

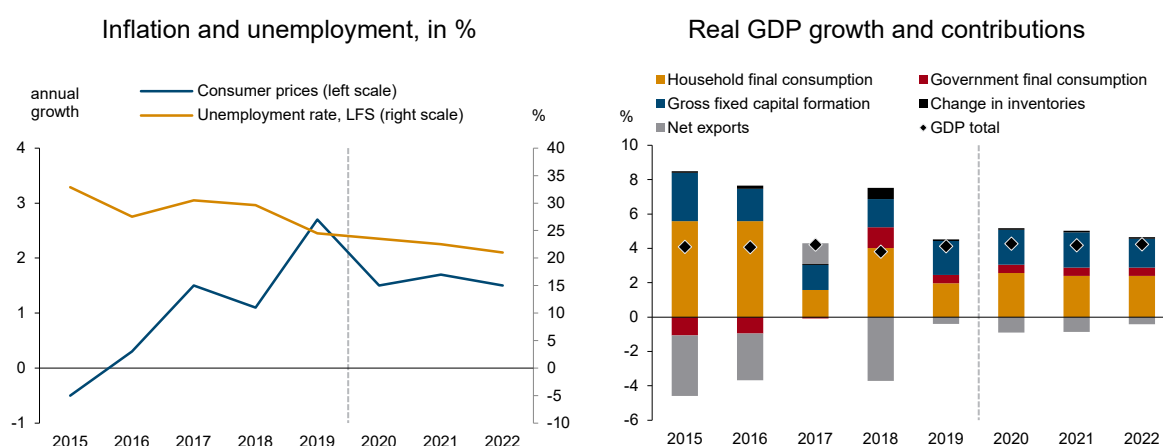


## KOSOVO: Great expectations and major challenges facing the new government

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Great things are expected of the new government, but it faces some big challenges in consolidating the rule of law and energising the economy. Its ambitious programme is expected to stimulate private and public investment. Kosovo-Serbia dialogue is likely to be resumed, thanks to the active and leading role of the USA. In the medium term, growth will remain robust at above 4%, backed by consumption and investment, and Kosovo is likely to remain among the fastest-growing economies in CESEE.

**Figure 6.10 / Kosovo: Main macroeconomic indicators**



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

**In 2019, Kosovo was among the fastest-growing economies in the Western Balkan region.** Real GDP growth persisted at a robust rate of 4.38% in the third quarter (year on year), following 4.24% and 4.13% in the first and second quarters, respectively. The acceleration in economic activity – estimated at 4.2% for 2019 as a whole – was fuelled by consumption and investment (each contributing 2 percentage points to growth). Despite being less strong than in 2018, household consumption benefited from the marked rise in real wages, employment opportunities and remittances. Also, there was a surge in public investment and gross fixed capital formation (GFCF) expanded by more than 7% over the first three quarters of 2019, year on year. Manufacturing, construction, financial and insurance, health and social work activities were the sectors that contributed most to the economy, while agriculture affected growth negatively.

**Great things are expected of the new government; but it also faces some major challenges in terms of consolidating the rule of law and stimulating the economy.** Albin Kurti took office on 3 February 2020, after almost four months of protracted and intensive negotiations between the Self-Determination Party (Vetevendosje – LVV) and the Democratic League of Kosovo (LDK), the two biggest winners in the parliamentary elections held in October 2019. The confidence vested in the Kurti

government will require it to achieve substantial transformations, especially as regards the rule of law, the fight against corruption, the consolidation of democratic institutions, energising of the economy, employment, and investment in education and health. This means enormous challenges ahead for Kurti's leadership. Whether he can succeed in meeting the electorate's expectations remains to be seen. Establishing the prerequisites for a constructive dialogue with Serbia and for achieving recognition of Kosovo also feature among the priorities of the new government. Membership of NATO and of the United Nations are on the agenda, too.

**In the medium term, the government's ambitious programme is expected to stimulate private and public investment.** An integral part of its strategy is the establishment of a Development Fund. This will have the remit of financially assisting the private sector (especially small and medium-sized enterprises) to expand their investments, production, exports and job-creation activities. In addition, the new government plans to set up a Sovereign Fund, which will aim to boost foreign investment in strategic sectors of the economy. In 2019, budget revenue performance was outstanding, and the indications are also encouraging for 2020. Last year, budget revenues rose by 11%, to the equivalent of EUR 2.2 billion (or 31% of GDP). Budget expenditure increased by 8.7%, to the equivalent of EUR 2.1 billion, with close to 20% absorbed by GFCF. Thus, 2019 closed with a slight budget surplus, which kept the public debt at a low rate of 17% of GDP. The economic platform flagged up by the Kurti government envisages a boost for public investment, active labour market policies and investment in the health and education sectors through a general government budget of EUR 3 billion for 2020. This may be rather ambitious and increases the risk of fiscal deficit, followed by an escalation of public debt.

