

ECONOMIC MONITOR

KOSOVO

Overview

- » 2022: economic growth at 3.5% following strong, tourism-driven service exports and buffering effect of state subsidies and remittances on private consumption
- » These factors outbalanced low public investment and negative terms of trade shock driven by surging prices for imported commodities
- » Economic growth expected to be higher in 2023 with a predicted rate of 3.8%
- » Drivers: surge in public consumption and investment after stalling in 2022
- » Ease in inflation observable: after surge in 2022 (average rate: 11.6%), inflation rates are decreasing sharply over the first months of 2023 (Jul-23: 2.8% yoy)
- » Current account deficit lower, but remains significant (estimated at 7.3% of GDP in 2023): stronger service exports and remittances on the one hand, increasing goods imports on the other hand

Special issues

- » **Tourism.** Key role for Kosovo's economic development
- » **Foreign direct investment.** Record inflows in 2022 and increasing diversification
- » **Economic zones.** First steps towards more effective zones
- » **National Energy and Climate Plan.** Shaping Kosovo's future energy and climate policy
- » **Banking sector.** Important and resilient role for Kosovo's economy

Basic indicators

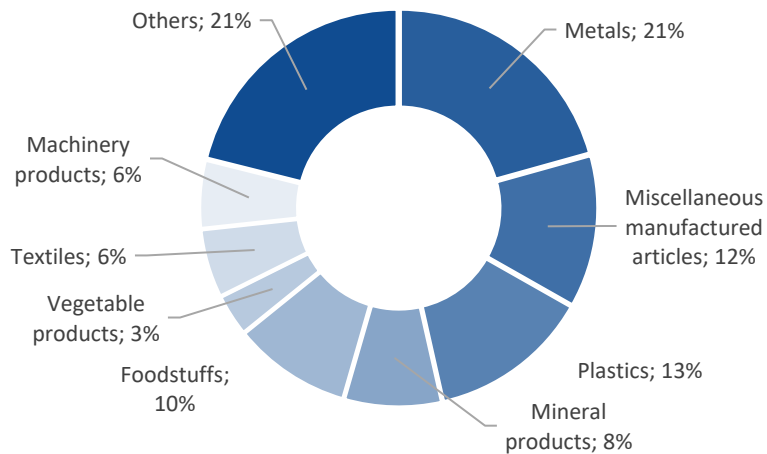
| | KOS | ALB | SRB | MNE | BIH | MKD |
|-----------------|-------|-------|--------|-------|-------|-------|
| GDP, USD bn | 9.4 | 18.5 | 70.1 | 6.1 | 25.5 | 13.7 |
| GDP/capita, USD | 5,291 | 6,457 | 10,361 | 9,812 | 7,337 | 6,608 |
| Population, m | 1.8 | 2.9 | 6.8 | 0.6 | 3.5 | 2.1 |

Source: IMF; Note: Numbers for 2022, all estimates

Trade structure

Exports

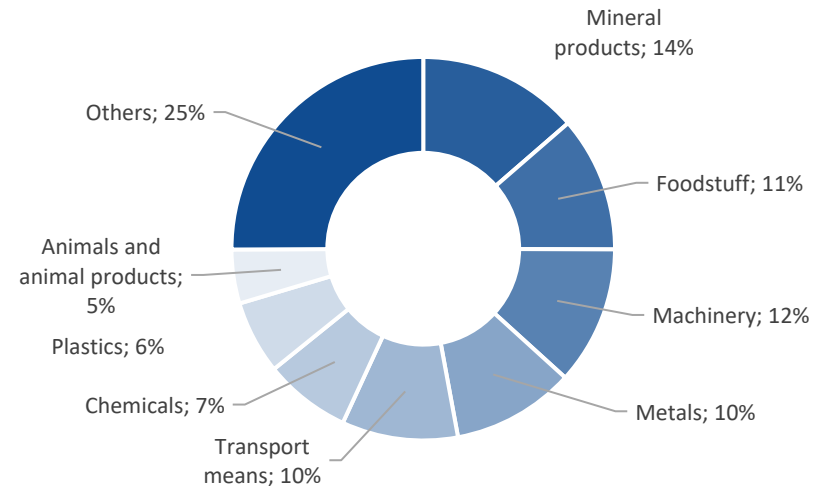
EU 32% | USA 11% | MKD 15% | Others 42%



Source: Central Bank of Kosovo, 6M2023, only goods

Imports

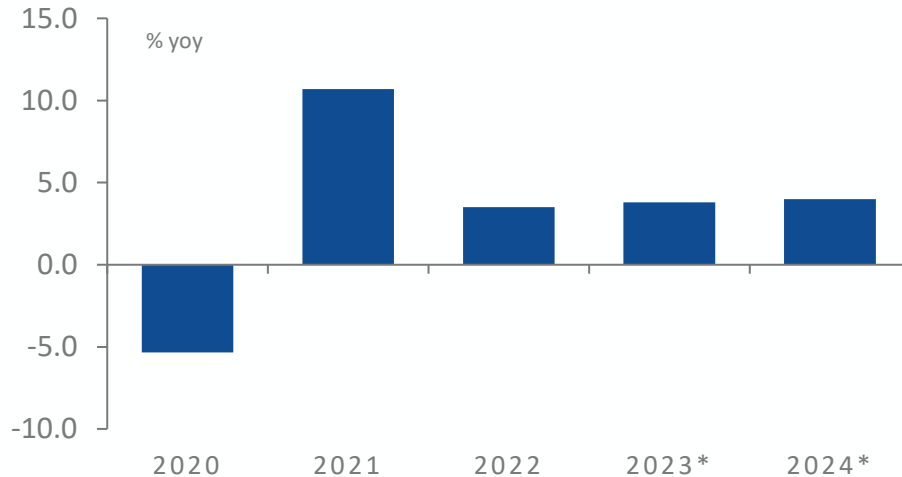
EU 43% | TUR 15% | CHN 10% | Others 32%



Source: Central Bank of Kosovo, 6M2023, only goods

Economic growth

Real GDP growth



Source: IMF, *estimate/forecast

Regional comparison of real GDP growth (% yoy)

| | 2021 | 2022 | 2023* | 2024* |
|-----------------|------|------|-------|-------|
| Kosovo | 10.7 | 3.5 | 3.8 | 4.0 |
| Albania | 8.5 | 3.7 | 2.3 | 3.3 |
| Serbia | 7.6 | 2.3 | 2.0 | 3.0 |
| Montenegro | 13.0 | 6.4 | 3.2 | 3.0 |
| BIH | 7.4 | 3.8 | 2.0 | 3.0 |
| North Macedonia | 3.9 | 2.2 | 1.4 | 3.6 |
| Germany | 2.6 | 1.8 | -0.1 | 1.1 |
| Eurozone | 5.4 | 3.5 | 0.8 | 1.4 |

