

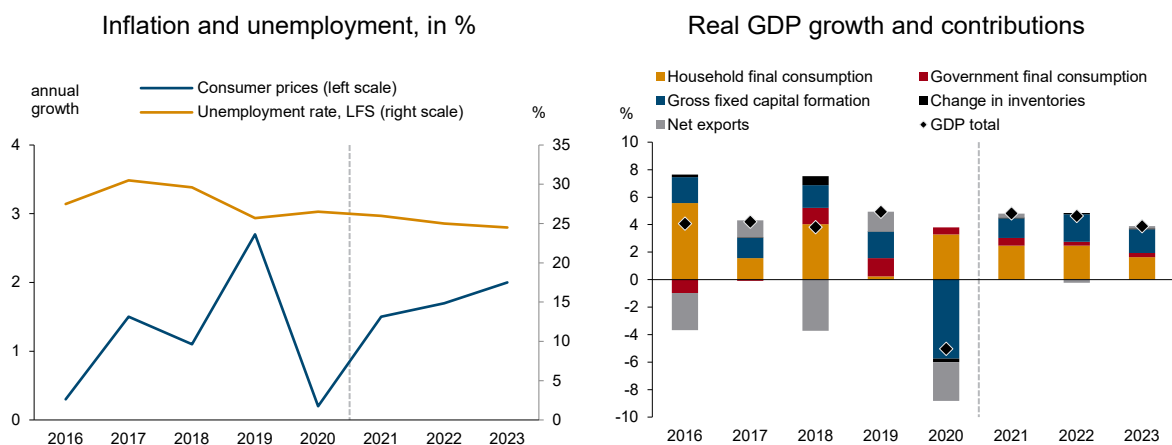


KOSOVO: Major future challenges and high expectations of new government

ISILDA MARA

The economy contracted by 5% in 2020, but growth will return to 4.5% in the medium term, supported by domestic and external demand. However, the downside risks remain high, with the current pandemic still raging and vaccines far off on the horizon. The triumphant return of a Kurti government ('Kurti 2') represents a new opportunity for Kosovo to gain political stability. In March 2021, the European Parliament reaffirmed its call to the EU council to adopt visa liberalisation for Kosovo.

Figure 4.10 / Kosovo: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Kosovo's economy contracted by 5% in 2020, but is expected to grow by 4.8% this year. In particular, the lockdown in the second quarter of 2020 led to a 9.3% fall in economic activity – although the subsequent lifting of the containment measures meant that the pandemic's impact diminished. Investments declined by 24% in the first three quarters of 2020. By contrast, consumption continued to grow at 7% over the same period, thanks to strong remittance flows. There were some interesting developments in foreign demand for goods and services: exports of the former increased by 21% (though as a proportion of trade, goods exports remain low), while exports of the latter fell by 39%. Imports of goods and services decreased by 6% and 21%, respectively. The overall effect was a drop in real net exports of 2.7% in 2020. In terms of output, in the first three quarters of 2020, those sectors that experienced a sharp decline in their activities on an annual basis were construction (25%) and retail trade and transport (13%); meanwhile, industrial production and manufacturing increased their activity to double-digit levels – 10% and 11%, respectively.

No vaccine has yet been made available to Kosovo, and the public healthcare system is coming under strain. A rapid government response at the start of the pandemic helped to keep the number of infections and deaths under control. However, as in other Western Balkan countries, while the first wave of the pandemic was weathered fairly well, the second half of 2020 and the first quarter of 2021 saw average weekly infections rise to almost 2,000 per million inhabitants. In March 2021, infections exceeded 4,700 cases per week and deaths were running at over 50 per week. The World Health Organization's COVAX scheme has announced that the first delivery of vaccines to Kosovo will not take place before May 2021. Albania offered to vaccinate 500 health workers in Kosovo, and the process started in the second half of March.

In 2020, consumption remained positive, thanks to remittances acting as a safety net in Kosovo. Remittances grew by 12% to reach almost EUR 1bn or 15% of GDP in 2020. The solidarity of the diaspora and the support of the Kosovar migrant community for family members back home were particularly apparent among those residing in Germany, Switzerland and Austria. As regards the employment situation, statistics for the first three quarters of 2020 show that employment decreased by 4%, while unemployment increased by 1 percentage point (p.p.) to 26.5%. Those sectors that constitute the main sources of employment – retail trade and construction – are also those that have been severely affected by the pandemic. The social benefit system in Kosovo is weak, and remittances are seen as the main safety net; this explains the sharp increase in remittances.

