



## Kosovo

### Highlights

- **Economic activity is slowing.** Strong demand-side pressures, underpinned by renewed mobility and the large diaspora, resulted in vigorous expansion in 2021. As the scope for recovery narrowed and demand became more muted, growth slowed to 3.2 per cent year on year in the first half of 2022.
- **Regulatory initiatives to improve the business environment have advanced.** Laws on inspection, the protection of competition and the establishment of a commercial court have been approved by the national assembly.
- **Reform is under way to improve the management of state assets.** The government has approved a concept paper on establishing a sovereign fund that will take over the management of strategic state assets from the Privatisation Agency of Kosovo.

### Key priorities for 2023

- **Greening the energy sector is a critical component in ensuring energy security.** The National Energy Strategy should be finalised, featuring plans to decommission lignite-powered plants, an auctions system for renewables that would capitalise on the interest of private investors and plans to undertake necessary infrastructure investment.
- **Public-sector reforms need to continue without delay.** State-owned enterprises (SOEs) suffer from corporate governance and efficiency weaknesses, requiring greater oversight and management. Given the significant infrastructure gaps, scaling up public investment would help strengthen regional and domestic labour-market integration, lifting the country's growth prospects.
- **Enhancement of the business climate should continue.** Recent legislative changes should be followed up by developing stronger institutional capacity among implementing entities, enabling sound operational frameworks and ensuring transparency and effectiveness. Other needed reforms include improving public-private dialogue and taking more resolute measures to reduce widespread informality and tax evasion.

**TABLE** Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	3.4	4.8	-5.3	10.7	4.0
Inflation (average)	1.1	2.7	0.2	3.3	12.0
Government balance/GDP	-2.9	-2.9	-7.9	-1.4	-1.0
Current account balance/GDP	-7.6	-5.7	-7.0	-8.7	-10.9
Net FDI/GDP [neg. sign = inflows]	-3.4	-2.7	-4.2	-4.0	-4.4
External debt/GDP	30.5	31.2	37.2	37.4	n.a.
Gross reserves/GDP	11.5	12.2	13.3	13.8	n.a.
Credit to private sector/GDP	44.5	46.7	51.6	52.8	n.a.

## Macroeconomic developments and policy response

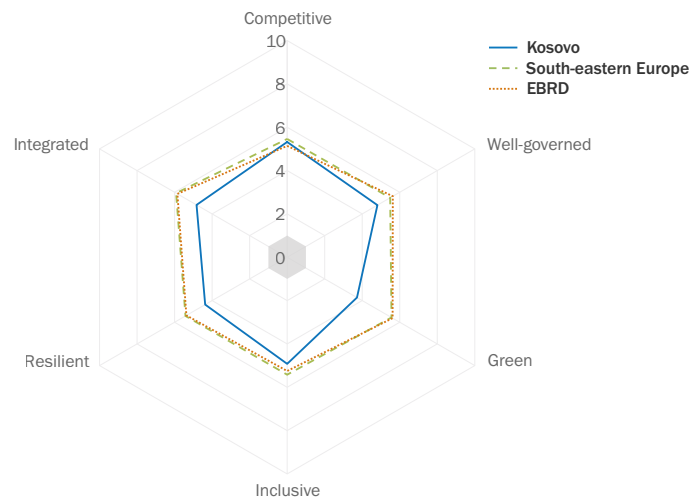
**The rapid post-pandemic recovery is slowing.** Output expanded by a stronger-than-expected 10.7 per cent in 2021 on the back of renewed mobility and support from the diaspora, reflected in a doubling of service exports compared with pre-pandemic levels and a high inflow of remittances. As the scope for recovery narrowed, growth moderated to 4.5 per cent and 2.1 per cent year on year in the first two quarters of 2022 respectively. In spite of continually strong annual credit growth, household consumption, which was previously driving the output expansion, became more muted in real terms in the second quarter and investment contracted by 17.0 per cent. In contrast to the domestic demand slowdown, external demand remained strong and net exports' contribution to growth turned positive in the second quarter of the year, helped by lower energy imports as the heating season ended. The broad-based output expansion, spanning nearly all economic segments in the first quarter, continued into the second quarter of the year but was partially offset by an 18 per cent annual contraction of the construction sector, in line with lower investment.

**Inflation is rising and the current account deficit is widening.** Higher food and oil prices pushed annual inflation to a high of 14.2 per cent in July 2022 before coming down to 12.7 per cent in September. Food accounts for as much as 34 per cent of the consumer price index in Kosovo, compared with 15 per cent in the European Union (EU). Electricity prices did not significantly contribute to inflationary pressures despite a state of emergency in the energy sector during the winter of 2021-22, as the public sector largely absorbed the impact of heightened electricity imports amid surging global prices. Higher energy prices (and volumes in the case of electricity during the winter) have, however, been reflected on the current account deficit which widened by a third on an annual basis in the first seven months of 2022.

