

Summary

The economy of euro area has marked a slowdown increase of economic activity in 2019. Only in Q4 2019, based on the preliminary data of Eurostat, economic activity marked an increase of 1.0 percent. In line with the slowdown economic activity has moved also the inflation trend (1.0 percent). Whereas, in the Western Balkan countries, the economic activity growth of 4.3 percent marked in Q3 2019 was the same as in Q3 2018.

According to the estimates of Kosovo Agency of Statistics (KAS), real GDP growth rate marked an average increase of 4.3 percent until September 2019, which basically was supported by the recovery of net exports. Due to the lack of official data for Q4 2019, being relied on other more frequent published indicators, the economic growth during this quarter is estimated to have been weaker compared to other previous quarters of 2019. These estimates are supported by not so favorable developments in the external sector (the decline of export of goods and services, and the decline of FDI, the accelerating increase of imports, etc.) and the decline of new consumer and investment loans.

The price level of consumption until December 2019 increased by 2.7 percent, mainly as a result of the increase of food prices. Core inflation, marked an increase of only 0.3 percent or 2.3 percentage points lower compared to the general inflation.

Fiscal sector was characterized with an increase of revenues with 7.5 percent and an increase of budgetary expenditures of 7.2 percent, during the year of 2019. Kosovo's budget recorded a primary budget deficit of EUR 168.4 million (a deficit of EUR 162.7 million marked in the same period of 2018).

As a percentage to GDP, the primary budget deficit reached 2.3 percent (2.4 percent it was in 2018). Public debt, at the end of 2019 reached EUR 1.2 billion, which is for 9.9 percent higher than the public debt marked in 2018. As a percentage to GDP, public debt reached 17.5 percent from 17.1 percent as it was in 2018.

Financial system during Q4 2019 marked an increase of EUR 243.2 million, which primarily is attributable to the banking sector and pension sector. The banking sector increased its activity being supported by the high level of deposits, which represent the main source of financing the credit activity. Collected contributions and the positive return from investments were reflected on the good performance of the pension sector. Insurance sector was characterized with a negative performance, despite the increase of the value of written premiums, whereas the microfinance sector marked a slowdown increase of its activity, as a result of the slowdown of credit activity, peculiarly for loans to households.

The external sector was characterized with a decline of the current account deficit of 23.0 percent. The decline of the current account deficit is attributed to the increase of the positive services balance, of the primary and secondary income account while the deficit of goods marked a slowdown increase. Within the balance of payments, remittances were characterized with an increase of 6.4 percent, while Foreign Direct Investments (FDI) marked a decline of 2.1 percent.

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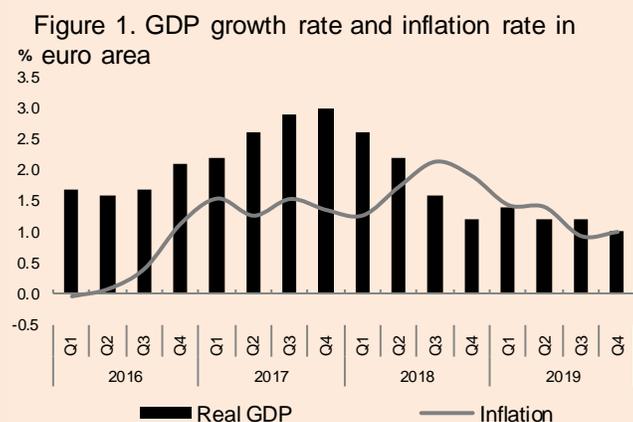
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ABBREVIATIONS

KAS	Kosovo Agency of Statistics
GDP	Gross Domestic Product
CBK	Central Bank of the Republic of Kosovo
SEE	Southeastern Europe
EUR	Euro currency
IMF	International Monetary Fund
CPI	Consumer Price Index
FDI	Foreign Direct Investments
IPI	Import Price Index
MF	Ministry of Finance of the Republic of Kosovo
REER	Real Effective Exchange Rate
WEO	World Economic Outlook

Euro area and Western Balkans

Based on the European Union Statistics Agency (Eurostat) preliminary data, in Q4 2019, euro area economy marked an annual increase of 1.0 percent, representing a slightly lower increased rate compared to the growth of 1.2 percent marked in Q4 2018 (figure 1).



