

Summary

Euro area was characterized with a contraction of the economic activity of 1.8% in Q1 2021, as a consequence of the representation of restrictive measures due to the higher number of new cases of Covid-19. While a stronger decline in economic activity was projected, measures taken such as increased fiscal stimulus, increased external demand, and better adaptation of economic agents to controlling measures, mitigated the effects of the pandemic crisis. In the Western Balkan countries were emerged recovery signs of the economic activity. In Q1 2021, it is estimated to have been marked an average economic growth of 0.8%, while the IMF forecasts for the whole year of 2021 suggest an increase in economic activity of 5.1% for the region.

Economic activity in Kosovo was recovered during the first quarter of 2021, after the decline that had been marked in 2020. In Q1 2021, real GDP growth rate according to KAS was 5.6%, where the growth of consumption and investments contributed positively, while net exports contributed negatively. Based on the indicator with the highest frequency of publication such as exports of goods and services, consumption and public investments, remittances, etc., real GDP growth is estimated to have continued in Q2 2021.

Consumer prices marked an average annual increase of 0.6% in Q1 2021, compared to the previous quarter when prices had marked a decline. The marked increase in prices in Q1 2021 was attributed to the increase in communication means, alcoholic beverages and tobacco, health services, education, hotels, etc.

Mitigating the negative effects of the Covid-19 pandemic on economic developments in the country has improved the performance of budget revenues compared to previous quarters. Budget revenues, in Q1

2021, increased by 14.5% (2.2% in Q1 2020), as a result of the growth of almost all categories.

With accelerated annual growth of 30.5%, were characterized also budget expenditures, as a result of the increase of capital expenditures but also current expenditures. The higher increase of expenditures compared to budget revenues affected the Kosovo budget to record a primary deficit of EUR 32.6 million. Public debt reached EUR 1.5 billion in Q1 2021, which is for 28.3% higher compared to Q1 2020. As a percentage to GDP, public debt reached 21.8% from 16.5%.

Assets of financial system reached the value of EUR 8.07 billion in Q1 2021. Financial system expanded with an accelerated pace compared to Q1 2020, primarily being affected by the developments in the banking and pension sector. Lending activity of the banking sector marked the highest increase, followed by securities and cash held at commercial banks. During this period, with an increase were characterized also deposits held at the banking sector. The pension sector expanded as a result of the positive return on investments and contributions received from contributors, fully recovering the withdrawal of 10% of trust funds, as a measure within the economic recovery package.

In the external sector, the current account deficit has more than doubled in Q1 2021, mainly due to the increase in the goods deficit, while the positive balance of services and secondary income have increased. The trade deficit of goods was EUR 767.3 million or 20.0% higher compared to Q1 2020, a dynamic that was mainly attributed to the significant increase of import despite the considerable increase of export. Within the balance of payments, a considerable increase was marked also by remittances in Q1 2021 (29.7%), while FDI marked a slowdown increase of 2.0%.

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ABBREVIATIONS

CBK	Central Bank of the Republic of Kosovo
CPI	Consumer Price Index
ECB	Central European Bank
EUR	Euro currency
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
IMF	International Monetary Fund
IPI	Import Price Index
KAS	Kosovo Agency of Statistics
MF	Ministry of Finance of the Republic of Kosovo
WEO	World Economic Outlook