Source: IMF, *estimate/forecast

GDP

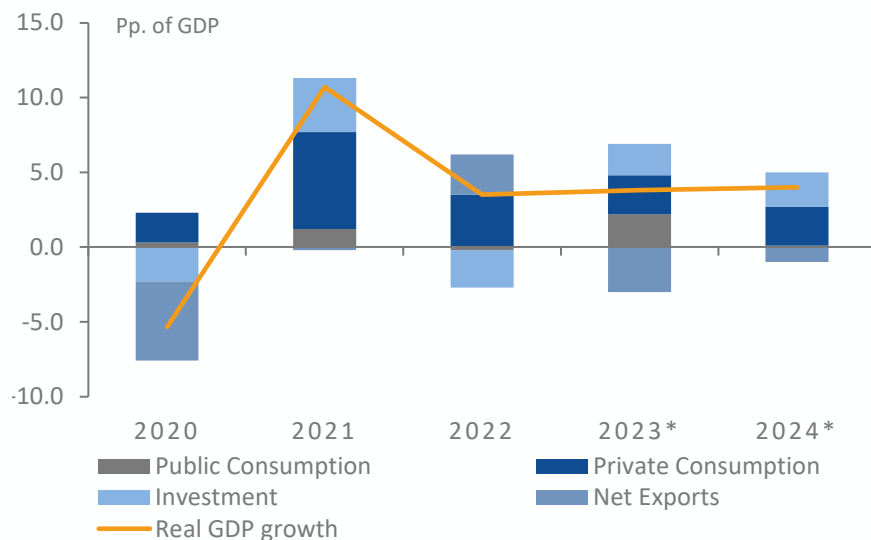
- » 2022: slower growth of 3.5% after surge in 2021
 - Driven by strong service exports and private consumption
- » 2023: slightly stronger growth of 3.8% expected
- » Drivers: resumed public consumption and investment activities
- » Growth trend is expected to continue in 2024

Regional comparison

- » Growth rates expected for Kosovo for both 2023 and 2024 highest compared to other countries in the region
- » Strong contrast with developments in Germany and the rest of the EU, where economic growth rates are very low or even negative
- » Considerable growth despite challenging environment

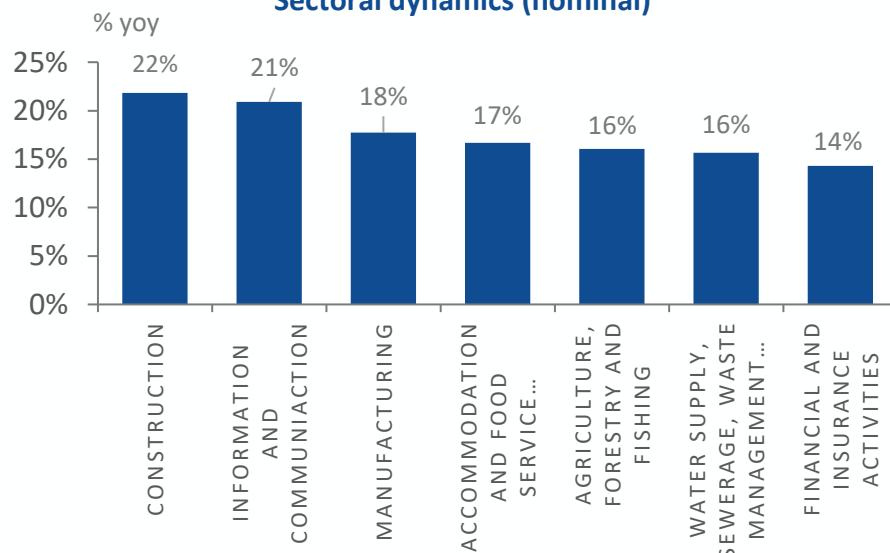
Sectoral perspective

Contribution to economic growth (real)



Source: IMF, *estimate/forecast

Sectoral dynamics (nominal)



Source: Kosovo Agency of Statistics, Q1 2023

Demand-side dynamics

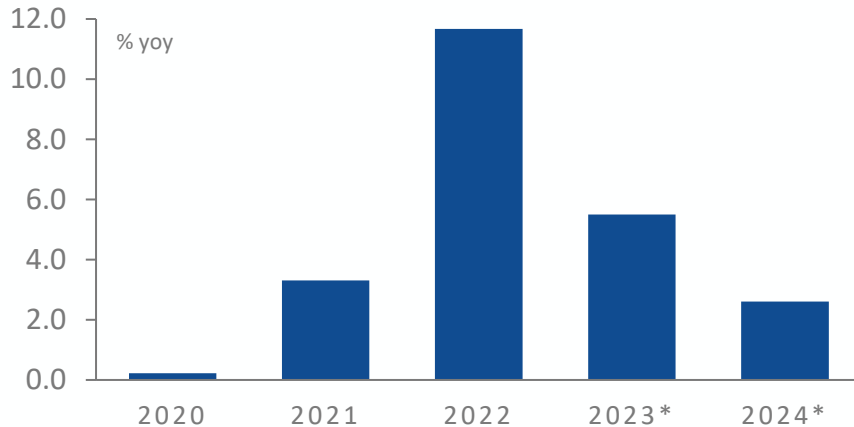
- » 2022: moderate growth following strong, tourism-driven service exports and buffering effect of state subsidies and remittances on private consumption
- » More than outbalanced low public investment activities and negative terms of trade shock driven by surging prices for imported commodities
- » 2023: increases in public consumption and investment as the main drivers of higher growth

Sectoral perspective in Q1-23

- » Strong dynamics in the construction and infrastructure sector associated with increased (public) investment
- » Strong development of the accommodation and food services sector associated with ongoing strong (diaspora) tourism
- Re-acceleration of public consumption and investment as key drivers of growth trend

Inflation

Inflation (CPI)



Source: IMF, *estimate/forecast. Note: period-average.

| | 2021 | 2022 | 2023* | 2024* |
|-----------------|------------|-------------|------------|------------|
| Kosovo | 3.3 | 11.7 | 5.5 | 2.6 |
| Albania | 2.0 | 6.7 | 5.0 | 3.4 |
| Serbia | 4.1 | 12.0 | 12.2 | 5.3 |
| Montenegro | 2.4 | 13.1 | 9.7 | 5.0 |
| BIH | 2.0 | 14.0 | 6.0 | 3.0 |
| North Macedonia | 3.2 | 14.2 | 9.2 | 3.5 |
| Eurozone | 2.6 | 8.4 | 5.3 | 2.9 |

