



KOSOVO: The exodus of young people from a poor country

MARIO HOLZNER

The growth outlook for Kosovo had to be revised downwards slightly owing to a longer than expected political stalemate besetting the formation of a new government as well as an exodus of the younger members of the population. However, while the level of economic activity is still extremely low in Kosovo, its dynamics are more promising. GDP growth in both 2014 and 2015 is expected to hover around 4%, mainly on account of strong household consumption fuelled by pre-election public wage increases and a rise in remittances.

Over the recent months tens of thousands have fled Kosovo (a small country of some 1.8 million inhabitants) via Serbia and crossed illegally the EU border with Hungary, heading for Germany, Austria or even further. Among them are many young families from smaller towns who lack prospects for a decent life due to high risk vulnerability, deep poverty and mass unemployment. There is hardly any public social security system existent in Kosovo. The average monthly net wage makes only about 450 euro. However, many do not have a job at all. The overall unemployment rate is at around 30%, while the youth unemployment rate hits some 55%. Moreover, many discouraged workers have stopped looking for work and contribute to a large hidden unemployment. Kosovo has the youngest population and the highest fertility rate in Europe. Although the economy experiences (by European standards) quite high growth rates, these are not high enough to absorb the younger generations that push into the labour market. The country generally lacks productive capacities. There are hardly any larger companies operating in Kosovo.

However, as these features of a developing economy have been present for a very long time the question arises why exactly the exodus started this winter. Travel restrictions for Kosovars going to Serbia have been relaxed back in 2012. One contributing factor may have been widespread disappointment with the recent formation of the government which took several months as the former Prime Minister Hashim Thaci (with the help of formal tricks, rather) did everything to make an alternative coalition government without the involvement of his PDK party impossible. Finally Isa Mustafa, from the second largest party LDK, became the new prime minister. Mr. Thaci now acts as the foreign minister. Especially younger people who had hoped for more political change were disappointed and the Kosovo capital Prishtina has seen several violent anti-government demonstrations more recently.

While clearly the level of economic activity is still very low in Kosovo, the dynamics are more promising. The average GDP growth rate in recent years has been close to 4%, and probably even higher in 2014.

During that year's parliamentary election campaign public wages were increased strongly and that has fuelled domestic consumption. This is also reflected in rising imports. However, exports were growing quite strongly as well, by double-digit rates as suggested by customs data for 2014. Remittances in the first three quarters of 2014 were increasing at a similar pace and may have reached up to EUR 700 million for the whole year, about 12.5% of GDP.

Investment fared less well. By November 2014 public capital expenditures were slashed by a third as compared to the same period a year earlier. Also foreign direct investment decreased by 45% over the first three quarters of 2014, year on year – a major reason being the almost six months that passed between the elections in early June 2014 and the formation of the government in mid-December. It can be expected that the new government will gradually increase public investment in infrastructure to earlier levels and this should also be associated with more FDI in the medium term.

The sluggish public and foreign investment activity in 2014 was partly outweighed by strongly increasing private domestic investment. Over the whole year new loans to the economy soared by more than 30% on an annual basis. New investment loans to non-financial corporations increased by 36%. New household mortgage loans increased by 28% (new household consumer loans by as much as 49%). However, the depth of financial intermediation is still rather low. Total new loans made up less than 20% of GDP. Effective interest rates are still high but falling. Overall interest rates on loans dropped continuously from close to 12% in January 2014 to about 9% in December. New long-run business investment and household mortgage loans' effective interest is at around 8%. A further reduction in the interest level should also contribute to improved investment conditions in 2015 and the years thereafter.

Signals for the future external supply of remittances are mixed. Germany, the main host country of Kosovo migrants, is expected by the European Commission to register a GDP growth rate of 1.5% in 2015, the same as in 2014. However, the recent winter forecast was revised upwards as compared to the earlier autumn forecast. For Switzerland, the second most important host country, the forecasts were revised sharply downwards after the sudden appreciation of the Swiss franc in mid-January. The KOF Swiss Economic Institute expects slightly negative GDP growth in 2015 and stagnation in 2016. Earlier forecasts expected growth rates of around 2%. On the other hand, remittances from Switzerland could experience a boost due to the 20% appreciation of the Swiss franc. Also a higher number of Kosovars living outside the country after the current emigration wave might contribute to rising remittances. However, the net effect of these contrary developments might be positive at first and later on fading away or even negative as regards the amount of remittances fuelling for instance the Kosovo construction sector but also consumption in the years to come.

