

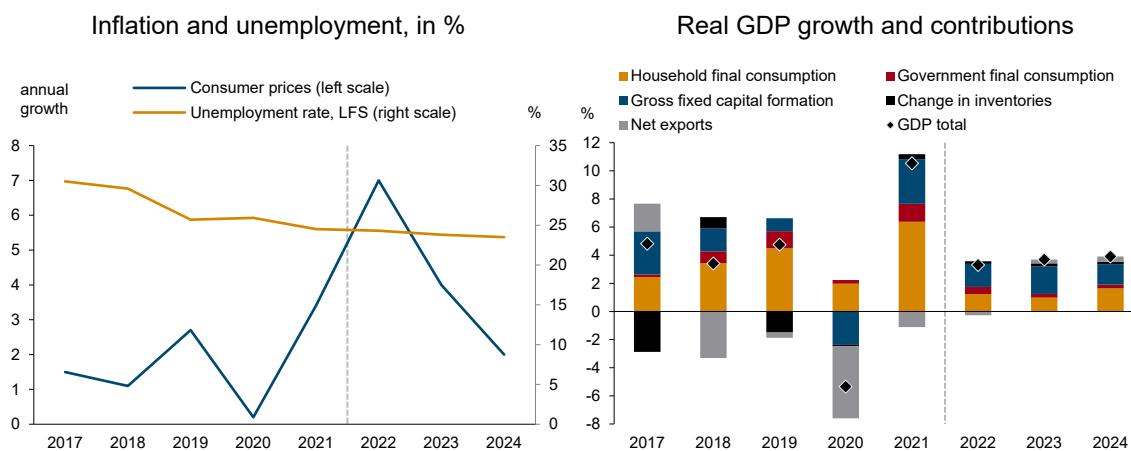


KOSOVO: Positive and negative spill-over effects expected as international trade adjusts

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Kosovo's economic growth is likely to lose steam, owing to its high exposure to external shocks and certain domestic bottlenecks surrounding energy supplies. Consumption will spur growth, but at a slower pace. The restructuring of international trade will have negative spill-over effects, but there is also likely to be a silver lining in the shape of a surge in lignite exports. According to the baseline scenario – and on the assumption that the war in Ukraine will be over this year – inflation will climb to 7% and the growth rate will be 3.3%. In the medium term, inflationary pressure will slacken and growth will accelerate to 3.9%.

Figure 4.10 / Kosovo: Main macroeconomic indicators



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

Domestic demand, backed by buoyant household and government consumption, boosted economic activity by 10% in 2021. Rising consumption contributed 6.7 percentage points (pp) to GDP growth, while a 10% rise in gross fixed capital formation contributed a further 3.2 pp. Exports of goods and services rebounded by 51% and 91%, respectively. Meanwhile, imports of goods and services increased by 31% and 43%. The net effect on growth was -1.1 pp. In production terms, those activities that powered ahead were wholesale and retail trade (21%), manufacturing (8%), construction (7%) and scientific activities (7%). Q4 2021 saw a slowdown in economic activity, owing to high exposure to external trade and bottlenecks in the energy sector.

Kosovo's economy, being highly dependent on imports, is already on high alert. The huge uncertainty stemming from the invasion of Ukraine and the war's impact on international markets – especially on the EU, Kosovo's main trading partner – suggest that the effects will not just be transient. The steep rise in import, consumer and producer prices seen in Q4 2021 continued into Q1 2022: import and consumer prices rose by 6.5% over November/December 2021, year on year, and in February 2022, consumer prices jumped by 7.5% year on year. The price hikes have especially affected edible oils and fat (32%), fuels for personal transport means (28%), gas (19%), electricity (12%) and solid fuels and firewood (14%). Trade relations with Russia and Ukraine are very modest – imports in 2021 from the two countries did not exceed 1.5% – but there is a heavy dependence on certain specific commodity goods, especially base metals (29% and 30% are imported from Russia and Ukraine, respectively). The sanctions imposed by the EU on the import of metals and steel from Russia will very likely affect Kosovo. Aside from the other commodity goods, there is also a crisis in energy products.

