KOSOVO: 2019 a decisive year for relations with Serbia

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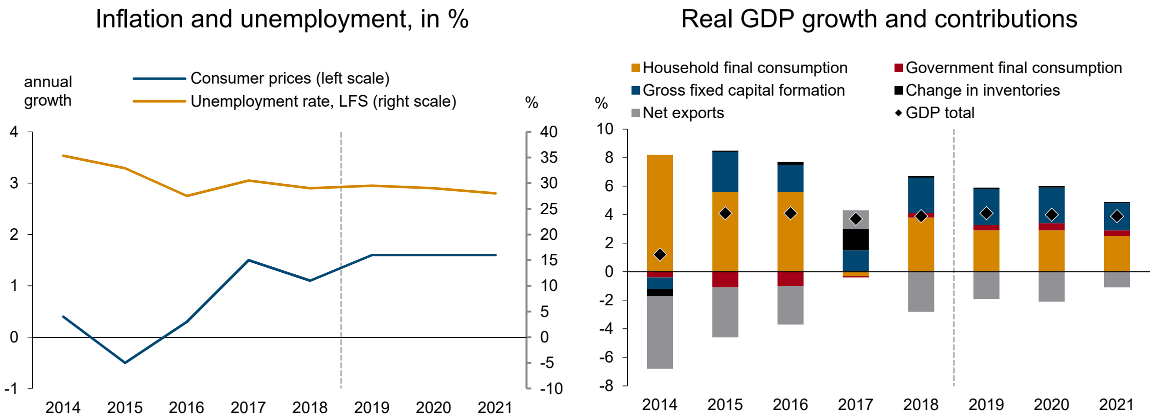
The pace of growth will pick up to above 4% in the medium term. Consumption as well as public and private investment will provide a new impetus to growth. The external sector will be characterised by a further widening of the trade deficit. The 100% tariff on imports from Serbia is unlikely to have a strong impact on the economy. 2019 is expected to be a decisive year for the Kosovo-Serbia dialogue and their future place in the EU.

Figure 6.10 / Kosovo: Main macroeconomic indicators



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

Economic growth is estimated to have accelerated to around 4% in 2018 as gross fixed capital formation picked up at a double-digit rate. In addition, supportive to growth has been the rise in consumption, at 4.3% in the first three quarters of 2018, year on year, which was backed mainly by a strong recovery in household consumption, up 4.7% in the same period. The boost in consumption is explained by the rise in remittances of 7% during Q1-Q3 2018, year on year, and that in real wages of 3%. Medium-term prospects are rather in favour of consumption continuing to support growth due to further hikes in real wages, social transfers and remittances. In addition, we expect a strong increase in public and private investment in the medium term – dynamics which can contribute to rebalancing the GDP's structural composition, which is largely dominated by consumption with a share of 85%.

The new general government budget is expected to put some strain on public debt. The fiscal position until November 2018 was characterised by rising budget revenues, up 4.4%, and expanding expenditures, up 13%. Indirect taxes and especially VAT continue to be the main sources of revenues. The strong rise in expenditures was due to public capital investment and expenditures on wages/salaries – which picked up by 19% and 8%, respectively. Still, such dynamics left the structural composition of expenditures almost unchanged, with close to one third allocated to wages/salaries and one quarter to public capital investment. The general government deficit widened, but the public debt to GDP ratio remained low, at around 17%. The general government budget in 2019 foresees a much stronger push on public wages and pensions, which might contribute to a further shift in expenditures towards wages and social transfers – the latter risking to jump to a 50% share in total budget expenditures. Leaving aside the change in composition, the foreseen budget might contribute to a rapid rise in the public deficit.

The banking sector continues to be stable. Demand for new loans has been on the rise and until November 2018 the stock of loans of the non-financial private sector picked up by 11%, year on year, while non-performing loans stood at a negligible level of 2.7% in the same period. Inflation, mainly imported from the economies of the EU, reached a relatively low level of 1.1% and in the near future will continue to stay subdued following the EU trend.

Signals from the labour market indicators are pessimistic. Despite a real GDP growth rate of close to 4%, labour market indicators did not improve: labour force participation shrank by 1.5 p.p. to 42% in the third quarter of 2018, year on year. In the same period the unemployment rate rose by 0.5 p.p. to 30.7%. More severe is the unemployment rate among the age group 15-24, which deteriorated further to 55%. It is especially this generation which suffers the most from the isolation and restricted mobility outside the country. The postponement of the EU Council's decision to grant free visa travel to citizens of Kosovo and the lengthy processing of visa applications are generating further frustration and social tensions especially for this age cohort. This decade the number of asylum seekers from Kosovo to the EU reached 179,000, even though their applications have been declining recently.

