KOSOVO: Strong growth momentum and reciprocity with Serbia

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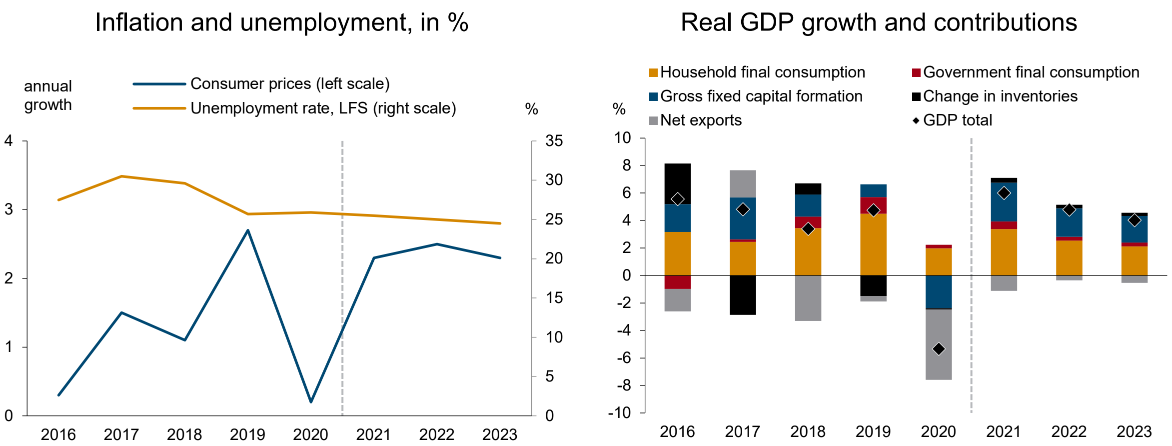
The economy has recovered quickly to pre-pandemic levels, and this year GDP growth will accelerate to 6%. The momentum is likely to persist and will be backed by strong domestic and external demand. Both consumption and investment will continue to benefit, as remittances flood in. Foreign investors are turning their gaze towards Kosovo: foreign direct investment has kept pace with the positive developments of 2020 and will continue on this path. Exports of goods will maintain their positive trend.

Figure 4.10 / Kosovo: Main macroeconomic indicators



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

Household spending and investment have driven the economy on. In Q2 2021, year on year, GDP growth accelerated to 16.3%, following the 4.2% of Q1. The economy is back in gear, thanks to advances made in all its sectors – apart from real estate activities. The construction sector was an important driver of growth in the first half of 2021, while manufacturing activity picked up in Q2. Information and communication activities have been gaining traction, encouraged by the expanding demand for such activities, not least at the global level. The economic revival reflects a sharp acceleration in both household spending and government consumption (10% and 15%, respectively) in the first half of 2021, year on year; meanwhile, gross fixed capital formation also rose by more than 22% over the same period. In contrast, external demand made a negative contribution to growth: despite a remarkable upsurge in merchandise and services exports in the first half of the year (62% and 56%, respectively), imports also grew substantially.

The vaccination rollout has been very slow, and partial restrictions may have to return. More than 1m doses have been administered, and close to 440,000 people have received two shots – less than 25% of the total population. August was quite a dramatic month, with new daily infections exceeding 2,500. The upsurge of infections coincided with the easing of restrictions, the greater mobility in and out of the country, the tourist season and the return of migrants for the summer holidays. Meanwhile, the COVID-related daily death toll hovered at around 30. However, the wave is receding: the number of daily infections has dropped to around 50 new cases and the daily death toll is below 5. Although new infections are declining, the slow pace of vaccination of the vulnerable population carries with it certain risks that may prompt the government to reintroduce further containment measures, which could hit economic activity for the rest of the year.

