KOSOVO

Highlights

- **The economy is growing robustly.** The main drivers of growth continue to be private consumption and strong investment figures, which in turn are driven by public investments in infrastructure. The IMF programme expired in August 2017.
- **Some investment climate measures have been introduced.** These include a new law on strategic investments, which is designed to simplify the process for investors and boost foreign direct investment (FDI), and progress in the areas of contract enforcement and public procurement.
- **Cross-border integration is being enhanced.** In the past year, measures have been taken to facilitate trade between Kosovo and Albania, and the regional transport connectivity agenda has also advanced.

Key priorities for 2018

- **Further investment climate reforms are needed.** Key areas needing attention include enhancing the impact and effectiveness of the National Economic Development Council, strengthening the capacity of the Competition Authority, and supporting the implementation of the bankruptcy law and other commercial laws.
- **Cross-border transport infrastructure should be further enhanced.** This should include progress towards the rehabilitation and improvements of major cross-border road and rail routes and improved capacity for the country's air navigation services agency.
- **Fiscal stability should be preserved.** Kosovo has built up an enviable record of fiscal prudence, contributing to the low level of public debt, and it will be important to preserve these achievements in order to bolster investor confidence.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	3.4	1.2	4.0	3.4	3.7
Inflation (average)	1.8	0.4	-0.5	0.3	1.4
Government balance/GDP	-3.1	-2.6	-1.9	-1.4	-3.4
Current account balance/GDP	-3.6	-7.0	-8.5	-9.8	-11.0
Net FDI/GDP [neg. sign = inflows]	-4.9	-2.2	-4.7	-4.2	-5.2
External debt/GDP	30.2	31.2	33.3	34.2	n.a.
Gross reserves/GDP*	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	33.0	33.6	34.5	36.6	n.a.

*Kosovo uses the euro as its legal tender.

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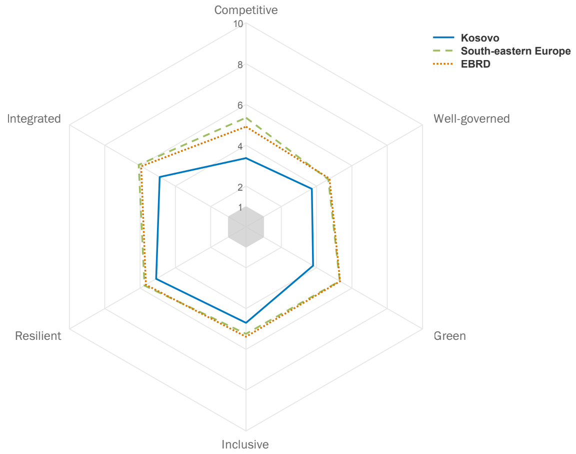
Macroeconomic performance

The economy continued to perform well in 2016. Economic growth in 2016 is estimated at 3.4 per cent, slightly smaller compared with 4.0 per cent in 2015, but continuing the strong recovery from the slow-down in 2014. Drivers of growth in Kosovo continue to be robust private consumption, helped by major inflows of remittances, and strong investment figures including public investments in infrastructure, such as the 65 km section of the highway connecting Pristina to the Macedonian border. On the other hand, government consumption and net exports made negative contributions to growth, with the latter reflecting the country's weak production base and low competitiveness. Kosovo's economy continued to perform well in the first half of 2017, with an estimated growth rate of 4.2 per cent year-on-year, primarily driven by rising investment but with positive contributions also from net exports and private consumption.

The IMF programme expired in August 2017. A 22-month, €185 million stand-by arrangement (SBA) was approved in July 2015. In March 2017 it was extended until August to facilitate policy continuity and to allow sufficient time for ongoing structural reforms to progress. However, the IMF shelved the programme's final reviews, as well as the final disbursement of around €15 million, because of the absence of a new government following the early general elections in June. Fiscal performance under the programme was strong, with a budget deficit in 2016 of 1.4 per cent of GDP, well within the 2.0 per cent of GDP fiscal rule. The government plans to boost capital expenditure in the next period and to run a wider deficit. It is possible that some extra fiscal space would be needed for the planned new Kosovo thermal power project (Kosovo C) (which, if it goes ahead, is expected to cost over €1 billion, or more than 20 per cent of the country's GDP), depending on whether private sources of finance are sufficient to cover the entire cost.

