

## Summary

Consequences from facing with COVID-19 pandemic were reflected in a decline of the economic activity in euro area in the first and second quarter of 2020. In Q3 2020, by opening the economy and easing the measures, euro area economy started a recovery where the quarterly economic growth reached 12.7%, while compared to the same period of 2019 the activity is estimated to have declined by 4.3%. The economic and social crisis was reflected also on the dynamics of the prices in euro area, while the inflation rate reached 0.0%. With an economic crisis is being faced also the Western Balkans, where, only in Q2 2020 was estimated to have been marked an economic decline of 11.8%, while the recent forecasts of IMF suggest a decline of the economic activity of 6.9% in 2020.

Based on KAS estimates, real GDP marked a decline of 4.6% in the first half of 2020. With a decline were characterized investments and net exports, whereas consumption was estimated to have marked an increase. Despite the opening of the economy, in the third quarter of 2020, the declining trend of the economy was estimated to have continued further. The estimates were supported by the decline of services exports, the decline of capital expenditures of the government, the decline of FDI, etc.

Consumer prices marked a decline of 0.4% in Q3 2020, mainly as a consequence of the decline of transport prices, recreation, furnishings, footwear and clothing, energy, etc. The slowdown increase of prices was marked also by the prices of food and non-alcoholic beverages, thus making the base deflation reach 0.9%.

Fiscal sector, during Q3 2020, was characterized with a decline of budget revenues of 13.5% and an increase of budget expenditures of 11.1%. Consequently, Kosovo's budget recorded a primary budget deficit of EUR 86.4 million. Public debt reached EUR 1.3 billion, which is for 12.2% higher compared to Q3 2019. As a percentage to GDP, public debt reached 19.9%, from 17.4%, as it was in Q3 2019.

Assets of financial system increased by EUR 258.8 million in Q3 2020, mainly being impacted by increase of the banking sector and pension sector assets. Assets increase of the banking sector is mainly attributable to the high level of deposits collected in this quarter, which at the same time presents the main financing source of the banking activity. While, the expansion of assets of the pension sector came as a result of the collected contributions and return on investments. Insurance sector was characterized with a slower increase of its activity. The premiums level marked a slight increase, while the value of claims paid and claims incurred was significantly higher. At the same time, microfinance sector marked a significant slowdown of the activity increase, and a lower financial performance compared to the previous period.

In Q3 2020, external sector was characterized with a deficit of the current account of EUR 90.9 million, which is attributable to the significant decline of the positive balance of services. On the other side, the deficit of goods was lower, while the positive balance of primary and secondary income was higher. Within the balance of payments, remittances were characterized with an increase of 18.1%, while Foreign Direct Investments (FDI) marked a decline of 27.0%, in Q3 2020.

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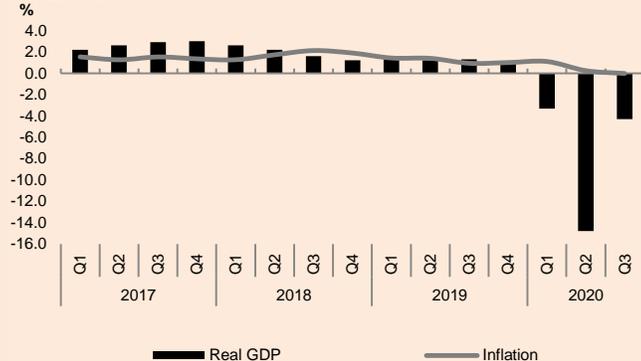
## **ABBREVIATIONS**

KAS	Kosovo Agency of Statistics
GDP	Gross Domestic Product
CBK	Central Bank of the Republic of Kosovo
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
WEO	World Economic Outlook

## Euro area and Western Balkans

As a result of opening the economy of euro area, economic activity has started to recover in Q3 2020. Compared to the previous quarter it was marked an increase of the GDP of 12.7%, representing the highest increase marked in the recent years. While, compared to the same quarter of 2019, based on the preliminary estimates of Eurostat, economic activity in euro area has marked a decline of 4.3% (graph 1).

