

KOSOVO

Table 1 **2022**

Population, million	1.8
GDP, current US\$ billion	9.4
GDP per capita, current US\$	5315.7
Upper middle-income poverty rate (\$6.85) ^a	34.2
Gini index ^a	29.0
Life expectancy at birth, years ^b	76.8

Source: WDI, Macro Poverty Outlook, and official data.
 a/ Most recent value (2017), 2017 PPPs.
 b/ Most recent WDI value (2021).

Amid a challenging global context, growth decelerated but remains positive. GDP growth reached 2.9 percent in H1 2023, supported by export performance and consumption. Inflation decelerated, but core inflation remains heightened. Over the medium term, growth is expected to reach around 4 percent, close to Kosovo's potential, but risks associated to Russia's invasion of Ukraine and to a growth slowdown in Europe remain elevated.

Key conditions and challenges

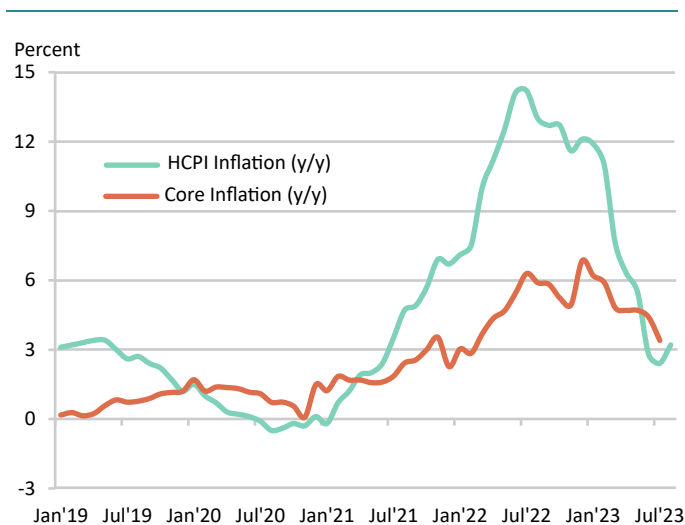
Following a robust post-pandemic recovery growth moderated in 2022 amid high inflation driven by increased international commodity prices brought on by the war in Ukraine. In 2023, amid a challenging global context, macroeconomic conditions remained favorable although growth decelerated. Despite steady economic progress since independence, there remains a large income gap between Kosovo and the average European Union member state. Limited firm dynamism and access to finance hamper private sector development and employment creation. The country's growth model relies on remittances to fuel consumption but has recently shifted to more export-driven growth. Investment is predominantly construction focused with limited contributions to growth. Human capital outcomes lag peer countries and the labor market continues to face severe challenges. Only one in three Kosovars is employed, 61.4 percent are classified as inactive, and gender gaps persist. In 2022, the working age population shrank, likely due to migration. Power generation capacity is limited and relies on outdated and unreliable lignite-fired generation plants, posing significant challenges to growth. Over the medium term, growth is expected to reach around 4 percent, close to Kosovo's potential, but risks remain elevated. An escalation of the war in Ukraine and weaker activity

in Europe could negatively affect growth. Increased tensions in Kosovo's northern municipalities remain a risk. Migration, if not offset by higher labor force participation, could constrain potential growth. To accelerate poverty reduction, Kosovo needs to transition to a more competitive growth model that creates more and higher quality jobs, supports firm growth, and is driven by increases in productivity. To make this transition and increase potential growth, Kosovo should further prioritize reforms to entrench macroeconomic stability and governance, enhance human capital, and address regulatory gaps to support private sector development.

Recent developments

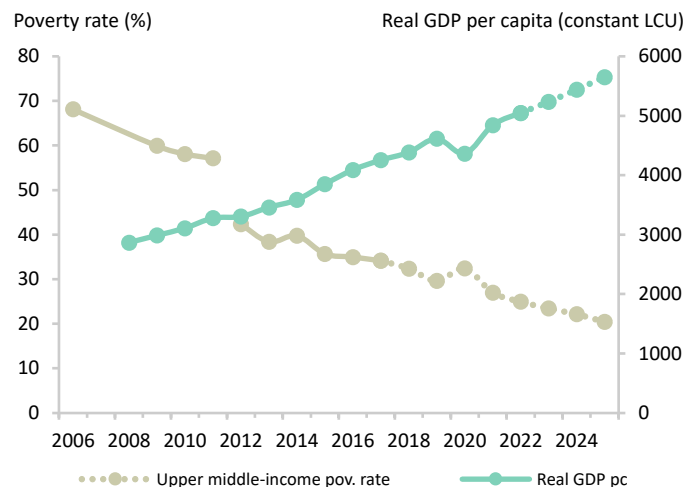
GDP growth reached 2.9 percent in H1 2023, driven primarily by a robust export performance (9.8 percent, y/y). At 2.4 and 1.6 percent (y/y) respectively, private consumption and gross capital formation marked a more moderate contribution to growth. On the production front, services and agriculture were the key contributors to H1 GDP growth. After reaching its 2023 peak in January, consumer inflation was on a downward trend until July 2023 (2.4 percent y/y) and experienced a slight uptick in August 2023 (3.2 percent y/y). During this period, significant contributors to inflation were furnishing, household items and maintenance (7.2 percent y/y), alcoholic beverages and tobacco (6.3 percent y/y), and food and non-alcoholic beverages (5.5 percent y/y), while transport

FIGURE 1 Kosovo / Consumer price inflation



Sources: Kosovo Statistics Agency and Central Bank of Kosovo.

