

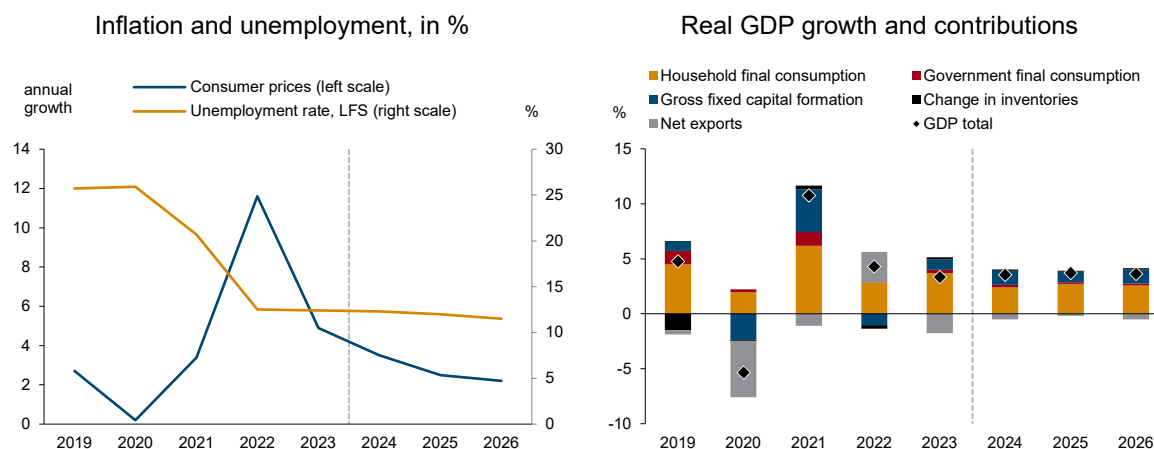


KOSOVO: Economy remaining resilient in the face of heightened regional tension

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The risks related to external tensions tend toward the upside. Despite the challenges posed by certain external events, the economy has demonstrated remarkable resilience, achieving a growth rate of 3.4% last year. Household consumption and investment both played a pivotal role in bolstering the economy, and these are expected to continue as the primary drivers of growth in the medium term. Moreover, inflation has receded and that trend is likely to continue in the coming years. In addition, there has been a surge in foreign direct investment specifically targeting renewable energy projects.

Figure 6.10 / Kosovo: Main macroeconomic indicators



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

The economy has successfully weathered the pressure that has arisen in the wake of certain external disagreements. In Q4 2023, GDP growth picked up further to 4% year on year, and 2023 as a whole saw real GDP growth of 3.4%, exceeding our expectations by 0.2 percentage points (pp). That growth was particularly supported by household consumption (which increased by 4%) and by public and private investment (which rose by 3% during the same period).

Household consumption made a significant contribution to GDP growth. Overall, it accounted for 4 pp of real GDP growth, due primarily to buoyant remittances, which surged by 10% to reach EUR 1.3bn (equivalent to 14% of GDP). However, the balance of trade in goods and services was negative, as exports of goods lost momentum while imports continued to rise. The overall net effect of trade on growth was -1.8 pp. Looking ahead to the medium term, we anticipate that growth will accelerate further to 3.5% in 2024 and 3.7% in 2025. Factors that will contribute to this include the easing of inflationary

pressures, improvements in the labour market, rising real wages and the continued support of generous remittances that will cushion consumption.

Apart from public administration, all sectors of the economy made a positive contribution to growth. Notably, the manufacturing, financial, and information and communication technology (ICT) sectors have been driving economic activity. It is particularly relevant to highlight the steady rise in Kosovo of the ICT sector, which is becoming a significant source of employment. According to the Oxford University Online Labour Index (OLI), the number of remote workers per capita is rapidly increasing in Kosovo. In fact, it has outstripped the figures for other Western Balkan and Central and Eastern European countries, such as Albania, Croatia, Slovenia and Slovakia.

Public finances have been further consolidated, although in the medium term public debt is expected to rise once again. Public investment surged significantly in 2023 and is projected to remain at a substantial level this year. Capital expenditure rose by 27%, while 12% of total government expenditure was allocated to public investment. Additionally, wage-related expenses increased by over 15%, suggesting that public-sector wages responded reasonably well to the marked surge in inflation. Overall, the general government budget balance was negative, at -0.3% of GDP, while public debt declined to 17.2% of GDP to rank among the lowest in Europe. However, the government has approved an ambitious budget for 2024, with expenditure due to rise by 14% over 2023. It may prove challenging to achieve a positive budget balance under such circumstances, and public debt could rise again this year and in the medium term.