Source: IMF, *estimate/forecast

Inflation

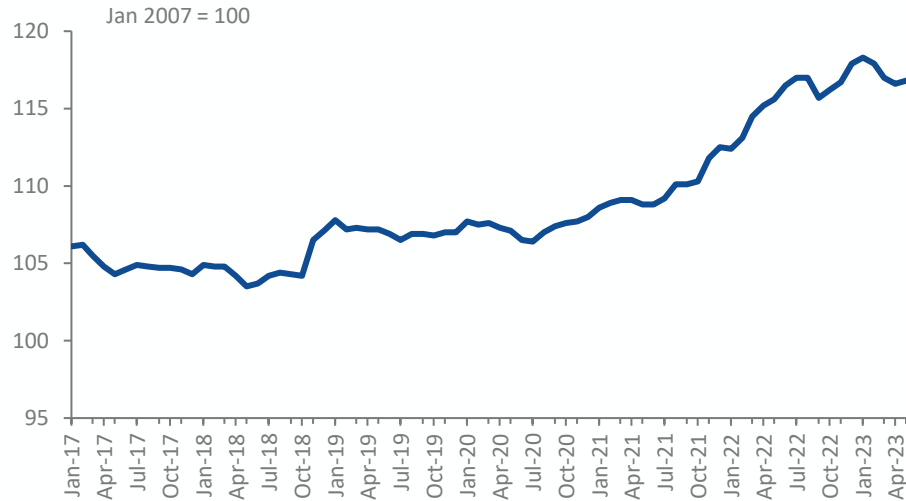
- » Lower inflation rate after surge in 2022, following easing developments of international commodity prices, especially for food and energy
- » Period average forecast for 2023: 5.5%
- » Sharp decrease in inflation already visible in the second quarter of 2023: while inflation still amounted to 7.6% (yoy) in Mar-23, it decreased to 2.8% (yoy) by Jun-23
- » Further disinflation expected for 2024 with a period average forecast of 2.6%

Regional perspective

- » Easing trend regarding inflation can be observed in the whole region
- » Rates predicted for Kosovo are at the lower end of what is predicted for the other WB6 countries
- **Clear reduction of the inflation rate, in line with regional development**

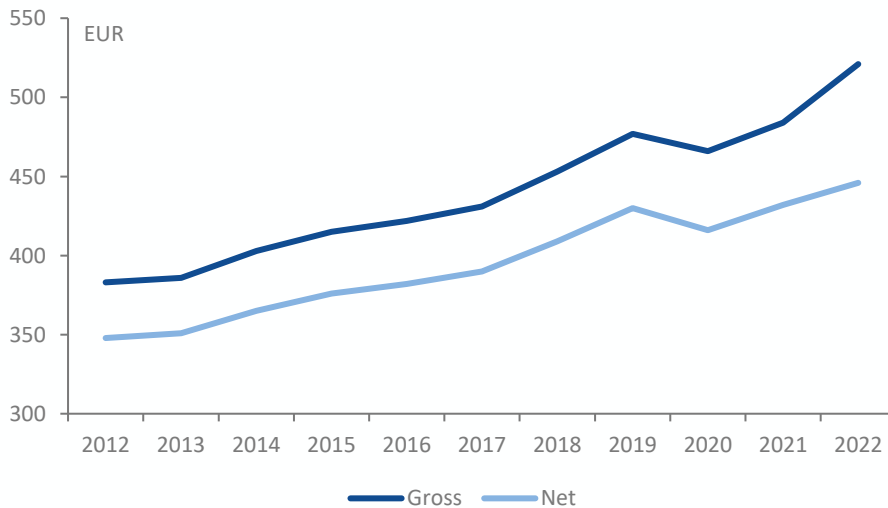
Real effective exchange rate

Real effective exchange rate



Source: Central Bank of Kosovo, note: an increase implies a real appreciation

Average gross and net salary



Source: Kosovo Agency of Statistics

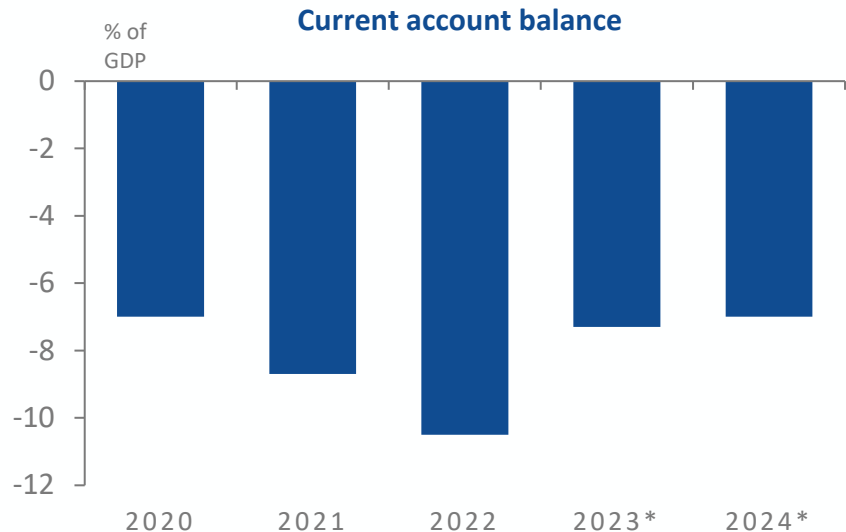
Real effective exchange rate

- » Combination of the use of the Euro as a legal tender and the surge in inflation in 2022 led to a strong real effective appreciation
- » 2023: first signs of flattening of this trend
- » Still: potential danger of a loss in international competitiveness for KOS remains

Labour market and wages

- » Wage flexibility important in the context of the use of the euro and recent real effective appreciation
- » Temporary reduction in wages during Covid-crisis, however, increase in 2022 following raise of minimum wage and new law on public wages
- » Not yet clear in how far wage flexibility can soften the problem of real effective appreciation
- Need to monitor real effective exchange rate

Current account



Source: IMF, *estimate/forecast

Current account

| | Goods balance | Service balance | Primary income | Secondary income (esp. remittances) | Current account balance |
|--------|---------------|-----------------|----------------|-------------------------------------|-------------------------|
| 2022* | -4,287 | 1,375 | 90 | 1,882 | -940 |
| 2023* | -4,419 | 1,504 | 109 | 2,081 | -726 |
| Change | -132 | 129 | 19 | 199 | -214 |

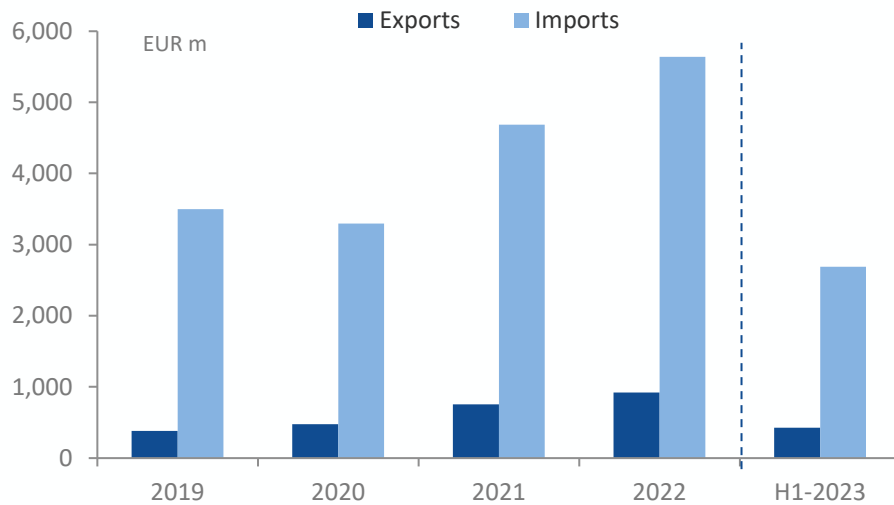
Source: IMF, *estimate/forecast, all numbers in EUR m.

