

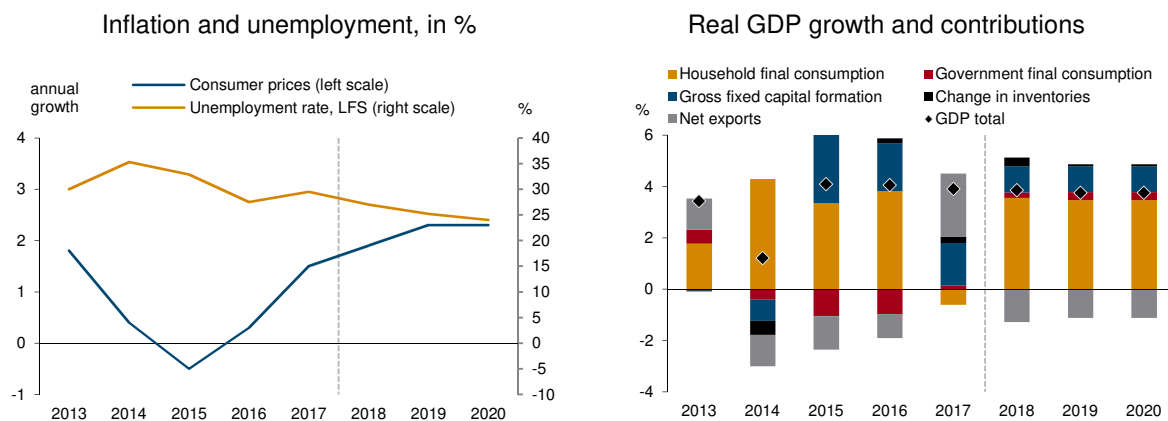


KOSOVO: Growth at healthy levels, helped by boom in Western Europe

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The economy is growing strongly, reflecting a boom in key sources of remittances and export demand. With growth showing no signs of slowing in Western Europe, this is likely to remain the case this year. Meanwhile stronger employment growth should help to lift private consumption. Real GDP growth is likely to average around 4% per year over the forecast period, although a major new energy investment could lift this higher.

Figure 49 / Kosovo: Main macroeconomic indicators



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

The economy is estimated to have grown by around 4% in 2017, a strong rate in the regional context, and Kosovo is likely to remain an outperformer compared with neighbouring countries during the forecast period. Growth in 2017 was driven chiefly by a combination of exports and investment. External factors were strongly supportive, not least the boom in the EU and Switzerland, which drove an uptick in demand for exports and remittances inflows. Nominal euro-denominated remittances rose by an average 10% year on year in the first three quarters of 2017. On the same basis, merchandise exports rose by 22% last year as a whole.

Kosovo remains a relatively closed economy, but the external sector is growing quickly as a share of GDP, and positive external conditions are feeding through to stronger domestic activity. After rising by a subdued 1.5% year on year in Q1, real GDP growth picked up to 5.2% in Q2 and 4.9% in Q3. External factors were the dominant driver; net exports contributed an average 4.2 percentage

points to real year-on-year headline growth of 3.9% in the first three quarters of last year. A further 2.1 percentage points came from gross capital formation, helping to offset a sharp decline in household consumption (which fell by an average 3.1% year on year over the period, in part owing to very high base effects).

The near-term outlook for the economy is strong, with high-frequency indicators suggesting that the boom-like conditions in key Western European markets will continue this year. Remittance inflows from key sources, notably Germany and Switzerland, are likely to continue growing strongly, reflecting the tightness of labour markets in those two countries. We expect a headline real GDP growth rate of around 4% this year and during the rest of the forecast period, driven primarily by private consumption, as real wages and employment continue to rise. However, investment will also make positive contributions.

Booming exports have helped to drive up employment growth, and further positive momentum is likely during the forecast period. Total employment rose by an average 10% year on year in the first three quarters of 2017. However, the labour force rose by 15% over the same period, leading to an increase in the unemployment rate. Joblessness reached 30.2% in Q3 2017, up 2.7 percentage points year on year. Kosovo continues to face very low levels of labour force participation by European standards, which act as a significant constraint on the country's growth potential.

