



KOSOVO

Highlights

- **Growth has started to recover in 2021.** After the 5.3 per cent contraction in 2020, the economy expanded by 16.3 per cent year-on-year in the second quarter of 2021 on the back of growth in domestic demand and exports.
- **A new economic recovery package has been adopted.** The package, worth €420 million, includes support to employment, manufacturing, families and the public sector, as well as investment in infrastructure and the environment.
- **The much-needed green agenda is gradually advancing.** Since the end of 2020 Kosovo's transmission system operator (TSO) KOSTT has signed three important agreements on new renewable energy projects (wind and solar).

Key priorities for 2022

- **Further improvements in the business environment and public governance are needed.** The private sector would benefit from the government cutting red tape, reforming business inspections and fighting corruption. Strengthening fiscal management and the governance of state-owned enterprises (SOEs) would also help to increase the economy's resilience to future shocks.
- **More progress towards a green transformation of the energy sector is critical.** Further efforts are needed in implementing the auctions systems in renewables, introducing a competitive market-based system to award new licences and exploring the potential of gas as a transition fuel instead of the old lignite power plants, which should be decommissioned.
- **Financial stability should be monitored carefully.** The financial sector withstood the recession well but non-performing loans (NPLs) could rise with the phasing out of regulatory measures and government support.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	4.8	3.4	4.8	-5.3	7.7
Inflation (average)	1.5	1.1	2.7	0.2	3.1
Government balance/GDP	-1.4	-2.8	-2.9	-7.8	-4.8
Current account balance/GDP	-5.7	-7.8	-5.8	-6.7	-7.9
Net FDI/GDP [neg. sign = inflows]	-3.3	-3.4	-2.7	-4.2	-1.2
External debt/GDP	32.9	30.5	31.2	37.2	n.a.
Gross reserves/GDP	10.8	11.5	12.2	13.3	n.a.
Credit to private sector/GDP	38.9	41.1	42.8	47.8	n.a.

Covid-19: macroeconomic implications

Gross domestic product (GDP) is recovering well in 2021. The economy experienced a recession of 5.3 per cent in 2020. While exports of services fell fairly sharply (by 40 per cent), investments contracted by a milder 7.1 per cent and household consumption recorded growth of 2.5 per cent, supported by remittance inflows. Manufacturing also recorded growth, reflected in a surprising growth in exports of goods of 21.7 per cent, but output from the trade, transport and construction sectors fell strongly. In the first quarter of 2021 GDP grew by 5.6 per cent year-on-year and by 16.3 per cent year-on-year in the second quarter on the back of a strong rise in consumption, investment and exports. Both exports of goods and services recorded a robust nominal growth in the first half of the year (each by around 60 per cent year-on-year).

Prices are trending up. Following a mild deflation in the second half of 2020 and early 2021, the year-on-year inflation rate picked up relatively strongly thereafter, rising from 0.2 per cent in January 2021 to 4.9 per cent in September 2021. The uptick in prices came primarily on the back of growth in prices of transport (oil), telecommunication services, alcoholic beverages and tobacco.

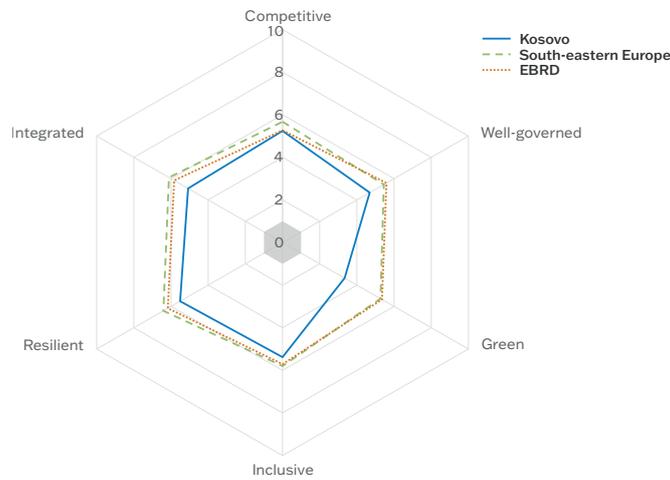
Economic activity could reach its 2019 level in 2021, subject to upside risks being realised. According to our latest forecasts, GDP should expand by 7.7 per cent in 2021, mainly driven by the recovery in investment and travel and tourism activities related to the country's large diaspora. In 2022 GDP growth is expected to pick up further to 4.5 per cent. Risks to the projection seem to be more on the upside in 2021, given the positive developments in the first half of the year and reopening of the borders. Still, the pace at which diaspora visits and the economy as a whole recover will depend on how the Covid-19 pandemic develops, both locally and globally. Stronger economic growth would be helped by improving public investment management and accelerating the hitherto slow implementation of key infrastructure projects.