This slowdown of economic activity has been impacted by certain factors: consistent weaknesses of global trade, a slowdown of economic growth marked in China, geopolitical uncertainties, problems regarding Brexit, etc. Such dynamics, which directly affected the business confidence, are expected to have consequences on the dynamics of the economic activity also in the mid-term period

In line with the slowdown of economic activity, also the inflation rate was lower compared to the same period of 2018. The average of the Harmonized Index of Consumer Prices in euro area during Q4 2019 was 1.0 percent (1.9 percent in Q4 2018) (figure 1). As a result

of the low level of inflation, in September 2019, the ECB Supervisory Committee has decided to keep unchanged the interest rate on main refinancing operations (0.0 percent), the interest rate on credit and deposits facilities (0.25 percent and -0.50 percent, respectively).

Credit and depository activity in euro area continued to increase, by which were characterized enterprises and households as well. Loans to enterprises marked an increase of 2.9 percent, while loans to households expanded by 3.2 percent. Conversely, deposits of the banking system have marked a further increase reaching a growth rate of 5.6 percent for enterprises and 5.5 percent for households.

Economic activity, also in the Western Balkans, in Q3 2019¹ has marked a similar average increase as in Q3 2018 (on average 4.3 percent). Serbia, Kosovo and North Macedonia were characterized with an accelerated increase, while Serbia and Montenegro marked a slowdown increase compared to Q3 2018 (table 1).

Table 1. Real GDP growth rate

Description	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1	2019 Q2	2019 Q3
Serbia	5.0	5.0	4.2	3.5	2.7	2.9	4.8
Montenegro	4.8	5.2	5.3	4.9	3.0	3.2	4.7
Kosovo	2.9	4.4	3.8	4.1	4.2	4.1	4.4
Albania	4.3	4.3	4.7	3.3	2.6	2.5	3.8
North Macedonia	0.9	3.0	3.0	3.7	4.1	3.1	3.6

Source: National Statistics Offices of the respective countries

In Q4 2019, the average inflation rate of 1.0 percent was lower compared to the inflation rate of 1.7 percent marked in Q4 2018. The lower inflation rate were present in all the the countries besides Albania, where the inflation rates were higher (table 2).

¹ The data for Q4 2019 have not been published yet, whereas for Bosnia and Herzegovina the data were not published since Q2 2018.

Table 2. Annual inflation rate

Description	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1	2019 Q2	2019 Q3	2019 Q4
Kosovo	0.0	0.7	1.4	2.2	3.2	3.3	2.6	1.7
Montenegro	3.7	3.7	2.4	1.7	0.4	0.5	-0.1	1.1
North Macedonia	1.5	1.5	1.6	1.2	1.2	1.2	0.6	0.0
Serbia	1.6	1.8	2.4	2.0	2.4	2.3	1.3	1.5
Albania	1.6	1.9	2.1	1.5	2.0	1.5	1.5	1.6

Source: National Statistics Offices of the respective countries

Regarding the developments in the banking sector, almost in all of the countries was marked a slowdown increase in lending, with the exception of Albania where it was marked an increase of 7.1 percent (-3.2 percent in Q4 2018). In Q4 2019, the average increase of loans (with the exception of Albania) was 7.1 percent (8.8 percent in Q4 2018). Countries which marked the lowest credit growth rates were Montenegro and Bosnia and Herzegovina (4.5 percent and 5.9 percent, respectively), while Kosovo and Serbia were characterized with higher rates compared with other countries (10.0 percent and 9.1 percent, respectively).

Conversely, deposits marked an accelerating increased rate. In Q4 2019, the average increase rate of deposits was 8.2 percent (7.1 percent in Q4 2018). In Kosovo and Serbia it was marked a higher increased rate of deposits and loans (16.2 percent, and 10.9 percent, respectively), followed by North Macedonia Herzegovina with 9.5, Bosnia and Herzegovina with 8.4 percent, etc.