The energy crisis in Kosovo is quite serious and there are no quick fixes. At the end of 2021, the government declared a state of emergency for 60 days, subsequently extended for another month at the end of February. According to Eurostat, Kosovo was dependent on imports for 30% of its annual consumption of energy in the period 2017-2020. In 2021, imports of electricity rose by 29%, as consumption expanded by 15% and domestic production dropped by 2%. This year, the early indications are that the picture will be similar: in January, imports surged by 37% year on year; production from power plants (mainly coal/lignite burning) contracted by 13%; and demand rose by 8%. The worst of it is that 97% of electricity generation depends on power plants that burn lignite: these are outdated, require huge investment and can only partially satisfy the demand for electricity. For Kosovo to import large quantities of energy is 'mission impossible', given the volatility of prices. Some positive steps have been taken in the direction of power production (renewable energy projects; the Selac Windpark in Mitrovica (EUR 170m, 100 megawatts); the Solar4Kosovo project (EUR 60m, 70 megawatts); however, this is still too little. The country's heavy dependence on imports of fuel and electricity, and the lack of strategic and large-scale projects in the energy sector, will leave it very exposed to external risks in the short-to-medium term. In March 2022, the government announced a ceiling on prices and on the profit margins of fuel retailers, in the hope of protecting consumers against price fluctuations.

Inflationary pressures will curb consumption. The strong economic growth recorded in 2021 did not translate into a major boost to employment. Real wages – up by 5% in 2021 – do not match the big rise in inflation. Negotiations are ongoing between the government and interest groups – the trade unions – which are seeking a rise in the minimum wage to EUR 400 a month. However, the government is not prepared to offer more than EUR 250 (up from the current EUR 150). If implemented by June 2022, an increase of some sort in the minimum wage could go some way to mitigating the erosion effect of high inflation on the purchasing power of households.

Remittances will continue to smooth consumption, though less than during the pandemic. Remittances will continue to assist Kosovo households. That said, this year inflation is hitting the very economies where most of the migrants from Kosovo reside. Accordingly, their saving power will decline, and with it the flow of remittances.

Public finances improved markedly in 2021. General government revenues rose by 27%. By contrast, expenditure grew by 2%, while capital expenditure surged by 25%. The year ended with a deficit of 2% of GDP and a slight rise in the public debt to 23.4%. This year there will most likely have to be a further

revision to the budget to cope with the current energy crisis and the surge in consumer prices: this is way above what could have been expected and was not envisaged in the current budget planning. Public investment will be sacrificed to support vulnerable households (in 2021, the share of the population living on less than USD 5.50 a day stood at 23% in Kosovo).

But every cloud has a silver lining. Kosovo relies heavily on imports – for energy, of course, but also for other consumer and commodity goods. And meanwhile, its exports cover only 17% of its goods imports. The readjustment of international trade relations and the sanctions imposed by the EU on Russian imports will have both positive and negative spill-over effects for Kosovo. In particular, the EU bans on Russian steel and iron imports will hit the country, given its heavy dependence on Russia in this field. Besides, in April 2022 the EU announced that by August 2022 it will also ban Russian coal imports. Meanwhile, in order to gain some independence from Russian gas, some EU countries have announced that they will revert to coal in order to generate energy. This is a forced choice between the devil and the deep blue sea; and given the EU's green agenda, the move is expected to be only a temporary one. Nevertheless, in the meantime it will provide a welcome boost to Kosovo's lignite exports (it is one of the top five countries in the world in terms of lignite reserves). Indeed, lignite exports tripled in January and February 2022, year on year, in both real and nominal terms.

The sense surrounding the COVID-19 pandemic is that it 'is already a thing of the past'. The vaccination rate against COVID-19 has reached 46%; daily infections have dropped to very low numbers; and fatalities are close to zero.

We expect growth to lose steam owing to the country's high exposure to imports and the international market dynamics. Its volume of trade with Russia and Ukraine is below 2%, but for certain commodity goods imports from those countries are of considerable significance. Consumption will continue to spur growth, while external demand will act as a drag on the economy. According to the baseline scenario, and assuming an end to the war in Ukraine this year, inflation will climb to 7%, while the economy will grow at 3.3% this year. In the medium term, inflation will fall to 2%, while growth accelerates to 3.9%.

