

KOSOVO

Key conditions and challenges

Table 1 **2020**

Population, million	1.8
GDP, current US\$ billion	7.5
GDP per capita, current US\$	4145
Upper middle-income poverty rate (\$5.5) ^a	24.4
Gini index ^a	29.0
Life expectancy at birth, years ^b	72.2

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2017), 2011 PPPs.
(b) Most recent WDI value (2018).

Economic activity contracted by 6.9 percent in 2020, driven by plunging diaspora tourism and lower investment. Government and Central Bank policy support measures coupled with higher remittances and goods exports mitigated the contraction. The recovery should start in 2021 with growth hovering above 4 percent in the medium term. However, real economic activity should recover losses only in 2022. Addressing long-standing structural impediments and prioritizing limited fiscal space for high-return human capital investments is vital to supporting a resilient recovery.

Kosovo entered 2021 under continued pressure from the COVID-19 pandemic and in expectation of a government change following the organization of early elections in February 2021. Given healthcare capacity constraints, stringent containment measures were imposed in Q2 2020 but were relaxed in Q3. Vaccination has not commenced as of March 2021. Because diaspora-related tourism exports accounted for almost one-quarter of GDP prior to the pandemic, recovery will also depend on international travel restrictions and vaccination progress in diaspora host countries.

Growth averaged 3.6 percent over 2009-2019 and, before the pandemic, was expected to exceed 4 percent in the medium term. Private investment added to growth in recent years, but was mostly concentrated in trade and construction industries, with limited productivity spillovers.

Likewise, robust growth did not translate into more jobs as the employment rate remained almost constant between 2017 and 2019. In 2019, 21 percent of the population still lived with under US\$5.5 per person per day (in 2011 PPP), and this share is expected to have increased in 2020 by 4-5 percentage points. Poor education and health outcomes limit the contribution of human capital to inclusive growth and the pandemic likely widened

this gap. As a largely service and consumption-based economy, Kosovo was particularly vulnerable to the COVID-19 shock.

To support the recovery in 2021, the Government should strengthen compliance with pandemic preventive measures, increase treatment capacity and effectiveness while reducing citizens' out-of-pocket costs, and boost vaccination. Targeting of social protection and private sector support measures should be improved and implementation of public projects with secured financing accelerated. To support a resilient recovery in the medium term, public spending effectiveness and the regulatory environment should be enhanced. Investment in human capital should be prioritized.

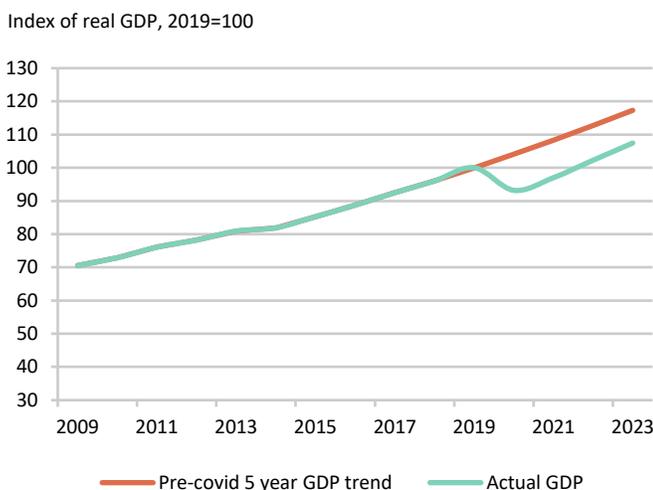
Recent developments

In 2020, economic activity is estimated to have contracted by 6.9 percent, driven by a plunge in exports—principally because of a 51 percent drop of diaspora travel services—and investment. Consumption contributed modestly, with higher government offsetting lower private consumption. Fiscal stimulus combined with increased remittances and goods exports cushioned the contraction.

Consumer price inflation decelerated in 2020 to 0.2 percent because of weak domestic demand and declining import prices.

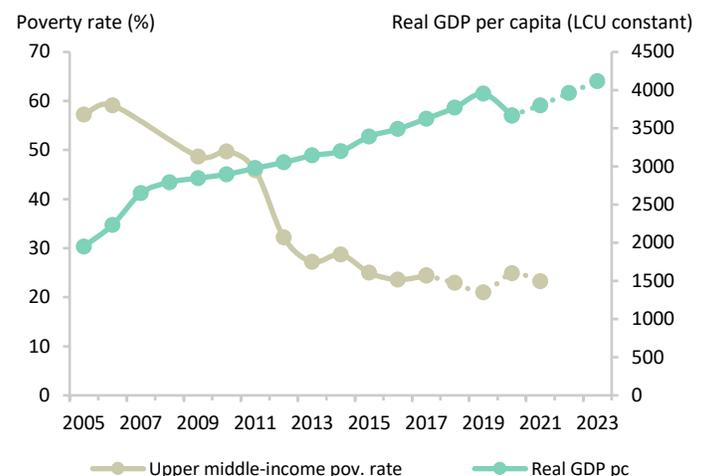
Formal employment weathered the impact of the downturn, but compensation

