal costs.** Czechia was one of the European countries most affected by heavy rainfall in September 2024. That forced the authorities to revise upwards the deficit target by around 0.4 per cent of GDP in the 2024 budget, while the European Union (EU) offered emergency grants.
- **Pension reform is advancing.** Following a politically intensive process and negotiations, a new pension reform plan advanced in August 2024, adopting a more moderate approach to raising the retirement age. This is expected to result in savings of about 0.4 per cent of GDP, lower than initially projected.

Key priorities for 2025

- **Efforts to reduce energy intensity need to accelerate.** The country needs to make full use of EU-funded and private investment to prepare its industry for the long-term challenges associated with the green transition.
- **Unlocking the permit system is important to boost construction.** Given the issues related to the new permit system, a swift update is needed to ease the strain on the housing market and enable planned investment projects.
- **Future-proofing the manufacturing sector is important for long-term competitiveness.** Amid the potential structural changes in the EU economy, Czech industry needs to accelerate innovation in decarbonisation, automation and digitalisation to ensure global competitiveness as well as diversify export markets.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-5.3	4.0	2.8	-0.1	1.1
Inflation (average)	3.3	3.3	14.8	12.0	2.5
Government balance/GDP	-5.8	-5.1	-3.2	-3.7	-2.4
Current account balance/GDP	1.8	-2.1	-4.7	0.3	1.9
Net FDI/GDP [neg. sign = inflows]	-2.5	-0.5	-1.2	-0.2	0.2
External debt/GDP	74.7	75.1	67.4	59.9	na
Gross reserves/GDP	61.0	60.4	44.9	43.6	na
Credit to private sector/GDP	51.9	53.1	49.0	46.0	na

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Macroeconomic developments and policy response

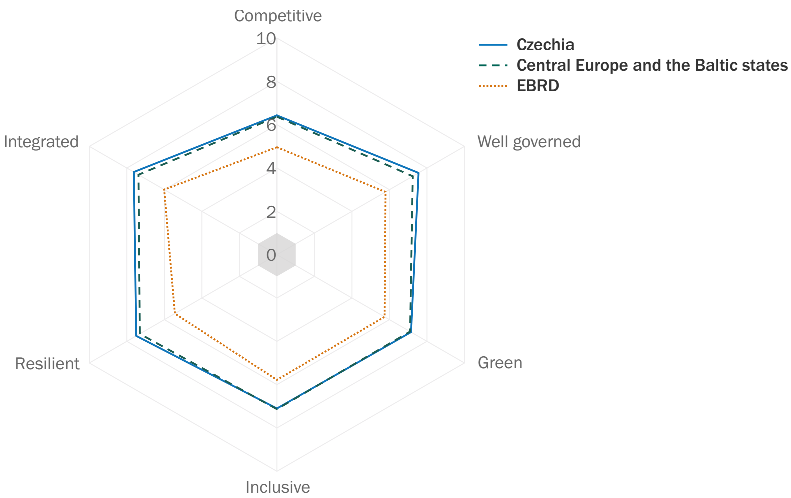
The economy is undergoing a modest recovery. In the first half of 2024, real GDP grew by 0.4 per cent year on year on the back of slowly recovering private consumption. In terms of sectors, growth was supported mainly by trade and financial services, but held back by manufacturing, construction and professional services. Weak foreign demand led to annual declines in industrial output in all months except one by July 2024. Still, in a sign of resilience, passenger car production reached a record level in the first half of 2024, largely on the back of strong growth by the third-largest manufacturer. On the expenditure side, protracted destocking held back GDP growth, and investment declined in the first half of the year in annual terms, as the construction sector has contracted annually since late 2022.

Households remain cautious despite rapid wage growth, ongoing disinflation and a tight labour market. Wages have recovered strongly in 2024, growing by 5.0 per cent in the first quarter and 3.9 per cent in the second quarter, year on year, albeit lower than in most regional peers and almost 10 per cent below the 2021 peak. In addition, the unemployment rate remains very low at 2.6 per cent. Inflation was just 2.2 per cent as of August 2024 and has been within the central bank's target range since the beginning of 2024. Consequently, the gross household saving rate has remained relatively high at around 19 per cent since mid-2022 (versus 11 per cent on average pre-Covid), although decreasing slightly in early 2024. The central bank's policy rate was cut to 4.25 per cent in 2024, but the resulting positive real interest rate gives a further incentive for households to save rather than spend.

Conservative fiscal policy is helping to lower the deficit in 2024. After recording a fiscal deficit of 3.8 per cent of GDP in 2023, the authorities have committed to a consolidation plan in 2024 and 2025, targeting a deficit of 2.5 per cent of GDP this year. This plan includes, on the expenditure side, a reduction in subsidies and savings on public administration. Revenues will grow through a rise in the corporate and personal income tax rates from 2025, an increase in levies for the self-employed, changes in the taxation of value-added tax, a re-introduction of sickness insurance for employees and a hike in property taxes. As a result, by August 2024 the budget deficit was 10 per cent lower than in 2023 in nominal terms. However, the floods in September 2024 forced the authorities to increase the target deficit to 2.8 per cent of GDP in 2024 and 2.3 per cent in 2025, up by 0.2 per cent of GDP. Still, EU grants will likely cover most of the estimated damages.

Growth prospects remain relatively weak. Considering the growth drivers at play in 2024 and the potential changes in 2025, there is limited space to benefit from stronger growth sources for the economy, especially for the rest of 2024. As a result, we forecast real GDP growth of 1.1 per cent in 2024, in line with the government's expectations. The main growth enabler, assuming persistent low inflation, would be further easing of monetary conditions, which could spur investment and household consumption in 2025. The latter should also eventually benefit from more robust real wage growth. There is uncertainty regarding export growth, as it is unclear whether the German economy, a key export destination for Czech companies, will rebound. We thus expect a domestically driven real GDP growth rate of 2.4 per cent in 2025.

Assessment of transition qualities (1-10)



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Structural reform developments

The production of energy from photovoltaic plants has increased. Czechia's solar power generation has continued to grow in 2024, albeit more slowly than the best-performing countries in the region. Solar sources accounted for more than 10 per cent of total electricity production in June 2024, compared with a share of around 5 per cent two years ago, representing a 69 per cent increase in absolute generated power over this period. This follows legislative changes introduced in 2023 that simplified the granting of permits for small-scale installations and accelerated permitting procedures for projects with more than 1 MW of capacity. In addition, energy communities were introduced in July 2024, allowing electricity sharing across the grid.

Energy security remains a priority, with a nuclear expansion project moving ahead. On top of the need to replace Russian gas, Czechia faces the even more daunting task of replacing its significant coal-based capacity. Coal-based power generation still accounted for 40 per cent of total production in 2023. While gas supplies were replaced with liquefied natural gas supplied from the Netherlands and Germany, the authorities remain committed to expanding the Dukovany nuclear power plant with two more units. In July 2024, the government selected South Korea's KHNP to carry out this project, which should start in 2029 and lead to commercial operation in 2038. Two companies, however – Westinghouse of the United States of America and EDF of France – have appealed the result of the tender. The estimated costs of the project range between 5.5 and 9.0 per cent of 2023 GDP.

Pension reform has advanced, but at a slower pace than originally planned. Pension reform, proposed by the government in April 2024, has been a key, politically important reform throughout the past year. It would bring estimated annual savings of 2.2 per cent of GDP. Negotiations were still ongoing as of August 2024, with a major change compared with the April proposal being a more gradual increase in the retirement age – from up to two months a year to just one month. Together with a slower indexation formula, the updated reform would still save about 1.7 per cent of GDP. The bill passed the second reading in parliament but it needs another two readings before being passed into law.

A new digitalised building permit system has been introduced but it has encountered problems. Efforts to digitalise the building permit system are part of the government's Recovery and Resilience Plan, to be financed from the EU's Recovery and Resilience Facility (RRF). The process, however, has proved to be more difficult than expected. Following the new system's introduction in July 2024, both private companies and public officials raised concerns about its functionality. In August 2024, the regional development ministry announced a new tender for the system, which could delay both private and EU-funded projects while the current system is still in use.

The authorities have progressed with expanding affordable housing. Given that Czechia has one of the least affordable housing markets in the EU, public authorities have prioritised the expansion of support schemes to develop more affordable housing for rentals, targeting those on lower incomes, public servants and young citizens. The government has identified more than 200 plots owned by the state which will be used for new buildings, in cooperation with municipalities and the private sector. After receiving a state aid notification in April 2024, the State Investment Support Fund and the National Development Bank will use RRF funding of around €380 million to channel preferential loans.

Efforts are under way to improve childcare. Women in Czechia are less active in the labour market than key regional peers, partly due to child-rearing responsibilities. In an effort to expand childcare options, the government has decided that in municipalities where children cannot find a place in kindergarten, the authorities will have to place them in a so-called children's group, which is a non-profit facility that operates based on education and care plans but is less demanding to establish than a kindergarten. If this is not possible, municipalities will have to compensate families with an amount equivalent to the maximum childcare benefit. The change will enter into force from 2026 for children above three years old.

Estonia

Highlights

- **Signs of a slow economic recovery are emerging after a deep recession.** Stronger external and domestic demand is helping the recovery, but ongoing issues such as increased taxes, declining productivity growth and a sharply appreciated real exchange rate remain significant obstacles to further growth.
- **The government plans to privatise seven state-owned companies to enhance transparency and economic efficiency.** Currently, 28 companies are state owned, and this decision is designed to stimulate the local capital market and allow non-strategic companies to be operated independently.
- **Estonia has introduced its first retail government bonds.** The bonds are targeting regular and professional investors with attractive returns. This initiative aims to diversify funding sources and strengthen the local capital market.