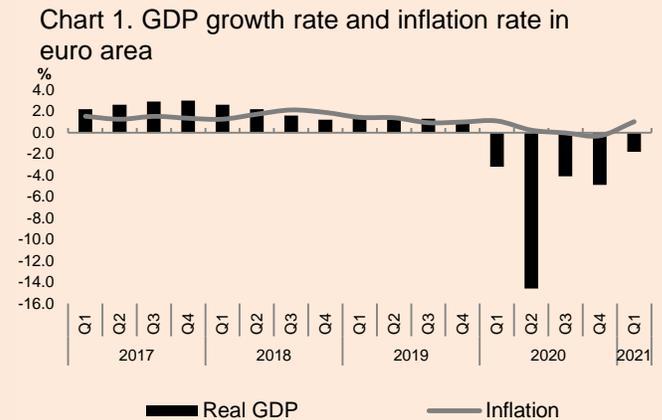
Euro area and Western Balkans

The deterioration of health crises due to the higher number of new infected cases with Covid-19, influenced many euro area countries to further tighten restrictive measures of movements and activities, in Q1 2021. Despite this, the contraction of the economic activity in the euro area of 1.8% (chart 1) was slighter than expected mainly as a result of strengthening the external demand, significant fiscal stimulus, but also due to the effect of better adjustment of economic agents with controlling measures.

Among the main euro area countries, Germany and Spain reported a decline of the economic activity of 3.0% and 4.3% respectively, whereas France reported an increase of economic activity with 1.5%. With the easing of control measures, especially in the second half of 2021, as well as the increase of consumer confidence as a result of the mass vaccination, the ECB has forecasted a recovery of the economic activity of 3.9% in 2021.

The average rate of Harmonized Consumer Price Index, in Q1 2021, was 1.0% (-0.3% in Q4 2020). Price increase in euro area mainly was attributable to the increase of prices of services and food, while energy prices contributed negatively. Despite the increase of prices, the domestic demand remains weak. In response to the weakened demand, in March 2021, the Governing Council of the ECB decided to continue with the purchase of assets under the Pandemic Asset Purchase Program of EUR 1.850 billion, until, at least March 2022. Also, the Governing Council of the ECB

decided to hold unchanged the key interest rates, until inflation rate reaches 2%.



Source: Eurostat.

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 4.7% in Q1 2021, while loans to households increased by 3.8%. With a high increase were characterized also deposits, where enterprise deposits marked an increase of 18.0%, while household deposits increased by 9.2%.

Also Western Balkan countries, which were hit hard by the Covid-19 pandemic, especially in Q2 and Q3 2020 (average decrease of 12.0% and 8.3%, respectively), have shown signs of economic recovery. In Q4 2020,¹ economic activity in the Western Balkans was characterized by an average decline of 1.2%, while in Q1 2021, economic activity recovered by an average of 0.8%. The highest growth of economic activity, in Q1 2021, was marked in Kosovo and Albania. With an increase of the economic activity was characterized also Serbia, whereas other countries have marked a decline

¹ The data for Q1 2021 have not been published yet.

(table 1). IMF forecasts suggest an increase of the economic activity of 5.1%, for the year of 2021.

Table 1. Real GDP growth rate in W. Balkans

Description	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1
Serbia	2.6	2.9	4.9	6.3	5.2	-6.2	-1.4	-1.1	1.2
Montenegro	3.2	3.6	5.2	3.7	2.6	-20.3	-26.9	-7.5	-6.4
Kosovo	4.3	2.9	6.0	5.6	1.6	-7.1	-6.3	0.8	5.6
North Macedonia	1.4	4.3	3.6	3.3	0.9	-14.9	-3.3	-0.7	-1.9
Albania	2.3	2.1	4.2	-0.1	-2.8	-11.3	-3.5	2.4	5.5

Source: National Statistics Offices of the respective countries

Slight increase of inflation was reported also in the Western Balkan countries, as a result of the growth of the domestic demand and the increase of prices in international markets. The average inflation rate, in Q1 2021, was 1.0%. A slight decline of prices was marked in Montenegro, whereas in other regional countries the prices were increased (table 2).

Table 2. Annual inflation rate in W. Balkans

Description	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1
Kosovo	3.2	3.3	2.6	1.7	1.1	0.2	-0.4	-0.1	0.6
Montenegro	0.4	0.5	-0.1	1.1	0.5	-1.1	-1.4	-1.3	-0.1
North Macedonia	1.2	1.2	0.6	0.0	0.6	0.5	1.5	2.2	2.0
Serbia	2.4	2.3	1.3	1.4	1.7	1.0	1.9	1.6	1.4
Albania	2.0	1.5	1.5	1.6	1.9	2.4	2.2	2.2	1.1

Source: National Statistics Offices of the respective countries

In terms of developments in the banking sector, Western Balkan countries recorded an increase of 5.4% in lending activity, which is a lower growth rate compared to 7.9% marked in Q1 2020.