During 2019, EUR appreciated against the Turkish lira with 10.4 percent, whereas it was depreciated against other major currencies and also against the currencies of the region. EUR was depreciated against U.S. dollar with 5.2 percent, Swiss franc with 3.7 percent, Albanian lek with 3.6 percent, British pound with 0.8 percent and Serbian dinar with 0.4 percent.

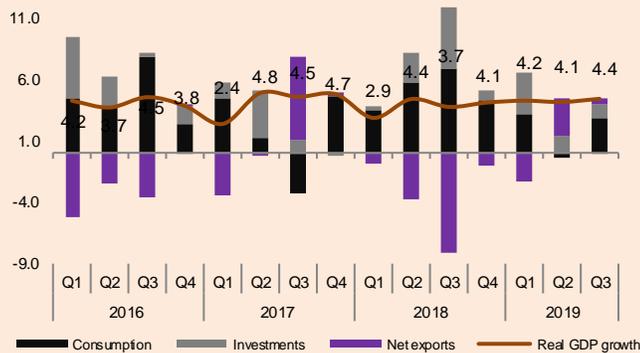
Kosovo's Economy

Real Sector

According to the quarter data of KAS, economic activity has marked an average increased rate of 4.3 percent until September 2019 compared with the same period of 2018 when it had been marked an increase of 3.7 percent. The highest increase was marked by financial and insurance activities (14.7 percent), followed by the processing industry (7.2 percent), construction (6.8 percent) and trade (6.2 percent).

Based on the expenditures approach, an accelerated increase of economic activity came mainly as a result of the positive contribution of net exports with 0.6 percent (-4.7 percentage points in the same period of 2018). Also the domestic demand gave a positive contribution with 1.8 percentage points, while in the same period of 2018, the contribution of the domestic demand was significantly higher (4.2 percentage points) (figure 2).

Figure 2. Real GDP growth rate and main contributors to the growth



Source: KAS (2020) and CBK calculations

Until September 2019, new consumer loans marked a decline of 3.3 percent, thus having an impact on the slowdown of consumption increase. Besides the decline of consumer loans also other financing sources such as

compensation of employees and expenses for salaries in the public sector were characterized with a slowdown increase, whereas remittances marked an accelerated increase. Despite the FDI increase of 15.1 percent, the decline of public investments for 12.7 percent has had an impact on the slower increase of overall investments. Conversely, the slowdown of the increase of domestic demand affected the decline of import, while export has marked an accelerated increase. This has made net exports to mark a lower trade deficit with around of 2.4 percent on real terms.

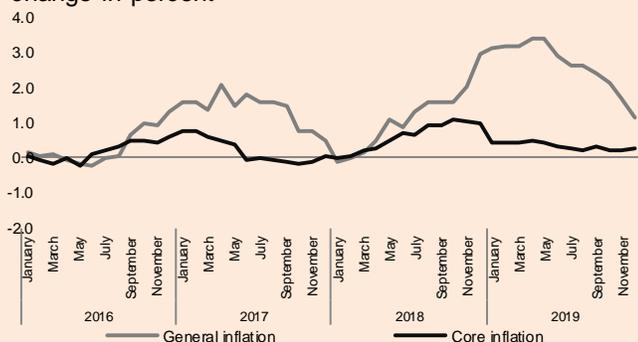
Due to the lack of official KAS data for GDP for the period of Q4 2019, being relied on other more frequently published indicators, the CBK has estimated that the economic growth during this quarter is expected to be weaker compared to other previous quarters of 2019. These estimates are supported by not so favorable developments in the external sector, which was characterized with a decline of export and an accelerating increase of import of goods. In addition, also new consumer loans and investment loans marked a decline.

Prices

Consumer Price Index (CPI) marked a significant increase since the last quarter of 2018 and has continued with the same increasing trend also in 2019 (figure 3).

Until December 2019, the average increase of consumer prices was 2.7 percent (1.1 percent in the same period of 2018).