Key priorities for 2025

- **To enhance energy security, Estonia should accelerate the adoption of renewable energy sources.** Despite recent progress, oil shale remains significant in the energy mix, and issues such as insufficient grid capacity hamper further renewable deployment. In 2023, renewables accounted for 65 per cent of the energy mix, and the government is aiming for 100 per cent by 2030.
- **The government should leverage the planned increase in defence spending to develop state-of-the-art technologies in-house, benefiting multiple sectors.** This will drive productivity and innovation and strengthen international competitiveness in the face of rising labour costs.
- **A growth-oriented fiscal consolidation plan is needed to restore budgetary balance.** As the economy emerges from recession, this strategy could help gross domestic product (GDP) to recover by focusing on revenue generation and directing investment towards crucial areas such as digital and green transitions, a more robust and resilient labour market and targeted support for vulnerable households.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-2.9	7.1	0.1	-3.0	-0.8
Inflation (average)	-0.6	4.5	19.4	9.1	3.6
Government balance/GDP	-5.4	-2.5	-1.0	-3.5	-3.4
Current account balance/GDP	-2.5	-3.6	-3.9	-1.7	-1.7
Net FDI/GDP [neg. sign = inflows]	-10.7	-3.1	-0.3	-7.7	-5.0
External debt/GDP	87.7	84.6	84.4	89.2	na
Gross reserves/GDP	na	na	na	na	na
Credit to private sector/GDP	62.9	59.8	57.6	58.5	na

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Macroeconomic developments and policy response

The economy has experienced the toughest broad-based recession since 2009. In 2023, real GDP contracted by 3.0 per cent, weighed by shrinking domestic demand, especially investments, as well as falling exports. The recession continued in the first half of 2024, with real GDP falling by 1.9 per cent year on year. Russia's war on Ukraine sparked supply-side disruptions, as raw materials such as oil, timber and minerals now need to be imported from more expensive markets. This loss of international competitiveness, further exacerbated by euro appreciation against the currencies of Estonia's key trading partners in the Nordic countries, contributed to a sharp drop in export volumes, by almost 10 per cent throughout 2023 and the first half of 2024. Since the Russian invasion of Ukraine, the European Central Bank's Harmonised Competitiveness Indicator shows a 12 per cent drop in Estonia's international competitiveness, down by nearly 19 per cent on pre-pandemic levels. Estonia's global export market share has fallen by 11 per cent over the past decade. Inflation has slowed, to 3.5 per cent in July 2024, but it remains at significantly higher levels than in Latvia and Lithuania. Services inflation, the second highest in the European Union (EU) at 7.6 per cent in July 2024, and the increased VAT rate introduced at the beginning of the year, are factors that hinder the decline in headline inflation. As a result, household consumption is reviving only slowly, further damped by historically low consumer confidence.

Rising production costs and weak external demand forced companies to cut back on both investments and hiring. In 2023, investment saw a drop of 3.0 per cent, while companies were operating at low capacity, triggered by elevated production costs, rising labour costs and weak demand. The unemployment rate increased from 5.1 per cent in the first quarter of 2023 to 7.8 per cent in the first quarter of 2024. The government introduced incentives to encourage further private sector investment in key areas such as renewable energy, information technology infrastructure and defence. However, competitiveness has suffered as cost pressures have mounted – concentrated on the labour supply side – and will require greater investment to boost productivity and value-added production capacity.

Estonia remains compliant with its deficit criteria. Despite a significant rise in the general government deficit from 0.9 per cent of GDP in 2022 to 3.4 per cent in 2023, Estonia was not included in the list of EU countries with imbalances, according to the European Commission's (EC) Spring 2024 European Semester package. Looking ahead, the deficit is projected to remain at 3.4 per cent of GDP in 2024, driven by ongoing defence investments and increased child benefits. In response, the government plans to introduce a series of tax hikes, including a two-percentage-point increase in the VAT rate and a rise in income taxes starting in mid-2025, and a temporary 2 per cent defence tax on corporate profits, which will fund essential military upgrades until the end of 2028. While this restrictive fiscal policy will likely hold back economic recovery to some extent, the new government is determined to keep the fiscal balance within the 3 per cent of GDP deficit threshold in 2025.

Positive growth is likely to return in 2025. Signs of recovery are apparent, driven by rising external demand from key international markets and increasing domestic demand. Factors such as improved business confidence, a broadly supportive policy environment and easing financial conditions are prompting companies to reassess their investment and hiring plans throughout 2024. However, underlying challenges persist, including structural issues such as declining productivity growth and the impact of a sharp real exchange rate appreciation. In addition, rising input costs, volatile commodity prices and supply chain disruptions continue to pose significant hurdles for the economy. In 2024, we anticipate a further contraction of real GDP, by 0.8 per cent, before the economy returns to growth, at 2.5 per cent, in 2025.

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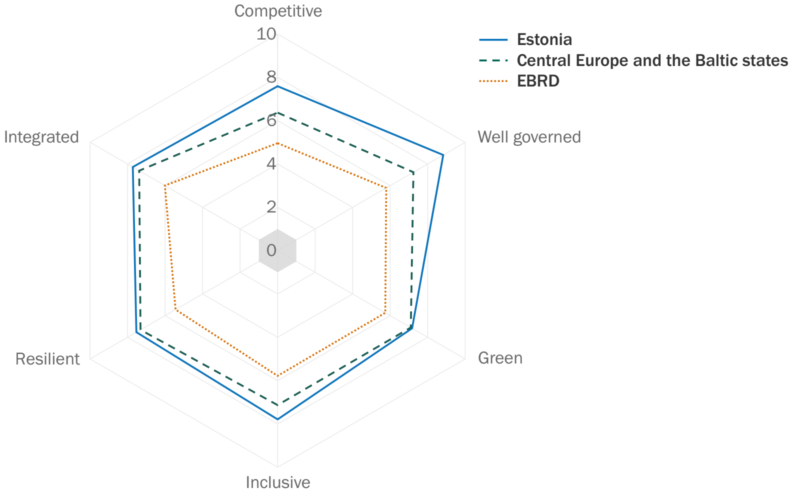
Assessment of transition qualities (1-10)



Structural reform developments

Seven state-owned companies are to be privatised. In February 2024, the finance ministry announced the full or partial privatisation of seven state-owned companies. Companies such as Teede Tehnokeskus (road maintenance), Operail (railway logistics), Nordic Aviation Group (airline) and Transpordi Varahaldus (transport asset management) will be divested, while the state will reduce its stake in AS Tallinna Sadam (port operator) to 51 per cent. Two subsidiaries of Eesti Energia – Enefit (energy solutions) and Enefit Green (renewable energy) – will be partially privatised. This move aims to raise transparency, improve finances and stimulate the local capital market. The government still holds stakes in 28 companies, with 23 fully state owned. The privatisation process is part of a broader strategy to allow independent operation of non-strategic companies and enhance economic efficiency.

The government has launched retail bonds for the first time. Estonia has introduced its first government bonds targeting retail investors, offering up to €200 million worth of two-year bonds with a 3.3 per cent annual interest rate from August 2024. The bonds, which can be purchased via banks, are expected to attract both regular customers and professional investors, offering a higher return than the 2.5 per cent interest that commercial banks offer on two-year deposits. This initiative follows the example of other European countries and is part of a broader strategy to diversify funding sources and boost the local capital market.

The European Commission is boosting funding for Rail Baltica. The European Commission has allocated an additional €1.2 billion to the Rail Baltica project, connecting Tallinn to the Polish border. Estonia will receive €370 million of this funding, contributing to a total budget of €1.5 billion, including national co-financing. The funds will support the construction of 55 km of the railway in Estonia, from Soodevahe to Alu. Rail Baltica aims to link the Baltic states with Poland by 2030, with an estimated cost of €15.3 billion. The economic benefits for the region are projected at €48 billion, surpassing the costs, according to the updated 2024 cost-benefit analysis. In 2024, around 15 per cent of the main line will be constructed, with passenger trains reaching speeds of 249 km per hour and freight trains 120 km per hour.

E-voting is becoming more accessible, helping to improve governance. In May 2024, Estonia's parliament passed a law to make e-voting more convenient and transparent by enabling voting via smart devices. This amendment, developed in response to recommendations from the Supreme Court, aims to ensure that e-voting is accessible to all citizens. The new rules, set to come into force in October 2024, are part of Estonia's broader strategy to enhance its digital democracy and maintain its position as a leader in e-governance. According to a recent survey[1] by the Organisation for Economic Co-operation and Development (OECD), Estonia ranks among the top countries globally in terms of e-government services.

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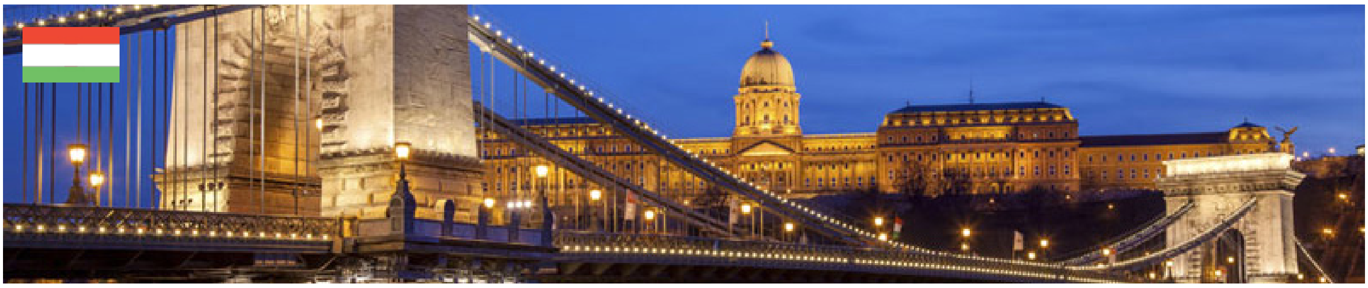
[1] OECD (2023), OECD Digital Government Index, OECD Public Governance Policy Papers, available at https://www.oecd-ilibrary.org/governance/2023-oecd-digital-government-index_1a89ed5e-en

Cross-border collaboration on hydrogen projects is advancing. In June 2024, nine transmission system operators around the Baltic Sea signed a memorandum of understanding to develop hydrogen infrastructure and common hydrogen markets. This initiative aims to shore up Estonia's energy security and reduce energy costs for companies. The common hydrogen market is projected to meet up to 45 per cent of the EU's planned hydrogen capacity by 2030. This move is part of Estonia's broader strategy to diversify its energy sources and reduce dependence on Russian oil and gas.