Graph 1. GDP growth rate and inflation rate in euro area



Source: Eurostat (2020)

Among the main euro area countries, Germany and France have marked a decline of the economic activity of 4.2% and 4.3% respectively, while Spain has reported a decline of GDP of 8.7%. By sectors, the highest losses result to have been marked by the manufacturers of vehicles, transport, art activities, entertainment and recreation. For 2020, mainly as a consequence of the health crisis, economic and social crisis caused by pandemics, the European Central Bank (ECB) has forecasted an economic decline of 8.0%. The decline of the economic activity was translated in weak dynamics also in the level of euro

area prices, mainly as a consequence of the decline of energy prices and the decline of prices of industrial production. The average rate of Harmonized Index of Consumer Prices, during Q3 2020, was 0.0% (0.9% in Q3 2019) (graph 1).

Aiming at mitigating the effects of pandemics and assisting the economic recovery through the support of financing the real economy (especially businesses and households), in June 2020, the ECB took a decision on the new program of the quantity easing. This program, named as “Pandemic Emergency Assets Purchase Program” increased to EUR 1.35 billion, and is expected to continue at least until the end of June 2021.

Conversely, 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 6.5%, while loans to households increased by 3.5%. With a high increase were characterized also deposits of the banking system, where enterprise deposits marked an increase of 19.5%, while household deposits increased by 6.7%.

Economic activity in the Western Balkan countries was characterized with an average decline of 11.8% in Q2 2020<sup>1</sup> (an increase of 4.3% in Q2 2019). Countries with coasts (Montenegro and Albania), which highly depend on tourism have marked a higher decline of the economic activity, while Serbia results to have been affected less by the crisis (table 1).

<sup>1</sup> The data for Q3 2020 have not been published yet.

**Table 1. Real GDP growth rate in W. Balkans**

Description	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2
Serbia	2.6	2.9	4.8	6.2	5.1	-6.4
Montenegro	3.0	3.2	4.7	3.1	2.7	-20.2
Kosovo	4.2	4.1	4.4	3.9	1.3	-9.3
North Macedonia	3.8	3.4	3.6	3.4	0.2	-12.7
Albania	2.4	2.6	4.2	-0.1	-2.5	-10.2

Source: National Statistics Offices of the respective countries

Besides the problems caused by COVID-19, also increased political uncertainties in the region are expected to reflect on a further decline of the confidence of investors and consumers, thus directly having an impact on the economic activity. Consequently, the forecasts realized by the IMF in October 2020 were more pessimistic compared to the forecasts realized in April 2020, suggesting a decline in economic activity in the region by an average of 6.9% in 2020.

The average inflation rate was 0.9% in Q3 2020, representing a lower rate compared with 1.1% as it was in Q3 2019. In Kosovo and Montenegro was recorded a deflation, while in other countries of the region the inflation rate was higher (table 2). This inflation trend is expected to continue also in the following quarters and based on the IMF, the average inflation rate in 2020 is expected to be 0.9%.

**Table 2. Annual inflation rate in W. Balkans**

Description	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3
Kosovo	3.2	3.3	2.6	1.7	1.1	0.2	-0.4
Montenegro	0.4	0.5	-0.1	1.1	0.5	-1.1	-1.4
North Macedonia	1.9	1.4	0.1	-0.5	-0.1	0.3	2.0
Serbia	2.4	2.3	1.3	1.4	1.7	1.0	1.9
Albania	2.0	1.6	1.5	1.6	1.9	2.4	2.2

Source: National Statistics Offices of the respective countries

In terms of developments in the banking sector, Western Balkan countries recorded an increase of 8.5% in lending activity, which is a higher growth rate compared to the rate of 6.5% marked in Q3 2019. The countries with the highest growth rates were Serbia

and North Macedonia (14.0% and 10.0%, respectively), followed by Kosovo (7.6%), Montenegro (5.7%) and Albania (5.1%). Deposits marked an average increase of 6.6%, representing a lower rate compared to the increase of 8.7% recorded in Q3 2019. The highest growth rates were recorded in Serbia and Kosovo (17.1% and 8.6%, respectively), followed by North Macedonia (6.8%) and Albania (6.5%), while Montenegro marked a decrease (-6.1%).

