

The impact of the COVID-19 pandemic on Kosovo's economy

January-June
Analysis



October 2020

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October 2020

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The original is written in Albanian.

This publication is supported by:

Executive Summary

After the emergence of the COVID-19 pandemic in Kosovo, the Government of Kosovo restricted the movement of people and ordered the closure of the vast majority of economy for more than two months. Measures to prevent the spread of the pandemic caused the highest decline in domestic production since the post-war period, leading to a fall of Gross Domestic Product (GDP) by 9.28 percent in the second quarter. GAP Institute, through this report, presents the main components that make up the GDP, as well as other macroeconomic indicators in the first half of 2020 (January-June) in order to reflect the impact of this crisis on the country's economic sectors. The following are the key findings of the report:

- In the first half of the year, domestic spending underwent significant changes. Household consumption focused mainly on basic products, such as food and utilities (water and electricity), while businesses spent more on digitizing services to operate during the pandemic.
- Economic activities that performed best include: extractive industries, manufacturing, electricity and water supply, which grew by 19.8 percent in the second quarter, and information and communication by 29.6.
- Meanwhile, there was a decline in revenues in all other industries. The biggest drop was in the construction industry, with -47.08 percent, and trade, transport, accommodation and food service activities, with -24.4 percent.
- During the first six months of the year, industries reported a turnover of around 584 million Euros, which is 11 percent less than in the same period the previous year, in the Tax Administration of Kosovo (TAK).
- On the other hand, to ease the financial burden after the restrictive measures were introduced, the Central Bank of Kosovo (CBK) and the credit institutions offered the possibility of deferring loan repayments for three months, as well as the possibility of applying for loan restructuring.
- The Government of Kosovo approved the first “fiscal emergency” package worth 190 million Euro, and proposed diverting certain budget expenditures from capital expenditures to salaries, transfers and subsidies. However, this package could not be fully implemented in the second quarter and, as a result, many citizens and businesses failed to receive the assistance in time.
- Public spending in 2020 increased by 18.8 million Euro, around 2 percent, compared to the first half of 2019. Meanwhile, budget revenues decreased in all categories. The fall in budget revenues is linked with poor private sector performance and a declining aggregate demand.
- This period was also accompanied by a fall in new loans and an increase in bank deposits, reaching a record value of close to 4 billion Euros. These two phenomena reflect a decline in the total demand in the first six months.
- Other aspects that contracted the economy in the first six months of the year included a decline in the export of services, particularly transportation, which is connected with the restriction of cross-border traffic and the non-arrival of the diaspora.

1. Introduction

On March 11, 2020, the World Health Organization officially declared COVID-19 a global pandemic. In response to this health crisis, which was spreading rapidly in all countries of the world, state leaders ordered the isolation of citizens and the closure of almost all economic activity.

This situation affected Kosovo too, and after the confirmation of the first two cases of the virus, the government decided to close all economic, cultural and sports activities, with the exception of certain essential activities, such as food and medical supplies from March 13 to May 18, 2020.¹ This decision also banned the circulation of inter-urban and international transport, and three days later, air travel too.

After the suspension of virtually all global economic activities, the world is undoubtedly moving towards a deep recession. However, unlike previous economic crises, where solving the problem was easier, this situation is unpredictable and unprecedented. Kosovo, for the first time since the war, is expected to face an economic crisis the extent of which is still unknown. According to the World Bank, Kosovo is one of the countries where production in 2020 is expected to fall by 8.8 percent.² However, the extent of this economic slowdown will depend on several factors, such as: the ability to control the spread of the virus, the effectiveness of economic measures taken by the government to facilitate economic recovery, and consumer and business expectations for the future of the country's economy.

One of the most important indicators of the impact of the pandemic on the economy is the Gross Domestic Product (GDP) which sums up the entire output of a state within a given period.

2. Changes to the Gross Domestic Product (GDP)

GDP is one of the most comprehensive indicators of an economy's performance over a period of time. There are two methods of measuring GDP which lead to the same result, but present different perspectives. For example, since expenditure of an individual is an income to someone else, similarly the total amount spent is equal to the total income. GDP is calculated this way, where one method represents the total expenditures, while the other represents the revenues of the whole economy.

To see the impact of the pandemic on the economy, we will first look at the expenditures reduced (chapter 2.1) then the industry revenues that have been affected as a result of those expenditure reductions (chapter 2.2).

2.1. GDP by expenditure approach at constant prices

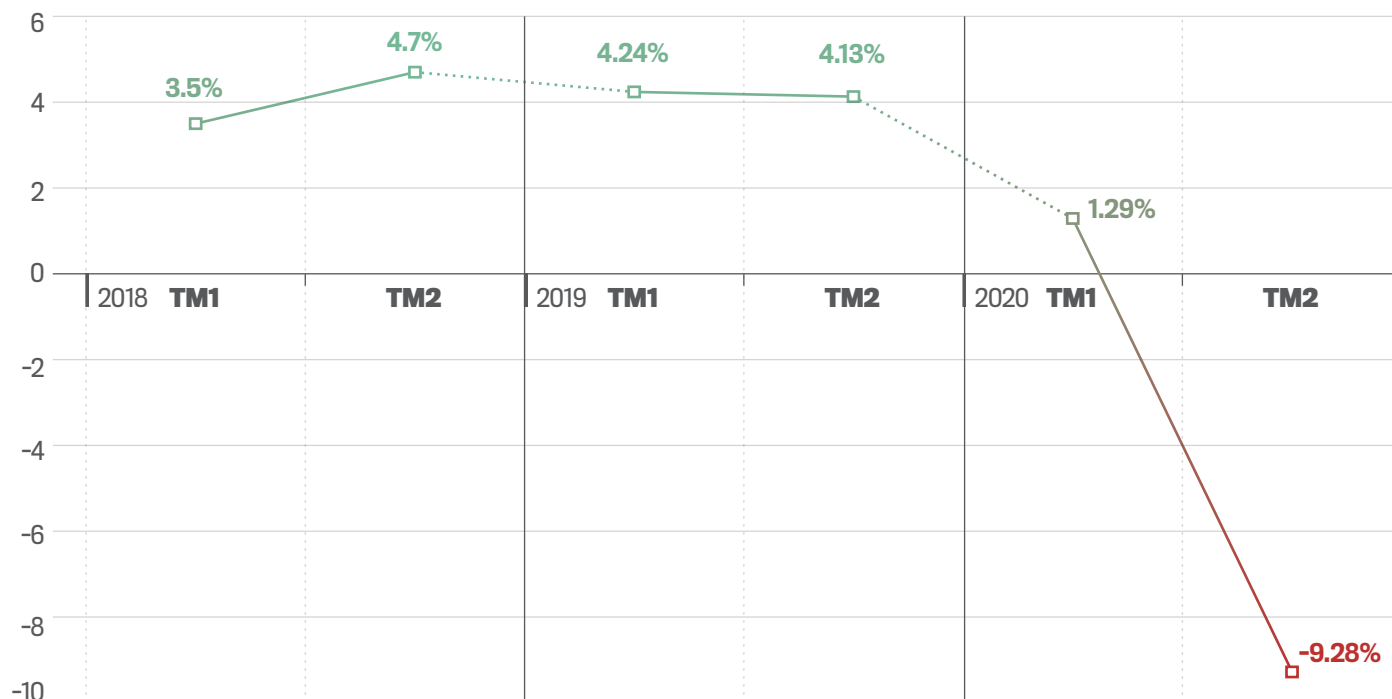
In the last seven years, the average GDP growth in the first quarter (January-March) was 3.82 percent, and 3.71 percent in the second quarter (April-June). After March 13, 2020, when almost all economic activity closed, the impact on the economy was immediate, making the first quarter grow by only 1.31 percent, namely 2.51 percentage points less than the average of recent years.

¹ Decision. Government of the Republic of Kosovo. No. 01/09. <https://bit.ly/2S8UxsH>

² World Bank. Source: <https://bit.ly/3ji95RC>

On the other hand, since the economic closure and the gradual reopening mostly fall in the second quarter, GDP data for this period show the largest decline since the post-war period, with 9.28 percent decline in the overall production.³

Figure 1. Real quarterly GDP growth compared to the same period of the previous year.