Current account

- » Traditionally high current account deficit is expected to decrease in 2023, but to remain at a significant size of 7.3% of GDP
- » Main reason: expected increasing deficit on the balance in merchandise trade
 - Driven by large growth in goods imports following investment-driven growth and FDI trends
- » Partially, but not completely balanced by further increases in service exports, driven by (diaspora) tourism, and remittances
- » Current account deficit is expected to decrease slightly in 2024 to an expected size of 7% of GDP
- **Decreasing but still significant current account deficit**

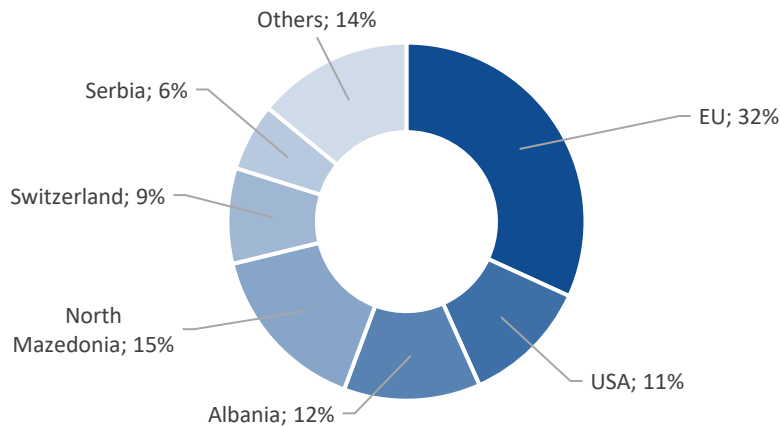
Foreign trade in goods

Foreign trade in goods



Source: Central Bank of Kosovo, goods

Exports by countries



Source: Central Bank of Kosovo, 6M2023

Trade in goods

- » General situation: traditional high deficit on trade balance; imports (2022: 57% of GDP) exceed exports by a lot (2022: 10% of GDP)
- » Deficit further exacerbated in 2022 due to negative terms of trade shock

Imports

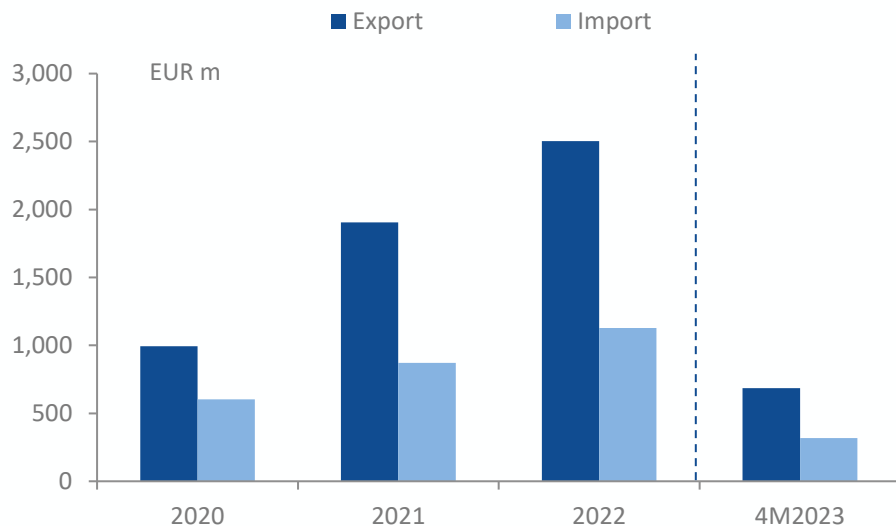
- » 2023: two opposing developments
 - On the one hand: decreasing global commodity prices should lead to lower goods imports
 - On the other hand: investment-driven growth and FDI trends lead to an increased demand for imports
- » In sum: goods imports expected to increase further in 2023, already visible in H1 2023

Exports

- » H1 2023: exports slightly below level of H1 2022
- Growth and FDI trends drive further increase in goods imports and trade deficit in 2023

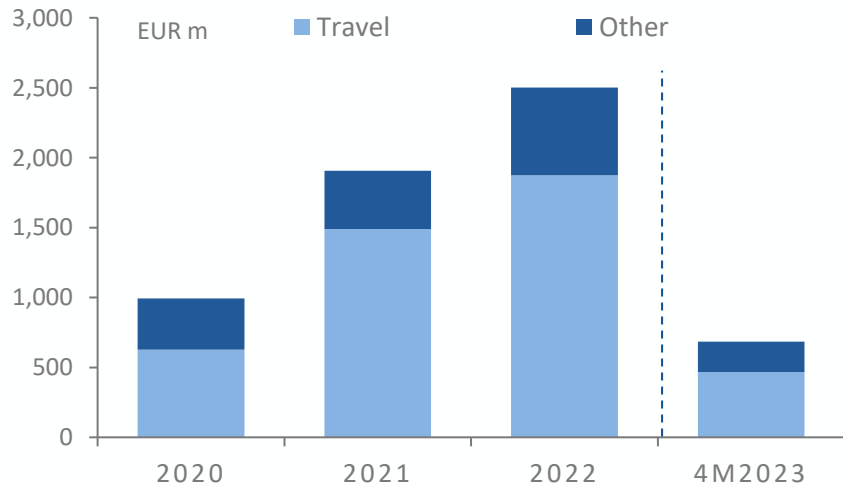
Foreign trade in services/Tourism

Foreign trade in services



Source: Central Bank of Kosovo

Revenue from services exports



Source: Central Bank of Kosovo

Trade in services

- » General situation: traditionally, much higher exports of services than imports (2022: 27% vs 15% of GDP)
- » Tourism as key driver of service exports in Kosovo and is thereby also becoming an important driver for economic growth

Exports

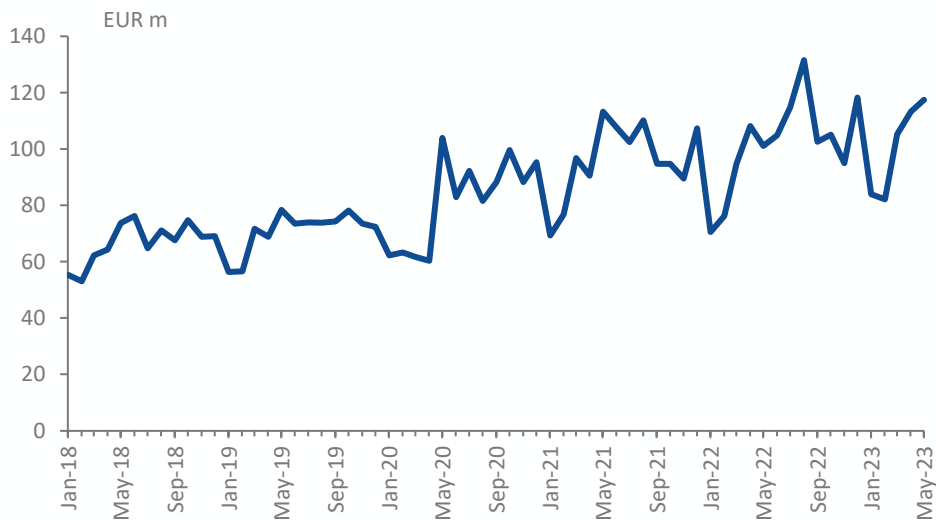
- » After a full recovery of service exports in 2021, further increases in 2022, driven by (diaspora) tourism
- » Positive trend continues in 2023: already 28% higher exports in 4M 2023 compared to 4M 2022