Figure 3. General inflation and base inflation, annual change in percent



Source: KAS and CBK calculations (2020)

This price increase was more emphasized in food prices and non-alcoholic beverages, which contributed with 2.15 percentage points in the overall inflation, followed by alcoholic beverages and tobacco prices with 0.16 percentage points, and prices of transport with 0.13 percentage points (table 3).

Table 3. Contribution of specific categories to overall inflation

Description	Weight 2019	Inflation rate	Contribution
<i>Total</i>	100.0%	2.7	2.67
Food and non-alc. beverages	40.0%	5.4	2.15
Alcoholic beverages and tobacco	5.6%	2.6	0.16
Footwear and clothing	3.9%	0.2	0.01
Energy	7.7%	0.1	0.01
Furnishing	7.9%	1.2	0.09
Health	2.5%	0.7	0.02
Transport	15.4%	0.8	0.13
Communication	3.7%	0.2	0.01
Recreation	4.4%	0.3	0.01
Education	1.0%	-0.7	-0.01
Hotels	3.1%	1.4	0.04
Goods and other services	4.9%	1.5	0.04

Source: KAS and CBK calculations

Since the Kosovar consumer basket is characterized with a very high share of products with seasonal fluctuations of prices (food, energy, alcoholic beverages and tobacco), the exclusion of these components makes the core inflation to be more stable (figure 3). Until

December 2019, core inflation stood at 0.3 percent, which resulted to be lower for 2.3 percentage points than the overall inflation.

Due to the high dependence of Kosovo's economy on import, the dynamic of Kosovar consumer basket is mainly determined by import price fluctuations, which until September 2019 marked an average increasing rate of 3.2 percent, which to some extent is a higher level compared to the consumer price index. Besides import prices, also producer prices were characterized with an increase which stood at 1.2 percent, albeit this rate was significantly lower compared to import prices.

Fiscal Sector

Budgetary revenues² in 2019 reached a net value of EUR 1.89 billion, representing an annual increase of 7.5 percent, while budget expenditures³ reached the value of EUR 2.06 billion, representing an annual increase of 7.2 percent. Consequently, Kosovo's budget recorded a primary budget balance of EUR 168.4 million compared to the budget balance of EUR 162.7 million in 2018. As a percentage to GDP, the primary budget deficit reached 2.3 percent (2.4 percent in 2018).

Within tax revenues, it was observed a higher increase of direct tax revenues which reached the value of EUR 292.3 million (an increase of 9.3 percent). Indirect budget revenues reached a value of EUR 1.42 billion or 5.3 percent more compared with 2018. Indirect tax revenues are primarily related to import of goods and comprise around 74.9 percent of total budget revenues. With a higher increasing rate were characterized non-

² Within the primary income were not included the revenues from borrowings, income from privatization, receipts of donor defined grants and receipts from deposits in trust.

³ Within budget expenditures are not included debt payments, membership payments at International Financial Organizations (IFO), and returns from deposit funds.

tax revenues, which reached a value of EUR 226.6 million or 17.5 percent more compared with 2018.

This slower increase of budget expenditures was a result of the delay of budget approval for 2019, undertaken by Kosovo's Assembly. The main category which contributed to the slower increase of budget expenditures was the one of capital expenditures which were for of the same level as in 2018 reaching EUR 530.8 millions. Other categories of budget expenditures were characterized with increase. Government expenditures on salaries marked an increase of 4.1 percent and reached a value of EUR 615.9 million. Government expenditures on goods and services (including municipal utilities) marked an increase of 17.5 percent, reaching a value of EUR 293.9 million. Subsidies and transfers increased by 12.4 percent and reached the value of EUR 627.3 million.

Public debt, in 2019 reached EUR 1.2 billion which is for 9.9 percent higher than the public debt marked in 2018. As a percentage to GDP, public debt reached 17.5 percent from 17.1 percent as it was in 2018. This increase of public debt in Kosovo is attributed to the growth of domestic debt with 17.0 percent (which reached EUR 791.9 million), while public external debt declined with 1.8 percent, reaching EUR 408.8 million in 2018. The share of public external debt to total public debt decreased to 34.0 percent from 38.1 percent as it was 2018. Despite the growth, this debt level is still far from the threshold of 40 percent set by the law, and also ranks Kosovo in the position of the country with the lowest level of public debt compared to the region countries.