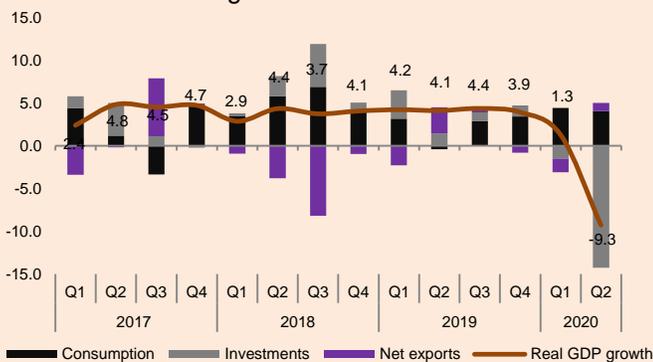
During Q3 2020, EUR depreciated against the Swiss franc (1.8%), while it appreciated against other currencies: 34.3% against the Turkish lira, 5.2% against the U.S. dollar, 1.9% against the Albanian lek, 1.8% against the Croatian kuna, 0.3% against the British pound, etc.

## Kosovo's Economy

### Real Sector

Facing the COVID-19 pandemic and taking measures to manage the health crisis affected the economic activity to slow down in Q1 (1.3%), namely to mark a decline in Q2 2020 (-9.3 percent). In the first half of the year, the country's economy was characterized with an average decline of GDP with 4.6%. To this level of the economic activity decline have contributed the investments and net exports with -8.7% and -0.2%, respectively. Conversely, the economic activity was supported by the positive contribution of consumption with 4.2 percentage points (graph 2).

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



Source: KAS (2020) and CBK calculations

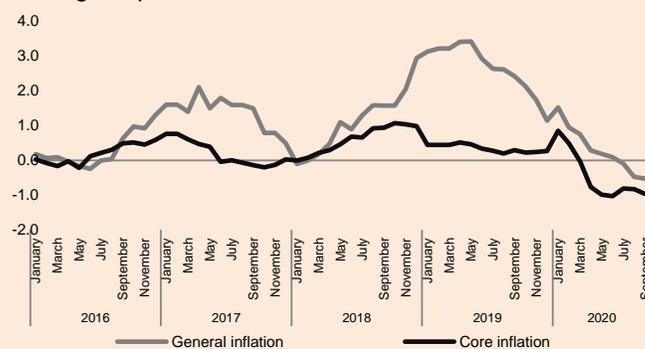
On sectoral basis, in the first half of 2020, the highest decline was recorded in the hotel and restaurant sector (-39.0%), construction (-35.5), transport and storage (-33.1), administrative and support activities (-22.8%), trade (-5.0%), etc. On the other hand, the highest growth was recorded in the sector of processing industry (15.7%), information and communication (15.7%), electricity and gas supply (12.8%), health and social work (11.1%), extractive industry (5.8%), etc.

Despite the opening of the economy, it is estimated that the downward trend of economic activity has continued also in Q3 2020. The estimates were supported by the decline of services exports in the reporting period, the decline of capital expenditures of the government, the decline of FDI, etc. An indication of the decline of domestic demand is presented also by the decline of goods import with 9.3% marked in Q3 2020. Conversely, remittances have marked an increase in Q3 2020.

### Prices

The consumer price index marked a slowdown increase of 0.3% by September 2020, compared to the same period of 2019 when it had been marked an increase of 3.0%. As of July it was marked a decline of prices and the average of deflation was 0.4%, in Q3 2020 (graph 3).

