

KOSOVO

Table 1	2021
Population, million	1.8
GDP, current US\$ billion	9.0
GDP per capita, current US\$	5057.7
Upper middle-income poverty rate (\$5.5) ^a	24.4
Gini index ^a	29.0
Life expectancy at birth, years ^b	72.5

Source: WDI, Macro Poverty Outlook, and official data.
 a/ Most recent value (2017), 2011 PPPs.
 b/ Most recent WDI value (2019).

Kosovo's economy experienced a strong recovery in 2021, supported by a rebound in domestic demand and record export growth. Inflation also intensified, driven by increases in import prices. Growth is expected to decelerate to 3.9 percent in 2022. The medium-term outlook remains positive, but prone to elevated risks; with the war in Ukraine significantly increasing inflationary pressures. Further reforms to enhance competitiveness would help sustain Kosovo's export momentum.

Key conditions and challenges

Kosovo's GDP grew by 9.1 percent in 2021, following a contraction of 5.3 percent in 2020. From Q2 of 2021, vaccination accelerated, and travel resumed, bolstering economic activity. Consumption and diaspora-driven service exports remain key growth drivers.

Private investment contributes increasingly but consists mostly of construction, with limited productivity spillovers. Positively, merchandise exports increased significantly from pre-pandemic levels and, though still low, are an encouraging sign of private sector growth. The trade deficit, however, remains high.

Low labor force participation, especially for women, remains a pressing constraint to growth. Overall, 1 in 3 working-age adults was employed before the recovery accelerated; women's employment increased by 14 percent, but still only 16 percent adult women were employed by Q1 2021. Positively, formal employment increased throughout 2021.

Kosovo, a Euroized economy, has a good track record of headline fiscal management. However, without access to international financial markets, concessional financing remains a significant source to close the infrastructure gap.

GDP growth is expected to reach 3.9 percent in 2022, but there are significant risks. While the pandemic appears to recede, risks of new vaccine-resistant variants

could disrupt international travel. Meanwhile, the Russian invasion of Ukraine and associated sanctions could generate further inflationary pressure, especially for energy and food, undermining consumption. Rising energy costs pressuring public finances since late 2021, given the vulnerability of aged power-generation infrastructure.

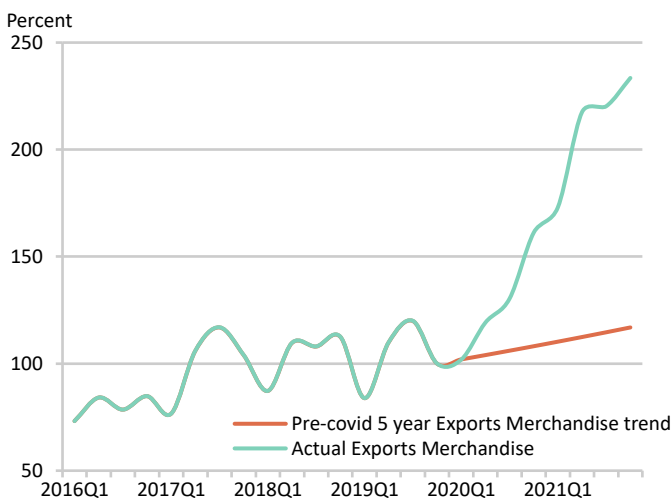
Under the changing external conditions, maintaining fiscal space to support the economy is crucial. Furthermore, Kosovo needs to build on the recent export growth momentum by further improving the regulatory environment and by investing on productivity-enhancing human capital and infrastructure.

Recent developments

Strong credit growth, remittances, and foreign direct investment (FDI), combined with a direct 3.2 percent-of-GDP fiscal stimulus and the spillover from quasi-monetary measures in 2020, restored confidence and boosted domestic demand, driving an exceptional 9.1 percent real output growth in 2021. Meanwhile, trade increased substantially. On the production side, services and industry contributed the most, while agriculture contributed negatively to growth.

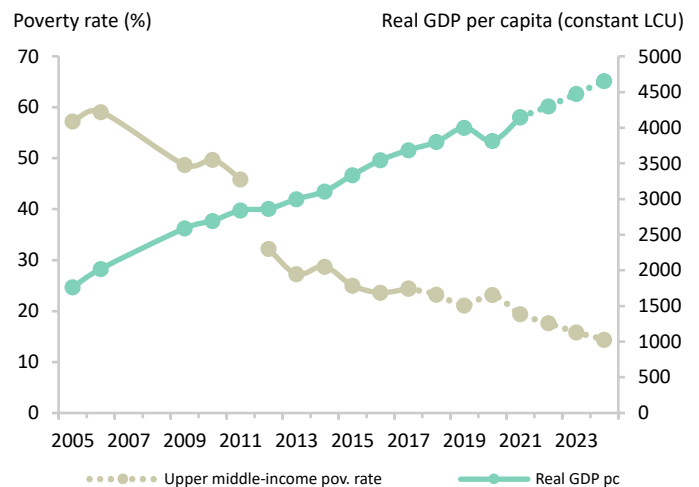
Until Q1 2021, labor force participation and employment increased only for women (under 25 especially) and slightly fell for men. However, tax-registered employment rose by nearly 10 percent throughout 2021. Poverty is estimated to have decreased by

FIGURE 1 Kosovo / Index of merchandise exports in USD, 2019Q4=100 percent



Sources: Kosovo agency of statistics and World Bank staff calculations.