The Baltic states are exiting the Russian power grid. In July 2024 the electricity transmission system operators (TSOs) of Estonia, Latvia and Lithuania signed a declaration of non-renewal of the BRELL (Belarus, Russia, Estonia, Latvia and Lithuania) agreement, informing Russian and Belarusian operators of their withdrawal from the electricity ring. On 8 February 2025 the Baltic TSOs will disconnect the Estonian, Latvian and Lithuanian electricity systems from the Russia-controlled electricity system IPS/UPS and will start a joint isolated operation test. Afterwards, on 9 February 2025, they will synchronise with the electricity network of continental Europe. The EU has committed €1.2 billion to support this transition, covering about three-quarters of the costs.

Estonia's decoupling from the BRELL grid will raise electricity prices. With the shift from the Russian BRELL grid scheduled for February 2025, Elering, Estonia's electricity transmission operator, has proposed a new rate of €5.31 per MWh, up from €0.04. This increase accounts for the higher costs associated with managing grid frequency and securing reserves. This adjustment supports Estonia's goal of synchronising with the continental European grid and follows a broader investment plan of €700 million by 2028 for infrastructure, plus €160 million for renewable energy integration. This change is part of a regional effort with Latvia and Lithuania to enhance energy independence.

The Balticconnector pipeline has been repaired after damage. In April 2024, Estonia finished repairing the 77 km Balticconnector gas pipeline connecting Estonia and Finland. The €35 million project, initiated in March 2024, addressed damage caused by a vessel incident. The renewed gas flow enables Estonia to import gas from Finland's Inkoo terminal, crucial for the upcoming storage season. The closure of the pipeline in October 2023 due to a sudden pressure loss highlighted the need for robust infrastructure maintenance.



Hungary

Highlights

- **Growing household consumption is pulling the Hungarian economy out of recession, but investments remain subdued.** At the same time, fiscal consolidation is ongoing, although the European Commission (EC) has formally proposed initiating an excessive deficit procedure against Hungary in light of the large government budget deficit in 2023.
- **Hungary has secured alternative gas supplies amid geopolitical tensions.** New contracts with Türkiye and Azerbaijan will help ensure energy security despite potential disruptions in Russian gas transit through Ukraine.
- **The EC's 2024 Rule of Law Report identified deficiencies in the rule of law and the anti-corruption framework.** The European Union (EU)'s conditionality regulation procedure, which was triggered in 2022, has been maintained, leading to the ongoing suspension of EU funds.

Key priorities for 2025

- **The authorities should implement structural reforms to address rule-of-law and anti-corruption issues.** Failure to do so has resulted in blocked EU funds, which in turn may undermine efforts to promote sustainable growth.
- **Further fiscal consolidation is needed to reduce the budget deficit faster and comply with the excessive deficit procedure.** Success in this area would align fiscal and monetary policies, thereby reducing inflation and improving public finance sustainability.
- **The authorities should accelerate renewable energy deployment.** Key short-term measures should include streamlining permit procedures and creating a supportive and predictable regulatory environment. This would reduce reliance on fossil fuels and help in the push towards energy security and sustainability, with a targeted 30 per cent share of renewables by 2030.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-4.3	7.1	4.3	-0.9	1.8
Inflation (average)	3.4	5.2	15.3	17.0	4.0
Government balance/GDP	-7.6	-7.2	-6.2	-6.7	-4.5
Current account balance/GDP	-0.9	-4.1	-7.2	0.7	1.5
Net FDI/GDP [neg. sign = inflows]	-1.5	-2.2	-2.8	-0.5	-1.0
External debt/GDP	83.9	89.0	93.9	86.1	na
Gross reserves/GDP	26.0	23.8	23.3	32.9	na
Credit to private sector/GDP	34.6	34.5	32.5	30.1	na

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Macroeconomic developments and policy response

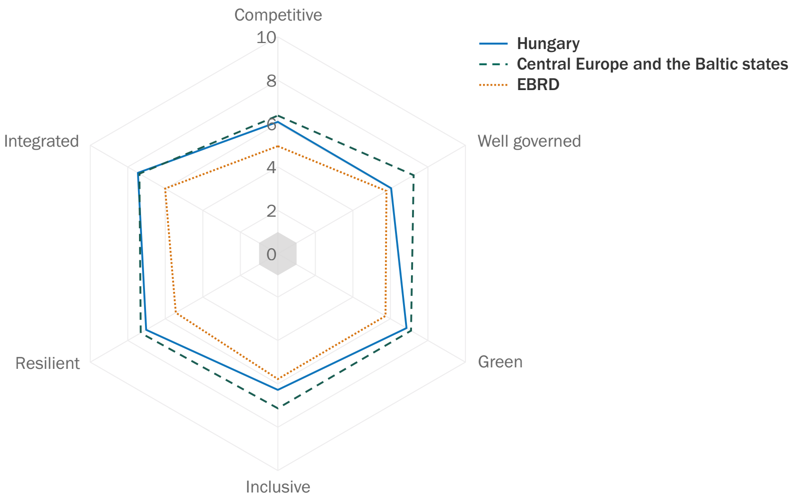
Growing household consumption is pulling the Hungarian economy out of recession. In 2023, the economy contracted by 0.9 per cent, dragged down by a slump in domestic demand, including a significant decline in investments. In the first half of 2024, however, the economy rebounded by 1.5 per cent year on year, primarily due to improving private consumption, which was boosted by rising real wages, at almost 10 per cent in mid-2024. Inflation has fallen steadily in the past year, reaching 4.1 per cent in July 2024. The strong labour market is fuelling the recovery in household spending, with unemployment at 4.3 per cent in June 2024 and the second-highest employment rate in central Europe and the Baltic states region, exceeding 81 per cent of the total population. Investments continued to decline, however, due to high economic uncertainty, elevated labour costs and a weak demand outlook.

Hungary has emerged as a major destination for Chinese investments in Europe. In 2023, Hungary overtook long-standing leaders Germany, France and the United Kingdom to become the primary European recipient of Chinese foreign direct investment (FDI), accounting for 44 per cent of all Chinese investments in the EU plus the United Kingdom, according to a 2024 report by the Rhodium Group and the Mercator Institute for China Studies. Hungary played a pivotal role in attracting investment in the electric vehicle (EV) sector, which drew more than two-thirds of Chinese FDI in Europe. According to the Financial Times' FDI database, the value of Chinese investments in Hungary from 2023 to mid-2024 reached almost €5 billion (nearly 2.5 per cent of Hungary's 2023 GDP), ultimately creating an estimated 9,000 jobs.

The European Commission (EC) has formally proposed opening an excessive deficit procedure against Hungary. In its Spring Semester report from mid-June 2024, the EC flagged Hungary's budget deficit, which reached 6.7 per cent of GDP in 2023, with government debt at 73.4 per cent of GDP by the end of the year. In response, the government introduced new taxes in August 2024, totalling HUF 400 billion (€1 billion), to help manage the budget. It also decided to defer some public-sector investments, amid elevated interest costs, to 2025 or even later. The government anticipates that these measures will reduce the fiscal deficit to 4.5 per cent of GDP in 2024.

Household consumption will continue to be the primary engine of short-term growth, while investments and exports are expected to rebound. We forecast real GDP growth at 1.8 per cent in 2024 and 3.3 per cent in 2025.The rise in disposable incomes should further boost consumption, with inflation staying within the central bank's target range of 2-4 per cent. As bank lending is anticipated to increase and export market conditions improve, corporate investments are likely to gain momentum. However, the low use of EU funds remains a downside risk, particularly affecting public investment. A notable strength of the Hungarian economy lies in its strong manufacturing base, deeply integrated into the supply chains of German automakers. With significant Chinese investments in EVs and its involvement in the German auto industry, Hungary has effectively hedged its position against the potential impact of EU tariffs on Chinese EVs in the medium term.

Assessment of transition qualities (1-10)



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Structural reform developments

Hungary has secured alternative gas supplies. New energy sources include a new contract with Türkiye for 275 million cubic metres of gas that started in April 2024. In addition, Hungary's state-owned energy company, MVM, acquired a 5 per cent stake in Azerbaijan's Shah Deniz gas field in June 2024, securing an annual entitlement of 1.5 billion cubic metres of gas. These measures aim to ensure energy security amid geopolitical tensions and EU embargoes on Russian energy imports.

Progress on the rule of law remains uneven. In July 2024, the European Commission's Rule of Law Report highlighted that Hungary had made no progress on any of the recommendations from the previous year. Despite the 2023 judicial reform, currently under way, the report noted the lack of transparency in low-instance courts, insufficient reforms in lobbying and tackling high-level corruption, and the failure to enhance the independence of the media regulator. Also, the EC noted that political influence on the prosecution and freedom of expression of judges remains a significant concern. In February 2024, the government adopted an anti-corruption strategy for 2024-25, focusing on public procurement procedures to address these issues. However, the absence of new measures to remedy the outstanding rule-of-law and anti-corruption issues has resulted in continued suspension of EU funds under several programmes.

The state has acquired a majority stake in Budapest Airport. In June 2024, the government finalised the purchase of an 80 per cent stake in Budapest Airport for €3.1 billion, with French operator Vinci acquiring the remaining 20 per cent. The acquisition, financed through asset sales, loans and a capital hike, aims to enhance the airport's role as a key transport hub. Major investments, including a new terminal, are planned.

China and Hungary are deepening economic ties through major infrastructure and energy projects. In May 2024, China and Hungary signed 18 agreements, primarily under the Belt and Road Initiative. These agreements include the construction of two new railway lines, one bypassing Budapest for freight transport and another connecting Budapest to its airport. In addition, a large border crossing with Serbia will be built to alleviate congestion. Cooperation on nuclear energy will address rising electricity demand, potentially leading to a new nuclear power plant. The agreements also cover the export licensing of cherry and cattle propagating material.

The country's railways are being upgraded with new investment. The government aims to finalise by the end of 2024 the terms of a €1 billion loan from the European Investment Bank for railway investment, with project implementation starting in 2025. The loan, supplemented by €1 billion from the state budget, will fund 500 km of new railways, a railway bridge reconstruction, tram line renovations and digitalisation of railway communication. This is part of a broader transport development plan, including public transport fleet renewal and restructuring the state-owned railway company, MAV. Construction of the Budapest-Belgrade railway line, a key project under the China Belt and Road Initiative, resumed after a six-month hiatus.