Major slack in the labour market and weak inflation in the rest of Europe will keep price growth relatively subdued during the forecast period. The headline harmonised index of consumer prices (HICP) rose by just 0.5% year on year in Kosovo in December 2017, its lowest level for well over a year, and despite further increases in global energy prices over the period. Inflation may rise in the near term, reflecting elevated oil prices. Beyond that, we expect inflation to strengthen moderately during the forecast period, mirroring trends across Europe, but at a forecast average 2.2% per year in 2018-20, price growth will remain at low levels in the historical context.

A major investment in a 500-megawatt coal-fired power plant announced in December could provide an important boost to growth over the forecast period. The deal is reported to be worth EUR 1.3 billion, equivalent to around one fifth of Kosovo's 2016 GDP, and will be financed by US firm ContourGlobal. Construction is set to begin either late this year or early in 2019, and the plant is expected to be completed in 2023. Kosovo has 14 billion tonnes of proven lignite reserves, the fifth largest in the world, and a large share of domestic energy comes from coal power stations. The project is expected to create 10,000 new jobs during construction, and some estimates have suggested that it could lift the rate of real GDP growth by 1-2 percentage points per year. However, with the timing of construction remaining uncertain, and EU rules on environmental standards set to be a roadblock, the investment is not yet built into our baseline forecasts.

Despite narrowing significantly in 2017, the current account deficit should widen during the forecast period, owing to rising domestic demand and slower export growth. The external deficit narrowed considerably last year, to an estimated 5.6% of GDP, from 9% in 2016. This reflected booming goods and services exports, and higher surpluses on the primary and secondary income accounts (the latter indicating a sharp uptick in remittance inflows). These developments more than offset the increase in energy import costs. Data for January-November show that the current account deficit narrowed to EUR 265 million, representing a decrease of more than a third compared with the same period of the

previous year. Net FDI inflows rose to EUR 241 million over the same period, and thereby covering the majority of the current account deficit. During the forecast period we expect the current account deficit to average 6% of GDP. This will continue to be financed by a combination of net FDI inflows and concessional lending, mitigating stability risks.

The recent elections produced a broad coalition with a tiny majority and facing major political challenges, which will make significant political reform difficult. A new administration formed under the premiership of Ramush Haradinaj in September 2017 is made up of 12 parties, and commands only 61 deputies in the 120-seat parliament. The new government's early months have been difficult, including a spat with the US and other important international partners over a desire to withdraw from an international criminal court investigating alleged war crimes, and the assassination of a key ethnic Serb politician in the North of the country. More broadly, the government will face political challenges that its predecessor struggled with, including a resolution on border demarcation with Montenegro and a solution to the status of ethnic Serbs living in Kosovo.

Political noise could distract the government from bigger economic challenges facing the country over the medium term. These include the gaping trade deficit, issues in the education system and low levels of labour productivity. Addressing these issues will be required to lift Kosovo's growth rate above 4%, and thereby speed up its convergence with wealthier countries in the region.

