

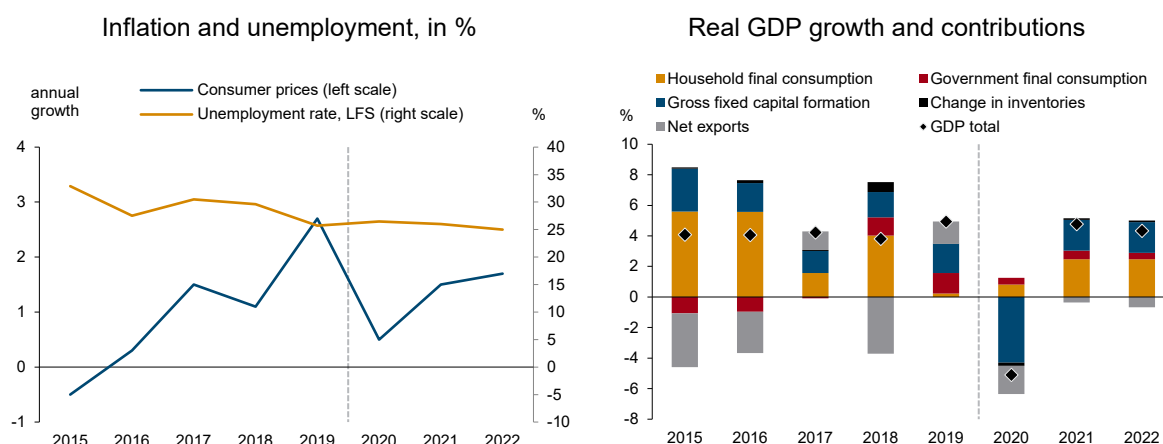


## KOSOVO: Rising remittances limit the extent of economic decline

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Against all expectations, remittances, foreign direct investment and goods exports rose during the pandemic. Still, the negative economic fallout has been considerable and the economy is expected to contract by 5% in 2020. The government has approved a recovery plan worth EUR 365 million to relaunch the economy. Remittances will continue to cushion consumption, and private investments will gain momentum in the medium term. The economy is expected to bounce back in 2021, with growth of 5%. However, recovery remains uncertain, given the continued presence of COVID-19.

**Figure 4.10 / Kosovo: Main macroeconomic indicators**



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

**The economy is expected to contract by over 5% in 2020, due to a sharp fall in investment and real net exports.** Economic activity grew slightly (1.4%) in the first quarter of 2020, year on year (y-o-y). The second quarter, however, saw a strong contraction of 9.3% y-o-y. The lockdown imposed from mid-March until May hit certain sectors particularly hard: the services, transport and trade sector contracted by 26%; construction activity dropped by 48%; and extraction industry output fell by 8%. By contrast, the manufacturing sector (which accounts for a fifth of GDP) saw output rise by 19% in the second quarter y-o-y. On the demand side, gross fixed capital formation slumped by 30% in the first half of 2020 (y-o-y). Meanwhile, consumption – with a 90% share of GDP in the first half of 2020 – continued in positive mode in both the first and the second quarters. Government consumption rose by 8% and household consumption by 3%. The external demand shock was mainly felt in the export of services, which fell by 32% over the first half of 2020, year on year. Meanwhile, goods exports gained momentum, soaring 17%

over the same period (although, at 7%, their share of GDP is modest). Overall, net exports declined by 2% over the first half of 2020. Imports contracted by 10%, owing mainly to a fall in the import of services.

**The effects of COVID-19 on the population have been severe.** Close to 16,000 people have been infected by COVID-19, and more than 630 have lost their lives. The number of both infections and deaths peaked in July, and from August the figure for both declined steadily.<sup>17</sup> However, during October the number of daily infections has been fluctuating, raising concerns about winter trends.

**The Kosovo-Serbia dialogue has resumed and the US is again playing an important role.** A step towards the normalisation of economic relations was taken on 4 September, with an agreement signed by Kosovo and Serbia in Washington. Both optimism and scepticism have surrounded this agreement. Nevertheless, the outcome of the Washington meeting looks promising. Two weeks later, Richard Grenell, the US envoy to the Kosovo-Serbia dialogue, visited both Kosovo and Serbia. A new agreement was signed between Kosovo and the US which envisages US investments worth EUR 1 billion for infrastructure projects in Kosovo. For a small economy such as Kosovo's, such an investment will provide a powerful stimulus to growth. Another positive outcome of the Washington agreement was the announcement of Kosovo's recognition by Israel. Ukraine also seems to be moving in the same direction, having recognised Kosovo passports.

