

Kosovo Watch: Beyond GDP, economic momentum and a glimmer of political hope

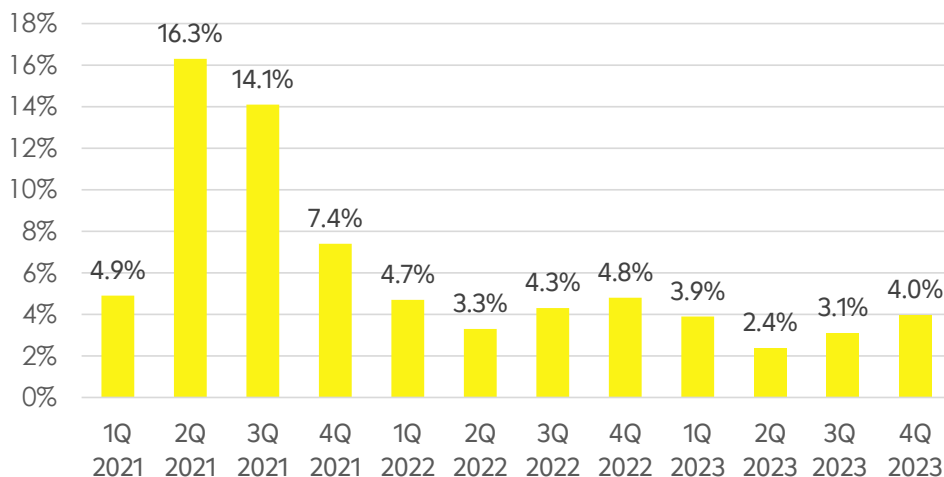
Kosovo's 2023 growth story centres on **robust domestic demand**, propelling a moderate **3.3% GDP rise**. But there's a glimmer of hope beyond economics. The CEC's decision to hold **elections** in Serb areas offers a chance to thaw tensions. Could this political step pave the way for a **brighter future** for Kosovo's economy?



Kosovo's Q4 Growth Surges, Matching Forecasts: Momentum Maintained

Kosovo's real GDP growth figures for Q4 2023, revealed a positive acceleration to **3.96%**. This outpaces the more modest gains observed in the preceding quarters (**2.4%** and **3.1%**) and aligns perfectly with our own forecast for the Kosovar economy (**3.93%**). This uptick represents a significant improvement and underscores the country's continuing economic **momentum**. However, for the entire year of 2023, GDP growth settled at a **moderate average of 3.3%**.

Real GDP growth recovered after two modest quarters



Source: ASK

Household Consumption Leads the Growth

Household consumption emerged as the **primary driver of growth**, expanding by an impressive **11.4% year-on-year (yoy) in real terms** in Q4 2023. This significant improvement follows a more modest **3.3% yoy growth** in the previous quarter, pointing to an acceleration of consumer spending in the last quarter of 2023. While a low base effect from the previous year cannot be discounted, other factors likely played a more prominent role. A key contributor appears to be the **deceleration of inflation**. Q4 2023 witnessed a welcome decline in average inflation to **2.8%**, compared to the elevated

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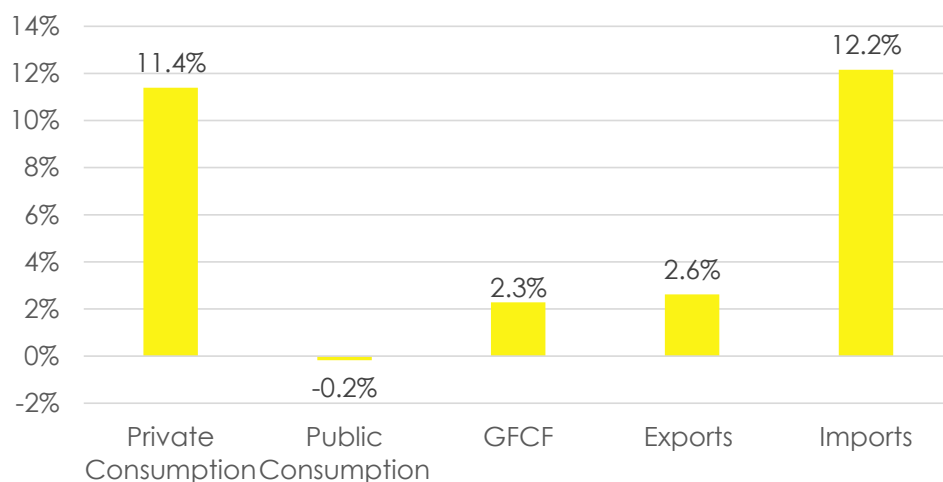
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11.6% experienced in 2022. This trend is projected to continue in 2024, with average inflation expected to fall further from **4.9% in 2023**. This moderation in inflation likely bolstered consumer confidence and disposable income, leading to the observed surge in private consumption.