Financial Sector⁴

Assets of financial system continued to increase also in the last quarter of 2019 reaching the value of EUR 7.2 billion in December. The increase of the activity of the financial system, in Q4 2019, was enabled mainly by the banking and pension sectors, which at the same time have a higher weight to total assets of the system. The banking sector, in Q4 2019, expanded primarily being supported by the higher level of collected deposits, which represent the main source of financing the credit activity. During Q4 2019, lending to nonfinancial corporations marked a significant increase compared to lending to households.

Also in Q4 2019, the performance of the banking sector was satisfactory, generating a net profit of a value of EUR 20.6 million. However, compared to the same period of the previous year, the banking sector has marked a decline of the profit as a result of the income decline (mainly from non-interest), while the level of incurred expenditures has remained almost the same. The indicators of credit portfolio also in Q4 2019 were of a satisfactory level, with low level of nonperforming loans and an increase of coverage level of provisions. Moreover, also the indicators of solvency and liquidity stand above the minimal level as recommended by the regulations, which show that the trade is well capitalized and liquid.

The pension sector, as the second sector by the weight of importance in the financial system, during this quarter continued to have an increase of assets, mainly as a result of collected contributions and positive return on investments. The assets structure of pension

⁴ For more information on financial sector, please refer to: Quarterly Assessment of Financial System (Q4 2019) published at the CBK website.

sector mainly consists of assets invested abroad (75.2 percent) and assets invested in the country, namely in securities and deposits certificates (23.3 percent).

Insurance sector during this quarter was characterized with a negative performance, despite the increase of the value of written premiums. Similarly as the written premiums, also the claims paid by sector marked an increase, consequently resulting in a negative performance during this period. The higher loss realized compared to the previous quarter was as a consequence of the higher increase of claims (paid and incurred claims) along with the increase of written premiums.

Microfinance sector was characterized with a slower increase of its activity in Q4 2019, compared to the same period of the previous year, as a consequence of the slower increase of lending, especially for households. The sector realized a quite high level of net profits in this quarter, while the level of loans with problems at the end of the period (December 2019) has marked an increase compared to the previous period (December 2018), albeit remains at quite low levels and well provisioned.

In the securities market, the amount of the debt issued by the Kosovo's Government reached the value of EUR 40 million, which is significantly lower than in Q4 2018. This is a consequence of the lower demand of the Government, as the the supply of the main participants of the securities market exceeded the amount that was demanded.

External Sector

In 2019, the current account deficit amounted to EUR 391.8 million, which is for 23.0 percent lower compared to 2018. Narrowing of the current account deficit is attributable to the increase of the positive balance of services, primary income and secondary income and also of the slowdown of the increase of the deficit of goods (figure 4).

Figure 4. Current account deficit and its components, In millions of EUR



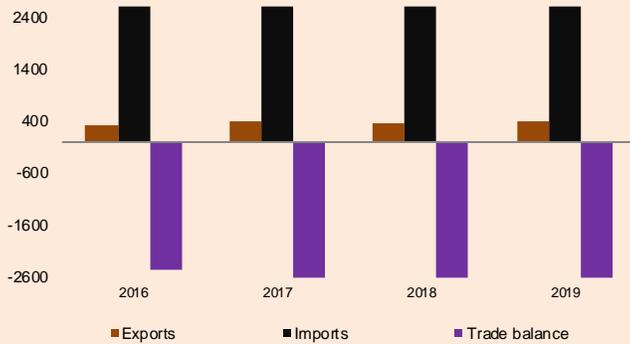
Source: CBK (2020)

The deficit in goods⁵ account reached the value of EUR 3.1 billion in 2019, representing an annual increase of 4.5 percent (an increase of 11.6 percent in 2018). This slower increase of the trade deficit of goods was due to the increase of export of goods and the slow increase of import, unlike in 2018 when it was marked a decline of export of goods and an accelerated increase of import.

The export of goods reached a value of EUR 383.5 million, marking an annual increase of 4.4 percent (-2.8 percent in 2018) (figure 5).