**The precariousness of the labour market stems from the high proportion of temporary employment.** With an employment rate of 29.1% and with more than 60% of employees on temporary employment contracts, labour market vulnerability is considerable. Both unemployment and inactivity have most likely increased (although the statistics for the second quarter of 2020 are not yet available). The growth in remittances during the lockdown was probably a response to the rising vulnerability of family members at home. The strong upsurge in remittances inflows, especially in the second quarter of 2020, could also explain why consumption did not contract, with household consumption being cushioned by the financial transfers from abroad. Remittances – especially from Germany and Switzerland – intensified, and in July exceeded EUR 500 million, an increase of 10% (y-o-y).

**Merchandise exports rose during the pandemic.** In January-July 2020, merchandise exports rose by 17% year on year, mainly to Albania and EU countries such as Germany, Italy and the UK. This stemmed largely from a surge in the export of base metals and articles manufactured from base metals, which increased by 37% in January-July (y-o-y) and accounted for 42% of total goods exports. Merchandise imports fell by 9% generally, although imports from the CEFTA countries rose by more than 5%. In April, Kosovo annulled the 100% tariff on Serbian imports. As a result, imports from Serbia surged and 20% of the imports from the CEFTA countries in January-July were Serbian in origin. The 'green corridors' established during the pandemic, with support from the Regional Cooperation Council, have been instrumental in bolstering trade relations within the region. During the pandemic there has been an intensification of trade relations with neighbouring countries, especially as concerns the export of goods; this has benefited Kosovo and may continue to do so.

**The first half of 2020 saw an increase in FDI inflows of EUR 165 million – almost 48% (y-o-y).** Sectors such as financial services and real estate, renting and business activities absorbed 50% of the FDI inflows, but the sectors that recorded the strongest growth were mining and energy. Countries such

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<sup>17</sup> <https://covid19.who.int/region/euro/country/xk>

as Hungary, Albania, Germany and Switzerland have been the main senders. The FDI inflows in the energy sector benefited from the start of construction works at a wind farm at Mitrovica, in northern Kosovo. This is an investment by SOWI Kosovo LCC, a German-Kosovo-Israeli joint venture and is worth EUR 169 million. The wind farm, with its 30 turbines, will have a total capacity of 105 megawatts and is expected to be operational by 2021.

**The banking sector continued expanding its lending activity, but at a slower pace.** Until August 2020, year on year, deposits (which are the main funding source for the banks) rose by 10.6%, while demand for loans – especially for households and non-financial corporations – increased by 7.1% over the same period. The central bank's three-month moratorium on loan payments during the pandemic affected more than 50% of bank loans, according to the IMF. The level of non-performing loans is relatively low. In August, their share rose slightly to 2.6% – 0.5 percentage points up on their proportion prior to the pandemic. However, the performance of loans is expected to deteriorate, given that 70% of them affect the service sector – wholesale, retail trade and services – which was severely hit by the lockdown.

**The public debt to GDP ratio is expected to deteriorate as the budget deficit rises.** In January-August, government revenue fell by 21% (with a sharp drop in both direct and indirect tax revenue), while expenditure rose by 8%. Total spending on wages, salaries and social transfers – which absorb the largest slice of budgetary expenditure – rose by more than 8%. Capital investments suffered the most, falling by 36% and accounting for only 8% of total expenditure. The public debt to GDP ratio may deteriorate to over 22%, given the fiscal deficit of 5% recorded for the first half of 2020. The financial package put together by the government to deal with the effects of COVID-19 is estimated at 3.1% of GDP. In July, the government approved a recovery package for 2020-2023 worth EUR 365 million. More specifically, the recovery plan envisages the allocation of EUR 100 million to facilitate access to loans for businesses and EUR 15 million to ease the tax burden and support short-term liquidity; more than EUR 67 million have been proposed to support job retention and reintegration into work; and financial support worth EUR 26 million is foreseen to sustain agricultural production and employment in that sector.

**Given the high dependence on imports, consumer prices will remain subdued.** In September, the consumer price index declined by -0.4% (y-o-y). This was due largely to lower import prices, but also to meagre consumer demand in the second quarter, given the restrictions on mobility. The lifting of the 100% import tariff on Serbian goods may also have prevented prices rising further. Given the high dependence on imports, we expect inflation to remain subdued and to hover at around 1.5%.

**Overall, we expect economic activity to contract by 5% in 2020; assuming there is no second lockdown, it is anticipated that the economy will bounce back in 2021, with growth of 5%.**

Domestic demand and merchandise exports will continue to drive the economy. Given the ongoing pandemic, external demand dynamics are subject to a high level of uncertainty, especially as concerns the export of services. Private investments are expected to gain momentum in the medium term, thanks to the agreement with the US to provide financial support for infrastructure projects in Kosovo.