FIGURE 2 Kosovo / Actual and projected poverty rate and real GDP per capita



Source: World Bank. Notes: see Table 2.

(-3.8 percent y/y) subtracted from the inflation rate. Labor market formalization is steadily growing, evident in the 2.3 percent increase in formal employment between July 2022 and July 2023. Additionally, the number of registered job-seekers decreased by 53 percent between July 2022 and 2023. The current account deficit showed signs of improvement by June 2023 (13.4 percent), driven by the lower value of imports coupled with a positive performance in service exports and balance of secondary income. By June 2023, the trade deficit decreased slightly (-4.6 percent, y/y), with nominal merchandise exports and imports dropping by 8.1 percent and 5.2 percent (y/y), respectively. During January-August 2023, tax revenues grew by 12 percent while overall revenues increased by 15 percent. Public and publicly guaranteed debt (PPG) decreased to 17.3 percent in June 2023, from close to 20 percent in 2022. The financial sector remains robust. In July 2023, the annual change in loans reached 14 percent. Bank capital buffers and asset quality also remain adequate, with non-performing loans remaining stable at 2 percent.

Outlook

Despite continued inflationary pressures, GDP growth is expected to reach 3.2 percent in 2023, driven by positive exports performance and private consumption. Diaspora-driven service exports are expected to remain positive throughout the year. Positive credit growth, stable remittances inflows, higher public wage spending following the implementation of the new Law on Public Wages, and elevated levels of public transfers, will support consumption growth. The medium-term outlook remains positive, with growth expected to accelerate towards 4 percent, bringing the level of economic activity closer to Kosovo's potential. The contribution of investment to growth is expected to pick up in 2024-2025, supported by the implementation of the Energy Strategy. Continued uncertainties related to the war in Ukraine, the slowdown in Europe, and the domestic political context entail significant risks. Poverty is projected to continue its decline,

falling to 23.5 percent in 2023, measured using the upper-middle-income poverty line (US\$6.85/person/day in 2017 PPP). Still, the materialization of downside risks could lead to a stagnation of poverty reduction. Inflation is expected to decelerate, yet price levels will remain elevated throughout 2023. The current account deficit is projected to narrow, with the expected decline in commodity prices and continued positive service exports. The fiscal deficit is expected to remain below 1 percent of GDP in 2023, driven by positive tax revenue performance and lower-than-budgeted capital expenditures. Over the medium term, public debt is projected to remain below 20 percent of GDP. Closing the income gap with the European Union requires an acceleration in the implementation of structural reforms in energy, education, social protection, and healthcare sectors. In addition, elevated global volatility requires authorities to continue preserving fiscal buffers while ensuring spending is balanced between promoting economic growth and current expenditures, including transfers.

TABLE 2 Kosovo / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2020	2021	2022	2023e	2024f	2025f
Real GDP growth, at constant market prices	-5.3	10.7	3.5	3.2	3.9	4.0
Private consumption	2.5	7.3	4.0	2.0	3.6	4.2
Government consumption	2.1	9.0	-1.5	4.9	2.7	-1.3
Gross fixed capital investment	-7.6	13.0	-6.1	1.2	4.2	4.3
Exports, goods and services	-29.1	76.7	17.2	9.8	5.5	5.5
Imports, goods and services	-6.0	31.4	4.9	4.6	4.2	4.2
Real GDP growth, at constant factor prices	-3.6	7.6	3.3	3.0	3.9	4.0
Agriculture	-5.8	-2.5	2.3	1.8	2.3	2.5
Industry	-1.0	7.8	1.9	2.0	3.5	4.0
Services	-4.8	9.4	4.4	3.9	4.4	4.3
Inflation (consumer price index)	0.2	3.4	11.6	4.8	3.0	2.5
Current account balance (% of GDP)	-7.0	-8.7	-10.5	-6.6	-6.0	-5.5
Net foreign direct investment inflow (% of GDP)	4.2	4.0	6.7	6.7	6.7	6.8
Fiscal balance (% of GDP)	-7.6	-1.3	-0.5	-0.6	-2.0	-1.5
Revenues (% of GDP)	25.4	27.4	27.7	28.8	28.3	28.4
Debt (% of GDP)	22.0	21.2	19.6	18.5	19.3	19.9
Primary balance (% of GDP)	-7.2	-0.9	-0.1	-0.3	-1.7	-1.1
Upper middle-income poverty rate (\$6.85 in 2017 PPP)^{a,b}	32.4	27.0	25.0	23.5	22.2	20.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.

Notes: e = estimate, f = forecast.

a/ Calculations based on ECAPOV harmonization, using 2017-HBS. Actual data: 2017. Nowcast: 2018-2022. Forecasts are from 2023 to 2025.

b/ Projection using neutral distribution (2017) with pass-through = 0.7 (Low (0.7)) based on GDP per capita in constant LCU.