Government spending has accelerated, but the fiscal position has improved beyond all expectations. The general government budget has managed to avoid a fiscal deficit – at least up to August, both revenue and expenditure stood at 27.8% of GDP. Revenues surged by 32%, while expenditure rose by 6%. Still, expenditure could pick up by the end of the year, given the EUR 420m recovery plan and the increased subsidies that the government has committed to over the coming months. A number of wage subsidies have been announced for those who lost their jobs during the pandemic: these range from EUR 50 to EUR 150 for a period of three months. Also, child benefits of EUR 24 a month will be introduced for children up to the age of 16. Other means-tested benefits to encourage female employment will be introduced. The year may close with a fiscal deficit that will not swell the public debt (as it did in 2020): this debt is projected to rise from 22% to 23% of GDP.

The financial sector has been supportive, and lending activity has expanded significantly. Lending to households and non-financial sector corporations picked up by 12.5% in the first half of the year, encouraged by an easing of the terms and conditions for new loans. The demand for new loans came mainly from small and medium-sized enterprises seeking fixed investment financing, but also inventories and working capital; this indicates that there has been a recovery in economic activity that will remain solid. Furthermore, the new loans taken out by households are intended as housing loans, rather than consumer credit, suggesting that consumer confidence has been restored. Also, as of 1 October 2021, the government is offering subsidies for consumer credit loans (up to 10% on credit of up to EUR 10,000), with the aim of alleviating the liquidity constraints on households – a manoeuvre that will certainly help the strong consumption momentum to continue.

Inflation has been rising, mainly driven by global trends. Inflation doubled between June and August 2021, to reach 4.7%, year on year. This has been caused by the higher prices for food, electricity, gas and other fuels internationally – and consequently domestically. Over the first eight months of the year, inflation rose by 2% on average. Given that the inflationary pressure stemming from international price dynamics – especially the cost of fuel and energy – will persist, we project that by the end of the year inflation will have reached 2.3% and will rise to 2.5% in 2022.

Employment has been catching up with pre-pandemic levels. The negative effects of the pandemic on the labour market were especially felt in the initial phase, and overall 2020 closed with a 0.2 percentage point rise in unemployment, although close to 20,000 jobs were lost. However, preliminary data from the administrative office suggest that employment has picked up, and by the second half of 2021 had returned to pre-pandemic levels. This upturn has been driven by a number of support schemes introduced by the government to assist access and re-entry to the labour market (EUR 50m), as well as other subsidies offered to companies to relaunch their business activity (EUR 43m). Also, the employment situation has benefited from the bounce-back of those sectors of the economy that are also the main sources of employment – such as construction, manufacturing, wholesale and retail trade – which have been catching up on their pre-pandemic levels.

The diaspora and remittances are keystones of Kosovo's economy and will continue to be supportive this year. In 2020, remittances exceeded EUR 1bn and accounted for almost 15% of GDP; in the first eight months of 2021, the inflow of remittances was 23% higher than in the same period last year. Because of high long-term unemployment (and particularly youth unemployment – one of the highest rates in Europe), remittances are mainly used to smooth consumption and to assist those families and social groups that are most vulnerable and at highest risk of poverty. In July 2021, the current government issued, for the first time, a 'Diaspora Bond' to the value of EUR 20m, with a maturity of three or five years and an interest rate of 1.2% and 2.4%, respectively. The amount that can be invested ranges from EUR 10,000 to EUR 500,000. The capital invested in these bonds by emigrants will be used for strategic investment projects that generate employment. This initiative seeks to boost the role of the diaspora and ensure that its financial support creates the momentum for investment and job creation.

External demand has grown hugely and will remain solid. External demand – for exports of both goods and services – has been growing. Especially goods exports have maintained the momentum of 2020, rising by over 62% in the first half of the year. However, when we consider the net trade balance, their effect is overshadowed by Kosovo's heavy dependence on imports. Brexit seems to have had a positive effect on goods exports from Kosovo: up to August 2021, the UK was the country that Kosovo exported most to – almost six times more than in the same period of 2020; previously, exports to the UK had been almost non-existent. Exports to Germany and Italy have also been increasing rapidly. Of the neighbouring countries, Albania continued to have the same weight, while exports to North Macedonia more than doubled to reach 30% of Kosovo's total exports to neighbouring Western Balkan countries. As the upturn in imports was also quite strong (41%), the current account deficit widened to 12% of GDP in the first half of the year. In particular, imports from Serbia have gained momentum – more than doubling in the period January-August 2021, year on year – and seem to have re-established their market share in Kosovo, following the abolition in March 2020 of the 100% tariff on Serbian imports.