Source: ASK

Gross capital formation also exhibited positive signs. It registered a growth of **2.3% yoy in Q4 2023**, decelerating from **3.5% yoy** of the previous quarter.

Net exports were the major drag on the economic activity subtracting **9.5%** to the real GDP in Q4 2023. Exports displayed lacklustre growth, expanding by **2.6% yoy** in Q4 2023, attributed primarily to two factors: a surge in travel-related exports by the Kosovar diaspora and the continued rise of the IT sector, which has now become the second-largest service export category. In contrast, exports of goods contracted into negative territory throughout 2023. Q4 2023 specifically witnessed a decline of **5.8% yoy**. Imports surged by **12.2% yoy** in real terms and together with Public consumption acted as detractors from overall GDP growth in Q4 2023. Public consumption exhibited a slight negative contribution to GDP in Q4 2023.

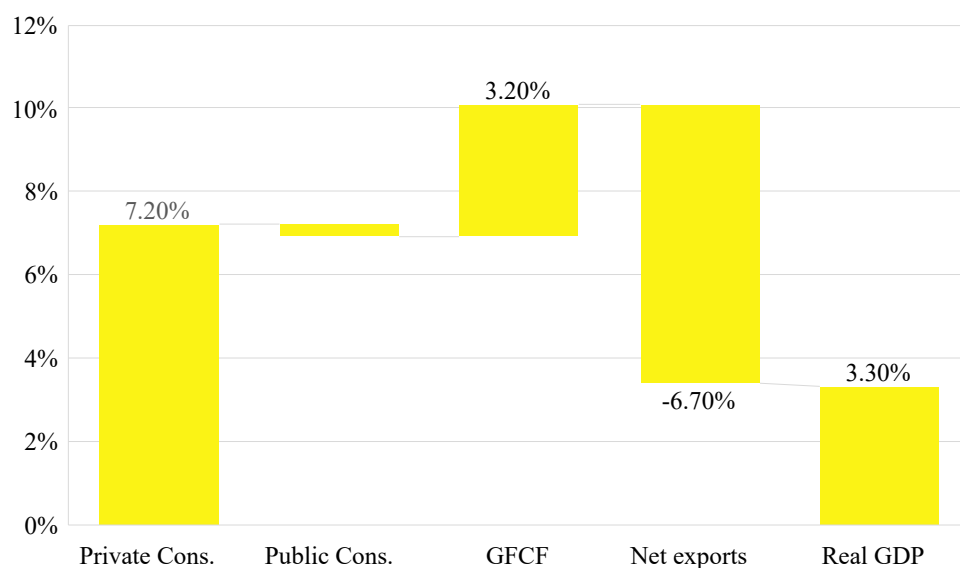
Kosovo's 2023 Growth: A Story of Domestic Strength and External Challenges

Overall, Kosovo's economic performance in 2023 was driven primarily by **robust domestic demand**. Household consumption, the largest expenditure component, contributed **7.2** percentage points, propelling overall growth. This surge in consumer spending can be attributed to two key factors. Firstly, lending activity witnessed exceptional growth (**17.3% in 2023 for household loans**). This expansion was likely fueled by a highly competitive lending market and moderate interest rate increases. Secondly, the labour market displayed positive dynamics, with a declining unemployment rate (**11.5% in Q1 2023 compared to 16.6% a year prior**) and an employment rate increase (**2.7% yoy**), alongside wage growth. Administrative data further confirms a 3.7% year-on-year rise in employed persons by November 2023. While official wage growth figures for 2023 remain unpublished, pressure for further increases is expected to persist in 2024.