Source: Kosovo Agency of Statistics

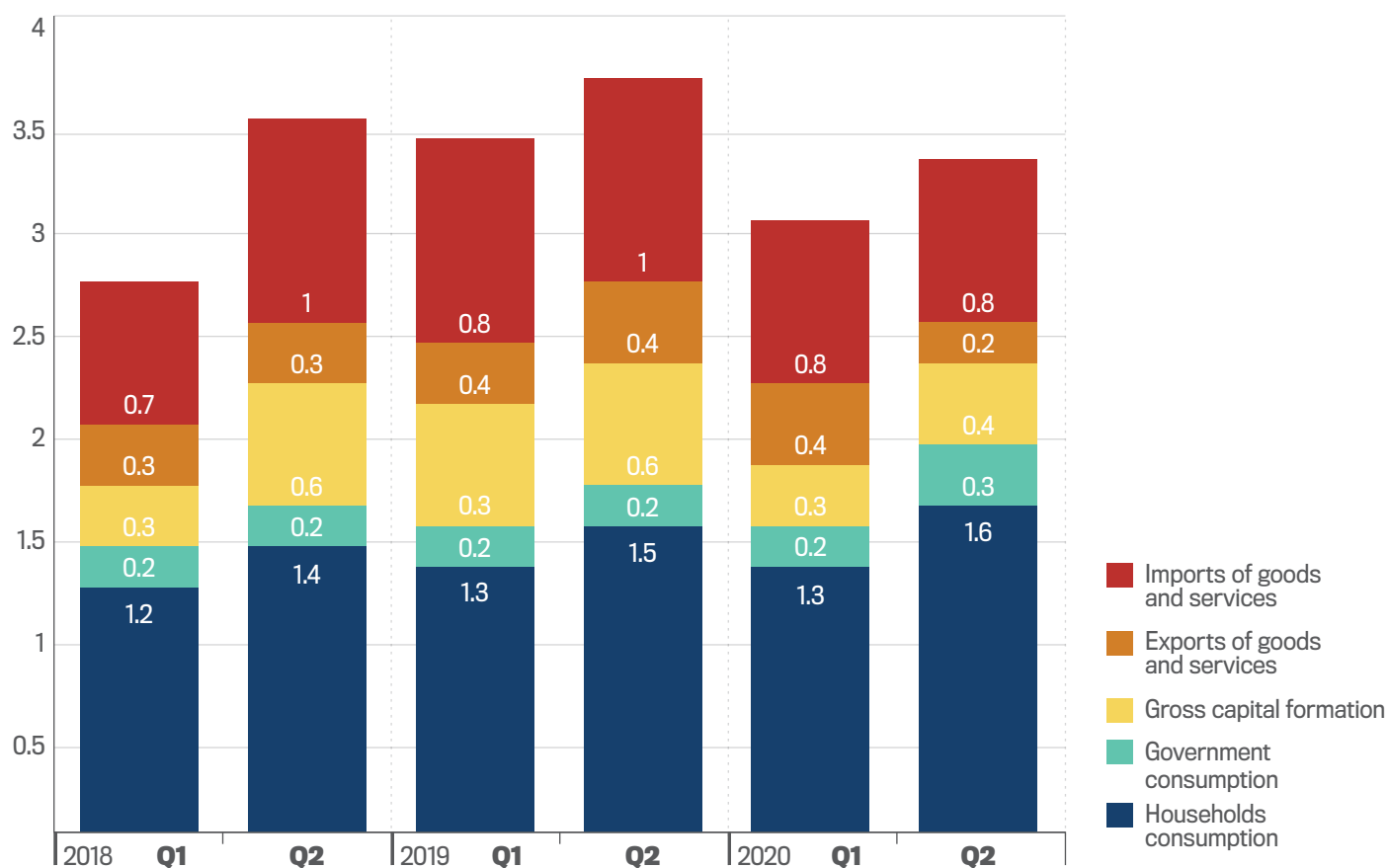
Factors that contributed to the decline in GDP in the second quarter were gross capital formation with -41.09 percent, and export of services with -62.93 percent.⁴ Gross capital formation in business terms includes the accumulation of business inventory and investments in production capacity, whereas in household terms it means the purchase of a new house, which in GDP is calculated as investment rather than consumption. The decline of this indicator for two consecutive quarters indicates the low expectations of businesses and households for the future of the economy.

Meanwhile, in the second quarter, there was an increase in household consumption by 3.47 percent, exports of goods by 12.18 percent and government expenditure by 8.58 percent.⁵

³ Kosovo Agency of Statistics. Gross Domestic Product Q2 2020. Source: <https://bit.ly/3jlhyEr>

⁴ Kosovo Agency of Statistics. Gross Domestic Product Q2 2020. Source: <https://bit.ly/3jlhyEr>

⁵ Ibid.

Figure 2. Gross Domestic Product by expenditures at constant prices

Source: Kosovo Agency of Statistics

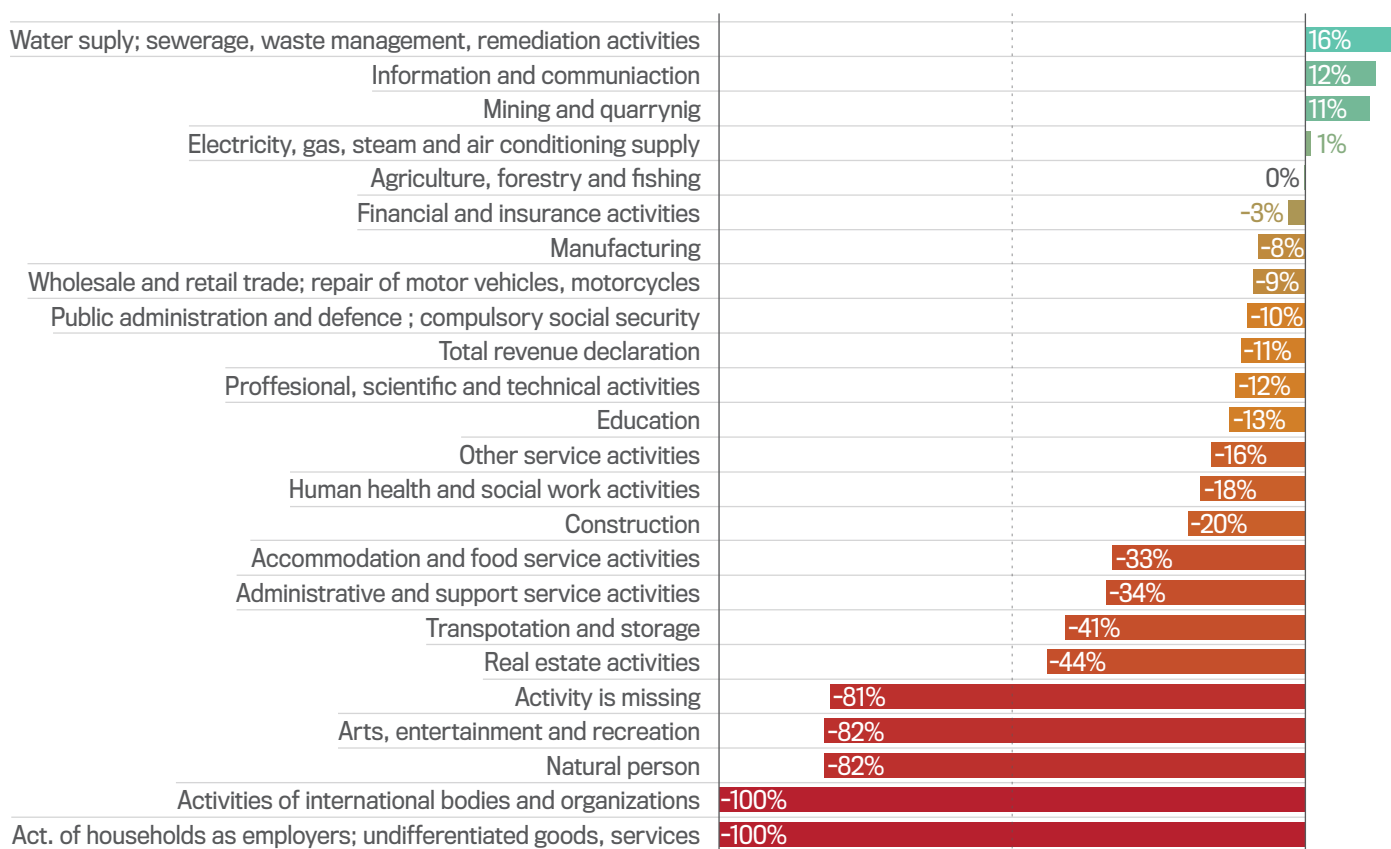
2.2. GDP by revenue approach

Revenues of economic activities affected the most by the decline in spending in the second quarter were construction with -47.08 percent, trade, transport, accommodation and food services with -24.4 percent, professional and administrative activities with -16.39 percent, financial and insurance activities with -6.71 percent, and agriculture, forestry and fishing with -1.74 percent. On the other hand, real growth was recorded in activities such as: extractive industry, processing, electricity, and water supply, with 19.8 percent, information and communication with 29.6 percent, and public administration, education and health with 4.73 percent.⁶

According to Tax Administration of Kosovo (TAK) data, about 584 million Euro, were declared the first half of this year, or 11 percent less revenues than in the same period of the previous year. The highest impact was felt in the decline in trade turnover and repair of motor vehicles (-241.5 million), construction (-77.2 million), transport and storage (-72 million), manufacturing (-54.2 million) and others presented as percentages in Figure 3. The decline in the turnover of businesses also impacted the tax revenues, as shown in Chapter 7.1.

6 Kosovo Agency of Statistics. Gross Domestic Product (GDP) Q2 2020. Source: <https://bit.ly/3cLWSTC>

Figure 3. Changes in tax return filing in the Tax Administration for six months in 2019-2020



Source: Tax Administration of Kosovo⁷

The poor performance of industries in the first half of the year is mostly related to the closure of the economy for more than two months, followed by the gradual opening of some industries until June. Opening of businesses in a non-synchronized manner represented challenges in achieving optimal revenues due to the supply chain where the production of one industry can mean raw materials for another.

In this economic situation, some industries will suffer more than others. This is due to the fact that the turnover in industries in Kosovo is realized in a cyclical form, where each industry in different periods of the year realizes highest revenues. Industries that normally realize their peak revenues in the second quarter, will have a harder time this year in recovering losses, as the most significant period of the year found them almost completely closed. This category includes construction, real estate, arts, entertainment and recreation industries, as shown in Table 1. During April-June 2020, the construction industry declared 37 percent less revenue, real estate activities 40 percent less, while arts, entertainment and recreation industries 85 percent less than in the same time last year.⁸ These are lost revenues that cannot be easily recovered within the year, as the peak of these industries has passed. Therefore, delays in the implementation of support measures by the government and the Central Bank could jeopardize the revenues of other industries during the coming months of the year.

⁷ Kosovo Tax Administration data sent by email.

⁸ Ibid.