Further disinflation will continue to be a priority for the government. The great inflationary pressure caused by soaring energy prices posed a challenge for households and businesses in 2023. While electricity imports outstripped exports (resulting in the country remaining a net importer), the energy crisis was managed effectively. In 2024, we anticipate that headline inflation will average 2.5% and will once again be mainly driven by energy and food prices. This judgement is based on the lower core inflation observed during the initial months of the year.

The banking sector performed reasonably well. Lending to households and firms increased by 13% in 2023, while non-performing loans remained at 2%. An emerging issue surrounds the Kosovo Central Bank's decision to introduce a new regulation in December 2023. This aims to define the conditions for cash payment transactions, as well as to establish rules, procedures and obligations for importing and exporting euro banknotes and coins, as well as other currencies. The move has generated significant concern among the authorities in Belgrade and ethnic Serbs in Kosovo. Initially due to have been implemented in February 2024, it has faced stiff opposition from the Serbian authorities: they view it as a move that will have an adverse impact on ethnic Serbs in Kosovo, particularly those who receive financial support from Serbia in Serbian dinars. It is noteworthy that Kosovo did not expressly ban the Serbian dinar: rather, it defined payment methods in euros within Kosovo (given that the euro is the official currency). The new regulation will apply to all foreign currencies, including the Swiss franc, which serves as an essential income source for many Kosovar households (thanks to remittances from family members residing in Switzerland). Kosovo's international partners noted that the decision had not been properly communicated and that more time was needed to allow the affected population to adjust. Accordingly, on 12 February the Central Bank of Kosovo granted a three-month extension, during which time other currencies may continue to be offered in payment.

The economy faces challenges related to low labour market participation and slow labour

productivity growth. Emigration is expected to rise, due to the free visa regime, which came into effect on 1 January 2024 and under which citizens of Kosovo can travel to the EU Schengen area without a visa. This move – which is generally being viewed positively – will have various implications: not only will it encourage Kosovars to travel to the EU, but it will also facilitate their temporary or short-term emigration to the EU (where a large diaspora already resides). Unfortunately, this is likely to have repercussions for the labour market: the emigration of health professionals remains of significant concern, despite government efforts to curb it (by offering higher wages, for example). Moreover, the labour market participation rates of women and young people are among the lowest in the Western Balkans and the EU. To address these challenges, active labour market policies are essential to promote inclusiveness and to meet the needs of vulnerable sections of the population. Remittances continue to play a crucial role as an income source for households. However, this reliance on remittances may inadvertently discourage labour market participation and lead to something akin to ‘Dutch disease’.

The current account has shown some improvement, largely due to better performance in

secondary income and services exports. In 2023, the current account deficit improved to -7.6% of GDP, primarily thanks to a more balanced combination of primary and secondary income. Notably, service exports – particularly those related to tourism – experienced growth. However, it is essential to recognise that trade in goods – especially goods imports – has a significantly negative influence on the current account balance, since Kosovo relies heavily on imports. On the other hand, foreign direct investment (FDI) remained robust. During the second half of 2023, FDI inflows exhibited a promising increase, so that for the year as a whole they expanded by 11%. Notably, new capital flowed in from Austria, Albania, Turkey, Slovenia and Switzerland. Meanwhile German investments saw only modest growth of 2% and US investments declined by 32%. Those sectors that attracted the new foreign capital were primarily financial and insurance activities, manufacturing and energy. The last of these is expected to continue to attract sizeable amounts of FDI, in light of the country’s substantial potential in terms of renewable energy and the government’s strategic initiatives to foster such investments.

Risks related to external tensions tend toward the upside. The relief surrounding the positive news about the resolution of the car-numberplates dispute with Serbia was short lived. The issue surrounding the dinar currency now resembles a nest of Matryoshka dolls, further fuelling the ongoing political tensions between Serbia and Kosovo. This impasse perpetuates the status quo in the Serbia-Kosovo dialogue, which remains deadlocked. There is another significant issue on which there has recently been some development: the row over the four ethnically Albanian mayors who were elected last year in North Kosovo, a region inhabited predominantly by ethnic Serbs. The latter contested the election of the mayors, and the issue became a source of tension that rumbled on throughout 2023. Now 21 April 2024 has been set as the date for referendums on the question of the dismissal of the Albanian mayors. On a positive note, Kosovo has made substantial strides toward its membership of the Council of Europe. In March 2024, the Committee on Political Affairs and Democracy of the Parliamentary Assembly of the Council of Europe (PACE) voted to endorse Kosovo’s application. The next step will involve a vote on a draft opinion regarding Kosovo’s membership, to be taken at a meeting in Strasbourg scheduled for 15-19 April 2024.

Overall, we expect the economy to grow at a rate of 3.7% this year and over the medium term. This growth will be propelled by household consumption, as remittances will remain robust, while real wages will experience an upswing. Additionally, public and private investments are both poised to expand.