Table 4.10 / Kosovo: Selected economic indicators

	2017	2018	2019 <sup>1)</sup>	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022
Population, th pers., average	1,791	1,797	1,789	.	.	.	1,765	1,764	1,763
Gross domestic product, EUR mn, nom.	6,414	6,726	7,104	1,438	1,636	3,074	6,800	7,200	7,600
annual change in % (real)	4.2	3.8	4.9	1.3	-9.3	-4.6	-5.1	4.8	4.3
GDP/capita (EUR at PPP)	7220	7610	7980	.	.	.	.	.	.
Consumption of households, EUR mn, nom.	5,370	5,738	5,836	1,308	1,549	2,856	.	.	.
annual change in % (real)	1.8	4.8	0.3	5.2	3.5	4.3	1.0	3.0	3.0
Gross fixed capital form., EUR mn, nom.	1,729	1,888	2,038	.	.	.	.	.	.
annual change in % (real)	5.7	6.1	6.8	.	.	.	-15.0	7.0	7.0
Gross industrial production <sup>2)</sup>									
annual change in % (real)	4.9	-1.3	6.3	2	-17	-8.9	-2.0	2.0	3.0
Gross agricultural production <sup>3)</sup>									
annual change in % (real)	-4.1	-20.4	11.2	.	.	.	.	.	.
Construction output <sup>4)</sup>									
annual change in % (real)	8.6	9.3	3.5	.	.	.	.	.	.
Employed persons, LFS, th, average <sup>5)</sup>	357.1	345.1	363.2	.	.	.	350	355	360
annual change in %	7.6	-3.4	5.2	.	.	.	-3.5	1.0	2.0
Unemployed persons, LFS, th, average <sup>5)</sup>	156.6	145.0	125.3	.	.	.	135	120	120
Unemployment rate, LFS, in %, average <sup>5)</sup>	30.5	29.6	25.7	.	.	.	26.5	26.0	25.0
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.	.	.
Average monthly gross wages, EUR	528	558	600	.	.	.	630	660	700
annual change in % (real, gross)	1.7	4.7	5.0	.	.	.	4.0	3.0	4.0
Average monthly net wages, EUR	471	498	550	.	.	.	570	600	620
annual change in % (real, net)	1.5	4.6	7.0	.	.	.	4.0	3.0	2.0
Consumer prices (HICP), % p.a.	1.5	1.1	2.7	1.1	0.2	0.6	0.5	1.5	1.7
Producer prices, % p.a.	0.6	1.4	0.9	-0.2	-1.5	-0.9	-1.0	1.4	1.5
General government budget, nat.def., % of GDP									
Revenues	30.0	29.8	31.3	28.0	35.7	32.1	29.0	32.0	32.0
Expenditures	28.6	29.4	30.3	27.8	32.6	30.4	34.0	31.5	31.5
Deficit (-) / surplus (+)	1.3	0.4	1.0	0.1	3.1	1.7	-5.0	0.5	0.5
General gov.gross debt, nat.def., % of GDP	15.5	16.3	16.9	16.3	18.2	18.2	22.0	21.0	20.0
Stock of loans of non-fin.private sector, % p.a.	11.6	10.8	10.0	9.2	6.4	6.4	.	.	.
Non-performing loans (NPL), in %, eop	3.1	2.7	2.0	2.9	2.6	2.6	.	.	.
Central bank policy rate, % p.a., eop <sup>6)</sup>	6.83	5.99	6.42	6.3	6.3	6.3	6.00	5.50	5.50
Current account, EUR mn	-349	-509	-399	-72	-145	-217	-405	-520	-630
Current account, % of GDP	-5.4	-7.6	-5.6	-5.0	-8.9	-7.1	-6.0	-7.2	-8.3
Exports of goods, BOP, EUR mn	378	377	393	98	115	213	420	440	460
annual change in %	22.9	-0.4	4.4	25.0	10.5	16.7	6.0	4.0	5.0
Imports of goods, BOP, EUR mn	2,843	3,114	3,233	679	673	1,352	3,140	3,270	3,430
annual change in %	9.4	9.6	3.8	3.3	-18.6	-8.9	-3.0	4.0	5.0
Exports of services, BOP, EUR mn	1,359	1,562	1,675	282	115	396	1,340	1,430	1,530
annual change in %	20.2	14.9	7.3	-0.1	-62.4	-32.5	-20.0	7.0	7.0
Imports of services, BOP, EUR mn	531	706	749	140	107	247	700	750	810
annual change in %	8.1	32.8	6.1	10.6	-36.0	-15.9	-7.0	6.5	8.0
FDI liabilities, EUR mn	255	272	272	105	60	165	340	.	.
FDI assets, EUR mn	43	46	66	8	8	17	40	.	.
Gross reserves of NB excl. gold, EUR mn	683	769	864	845	900	900	.	.	.
Gross external debt, EUR mn	2,088	2,036	2,201	2,207	2,273	2,273	2,300	2,200	2,300
Gross external debt, % of GDP	32.6	30.3	31.0	33.4	34.4	33.4	34.0	31.0	30.0

1) Preliminary. - 2) Turnover in manufacturing industry (NACE C). - 3) wiiw estimate in 2019. - 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.