Imports

- » Positive trend for service imports is also expected to continue in 2023 but to become weaker
- Continuing increase in service exports driven by (diaspora) tourism as a driving force for economic development

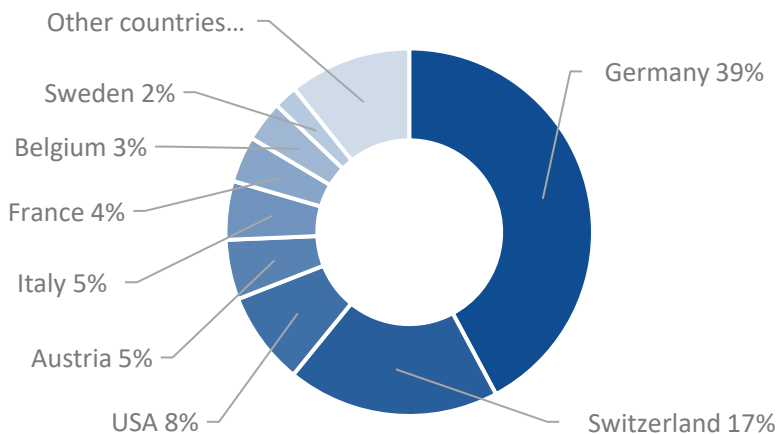
Remittances

Remittances inflows



Source: Central Bank of Kosovo

Remittances by countries of origin



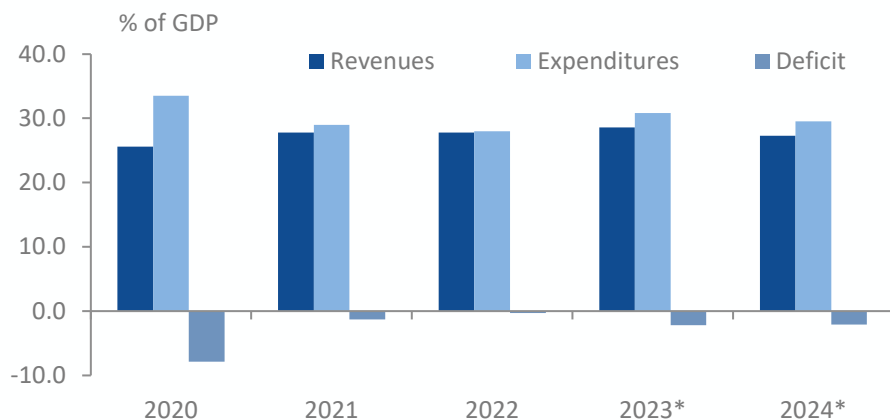
Source: Central Bank of Kosovo, 4M2023

Remittances

- » Remittances as a key factor for Kosovo's economy, especially for financing consumption and imports
- » 2022: remittances amounted to 13% of GDP, despite challenging global times
- » Most important source of income in the context of secondary income
- » Most remittances come from Germany, followed by Switzerland and the United States
- » Increasing trend in remittances observable for 2023 as well: remittances in 5M 2023 12% higher compared to 5M 2022
- » Remittances prove to be resilient and remain an important economic factor

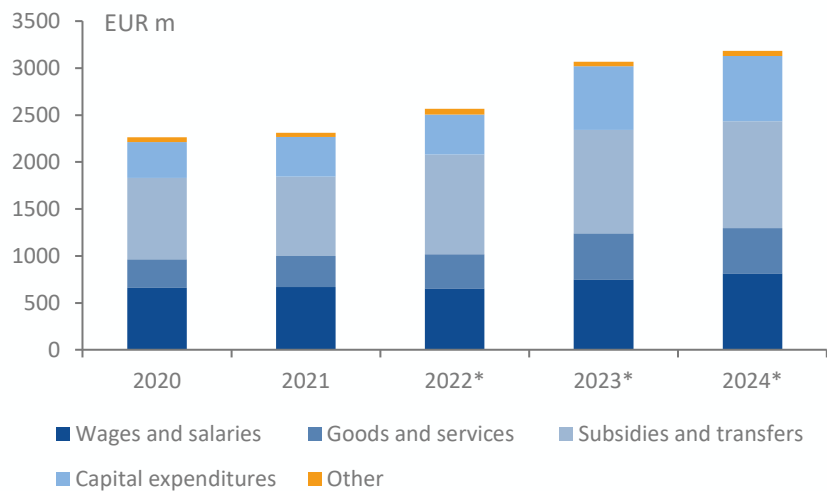
Public finances

Public finances



Source: IMF, *estimate/forecast

Public expenditure



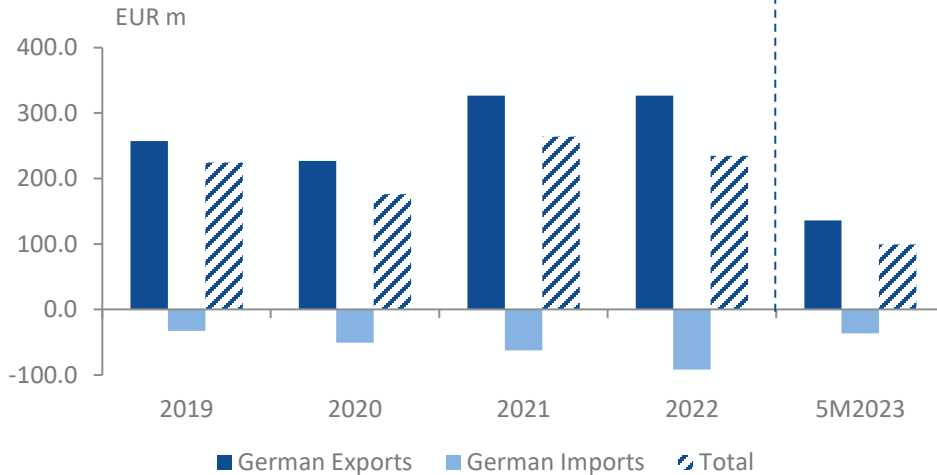
Source: IMF, *estimate/forecast

Public finance

- » 2022: balanced budget
 - Despite increases in transfers and subsidies
 - At the expense of low public investment activities
- » 2023: public expenditure expected to increase by almost 20%
- » Main drives: increase in capital expenditure (60% yoy) and expenditure on goods and services (35% yoy)
- » One of the key drivers for growth both in the short- and long term
- » Revenues: slight increase expected for 2023 and 2024
- Increased public investment and consumption activities expected for 2023: positive for both short and long-term growth