Short-term growth is likely to remain robust. The economy is projected to grow by 3.7 per cent in 2017 and 3.5 per cent in 2018, supported once again by remittance inflows and critical investment in transport and energy infrastructure. Downside risks remain significant. The recent political uncertainty may have an adverse effect on investor and consumer confidence and could delay key infrastructure projects, which are crucial for the country's long-term development.

Assessment of transition qualities (1-10)



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Major structural reform developments

Key reforms are being anchored within the framework of the Stabilisation and Association Agreement (SAA). In February 2017, Kosovo and the EU held the first SAA sub-committee meeting on transport, environment, energy, climate and regional development. The talks were within the framework of the SAA, which entered into force in April 2016. Among other topics, the European Commission (EC) stressed the need to continue the development of projects to help establish the core transport network for the Western Balkans. There was agreement on the need for continuing reforms, including strengthening the independence and capacities of the transport sector's regulatory institutions and taking concrete measures to improve road safety. The EC also highlighted the need for enhanced efforts on renewable energy and energy efficiency, including the establishment of a supporting financial mechanism for financing energy efficiency.

Procurement procedures are being progressively digitised. In an effort to promote transparency and good governance, the government has made electronic procurement ("e-procurement") compulsory for all central government procurement agencies from September 2016, and for municipalities from January 2017. Kosovo ranked 40th out of 190 economies in the World Bank's *Doing Business 2018* report, 20 places up from last year. A particular improvement was made in the area of resolving insolvency as the country has introduced a legal framework for corporate insolvency, making liquidation and reorganisation procedures easier.

Integration between Kosovo and Albania is advancing. The two countries have agreed to open a joint customs point in the Albanian port of Durres for goods that are destined for Kosovo. This means that any Kosovan business may be inspected and cleared in the port, rather than at the border. Establishing a facility of the Kosovo customs office at the port of Durres, harmonisation of excise duties and creating a "green corridor" for the export and import of agricultural seasonal products are all steps towards further economic cooperation and integration between the two countries.

A new law on strategic investments is in place. The law was signed by the President in February 2017. The law targets the reduction of bureaucratic procedures and other barriers to investment. In future, if a project is classified as strategic, investors should be able to obtain all the necessary licences and permits within 15 days. However, privatisation revenues have been negligible in recent years and FDI in 2016 was around €250 million, or just 4 per cent of GDP.

Kosovo has transposed EU law on the energy performance of buildings. In December 2016 Kosovo adopted national legislation transposing the 2010 EU Energy Performance of Buildings Directive. This rectifies breaches and ensures the country's compliance with Energy Community ministerial council decisions from October 2016.

The central bank has launched a new credit registry system. The new system, operational since June 2017, was developed according to the latest standards and technology in the credit reporting field. It provides more information on lending activity, as new reporting fields have been added following requests from the Kosovo Credit Guarantee Fund (KCGF), financial institutions and various central bank departments. New information also enables credit institutions to gain a clearer picture on their clients' ability for repayment and the responsibility for financial obligations, and it allows users to instantly research a large volume of credit reports.

Lending activity is recovering. Average monthly year-on-year growth of credit to the private sector in 2016 was 9.2 per cent, speeding up to an average of 10.6 per cent over the first half of 2017. Nevertheless, private sector credit accounts for just 36 per cent of GDP. The average lending rate in 2016 was 7.2 per cent and is on a downward trend, while the average deposit rate in 2016 was 1.2 per cent. Kosovo's banking sector comprises 10 active, private banks, of which eight are majority foreign-owned. The sector is highly concentrated, with the top four banks, Austrian Raiffeisen, Slovenian NLB, Turkish TEB and German ProCredit Bank, accounting for more than 80 per cent of the total banking assets. Capitalisation remains strong with a capital adequacy ratio of 18 per cent at the end of 2016, with each individual bank being in compliance with the minimum regulatory requirement of 12 per cent. Asset quality remains good, as non-performing loans, which, according to Kosovo's central bank, do not include sub-standard loans, dropped to 5 per cent as of March 2017, and are among the lowest in the central and south-eastern Europe region.