Table 4.10 / Kosovo: Selected economic indicators

	2018	2019	2020	2021 ¹⁾	2022	2023	2024
					Forecast		
Population, th pers., average	1,797	1,789	1,790	1,795	1,798	1,800	1,802
Gross domestic product, EUR m, nom.	6,672	7,056	6,772	7,817	8,600	9,300	9,900
annual change in % (real)	3.4	4.8	-5.3	10.5	3.3	3.7	3.9
GDP/capita (EUR at PPP)	7470	8030	7550	8520	.	.	.
Consumption of households, EUR m, nom.	5,296	5,621	5,720	6,414	.	.	.
annual change in % (real)	4.4	5.7	2.5	7.6	1.5	1.2	2.0
Gross fixed capital form., EUR m, nom.	2,116	2,190	2,012	2,547	.	.	.
annual change in % (real)	5.4	2.9	-7.6	10.7	5.0	6.0	4.5
Gross industrial production ²⁾							
annual change in % (real)	-1.3	6.3	0.8	21.7	6.0	4.0	4.0
Gross agricultural production							
annual change in % (real)	-8.8	9.5	2.7	4.0	.	.	.
Construction output ³⁾							
annual change in % (real)	1.5	1.5	-9.0	6.0	.	.	.
Employed persons, LFS, th, average ⁴⁾	345.1	363.2	347.1	375.0	377	379	383
annual change in %	-3.4	5.2	-4.4	8.0	0.5	0.5	1.0
Unemployed persons, LFS, th, average ⁴⁾	145.0	125.3	121.4	120.0	120	120	120
Unemployment rate, LFS, in %, average ⁴⁾	29.6	25.7	25.9	24.5	24.3	23.8	23.5
Reg. unemployment rate, in %, eop
Average monthly gross wages, EUR	453	477	466	510	580	630	670
annual change in % (real, gross)	4.0	2.5	-2.5	6.0	6.0	4.0	4.0
Average monthly net wages, EUR	409	430	416	450	490	520	540
annual change in % (real, net)	3.7	2.4	-3.4	5.0	1.0	2.0	2.0
Consumer prices (HICP), % p.a.	1.1	2.7	0.2	3.4	7.0	4.0	2.0
Producer prices, % p.a.	1.4	0.9	-0.6	4.9	6.0	3.0	2.0
General governm. budget, nat.def., % of GDP							
Revenues	26.3	26.8	25.4	27.9	28.0	29.0	29.5
Expenditures	29.2	29.7	33.0	29.3	30.0	31.0	30.0
Deficit (-) / surplus (+)	-2.9	-2.9	-7.6	-1.3	-2.0	-2.0	-0.5
General gov. gross debt, nat.def., % of GDP	16.4	17.0	22.0	23.0	23.3	22.5	22.0
Stock of loans of non-fin. private sector, % p.a.	10.8	10.0	7.1	15.4	.	.	.
Non-performing loans (NPL), in %, eop	2.7	2.0	2.7	2.3	.	.	.
Central bank policy rate, % p.a., eop ⁵⁾	5.99	6.42	6.01	5.80	6.00	6.00	6.00
Current account, EUR m	-509	-399	-472	-691	-850	-910	-930
Current account, % of GDP	-7.6	-5.7	-7.0	-8.8	-9.9	-9.8	-9.4
Exports of goods, BOP, EUR m	377	393	475	753	840	870	950
annual change in %	-0.4	4.4	20.8	58.4	11.0	3.5	9.0
Imports of goods, BOP, EUR m	3,114	3,233	3,048	4,320	4,710	4,840	5,030
annual change in %	9.6	3.8	-5.7	41.7	9.0	2.8	4.0
Exports of services, BOP, EUR m	1,562	1,675	995	1,946	2,080	2,160	2,200
annual change in %	14.9	7.3	-40.6	95.6	7.0	4.0	2.0
Imports of services, BOP, EUR m	706	749	603	864	1,000	1,100	1,150
annual change in %	32.8	6.1	-19.5	43.2	16.0	10.0	4.5
FDI liabilities, EUR m	272	255	346	421	.	.	.
FDI assets, EUR m	46	66	59	100	.	.	.
Gross reserves of CB excl. gold, EUR m	769	864	901	1,100	.	.	.
Gross external debt, EUR m	2,036	2,201	2,517	2,895	2,800	3,000	3,100
Gross external debt, % of GDP	30.5	31.2	37.2	37.0	33.0	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.