Policy response to Covid-19

The Law on Economic Recovery has been adopted. The law, approved in December 2020, included an additional stimulus for businesses affected by the Covid-19 crisis, proposals to subsidise wages to employees who lost their jobs and the removal of value added tax (VAT) on all raw materials. Since the fiscal implications of the law were not fully covered by the 2021 budget, a revised budget was prepared in July 2021, following the adoption of the new government's programme 2021-25. The economic recovery package amounted to €420 million, with €190 million envisaged to come from the budget and the rest from borrowing.

The country has issued treasury bonds for the diaspora. In July 2021 the Ministry of Finance issued a public call to resident and non-resident physical persons to buy three-year and five-year diaspora bonds (carrying an annual interest rate of 1.2 per cent and 2.2 per cent, respectively), which are part of the economic recovery package. The first sale, in the amount of €10.4 million, was completed in August 2021.

Assessment of transition qualities (1-10)



Structural reform developments

There has been little progress in the European Union (EU) approximation process over the past year. Kosovo signed the Stabilisation and Association Agreement with the EU in October 2015, which formally entered into force in 2016. While the European Commission (EC) has repeatedly stressed that Kosovo shares the European perspective of the Western Balkans, the question of its integration into the EU remains contentious due to the fact that five EU member states do not recognise Kosovo bilaterally. Although the Commission confirmed that Kosovo fulfilled outstanding visa liberalisation benchmarks, the decision on visa liberalisation is pending in the European Parliament and the Council, and citizens of Kosovo remain unable to travel to the Schengen area without a visa.

The TSO KOSTT has started operating as part of the energy bloc with Albania. The connection agreement between KOSTT and TSOs from continental Europe entered into force in December 2020, marking the start of operations of KOSTT as a control area within the joint control block with OST, the Albanian TSO. A year earlier, KOSTT and OST signed an agreement to set up a common energy market consisting of Kosovo and Albania. In addition, the new 400 kV line between Kosovo and Albania has been put into operation, contributing to further cross-border exchanges.

A draft law on the Commercial Court has been prepared. The Commercial Court is being set up to increase the effectiveness of trade dispute resolution. Until now, many businesses have had to file claims in two departments of the Pristina Basic Court (the Economic Department and the Administrative Department). However, their unclear mandates and jurisdictions result in delays and sometimes inconsistent decisions by the two departments. The Commercial Court would be the sole body in charge of resolving trade disputes involving foreign businesses and other investors. The draft law was prepared in March 2021 and adopted by the Kosovo Assembly's legislation committee in July 2021.

The central bank of Kosovo (CBK) has developed a national strategy for retail payments. The National Retail Payments Strategy 2021-26 was prepared and published in July 2021. The strategy stipulates that the CBK should finalise transposing the relevant EU Directives, continuously review the legal and regulatory framework of the country's retail payments market and encourage the use of innovative payment services and instruments. To ensure progress of the strategy's implementation, increasing the adult account ownership ratio and the number of cashless payments per capita are set as objectives.

The financial system has remained stable throughout the Covid-19 pandemic. Banks withstood the recession well, relying on previously high levels of liquidity and capital. In June 2021 the capital adequacy ratio in the banking sector averaged 17.3 per cent, while the liquidity ratio (showing the coverage of short-term liabilities by liquid assets) was 36.7 per cent. The quality of bank assets has also remained good, with the NPL ratio at 2.5 per cent in June 2021. However, asset quality requires continued vigilance as regulatory forbearance measures are being lifted.

