KOSOVO

Highlights

- **Robust economic growth is continuing.** GDP grew by 3.7 per cent in 2017, driven by investment and net exports. Unemployment has also continued its declining path, although the rate is still among the highest in Europe.
- **Plans to build a new coal-fired plant have advanced.** The government signed a contract with power generator ContourGlobal to build a 500 MW coal-fired power plant, with a value of €1 billion.
- **Cross-border transport infrastructure is being enhanced.** The reconstruction and development of Kosovo's major road and railway infrastructure network is taking place**.**

Key priorities for 2019

- **Privatisation should be re-energised. Little progress has been made in this area in recent years.** Attracting private ownership and investment into state-owned enterprises could give the economy a much-needed boost.
- **A major reform push in the energy sector is needed.** Renewable energy investments and energy efficiency measures can help mitigate power shortfalls, while enhancing environmental sustainability and energy security.
- **Implementation of key cross-border infrastructure projects needs to speed up.** Infrastructure development is key to Kosovo's continued integration within the region. Finalisation and rehabilitation of the main transport links to pan-European corridors would boost trade and investment with neighbouring countries.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	1.2	4.0	4.1	3.7	4.0
Inflation (average)	0.4	-0.5	0.3	1.5	0.8
Government balance/GDP	-2.4	-1.8	-1.3	-1.2	-3.4
Current account balance/GDP	-6.9	-8.6	-7.9	-6.6	-7.2
Net FDI/GDP [neg. sign = inflows]	-2.2	-4.7	-2.9	-4.0	-3.9
External debt/GDP	31.2	33.3	33.2	32.6	n.a.
Gross reserves/GDP*	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	33.6	34.5	36.5	38.6	n.a.

*Kosovo uses the euro as its legal tender.

CONTINUES

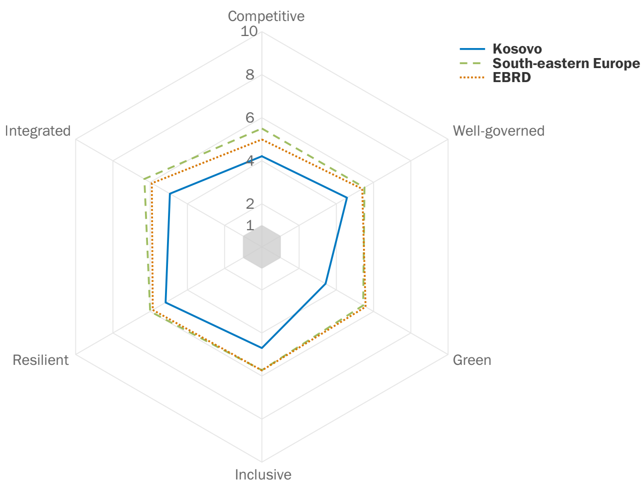
Macroeconomic performance

Robust growth has continued. GDP grew by 3.7 per cent in 2017, slightly below the level of the previous two years. Last year's growth was mainly investment driven, although net exports were also a positive contributor to growth. The unemployment rate continued its declining path over the last three years and now stands at 27.5 per cent, still very high by regional standards. The low rate of labour force participation, especially among women, represents a key bottleneck for further economic development. Growth has continued into 2018 with overall output rising 4.2 per cent year-on-year in the first half of the year. It was again mainly investment-driven, as construction of key transport infrastructure progressed, although private and government consumption were also positive contributors to growth. Inflation averaged 1.5 per cent in 2017.

Fiscal policy has remained moderate. Following the end of the IMF programme in 2017, the government has stuck to a prudent fiscal path, with the government deficit at 1.2 per cent of GDP in 2017. Public debt also remains exceptionally low by regional standards at just 17 per cent of GDP by the end of 2017 (excluding debt related to the Yugoslav era). The government is therefore staying well within the fiscal rule targets of a deficit below 2.0 per cent of GDP and public debt remaining below 30.0 per cent of GDP, although there have been signs of rising spending commitments in 2018. On the external side, the current account deficit remains large at 6.0 per cent of GDP in 2017, although partly balanced by inflows of foreign direct investment which amounted to 4.0 per cent of GDP.

