

KOSOVO

Table 1 **2021**

Population, million	1.8
GDP, current US\$ billion	9.2
GDP per capita, current US\$	5209.0
Upper middle-income poverty rate (\$6.85) ^a	34.2
Gini index ^a	29.0
Life expectancy at birth, years ^b	71.1

Source: WDI, Macro Poverty Outlook, and official data.

a/ Most recent value (2017), 2017 PPPs.

b/ Most recent WDI value (2020).

Global inflationary pressures interrupted Kosovo's boisterous recovery path. Real GDP growth is expected to decelerate to 3.1 percent in 2022 following a slowdown in investment and private consumption. Exports continued to boost growth. In the current context, support to mitigate the impact of surging energy and food prices should be targeted towards the most vulnerable. Over the medium-term, accelerated implementation of structural reforms in energy, education, social protection, and healthcare is critical to enhance inclusive and sustainable growth.

Key conditions and challenges

With a history of strong growth compared to peers, Kosovo exits the COVID-19 crisis facing a renewed imperative: addressing key structural bottlenecks to enhance competitiveness and support sustainable and inclusive growth. During the past years, Kosovo experienced economic growth with limited firm-level productivity growth and higher-quality job creation, in a context of persistent structural informality and high trade deficit. Given the initial low base, new post-pandemic momentum in exports could be leveraged to break the circle of consumption-driven growth that relies on diaspora inflows.

Low labor force participation and employment, especially among women, continue to remain a strong binding constraint to growth and poverty reduction. The labor market continues to be also characterized by informality and skills mismatches: firms increasingly report difficulties in filling vacancies.

Outdated power generation capacity remains a key source of vulnerability. Rising energy import costs represent a key challenge for 2022 and could adversely impact the fiscal position given the higher need to subsidize electricity imports. Kosovo has a good track record of prudent fiscal management. However, without access to international financial markets, resources to cover growing development

needs are limited. Continued public investment under-spending is a lost opportunity to close faster the looming infrastructure gap.

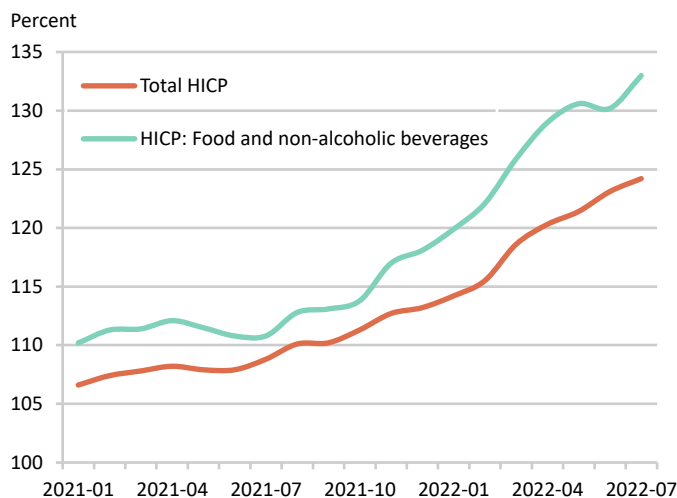
As a unilaterally Euroized economy, Kosovo has limited room to mitigate the impact of rising inflation, exacerbated by the war in Ukraine. Despite high levels of spending on social protection, the social assistance scheme is inflexible and can provide only limited protection for the most vulnerable. Rising inflation is also exerting upward wage pressures. Persistence of energy and food price pressures could further erode disposable incomes and hurt more the less well-off who spend a larger share of their budget on these essential items.

Recent developments

After reaching a record of 10.5 percent in 2021, GDP growth moderated to 3.2 percent in H1 of 2022, driven by domestic demand and exports. On the production side, the service sector – driven by remittances, credit growth, and higher public transfers – was the main contributor to economic growth. Inflation soared reaching 13 percent (y-o-y) in August 2022, triggered by an increase in import prices. Food and transport price increases surpassed 20 percent by August 2022, disproportionately impacting the most vulnerable.

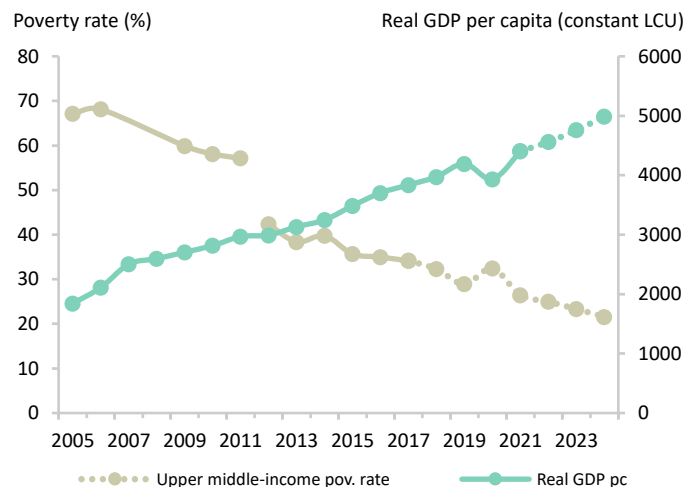
The average number of pension contributors for the first half of 2022 suggests an increase of 8 percent (y-o-y) in formal employment. For the same period, the number of

FIGURE 1 Kosovo / Consumer price inflation



Source: Kosovo Statistics Agency.