The banking sector remains robust, and demand for credit has continued to expand, albeit at a slower pace. The private-sector demand for loans increased by 7% in 2020; this was a smaller increase than in previous years, but is understandable, given the pandemic and the tightening of credit standards by banks. The increase in the demand for credit was driven by small and medium-sized enterprises, and the loans were mainly destined for inventories and the restructuring of firms, but also for debt restructuring. Meanwhile, although the level of non-performing loans remains very low (2.7%), it did increase by 0.7 p.p. in 2020 and is expected to increase further, since the pandemic-related moratorium on debt restructuring ended in September 2020. As regards deposits, which are an important source of loan financing, 2020 saw a further increase of more than 12%, to reach EUR 4bn.

Public debt is rising sharply, but is still sustainable. The fiscal stimulus and financial support package offered to mitigate the negative effects of the pandemic (focusing mainly on subsidies, but also covering social transfers and wages) led to a sharp increase in fiscal expenditure of 8.8%, to approach 34.8% of GDP. The adverse effects of the pandemic resulted in a decline of 7.4% in general government revenues (including loans). As a result, the budget deficit reached 7.2% of GDP in 2021, while public debt increased to almost 22% of GDP. At this level, public debt is still sustainable, but with the pandemic ongoing and public finances coming under pressure, the figure will rise further.

The export of goods seems to have benefited from the pandemic, and will continue to do so. Foreign demand led to a big increase in the export of goods, which contrasted with a sharp reduction in the export of services. Kosovo's exports of goods to the EU and Central European Free Trade Agreement (CEFTA) countries – its main trading partners – increased by 28% in 2020. As far as the EU is concerned, in particular there was an increase in exports to Germany, Italy and the Netherlands. As regards CEFTA, half of the exports went to Albania – a record increase of 60% in 2020, year on year – and the rest went mainly to other neighbouring countries such as Bosnia and Herzegovina and Serbia. Those categories of goods that witnessed an expansion of their exports included basic metals,

agricultural products and chemicals. This positive trend has continued into early 2021. The pandemic has apparently sparked an intensification of trade relations with countries that geographically are closer: in part, this explains Kosovo's exports of goods gaining momentum. By contrast, exports of services fell sharply, by almost 40%. In 2020, imports of goods and services fell by 6% and 21%, respectively. That said, imports of goods from CEFTA increased by 22%, as imports from Serbia were reinstated, following the lifting of the 100% tariff on such imports. Foreign direct investment (FDI) had a good year in 2020, recording a 16% increase. In particular, FDI inflows from Austria, Slovenia and Albania more than doubled; but other countries – such as Hungary, the United States and Serbia – also significantly increased their FDI inflows into Kosovo. The outlook for 2021 is rather uncertain, as the pandemic remains a concern.

There are great expectations of the Kurti 2 government, which nevertheless faces considerable challenges. Parliamentary elections were held on 14 February 2021. The Vetëvendosje party, led by Albin Kurti, obtained 50.3% of the vote, securing 58 out of the 120 seats in parliament. A government was formed on 23 March, with Albin Kurti as prime minister. This time around, the Kurti administration's chances of pursuing its ambitious programme for at least four years are good, given the big representation of the Vetëvendosje party in parliament and government. In the coming weeks, the next milestone is the election of president: Vjosa Osmani – now aligned with Albin Kurti – is currently the president-designate (until May 2021) and is the main candidate for this position (since former President Hashim Thaçi was indicted in The Hague by the Kosovo Specialist Chambers on war crimes charges). Negotiations between the leading party and the opposition parties are still ongoing, as a two-thirds majority in parliament is needed to elect the president. The probability that Vjosa Osmani will be elected president remains high. Management of the pandemic, the vaccination programme, the promotion of employment and the fight against corruption are among the top priorities of the Kurti 2 government. As regards dialogue with Serbia, Kurti has stated that he will prioritise the issue of 1,604 missing persons – still an open wound for families in Kosovo.

We expect the economy to return to 4.5% growth in the medium term. Goods exports have gained momentum, and this trend will continue – even though their weight in foreign trade remains low. Growth will be driven mainly by domestic demand. Albin Kurti has assumed office in difficult times: high expectations are pinned on him, but there is also optimism for political stability and economic prosperity that could reassure also international partners. A further source of optimism is the EU Parliament's vote in March 2021 which calls for the EU council to adopt visa liberalisation for Kosovo.