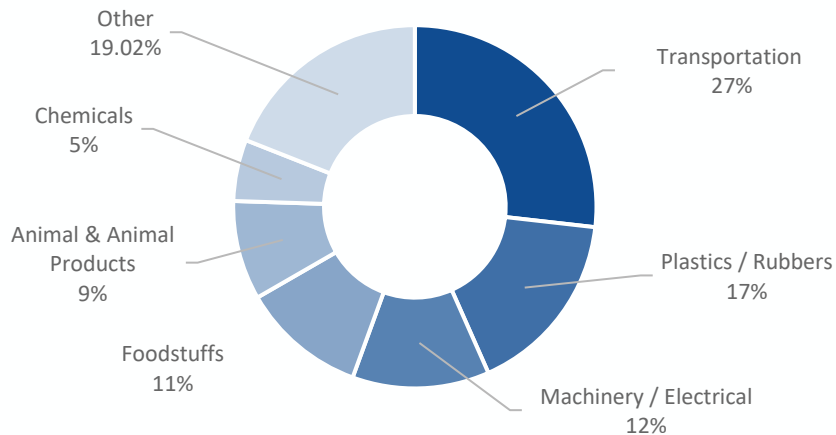
Bilateral trade between Germany and Kosovo

German trade with Kosovo



Source: Federal Statistical Office of Germany, trade in goods

German exports to Kosovo



Source: Federal Statistical Office of Germany, 5M2023, trade in goods

Bilateral trade volume

- » Strong trade dynamics between Germany and Kosovo observed during the recovery year 2021 continued in 2022

German exports to Kosovo

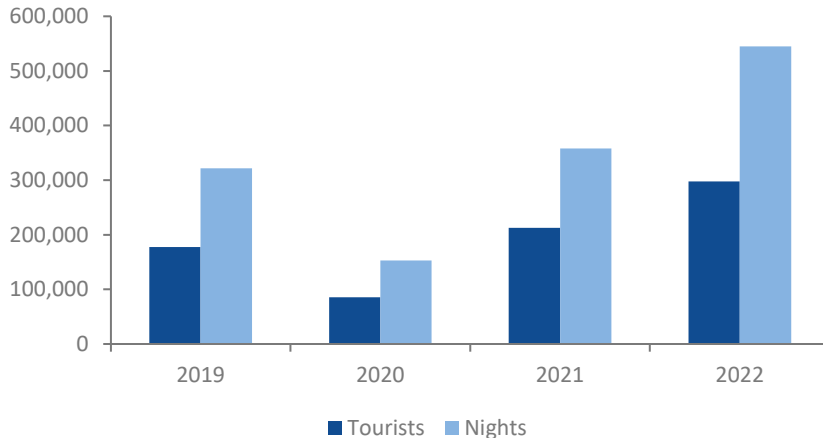
- » Level of exports from Germany to Kosovo remained stable in 2022
- » Stable trend continues in the first five months of 2023
- » Main export goods relate to transportation, plastics, machinery/electrical goods as well as foodstuffs

German imports from Kosovo

- » Imports increased by 46% in 2022
- » 5M 2023: main import goods were plastics and metals
- Ongoing bilateral trade dynamics

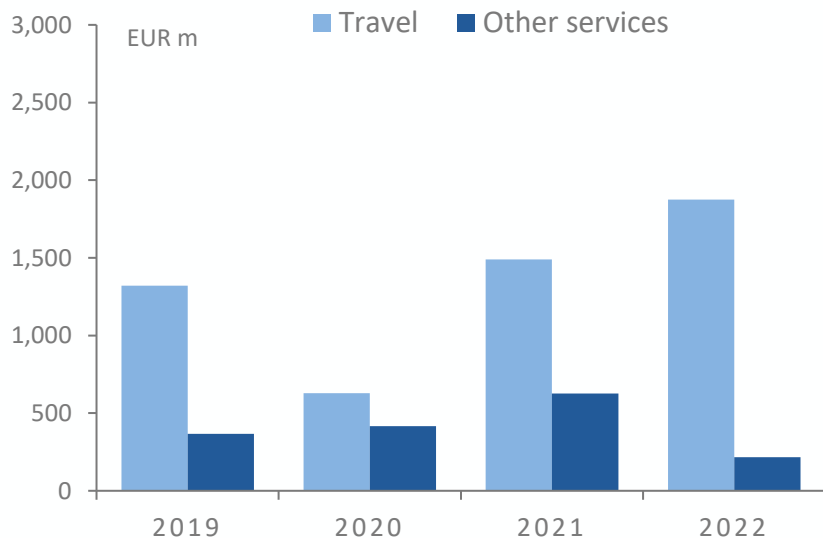
Tourism

Number of tourists and nights spent in Kosovo



Source: Kosovo Agency of Statistics

Role of tourism for revenues from service exports



Source: Central Bank of Kosovo

Development of tourism in Kosovo

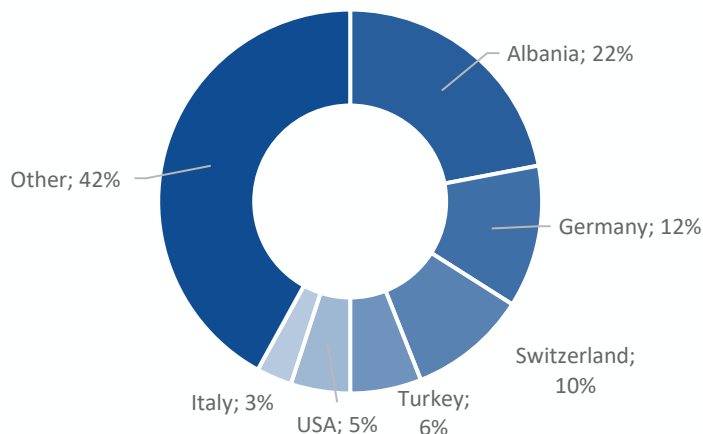
- » Record number of tourists visiting Kosovo in 2022: Almost 300 000 people visited the country
- » Increasing trend also regarding the nights spent by tourists in Kosovo
 - Nights spent increased by almost 70% in 2022 compared to the pre-pandemic value of 2019

Role of the tourism sector for the economy

- » Very strong recovery of tourism in 2021 as key driver of the country's overall economic recovery following the pandemic
- » 2022: contribution of tourism revenues to service exports and thus economic growth even stronger
- Increasing role of tourism in the economy