The new government's budget plan for 2015 foresees a strong increase in tax revenues and another major boost in wages and salaries outlays while capital expenditures are assumed to decrease further. While this will obviously continue to fuel household consumption growth, gross fixed capital formation will be further depressed. Overall this should lead to a tightening effect of the public sector with regard to aggregate demand. Given the wage increases and the likely increases in remittances, private households should consume substantially more than last year. However, uncertainties regarding the extent of the exodus of Kosovars might point to a somewhat slower growth of household consumption as compared to a year earlier. Given the soaring credit development, private firms could contribute to a slight increase in gross fixed capital formation in 2015. In terms of exports it will be difficult to repeat the strong increase in 2014. Overall we expect a GDP growth rate of 3.6% for the year 2015. As compared

to the autumn forecast we had to revise both the year 2014 and 2015 growth estimates slightly downwards due to the longer than expected political stalemate regarding the formation of the new government and associated postponed public investment decisions as well as because of the population exodus.

Growth in 2016 will probably be less than 3% given that no more public wage increases are planned and public investment will only slowly recover. However, 2017 might again see economic growth rates of close to 4% once the much needed public and foreign investment projects mostly in transport and energy infrastructure will hopefully materialise.

Table 1 / Kosovo: Selected Economic Indicators

| | 2010 | 2011 | 2012 | 2013 | 2014 ¹⁾ | 2015 Forecast | 2016 Forecast | 2017 |
|---|--------|--------|--------|--------|--------------------|------------------|------------------|-------|
| Population, th pers., average | 1,775 | 1,799 | 1,816 | 1,821 | 1,838 | 1,855 | 1,872 | 1,890 |
| Gross domestic product, EUR mn, nom. ²⁾ | 4,402 | 4,815 | 5,059 | 5,327 | 5,600 | 5,900 | 6,100 | 6,500 |
| annual change in % (real) ²⁾ | 3.3 | 4.4 | 2.8 | 3.4 | 4.5 | 3.6 | 2.9 | 3.8 |
| GDP/capita (EUR at exchange rate) | 2500 | 2700 | 2800 | 2900 | 3000 | . | . | . |
| GDP/capita (EUR at PPP) | 5900 | 6200 | 6500 | 6700 | 6900 | . | . | . |
| Consumption of households, EUR mn, nom. ²⁾ | 3,768 | 4,142 | 4,458 | 4,652 | 4,900 | . | . | . |
| annual change in % (real) ²⁾ | 3.5 | 3.5 | 2.9 | 2.0 | 4.5 | 4.0 | 3.5 | 4.0 |
| Gross fixed capital form., EUR mn, nom. ²⁾ | 1,301 | 1,476 | 1,317 | 1,323 | 1,300 | . | . | . |
| annual change in % (real) ²⁾ | 11.0 | 8.1 | -13.6 | -0.2 | 0.0 | 1.0 | 1.5 | 3.0 |
| Gross industrial production ³⁾ | | | | | | | | |
| annual change in % (real) | 1.8 | -5.7 | -3.3 | 0.0 | 10.0 | 5.0 | 6.0 | 8.0 |
| Gross agricultural production ³⁾ | | | | | | | | |