Table 19 / Kosovo: Selected economic indicators

	2013	2014	2015	2016	2017 ¹⁾	2018 Forecast	2019 Forecast	2020
Population, th pers., average	1,818	1,813	1,788	1,778	1,784	1,777	1,770	1,763
Gross domestic product, EUR mn, nom.	5,327	5,568	5,807	6,070	6,400	6,800	7,200	7,600
annual change in % (real)	3.4	1.2	4.1	4.1	3.9	3.9	3.8	3.8
GDP/capita (EUR at PPP)	6500	6700	7400	7700	8000	.	.	.
Consumption of households, EUR mn, nom.	4,652	4,926	5,045	5,268	7,902	.	.	.
annual change in % (real)	2.0	4.9	3.8	4.4	-0.7	4.1	4.0	4.0
Gross fixed capital form., EUR mn, nom.	1,323	1,294	1,499	1,550	2,326	.	.	.
annual change in % (real)	-0.2	-3.3	12.1	7.3	6.5	4.0	4.0	4.0
Gross industrial production ²⁾								
annual change in % (real)	6.5	-1.3	4.8	2.8	4.0	3.6	3.5	3.2
Gross agricultural production ²⁾								
annual change in % (real)	1.4	0.8	-4.1	3.1	3.0	.	.	.
Construction output ²⁾								
annual change in % (real)	2.6	-6.1	15.8	4.5	4.0	.	.	.
Employed persons, LFS, th, average ³⁾	338.4	323.5	296.9	331.8	370.0	390	400	410
annual change in %	11.7	-4.4	-8.2	11.7	11.5	4.3	3.1	3.0
Unemployed persons, LFS, th, average ³⁾	144.8	176.7	145.8	126.1	160.0	140	130	130
Unemployment rate, LFS, in %, average ³⁾	30.0	35.3	32.9	27.5	30.2	27.0	25.2	24.0
Reg. unemployment rate, in %, eop
Average monthly net wages, EUR	393	430	451	457	450	470	490	510
annual change in % (real, net)	0.5	9.0	5.4	1.0	-3.0	1.5	1.5	1.5
Consumer prices, % p.a.	1.8	0.4	-0.5	0.3	1.5	1.9	2.3	2.3
Producer prices, % p.a.	2.3	1.6	2.7	-0.1	4.3	3.5	2.5	2.5
General governm.budget, nat.def., % of GDP								
Revenues	25.5	24.2	29.4	29.3	29.4	29.8	30.0	30.2
Expenditures	28.0	27.2	27.8	29.1	29.5	30.5	30.8	31.0
Deficit (-) / surplus (+)	-2.5	-2.9	1.6	0.2	-0.1	-0.7	-0.8	-0.8
General gov.gross debt, nat.def., % of GDP	8.9	10.5	12.9	14.0	16.0	16.7	18.0	19.0
Stock of loans of non-fin.private sector, % p.a.	2.6	6.2	7.2	10.5	9.7	.	.	.
Non-performing loans (NPL), in %, eop	8.7	8.3	6.2	4.9	3.9	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	10.90	9.29	7.69	7.22	6.72	7.00	7.30	7.50
Current account, EUR mn	-179	-385	-497	-549	-360	-396	-434	-475
Current account, % of GDP	-3.4	-6.9	-8.6	-9.0	-5.6	-5.8	-6.0	-6.2
Exports of goods, BOP, EUR mn	291	324	322	308	370	396	424	453
annual change in %	3.4	11.3	-0.6	-4.5	20.2	7.0	7.0	7.0
Imports of goods, BOP, EUR mn	2,287	2,383	2,432	2,599	2,835	2,977	3,126	3,282
annual change in %	-1.9	4.2	2.1	6.9	9.1	5.0	5.0	5.0
Exports of services, BOP, EUR mn	875	929	952	1,038	1,300	1,369	1,441	1,518
annual change in %	-2.2	6.1	2.5	9.1	25.2	5.3	5.3	5.3
Imports of services, BOP, EUR mn	355	469	494	473	495	523	553	585
annual change in %	-10.1	32.0	5.5	-4.3	4.6	5.7	5.7	5.7
FDI liabilities, EUR mn	280	151	309	216	450	.	.	.
FDI assets, EUR mn	30	27	37	40	40	.	.	.
Gross reserves of NB excl. gold, EUR mn	694	645	734	830	850	.	.	.
Gross external debt, EUR mn	1,608	1,737	1,932	2,045	2,080	2,300	2,500	2,700
Gross external debt, % of GDP	30.2	31.2	33.3	33.7	32.5	34.0	35.2	35.7

1) Preliminary and wiiw estimates. - 2) According to gross value added (manufacturing industry for industrial production). - 3) Population 15-64. - 4) 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.