Windfall taxes are being phased out. The government announced in July 2024 that it would phase out windfall taxes on pharmaceutical and telecom companies in 2025. This move follows the announced abolition of the windfall tax on airlines, also set for next year. The government extended the banks' windfall tax relief to the insurance sector, offering 50 per cent relief for purchasing government securities. The windfall tax on pharmaceutical companies, introduced in late 2022, was expected to generate HUF 32 billion (€81.2 million) in 2024, with potential relief for research and development investments. Telecoms windfall tax revenues were estimated at HUF 40 billion (€101.5 million).

The government has launched a new employment programme. In May 2024, the government introduced a HUF 150 billion (€380.7 million) initiative to boost employment and labour force participation. The programme, partly financed by EU funds, aims to support 77,000 job seekers, focusing on disadvantaged groups. It includes wage, training, housing and commuting subsidies. Wage subsidies cover 50 per cent of the gross monthly wage, up to HUF 250,000 (€635.50), for six months for disadvantaged employees. This aligns with the government's strategy to mobilise the country's 300,000-strong labour reserve and boost the employment ratio to 85 per cent by 2030.

Hungary has been fined for migration policy violation. In June 2024, the European Court of Justice (ECJ) imposed a fine on Hungary for failing to comply with EU asylum policy, a €200 million lump sum and a penalty of €1 million for each day of delay. This unprecedented breach of EU law, as described by the ECJ, stems from Hungary's refusal to uphold the right to seek asylum, which poses a major threat to the unity of EU law, per the court's ruling. The Hungarian government has signalled its intention to review the ruling and explore potential responses.

Latvia

Highlights

- **The resurgence in private consumption is gradually lifting the economy.** After a contraction in real gross domestic product (GDP) in 2023, households' rising disposable incomes are giving the economy a significant boost in 2024.
- **The Rail Baltica project has received a major financial injection.** The European Commission has allocated €1.2 billion for the project, with €346 million earmarked for Latvia, to address delays and enhance regional connectivity through improved transport routes.
- **A second Recovery Fund payment is accelerating key reforms in justice and infrastructure.** In May 2024, Latvia received from the European Commission €336 million, following an initial €201 million, to digitalise the justice system, construct up to 700 low-cost rental apartments, improve national and regional highways, and establish industrial parks.

Key priorities for 2025

- **The tax system should be reformed to reduce the burden on lower-income groups and improve public-sector efficiency.** Such changes are essential in order to attract investment, reduce the fiscal deficit, and enhance economic growth amid slowing convergence with the European Union (EU).
- **The planned increase in defence spending should be channelled into building domestic industrial capabilities and fostering innovation.** This will drive productivity, create high-tech jobs and enhance national security through advanced manufacturing and cybersecurity.
- **The authorities should selectively list state-owned companies on the stock exchange to improve corporate governance and market capitalisation.** Unlike its Baltic peers, Latvia has no state-owned companies listed, which limits investment opportunities and market growth.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-3.5	6.7	3.0	-0.3	0.9
Inflation (average)	0.1	3.2	17.2	9.1	1.6
Government balance/GDP	-4.4	-7.2	-4.6	-2.2	-3.0
Current account balance/GDP	2.9	-3.9	-5.1	-3.8	-1.9
Net FDI/GDP [neg. sign = inflows]	-2.1	-2.6	-3.4	-1.5	-2.0
External debt/GDP	121.5	109.6	100.5	98.6	na
Gross reserves/GDP	na	na	na	na	na
Credit to private sector/GDP	34.9	32.4	29.8	28.5	na

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Macroeconomic developments and policy response

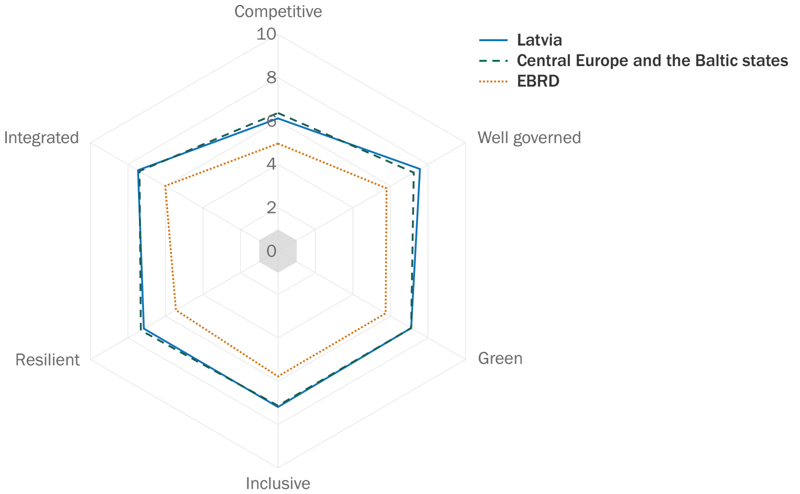
The economy is improving after last year's recession. Following an impressive post-Covid recovery, the Latvian economy contracted by 0.3 per cent in 2023, weighed down by falling household consumption and weak demand from key international markets. Real GDP growth returned to positive territory in the first half of 2024, albeit by just 0.1 per cent year on year, mostly driven by higher household consumption. Robust nominal wage growth, above 11 per cent in the first quarter of 2024, and sharply falling inflation to 0.8 per cent in July 2024, have dovetailed to restore consumer confidence to some extent. The labour market remains strong, with the unemployment rate at 6.7 per cent in June 2024. Exports have continued to suffer, impacted by low demand from the Nordic countries, especially for wood and metal products. Despite stabilising inflation, a Luminor Bank survey from May 2024[1] reveals that businesses have not fully recovered from the recent inflationary surge. Inflation and rising costs remain a significant concern for 40 per cent of small and medium-sized enterprises (SMEs).

Elevated financing costs and weak demand have put investments on hold. Investments experienced a robust recovery in 2023, growing by 8.2 per cent, largely fuelled by accelerated public-sector construction projects supported by EU co-financing from the previous budget (2014-20, with the funds to have been spent by the end of 2023). However, in the first half of 2024, investments largely came to a halt across both the public and private sectors. While EU-co-financed investments from the new programming period are expected to take time to gain momentum, private-sector companies have paused investments, awaiting lower interest rates and a more solid recovery in demand, both domestically and internationally. Inward foreign direct investment (FDI) flows contracted from 3.4 per cent of GDP in 2023 to 1.5 per cent of GDP in the first half of 2024.

Slow economic growth and higher spending weigh on public finances. The general government deficit narrowed to 2.2 per cent of GDP last year but is expected to widen to 3.0 per cent of GDP in 2024, before narrowing again in the following years. Greater government spending, especially on employee compensation and defence, which saw growth of 17.8 per cent and 15.6 per cent, respectively, put a significant strain on the state budget in the first half of 2024. As a result of the former, public-sector gross wages saw a strong increase of more than 16 per cent in the first quarter of 2024, above the 9 per cent growth for private-sector wages. Amid the improving outlook, a less expansionary fiscal approach for 2024 is justified.

Growth will continue in the short term. Robust real wage growth, coupled with one of the lowest inflation rates in the EU by mid-2024, is expected to cautiously drive household expenditure, as savings buffers, depleted by the high inflation of 2022, are rebuilt. In 2024-25, inflation is projected to stabilise around the European Central Bank's target at 2 per cent, although service inflation is likely to remain elevated due to persistent wage and cost pressures within the sector. The recovery in exports will be heavily contingent on economic improvements in the Nordic countries, which are slowly emerging from stagnation. Investment is expected to gain momentum as both domestic and external demand conditions improve. We therefore project real GDP growth of 0.9 per cent in 2024, rising to 2.4 per cent in 2025.

Assessment of transition qualities (1-10)



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[1] As reported at https://emergingmarketwatch.com/browser#/article/1270288

Structural reform developments

New funding is boosting the Rail Baltica project. The European Commission allocated an additional €1.2 billion to the Rail Baltica railway line in July 2024, with €346 million earmarked for Latvia. Including co-financing from the Baltic states, total funding amounts to €1.5 billion. Latvia's portion will be used for priorities such as constructing the main track in the Misa-Latvia-Lithuania border section. The government also approved €61.03 million of national co-financing for the project in August 2024. This funding is crucial for the project's progress, as delays have been reported, particularly at the Riga Airport and Riga Central stations. The Rail Baltica project aims to enhance regional connectivity and stimulate economic activity through improved transport routes.

The government is planning to privatise a major state-owned enterprise (SOE). Privatisation is being prepared for the state-owned carrier, airBaltic, which posted a €33.85 million profit in 2023. The Latvian state currently holds almost 98 per cent of the airline's shares and aims to maintain at least 25 per cent plus one share after the initial public offering (IPO), ensuring veto power. AirBaltic's simplified share structure and recent financial performance, with turnover up by 33.2 per cent, strengthen its market appeal. The IPO's timing is set to be decided by the end of 2024. Should the IPO materialise, airBaltic will be the first Latvian SOE to be listed on the stock exchange.

A second Recovery Fund payment is boosting important reforms, including in the justice system and infrastructure. In May 2024, Latvia received from the European Commission the second Recovery Fund payment of €336 million, requested in December 2023. This follows the initial payment of €201 million and aims to maintain ongoing projects and initiate new ones. The Ministry of Finance announced that 89 per cent of the total available funding of €1.97 billion has been allocated for project selection. The second tranche will support the digitalisation of the justice system, construction of up to 700 low-cost rental apartments, improvement of national and regional highways, and establishment of industrial parks. The pace of fund absorption needs to accelerate if the country is to use all available funding by the end of 2026.

The Baltic states are exiting the Russian power grid. In July 2024 the electricity transmission system operators (TSOs) of Estonia, Latvia and Lithuania signed a declaration of non-renewal of the BRELL (Belarus, Russia, Estonia, Latvia and Lithuania) agreement, informing Russian and Belarusian operators of their withdrawal from the electricity ring. On 8 February 2025 the Baltic TSOs will disconnect the Estonian, Latvian and Lithuanian electricity systems from the Russia-controlled electricity system IPS/UPS and will start a joint isolated operation test. Afterwards, on 9 February 2025, they will synchronise with the electricity network of continental Europe. The EU has committed €1.2 billion to support this transition, covering about three-quarters of the costs.