| annual change in % (real) | 1.4 | 0.2 | 9.9 | 2.0 | 6.0 | 4.0 | 5.0 | 6.0 |
| Construction output ³⁾ | | | | | | | | |
| annual change in % (real) | -9.7 | 18.0 | 3.0 | 0.6 | 3.0 | 5.0 | 4.0 | 5.0 |
| Unemployment rate, LFS, in %, average ⁴⁾ | 45.1 | 44.8 | 30.9 | 30.0 | 30.0 | 29.0 | 29.0 | 28.0 |
| Reg. unemployed persons, th, end of period | 335 | 325 | 260 | 268 | 274 | . | . | . |
| Average monthly net wages, EUR | 286 | 348 | 354 | 356 | 416 | . | . | . |
| annual change in % (real, net) | 12.3 | 13.4 | -0.8 | -1.2 | 16.4 | 10.0 | 0.0 | 2.0 |
| Consumer prices, % p.a. | 3.5 | 7.3 | 2.5 | 1.8 | 0.4 | 1.0 | 1.0 | 2.0 |
| Producer prices in industry, % p.a. | 4.7 | 5.7 | 1.7 | 2.5 | -0.6 | . | . | . |
| General governm.budget, nat.def., % of GDP ⁵⁾ | | | | | | | | |
| Revenues | 25.9 | 27.2 | 27.3 | 35.0 | 35.0 | 36.0 | 37.0 | 37.0 |
| Expenditures | 27.7 | 28.3 | 28.6 | 37.0 | 37.0 | 37.0 | 37.0 | 38.0 |
| Deficit (-) / surplus (+) | -1.8 | -1.1 | -1.2 | -2.0 | -2.0 | -1.0 | 0.0 | -1.0 |
| Public debt, nat.def., % of GDP | 5.9 | 5.3 | 8.1 | 8.9 | 10.7 | 11.2 | 10.8 | 11.1 |
| Central bank policy rate, % p.a., end of period ⁶⁾ | 14.3 | 13.9 | 12.9 | 11.1 | 10.0 | . | . | . |
| Current account, EUR mn ⁷⁾ | -516 | -658 | -380 | -339 | -400 | -450 | -550 | -500 |
| Current account, % of GDP | -11.7 | -13.7 | -7.5 | -6.4 | -7.1 | -7.6 | -9.0 | -7.7 |
| Exports of goods, BOP, EUR mn ⁷⁾ | 299 | 317 | 282 | 291 | 320 | 330 | 350 | 390 |
| annual change in % | 73.5 | 5.8 | -10.9 | 3.4 | 9.8 | 3.1 | 6.1 | 11.4 |
| Imports of goods, BOP, EUR mn ⁷⁾ | 2,041 | 2,364 | 2,332 | 2,287 | 2,380 | 2,470 | 2,570 | 2,720 |
| annual change in % | 12.2 | 15.8 | -1.3 | -1.9 | 4.1 | 3.8 | 4.0 | 5.8 |
| Exports of services, BOP, EUR mn ⁷⁾ | 574 | 625 | 641 | 633 | 700 | 730 | 770 | 850 |
| annual change in % | 10.1 | 8.9 | 2.5 | -1.3 | 10.7 | 4.3 | 5.5 | 10.4 |
| Imports of services, BOP, EUR mn ⁷⁾ | 398 | 369 | 317 | 320 | 330 | 340 | 350 | 390 |
| annual change in % | 35.5 | -7.3 | -14.0 | 1.0 | 3.0 | 3.0 | 2.9 | 11.4 |
| FDI inflow (liabilities), EUR mn ⁷⁾ | 369 | 384 | 229 | 280 | 170 | 200 | 300 | 400 |
| FDI inflow (assets), EUR mn ⁷⁾ | 37 | 5 | 16 | 30 | 20 | 40 | 50 | 60 |
| Gross reserves of NB excl. gold, EUR mn | 634 | 575 | 840 | 799 | 850 | . | . | . |
| Gross external debt, EUR mn | 1,361 | 1,428 | 1,517 | 1,596 | 1,736 | . | . | . |
| Gross external debt, % of GDP | 30.9 | 29.7 | 30.0 | 30.0 | 31.0 | . | . | . |
| Purchasing power parity EUR/EUR | 0.4170 | 0.4350 | 0.4280 | 0.4380 | 0.4390 | . | . | . |

1) Preliminary and wiiw estimates. - 2) According to ESA 2010. - 3) According to gross value added data. - 4) From 2012 new improved sample survey based on census 2011, not comparable with previous years. - 5) National definition based on ESA 2010. - 6) Average weighted lending interest rate (Kosovo uses the euro as national currency). - 7) BOP 6th edition.
Source: National statistics and IMF. Forecasts by wiiw.