Table 6.10 / Kosovo: Selected economic indicators

	2020	2021	2022	2023 ¹⁾	2024	2025 Forecast	2026
Population, th pers., average	1,790	1,786	1,768	1,775	1,774	1,772	1,770
Gross domestic product, EUR m, nom.	6,772	7,958	8,896	9,653	10,300	10,900	11,500
annual change in % (real)	-5.3	10.7	4.3	3.3	3.5	3.7	3.6
GDP/capita (EUR at PPP)	7410	8690	9840	10310	.	.	.
Consumption of households, EUR m, nom.	5,718	6,573	7,593	8,072	.	.	.
annual change in % (real)	2.5	7.3	3.4	4.4	2.8	3.2	3.0
Gross fixed capital form., EUR m, nom.	2,012	2,617	2,892	3,049	.	.	.
annual change in % (real)	-7.6	13.0	-3.2	3.0	4.0	3.0	4.0
Gross industrial production ²⁾							
annual change in % (real)	0.8	0.3	0.2	2.5	2.0	3.0	3.0
Gross agricultural production ³⁾							
annual change in % (real)	5.2	-7.7	0.3	2.5	.	.	.
Construction output ⁴⁾							
annual change in % (real)	-9.0	8.8	-3.1	2.0	.	.	.
Employed persons, LFS, th, average ⁵⁾	347.1	383.3	403.8	410.0	430	450	460
annual change in %	-4.4	10.4	5.4	1.5	4.0	4.0	3.0
Unemployed persons, LFS, th, average ⁵⁾	121.4	100.2	58.1	60.0	60	60	60
Unemployment rate, LFS, in %, average ⁵⁾	25.9	20.7	12.5	12.4	12.3	12.0	11.5
Unemployed rate, reg, th, eop ⁶⁾	.	16.1	15.7	8.8	.	.	.
Average monthly gross wages, EUR	466	484	521	610	670	710	750
annual change in % (real, gross)	-2.5	0.4	-3.5	12.0	6.0	4.0	4.0
Average monthly net wages, EUR	416	432	446	520	550	570	590
annual change in % (real, net)	-3.4	0.4	-7.5	11.0	3.0	1.5	1.5
Consumer prices (HICP), % p.a.	0.2	3.4	11.6	4.9	3.5	2.5	2.2
Producer prices, % p.a.	-0.6	4.9	9.3	-3.1	1.0	2.5	2.0
General governm. budget, nat. def., % of GDP							
Revenues	25.4	27.4	27.9	29.4	29.5	29.0	29.0
Expenditures	33.0	28.8	28.4	29.7	30.5	30.0	31.0
Deficit (-) / surplus (+)	-7.6	-1.3	-0.5	-0.3	-1.0	-1.0	-2.0
General gov. gross debt, nat. def., % of GDP	22.0	21.1	19.7	17.2	19.0	19.0	20.0
Stock of loans of non-fin. private sector, % p.a.	7.1	15.4	16.0	12.6	.	.	.
Non-performing loans (NPL), in %, eop	2.7	2.3	2.0	2.0	.	.	.
Central bank policy rate, % p.a., eop ⁷⁾	6.01	5.80	6.29	6.35	6.2	6.0	6.0
Current account, EUR m	-472	-695	-917	-738	-890	-950	-980
Current account, % of GDP	-7.0	-8.7	-10.3	-7.6	-8.6	-8.7	-8.5
Exports of goods, BOP, EUR m	475	753	932	871	880	900	930
annual change in %	20.8	58.4	23.8	-6.5	1.0	2.5	3.0
Imports of goods, BOP, EUR m	3,048	4,320	5,219	5,469	5,630	5,740	5,880
annual change in %	-5.7	41.7	20.8	4.8	3.0	2.0	2.5
Exports of services, BOP, EUR m	995	1,906	2,505	2,966	3,090	3,210	3,310
annual change in %	-40.6	91.6	31.4	18.4	4.3	3.8	3.0
Imports of services, BOP, EUR m	603	871	1,132	1,337	1,380	1,490	1,580
annual change in %	-19.5	44.4	29.9	18.2	3.0	8.0	6.0
FDI liabilities, EUR mn	346	421	732	844	.	.	.
FDI assets, EUR mn	59	100	175	189	.	.	.
Gross reserves of CB excl. gold, EUR m	901	1,100	1,176	1,131	.	.	.
Gross external debt, EUR m	2,502	2,956	3,437	3,848	3,600	3,700	3,900
Gross external debt, % of GDP	37.0	37.1	38.6	39.9	35.0	34.0	34.0

1) Preliminary and wiiw estimates. - 2) Turnover in manufacturing industry (NACE C), wiiw estimate in 2023. - 3) According to Economic Accounts for Agriculture (EAA). - 4) Value added. - 5) Population 15-64. - 6) From 2023 new definition of data collection for unemployed persons. - 7) 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.