The countries with the highest growth rates were Serbia and Kosovo (8.8% and 7.7%, respectively), followed by North Macedonia (5.2%), Montenegro (3.3%) and Albania (2.2%). Deposits marked an average increase of 9.5%, representing a higher growth rate compared to the increase of 7.2% recorded in Q1 2020. The highest increased rate of deposits was marked in Serbia and Kosovo (17.7%, and 15.0%, respectively), followed by North Macedonia (7.4%), Bosnia and Herzegovina (4.6%) and Montenegro (2.8%).

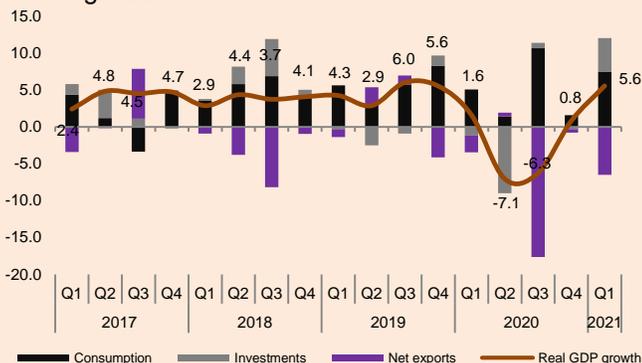
During Q1 2021, EUR appreciated against other currencies: 32.1% against Turkish lira, 9.4% against American dollar, 2.2% against Swiss franc, 1.5% against British pound, 1.1% against Croatian kuna, 0.5% against Albanian lek, etc.

Kosovo's Economy

Real Sector

As a result of the Covid-19 pandemic and measures taken to protect public health (restriction of movement, physical distancing, etc.), economic activity has declined by 3.0%, in 2020. The highest decline of economic activity was marked in Q2 and Q3, whereas in Q4 2020 the economic activity was recovered to some extent, marking an increase of 0.8%. An accelerated increase of economic activity was marked in Q1 2021, where the growth rate of GDP reached 5.6%. Consumption and investments have contributed positively with 7.5% and 4.6%, respectively, while net exports have had negative contribution on the economic activity with 6.5 percentage points (chart 2).

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



Source: KAS and CBK calculations.

According to KAS, the highest GDP growth rate, in Q1 2021, was recorded in the sectors of health and social work (26.3%), construction (11.5%), public administration (10.2%), education (9.6%) and financial activities and insurance (8.9%). Also in the trade sector was marked an increase of 2.3%, which is one the sectors with the highest share to total economic activity. Besides the added value in GDP, the net sales

index in trade increased by 15.7%. Conversely, a decline of 9.9% was marked in the sector of supply with electricity and gas. A decrease in economic activity was also recorded in the extractive industry sector (-5.9%) and transport and storage (-3.1%). The decline in economic activity in these sectors was also recorded in the production volume index where the extractive industry decreased by 4.5% while the net sales index in the transport and storage sector decreased by 8.0%.

Estimates of the CBK suggest that the accelerated increasing trend of the economic activity has continued also in Q2 2021. These estimates are based on the increase of exports of goods and services in the reporting period, in public consumption and investments, the increase of remittances, etc. On the other side, the considerable high increase of goods import has contributed negatively to the increase of GDP.

The pandemic crisis and the decline marked in certain economic sectors have been accompanied by the deterioration of the main labor market indicators in the country. According to KAS, the average employment rate, for 2020, has dropped to 28.4% from 30.1% as it was in 2019, while the registered unemployment rate has reached 27.0% in Q4 2020, from 25.9% as it was in Q4 2019.

