

Kosovo Watch: Resilient economy in a delicate geopolitical moment

The meeting of March 18, which took place under the mediation of the EU between Kurti & Vucic, was advertised as the culmination of the efforts for a **final agreement towards the normalization of relations between Kosovo & Serbia**. However, in the end, no official signing occurred, although there is an understanding that **de-facto, both countries agree with this proposal**.



Source: Eurostat

Kosovo & Serbia inch closer to EU integration

The meeting of March 18, which took place under the mediation of the EU between Kurti & Vucic, was advertised as the culmination of the efforts for a final agreement towards the **normalization of relations between Kosovo & Serbia**. However, in the end, no official signing occurred, although there is an understanding that **de-facto, both countries agree with this proposal**. The agreement/non-agreement reached in Ohrid is considered an **integral part of the European path for Kosovo and Serbia**. EU will closely monitor its implementation. It does not specifically mention mutual recognition, but the document requires **both countries to accept each other's documents and symbols**, including passports, diplomas and license plates.

The parties agree to establish a Joint Monitoring Committee, chaired by the EU, within 30 days. The implementation of all provisions will be ensured and supervised by the Joint Monitoring Committee. **EU will organize a donor conference within 150 days** to create a package of **investments and financial assistance for Kosovo and Serbia**. No distribution will occur before the EU determines that all provisions of the Agreement have been fully implemented. "Kosovo and Serbia acknowledge that non-compliance with their obligations from the Agreement, Annex or past Dialogue Agreements **may have direct negative consequences for their respective EU membership processes and for the financial assistance they receive from the EU.**"

Economy coped relatively well with the food and energy prices shock in 2022

Economic activity accelerated further in **Q4 2022, reaching 3.6% yoy** compared to **3.3% yoy growth in Q3**. This growth rate proved to be higher than our projection for a sluggish economic growth activity of only **2.1% in Q4, reflecting a stronger resilience of the private sector** than originally expected. Coupled with the upward revision of the GDP figure in Q2 (+0.8%), **GDP growth for a whole year was 3.5% yoy**, higher than **our last forecast of 3.0%**.

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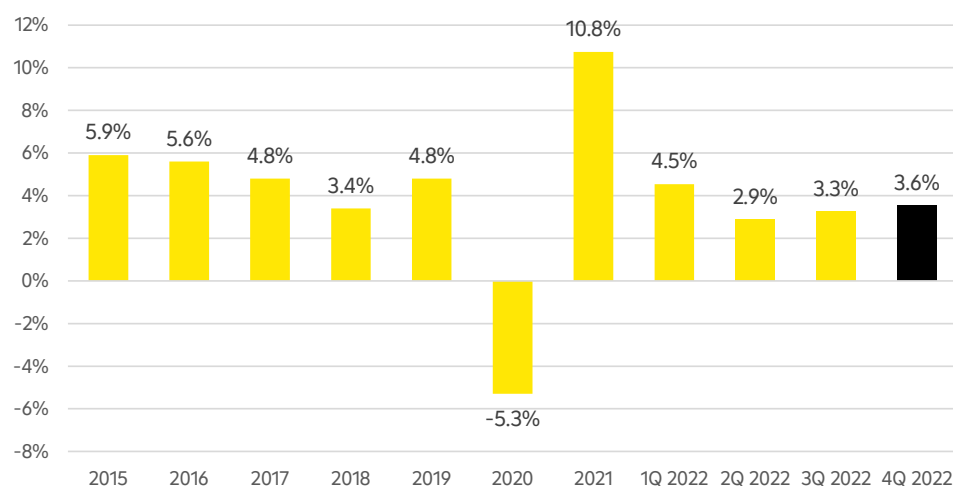
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Economic growth clouded by high inflation