Cooperation with Ukraine is being enhanced. In April 2024, Latvia signed a bilateral defence agreement with Ukraine, pledging assistance over the next decade in cyber defence, demining and the development of unmanned aerial vehicles. Annual military aid, equal to 0.25 per cent of Latvia's GDP, will amount to approximately €112 million in 2024. This agreement aims to support Ukraine's fight against aggression and facilitate its entry into the EU and NATO. The Ukrainian parliament ratified a related agreement on technical and financial cooperation, providing a framework for Latvia's development cooperation programmes and reconstruction projects in Ukraine.

Mortgage refinancing is being simplified. In December 2023, the government introduced legislation to make refinancing mortgages cheaper and easier. This move aims to boost competition and reduce the high concentration in the mortgage lending market, where the four largest credit institutions hold nearly 100 per cent of the market share. Borrowers will be able to refinance loans through a different creditor without the original lender's consent, and the fee charged by the new creditor cannot exceed 1 per cent of the transaction amount. The legislation also eliminates the state fee for registering mortgage rights in the land register. This initiative is part of broader efforts to improve mortgage affordability and follows the introduction of a subsidy on mortgage interest payments in November 2023.

Lithuania

Highlights

- **Robust domestic demand is driving an economic recovery in 2024.** The economy bounced back strongly in the first half of the year with real gross domestic product (GDP) growth of 2.3 per cent (year on year) but external markets remain weak.
- **The development of offshore wind energy is accelerating.** The energy regulator has granted a 41-year permit to Ignitis Renewables and Ocean Winds for a 735 MW wind farm project worth €1.8 billion, operational by 2030.
- **Parliament has mandated fixed-rate mortgage options and simplified refinancing to foster competition.** The new laws aim to mitigate interest rate risks and offer better loan conditions for customers.

Key priorities for 2025

- **The grid capacity needs to be constantly upgraded to accommodate increasing renewable energy generation and ambitious energy system development goals.** This would prevent market saturation and ensure reliable access for producers and consumers, aligning with European Union (EU) electricity grid synchronisation goals.
- **Transport reforms are needed to reduce regional inequalities and levels of pollution.** Key measures would be a multimodal public transport system and an annual car tax based on emissions. This would help to bridge the urban-rural divide and reduce pollution, aligning with EU environmental standards.
- **Further structural reforms in pensions, healthcare and education should be introduced.** Key reforms in these sectors are essential to preserve fiscal sustainability and support long-term economic growth, as highlighted by the International Monetary Fund (IMF)'s recent recommendations.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	0.0	6.4	2.5	0.3	2.3
Inflation (average)	1.1	4.6	18.9	8.7	1.0
Government balance/GDP	-6.5	-1.1	-0.6	-0.8	-1.6
Current account balance/GDP	7.2	1.4	-6.1	1.1	-2.0
Net FDI/GDP [neg. sign = inflows]	-1.1	-1.9	-4.6	-1.8	-3.0
External debt/GDP	79.9	77.4	66.8	69.2	na
Gross reserves/GDP	na	na	na	na	na
Credit to private sector/GDP	37.3	37.2	35.8	34.8	na

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Macroeconomic developments and policy response

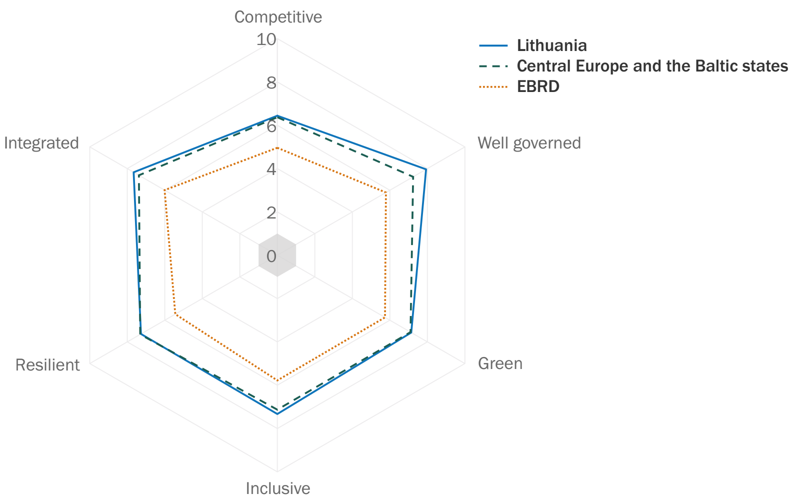
Solid household consumption, investment and services exports are fuelling growth. Following slow growth in 2023, the economy has begun to perform strongly, with real GDP growing at an impressive 2.3 per cent year on year in the first half of 2024. This economic recovery was powered by strong private consumption as households' disposable incomes continue to improve. Real gross wage growth reached 8.6 per cent year on year in the second quarter of 2024, continuing the trend of strong wage increases that had started the previous year. Rising labour costs are expected to inflate price levels somewhat, with services inflation at 6.2 per cent in September 2024. At the same time, the headline inflation rate was just 0.4 per cent and it is expected to stay at a low level throughout the remainder of 2024. Public investments, particularly in energy infrastructure and defence, have bolstered real GDP growth, aligning with Lithuania's ambitious plan to boost green energy production and increase defence spending. Service exports, especially financial and fintech-related activities, have shown resilience, and transport services, previously affected by global trade disruptions, are now rebounding.

Declining productivity has weakened external competitiveness. Since Russia's invasion of Ukraine in February 2022, the European Central Bank (ECB)'s Harmonised Competitiveness Indicator shows a nearly 9 per cent drop in Lithuania's international competitiveness, down by almost 12 per cent on pre-pandemic levels. Rising energy prices and falling labour productivity have temporarily affected the external balance, particularly in goods, even as service exports remain resilient. Since 2021, nominal labour costs have surged by over 40 per cent, while real productivity has declined by nearly 5 per cent (both measured in hours worked). The labour market remains tight, with registered unemployment at 8.7 per cent as of September 2024. Lithuania faces one of the highest skills mismatches in the EU, with a shortage of highly skilled workers and an oversupply of medium- and low-skilled workers. To address these mismatches, the government launched several programmes, including a smart specialisation multi-year programme for companies this year, along with financial incentives and targeted scholarships.

Fiscal performance surpassed expectations last year. The general government deficit was at 0.7 per cent of GDP in 2023. Revenue growth, driven by elevated inflation, the windfall profit tax on banks and the expedited phaseout of energy subsidies, offset the increase in military and interest expenditures. As a result, government debt continued its downward trajectory, decreasing from 45.9 per cent of GDP in 2020 to 37.9 per cent of GDP in 2023. The IMF expects the general government deficit to widen to 1.6 per cent of GDP in 2024, driven primarily by increases in pensions, social benefits and public-sector wages. Increased defence spending, rising to 3.2 per cent of GDP in 2024, will be partially funded through the extension of the windfall tax on banks, an increase in the corporate tax rate and higher excise duties.

Robust growth is forecast in the short term. The key driver is expected to be household consumption, supported by significant increases in the minimum and overall wage growth. The labour market remains stable, supported by net migration inflows, including refugees. Anticipated interest rate reductions by the ECB, coupled with a revival in external demand, should bolster business confidence and, in turn, stimulate private investment. Increased defence spending and higher investments in the green transition are also expected to contribute to economic growth. However, in the short term, skills mismatches in the labour market may continue to exert wage pressure, potentially leading to a slight uptick in inflation. Growth is forecast at 2.3 per cent this year and 2.5 per cent in 2025.

Assessment of transition qualities (1-10)



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Structural reform developments

The government revised its recovery and resilience plan. In July 2024, the government approved a revision of its national recovery and resilience plan (NRRP) to submit a second payment request under the EU's Recovery and Resilience Facility (RRF) in September 2024. This decision aims to bring forward the formal deadlines of already achieved indicators and unify the implementation timelines for poverty reduction and income inequality reforms. The revised plan, valued at €3.85 billion, includes €2.3 billion in grants and €1.55 billion in loans. To date, more than two-thirds of the envisaged reforms have been implemented, with €1.36 billion already disbursed by the European Commission.

Offshore wind energy is advancing. In February 2024 the National Energy Regulatory Council (VERT) granted a 41-year permit to Offshore Wind Park 1 - Ignitis Renewables and Ocean Winds to construct the country's first offshore wind farm in the Baltic Sea. The project, valued at €1.8 billion, will have an installed capacity of 735 MW and is expected to become operational between 2028 and 2030. This development follows a successful tender by Ignitis Group and Ocean Winds in 2023, in which they offered €20 million as a development fee to the state. The authorities plan to build two wind farms in the Baltic Sea by 2030, each with a capacity of 700 MW. These two offshore farms would provide around half of the country's current electricity demand.

The Baltic states are exiting the Russian power grid. In July 2024 the electricity transmission system operators (TSOs) of Estonia, Latvia and Lithuania signed a declaration of non-renewal of the BRELL (Belarus, Russia, Estonia, Latvia and Lithuania) agreement, informing Russian and Belarusian operators of their withdrawal from the electricity ring. On 8 February 2025 the Baltic TSOs will disconnect the Estonian, Latvian and Lithuanian electricity systems from the Russia-controlled electricity system IPS/UPS and start a joint isolated operation test. Afterwards, on 9 February 2025, they will synchronise with the electricity network of continental Europe. The EU has committed €l.2 billion to support this transition, covering about three-quarters of the costs.

Parliament has mandated fixed-rate mortgage options to mitigate interest rate risks, and simplified mortgage refinancing to foster competition among banks. In June 2024 parliament passed a bill obliging banks to provide housing loan borrowers with a choice between at least a five-year fixed interest rate or a variable interest rate. This move, effective from May 2025, aims to mitigate the risk of interest rate fluctuations for borrowers, who previously had limited options. In addition, the law mandates credit institutions to offer measures to manage interest rate risks if they cannot provide a fixed-rate option. Also, in October 2024, parliament approved a new simplified refinancing procedure. It aims to foster competition among mortgage credit providers and encourage consumers to shop around in order to get the best deal on their loans.

Artificial intelligence (AI) is advancing. In July 2024, the Ministry of the Economy and Innovation prepared draft amendments to create a favourable environment for AI technology, aligning with the EU's new AI law. The amendments will empower two national authorities: the Innovation Agency, responsible for a pilot regulatory environment, and the Regulatory Communications Authority, overseeing AI market surveillance. Lithuania's AI strategy, established in 2019, aims to make the country a regional leader in AI. The Ministry has launched financial measures, including a €15 million budget to support AI start-ups and €110 million for digitalising public services. Lithuania has been emerging as one of the main fintech hubs in Europe (the third in terms of size and the leader in terms of licences), with the fintech strategy 2023-28 to continue supporting further development of the sector.