Prices

The decline of the economic activity, marked in 2020, was accompanied with expected deflation pressures in the country. However, the marked recovery of dynamics in certain economic sectors, during Q1 2021, as well as the increase in external demand and, consequently, inflationary pressures has been

translated into an increase of prices in Kosovo, as well. In Q1 2021, it was marked an average increased rate of 0.6%, while the increasing trend is depicted in chart 3. This trend is expected to continue also in the following months, where according to the CBK forecasts, the average of inflation rate for 2021, is expected to be 2%. Similar to the CBK forecasts are the expectations of commercial banks as well, which, in the last survey conducted in April 2021, it was stated that they expect the inflation rate to be 1.9%, in 2021.

Chart 3. Overall inflation and core inflation, annual change in percent



Source: KAS and CBK calculations.

Price increase, in Q1 2021, was marked in communication means, alcoholic beverages and tobacco, health services, education, hotels, etc. Prices of food and non-alcoholic beverages were also characterized by a slower increase, however, due to the large weight in the basket of Kosovar consumers, they contributed positively by 0.10 percentage points to the overall price level. Conversely, a price decline was marked by housing, water, electricity, transport services, prices of footwear and clothing, and prices of furnishing (table 3).

Table 3. Contribution of specific categories to overall inflation, in Q4 2021

Description	Weight 2020	Inflation rate	Contribution
<i>Total</i>	<i>100.0%</i>	<i>0.6</i>	<i>0.59</i>
Food and non-alc. beverages	40.1%	0.2	0.10
Alcoholic beverages and tobacco	5.7%	3.3	0.21
Footwear and clothing	4.1%	-0.8	-0.03
Housing, water, electricity	7.7%	-2.6	-0.19
Furnishing	7.6%	-0.4	-0.03
Health	2.1%	2.1	0.04
Transport	15.7%	-1.8	-0.27
Communication	3.8%	16.1	0.56
Recreation	4.4%	0.7	0.03
Education	1.0%	1.3	0.01
Hotels	3.2%	0.9	0.03
Goods and other services	4.5%	1.4	0.06

Source: KAS and CBK calculations

Fiscal Sector

Budget revenues,² in Q1 2021, reached a net value of EUR 454.9 million, representing an annual increase of 14.5%, while budget expenditures³ marked an annual increase of 30.5% and reached a value of EUR 487.5 million. Consequently, Kosovo's budget recorded a primary budget deficit of EUR 32.6 million during this quarter.

The recovery of the economic activity marked in Q1 2021, results to have affected the considerable increase of direct tax revenues of 15.0%. The tax on personal income, as the main category of the direct tax revenues, increased by 12.9%, while the tax on corporate income increased by 8.3%. With an increase of domestic demand, which has affected the growth of imports of goods, there has been marked an increase of 14.3% also in indirect tax revenues, a category that dominates budget revenues by around 74%. In Q1 2021, indirect tax revenues amounted to EUR 336.3 million, where VAT and excise as the two main categories of indirect

² Within budget revenues is not included finance income.

³ Within budget revenues are not included finance payments.

tax revenues marked a growth of 18.4% and 10.5%, respectively.

Measures taken by the Government to mitigate the negative economic and social effects of the Covid-19 pandemic health crisis resulted in increased budget expenditures. The main category which contributed to the increase of budget expenditures, during Q1 2021, was the one of subsidies and transfers, which reached the value of EUR 196.6 million, representing an increase of 36.6%, compared to Q1 2020. Expenses on salaries marked an increase of 13.3%, reaching the value of EUR 175.2 million, while government expenditures on goods and services (including municipal utilities) marked an increase of 23.7% and reached the value of EUR 58.0 million. Capital expenditures were doubled in Q1 2021, reaching the value of EUR 57.9 million (EUR 28.4 million in Q1 2020).

Public debt, in Q1 2021, reached EUR 1.5 billion, which is for 28.3% higher compared to Q1 2020. As a percentage to GDP, public debt reached 21.8%, from 16.5% as it was in Q1 2020. The increase of public debt is attributed to the growth of domestic debt of 27.7% (which reached EUR 1.0 billion), and the increase of external debt of 29.4% (which reached to EUR 516.8 million). The threshold of public debt in Kosovo is set by law at 40% of GDP, and consequently the level of 21.8% 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 Sector⁴

Assets of financial system reached a value of EUR 8.07 billion, by the end of March 2021. Financial system expanded with an accelerated pace compared to the same period of the previous year, mainly being affected by the developments in the banking and pension sector.