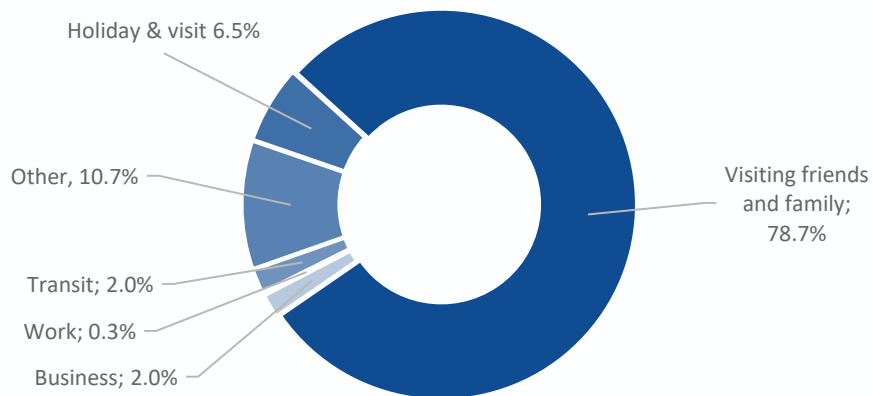
Tourism

Countries of origin of tourists coming to Kosovo



Source: Kosovo Agency of Statistics

Reasons for visiting Kosovo



Source: Kosovo Agency of Statistics

Government's vision

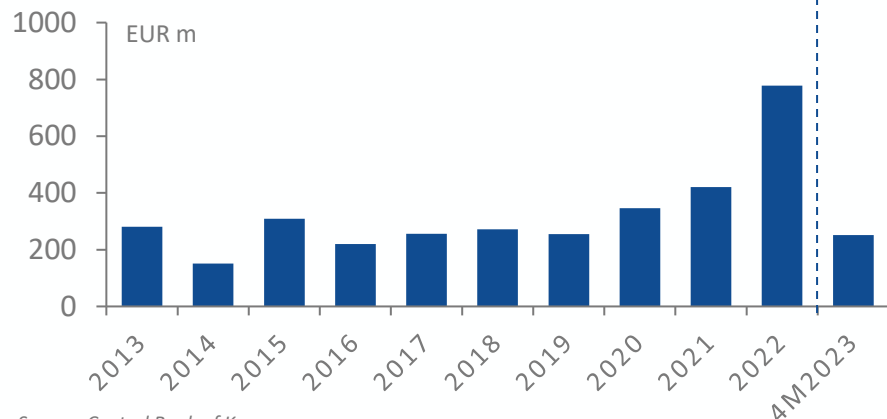
- » Based on increasing tourism trend, the sector is also becoming a priority for the Kosovar government
 - Vision: becoming a sustainable tourist destination in the Western Balkans
- » However, currently: mostly either diaspora or visitors from the region coming to Kosovo, mainly to visit friends and family

Recommendations

- » Attracting new tourist groups and thereby competing with WB-countries such as Albania or Montenegro will require substantial (public) resources
- » Allocating public funds into the sector should not come at the expense of developing more promising sectors
- Role of government for supporting tourism needs to be thoroughly analysed

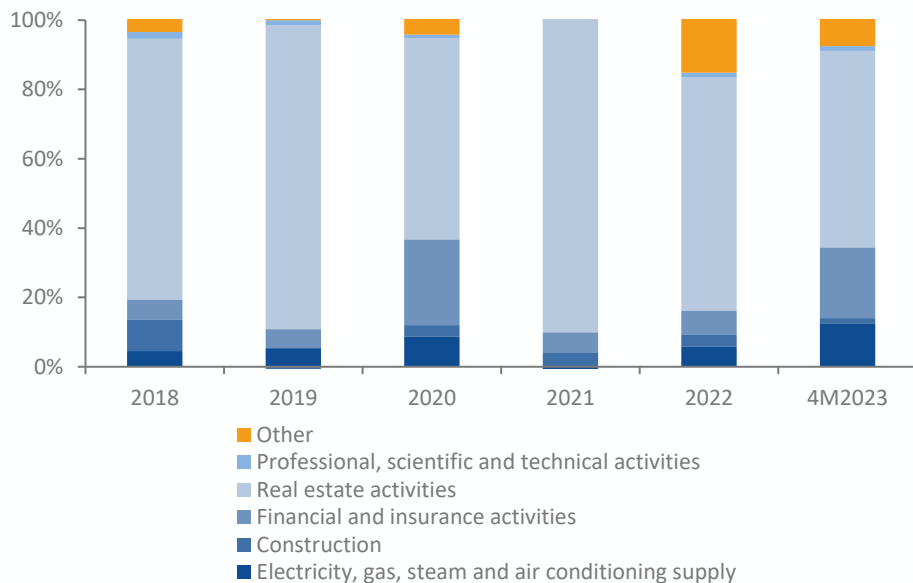
Foreign direct investment

FDI inflows to Kosovo



Source: Central Bank of Kosovo

FDI in Kosovo by economic activities



Source: Central Bank of Kosovo

FDI inflows

- » 2022: record FDI inflows
 - Inflows almost doubled compared to previous year
- » Indication that Kosovo can profit from re-allocation and nearshoring trends
- » Traditionally: diaspora-driven FDI activities in the real estate sector most important
- » Diversification trend over the past years:
 - Increase in FDI in the financial and insurance activities, electricity, gas, steam and air conditioning supply
- » 2023: positive trend continues with an inflow of over EUR 250 m in M4 2023
 - In line with increasing investment trend
- **FDI inflows at a record high and increasingly more diversified**

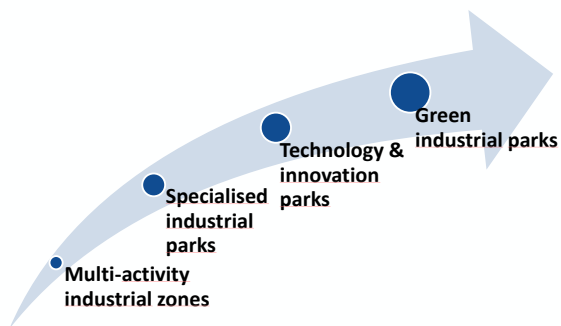
Economic zones

Overview of Economic Zones in Kosovo

| Economic Zone | Year of establishment | Size (ha) | Active companies | Employees |
|---------------------------|-----------------------|-----------|------------------|-----------|
| Drenas Business Park | 2010 | 24 | 41 | 500 |
| Mitrovica Business Park | 2012 | 4 | 22 | 300 |
| Shtime Technology Park | 2013 | 13 | 13 | 500 |
| Mitrovica Industrial Park | 2014 | 48 | 2 | n.a. |
| Suhareka Agro-Ind. Zone | 2015 | 28 | - | - |
| Lipjan Industrial Park | 2016 | 56 | - | - |
| Suhareka Industrial Park | 2017 | 162 | 60 | 1,000 |
| Viti Industrial Park | 2017 | 15 | - | - |
| Vushtrri Industrial Park | 2018 | 15 | - | - |
| Rahovec Industrial Park | 2020 | 35 | - | - |

Source: Own research

Proposed development path



Source: Own research and illustration

Background

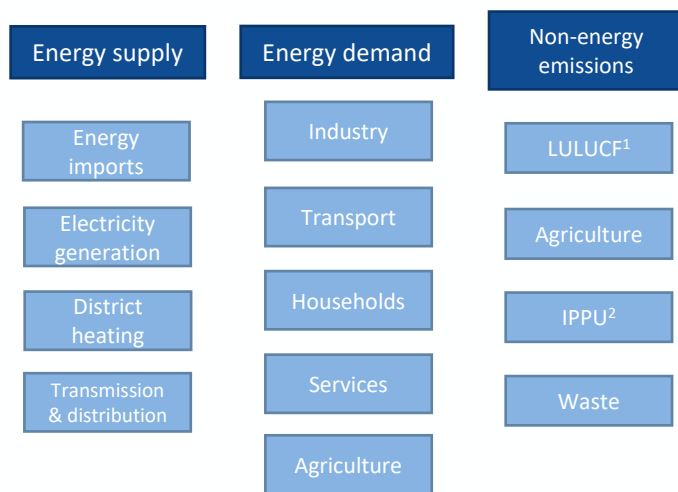
- » Over the past decade: a total of ten economic zones were created in Kosovo, five of which are operational so far
- » However: rather moderate performance of zones in terms of attracting investors and creating employment so far