Lithuania is set to increase defence spending to 3 per cent of GDP for 2025-30, financed through various tax hikes. In August 2024, the finance ministry proposed an additional €130 million for weapons systems procurement, raising defence spending to 3.2 per cent of GDP for the year. The government also announced €250 million in soft loans for firms in the defence and security sectors, aiming to attract investors and boost competitiveness. Significant growth in this sector, with a 14 per cent increase in employment and a near doubling of turnover to €700 million over the past five years, suggests potential spillovers for other sectors, enhancing innovation and competitiveness. In addition, Lithuania and Rheinmetall signed an agreement for a €180 million artillery ammunition factory in Radviliskis, expected to create 150 jobs and further bolster the defence industry.

Poland

Highlights

- **The economy has rebounded in 2024, helped by a robust labour market and rising wages.** Despite increases in domestic demand and the tax base, the soaring budget deficit poses a major challenge for the government. Growing revenues are accompanied by rising expenditures, including on defence, with military expenditures set to reach the highest level relative to gross domestic product (GDP) among North Atlantic Treaty Organization (NATO) members.
- **The government is shifting resources to local authorities.** A recent reform is enhancing financial autonomy for local governments by directly linking their income to taxpayer revenues, thus reversing centralisation and bolstering governance at the local level.
- **Poland's revised Recovery and Resilience Plan (RRP) has gained European Commission approval, but calls for further reforms continue.** While fund disbursements are proceeding, the European Commission has stressed the need for improvements in judicial independence and anti-corruption measures.

Key priorities for 2025

- **The government should adopt firm measures to reduce the fiscal deficit while prioritising essential national needs.** One of the key directions of the considered changes should be a better and more selective targeting of social spending. The European Union's excessive deficit procedure highlights the challenge of maintaining this discipline amid rising defence and healthcare costs.
- **Military spending should be channelled where possible into building domestic industrial capabilities, fostering innovation and creating high-tech jobs.** Investing in local research and development and advanced manufacturing will drive productivity growth and generate economic spillovers beyond the defence sector.
- **The authorities should swiftly invest in grid upgrades and energy storage capacity to meet the government's 2030 goal of 50 per cent renewable electricity.** Granting essential connection rights is crucial to boosting private-sector production.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-2.0	6.9	5.3	0.1	3.2
Inflation (average)	3.6	5.2	13.2	10.8	3.8
Government balance/GDP	-6.9	-1.8	-3.4	-5.1	-5.7
Current account balance/GDP	2.4	-1.4	-2.3	1.8	0.8
Net FDI/GDP [neg. sign = inflows]	-2.5	-4.0	-4.2	-2.4	-2.3
External debt/GDP	60.8	56.6	53.7	51.9	na
Gross reserves/GDP	25.6	24.4	24.2	25.1	na
Credit to private sector/GDP	47.7	45.2	39.1	35.9	na

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Macroeconomic developments and policy response

Higher household spending is powering a rebound in the economy. After a sluggish 0.1 per cent real GDP growth rate in 2023, the economy surged to 2.9 per cent year-on-year growth in the first half of 2024. Real wages leapt by 12 per cent over the same period, buoyed by easing inflation and a sharp rise in nominal wages. Although household consumption has surged, as shown by higher spending on services, the recovering disposable incomes have also been channelled towards rebuilding savings, which were depleted to some extent by high inflation. Corporate investment remains low, due to falling net returns on turnover, weak export conditions as well as high debt-financing costs. At the same time, public investment is performing well. This is largely due to a significant uptick in defence spending, which is set to become the highest among NATO members relative to GDP.

The labour market is in robust health, with foreign workers bolstering the economy. Despite last year's economic slowdown, unemployment in Poland remains at historically low rates, at 2.9 per cent in July 2024, among the lowest rates in the European Union (EU). Foreign workers are filling gaps in sectors such as transportation, logistics, industry, construction and agriculture, and contributed an estimated 2.3 per cent to GDP growth in 2015-23 – an average annual increase of 0.24 percentage point, according to a recent Centre for Social and Economic Research report.[1] By January 2024 the number of foreign workers registered in Poland represented 6.5 per cent of the total workforce. Nearly 70 per cent of these workers are from Ukraine, according to the Polish Statistical Office.

Poland is under the excessive deficit procedure (EDP). The European Union launched the EDP for Poland in July 2024, as the general government deficit was 5.1 per cent of GDP in 2023, above the 3.0 per cent threshold. The gradual increase in defence spending – expected to reach 4.7 per cent of GDP by 2025 (up from 2.4 per cent in 2022) – along with rising healthcare expenditures, could further drive up the deficit. Poland will receive €5 billion from pre-allocated EU cohesion grant funds to finance post-flood recovery investments. Nevertheless, the costs of recent floods will impact the already stretched public finances. The general government deficit is projected to soar to 5.7 per cent of GDP in 2024, before easing slightly to 5.5 per cent of GDP in 2025. Following changes to EU fiscal rules in spring 2024, the government chose to chart a course to reduce the deficit to 3.0 per cent of GDP within the next four years.

Investment in the private sector and somewhat weaker private consumption will drive Poland's economic growth. Strong labour market conditions and rising disposable incomes will remain key to the economy's momentum. It will be supported by defence spending and EU-funded projects, including those under the Recovery and Resilience Facility, which should gain pace by 2025. Expected improvements in economic conditions in the EU, particularly Germany, will likely boost Polish exports, especially in manufacturing. This will allow the contribution of net exports to economic growth to be maintained at a similar level to 2024, despite the growing import-intense investment demand. The further expected resurgence of inflation will be mainly driven by the removal of energy bill subsidies, while core inflation will remain elevated due to demand pressures, resulting especially in increasing service-sector prices. This, along with higher savings, will somewhat moderate the rise in consumption next year. In 2025 investment demand will surge, driven by accelerated EU fund absorption under the 2021-27 framework. Additional boosts will come from the need to rebuild capital stocks post-pandemic, Poland's low automation levels and rising labour costs. We therefore project real GDP growth at 3.2 per cent in 2024 and 3.8 per cent in 2025.

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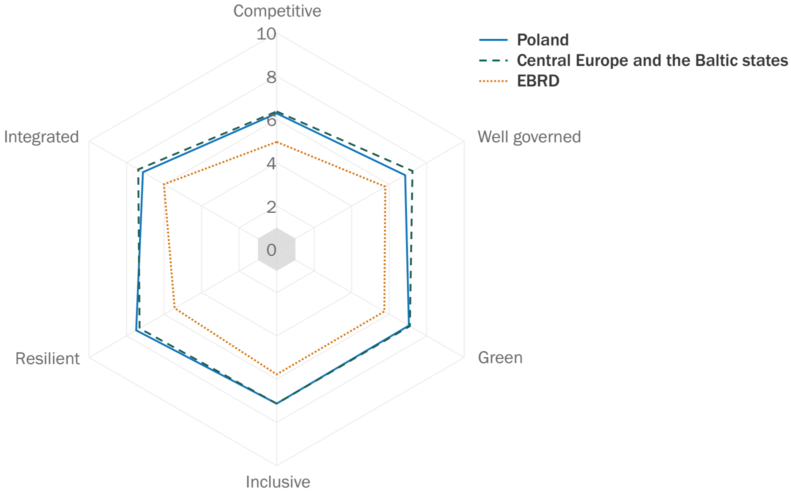
[1] https://for.org.pl/wp-content/uploads/2024/08/raport-fioletowy_znaczenie-imigracji-dla-rozwoju-gospodarczego-Polski.pdf

Assessment of transition qualities (1-10)



Structural reform developments

The government is implementing major reforms to enhance local finance. In September 2024 the government approved a sweeping reform to overhaul local government funding, directing PLN 24.8 billion (€5.8 billion) to local budgets in 2025 and a total of PLN 345 billion (€80.8 billion) over 10 years. This reform links local government income directly to local personal and corporate incomes, instead of it being a share in tax revenues of local people and firms. In this way, the financial autonomy of local governments will be enhanced, as their revenues will no longer depend on tax rates set by the government centrally, at the country-wide level. By replacing parts of the general subsidy with targeted funds for education, development and ecological needs, this move aims to reverse the centralisation policies of the previous government and strengthen local governance.

Banks are intensifying efforts to resolve Swiss franc mortgage disputes. In June 2024, the Justice Ministry and the Financial Supervision Authority (KNF) signed an agreement to develop a comprehensive solution for Swiss franc mortgage issues, as borrowers continue to win nearly all court cases. This follows a Supreme Court ruling in April 2024, clarifying that invalid currency clauses cannot be replaced by central bank rates and that both banks and borrowers are entitled to refunds if contracts are voided. According to the central bank's June 2024 financial stability report, the banking sector remains resilient, with high loss-absorption capacity and substantial capital buffers. The legal risks associated with foreign exchange loans continue to be a burden, especially to the most exposed banks, thus creating barriers to their development, but without threatening the stability of the financial system.

Financial benchmark reform has been postponed to allow time for a smooth transition. In August 2024 the KNF confirmed that the deadline for converting from the Warsaw Interbank Offered Rate (WIBOR) to the Warsaw Interest Rate Overnight (WIRON) benchmark would be postponed to 2028, further extending the previous delay from 2025 to 2027. This decision, prompted by concerns over market readiness and technical complexities, follows the national working group's ongoing review of alternative benchmarks. The delay provides additional time to address operational, legal and communication challenges, but prolongs uncertainty in the financial sector. A decisive attitude and cooperation among all government agencies involved in this matter is important, as the benchmark reform might entail legal risks with the potential to adversely impact future financial stability.

Poland's updated RRF plan has secured European Commission approval. The €59.8 billion fund, with €25.3 billion in grants and €34.5 billion in loans, will see payment applications submitted by 2026. The revised plan was necessary after previous rule-of-law infractions delayed disbursements. To address concerns about judicial independence, the government has launched a series of legislative and non-legislative measures. The European Commission decided in May 2024 to close the Article 7(1) of the Treaty on European Union procedure for Poland, launched in December 2017. Despite progress, the European Commission has recommended further steps to strengthen judicial independence and improve effective anti-corruption enforcement.