Table 1. Revenues of sectors by quarter in 2019

Sectors	Revenues		TM1	TM2	TM3	TM4
	▲ highest ▼ lowest					
Agriculture, forestry and fishing	Q4	Q1	▼ 91,426,000	136,429,000	106,388,000	▲ 144,194,000
Mining and quarrying	Q3	Q4	39,552,000	41,023,000	▲ 45,729,000	▼ 27,747,000
Manufacturing	Q3	Q1	▼ 123,194,000	220,655,000	▲ 235,261,000	227,156,000
Electricity, gas, steam and air conditioning supply	Q1	Q3	▲ 66,033,000	55,397,000	▼ 55,062,000	56,472,000
Water supply	Q2	Q4	11,859,000	▲ 13,686,000	12,240,000	▼ 11,740,000
Construction	Q2	Q1	▼ 100,284,000	▲ 195,716,000	173,482,000	147,976,000
Wholesale and retail trade; repair of motor vehicles and motorcycles	Q3	Q1	▼ 159,725,000	208,501,000	▲ 295,495,000	263,736,000
Transportation and storage	Q3	Q1	▼ 44,805,000	76,398,000	▲ 91,122,000	58,878,000
Accommodation and food service activities	Q3	Q1	▼ 18,696,000	21,082,000	▲ 27,450,000	21,847,000
Information and communication	Q4	Q1	▼ 24,272,000	24,962,000	38,159,000	▲ 39,293,000
Financial and insurance activities	Q3	Q1	▼ 60,799,000	70,057,000	▲ 72,311,000	63,625,000
Real estate activities	Q2	Q1	▼ 121,520,000	▲ 130,287,000	127,845,000	127,779,000
Professional, scientific and technical activities	Q4	Q2	30,448,000	▼ 19,665,000	21,278,000	▲ 30,718,000
Administrative and support service activities	Q3	Q1	▼ 7,204,000	12,861,000	▲ 15,348,000	14,815,000
Public administration and defence; compulsory social security	Q4	Q1	▼ 118,833,000	128,587,000	128,879,000	▲ 150,635,000
Education	Q2	Q3	64,684,000	▲ 66,490,000	▼ 60,188,000	66,476,000
Human health and social work activities	Q4	Q1	▼ 28,827,000	32,420,000	32,703,000	▲ 34,508,000
Arts, entertainment and recreation	Q2	Q4	6,991,000	▲ 7,471,000	4,564,000	▼ 3,199,000
Other service activities	Q3	Q1	▼ 2,767,000	3,721,000	▲ 4,043,000	3,365,000
Net tax on products	Q3	Q1	▼ 282,501,000	324,884,000	▲ 404,098,000	366,176,000
Total GDP	Q3	Q1	▼ 1,404,421,000	1,790,290,000	▲ 1,951,644,000	1,860,334,000

Source: Kosovo Agency of Statistics

3. Changes in the financial sector

In 2002, Kosovo unilaterally adopted the Euro as its official currency. This act limited the possibility of intervening in the economy through monetary policies. As a result, the main impact on the injection of money into the economy comes from lending institutions, such as commercial banks and other financial institutions, which stimulate domestic consumption, government, and business investment.

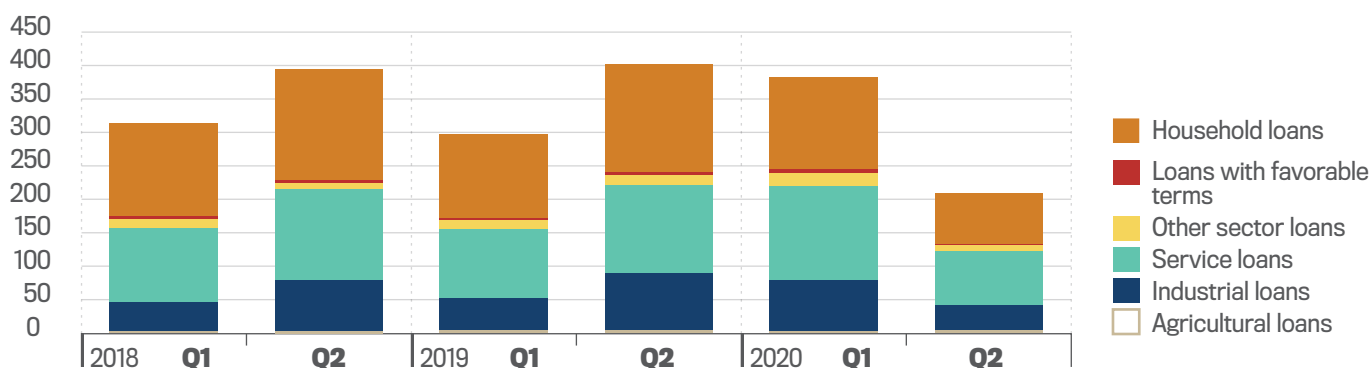
3.1. Commercial banks

After economic activities were stopped for more than two months, revenues of businesses were also stopped, whereas liabilities to lending institutions remained in place. To overcome the difficulties faced by some businesses and to avoid an increase in non-performing loans, CBK in cooperation with lending institutions, initially offered the possibility of deferring the repayment of loan installments for three months, from March 16 until June 16, 2020, and then the possibility of applying for restructuring.⁹ Only in March, 44,670 loan repayment deferral applications were submitted. Their value was 1.3 billion Euros, of which 71.5 percent from businesses.¹⁰ By July, over 70,500 applications were approved for loan restructuring, of which 80 percent were for individuals and 20 percent for businesses.¹¹

These two measures eased the financial burden of some businesses and citizens, but created liquidity stress in commercial banks, as bank revenues from these loans were postponed, while other customers' deposits remained active.¹² Thanks to the rather liquid state of commercial banks, these measures were made possible without jeopardizing the Kosovo financial stability.

In addition to applications for loan deferral or restructuring, data from the banking system in the first half of the year also indicate that there was an increase in deposits and a decrease in new loans. These two phenomena reduce the circulation of money in the economy, leading to a decline in the aggregate demand. In the second quarter, the amount of new loans was 48 percent lower than in the same period last year.¹³ Lending was reduced in all sectors, with the exception of the agricultural sector, which had a slight increase of two percent compared to the second quarter of 2019.

Figure 4. New loans from commercial banks in Kosovo for the first half of 2018-2020



Source: Central Bank of Kosovo

9 Central Bank of Kosovo. Source: (1) <https://bit.ly/2Tkjvpj>, (2) <https://bit.ly/3z6FGEv>

10 Statement of the Central Bank spokesman given to the 'Free Europe' portal. Source: <https://bit.ly/2WVW05K>

11 Central Bank data sent by email.

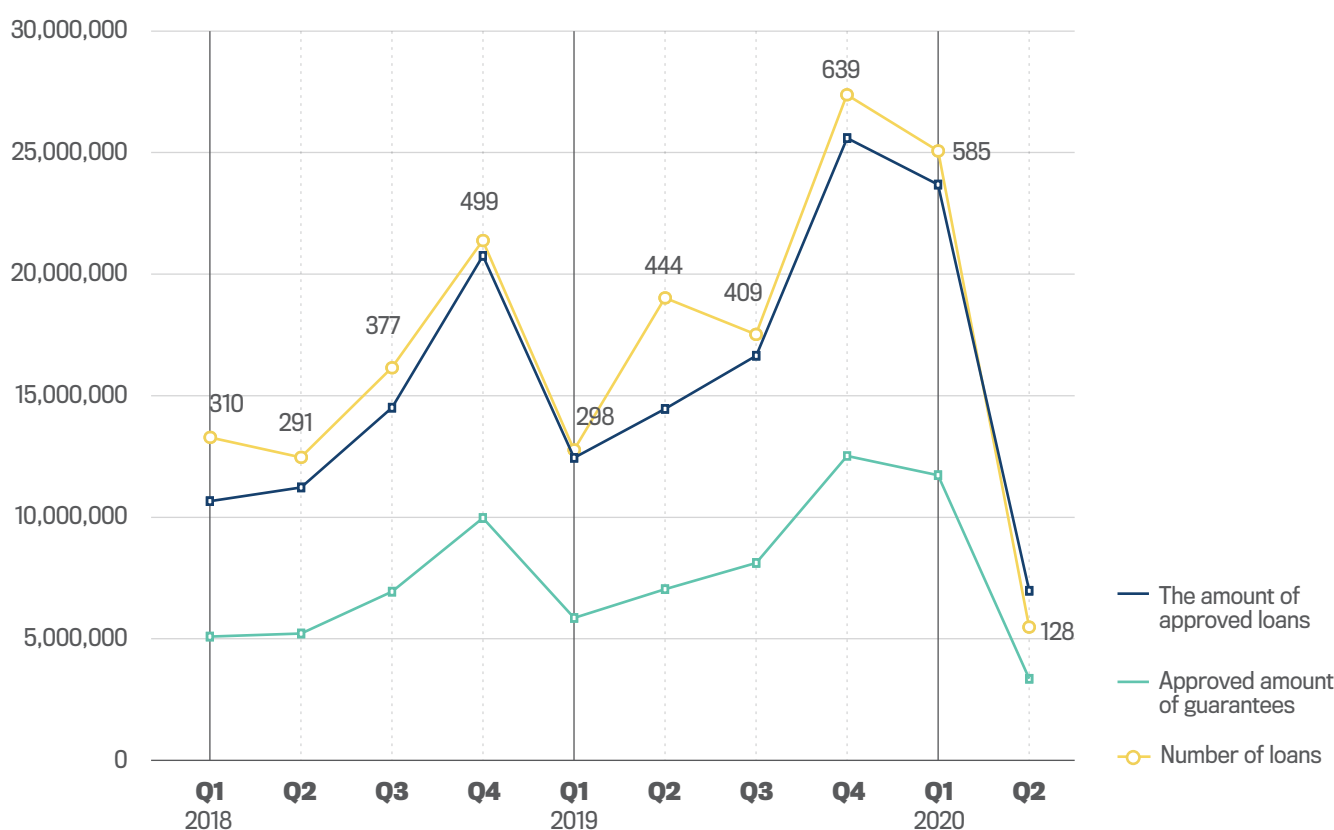
12 Central Bank of Kosovo. Commercial Banks. Source: <https://bit.ly/3cMWjYP>

13 Central Bank of Kosovo Source: <https://bit.ly/2WshdGF>

Continued lending in these circumstances is necessary in order to stimulate household consumption and private sector investment. However, in the coming months as the situation in the private sector is expected to worsen further, the fact that commercial banks are liquid and with high capital may be insufficient to continue lending. Banks may consider that there is a risky environment to offer new loans and, as a result, further reduce new lending. In this situation, the Kosovo Credit Guarantee Fund (KCGF) can play a key role in assuming a part of the risk and enable lending. Similar funds proved effective in many parts of the world during the global financial crisis.