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



Source: KAS and CBK calculations (2020)

A decline of prices, in Q3 2020, was marked in transport prices, recreation, furnishing, footwear and clothing and energy prices. Conversely, an increase was marked by health services, hotels, communication means, etc. The prices of food and non-alcoholic beverages were also characterized by a slower rise in

prices, however, due to the large weight in the basket of Kosovar consumers, they contributed positively by 0.47 percentage points to the overall price level (table 3).

**Table 3. Contribution of specific categories to overall inflation in Q3 2020**

Description	Weight 2020	Deflation rate	Contribution
<i>Total</i>	<i>100.0%</i>	<i>-0.4</i>	<i>-0.36</i>
Food and non-alc. beverages	40.1%	1.1	0.47
Alcoholic beverages and tobacco	5.7%	0.6	0.04
Footwear and clothing	4.1%	-0.2	-0.01
Energy	7.7%	-0.1	0.00
Furnishing	7.6%	-0.4	-0.03
Health	2.1%	4.9	0.10
Transport	15.7%	-7.2	-1.15
Communication	3.8%	0.5	0.02
Recreation	4.4%	-1.2	-0.05
Education	1.0%	0.5	0.00
Hotels	3.2%	2.3	0.07
Goods and other services	4.5%	4.2	0.17

Source: KAS and CBK calculations

As shown in the table, the Kosovar's consumer basket is characterized with a very high share of products with seasonal prices fluctuations (food, energy, alcoholic beverages and tobacco), where the exclusion of these components results in a lower base deflation compared to the overall deflation (graph 3). Core deflation stood at 0.9%, which resulted to be lower for 0.5 percentage points than the overall deflation.

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 in Q2 2020 marked an average decline rate of 3.5% (an increase of 3.9% in Q2 2019). Besides import prices, also producer prices were characterized with a decline which stood at 1.5%, albeit this rate was lower compared to import prices.

### Fiscal Sector

Budget revenues<sup>2</sup> until September 2020 reached a net value of EUR 1.2 billion (an annual decline of 11.9%), while budget expenditures<sup>3</sup> reached the value of EUR 1.4 billion (an annual increase of 5.4%). Only in Q3 2020, budget revenues amounted to EUR 454.9 million, representing an annual decline of 13.5%, while budget expenditures increased by 11.1% and reached the value of euro 541.3 million. Consequently, Kosovo's budget recorded a primary budget deficit of EUR 86.4 million during this quarter.

COVID-19 pandemic has had an impact on the decline of domestic demand, influencing a decrease of direct tax revenues of 6.3% in Q3 2020. All the categories of direct tax revenues marked a decline. Corporate income tax and personal income tax, which represent the two main categories of direct tax revenues, marked a decline of 2.5% and 3.7%, respectively. COVID-19 pandemic has had a negative impact also on import of goods, thus causing a decline of 17.3% of indirect tax income which reached the value of EUR 335.5 million and comprised 73.8% of total budget revenues in Q3 2020. VAT and excise, which represent the two main categories of indirect tax revenues, marked a decline of 14.9% and 19.2%, respectively.

Budget expenditures were characterized with an increase as a result of the measures taken to mitigate the negative effects of the COVID-19 pandemic. The main category which contributed to the increase of budget expenditures, during Q3 2020, was the one of subsidies and transfers, which reached the value of

<sup>2</sup> Within the primary income were not included the revenues from borrowings, income from privatization and donor defined grant receipts.

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

EUR 197.6 million, representing an increase of 34.9%, compared to the same period of 2019. With a growth of 7.5% were characterized also expenditures on salaries, which reached the value of EUR 164.0 million. Other categories of budget expenditures were characterized with a decline. Government expenditures on goods and services (including municipal utilities) marked a decline of 2.2%, reaching the value of EUR 68.0 million, while capital expenditures marked a decline of 5.8% and reached the value of EUR 111.8 million.