Source: ASK, RBI/Raiffeisen Research

Household consumption impacted by high food and energy prices

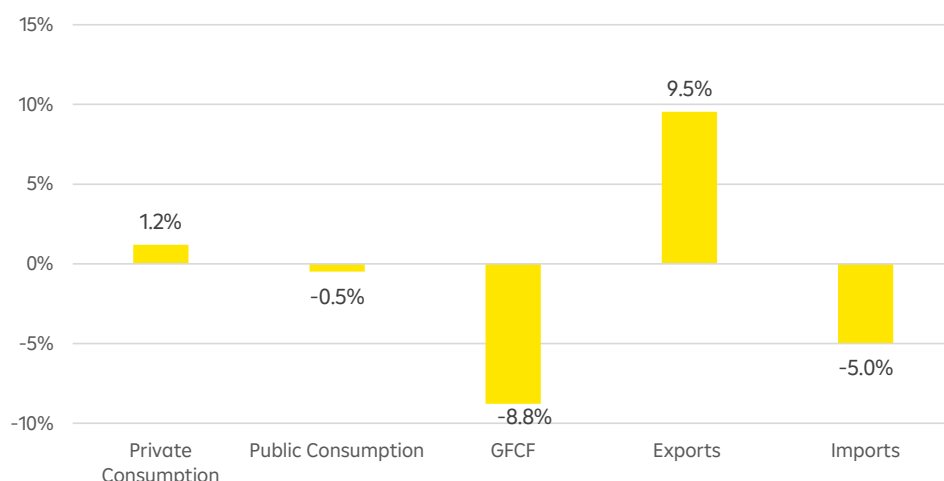
The GDP growth of Q4 2022 was **driven by net exports**, while **household consumption**, which is the main component of GDP, increased by **only 1.2% yoy**, slowing down from **3.8% yoy** in the previous quarter. It was adversely affected by the elevated consumer prices.

Net exports contribution was substantial in GDP growth, as imports of goods and services for the first time since the pandemic period dropped into negative territory (**-5.0% yoy**) in **real terms**, while **exports of goods and services expanded almost by a double-digit rate of 9.5% yoy**.

The Disappointing contribution came from the **gross capital formation**, which remained in **negative territory for the third quarter in a row with a drop of 8.8% in Q4**, as private and public investments have been restrained due to pessimistic economic sentiment and significantly increased construction costs. In Q4 2022, the **construction cost index** increased by **16.7% yoy**, although it has gradually slowed down compared to previous quarters' growth rate of 19.5%-24.6% yoy.

In addition, the **government almost halved the capital expenditures** in 2022 compared to 2021, as it was more active in supporting citizens by introducing anti-inflationary financial handouts. Nevertheless, public consumption had almost a muted impact on GDP growth as it **dropped slightly by 0.5% yoy**.

Investments feeling the pinch of uncertainty in Q4 2022



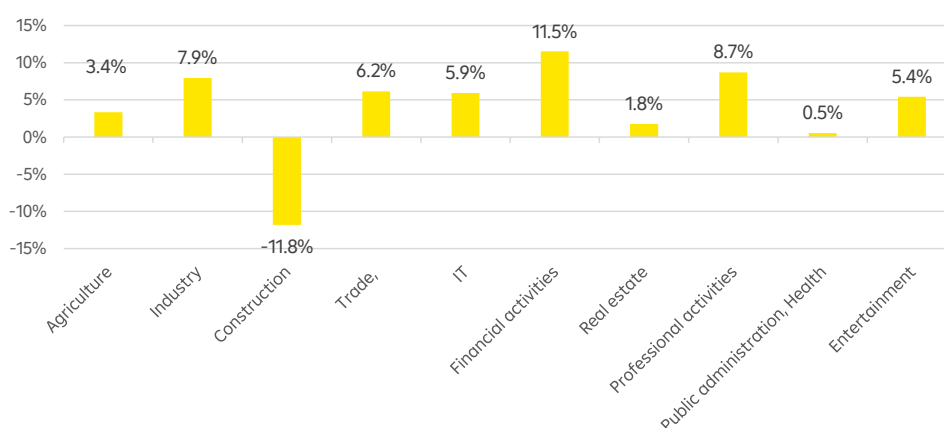
Source: ASK

Construction, the only sector dragger of economy

Services, the largest contributor to GDP, was also the main driver of GDP growth in the last quarter of the year. All services categories indicated substantial growth, starting with Finance and Insurance activities, which increased by a **double-digit of 11.5% yoy**, followed by Professional and science activities with an 8.7% yoy increase. **Trade and tourism-related activities grew by 6.2%**, IT and communication by 5.9%, and Entertainment by 5.4%.

In addition, the **industry jumped by 7.9%** despite the energy issues the economy faced, especially manufacturing, which climbed by 12.5% yoy. **Agriculture** also contributed positively, with an **increase of 3.3%** on a yearly basis. The only sector that marked a **drop** in the last quarter was **Construction**, with a **double-digit decrease of 11.8% yoy**.

Construction the only industry in red in Q4 2022



Source: ASK

Upside risks for GDP growth in 2023

To sum up, despite the economy faced significant risks from high **inflation (11.6% yoy on average in 2022)** and energy price shock, it showed resilience with a satisfying **growth rate of 3.5% yoy in 2022**.

Relatively high **inflationary pressures are expected to persist** at least in the first part of the year, which will continue to **dent the private consumption demand**. However, on the other side, fiscal policy is expected to be **expansionary**, with increases in public

investments and higher wages. Thus, there are **upside risks to our GDP projection of 2.9% for 2023.**

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