FIGURE 1 Kosovo / Actual and forecast GDP vs Pre-COVID-19 5-year GDP trend



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.

and working hours were reduced. Registered unemployment increased, most likely from informal job losses. Overall, unemployment remains high at 25 percent of the labor force (46.9 percent of youth) in Q3 2020. Projections suggest a poverty increase of 4-5 p.p. in 2020 (70-90 thousand new poor). The expected return to growth in 2021 should modestly reduce poverty as the services sector recovers.

Despite a 28.4 percent reduction in public investment, the budget deficit closed 2020 at 7.6 percent of GDP, due to lower public revenues against the contraction. Current spending increased by 18.6 percent, driven by pandemic-related spending of an estimated 4.4 percent of GDP. The deficit was financed primarily through domestic and external debt and liquidation receipts. The drop in imports and a rise in secondary income almost compensated the plunge in exports during 2020. As a result, the current account deficit (CAD) deteriorated marginally from 5.5 to 5.7 percent of GDP. CAD was primarily financed by net FDI inflows and other international debt-driven investment flows.

Bank deposits and bank credit increased by 11.5 and 7.1 percent, respectively. New loans increased only by 1.8 percent, reflecting restructuring activity throughout the year. Capital adequacy is above regulatory requirements, while NPLs

increased by 0.7 p.p. Forbearance measures by the Central Bank cushioned the impact of the pandemic on the financial sector.

Outlook

Growth is projected to reach 4 percent in 2021. The recovery is expected to be gradual. Economic activity will reach pre-pandemic levels only in 2022, mainly driven by a rise in exports and consumption. Growth in goods exports should continue to be strong in the medium term, as base metal prices are expected to rise. Service exports should also recover driven by a recovery in diaspora-related tourism exports, as international travel restrictions are relaxed, and vaccination accelerates in Europe.

Economic growth is projected to remain over 4 percent in the medium term, but downside risks to the outlook are high. The projected outlook rests on the assumption of relaxed international mobility between Europe and Kosovo, no further strict local containment measures and a recovery in Euro Area growth. There is also potential for higher growth, including through faster implementation of IFI-financed public investment.

Fiscal deficit will remain elevated in 2021 projected at 5.1 percent of GDP, driven by fiscal stimulus measures and the disruption in the growth trajectory induced by the pandemic. Revenues are expected to recover as growth picks up. Fiscal stimulus aimed at supporting businesses and livelihoods should be fully executed in 2021, at about 3.2 percent of GDP.

The CAD should remain at 5.7 percent of GDP in 2021 and gradually improve over the medium-term. Goods exports should increase gradually, while imports also increase on the back of higher aggregate demand. The size CAD will be determined by the pace of remittance growth and recovery of diaspora-related tourism exports.

The pandemic has intensified the developmental gaps, hence progress on structural reforms, including improvements in the design and targeting of social protection spending and regulatory environment for businesses is vital in reversing the adverse economic and social impact of the pandemic and building resilience against future negative shocks.

TABLE 2 Kosovo / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices	3.8	4.9	-6.9	4.0	4.5	4.1
Private Consumption	5.3	1.6	-0.2	0.8	2.5	3.2
Government Consumption	8.9	9.6	4.8	2.1	-0.3	-1.0
Gross Fixed Capital Investment	6.1	6.8	-13.5	3.3	6.6	8.0
Exports, Goods and Services	2.2	7.5	-27.2	25.5	13.6	7.2
Imports, Goods and Services	8.9	3.3	-7.9	6.7	5.3	4.9
Inflation (Consumer Price Index)	1.1	2.7	0.2	0.7	1.0	1.3
Current Account Balance (% of GDP)	-7.6	-5.5	-5.7	-5.7	-4.9	-4.7
Net Foreign Direct Investment (% of GDP)	3.4	2.7	4.0	3.2	3.2	3.2
Fiscal Balance (% of GDP)	-2.9	-2.9	-7.6	-5.1	-3.1	-3.0
Debt (% of GDP)	16.3	16.9	22.3	24.9	26.5	28.2
Primary Balance (% of GDP)	-2.6	-2.6	-7.2	-4.6	-2.4	-2.2
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b}	23.0	21.0	24.9	23.2		

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate. f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2017-HBS Actual data: 2017. Nowcast: 2018-2019. Forecast: 2020-2021.

(b) Nowcast using neutral distribution (2017) with pass-through = 0.7 based on GDP per capita in constant LCU. Projection using sector-level GDP forecast for 2020 and 2021 with pass-through = 1