Public debt, in Q3 2020, reached EUR 1.3 billion, which is for 12.2% higher than the public debt marked in Q3 2019. As a percentage to GDP, public debt reached 19.9% from 17.4% as it was in Q3 2019. The increase of public debt is attributed to the growth of domestic debt of 18.7% (which reached EUR 934.5 million), while public external debt declined by 0.3% amounting to EUR 407.3 million. The share of public external debt to total public debt decreased to 30.4%, from 34.2% as it was in Q3 2019. The threshold of public debt in Kosovo is set by law at 40% of GDP, and consequently the level of 19.9% ranks Kosovo in the position of the country with the lowest level of public debt compared to the region countries. Nevertheless, this low level of public debt may quickly surge in the future as a result of the negative impact of COVID-19 pandemic in Kosovo's economy and due to the Government's plans to finance the budget deficit through the public debt.

#### **Financial Sector**<sup>4</sup>

On quarterly basis, assets of financial system expanded by EUR 258.8 million in Q3 2020, mainly

reflecting the increase of the banking sector and pension sector assets. The increase of the banking sector assets mainly is attributable to the increase of the sector's financing sources (mainly deposits collected), which were reflected on the increase of lending activity. Meanwhile, the expansion of assets of the pension sector was supported by the increase of the collected contributions and return on investments during this period. Compared to Q3 2019, credit activity marked an increase, which was more pronounced for households against the increase of credit activity to nonfinancial corporations during Q3 2020. New loans during this quarter marked a significant annual increase for two categories of households and enterprises. The banking sector marked a net profit of EUR 17.6 million in this quarter, representing a lower level for EUR 7.7 million compared to Q3 2019. The decline marked on the sector's profit mainly was attributable to the higher increase of expenditures against the slower increase of the sector income. Financial soundness indicators of the sector continued to stand at satisfactory values. Despite of changing its direction, banking sector continued to be characterized with a high credit portfolio quality, and optimal coverage with loan loss provisions. The solvency and liquidity indicators continued to remain above the minimum level as recommended by the regulation (12.0% and 25.0%, respectively).

Pension sector was characterized with an expansion of its activity also in Q3 2020, as a result of the collected contributions and positive return on investments in

<sup>4</sup>For more information on financial sector, please refer to: Quarterly Assessment of Financial System (Q3 2020) published at the CBK website.

two recent quarters. Also insurance sector was characterized with an activity increase in Q3 2020, albeit at lower level compared to Q3 2019. The value of collected premiums marked a slight increase during this period. Whereas, the value of claims paid and claims incurred was significantly higher compared to the previous period.

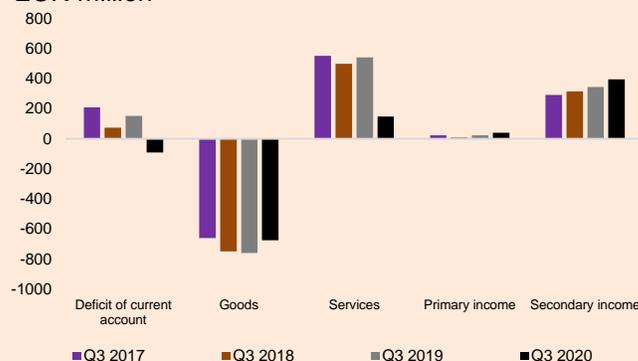
During Q3 2020, microfinance sector has marked a significant slowdown increase of its activity and a lower financial performance against the previous year. However, the sector continued to have good credit portfolio quality.

During Q3 2020, Kosovo's Government issued debt significantly lower compared to the previous quarter (Q2 2020) and Q3 2019. This decline of the sovereign debt issued reflects the needs of Kosovo's Government to finance its activity through this instrument.

### **External Sector**

Until September 2020, the current account deficit amounted to EUR 308.1 million, which is for 129.7% higher compared to the same period of 2019. In recent years, the current account balance has been positive during the third quarter, while during Q3 2020, a deficit of EUR 90.9 million was recorded (EUR 151.9 million surplus in Q3 2019). The increase of the current account deficit in Q3 2020 is mainly attributable to the decline of the positive balance of services. On the other side, the deficit of goods was lower and the positive balance of primary and secondary income resulted to be higher (graph 4).