⁵The source of data for import and export of goods in Kosovo is Kosovo Agency of Statistics.

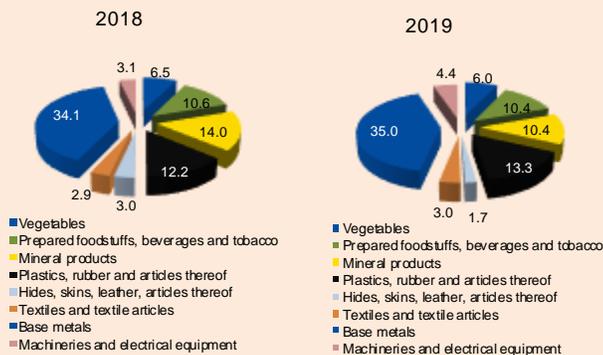
Figure 5. Export and import of goods, in millions of EUR



Source: KAS (2020)

The increase of export of goods was more significant in base metals, products of plastics and rubber, and machinery and electrical equipment. Conversely, a decline was marked by export of mineral products, leather and articles thereof etc. (figure 6).

Figure 6. Structure of exports by category, in percent

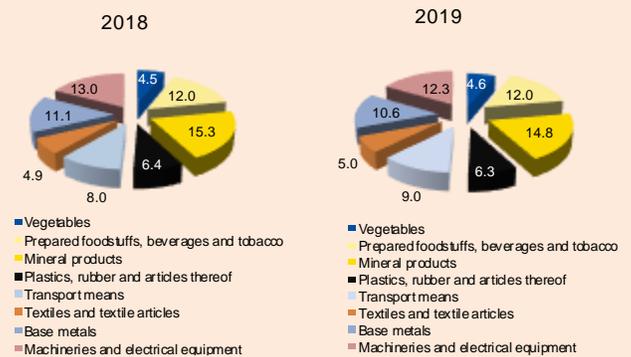


Source: KAS (2020)

The value of import of goods reached EUR 3.5 billion, which was for 4.5 percent higher compared to the previous year, while in 2018 it had been marked an increase of 9.8 percent. The slowdown increase of import of goods was affected mainly the low level of import of machinery and mechanical equipment and the import of base metals, while a higher increase was

marked in import of transport means, import of food stuff, import of textile and articles of it, etc. (figure 7).

Figure 7. Structure of imports by category, in percent



Source: KAS (2020)

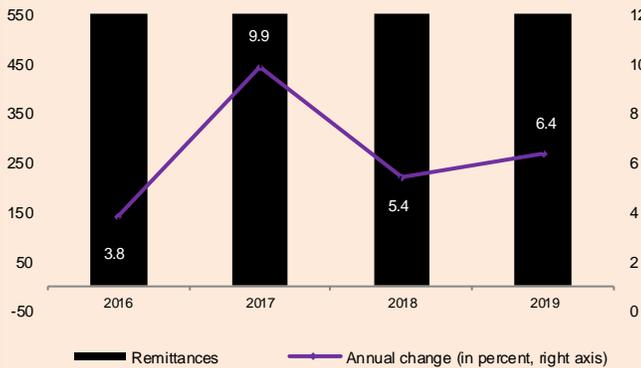
The balance in trade of services marked a value of EUR 932.3 million, representing an increase of 8.9 percent compared to 2018. The value of total exported services marked an annual increase of 7.3 percent, reaching EUR 1.68 billion, while the value of imported services marked an increase of 5.4 percent, reaching a value of EUR 743.9 million.

The balance of the primary income account marked a value of EUR 153.6 million, representing a growth of 35.9 percent. The balance of secondary income reached a value of EUR 1.36 billion which is for 8.1 percent higher compared 2018. The higher level of the balance of secondary income is attributable mainly to the higher level of remittances. Remittances received in Kosovo marked a value of EUR 851.9 million, which is for 6.4 percent higher compared to 2018 (figure 8).

Remittances received in Kosovo mainly come from Germany and Switzerland, which represent the countries with a share of 40.6 and 20.2 percent, respectively, of total remittances. A considerable amount of remittances was received also from the

U.S.A, namely 7.0 percent of total remittances received in Kosovo.