In the second quarter of this year, the number and amount of loans guaranteed by KCGF decreased significantly. Thanks to a KfW grant, this year KCGF will have another 6.5 million Euros more, further expanding its guarantee capital.¹⁴ However, meeting the demand of businesses for new loans during the deepening economic crisis, requires more funds of this nature. KCGF support is proposed in the second package, enshrined in the Draft Law on Economic Recovery.¹⁵

Figure 5. The amount of new loans guaranteed by the Kosovo Credit Guarantee Fund



Source: Kosovo Credit Guarantee Fund

¹⁴ Kosovo Credit Guarantee Fund. Source: <https://bit.ly/2AMfK61>

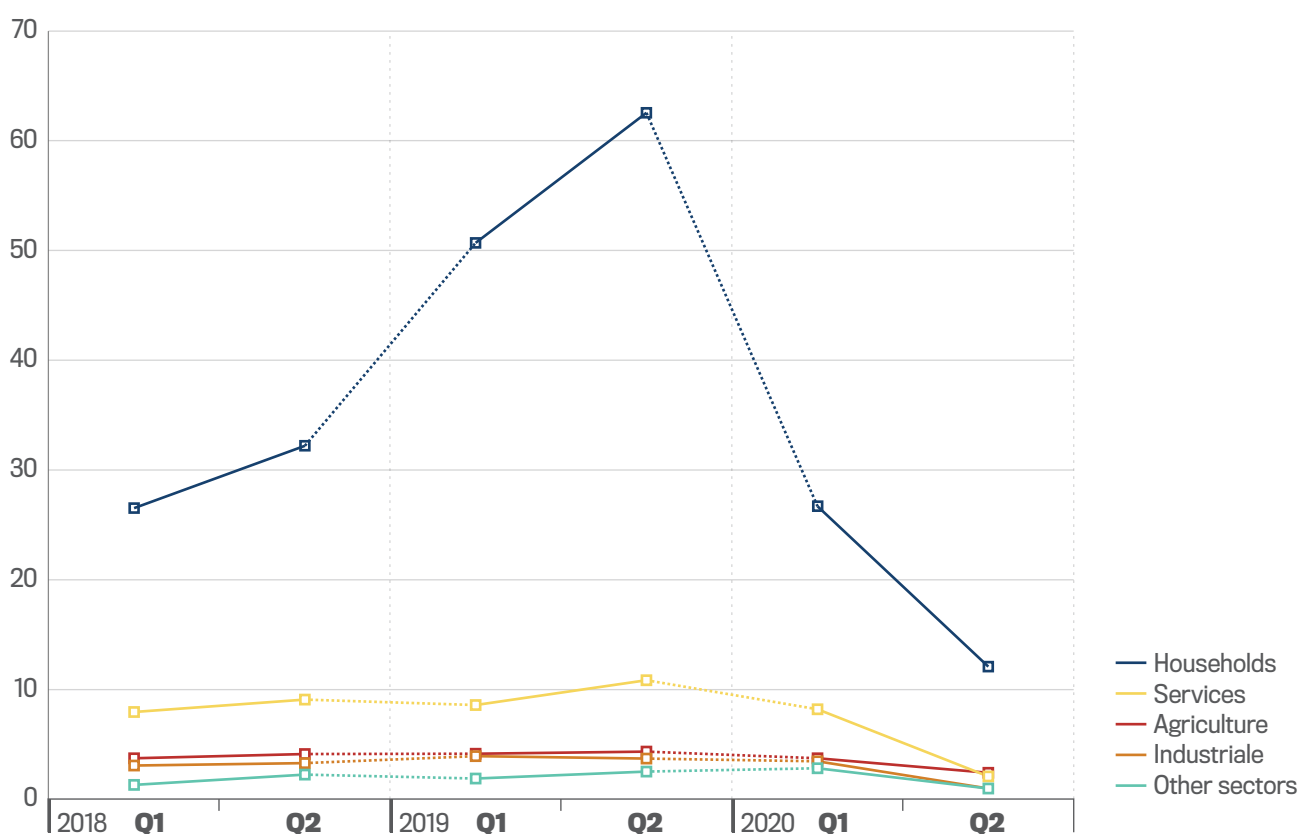
¹⁵ Draft-Law on Economic Recovery Assembly of Kosovo. Source: <https://bit.ly/2FG3YN6>

3.2. Micro-Finance institutions

New loans also declined in micro-finance institutions. In the first half of this year, lending declined by 59 percent.¹⁶ This contraction of the loan portfolio was expectable, as these institutions do not accept deposits from customers and, as a result, have a higher exposure to liquidity risk in the event of an increase in loan defaults. The decline in new loans may also be related to the decline in the demand for loans.

Micro-finance institutions mainly offer loans of no higher than 25 thousand Euros for low-income households and individuals, or micro-entities. The lack of loans from these institutions mostly affects citizens and micro-businesses with low incomes and insufficient collateral to apply in commercial banks. Even in this situation, the expansion of the Kosovo Credit Guarantee Fund portfolio can be significant in guaranteeing a part of loans of this group, in order to enable lending by commercial banks, where the interest rate is more affordable. Lack of access to finance is another reason that this crisis is expected to be challenging for low-income individuals. The necessary reduction of expenditures of this group will further deepen the decline of GDP. Thus, if access to finance doesn't take place through loans and employment, it risks being done through social assistance as a result of deepened poverty.

Figure 6. New loans from Micro-Finance Institutions in Kosovo



Source: Central Bank of Kosovo¹⁷

¹⁶ Central Bank of Kosovo. Microfinance Institutions. Source: <https://bit.ly/3cMmQ8r>

¹⁷ Ibid.

3.3. Pension fund and insurance companies

Unlike commercial banks, where deposits of client can be withdrawn at any moment, pension funds have more predictable payments. This is why they are allowed to be invested in international financial markets, as long as pension funds in the long-term perform above the average rate of inflation in Kosovo.¹⁸ This investment freedom also holds the risk of the loss of funds in cases of price fluctuations in financial markets.

According to the Pension Fund Law, the Fund is not a means to achieve economic development in Kosovo. The objective of the Fund is to only maximize the returns of its contributors. In this regard, the aim is to ensure security of pension funds' investments, diversification of investments to reduce risk, and maintaining sufficient liquidity to make payments to those who meet the eligibility criteria for beneficiaries.

There are two pension funds in Kosovo, the Pension Trust, which has a vast majority market share, and the private "Slovenian Kosovo" Fund. Regarding the Trust, pension saving funds are invested through management companies specializing in financial investments, reporting regularly to the Trust's investment committee. Initially, the Fund's Board of Directors approves the Statement of Investment Principles (SIP) and the investment strategy defines the ceilings and goals of investment categories.¹⁹ According to this strategy, the most liquid and secure asset is cash, which includes Kosovo treasury bills, bank deposits, and money in transit. Other assets include Kosovo government bonds, with a maturity of over one year, and other instruments as shown in Table 2, ordered based on risk.²⁰

Table 2. Investment targets and their allocation in the first six months in 2019-2020

Asset class	Target	Investment in June 2019	Investment in June 2020
Cash	35%	34.6%	33.1%
Kosovo Bonds	15%	12.2%	19.5%
Debt Instruments	5%	5.0%	1.6%
Multi-assets	30%	35.9%	33.6%
Stocks	15%	12.4%	12.2%
Total fund invested		1,863,348,229 €	2.005.492.497€

Source: Kosovo Pension Trust²¹

The pandemic crisis in late February caused a severe shock in global financial markets. The investment committee, at the beginning of these shocks, withdrew investments from the category of stocks and returned them to Kosovo, where the risk is lower. As a result, exposure in the stock markets in February was at the lowest historic level, with 3.8 percent, and cash increased to 34.4 percent. Investments in stocks were restored in March, in the hope that after the fall of financial markets, stock prices are below market value. However, as seen in Figure 7, in February and March the Trust suffered interest losses of close to 100 million

¹⁸ Investment Manual. Trust. Source: <https://bit.ly/3kcXxAe>

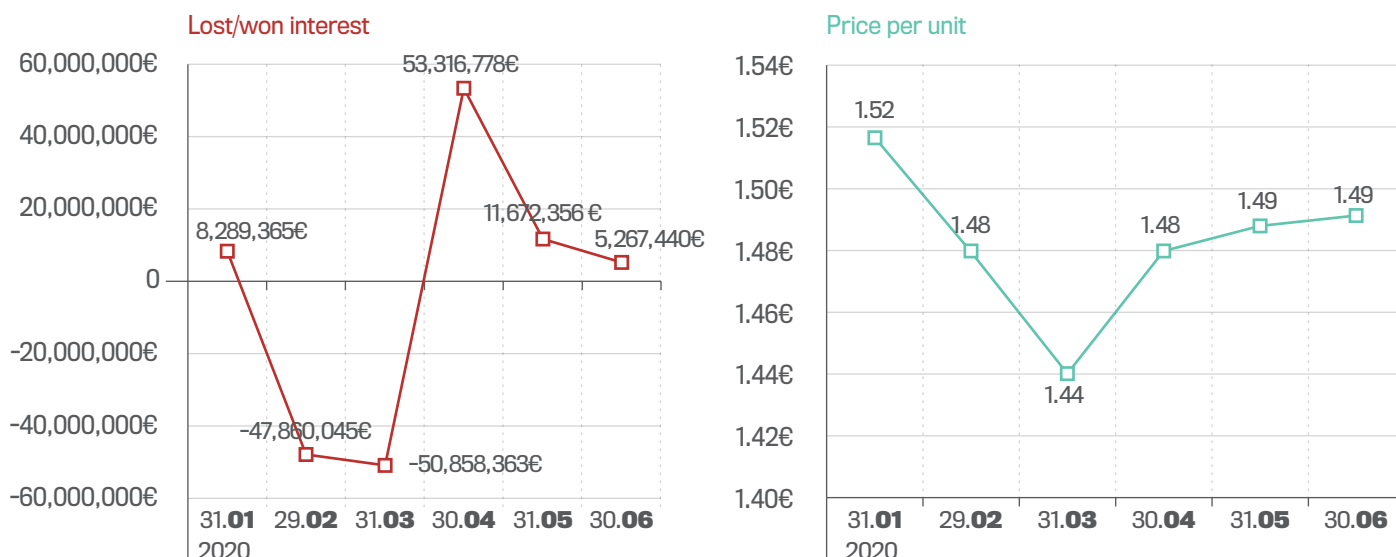
¹⁹ Investment Manual. Trust. Source: <https://bit.ly/34cnSJ4>

²⁰ Kosovo Pension Trust. Source: <https://bit.ly/2Ti3Maj>

²¹ Ibid.

Euro. This fall was mainly caused from the drop in stock prices.²² Fluctuations of financial markets continued throughout the second quarter, however, profit in interest was achieved in this period and consequently there was a slight increase of Trust unit prices.²³

Figure 7. Changes in interest rates and unit prices of the Trust in the first half of 2020



Source: Kosovo Pension Trust

The decline in the value of the Pension Trust assets does not have an impact on the aggregate short-term demand of the economy and, consequently, on GDP. As of 2020, the Pension Fund started with two investment portfolios, one for persons under 65 years of age, and the other for persons over 65 years of age, which is more conservative in investments. This means that the savings of persons receiving a pension from the Trust are not invested in assets that have high volatility or risk. Therefore a drop in unit price or eventual short-term losses do not have a significant impact on the income of persons already benefiting from the Trust.