On quarterly basis, during Q1 2021, within the banking sector, lending activity marked the highest increase, followed by investments in securities, and cash held at commercial banks. Whereas, within liabilities, deposits marked the most significant increase in this quarter. With an increase were characterized also the category of own resources (from the retained earnings and realized profit). Moreover, banks continue to be well capitalized, to have adequate liquidity, and with high quality of credit portfolio.

During Q1 2021, pension sector expanded as a result of the positive return on investments and contributions received from contributors, fully recovering the withdrawal of 10% of trust funds, as a measure within the economic recovery package taken at the end of 2020.

Insurance sector during the first quarter of 2021 was characterized with an activity expansion and a higher level of premiums received. However, the higher level of claims paid (insurers and KIB), had an impact on the sector to operate with loss in Q1 2021.

⁴For more information on financial sector, please refer to: Quarterly Assessment of Financial System (Q1 2021) published at the CBK website.

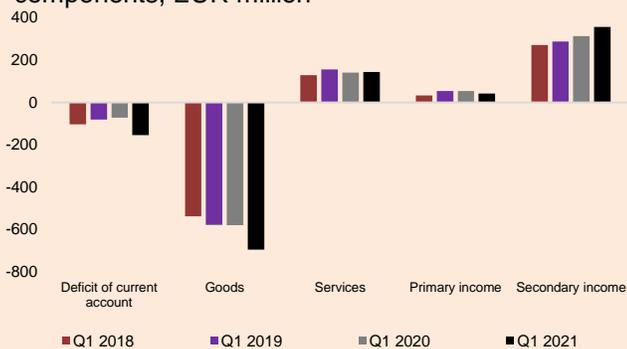
During Q1 2021, the microfinance sector recorded an increase in lending, positive financial performance, as well as a low level of nonperforming loans.

During the first quarter of 2021, the Government of Kosovo issued debt of the amount of EUR 85.0 million, where the demand to invest in government bonds was 2.18 times higher than the demand of the Government of Kosovo.

External Sector

External sector of the economy was the main channel through which was transmitted the economic and social crises driven by the Covid-19 pandemic in Kosovo. Current account deficit in 2020 marked an increase of 20.4%, reaching an amount of EUR 480.7 million.

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



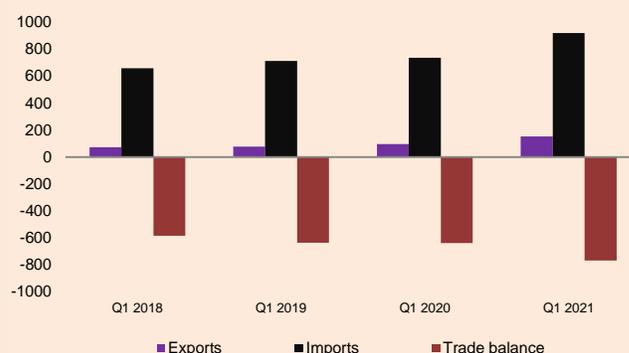
Source: CBK.

The accelerated increasing trend of the current account deficit continued also in Q1 2021. From EUR 72.5 million as it was in Q1 2020, was more than doubled in Q1 2021, reaching the value of EUR 154.0 million. Within the balance of payments, the positive balance of services as well as primary and secondary income have

increased, while the goods deficit has deepened (chart 4).

Despite the significant increase in exports of goods, the increase in imports has affected the deficit in trade in goods⁵ to mark an increase of 20.0%, reaching the level of EUR 767.3 million (chart 5).

Chart 5. Export and import of goods, EUR million



Source: KAS.