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Green energy transition is advancing through strategic investments. In August 2024, BGK, Poland's state development bank, initiated a €4.79 billion financing programme for offshore wind farms in the Baltic Sea under the National Resilience and Restructuring Plan, targeting at least 300 MW of capacity. The Ministry of Climate and Environment also announced that Poland's first nuclear power plant, expected to be operational by 2040, will contribute about 19 per cent of the country's electricity by 2050. The recent amendment to onshore investment regulations reduced the required distance between wind turbines and residential buildings from 10 times the height of the turbine to 700 metres, making it easier to find suitable locations for new turbines. In 2023, renewables comprised more than 40 per cent of installed capacity, generating 27 per cent of total electricity, while fossil fuels, primarily coal and lignite, continued to dominate, producing around 73 per cent of Poland's electricity. The government plans to reach 50 per cent of electricity generation from renewables by 2030.

Energy prices are being selectively unfrozen. Poland's energy regulator URE has approved a new natural gas tariff setup, leading to a 20 per cent price increase for households in the second half of 2024. The tariff, set at PLN 239 (€56) per MWh, will remain effective until June 2025, alongside a 27 per cent rise in distribution fees. These adjustments, stemming from the partial lifting of the anti-inflation shield, are expected to add about 0.5 percentage point to inflation. The Ministry of Climate estimates that extending the remaining energy-related anti-inflation measures throughout 2025 will cost PLN 4.4 billion (€1.03 billion), with PLN 2 billion (€468 million) already allocated in the draft budget. The government is exploring additional financing sources as it balances fiscal constraints with the need to manage energy costs amid upcoming elections.

The government has introduced financial incentives for working parents. In April 2024, the government approved a programme providing PLN 1,500 (€350) per month to parents returning to work when their child is aged between 12 and 35 months, costing PLN 8.9 billion (€2.1 billion) annually. Enhanced support of up to PLN 1,900 (€445) a month is available for parents of children with disabilities. This initiative aims to boost labour force participation, particularly among women. However, this costly social programme is unconditional and not targeted, and its overall benefit will depend on balancing fiscal costs with increased workforce inclusion.

Slovak Republic

Highlights

- **Household consumption is driving economic growth.** Investment and exports are expected to gain momentum in the short term, but the planned multi-year fiscal consolidation will necessitate a reduction in government spending from 2025.
- **The government has introduced green energy subsidies totalling €150 million.** This initiative aims to enhance energy efficiency and reduce carbon emissions, giving households significant financial assistance with renewable energy equipment.
- **New nuclear capacity is being developed.** The government has approved the building of a new nuclear reactor, with a capacity of up to 1,200 MW, at Jaslovské Bohunice, leveraging existing infrastructure, while Mochovce's new block is expected to be operational by September 2025.

Key priorities for 2025

- **The government should implement ambitious fiscal measures to improve long-term sustainability.** According to the country's Budget Responsibility Council (RRZ), its public finances are in a high-risk state, with debt projected to exceed 66 per cent of gross domestic product (GDP) by 2028. In July 2024 the European Union (EU) initiated an excessive deficit procedure in respect of the Slovak Republic.
- **The country's renewable energy capacity needs to be increased.** Although it surpassed its 2020 target for renewables and has 15 per cent of its energy needs being met by hydroelectric power, the 7 per cent that is currently coming from solar and wind power is insufficient and among the lowest levels in the EU. The current National Energy and Climate Plan (NECP) sets the national target at a 19.2 per cent share of energy consumption from renewables.
- **Further support is needed to boost research and development and technology adoption in the manufacturing sector.** This will help small firms to overcome financing constraints and enhance their innovation capacity, which is crucial in order to navigate global shocks and adverse trends.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-3.3	4.8	1.9	1.4	2.3
Inflation (average)	2.0	2.8	12.1	11.0	3.1
Government balance/GDP	-5.3	-5.2	-1.7	-4.9	-5.9
Current account balance/GDP	0.6	-4.4	-8.7	-2.1	-1.5
Net FDI/GDP [neg. sign = inflows]	2.8	-1.4	-2.5	-0.1	-0.4
External debt/GDP	119.6	134.2	105.7	96.1	na
Gross reserves/GDP	na	na	na	na	na
Credit to private sector/GDP	67.1	67.0	67.9	62.5	na

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Macroeconomic developments and policy response

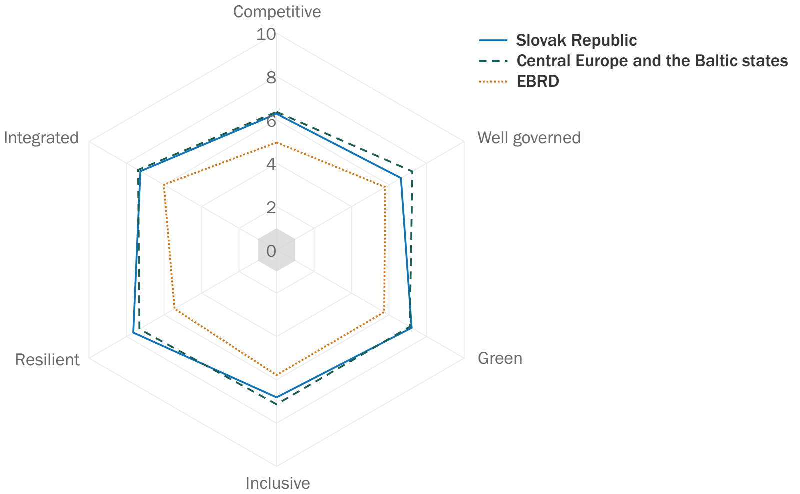
The rebound in private consumption has become the primary driver of economic growth. In 2023 the economy grew by 1.4 per cent, propelled by a marked increase in investment expenditure (particularly for public-sector investment projects that were co-financed by the EU). Following a significant decline last year, household consumption has recovered in 2024, buoyed by real wage growth amid a rapid weakening of inflation. This resurgence in consumer spending has led to a strengthening of activity, with economic growth of 2.3 per cent year on year in the first half of 2024.

The labour market remains tight, despite some temporary economic turbulence. Headwinds caused by a decline in external demand have affected the manufacturing sector, but employment rates have proved to be resilient. Unemployment has fallen, standing at 5.5 per cent in mid-2024, while employment has continued its steady rise, reaching 78.1 per cent of the total working-age population (defined as people aged 20 to 64) in the first quarter of 2024. As annual inflation has fallen (with a rate of 2.4 per cent being recorded in June 2024), real wage growth has taken off, with year-on-year increases of more than 7.0 per cent being seen in the first half of 2024. Inflation stood at 3.2 per cent in August 2024, but it may rise slightly in the short term because of base effects and the impact of relatively high service price inflation amid rising wages.

The EU has initiated an excessive deficit procedure in respect of the Slovak Republic. This decision was taken in July 2024 following a general government deficit of 4.9 per cent of GDP in 2023, which was not judged to be due to any extraordinary event or a significant economic downturn. Furthermore, the European Commission's May 2024 forecasts envisage that deficit remaining above the 3.0 per cent of GDP threshold in 2024 and 2025 – at 5.9 per cent and 5.4 per cent of GDP, respectively. In October 2024, parliament approved a package of consolidation measures for 2025, which includes a four-year plan to stabilise debt. By 2028 the aim is to cut the deficit to 2.2 per cent of GDP, allowing the debt-to-GDP ratio to begin a yearly decline.

Growth is likely to remain modest in the short term. We forecast that real GDP growth will rise to 2.3 per cent in 2024 and 2.6 per cent in 2025. Household consumption will be the primary driver of economic growth, with investment and exports expected to contribute as well. Increases in real wages will also help to fuel economic growth. Private investment is expected to strengthen, particularly in the automotive sector, but public investment may grow more slowly as funding under the 2021-27 EU budget starts to be wound down. Exports are expected to rise in 2025, in line with improved economic conditions in western parts of the EU. The planned multi-year fiscal consolidation will necessitate a reduction in government spending from 2025 onwards, and success in this area could boost the country's sovereign rating.

Assessment of transition qualities (1-10)



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Structural reform developments

Progress with reforms in selected areas has helped to secure more funding from the EU's Recovery and Resilience Facility (RRF). A fourth payment of €923 million from the RRF was approved by the European Commission in July 2024, following the disbursement of €662 million in December 2023, highlighting the country's success in meeting the EU's stringent requirements. The Slovak Republic has already received €2.7 billion in funding – 42 per cent of its total allocation of €6.4 billion under the RRF. The government is preparing to request its fifth payment, with only two of the 22 milestones and targets remaining problematic.

A new nuclear reactor has been approved by the government. The new reactor, with a capacity of up to 1,200 MW, will be built at the power plant in Jaslovské Bohunice, leveraging existing infrastructure. Meanwhile, progress has been made with the expansion of the Mochovce nuclear power plant, with its new block expected to be operational by September 2025. The new reactor will be fully state owned, unlike the Mochovce plant and the remainder of the Jaslovské Bohunice plant, both of which are only partially state owned.

Additional liquefied natural gas (LNG) supplies are enhancing energy security. In July 2024 gas trading company ZSE signed a contract for additional LNG deliveries, diversifying sources and increasing energy security. The contract is with a member of the Polish Orlen Group and will cover 30 per cent of ZSE clients' gas needs, with deliveries starting in 2025. This follows the Environment Minister's approval of a different LNG terminal at Bratislava's river port in January 2024, which is aimed at stabilising energy supplies disrupted by sanctions on Russia. The government also expects continued gas flows via Ukraine, potentially from Azerbaijan, despite Ukraine's decision not to extend its transit contract with Gazprom beyond 2024.

The government has launched green energy subsidies. In June 2024 the government announced a €150 million project supporting the installation of renewable energy equipment in homes. The state will reimburse approximately 50 per cent of the cost, with that figure rising to 90 per cent for low-income households. This initiative includes subsidies of up to €3,000 for photovoltaic panels, €2,000 for solar collectors and €3,040 for heat pumps. Only this year, about €29 million of subsidies were spent on large-scale renewables and about €12 million on grid batteries co-located with renewable energy sources. The scheme also supports biomass boilers. These measures are seeking to enhance energy efficiency and reduce carbon emissions, in line with the EU's broader environmental goals.