Graph 4. Current account deficit and its components, EUR million

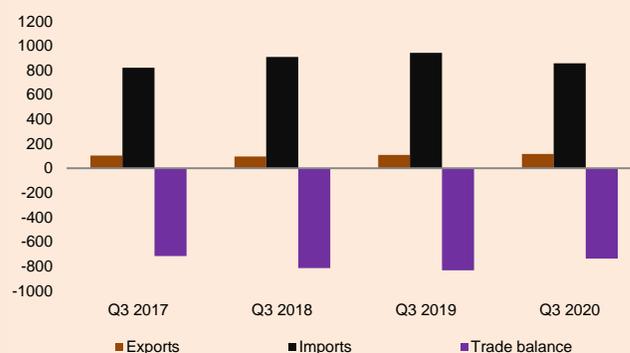


Source: CBK

The deficit in goods<sup>5</sup> account reached the value of EUR 2.0 billion in September 2020, representing an annual decline of 12.1% (an increase of 3.0% marked in the same period of 2019). Only in Q3 2020, trade deficit of goods was EUR 738.3 million of 11.4% lower compared to Q3 2019. This deficit decline of goods is mainly attributable to the higher increase of export and the decline of import of goods.

The profit value realized, until September 2020, was EUR 118.7 million, representing an annual increase of 7.1% (graph 5).

Figure 5. Export and import of goods, EUR million



Source: KAS (2020)

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

The increase in exports of goods during Q3 2020 was more pronounced in vegetables, textiles and textile articles, plastic and rubber products, etc. Conversely, a decline was marked by base metals, mineral products, etc. (graph 6).

Graph 6. Structure of exports by category, in percent



Source: KAS (2020)

The value of goods imported reached EUR 857.0 million in Q3 2020, representing an annual decline of 9.3%. The decline of imports has been mainly influenced by the lower level of imports of mineral products (mainly oil products) metals, a category which has been characterized by declining prices in international markets. With a significant decline were characterized also the import of prepared foods, beverages and tobacco, the import of textiles and textile products as well as the import of vegetables. On the other hand, import of machinery and electrical equipment, import of transport means, base metals, and the import of plastics, rubber and articles thereof marked an increase (graph 7).

The balance in trade of services marked a value of EUR 147.7 million in Q3 2020, marking an annual decline of 72.8%. The value of exported services results to have been only EUR 334.9 million or 59.4% less compared to

Q3 2019. Considering that half of export of travel services is realized in the third quarter and due to the restrictive measures that were taken by the governments of the countries where Kosovo's diaspora is concentrated, then this decline is understandable.

Graph 7. Structure of imports by category, in percent



Source: KAS (2020)

The decline of export of services results to be one of the main external channels to transmit the crisis. Conversely, the value of imported services was EUR 187.2 million or 33.9% less compared to Q3 2019. The same as in export of services also in the activity of their import, the highest decline was marked in travel services and transport services, which mainly are connected to the restrictive measures taken in order to contain the corona virus.

The balance of the primary income account marked a value of EUR 41.3 million, representing a growth of 75.5%. Conversely, the balance of secondary income reached a value of EUR 395.5 million, which is for 14.2% higher compared to Q3 2019. Remittances received in Kosovo reached a value of EUR 697.0 million until September 2020, representing a growth of 11.1% compared to the same period of 2019. Only in Q3

2020, the value of remittances received was EUR 262.2 million or 18.1% more compared to Q3 2019 (graph 8).