**The Kosovo-Serbia dialogue – deadlocked since October 2018 – is likely to be resumed, thanks to the active and leading role of the USA.** The Munich Security Conference held in February 2020 presented a good opportunity for Kosovo and Serbia to sign new agreements on railways and highways; this followed an agreement to resume flights between Belgrade and Pristina, reached a few weeks previously. These agreements were concluded thanks to the mediation and direct engagement of the US special envoy for the Kosovo-Serbia dialogue, Richard Grenell, who is also the US ambassador in Berlin. The mediating role of the USA presupposes above all the development and stabilisation of economic relations between the two countries, which could further facilitate and pave the way to important political agreements, such as Kosovo's recognition. Prime Minister Kurti, upholding the fairness principle, has announced that the 100% tariff on imports from Serbia and Bosnia and Herzegovina will be abolished; the principle of reciprocity will be applied in political, economic and trade relations with those countries. In fact, the USA does not favour this approach: the US envoy has suggested that Kosovo should abolish the 100% tariff and Serbia should cease lobbying against Kosovo's recognition. EU engagement with Kosovo seems lethargic, with EU visa liberalisation for Kosovo having stalled. Thus a population of 1.9 million continues to be isolated in the middle of Europe.

**The signs from the labour market are encouraging, but employment abroad remains alluring.** There have been improvements on the labour market, reflected in rising employment. The overall unemployment rate has declined, but youth unemployment remains among the highest in the region. Remittances continue to be an important source of income, rising by a further 7% up until October 2019, year on year. In 2019, a net outflow of 30,000 Kosovars was recorded. Germany is, and will continue to be, a magnet for emigrants from Kosovo. Germany's Skilled Immigration Act, which comes into force in March 2020, aims at facilitating labour market access and the employment of highly qualified professionals from countries outside the European Union. Kosovars will not let this opportunity pass them by. Even now, Germany attracts a sizeable contingent of medical professionals from Kosovo. In

July 2019, Germany signed an agreement with the government of Kosovo to offer assistance in the training and qualification of nurses. Moreover, Germany has announced an investment of EUR 25 million for vocational training and education in the Western Balkan region, and Kosovo will certainly seek to benefit from this.

**The rate of inflation accelerated to 2.7% in 2019, in part affected by the 100% tariff imposed from October 2018 on goods from Serbia and Bosnia and Herzegovina.** Inflation-rate dynamics tend to be strongly associated with international price developments – especially in the EU, given Kosovo's high dependence on goods imported from there. In addition, the 100% tariff on goods from Serbia and Bosnia and Herzegovina and the time it necessarily takes to line up new trade partners pushed prices up in the first half of 2019. However, in the second half of the year inflation slowed, suggesting that the initial effect of the 100% tariff had levelled off.

**The expansion of the demand for credit has been remarkable and will maintain its pace.** The banking sector has high liquidity and is financially sound, with the level of non-performing loans standing at 2.3% at the end of 2019. Credit activity aimed at the non-financial private sector expanded by 10% in 2019 owing to a further easing of lending conditions. The main source of financing continues to be deposits, which rose 16% in 2019 year on year, and amounted to EUR 3.75 billion.

**The dynamics of the external sector were encouraging, thanks to a positive trade balance on services, and also secondary income.** The export of services, mainly tourism, recorded another year with double-digit growth – 12% over the first three quarters of 2019, year on year. The 100% tariff required a shift in trade partners, especially as concerns imports. North Macedonia and Slovenia benefited most, with both countries almost doubling their exports to Kosovo. As for Albania, the volume of trade did not expand so much, because of a number of non-tariff measures imposed by Albania. Still, it is worth mentioning the opening of a Kosovo customs office in Albania, at Durrës harbour, in January 2019 – a step that will facilitate cooperation between the two countries. Up to November 2019, goods exports from Kosovo rose by 5% year on year, with the main destinations being Italy and Germany. FDI was buoyant – a rise of 15% year on year up to October 2019 – with investment flowing in from Germany and the USA. The Kosovo diaspora may have been an important conduit for revitalising FDI inflows, as there are large and well-established communities of Kosovars in both Germany and the USA. Also, remittances continue to be an important source of income – up to three times greater than FDI inflows.

**The 'Kosova e Re' coal-fired power plant project may gain momentum.** The new government has announced that between 2020 and 2023, 'Kosova e Re' will replace the old coal-fired power plant 'Kosova A'. However, it is uncertain under what conditions and arrangements this project will be launched, given that in the past both the LVV and the LDK opposed the previous government's agreement with US company ContourGlobal.

**In the medium term, growth will remain robust, at above 4%, backed by consumption and investment.** With the new government on board, and given its ambitious programme, it is anticipated that the economy will accelerate further. Dialogue with Serbia is expected to resume soon. Positive results are envisaged, given the active role of the USA. Given this robust growth, Kosovo is likely to maintain its position as one of the fastest-growing economies in CESEE.