In the coming months, the significance of the pension fund may be essential in providing liquidity in the financial sector. Due to the high risks of investing abroad, at the end of the first quarter and during the second quarter, pension savings were largely invested in Kosovo Government bonds (392 million) as well as bank deposits.²⁴ This allows a growth of domestic public debt without depleting the funds available for private sector loans.

The insurance sector has the lowest share in the overall financial sector, with close to 2.7 percent of total assets. In the first half of this year, the assets of insurance companies marked a slower growth, compared to the first half of last year. While last year the assets of the first six months increased by about eight percent, this year there was a six percent increase.²⁵ This increase in assets includes the increase in the purchase of securities, the increase in deposits in commercial banks, and others. Capitalization of the insurance sector is important in maintaining the stability of the financial sector and in covering payments and liabilities to customers.

²² Quarterly reporting. List of pension assets. Source: <https://bit.ly/3cAFksF>

²³ Kosovo Pension Trust. Financial Reports. Source: <https://bit.ly/36eoWIM>

²⁴ Kosovo Pension Trust. Strategic Allocation. Source: <https://bit.ly/2SoCrIR>

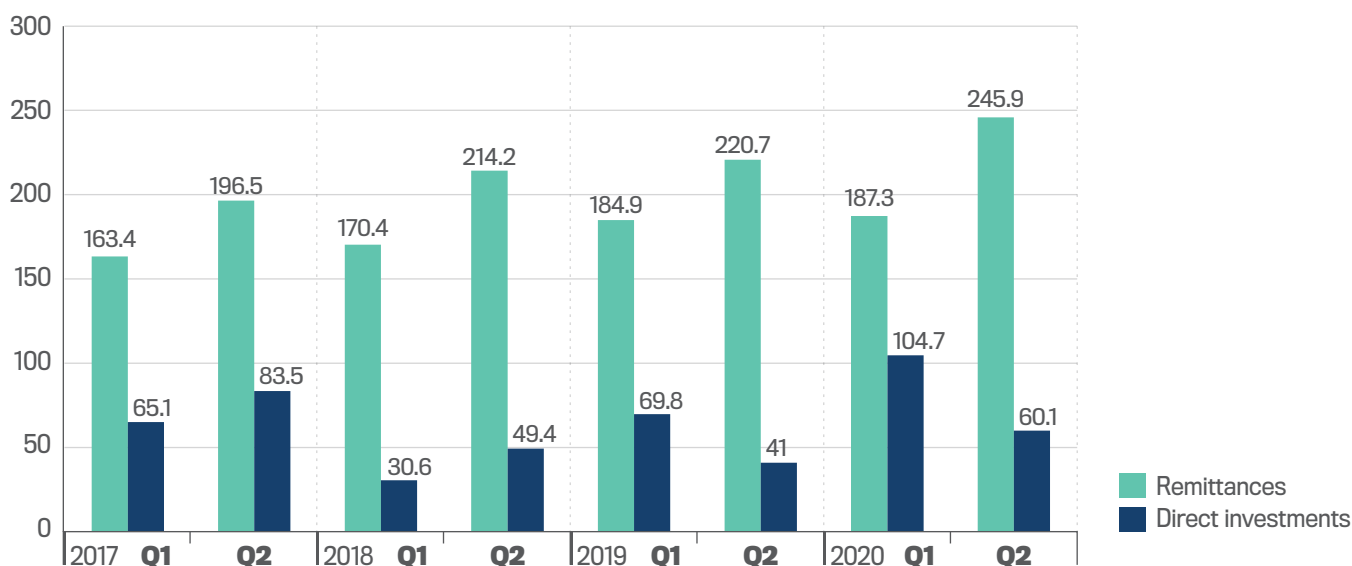
²⁵ Central Bank of Kosovo Source: <https://bit.ly/3g6QFCC>

4. External sector (remittances and foreign direct investment)

Remittances, in addition to having a developmental character in stimulating the demand in the economy and money circulation, also have a positive social aspect. In 2012, more than 22 percent of Kosovo households declared that they receive remittances from their family members.²⁶ In 2019, over 850 million Euros were sent from abroad, comprising around 12.2 percent of Gross Domestic Product.²⁷ In the first half of this year, over 433 million Euros were sent from abroad in various forms. Compared to the first half of 2019, remittances this year increased by over 27.5 million Euros, or about 7 percent.²⁸ This may have led to the growth of household final consumption which, in the second quarter, marked an increase of 3.47 percent. However, restrictions of movement across the land and air borders prevented the arrival of the diaspora, who stimulate the economy throughout the year, especially in the summer months when the largest economic output - GDP - is realized.

Foreign direct investments are another stimulating component of GDP. In the first half of this year Kosovo received over 164.7 million Euros of foreign direct investment (FDI), or about 54 million more than in the same period last year.²⁹ This increase was mainly a result of the first quarter, which had a growth of 50 percent. These investments were mainly in mining, energy and real estate.³⁰ This increase is another stimulus element that prevented the reduction of GDP in the first quarter of this year despite the closure of the economy for more than half a month during January-March.

Figure 8. Remittances and Foreign Direct Investment in the first and second quarters 2017-2020



Source: Central Bank of Kosovo

²⁶ Kosovo Agency of Statistics. Study on remittances in Kosovo. Source: <https://bit.ly/zzFTOC7>

²⁷ Central Bank of Kosovo Source: <https://bit.ly/3eYQ11t>

²⁸ Ibid.

²⁹ Central Bank of Kosovo Source: <https://bit.ly/2VM21Ek>

³⁰ Ibid.

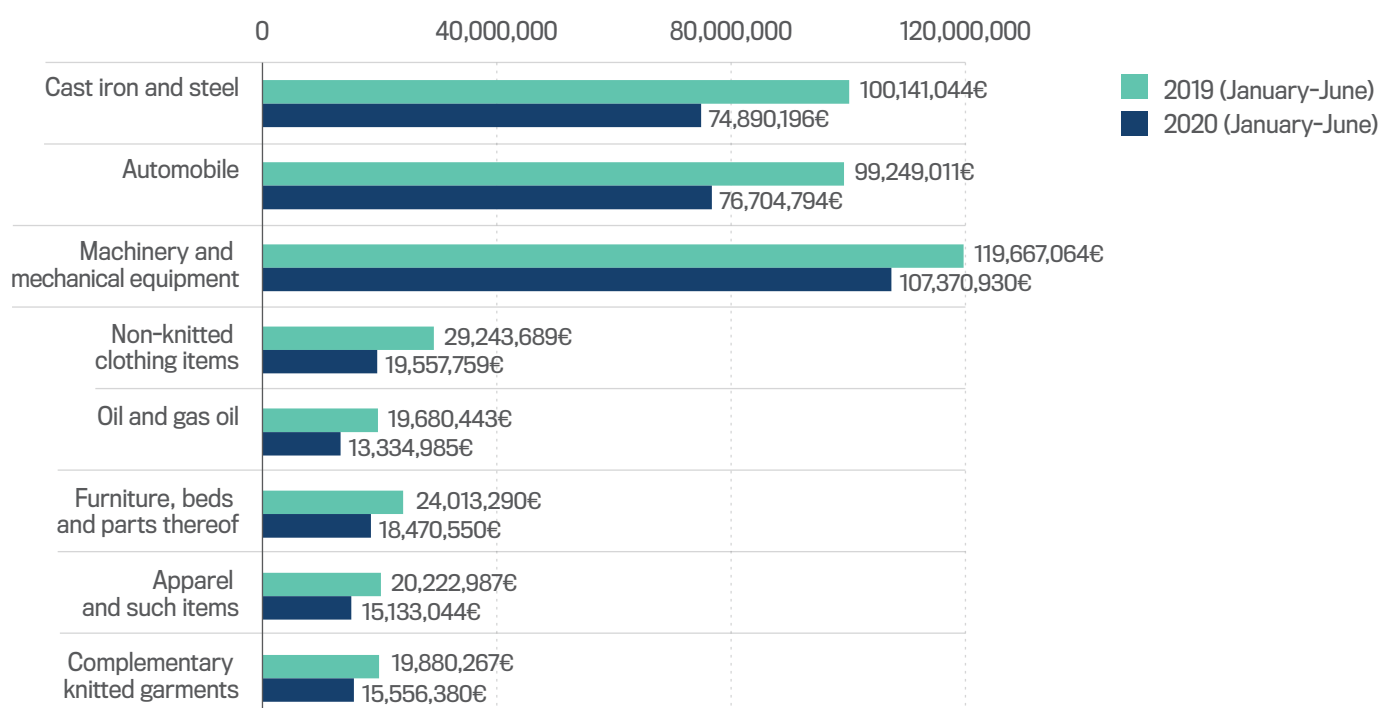
5. Changes in the import and export of goods and services

5.1. Import and export of goods

The trade deficit of goods is a negative component which continuously prevents the growth of Gross Domestic Product. In the first half of this year, around 146.2 million Euro were imported which, compared to the first half of 2019, is nine percent less. This decline is mainly related to the decrease in domestic consumption in the second quarter. On the other hand, exports increased by 31.8 million Euro (20 percent), in which case the trade deficit decreased by around 178 million Euro (-12 percent).³¹

During the first half of the year, the largest decline in imports was in products that are considered non-essential, such as vehicles, clothing and footwear, household appliances, construction materials, and others, shown in Figure 9.