**Policy measures were implemented in response to the energy crisis and rising inflation.** A 60-day energy emergency was first announced at the end of 2021 and reinstated in August 2022, as domestic power generation failed to meet demand and the price of imported power multiplied. The national energy distribution company, KEDS, introduced systemic temporary electricity outages both times. Kosovo's energy regulator approved a temporary discriminatory pricing model, increasing electricity tariffs from February 2022 for households consuming more than 800 kilowatts of electricity a month. In response to elevated inflation and food security concerns caused by the war on Ukraine, an export ban on agricultural products such as wheat, flour, corn and sunflower oil was introduced in April 2022. In the following months, the government scaled up agricultural subsidies, including for oil, introduced public-sector wage bonuses, approved temporary increases in social transfers and pensions and capped fuel prices. As inflationary pressures continued, another €150 million support package was introduced in September, continuing the trend of one-off aid for vulnerable citizens and public-sector wage bonuses, alongside subsidies of private-sector wage increases and electricity bills for those reducing consumption.

**Growth is expected to continue at a slower pace.** We forecast gross domestic product (GDP) growth of 4.0 per cent in 2022 and 3.7 per cent in 2023. The instability of the energy sector is likely to further impact the fiscal and external accounts and may adversely affect economic activity. Other key risks to the near-term outlook include elevated inflation, which is set to further dampen domestic demand, rising geopolitical uncertainty and an anticipated slowdown in external markets, affecting exports.

**CHART** Assessment of transition qualities (1-10)



## Structural reform developments

**There has been little progress on the EU approximation process.** Kosovo signed its Stabilisation and Association Agreement (SAA) with the EU in October 2015. While the European Commission and the European Council have repeatedly stressed that the country shares the European perspective of the Western Balkans, the question of its practical integration into the EU remains contentious due to the fact that five member states do not recognise Kosovo bilaterally. Although the European Commission confirmed that Kosovo had met all visa liberalisation benchmarks, the decision on visa liberalisation is still pending in the European Parliament and European Council, and citizens of Kosovo remain unable to travel without a visa to the Schengen area.

**Renewables development progressed.** The Bajgora wind farm, which supplies up to 10 per cent of the country's electricity, started supplying electricity to the power grid in September 2021 and was fully operational as of March 2022. Kosovo's first biomass-fuelled heating plant opened in Gjakova in November 2021, aiming to reduce air pollution and costs incurred by the heavy oil-powered district heating system. In March 2022 the government approved the large-scale Solar Kosova project, which should span some 69,000 square kilometres and contribute to the heating system of the capital, Pristina. The National Energy Strategy, currently being finalised following public consultation in June 2022, is expected to set the pace of energy transition in the coming years.

**The Commercial Court was established.** In January 2022 the national assembly approved the Law on the Commercial Court, which establishes a special court for handling business disputes. Work is under way to develop an action plan to get the court up and running, including regulations on internal organisation, case transfer and the recruitment of key personnel. The Commercial Court, expected to open by the end of 2022, will take over the responsibilities of the Economic Department of the Pristina Basic Court and the Court of Appeals in handling commercial cases and those of the Administrative Department of the Pristina Basic Court in handling commerce-related administrative cases.

**Inspections reform advanced.** The Law on Inspections, approved by the national assembly in December 2021, is part of ongoing reforms to revise all laws and bylaws governing inspections. It is a novelty in Kosovan legislation as, to date, there has been no unified legislation governing inspections of businesses. Its approval met one of the conditions of the latest round of Development Policy Financing (DPF) from the World Bank, signed in March 2022. Amounting to €50.6 million, the DPF will support Kosovo's reform efforts to improve fiscal transparency, enhance private-sector development and strengthen environmental sustainability.

**The national assembly approved the new Law on the Protection of Competition in May 2022.**

The regulation represents a milestone in the alignment of the country's legislative framework with the EU *acquis communautaire*. The approval of this legislation aims to fulfil key commitments by Kosovo under three treaties: the EU-Kosovo SAA, the Energy Community Treaty, and the Central and Eastern European Free Trade Agreement (CEFTA). However, an assessment by the US State Department notes that Kosovo's Competition Authority, responsible for implementing the law, generally lacks the human resources for thorough investigations.

**A sovereign fund to manage state assets is in development.** In May 2021 the government dismissed the previous board of the Privatization Agency of Kosovo (PAK) as a first step in the process of closing the agency and establishing a sovereign fund to manage strategic state assets. The new PAK board identified the assets that it plans to transfer to the sovereign fund and, in June 2022, the government approved the concept paper on establishing the fund.