Gross capital formation emerged as the second growth driver, contributing **3.2** percentage points. This can be linked to lower inflation and the support provided to the construction sector, which benefited from reduced costs.

Public consumption, however, delivered a slight negative contribution due to a consolidated fiscal policy. This strategy yielded positive results, closing the year with an

estimated fiscal deficit of **0.7% of GDP** and public debt at **17.2% of GDP** (down from **20% in 2022**).



Source: RBI/Raiffeisen Research

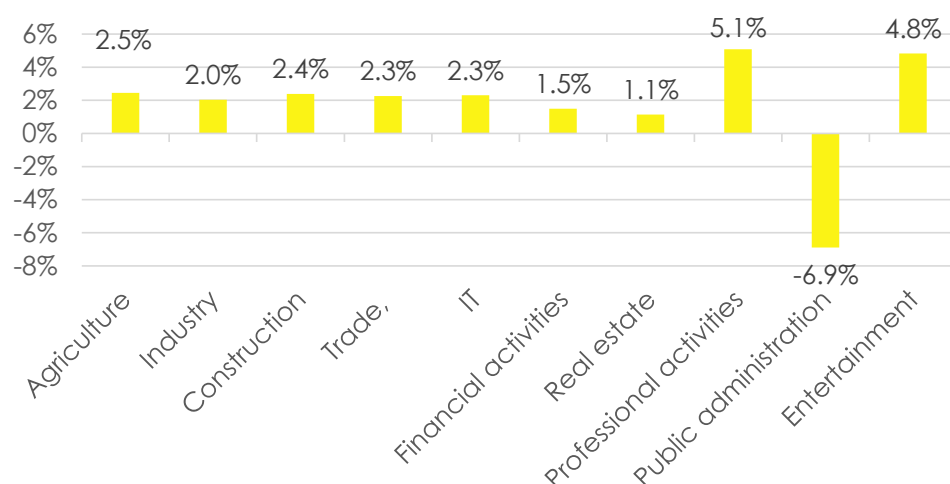
The external sector remains Kosovo's main **structural weakness**. Net exports negatively impacted real GDP growth by **6.7** percentage points. While exports of services grew, reflecting increased diaspora travel and IT exports, Kosovo persists as a net importer. Imports of goods, a significant portion of total imports, continue to drive the trade deficit, posing a major **hurdle for the economy's long-term growth**.

Most Sectors Expand, But Public Services Lag

Kosovo's economic expansion in Q4 2023 witnessed a broad-based increase across most sectors, with a notable exception. Public administration, education, and healthcare experienced a **6.9%** yoy decline, following a moderate **2.7%** yoy growth in the same quarter of 2022.

The services sector, the largest contributor to GDP, displayed mixed results. Professional and technical activities led the charge with a robust **5.1%** yoy increase, followed by entertainment activities at **4.8%** yoy. However, these sectors represent a smaller share of the overall GDP. Trade, the largest services subcomponent, recorded a more **moderate growth of 2.3%** yoy, while the broader services category exhibited similar or lower expansion rates.

Broad-based growth in Q4 2023



Source: ASK

The industrial sector exhibited signs of recovery, transitioning from negative growth in the previous two quarters to a **2.0%** yoy increase. Notably, manufacturing spearheaded this improvement with a **2.7%** yoy rise. Finally, the agricultural sector maintained its expansion trajectory, albeit at a modest **2.5%** yoy growth rate.