Figure 9. Items with the highest decline in import



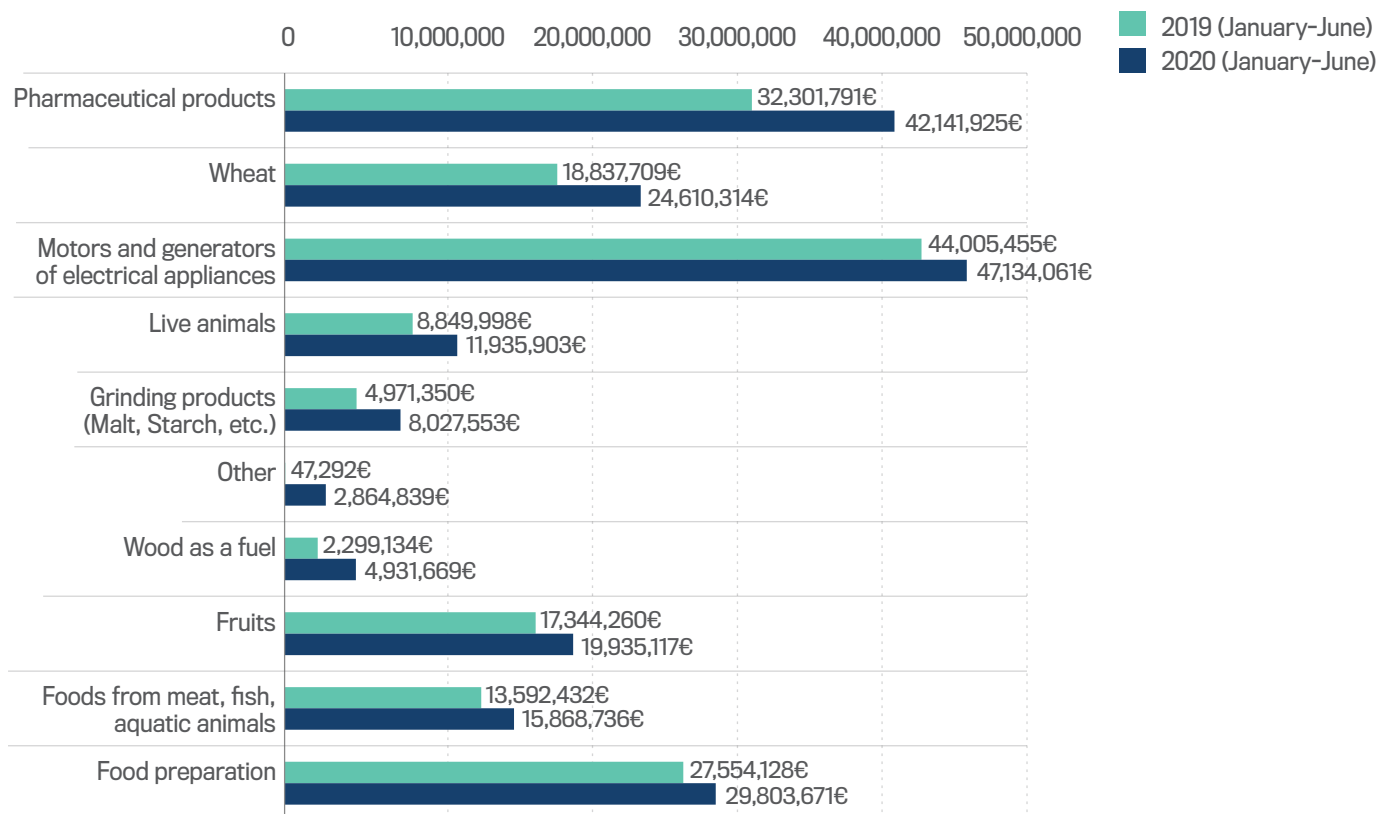
Source: Kosovo Customs

On the other hand, the products with the largest increase in imports, compared to the previous year, were essential products such as oil, sugar, cereals, food preparations, fruits, pharmaceuticals, detergents, disinfectants, and other. These are considered basic products that are not much affected by economic fluctuations. This change in consumer behavior may have been influenced by the decision of the Ministry of Finance and Transfers in March to temporarily exempt the payment of VAT on imports of wheat and flour,³² and the government decision to abolish the 100 percent tariff on products from Serbia, and Bosnia and Herzegovina.³³

³¹ Kosovo Customs. Source: <https://bit.ly/36hMfEz>

³² Republic of Kosovo. Decision. Source: <https://bit.ly/3bLeDjO>

³³ Government of the Republic of Kosovo. Decisions. Source: <https://bit.ly/3g3RegK>

Figure 10. Items with the highest decline in import

Source: Kosovo Customs

The change in consumer behavior manifested in imported products can be the same in domestic products, where household consumption can be focused mainly on basic products, thus avoiding non-essential expenses which form the basis of economic growth.

On the other hand, the outbreak of the pandemic will inevitably present barriers to supply because not all states will open up at the same time. In these circumstances, local production and manufacturing businesses that are in competition with imports will have a special opportunity to place more of their products on the market. In addition to increased exports, spending money on domestic products is one of the best ways to increase cash flow and GDP in a period of economic recession.

5.2. Balance of service payments

In recent years, Kosovo has consistently recorded a positive balance in terms of service payments with other countries. In January-June 2020, services marked a decrease of 152.6 million Euro, or about 52 percent, compared to the same months of the previous year. However, despite this, the balance of services continued to remain positive by 5 million Euro.³⁴ The biggest impact in the decline in revenues from services was felt in travel revenues, which were about 154 million Euro less.³⁵ On the other hand, revenues from computer, information and telecommunication services increased by about 168 percent.³⁶

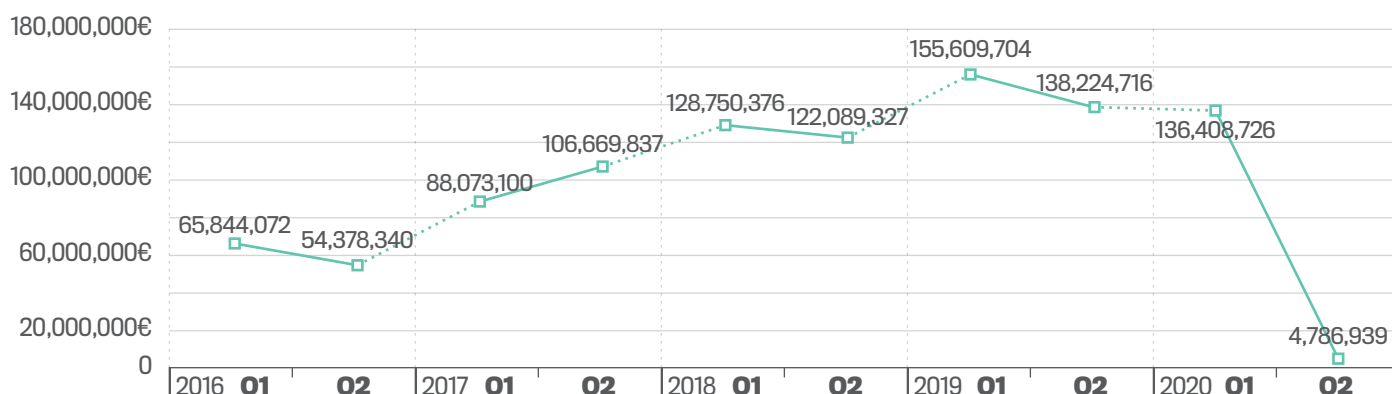
³⁴ Central Bank of Kosovo Services: Source: <https://bit.ly/36kThIU>

³⁵ Ibid.

³⁶ Ibid.

Travel restrictions during the second quarter had the largest impact on the decline in transport revenues. The non-arrival of the diaspora will negatively affect the revenues of services in the coming months. On the other hand, the computer and technology services sector, which has consistently recorded a positive balance, is expected to have revenue increases due to the needs of the global economy to digitize services in order to function during the pandemic.

Figure 11. The net balance of the payment of services



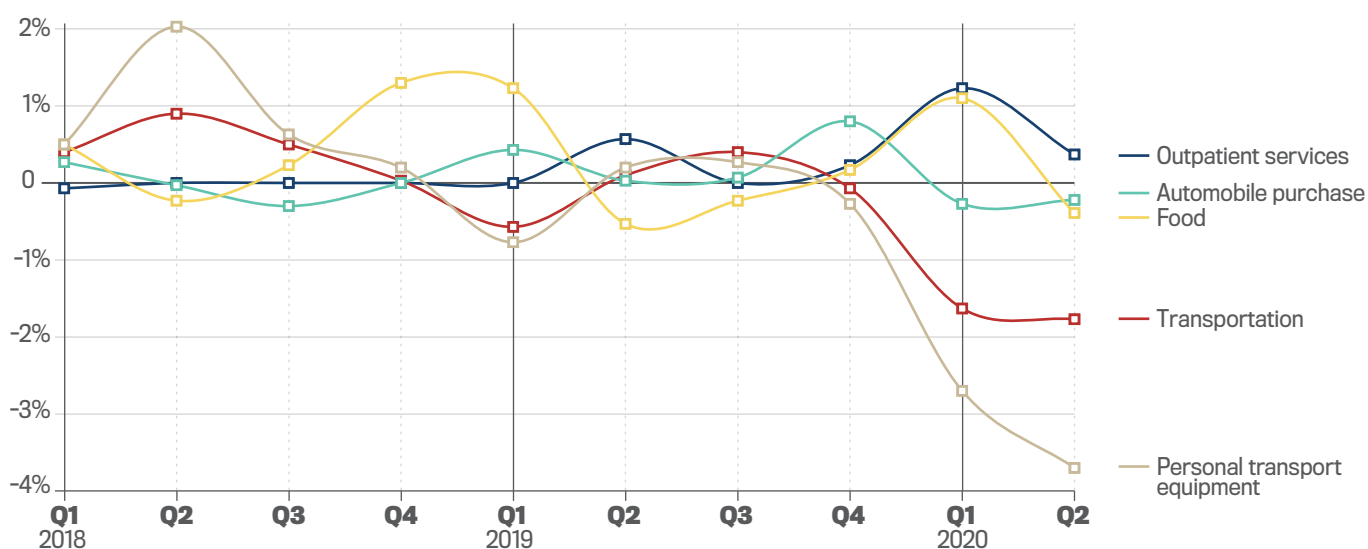
Source: Central Bank of Kosovo

6. Price changes

After the introduction of emergency measures, there was a sudden increase in demand for food products and medical services. For this reason, prices of these products in the first quarter rose. In March, the Minister of Finance and Transfers, and the Director of TAK requested the implementation of measures against arbitrary price increases during the pandemic period.³⁷

In the second quarter, with the general decline in aggregate demand, food, vehicle and transport prices dropped. As a result, there was a deflation of 1.2 percent in the second quarter.