Table 4.10 / Kosovo: Selected economic indicators

	2017	2018	2019	2020 ¹⁾	2021	2022	2023
					Forecast		
Population, th pers., average	1,791	1,797	1,789	1,772	1,764	1,763	1,769
Gross domestic product, EUR m, nom.	6,414	6,726	7,104	6,800	7,200	7,700	8,200
annual change in % (real)	4.2	3.8	4.9	-5.0	4.8	4.6	3.9
GDP/capita (EUR at PPP)	7210	7340	7790	7580	.	.	.
Consumption of households, EUR m, nom.	5,370	5,738	5,836	6,100	.	.	.
annual change in % (real)	1.8	4.8	0.3	4.0	3.0	3.0	2.0
Gross fixed capital form., EUR m, nom.	1,729	1,888	2,038	1,600	.	.	.
annual change in % (real)	5.7	6.1	6.8	-20.0	4.9	7.0	6.0
Gross industrial production ²⁾							
annual change in % (real)	4.9	-1.3	6.3	0.8	1.2	3.0	3.0
Gross agricultural production							
annual change in % (real)	-4.1	-8.8	9.5	-1.5	.	.	.
Construction output ³⁾							
annual change in % (real)	8.6	9.3	3.5	-3.0	.	.	.
Employed persons, LFS, th, average ⁴⁾	357.1	345.1	363.2	348.6	355	365	375
annual change in %	7.6	-3.4	5.2	-4.0	1.0	2.0	2.0
Unemployed persons, LFS, th, average ⁴⁾	156.6	145.0	125.3	130.0	120	120	120
Unemployment rate, LFS, in %, average ⁴⁾	30.5	29.6	25.7	26.5	26.0	25.0	24.5
Reg. unemployment rate, in %, eop
Average monthly gross wages, EUR	528	558	600	630	660	680	700
annual change in % (real, gross)	1.7	4.7	5.0	5.0	3.0	1.5	1.5
Average monthly net wages, EUR	471	498	550	580	610	630	660
annual change in % (real, net)	1.5	4.6	7.0	4.5	3.0	2.0	2.0
Consumer prices (HICP), % p.a.	1.5	1.1	2.7	0.2	1.5	1.7	2.0
Producer prices, % p.a.	0.6	1.4	0.9	-0.6	1.4	1.5	1.7
General governm.budget, nat.def., % of GDP ⁵⁾							
Revenues	30.0	29.8	31.3	32.8	31.0	31.0	32.0
Expenditures	28.6	29.4	30.3	34.8	32.0	31.5	31.0
Deficit (-) / surplus (+)	1.3	0.4	1.0	-2.0	-1.0	-0.5	1.0
General gov.gross debt, nat.def., % of GDP	15.5	16.3	16.9	22.0	23.0	23.0	22.0
Stock of loans of non-fin.private sector, % p.a.	11.6	10.8	10.0	7.1	.	.	.
Non-performing loans (NPL), in %, eop	3.1	2.7	2.0	2.7	.	.	.
Central bank policy rate, % p.a., eop ⁶⁾	6.83	5.99	6.42	6.01	6.00	6.00	6.00
Current account, EUR m	-349	-509	-399	-429	-500	-530	-470
Current account, % of GDP	-5.4	-7.6	-5.6	-6.3	-6.9	-6.9	-5.7
Exports of goods, BOP, EUR m	378	377	393	475	510	540	560
annual change in %	22.9	-0.4	4.4	20.8	8.2	6.0	4.0
Imports of goods, BOP, EUR m	2,843	3,114	3,233	3,048	3,170	3,300	3,370
annual change in %	9.4	9.6	3.8	-5.7	4.0	4.0	2.0
Exports of services, BOP, EUR m	1,359	1,562	1,675	1,019	1,110	1,180	1,240
annual change in %	20.2	14.9	7.3	-39.1	9.0	6.5	5.5
Imports of services, BOP, EUR m	531	706	749	589	630	670	700
annual change in %	8.1	32.8	6.1	-21.3	6.5	6.0	4.0
FDI liabilities, EUR mn	255	272	255	322	.	.	.
FDI assets, EUR mn	43	46	66	54	.	.	.
Gross reserves of CB excl. gold, EUR m	683	769	864	901	.	.	.
Gross external debt, EUR m	2,088	2,036	2,201	2,380	2,200	2,300	2,500
Gross external debt, % of GDP	32.6	30.3	31.0	35.0	31.0	30.0	30.0

1) Preliminary and wiiw estimates. - 2) Turnover in manufacturing industry (NACE C). - 3) Value added. - 4) Population 15-64. - 5) According to IMF Government Finance Statistics and ESA 2010 requirements. - 6) Average weighted effective lending interest rate of commercial banks (Kosovo uses the euro as national currency).

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.