



Kosovo

Highlights

- **Economic growth continues at a robust rate.** Output growth in the first half of 2023 was led by a strong performance of service exports, driven by the tourism and information and communications technology (ICT) sectors.
- **The authorities have renewed engagement with the International Monetary Fund (IMF) under two disbursing programmes.** A two-year precautionary Stand-by Arrangement (SBA) is expected to provide liquidity in case downside risks materialise, while the Resilience and Sustainability Facility (RSF) will provide affordable financing to support Kosovo's climate change mitigation and adaptation efforts.
- **Kosovo has adopted an energy strategy and launched renewable energy auctions.** The energy strategy affirms that coal plants will be phased out by 2050 and includes plans to scale up renewable energy capacity significantly. Kosovo's first renewable energy auction for solar electricity generation was launched as one of the first steps.

Key priorities for 2024

- **Public investment should be accelerated.** As the authorities take steps to address bottlenecks in public investment management, including through structural benchmarks of the SBA with the IMF, there is space to step up investment, thereby boosting both short- and medium-term growth prospects.
- **Energy sector reforms and targeted support for vulnerable groups are needed to support the country's green transition.** Higher electricity tariffs and the elimination of blanket subsidies should be accompanied by a new definition of vulnerable energy consumers, enabling those most in need to receive support.
- **The recent increase in public sector wages should be accompanied by efficiency gains.** The authorities should improve the financial oversight and accountability of oversized and loss-making public enterprises, a key source of inefficiency.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	4.8	-5.3	10.7	5.2	3.5
Inflation (average)	2.7	0.2	3.3	11.7	4.7
Government balance/GDP	-2.9	-7.8	-1.2	-0.7	-2.3
Current account balance/GDP	-5.7	-7.0	-8.7	-10.5	-8.1
Net FDI/GDP [neg. sign = inflows]	-2.7	-4.2	-4.0	-6.2	-4.5
External debt/GDP	31.0	37.0	37.1	38.5	n.a.
Gross reserves/GDP	12.2	13.3	13.8	13.2	n.a.
Credit to private sector/GDP	42.0	45.5	43.5	40.4	n.a.

Macroeconomic developments and policy response

The economy has continued to grow in 2023, despite headwinds. Following an expansion of 5.2 per cent in 2022, supported by heightened external demand, gross domestic product (GDP) growth moderated to a robust 2.9 per cent year on year in the first half of 2023, reflecting continued favourable movements in the net export position. Diaspora-related (financial) inflows supported a 6 per cent increase in the retail and tourism sector and boosted service exports which grew by 19 per cent year on year in the first half of 2023, offsetting the contraction of goods exports. With moderate import growth, the net export position moved in a positive direction in the first half of the year. The current account deficit also narrowed by 23 per cent year on year in the first seven months of 2023 but remains elevated compared with the 2019-21 average. Household consumption growth remained positive (growing by 2 per cent year on year) despite persistently high inflation, helped by robust remittances (14 per cent of GDP in the first half of the year), double-digit credit growth to households and a long-awaited hike in public sector wages. Investments remained sluggish, however, reflecting a low level of public investment.

Fiscal measures to support the economy are becoming more targeted. Annual inflation reached 14.2 per cent in July 2022, driven by higher food and oil prices, gradually decelerating to 2.4 per cent in July 2023 before picking up again to 4.2 per cent in September. The energy regulator ended the freeze on electricity tariffs introduced in 2022 by approving an almost 15 per cent tariff increase, effective from April 2023. Meanwhile, the government scaled up subsidies for households that reduce their electricity consumption and for purchases of energy efficiency equipment. The coefficient for public sector wages was raised in February 2023, with the average salary in the public sector increasing by 15 per cent on the year the same month, while in July 2023 the parliament approved a minimum wage increase of 103 per cent for employees under 35 years of age, and an increase of 55 per cent for workers over 35. Public debt remains low, at an estimated 20 per cent of GDP at the end of 2022, allowing space for increased public investment, as envisaged under the SBA with the IMF.