Figure 12. Domestic price changes by quarter 2018-2020



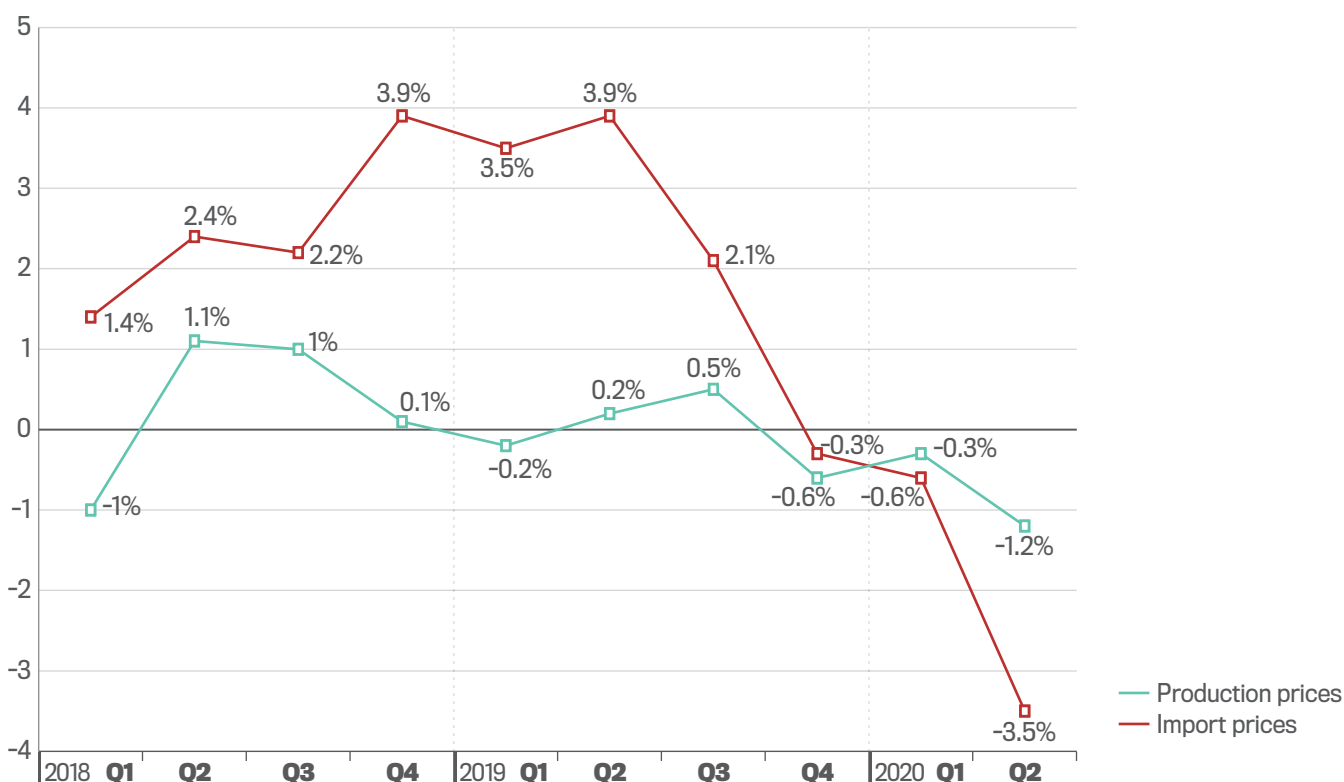
Source: Kosovo Agency of Statistics

³⁷ Minister Besnik Bislimi requests TAK to apply strict measures against businesses that manipulate with prices in the market

Domestic consumer prices may also change due to fluctuations in import prices, which in the first quarter were -0.6 percent and in the second quarter -3.5 percent.³⁸

During the first half of the year, international currencies experienced significant fluctuation. This led to the strengthening of the Euro against other currencies with which Kosovo trades, such as: Turkish lira, Albanian lek, Serbian dinar, and others.³⁹ The strengthening of the Euro enables cheaper imports, and more expensive exports to countries that do not use the Euro as their currency. Therefore, without considering other factors, the strengthening of the Euro and the drop in fuel prices have reduced import prices with some countries which do not use Euro.

Figure 13. Changes in import and domestic production prices by quarter



Source: Kosovo Agency of Statistics

7. Changes to the state budget

7.1. Changes in budget revenues in the first half of 2020

The health emergency situation also had major effects on budget revenues and expenditures. Budget revenues in the first half of this year were about 760 million Euro, or about 11 percent less than in the same period last year. The biggest impact on the decline in revenues was felt by VAT at the border, with -30.6 million Euro (-11 percent), Corporate Income Tax (-15 percent), other direct taxes (-76 percent), customs duties (-23 percent), and others, as shown in Figure 14. Declining trends in budget revenues were mainly recorded in the second quarter and are related to the decline in consumption, reflected in VAT and the poor performance of the private sector caused by the pandemic.

³⁸ Import Price Index, Q1 2020. Source: <https://bit.ly/3eOYKen>

³⁹ XE. Source: <https://bit.ly/2EC36Zm>

On the other hand, there was an increase in budget revenues from other sources, such as external and internal borrowing, which increased by about 100 million Euro, or 164 percent compared to the first half of last year.

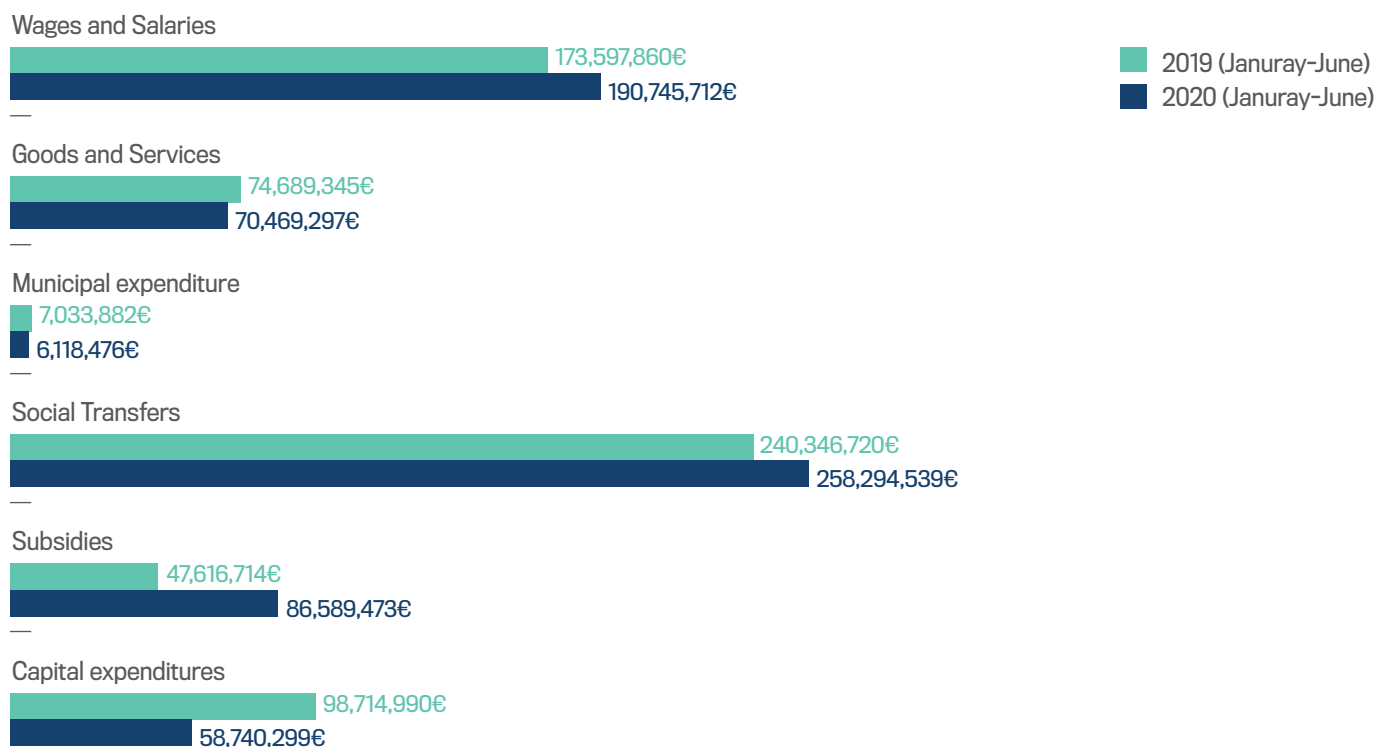
Table 3. Budget revenues in the first halves of 2019 and 2020

Description	2019 in million €	2020 in million €	Difference in million € (2020-2019)	Difference in % (2020/2019)
1. Total Receipts	1,075.61	989.67	-85.94	-8%▼
1.1 Budget revenues	853.51	760.35	-93.16	-11%▼
1.1.1 Tax revenues	755.12	683.93	-71.19	-9%▼
1.1.1.1. Direct taxes	146.76	126.1	-20.66	-14%▼
Corporate Income Tax	49.22	41.9	-7.32	-15%▼
Personal Income Tax	82.16	74.76	-7.40	-9%▼
Property tax	13	8.86	-4.14	-32%▼
Other direct taxes	2.38	0.58	-1.80	-76%▼
1.1.1.2. Indirect taxes	628.89	569.13	-59.76	-10%▼
Value Added Tax VAT	375.89	339.2	-36.69	-10%▼
Customs Duty	58.66	45.31	-13.35	-23%▼
Excise	192.7	183.68	-9.02	-5%▼
Other indirect taxes	1.64	0.94	-0.70	-43%▼
1.1.1.3. Tax returns	-20.54	-11.3	9.24	-45%▼
1.2. Non-tax revenues	98.39	76.42	-21.97	-22%▼
1.2. Receipts from funding	222.1	229.33	7.23	3%▲
External Borrowing	19.96	72.79	52.83	265%▲
Internal Borrowing	45.33	92.57	47.24	104%▲
Liquidation funds from PAK	150	55.05	-94.95	-63%▼
Other	6.81	8.92	2.11	31%▲