Investment in e-mobility is on the rise. GIB EnergyX Slovakia, a joint venture between China's Gotion and the Slovak Republic's InoBat, will invest at least €1.23 billion in a new electric car battery factory in the south of the country by 2028, creating an estimated 1,311 jobs over the next three years. In April 2024 the European Commission approved €267 million in state aid for Volvo's new electric vehicle plant in the Košice region, which aims to produce 250,000 electric cars annually and directly create at least 3,300 jobs. Moreover, in January 2024 the government granted €29.95 million in investment aid to Kia Slovakia's car plant in Zilina to support the expansion of production, preserving 3,693 existing jobs. ●

Slovenia

Highlights

- **Economic growth has decelerated.** Real gross domestic product (GDP) growth in the first half of 2024 was 1.4 per cent year on year, down on the 2.1 per cent in 2023, as investment and exports declined, while inflation has dropped below 1.0 per cent.
- **Post-flood reconstruction is progressing slowly.** Despite additional European Union (EU) funding and the rapid passing of necessary programmes and legislation, only 24 per cent of the earmarked budgetary spending in 2024 was paid out in the first eight months of the year.
- **The green transition is accelerating, driven by solar capacity installations.** Solar capacity has grown strongly since the energy crisis, with installations doubling in 2023 compared with 2022. New incentivising rules introduced in 2024 will further boost renewables.

Key priorities for 2025

- **Ongoing pension reform needs to be completed.** Given the acute problem of the ageing population in Slovenia, pension reform has long been planned as a way to ensure the long-term sustainability of the pension system. Discussions are ongoing with stakeholders concerning the retirement age, contribution period, indexation rules and the second pillar.
- **Public-sector wage reform should be implemented.** An important reform, as part of the Recovery and Resilience Plan (RRP), is the change to public-sector wages due by the end of 2024 and to be implemented in 2025. This reform aims to expand performance bonuses and increase the appeal of public-sector jobs.
- **Complementary investment in the grid is needed to support the surge in solar capacity.** Slovenia has accelerated the pace of installing photovoltaic (PV) panels since 2022, but the small-scale model requires more investment in distribution networks.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-4.1	8.4	2.7	2.1	1.5
Inflation (average)	-0.3	2.0	9.3	7.2	2.8
Government balance/GDP	-7.6	-4.6	-3.0	-2.5	-2.4
Current account balance/GDP	7.7	3.8	-1.1	4.5	3.0
Net FDI/GDP [neg. sign = inflows]	0.6	-0.8	-2.5	-0.9	-0.2
External debt/GDP	102.3	97.7	91.0	90.4	na
Gross reserves/GDP	na	na	na	na	na
Credit to private sector/GDP	43.7	41.6	41.7	37.3	na

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Macroeconomic developments and policy response

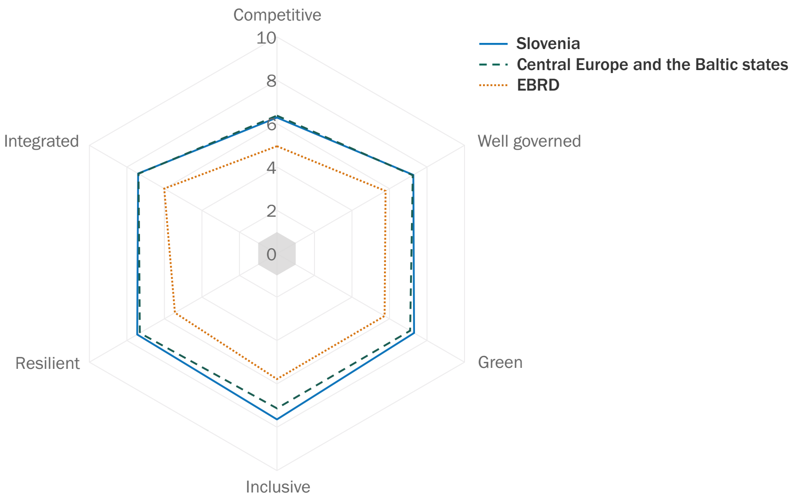
Economic growth was weak in the first half of 2024. After expanding by 2.1 per cent in 2023, the economy entered a phase of even milder growth as real GDP grew by just 1.4 per cent year on year in the first half of 2024. Behind the slowdown were falls in investment, inventories and exports of services. Conversely, government spending accelerated strongly by almost 10 per cent year on year over the same period. The most notable decelerations were in the construction, services and industry sectors. After a 5.8 per cent fall in 2023, industrial production was more volatile in the first half of 2024, but still declined by an average of 3.6 per cent, reflecting weaker foreign demand. The trade in services showed signs of acceleration, however, including on the back of higher tourist inflows.

Inflation dropped below 1.0 per cent. Inflation was still elevated in 2023, averaging 7.2 per cent, largely due to more expensive food, but it had moderated by the end of the year. In 2024, inflation had fallen to 0.9 per cent by August 2024. Deflation was recorded in clothing, utilities and basic services, although prices were still rising by around 6.5 per cent (year on year) in restaurants and accommodation services.

The fiscal position has improved on the back of lower-than-planned spending. The government revised the deficit upwards following the 2023 floods, expecting a GDP deficit of 4.9 per cent in 2023, but given lower-than-planned spending, the deficit was just 2.5 per cent of GDP. In 2024, the government is targeting a deficit of 3.0 per cent of GDP, given a net allocation of 0.6 per cent of GDP to post-flood reconstruction. Still, the deficit was more than 40 per cent lower in the first eight months of 2024 year on year as a result of robust tax revenue growth and the phasing out of inflation mitigation measures. On the spending side, capital expenditures declined by 10 per cent in the same period, while flood relief amounted to €262 million out of the €1.1 billion allocated up to September 2024.

Growth is likely to remain weak in the short term. Considering the dynamics in the first half of 2024, we forecast growth of 1.5 per cent for the entire year, assuming that the quarterly growth path for the rest of the year will improve somewhat. Private consumption could rise slightly as real wage growth drives higher consumer confidence, while investment could accelerate if post-flood reconstruction picks up pace. The evolution of manufacturing and exports remains highly uncertain, translating into a lower trade surplus in 2024 compared with 2023. In 2025, easing conditions in the eurozone and the tight labour market should support higher growth of around 2.6 per cent, close to the economy's estimated potential growth rate.

Assessment of transition qualities (1-10)



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Structural reform developments

Progress on reforms is enabling EU funding. So far, the European Commission (EC) has disbursed two payment requests as part of the Recovery and Resilience Facility. The Slovenian authorities are maintaining a satisfactory pace in implementing the RRF, and the third payment request was submitted in June 2024. To date, 15 of 36 planned reforms have been implemented, with the third request including a proposed ban on the use of fossil fuels to heat new buildings, amendments to pension legislation and new contracts for productivity-enhancing investment projects. The EC has disbursed €841 million, of which €531 million comprises grants and €310 million comprises loans, and €480 million was paid to the final beneficiaries, mostly to public rental housing and railway infrastructure projects, according to the authorities.

A package of tax changes targeting competitiveness has been proposed. Published in August 2024, the package proposes three main changes related to income taxes, aimed at increasing the attractiveness of Slovenia for highly skilled individuals. These include tax incentives for highly qualified staff under 40 years of age returning to Slovenia after two years of work or studying abroad, as well as foreign citizens who had not been Slovenian residents for the two years before starting the job. Both categories would receive a tax benefit of 7 per cent of their gross pay for five years if it is twice as high as the average wage in the country. Another change is a deferral of tax liabilities on stock options, which will benefit start-ups. However, the tax threshold for sole proprietorships will be reduced significantly, which could affect many information technology professionals.

The government approved a new state asset management strategy with some changes to ownership rationale. In July 2024, the parliament approved a new state asset management strategy, updating the previous one from 2015 that defined the ownership strategy of the state. The new document covers 84 state-owned companies and assigns one of three labels to each one: strategic, important and portfolio. It also changes the status of a few key entities. Telekom Slovenije and aluminium producer Talum were upgraded from portfolio to important and strategic, respectively, while gas supplier Geoplin, Nafta Lendava and steel group SIJ were downgraded to portfolio. The strategy also split the state's involvement in the tourism sector by separating real-estate ownership and tourism operations – the first under the Sava group and the second function to Istrabenz Turizem. Proposed downgrades of the postal company and insurer Zavarovalnica Triglav from strategic to important were reversed in the final version, thus limiting the possibility of minority sales for these companies.

The government is progressing with the affordable housing programme. In August 2024 the real-estate assets of the former bad bank, the Bank Assets Management Company, were transferred from the Slovenian State Holding company to the state-owned real estate investment firm DSU (Družba za svetovanje in upravlenje). On the back of managing or selling the properties, DSU will be tasked with building affordable public rental housing, a major government priority. DSU's ownership status, therefore, was changed from important to strategic. The authorities project that 2,500 affordable rental apartments could be built by 2030 out of a total 20,000 flats pledged over the next 10 years, mainly by allocating €100 million per year for the purpose.

The government simplified procedures to accelerate post-flood reconstruction. Following the devastating August 2023 floods, the government revised in December 2023 the August 2023 bill to speed up administrative processes as well as zoning and procurement procedures. In August 2024, after relatively slow progress throughout the year, spatial planning processes and the loan guarantee scheme for homeowners were further amended. Additional EU funding bringing the total to €428 million was announced in September 2024.

New rules aim to further boost solar power capacity. Slovenia has historically lagged regional peers in expanding solar power generation. The energy crisis has nonetheless boosted demand, as capacity increased by 412 MW in 2023 to a total of 1.1 GW, up from 228 MW installed in 2022. In April 2024, the government adopted rules that new large commercial buildings, car parks, public infrastructure and undeveloped building land intended for commercial use will be required to install solar panels. PV panels can now be installed on all buildings.

The government issued its first digital and retail bonds. In July 2024, the government issued €30 million of short-term digital bonds on the private tokenisation Neobonds platform of France's BNP Paribas. The digital bond had a coupon of 3.65 per cent with a maturity of four months. The issue is the first distributed ledger technology bond of an EU country. In addition, the government arranged the first retail bond issuance worth €250 million, designed to increase liquidity on the local capital market and boost citizens' financial literacy and savings options.