Further growth is likely in the short term. The current forecast for GDP growth in 2018 is 4.0 per cent, with the same projection also in 2019, due mainly to a more favourable external environment and hence higher remittances and exports, as well as an anticipated acceleration of investment, including in public infrastructure. Future growth may also depend on the pace of implementation of the planned new 500 MW thermal power plant (see below), which would represent the biggest investment project in the country. Conversely, a failure to proceed with the project or to put in place alternative arrangements for an adequate power supply could have a serious negative impact on the economy.

Assessment of transition qualities (1-10)



CONTINUES

Major structural reform developments

The government has approved an action plan to meet EU requirements. The action plan, approved in April 2018, is designed to address the country's challenges as identified in the latest European Commission (EC) progress report. The EC noted that corruption remains an issue of concern, and suggested that the country step up the fight against the informal economy, which remains widespread, as well as against tax evasion. The report also recognised that the energy sector continues to face serious challenges and is a major bottleneck for economic development.

Steps are under way to revive the major mining complex Trepca. In May 2018, the government approved the statute for Trepca, almost two years after the complex was put under government control in a bid to save it from bankruptcy. This followed the decision by the parliament to settle the legal situation of the company by transforming it from a socially owned enterprise into a shareholding company, giving the state an 80 per cent stake and miners 20 per cent. Trepca's ownership structure has been disputed by Serbia, which claims the majority stake. The Trepca board is expected to proceed soon with the creation of all managerial structures and an operational plan.

Cross-border linkages with Albania are being strengthened. In June 2018, the parliament endorsed the implementation of the agreement between Kosovo and Albania on the unification of customs points between the two countries. The agreement is expected to facilitate the exchange of goods and the movement of people. Also, in parallel the parliament of Kosovo adopted a resolution on the removal of telephone roaming charges with Albania.

Progress in transport infrastructure is moving ahead slowly. In July 2018, the government approved plans to borrow €80 million from the European Investment Bank to finance the construction of the 30 km Pristina-Peja motorway segment (Kijeve-Zahaq), which leads to Montenegro. The project, which has a total value of €200 million, will be co-financed by the EBRD. The government has also decided to extend the deadline for the completion of the €600 million, 60 km highway that leads from Pristina to the Macedonian border until the end of 2018, built by the American-Turkish consortium Bechtel Enka. In the area of railways infrastructure, the European Union is providing a grant of €38.5 million to Kosovo to co-finance (with the EBRD) the modernisation of the country's railway infrastructure network, thus improving its connection with the Pan-European Corridors VIII and X. This project covers the three sections of the main railroad Route 10 connecting Kosovo with Serbia in the north and with FYR Macedonia in the south.

Plans to build a new coal-fired plant have advanced. In December 2017, the government signed a contract with power generator ContourGlobal to build a 500 MW coal-fired power plant, with a value of €1 billion. In June 2018 ContourGlobal called a pre-qualification tender for the construction of the plant, and in September 2018 the government of Kosovo and ContourGlobal jointly announced that four out of six applicants had pre-qualified for the next stage of the tender. Currently Kosovo relies mostly on two old coal-fired plants, Kosova A and Kosova B, both part of Kosovo Electricity Corporation (KEK), which are considered to be among the worst polluters in Europe. However, the proposed new project has been criticised by environmental groups who argue that the country should look to alternative fuel sources rather than investing in more coal capacity.

New legislation is being introduced in the financial sector. Currently the level of financial intermediation is well below that of neighbouring countries, but the banking system is well capitalised and has a very low level of non-performing loans, at just 3.1 per cent of total loans. The Law on Banks is expected to undergo amendments as regulations are harmonised with Basel and EU standards. The EBRD is assisting the central bank to review and amend the legal framework for the receivership and liquidation of financial institutions. A new draft law on microfinance institutions and non-bank financial institutions is also being discussed and is expected to enter into force by the end of 2018.