Recommendations

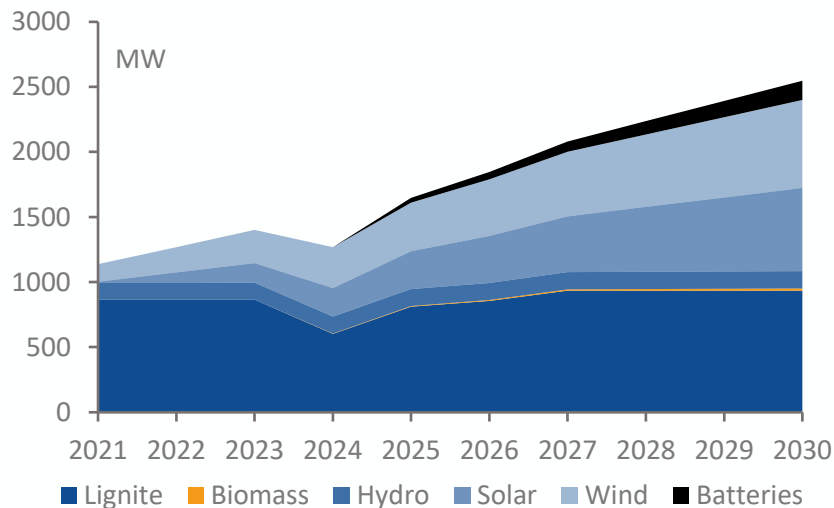
- » Starting point to increase the effectiveness of economic zones: guiding strategy shifting focus towards specialized/green industrial parks and technology & innovation parks
 - Based on this: refining the value proposition, institutional model and core processes for planning, developing and operating zones
- » Many of these recommendations were taken over by the government in the new law on Industrial and Technological Parks
- First steps towards more effective economic zones

National Energy and Climate Plan (NECP)

Sectoral breakdown NECP Kosovo



Electricity generation and storage capacities (expansion targets)



Note: Expansion targets based on Energy Strategy. Available capacities of lignite units are based on exp. schedule for unit retrofits. Sources: Ministry of Economy, ERO, KEK, DH Gjakova, own analysis

¹ Land Use, Land-use Change and Forestry

² Industrial Processes and Product Use

Background

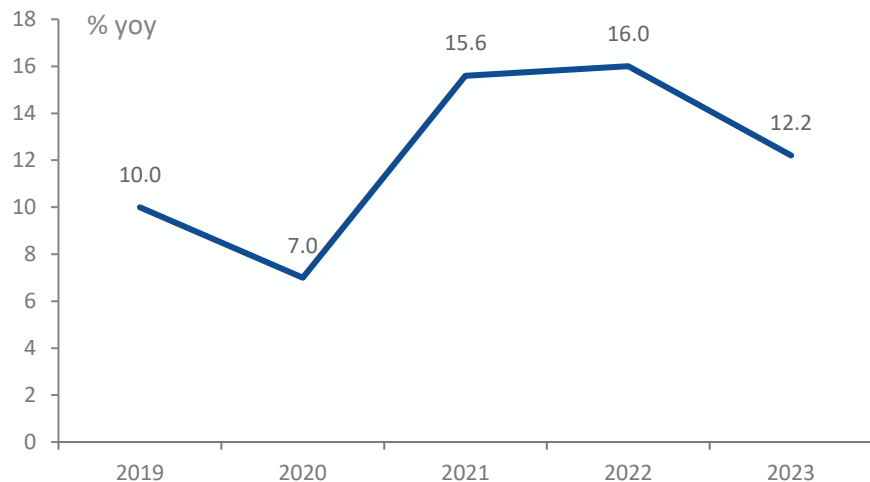
- » Cross-sectoral plan for coordinating targets and policy measures in the dimensions decarbonisation, energy efficiency, market integrity, energy security and R&I
 - Time horizon: Until 2030
 - Mandatory for Kosovo as one of the Contracting Parties of the Energy Community
 - First draft submitted in July 2023

Headline 2030 targets

- » GHG emissions: -16.3% (vs. 2016)
- » Renewables: 32% of gross final consumption
 - Implies ambitious expansion of renewable electricity generation
- » Energy efficiency: primary energy consumption -9% (vs. 2021) - implies large-scale renovations
- Will shape KOS energy and climate policies for this decade and beyond

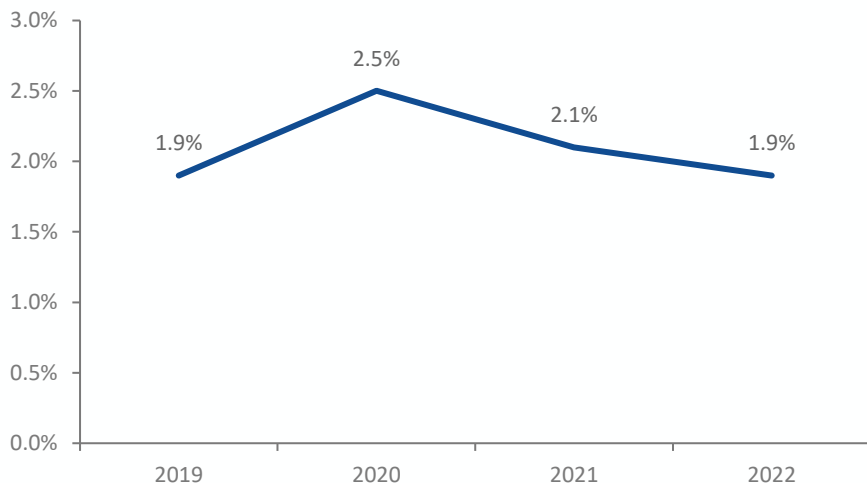
The banking sector

Bank credit to the private sector



Source: IMF, 2022 and 2023 estimation/forecast

Non-performing loans (as share of total loans)



Source: IMF, 2022 and 2023 estimation/forecast

Role of the banking sector

- » Banking sector in Kosovo: increasingly important role for the economy in general and as a source of finance for companies in particular
- » 2022: 16% increase (yoy) in bank credit given out to the private sector

Development

- » The banking sector in Kosovo has proved to be resilient regardless of the multiple shocks the economy was faced with over the past years
- » Only slight increase in the share of non-performing loans in the Covid-years 2020 and 2021, while the share was already back to pre-Covid times in 2022
- **Important and resilient role of Kosovo's banking sector for the economy**

About the German Economic Team

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.*

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