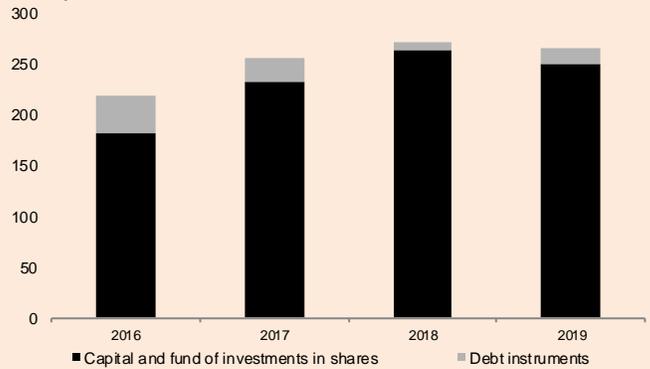
Figure 8. Remittances, in millions of EUR



Source: CBK (2020)

Financial account of the balance of payment marked a value of -185.3 million which is for 44.8 percent lower compared to 2018. The narrowing of the negative balance of financial account was mainly as a result of investments abroad, such as portfolio investments or direct investments. Also liabilities within the financial account marked an increase (16.6 percent), where the increasing rate was lower compared to assets increase. Within the financial account, FDI in Kosovo reached a value of EUR 266.5 million which is for 2.1 percent lower compared to 2018. Within FDI structure, capital and investments fund in shares reached the value of EUR 250.7 million marking an increase of 4.8 percent, while FDI in the form of debt instruments marked a value of EUR 15.8 million (EUR 8.8 million in the same period of 2018) (figure 9).

Figure 9. Structure of foreign direct investments by components, in millions of EUR



Source: CBK (2020)

The decline of FDI was recorded mainly in the construction and in the trade services sector, whereas the real estate sector, the industry sector and the financial services sector marked an increase. Regarding the origin of FDI, Germany represents the country from where came the majority of FDI (EUR 72.5 million), followed by Switzerland with EUR 61.9 million, the U.S.A with EUR 21.0 million, Albania with EUR 18.3 million, etc.

The suggested citation of this publication:

CBK (2020): Quarterly Assessment of Macroeconomic Developments No. 29 Q4 2019, Central Bank of the Republic of Kosovo

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Macroeconomic selected indicators

Description	December 2018	December 2019
Real sector 1/		
Gross Domestic Product (GDP) (in millions of EUR)*	4,936.3	5,212.7
Consumer prices (annual average)	1.1%	2.7%
Consumer prices (end of period)	2.9%	1.1%
Fiscal Sector* 2/		
Budget Revenues (in millions of EUR)	1,756.6	1,888.6
Budget Expenditures (in millions of EUR)	1,919.3	2,057.0
Primary balance (in millions of EUR)	-162.7	-168.4
Financial sector (in millions of EUR) 3/		
Assets of financial corporations	6,316.1	7,249.5
of which : Banks	4,185.5	4,755.7
Loans	2,755.5	3,031.9
Deposits	3,362.9	3,908.1
<i>Interest Rates on Loans, end of period</i>	6.0%	6.4%
<i>Interest Rates on Loans, end of period</i>	1.5%	1.6%
Interest rate gap	4.5%	4.8%
External sector*,(in millions of EUR) 3/		
Balance of payments		
Current and capital account	-519.9	-400.0
of which: remittances	800.5	851.9
Financial account	-335.5	-185.3
Foreign Direct Investments in Kosovo	272.1	266.5
Portfolio investments, net	-199.9	59.0
Other investments, net	3.4	-138.7
International Investment Position (PNI), net*	-126.5	-299.6
Assets	5,005.8	5,185.2
Liabilities	5,132.2	5,484.8
External debt, total*	2,103.4	2,150.6
Private external debt	1,608.6	1,651.7
Public external debt	494.8	498.8

Source:

1/ KAS (2020).

2/ MF (2020).

3/ CBK (2020).

*Data on GDP, IIP and external debt are as of September 2019.