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



Source: World Bank. Note: see Table 2.

about 4 percentage points in 2021 to under 20 percent.

Consumer price inflation jumped from 0.2 percent in 2020 to 3.4 percent in 2021, reaching 7.5 percent in February 2022. Import prices of energy, food and commodities fueled inflation.

Manufacturing exports rose by almost 70 percent year-on-year. Services' exports more than doubled as diaspora travel bounced back in 2021. Remittances also increased by 26 percent y-o-y. However, the recovery also increased import demand by almost 50 percent, resulting in a deterioration of the current account deficit (CAD).

The fiscal deficit fell from 7.6 percent of GDP in 2020 to 1.4 percent in 2021, thanks to a record 29 percent increase in tax revenues. Tax revenues were boosted by the economic recovery, higher inflation, and formalization. Nominal current expenditure grew by 7 percent, mostly due to the fiscal stimulus program. Nominal public capital expenditure increased but remains below its pre-pandemic share of GDP. Public and publicly guaranteed (PPG) debt remained stable at 22.5 percent of GDP. The financial sector strengthened,

supporting the recovery through double-digit credit growth.

Outlook

As of March 2022, growth is projected to reach 3.9 percent by year end, but there are significant downside risks. While the post-COVID recovery furthers economic activity, the consequences of the Russian invasion of Ukraine are still unfolding and could dampen economic prospects.

Private investment growth, from higher construction and export-related investment, is expected to support growth in 2022. Improved execution in public investment should accelerate its recovery. However, a positive contribution from investment hinges on the strength of diaspora demand for real estate, a moderation in construction input prices, and the ability of the Government to maintain current capital budgeting against higher pressures for energy and social transfers. The current account deficit is projected to exceed 9 percent of GDP, as imports continue to rise due to higher domestic demand.

Headline inflation is expected to rise to 5.4 percent in 2022 but the negative impact of the war in Ukraine on global trade and prices could increase inflation further. As a net importer of food, agricultural inputs, and energy, Kosovo is directly affected by global price surges of these goods, despite minor direct trade links with Russia and Ukraine. Food and energy inflation could affect the most vulnerable households disproportionately, as they devote large budget shares to these items. Rising electricity costs might increase fiscal pressures. On the other hand, base metals' export revenues could increase from higher global demand.

Tax revenue collection is expected to remain strong in 2022, however, expenditure should outpace revenues due to a rebound in capital expenditure and higher current expenditures from energy subsidies and social transfers. As a result, the fiscal deficit is expected to widen to 2.2 percent of GDP and remain within the fiscal rule over the medium term. PPG debt is expected to reach 24.3 percent of GDP in 2022.

TABLE 2 Kosovo / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2019	2020	2021e	2022f	2023f	2024f
Real GDP growth, at constant market prices	4.8	-5.3	9.1	3.9	4.3	4.2
Private Consumption	5.6	2.5	7.0	1.7	1.8	1.8
Government Consumption	10.1	2.1	0.7	2.3	6.8	3.1
Gross Fixed Capital Investment	2.9	-7.6	10.5	9.0	7.5	7.7
Exports, Goods and Services	7.6	-29.1	69.1	5.0	5.5	6.0
Imports, Goods and Services	4.5	-6.0	27.9	3.4	3.6	3.5
Inflation (Consumer Price Index)	2.7	0.2	3.4	5.4	1.6	2.2
Current Account Balance (% of GDP)	-5.6	-7.0	-9.1	-9.7	-9.0	-8.0
Net Foreign Direct Investment (% of GDP)	-2.7	-4.2	4.2	4.2	4.0	4.0
Fiscal Balance (% of GDP)	-2.9	-7.6	-1.4	-2.2	-2.6	-2.5
Debt (% of GDP)	17.0	22.0	22.1	24.0	25.3	26.9
Primary Balance (% of GDP)	-2.6	-7.1	-1.0	-1.7	-2.2	-2.2
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b}	21.1	23.2	19.4	17.6	15.8	14.4

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

a/ Calculations based on ECAPOV harmonization, using 2017-HBS. Actual data: 2017. Nowcast: 2018-2021. Forecasts are from 2022 to 2024.

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