Foreign direct investment inflows are likely to recover in the medium term. FDI inflows have been shrinking in 2018, dropping by 15% until October 2018, year on year. Nevertheless, starting from 2019 the outlook is promising. SOWI Kosovo LCC, a German-Kosovo joint venture, will invest EUR 169 million to build a wind farm with 30 turbines and a total capacity of 105 megawatt in Mitrovica in the north of Kosovo. Also two other companies, Solar Kosova 2020 and KelKos-Energy Peja, both plan to invest EUR 225 million in renewable energy. Despite the withdrawal of the World Bank from supporting the construction of the Kosova e Re coal power plant, the government of Kosovo is keen to go ahead with the project. It has been confirmed that the US company Global Contour, in charge of building the new coal power plant, has found new financial partners supporting the project. EUR 1.3 billion are expected to be invested in its construction. It will have a capacity of 500 megawatt and will use lignite coal; the estimated $C0_2$ emission is 2.01 Mt/year. The new plant will replace the existing 'Kosovo B' coal power plant, which is at the end of its life cycle. The new project has been criticised by the Vienna-based Energy Community concerning the unfavourable terms of the deal towards the Kosovo government. For a small economy such as Kosovo's, this investment project will give a strong impetus to growth. Nevertheless, for a number of reasons – delays and uncertainties about its financing, the timing of construction, environmental impact and terms of agreement – the project is not included among the contributing components to our mid-term forecast.

Damaging rhetoric has surrounded the fragile Kosovo-Serbia dialogue. Recent statements about the idea of territorial swapping, border corrections, the potential of Kosovo being another arena for NATO-Russia tensions, the idea of 'ethnic Albania' and many more challenging issues do not make the dialogue between Kosovo and Serbia, which has been stalling, any easier.

A tariff of 100% was imposed on imports from Serbia and Bosnia and Herzegovina. Last November Kosovo introduced a tariff of 100% on imports from Serbia and Bosnia and Herzegovina, with the argument that Serbia had been sabotaging Kosovo's membership in international organisations such as Interpol, UNESCO etc. and its recognition by further countries. Since then Serbia refuses to continue the dialogue with Kosovo as long as the 100% tariff on its exports remains in place. The international partners have stepped in to calm the tensions. The United States and the EU have invited Kosovo to suspend the 100% tariff and at the same time President Trump urged Serbia to take concrete steps towards Kosovo's recognition. The Achilles' heel of the Kosovo-Serbia relationship is certainly the north of Kosovo. Prime Minister Ramush Haradinaj is firm in that the integrity of Kosovo territory is indisputable. For the most, territorial swapping or border correction was never part of the Kosovo-Serbia dialogue convened by the EU and its High Representative for Foreign Affairs, Federica Mogherini. As concerns Serbia, its progress on EU integration is conditioned on the recognition of Kosovo. As for Kosovo, despite the EU Parliament's recommendation for visa liberalisation in September 2018, the EU Council has still not decided to support it. After so many years of dialogue – starting already in 2011 as two entities – Kosovo and Serbia need to take courageous steps and come up with an agreement (for example one similar to the Prespa agreement between Greece and Macedonia) which would bring to an end the centennial disputes and pave the way for EU integration of both countries. Given the current state of affairs, it is difficult to say whether such an agreement will be reached and what will be the outcome.

Obviously, the 100% tariff has been a political rather than an economic instrument. In November-December 2018 imports from Serbia to Kosovo dropped by 90%, year on year, and their share in total imports shrank from 18% to less than 2%. Certainly, Kosovo quickly diversified its trading partners and stepped up imports from its neighbours. A large part of imports from Serbia has been replaced with imports from Albania, Macedonia, Slovenia, Greece and Bulgaria – countries whose exports to Kosovo rose by 45% combined during the same period. Nevertheless, Kosovo is quite dependent on imports of electricity from Serbia. Statistics for 2017 indicate that 90% of electricity imported to Kosovo came from Serbia. Serbia does not report trade statistics with Kosovo. However, mirror statistics suggest that Serbian exports to Kosovo represented not more than 3% of total Serbian exports – at least in 2017. In fact, trade statistics indicate that overall Serbian goods exports rose by 8% in 2018; in November-December 2018 the rise was at 7% compared with the same period in 2017 – a rate of growth higher than the 5% observed for the same period between 2016 and 2017. Accordingly, Serbia is likely to quickly counterbalance the effect of the 100% tariff imposed by Kosovo.

Growth will accelerate to above 4% in the medium term, backed by domestic demand and investment in infrastructure projects. A number of new projects in renewable energy will contribute to the diversification of energy sources, raising the energy supply and reducing Kosovo's dependence on imported energy. 2019 might be a pivotal year for the Kosovo-Serbia dialogue and for the EU perspective of both countries.