Kosovo's CEC Decision: A Glimmer of Hope for Reconciliation

Kosovo's recent political landscape has become even more **complex**. The Central Election Commission's (CEC) decision to hold votes on removing Albanian mayors in four Serb-majority municipalities in northern Kosovo, scheduled for April 21st aims to address a key **hurdle in the ongoing normalization** efforts between Kosovo and Serbia. However, it exists alongside other unresolved issues: **the controversial ban on the Serbian dinar and the stalled formation of a Community of Serb Municipalities**.

Following Kosovo's 2008 declaration of independence, tensions have simmered in the north, where a Serb majority resides. These tensions were further inflamed by the April 2023 local elections, which witnessed a mass boycott by Kosovo Serbs who deemed the process **illegitimate**. This resulted in the uncontested election of Albanian mayors, fueling resentment among the Serb population. Additionally, Kosovo's February 2024 **ban on the use of the Serbian dinar** in Serb-dominated areas has further **strained** relations. The stalled formation of a Community of Serb Municipalities envisioned in the 2013 Brussels Agreement as a mechanism for Serb minority self-governance, remains a **major point of contention**.

The CEC's decision to hold mayoral removal votes is a calculated attempt to create a more **inclusive** political environment in northern Kosovo. By offering the Serb population a chance to have their voices heard through voting, the CEC hopes to pave the way for future elections with broader participation. This move has received cautious support from the European Union (EU), which recognizes its potential to de-escalate tensions and create space for dialogue between Kosovo and Serbia.

The success of this initiative hinges on several factors. First, achieving a **50% plus one voter turnout** in each municipality is a significant hurdle. Second, Serbia's stance on both the CEC's decision and the dinar ban is crucial. While Serbia has not officially endorsed the vote, it has refrained from outright condemnation. This cautious approach suggests a potential willingness to engage in future dialogue with Kosovo, provided the elections

are conducted fairly and transparently, and the dinar issue and the Community of Serb Municipalities are addressed.

Beyond the immediate vote, the situation offers a **potential turning point for Kosovo-Serbia relations**. If the vote is successful and leads to inclusive elections, it could create a foundation for further dialogue on other issues. A recent visit by Gabriel Escobar, the US Deputy Assistant Secretary for European and Eurasian Affairs and Special Representative to the Western Balkans, further underscores the international community's commitment to facilitating progress on these issues. His discussions with Kosovar leaders and the Kosovan Serb community highlighted the need for inclusivity and a willingness to find common ground.

However, significant challenges remain. Overcoming historical mistrust and creating a genuine commitment to peaceful coexistence will require sustained effort from both sides. The international community, particularly the EU and the US, have a vital role to play in facilitating constructive dialogue and fostering a spirit of compromise, considering the **challenging geopolitical situation in Europe** and the forthcoming elections in the US and for the European Parliament.

The CEC's decision marks a bold step towards addressing the political **impasse** in northern Kosovo. While the path forward is fraught with challenges, it presents a **valuable opportunity** for both Kosovo and Serbia to demonstrate their commitment to reconciliation and a more peaceful future for the region. The success of this initiative will depend on a collective effort and a willingness to address the root causes of tensions, including the dinar issue and the formation of a Community of Serb Municipalities.

In conclusion, Kosovo's economic performance in 2023 demonstrated **robust domestic demand**, particularly driven by resurgent **household consumption** and a strengthening service exports sector. This momentum is expected to carry over into 2024, with our forecast predicting an upward **trajectory in GDP growth from 3.3% to 3.9%**. Continued growth in consumer spending fueled by a **recovering labor market and lower inflation are likely to be key contributors**. However, navigating this expected growth path won't be without challenges. Potential risks include **the emigration** of skilled workers, which could **hamper productivity** and long-term growth potential. Additionally, stalled progress in dialogue with Serbia could **negatively impact trade and foreign investment**. Finally, a significant rise in inflation could erode consumer purchasing power and dampen economic activity. However, recent efforts to hold mayoral votes in Serb-majority areas, led by the CEC, offer a **glimmer of hope** for improved regional cooperation, potentially bolstering future economic prospects.

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