Foreign investors are turning their gaze towards Kosovo. During the first pandemic year, foreign direct investment (FDI) in Kosovo rose by 40% to EUR 345m (5% of GDP). This year looks even better: foreign capital investment in Kosovo in the first seven months of the year was greater than the total amount invested in 2019 – and 33% higher than in the first seven months of 2020. The FDI pouring into the country originated mainly in Germany, Switzerland, Austria, Albania and the USA. Germany has been the main foreign investor, having invested EUR 56m up to July 2021 – 46% more than in the same period of 2020. Also, Austrian investment in Kosovo rose significantly – up 68% to EUR 26m over the same period. The sectors of the economy that have mainly attracted FDI are real estate, information and communications, and financial and insurance activities. Certainly, Kosovo is benefiting from the difficulties that emerged due to supply-chain disruptions after the start of the pandemic. Apart becoming a magnet for investment from EU countries, it has also succeeded in attracting FDI in certain sectors where demand is high at the global level – e.g. information and communications technology services. This could become an important source of employment, especially for young people.

The Kurti government is committed to reciprocity in its dealings with Serbia. The last days of September were quite chilly for Kosovo-Serbia relations. The reason was a dispute over vehicle licence plates and the state symbols used on them. The free-movement agreement between the countries reached 10 years ago stipulated that vehicles in Kosovo should use number plates issued by the Interior Ministry of Kosovo – with the symbol of Kosovo – replacing those issued previously by the Interior Ministry of Serbia. All this time, Serbia has refused to recognise these plates, so that any vehicles from Kosovo that enter Serbia are expected to affix temporary licence plates. On 20 September, Kosovo decided to apply the same rules to vehicles from Serbia that enter Kosovo. This decision sparked tension between the two. Local Serbs organised protests and blocked two border crossings in the north of Kosovo. The situation escalated, with the mobilisation of special police forces in Kosovo, the NATO-led Kosovo Force (KFOR) and armed forces in Serbia at the border between the two countries. Thanks to mediation by Brussels, a temporary solution was found, and from 2 October 2021 both countries will use stickers – rather than temporary plates – when crossing the border.

The economy will continue to recover steadily. Already, in the first half of 2021 economic activity had caught up with pre-pandemic levels. The main driver of growth will continue to be solid domestic demand. External and near-shore demand will expand further, and especially FDI from Germany and other European countries may well continue on an upward trajectory. Consumption will stay solid, as remittances continue to flood into the country. Given the strong growth momentum, we have revised our GDP forecast for this year upwards – from 5.3% to 6%.