Table 6.10 / Kosovo: Selected economic indicators

	2014	2015	2016	2017	2018 [1)]	2019	2020 Forecast	2021
Population, th pers., average	1,813	1,788	1,778	1,791	1,813	1,830	1,845	1,860
Gross domestic product, EUR mn, nom.	5,567	5,807	6,070	6,282	6,600	7,000	7,400	7,800
annual change in % (real)	1.2	4.1	4.1	3.7	3.9	4.1	4.0	3.9
GDP/capita (EUR at PPP)	6800	7400	7600	7700	8000	.	.	.
Consumption of households, EUR mn, nom.	4,802	4,943	5,194	5,271	5,600	.	.	.
annual change in % (real)	9.8	6.5	6.6	-0.4	4.5	3.5	3.5	3.0
Gross fixed capital form., EUR mn, nom.	1,294	1,499	1,550	1,729	1,900	.	.	.
annual change in % (real)	-3.3	12.1	7.3	5.7	9.0	9.0	9.0	7.0
Gross industrial production [2)]								
annual change in % (real)	7.3	3.7	-6.7	4.9	3.0	3.5	3.0	5.0
Gross agricultural production								
annual change in % (real)	-21.4	13.8	15.2	-8.6	2.0	.	.	.
Construction output [3)]								
annual change in % (real)	-6.1	15.8	4.5	12.4	10.0	.	.	.
Employed persons, LFS, th, average [4)]	323.5	296.9	331.8	357.1	357.8	365	370	375
annual change in %	-4.4	-8.2	11.7	7.6	0.2	2.0	1.5	1.5
Unemployed persons, LFS, th, average [4)]	176.7	145.8	126.1	156.6	150.0	150	150	150
Unemployment rate, LFS, in %, average [4)]	35.3	32.9	27.5	30.5	29.0	29.5	29.0	28.0
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.	.
Average monthly gross wages, EUR	482	510	519	511	530	570	600	630
annual change in % (real, gross)	-6.0	0.0	1.5	-0.1	3.0	5.0	4.0	4.0
Average monthly net wages, EUR	430	451	457	450	490	520	540	570
annual change in % (real, net)	9.0	5.4	1.0	-3.0	7.0	4.0	3.0	3.0
Consumer prices (HICP), % p.a.	0.4	-0.5	0.3	1.5	1.1	1.6	1.6	1.6
Producer prices, % p.a.	1.7	2.7	-0.1	3.4	3.0	2.0	1.5	1.2
General governm.budget, nat.def., % of GDP								
Revenues	24.2	29.4	29.3	30.6	31.5	31.0	31.0	31.5
Expenditures	27.2	27.8	29.1	29.2	31.0	33.0	33.0	33.0
Deficit (-) / surplus (+)	-2.9	1.6	0.2	1.4	0.5	-2.0	-2.0	-1.5
General gov.gross debt, nat.def., % of GDP	10.5	12.9	14.0	15.9	17.0	18.0	19.0	20.0
Stock of loans of non-fin.private sector, % p.a.	6.2	7.2	10.5	11.6	10.8	.	.	.
Non-performing loans (NPL), in %, eop	8.3	6.2	4.9	3.1	2.7	.	.	.
Central bank policy rate, % p.a., eop [5)]	9.29	7.69	7.22	6.83	5.99	6.00	6.00	5.50
Current account, EUR mn	-385	-497	-481	-383	-430	-510	-580	-600
Current account, % of GDP	-6.9	-8.6	-7.9	-6.1	-6.5	-7.3	-7.8	-7.7
Exports of goods, BOP, EUR mn	324	323	308	379	364	380	390	400
annual change in %	11.3	-0.5	-4.5	23.1	-4.0	5.0	3.5	3.5
Imports of goods, BOP, EUR mn	2,383	2,432	2,599	2,843	3,077	3,300	3,550	3,730
annual change in %	4.2	2.1	6.9	9.4	8.2	7.2	7.5	5.0
Exports of services, BOP, EUR mn	929	952	1,131	1,330	1,420	1,510	1,590	1,690
annual change in %	6.1	2.5	18.8	17.6	6.8	6.0	5.0	6.0
Imports of services, BOP, EUR mn	469	494	492	536	570	630	660	710
annual change in %	32.0	5.5	-0.5	9.0	6.3	10.0	5.0	7.0
FDI liabilities, EUR mn	151	309	220	255	230	.	.	.
FDI assets, EUR mn	27	37	43	43	60	.	.	.
Gross reserves of NB excl. gold, EUR mn	645	708	605	683	769	.	.	.
Gross external debt, EUR mn	1,737	1,932	2,015	2,089	2,110	2,300	2,400	2,400
Gross external debt, % of GDP	31.2	33.3	33.2	33.2	32.0	32.5	32.0	31.0

1) Preliminary and wiiw estimates. - 2) Turnover in manufacturing industry (NACE C). - 3) Value added. - 4) Population 15-64. - 5) 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.