Growth will continue in the short term, but downside risks are significant. GDP growth is forecast to reach 3.5 per cent in 2023, rising to 4 per cent in 2024. Downside risks to the outlook include stickier-than-expected inflation, lower-than-planned public investments and rising geopolitical uncertainty which may negatively affect domestic demand, trade flows, the availability of international funding and investor confidence.

Assessment of transition qualities (1-10)



Structural reform developments

Reform efforts have been somewhat stalled by rising political tensions related to the situation in northern Kosovo and the European Union (EU)-facilitated dialogue with Serbia. In response to the authorities' failure to take measures requested by the EU for a de-escalation in the north of Kosovo, the European Commission decided to take a number of "temporary and reversible" measures, including putting on hold the work of the Stabilisation and Association Agreement bodies and the programming of funds for the Instrument of Pre-accession Assistance (IPA) exercise in 2024 under the Western Balkans Investment Framework (WBIF). The Commission's measures also put on hold the signing of new contracts and suspended high-level meetings (other than those focused on addressing the crisis). In September 2023 the EU indicated that it could impose further measures on both parties if no progress was made in the de-escalation and implementation of the commitments under the Agreement on the path to normalisation between Kosovo and Serbia.

Public sector wage reforms are advancing. The main aims of the reforms are to create a uniform and transparent system of salaries and compensate for real wage losses. The law governing public sector wages was approved in parliament at the end of 2022, following a months-long strike by public sector employees. The legislation entered into force in February 2023, following a significant decrease in real wages in the public sector in the preceding two years.

Renewed engagement with the IMF is alleviating liquidity risks and supporting the greening of the economy. A €100 million two-year precautionary SBA, approved by the IMF Board in May 2023, is expected to provide liquidity in case downside risks materialise, including from Russia's war on Ukraine. The €78 million RSF, approved alongside the SBA, will in turn provide affordable financing for Kosovo's climate change mitigation and adaptation efforts, including through greener electricity production and more efficient energy use. It is also expected to act as a catalyst for other climate financing. Kosovo is the first European country to access the RSF.

A new energy strategy sets ambitious targets for renewable energy generation. The strategy for the 2022-31 period, adopted in March 2023, affirms that coal plants will be phased out by 2050 but envisages modernisation works on three coal-powered thermal power plant units, given that at present some 90 per cent of the country's electricity is produced from lignite. The country is planning to reach a total of 1.6 GW in renewable capacities (up from around 300 MW of existing capacity) by 2031, while a carbon pricing system is to be introduced by 2025. As one of the initial steps, Kosovo's first renewable energy auction for solar electricity generation was launched in May 2023 for 100 MW under a 15-year power purchase agreement with the national market operator, with an extended deadline for bids of the end of January 2024. Market integration with Albania is expected by the end of 2023, as the Albanian Power Exchange (ALPEX), which is now operational, was awarded nominal electricity market operator status in both countries in July 2023, paving the way for market coupling.

Kosovo is revising its policies on attracting foreign direct investment (FDI). The new Law on Sustainable Investment, which aims to accelerate investment into the country while ensuring an equal environment for foreign and domestic investors, passed the first reading in parliament in May 2023. The law foresees the establishment of a new agency within the prime minister's office, which will replace the Kosovo Investment Enterprise and Support Agency (KIESA) in functions related to FDI facilitation and export promotion, with a platform for public-private dialogue to be established within the agency.

A new sovereign fund will manage key public enterprises. A draft law establishing the sovereign fund passed first reading in parliament in July 2023. The five largest public enterprises (out of 18 in total), including the national telecommunications, railway, mining and postal companies, will be transferred to the fund, which will operate as an autonomous public institution under the Assembly. In an additional step to strengthen the management of public enterprises, the authorities have committed to publishing timely quarterly and annual financial reports on those enterprises under the ongoing SBA with the IMF.