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



Source: World Bank. Notes: see Table 2.

registered job-seekers at employment centers dropped by 32 percent (y-o-y).

Exports – particularly for manufactured goods – increased by 29.4 percent (y-o-y) in July. Diaspora-driven service exports also increased by 46 percent by May; and travel data suggest a positive momentum continued during the summer season. Against a significant increase in prices, merchandise imports – which represented 53.4 percent of GDP in 2021 –increased nominally by 26 percent until July 2022, further exacerbating Kosovo’s structurally high trade deficit. After declining by 0.3 percent (y-o-y) between January and June, remittance inflows have plateaued.

Supported by inflation and formalization, total tax revenues increased by 15.4 (y-o-y) percent until end-August, 2022. Current spending increased by 17.6 percent for the same period and is expected to continue increasing as the government implements over 4.5 percent of GDP in inflation-mitigation and energy subsidy measures. Capital spending remained exceptionally low with an execution rate of 17 percent by end-August, and almost 30 percent lower than a year before.

The banking sector remained stable, with the annual change in loans at 18 percent in

July. Bank capital buffers and asset quality remain adequate, with non-performing loans remaining stable at 2.1 percent.

Outlook

GDP growth in 2022 is expected to slow down below potential to 3.1 percent. Inflationary pressures are expected to subdue purchasing power, slowing private consumption growth. Net exports are expected to drive growth. On the other hand, investment - driven by a plunge in public capital spending and a slowdown in construction - should subtract from growth. On the production side, services – supported by higher diaspora demand, credit growth, and public transfers - are expected to be the main driver of growth. After a significant reduction in 2021, poverty is expected to marginally decline in 2022, but the continuation of inflationary pressures could lead to a stagnation of poverty rates. The medium-term outlook remains positive. However, it is also mired by downside risks related to food and energy

price increases and upward pressures on interest rates.

Consumer inflation is expected to average 12.1 percent in 2022, before moderating gradually over the medium-term. With high import inflation leading to a nominal increase in the level of trade imbalances, and with slowing remittances, the current account is expected to deteriorate until 2023. In the medium-term, non-debt creating FDI and external lending will be the key source of financing for the current account.

The fiscal deficit is expected to reach 0.8 percent of GDP in 2022. Further spending on energy subsidies could, however, increase the deficit. Over the medium-term, compensation of employees, transfers, and a gradual improvement in capital investment execution, are expected to drive spending and push the fiscal deficit above 2 percent of GDP.

Over the medium-term, there is a pressing need to preserve fiscal buffers by containing spending on untargeted transfers to respond to the changing macroeconomic environment, and accelerate implementation of structural reforms in energy, education, social protection, and healthcare to enhance inclusive and sustainable growth.

TABLE 2 Kosovo / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2019	2020	2021	2022e	2023f	2024f
Real GDP growth, at constant market prices	4.8	-5.3	10.5	3.1	3.7	4.2
Private Consumption	5.6	2.5	7.6	0.5	1.9	3.4
Government Consumption	10.1	2.1	9.1	3.0	5.1	2.0
Gross Fixed Capital Investment	2.9	-7.6	10.7	-2.3	8.5	5.9
Exports, Goods and Services	7.6	-29.1	78.7	11.5	6.0	8.0
Imports, Goods and Services	4.5	-6.0	32.8	1.4	5.2	5.5
Inflation (Consumer Price Index)	2.7	0.2	3.4	12.1	4.0	3.0
Current Account Balance (% of GDP)	-5.7	-7.0	-8.3	-11.3	-13.1	-12.3
Net Foreign Direct Investment Inflow (% of GDP)	2.7	4.2	3.9	3.7	4.9	5.0
Fiscal Balance (% of GDP)	-2.9	-7.6	-1.3	-0.8	-1.6	-2.1
Debt (% of GDP)	17.0	22.0	21.5	20.9	21.9	23.2
Primary Balance (% of GDP)	-2.6	-7.1	-0.9	-0.4	-1.1	-1.6
Upper middle-income poverty rate (\$6.85 in 2017 PPP)^{a,b}	28.9	32.4	26.4	25.0	23.3	21.6

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

Notes: e = estimate, f = forecast. Poverty lines are expressed in 2017 PPP, resulting in changes from earlier editions that used 2011 PPP. See pip.worldbank.org.

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 (Low (0.7)) based on GDP per capita in constant LCU.