Table 4.10 / Kosovo: Selected economic indicators

	2018	2019	2020 1)	2020 January-June	2021 January-June	2021 Forecast	2022 Forecast	2023 Forecast
Population, th pers., average	1,797	1,789	1,790	.	.	1,795	1,798	1,800
Gross domestic product, EUR m, nom. 2)	6,672	7,056	6,772	3,145	3,540	7,300	7,800	8,300
annual change in % (real)	3.4	4.8	-5.3	-4.3	10.5	6.0	4.8	4.0
GDP/capita (EUR at PPP)	7510	7970	7760	.	.	.	.	.
Consumption of households, EUR m, nom. 2)	5,296	5,621	5,720	2,759	3,105	.	.	.
annual change in % (real)	4.4	5.7	2.5	1.0	9.8	4.0	3.0	2.5
Gross fixed capital form., EUR m, nom.	2,116	2,190	2,012	.	.	.	.	.
annual change in % (real)	5.4	2.9	-7.6	.	.	9.5	7.0	6.5
Gross industrial production 3)								
annual change in % (real)	-1.3	6.3	0.8	-8.9	32	8.0	5.0	4.0
Gross agricultural production								
annual change in % (real)	-8.8	9.5	2.7	.	.	.	.	.
Construction output 4)								
annual change in % (real)	1.5	1.5	-9.0	.	.	.	.	.
Employed persons, LFS, th, average 5)	345.1	363.2	347.1	.	.	364	371	378
annual change in %	-3.4	5.2	-4.4	.	.	5.0	2.0	2.0
Unemployed persons, LFS, th, average 5)	145.0	125.3	121.4	.	.	120	120	120
Unemployment rate, LFS, in %, average 5)	29.6	25.7	25.9	.	.	25.5	25.0	24.5
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.	.
Average monthly gross wages, EUR	453	477	466	.	.	490	510	530
annual change in % (real, gross)	6.1	8.7	6.0	.	.	3.0	2.0	2.0
Average monthly net wages, EUR	409	430	416	.	.	440	460	480
annual change in % (real, net)	3.7	2.4	-3.4	.	.	3.0	2.0	2.0
Consumer prices (HICP), % p.a.	1.1	2.7	0.2	0.6	1.3	2.3	2.5	2.3
Producer prices, % p.a.	1.4	0.9	-0.6	-0.8	2.8	1.4	1.5	1.7
General governm.budget, nat.def., % of GDP								
Revenues	26.3	26.8	25.4	24.2	27.8	28.0	29.0	30.0
Expenditures	29.2	29.7	33.0	28.3	27.8	30.0	31.0	31.0
Deficit (-) / surplus (+)	-2.9	-2.9	-7.6	-4.2	-0.1	-2.0	-2.0	-1.0
General gov.gross debt, nat.def., % of GDP	16.4	17.0	22.0	18.2	23.2	23.0	23.0	22.5
Stock of loans of non-fin.private sector, % p.a.	10.8	10.0	7.1	6.4	12.2	.	.	.
Non-performing loans (NPL), in %, eop	2.7	2.0	2.7	2.6	2.5	.	.	.
Central bank policy rate, % p.a., eop 6)	5.99	6.42	6.01	6.3	6.0	6.00	6.00	6.00
Current account, EUR m	-509	-399	-481	-217	-450	-610	-630	-600
Current account, % of GDP	-7.6	-5.7	-7.1	-6.9	-12.7	-8.4	-8.1	-7.2
Exports of goods, BOP, EUR m	377	393	475	213	344	580	630	670
annual change in %	-0.4	4.4	20.8	16.7	61.6	23.0	8.5	6.0
Imports of goods, BOP, EUR m	3,114	3,233	3,048	1,352	1,912	3,400	3,540	3,680
annual change in %	9.6	3.8	-5.7	-8.9	41.4	11.5	4.0	4.0
Exports of services, BOP, EUR m	1,562	1,675	994	396	616	1,180	1,260	1,340
annual change in %	14.9	7.3	-40.7	-32.5	55.6	19.0	7.0	6.0
Imports of services, BOP, EUR m	706	749	602	247	335	650	700	730
annual change in %	32.8	6.1	-19.6	-15.9	35.9	8.0	7.0	4.0
FDI liabilities, EUR mn	272	255	342	174	230	400	.	.
FDI assets, EUR mn	46	66	59	17	38	10	.	.
Gross reserves of CB excl. gold, EUR m	769	864	901	900	947	.	.	.
Gross external debt, EUR m	2,036	2,201	2,517	2,259	2,691	2,700	2,600	2,500
Gross external debt, % of GDP	30.5	31.2	37.2	33.4	36.9	37.0	33.0	30.0

1) Preliminary. - 2) Half-year data unrevised. - 3) Turnover in manufacturing industry (NACE C). - 4) Value added. -
5) Population 15-64. - 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.