**Table 6.10 / Kosovo: Selected economic indicators**

	2015	2016	2017	2018	2019 <sup>1)</sup>	2020	2021	2022
						Forecast		
Population, th pers., average	1,788	1,778	1,791	1,797	1,820	1,845	1,860	1,870
Gross domestic product, EUR mn, nom.	5,807	6,070	6,414	6,726	7,200	7,700	8,200	8,800
annual change in % (real)	4.1	4.1	4.2	3.8	4.1	4.3	4.2	4.2
GDP/capita (EUR at PPP)	7400	7500	7700	8100	8500	.	.	.
Consumption of households, EUR mn, nom.	4,943	5,194	5,370	5,738	6,000	.	.	.
annual change in % (real)	6.5	6.6	1.8	4.8	2.3	3.0	2.8	2.8
Gross fixed capital form., EUR mn, nom.	1,499	1,550	1,729	1,888	2,100	.	.	.
annual change in % (real)	12.1	7.3	5.7	6.1	7.0	7.2	7.3	6.0
Gross industrial production <sup>2)</sup>								
annual change in % (real)	3.7	-6.7	4.9	-1.3	3.5	3.0	5.0	3.0
Gross agricultural production <sup>3)</sup>								
annual change in % (real)	13.8	14.5	-4.1	-20.4	-1.5	.	.	.
Construction output <sup>4)</sup>								
annual change in % (real)	15.8	4.5	8.6	9.3	8.0	.	.	.
Employed persons, LFS, th, average <sup>5)</sup>	296.9	331.8	357.1	345.1	380.0	395	405	410
annual change in %	-8.2	11.7	7.6	-3.4	10.1	4.0	2.0	2.0
Unemployed persons, LFS, th, average <sup>5)</sup>	145.8	126.1	156.6	145.0	120.0	120	120	110
Unemployment rate, LFS, in %, average <sup>5)</sup>	32.9	27.5	30.5	29.6	24.5	23.5	22.5	21.0
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.	.
Average monthly gross wages, EUR	510	519	528	558	600	630	670	710
annual change in % (real, gross)	0.0	1.5	1.7	4.7	5.0	4.0	4.0	4.0
Average monthly net wages, EUR	451	457	471	498	550	580	610	630
annual change in % (real, net)	5.4	1.0	1.5	4.6	7.0	4.0	3.0	2.0
Consumer prices (HICP), % p.a.	-0.5	0.3	1.5	1.1	2.7	1.5	1.7	1.5
Producer prices, % p.a.	2.7	-0.1	0.6	1.4	1.5	1.5	1.5	1.5
General governm.budget, nat.def., % of GDP								
Revenues	29.4	29.3	30.0	29.8	30.7	31.0	31.5	32.0
Expenditures	27.8	29.1	28.6	29.4	30.0	33.0	32.0	32.0
Deficit (-) / surplus (+)	1.6	0.2	1.3	0.4	0.7	-2.0	-0.5	0.0
General gov.gross debt, nat.def., % of GDP	12.9	14.0	15.5	16.3	17.2	17.5	18.0	18.0
Stock of loans of non-fin.private sector, % p.a.	7.2	10.5	11.6	10.8	10.0	.	.	.
Non-performing loans (NPL), in %, eop	6.2	4.9	3.1	2.7	2.0	.	.	.
Central bank policy rate, % p.a., eop <sup>6)</sup>	7.69	7.22	6.83	5.99	6.42	6.00	5.50	5.50
Current account, EUR mn	-497	-481	-349	-509	-490	-550	-620	-710
Current account, % of GDP	-8.6	-7.9	-5.4	-7.6	-6.8	-7.1	-7.6	-8.1
Exports of goods, BOP, EUR mn	322	308	378	377	405	430	450	480
annual change in %	-0.6	-4.5	22.9	-0.4	7.6	6.0	5.5	7.0
Imports of goods, BOP, EUR mn	2,432	2,599	2,843	3,114	3,300	3,480	3,650	3,830
annual change in %	2.1	6.9	9.4	9.6	6.0	5.5	5.0	5.0
Exports of services, BOP, EUR mn	952	1,131	1,359	1,562	1,750	1,870	1,980	2,140
annual change in %	2.5	18.8	20.2	14.9	12.1	7.0	6.0	8.0
Imports of services, BOP, EUR mn	494	492	531	706	800	870	930	1,000
annual change in %	5.5	-0.5	8.1	32.8	13.4	9.0	7.0	8.0
FDI liabilities, EUR mn	309	220	255	272	290	350	.	.
FDI assets, EUR mn	37	43	43	46	20	30	.	.
Gross reserves of NB excl. gold, EUR mn	708	605	683	769	863	.	.	.
Gross external debt, EUR mn	1,932	2,015	2,089	2,036	2,300	2,500	2,500	2,600
Gross external debt, % of GDP	33.3	33.2	32.6	30.3	32.5	32.0	31.0	30.0

1) Preliminary and wiiw estimates. - 2) Turnover in manufacturing industry (NACE C). - 3) wiiw estimate from 2018. - 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.