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Moderate growth in a challenging global environment

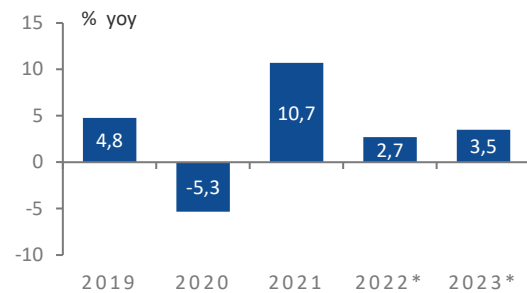
With a real GDP growth rate of merely 2.7% in 2022, Kosovo's economy is experiencing only moderate economic growth after a strong recovery in 2021. This moderate performance is the result of two sets of economic factors pulling in different directions: on the one hand, a massive increase in imports of goods - following surging global prices for key products - negatively influenced Kosovo's economic performance. But also weak consumption on the back of an inflation-driven reduction in real income, as well as declining investments due to an under-execution of public investment, hindered economic growth. On the other hand, these negative developments were at least partially absorbed by strong economic activities of the Kosovar diaspora: firstly, resilient remittances inflows helped to somewhat cushion the negative impact on private consumption. Secondly, service exports benefitted from a strong development of diaspora-related tourism, thereby mitigating the rise in the merchandise trade deficit.

For 2023, the outlook is slightly more favourable, with a recovery predicted for both consumption and investment following an expected ease in global commodity prices. However, the current economic situation also reveals several structural challenges which need to be closely monitored.

Background

Economic growth in Kosovo has been rather moderate in 2022, marked by an increase in real GDP of merely 2.7%. This is driven by an almost flat contribution of consumption, on the back of inflation-induced reductions in real income. In addition, an under-execution of public investment led to a negative contribution of investment to economic growth. However, positive dynamics related to the economic activities of the Kosovar diaspora were able to partially absorb these negative influences on growth. The main channels in this regard were increases in remittances, which helped to mitigate the negative impact on private consumption, and revenues from diaspora-related tourism.

Real GDP growth



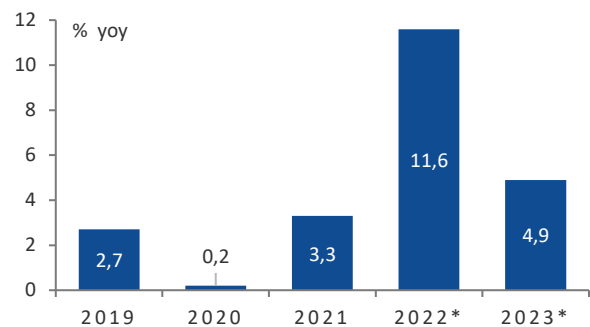
Source: IMF, *forecast

These demand-side dynamics are also reflected on the supply side, where tourism-related sectors such as transportation and accommodation showed a good performance. On the other hand, sectors strongly dependent on public investment and consumption, such as health or education, displayed poor dynamics. For 2023, predictions point to increases in consumption and investment and thus to a higher growth rate of 3.5%.

Inflation

Driven by a severe increase in global prices for food and energy following the war in Ukraine, Kosovo experienced a surge in inflation in 2022. With an average inflation rate of 11.6%, Kosovo featured one of the highest inflation rates in the region. This outstanding vulnerability can be traced back to the pivotal role of food and energy in the CPI consumer basket of Kosovo, with food already accounting for 46% of the basket.

Inflation (CPI)



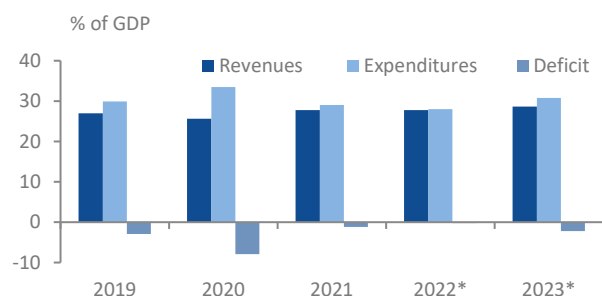
Source: IMF, *forecast, note: period-average

Given the limited space for monetary policy due to the use of the Euro as the legal tender, possibilities for tackling inflationary pressures are limited. However, expected decreases in international commodity prices are anticipated to reduce inflation in the current year.

Public finances

Despite a notable increase in public expenditures on transfers and subsidies (31.4% compared to 2021) to mitigate the effects of soaring prices for key commodities, no new public deficit was observed in 2022. This is mainly due to an under-execution of public investment, resulting from price increases for key inputs, such as construction materials, and a temporary non-functioning of the Public Procurement Review Body. In terms of public debt, these developments have resulted in a strong decrease of the debt to GDP ratio in 2022. However, low public investment activities are also problematic, posing an impediment to the growth of the economy and of companies dependent on public investment (e.g. construction sector).

Public finances



Source: IMF, *forecast

Remittances

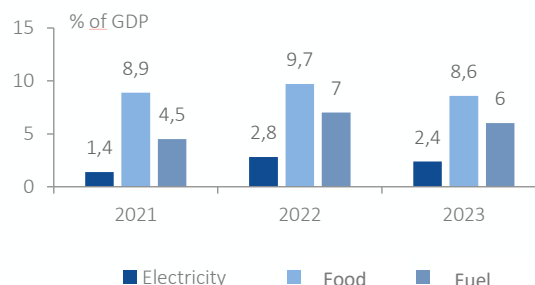
Despite the tense economic situation in the main destination countries of Kosovar emigrants, remittances inflows remained resilient in 2022 and continue to display an increasing trend. Amounting to 14% of GDP in 2022, remittances remain a key factor for the economy of Kosovo, especially for financing consumption and imports. As such, remittances function as a buffer against the adverse economic developments following global price increases.

Foreign trade

In addition to remittances, economic activities of Kosovar emigrants play a key economic role in terms of trade. In this regard, 2022 saw significant increases in terms of service exports, mainly driven by diaspora-related tourism. Tourism revenues alone accounted for 20% of GDP in 2022. Thereby, the traditional surplus in the service balance of Kosovo increased further. These developments contrast with those in trade in goods, where the traditional deficit in the trade balance was further exacerbated in 2022. This was driven by a massive increase in goods imports, amounting to 11% of GDP. This massive increase was linked to the surge in

global prices for food and energy, of which Kosovo is a net importer and demand is inelastic. The increase in imports of these goods alone already accounted for 4.5% of GDP.

Food and energy imports



Source: IMF

Outlook

A more favorable economic outlook can be expected for 2023 as inflation and import prices should stabilise on the back of declining global prices for food and energy. Especially, consumption can be expected to recover in light of lower inflationary pressures. Also, the massive trade deficit observable in 2022 is anticipated to decrease on the back of lower import prices. In this regard, economic activity of the Kosovar diaspora in terms of remittances for financing consumption and imports as well as tourism will continue to play an important role. However, the recent economic developments also reveal structural challenges that need to be closely monitored and tackled. Next to low public investment levels, which bear high risks for sectors traditionally dependent on public investment, challenges relating to the energy system and goods exports stand out in this regard.

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Financed by the Federal Ministry for Economic Affairs and Climate Action, the German Economic Team (GET) advises the governments of Ukraine, Belarus*, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.

*Advisory activities in Belarus are currently suspended.

Editor

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