Graph 8. Remittances, EUR million



Source: CBK (2020)

Remittances received in Kosovo mainly come from Germany and Switzerland, which represent the countries with a share of 43.1 and 24.3% , respectively, of total remittances in Q2 2020. A considerable amount of remittances was received also from the U.S.A, namely 5.4 per cent of total remittances received in Kosovo. Despite the fact that countries where the Kosovar diaspora is concentrated have highly been impacted by pandemic crisis, remittances marked an accelerated increase. The increase of remittances was continuously of double digit, except in the months of March and April when it had been marked a decline. Remittances sent through money transferring operators marked an increase of 62.0% until September while remittances sent by banks marked an increase of 10.3%. On the other hand, taking into account the closure of borders and other restrictions, remittances which are received through “informal” channel marked a decline of 57.5%, until September 2020. The increasing trend of remittances is expected to continue also in the following months (only in October the increase of remittances was 27.6%). Financial account of the balance of payments marked a value of EUR -293.0 million (EUR -36.5 million, until September 2019). Only in Q3 2020 the

balance of financial account was EUR -0.4 million (EUR 108.6 million in Q3 2019). Liabilities within the financial account marked an increase of 9.3% during Q3 2020. Within the financial account, FDI in Kosovo reached a value of EUR 250.6 million until September 2020, which is for 15.8% higher compared to the same period of 2019. An increase of FDI level was marked in Q1 and Q2, while in Q3 2020 it was marked a lower level of FDI for 27.0% compared to Q3 2019.

The total of EUR 77.1 million, as it was the amount of FDI in Q3 2020, the value of EUR 70.2 million was comprised by the capital and the fund of investments in shares, while EUR 6.9 million accounted for the debt instruments (graph 9).

Graph 9. Structure of foreign direct investments by components, EUR million



Source: CBK (2020)

FDI growth in Q3 2020 was marked by the financial services sector, construction sector and trade sector, while other sectors were characterized with a decline. Only in the real estate sector the level of FDI was EUR 52.4 million or 32.9% lower compared to Q3 2020. Regarding the origin of FDI, Germany represents the country from where came the majority of FDI in Q3 2020 with EUR 24.9 million, followed by Switzerland with EUR 16.6 million, U.S.A with EUR 9.4 million, Turkey with EUR 8.6 million, etc.

**The suggested citation of this publication:**

CBK (2020): Quarterly Assessment of Macroeconomic Developments No. 32 Q3 2020, Central Bank of the Republic of Kosovo

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## Macroeconomic selected indicators

Description	September 2019	September 2020
Real sector 1/		
Gross Domestic Product (GDP) (in millions of EUR)*	3,245.3	3,073.9
Consumer prices (annual average)	3.0%	0.3%
Consumer prices (end of period)	2.4%	-0.5%
Fiscal Sector 2/		
Budget Revenues (in millions of EUR)	1,379.3	1,215.2
Budget Expenditures (in millions of EUR)	1,340.3	1,413.1
Primary balance (in millions of EUR)	39.1	-197.9
Financial sector (in millions of EUR) 3/		
Assets of financial corporations	7,006.3	7,671.0
of which : Banks	4,577.2	5,036.0
Loans	2,957.2	3,182.5
Deposits	3,735.6	4,055.4
<i>Interest Rate s on Loans, end of period</i>	6.54%	6.35%
<i>Interest Rate s on Loans, end of period</i>	1.50%	1.49%
Interest rate gap	5.0%	4.9%
External sector,(in millions of EUR) 3/		
Balance of payments		
Current and capital account	-144.2	-301.8
of which: remittances	627.6	697.0
Financial account	-36.5	-293.0
Foreign Direct Investmentsin Kosovo	216.4	250.6
Portfolio investments, net	-23.6	-35.6
Other investments, net	-143.3	-62.1
International Investment Position (PNI), net*	-462.4	-709.7
Assets	4,912.3	5,076.3
Liabilities	5,374.7	5,786.1
External debt, total*	2,155.0	2,273.0
Private external debt	1,663.2	1,754.4
Public external debt	491.7	518.6

Source:

1/ KAS (2020).

2/ MF (2020).

3/ CBK (2020).

\*Data on GDP, IIP and external debt are as of June 2020.