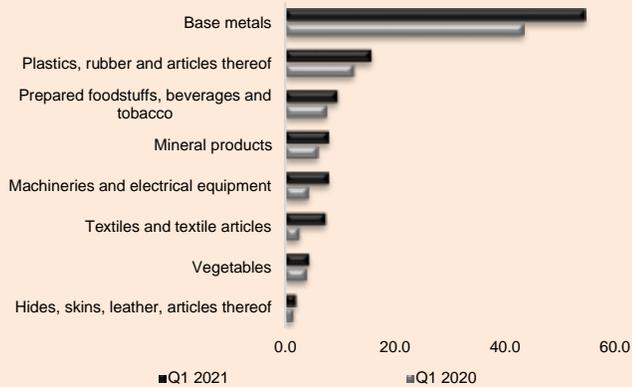
The value of export of goods, in Q1 2021, was EUR 152.8 million, representing an annual increase of 57.4%. With an increase of export of goods were characterized almost all categories, while the highest increase compared to the same period of 2020 was recorded in base metals, textiles and textile articles, machinery and electrical equipment, as well as plastic and rubber products (chart 6). The increase of metal exports, among others, can be attributed to the increase of metal prices in international markets of 38.2%, in Q1 2021.

The value of goods imported reached EUR 920.1 million in Q1 2021, representing an increase of 24.9%. The increase of import was mainly impacted by the higher level of import of machinery and electrical

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

equipment, transport means, chemical industry products, etc. Conversely, import of vegetables was characterized with a decline (chart 7).

Chart 6. Export of goods, EUR million



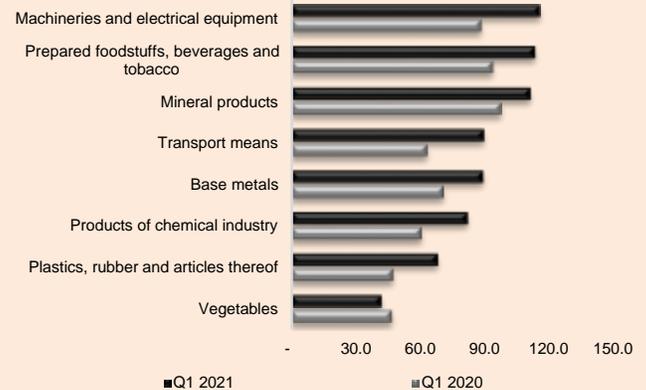
Source: KAS.

Within the balance of payments, trade of services was the component that suffered the sharpest decline during 2020, as a direct consequence of the restrictive measures taken to manage the health crises. However, in the last two quarters the balance of services has continued to recover. In Q1 2021, the balance in trade of services marked a value of EUR 143.4 million, representing an increase of 1.3% compared to Q1 2020. The value of export of services increased by 1.0%, amounting to EUR 284.3 million. The highest increase was recorded in export of pension and insurance services as well as construction services, while travel services decreased by 8.7% , in Q1 2021.

Also the import of services marked a slight increase in Q1 2021, where the value of services imported amounted to EUR 140.8 million, or for 0.6% more compared to Q1 2020. The highest increase was recorded in the import of transport services as well as pension and insurance services, while travel services, as in exports and imports, marked a decrease (2.8%).

The primary income account decreased by 21.5% in Q1 2021, mainly as a result of the income from investments, while also the income from employees compensation were characterized with a decrease.

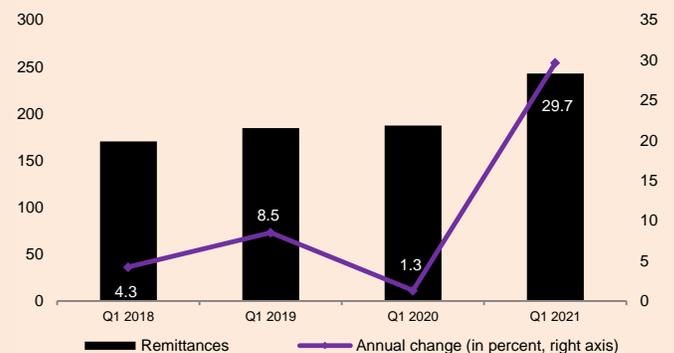
Chart 7. Import of goods, EUR million



Source: KAS.

The balance of secondary income marked an increase of 14.2%, which is mainly attributable to the higher level of remittances. The high growth rate of remittances in 2020, despite the difficult situation created by the Covid-19 pandemic, continued also in Q1 2021, where the level of remittances reached EUR 242.9 million or 29.7% more compared to Q1 2020 (chart 8).

Chart 8. Remittances, EUR million

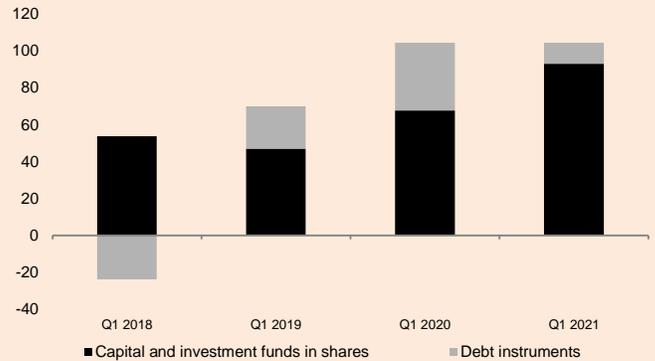


Source: CBK.

In terms of transferring channels, the vast majority of remittances (61.2%) came through money transferring agencies, which marked an increase of 41.3%, in Q1 2021. Remittances received through banks marked an increase of 43.3%, while remittances which came through “informal channels” marked an increase of 3.4%. Remittances received in Kosovo mainly come from Germany and Switzerland, which represent the countries with a share of 42.3% and 22.3%, respectively, of total remittances. A considerable amount of remittances was received also from the U.S.A (6.4% of total remittances).

Foreign Direct Investments (FDI), in Q1 2021, reached the value of EUR 106.6 million, representing an increase of 2.0%. Within the structure of FDI, investments in capital and fund of investments in shares marked an increase of 40.6%, while debt instruments declined by 68.9% compared to Q1 2020 (chart 9).

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



Source: CBK.

The growth of FDI was recorded mainly in the sectors of real estate, construction, financial and insurance activities, trade, etc., while in the sectors of energy, mining and quarrying, information and communication, etc., there has been marked a decline of FDI.

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Macroeconomic selected indicators

Description	March 2020	March 2021
Real sector 1/		
Gross Domestic Product (GDP) (in millions of EUR)	1,410.0	1,493.0
Consumer prices (annual average)	1.1%	0.6%
Consumer prices (end of period)	0.8%	1.2%
Fiscal Sector 2/		
Budget Revenues (in millions of EUR)	397.3	454.9
Budget Expenditures (in millions of EUR)	373.7	487.5
Primary balance (in millions of EUR)	23.5	-32.6
Financial sector (in millions of EUR) 3/		
Assets of financial corporations	7,174.0	8,067.7
of which : Banks	4,721.9	5,449.2
Loans	3,083.3	3,320.8
Deposits	3,845.4	4,422.9
<i>Interest Rate s on Loans, end of period</i>	6.28%	6.12%
<i>Interest Rate s on Loans, end of period</i>	1.32%	1.39%
Interest rate gap	5.0%	4.7%
External sector,(in millions of EUR) 3/		
Balance of payments		
Current accounts	-72.5	-154.0
of which: remittances	187.3	242.9
Financial account	-103.5	-96.2
Foreign Direct Investmentsin Kosovo	104.5	106.6
Portfolio investments, net	-17.4	94.2
Other investments, net	29.1	-3.8
International Investment Position (IIP), net	-592.2	-887.4
Assets	5,054.3	5,348.4
Liabilities	5,646.6	6,235.8
External debt	2,206.9	2,513.8
Private external debt	1,717.5	1,907.3
Public external debt	489.4	606.5

Source:

1/ KAS (2021);

2/ MF (2021);

3/ CBK (2021).