Source: Ministry of Finance and Transfers⁴⁰

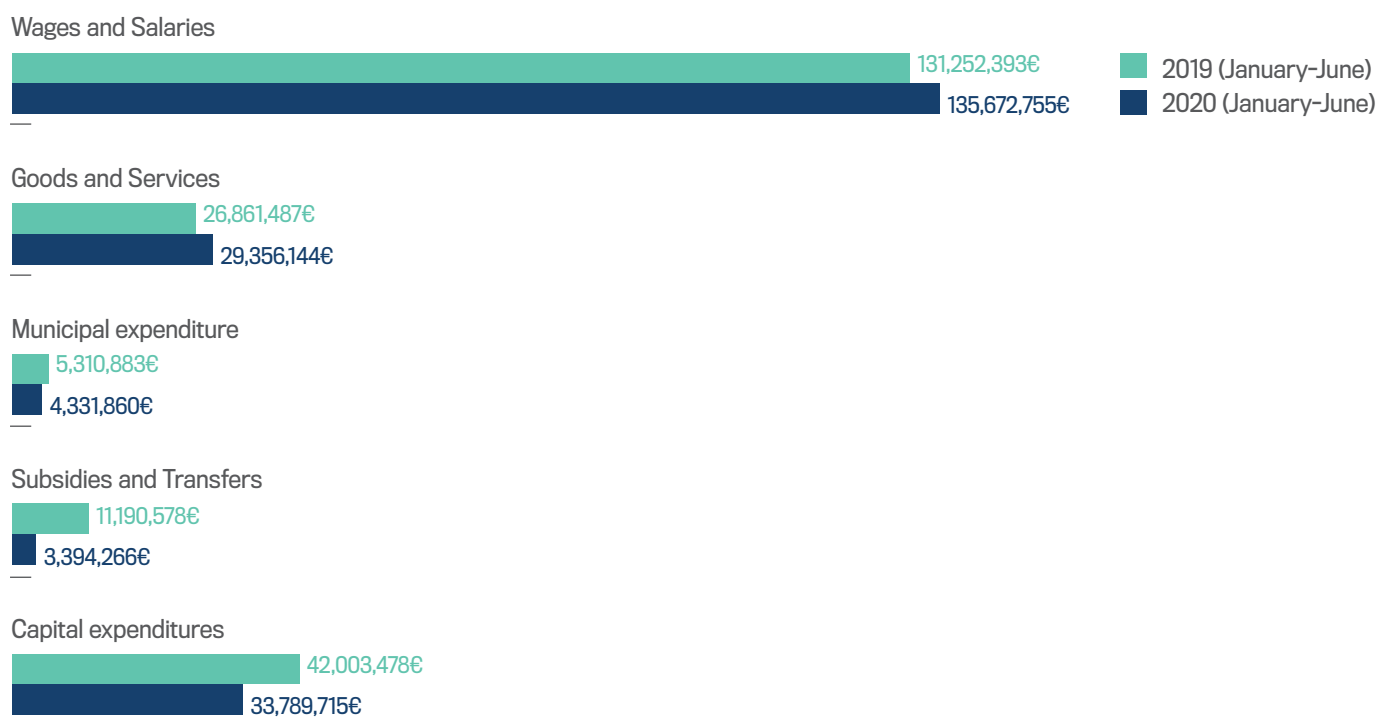
7.2. Changes in budget expenditures for the first half of 2020

In the first half of 2020, budget expenditures increased by about 18.8 million Euro, or 2.2 percent compared to the same period last year. At the central level, expenditures were reduced in the category of goods and services, by 4.2 million (-6 percent), municipal expenditures by close to 1 million Euro (-13 percent), and capital expenditures by about 40 million Euro (-40 percent). At the same time, salary expenditures increased by over 17 million Euro (10 percent), social transfers by 18 million Euro (7 percent), and subsidies by 39 million Euro (82 percent) compared to the same period last year.

Figure 14. Central budget expenditures in the first half of 2019-2020

Source: Ministry of Finance and Transfers

There were also changes in spending at the local level. Compared to the first half of 2019, this year there was a decrease in capital expenditures by 8.2 million Euro (-20 percent), subsidies and transfers by 7.8 million Euro (-70 percent), while there was an increase in expenditures on salaries by 4.4 million Euro (3 percent), and goods and services (2.5 million Euro).

Figure 15. Municipal budget expenditures in the first halves of 2019 and 2020

Source: Ministry of Finance and Transfers

The budget deficit in the first half of this year was about 117 million Euro. This deficit has more to do with declining revenues rather than increased budget expenditures. Compared to the first half of 2019, expenditures this year increased by only 18.8 million Euro, or about 2 percent. Meanwhile, to address the emergency situation, there was a reallocation of expenditures at both the central and local levels, within the legal threshold. In the first half of the year capital expenditures were reduced in both levels.

Without considering other factors, the reallocation of expenditures from one category to another may reduce the inequality in society caused by the pandemic, but not necessarily increase the Gross Domestic Product in the short run. To recover the decline in economic activity or GDP, an increase in public spending is generally required to cover for private sector lack of spending. For this reason, until June, the government decided to issue securities worth 92.57 million Euro and signed several international financing agreements at a value of 68.95 million Euro, to increase its spending capacity.⁴¹

7.3. Economic stabilization measures of the Government of Kosovo

In economic recessions, human and production capacity remains the same as under normal circumstances, but lacks full utilization. Citizens and businesses facing low expectations for the economic future, reduce costs. Considering that the spending of one individual is an income for someone else, the reduction of the general demand necessarily reduces the income of all citizens and, consequently, the GDP. In these circumstances when citizens do not spend, the state budget is the only source of weight that can restore money circulation and make production capacity functional.

Fortunately, Kosovo has a relatively low public debt, of about 20 percentage points below the legal limit, but also a liquid banking environment, where the public and private sectors do not compete for loans. Increasing spending and keeping taxes low increases the budget deficit and public debt in the short run. However, on the other hand, money is saved which would otherwise be spent on various social assistance schemes or reduction of tax revenues as a result of the reduced economy.

Following the closure of economic activity, the Ministry of Finance and Transfers, on March 30, 2020, received government approval for the “Emergency Fiscal Package”, worth 190 million Euro, to reduce the damages from revenue cuts amid the closure of a large part of the economy.⁴²

This package consists of 15 measures. The first part, which includes measures 1, 2, 9, 15, is designed to provide support to groups of the society who are most exposed to extreme poverty, such as social assistance beneficiaries, non-majority groups, people with unstable employment, and those in the informal sector of the economy. The second part addresses employees through measures 3, 7 and 14 with supplementary payments of 170 Euro as well as business incentives for the registration of workers in the formal sector. The third part is aimed at businesses, where the Government of Kosovo will undertake to pay up to 50 percent of the rent of businesses affected by the state of emergency. In addition,

⁴¹ Ministry of Finance and Transfers Quarterly data on total debt. Source: <https://bit.ly/3kUNYG5>

⁴² Ministry of Finance and Transfers Decision No. 31/2020. Source: <https://bit.ly/2Sw4cKb>

a loan guarantee of 30 percent above that of the Kosovo Credit Guarantee Fund is offered to facilitate lending, the dates for the filing of liabilities to the Tax Administration of Kosovo is deferred, and assistance is provided to public and private enterprises that offer the same products or services such as public ones. Find the full description in the Annex.

The last opportunity to apply for the “Emergency Package” measures was May 15, 2020. In the second quarter, over 100 thousand beneficiaries of social schemes received double payments for three months (Measure 1) and 116,770 received allowances of 30 Euro (Measure 2).⁴³ Within this period, 116,770 employees received the payment of 170 Euro (Measure 3) with another 44 thousand pending receipt of the payment. Beneficiaries of other measures are presented in the Annex.

The emergency package was not fully implemented in the second quarter and, as a result, many eligible people to benefit from this package did not receive timely support. Delays in implementing the package, among other things, were caused due to the break-up of the ruling coalition and the change in government.

Before the full implementation of the first package was completed, in the second quarter, the second “Economic Recovery Package” was drafted, which amounts to over one billion Euro and requires the approval of the Assembly. Given the break-up of the government and the delays in forming the new government, it is still unclear when the second package will be adopted. The lack or delays to quickly execute the “Economic Recovery Package” at the beginning of the third quarter may cause irreparable economic and social consequences in the country. Many households and economic enterprises, in the absence of income against financial obligations, such as loans or other debts, will be forced to sell assets. This would be normal in isolated instances, but if the majority of enterprises or households take such decisions, it will risk causing a decrease of overall prices, depreciating all existing assets and further deteriorating the situation.

43 Ministry of Finance and Transfers Economic Recovery Package. Source: <https://bit.ly/2HweN4T>

8. Conclusions

After the confirmation of the first cases with COVID-19, on March 13, 2020 the Government of Kosovo decided to close all economic activities, with the exception of essential activities such as the supply of food and pharmaceuticals. Although most of the first quarter continued normally, the social closure for a few days caused immediate effects in the economy. Gross Domestic Product in the first quarter had the lowest growth in the last four years, decreasing in the second quarter by 9.28 percent.

The emergency situation changed consumer behavior, as households raised spending on basic products such as food, water and electricity, while reducing non-essential spending. This is reflected in the import data and the performance of industries in Kosovo. Economic activities that marked an increase in the second quarter were the extractive industry, processing, electricity and water supply, by 19.8 percent, and information and communication industries by 29.6 percent. All other industries suffered a decline in revenues. The highest decline was recorded in the construction industry, with -47.08 percent, and trade, transport, accommodation and food services, with -24.4 percent.

Following the restrictive measures, the Central Bank, in cooperation with lending institutions, offered the possibility of deferring the repayment of loan installments for three months, followed by the possibility to apply for restructuring of loans. At the same time, banking system data indicated signals of decline in aggregate demand, with bank deposits increasing and new loans dropping.

The Government of Kosovo, in an effort to stimulate domestic consumption and ease the economic situation, approved the first fiscal package worth 190 million Euro. It also proposed a refocus of budget expenditures, within the legal thresholds, from the category of capital expenditures to the category of salaries, transfers and subsidies. Although a large number of citizens and businesses benefited from this package, its full implementation did not take place in the second quarter. As a result, expenditures in the first six months amounted to only 18.8 million Euro, or around 2 percent higher than in the first half of the previous year. The refocus of the budget, as the only measure barring an increase in public debt, will be ineffective in supporting economic recovery.

Kosovo has a very low public debt and a very liquid and well-capitalized financial system. This provides opportunities for public institutions to intervene in the economy to slowdown the decline in domestic production. The second quarter and, particularly, the third quarter of September are the periods when Kosovo achieves the highest production in the year. This period is essential in reflecting the economic damages caused by the pandemic. Consequently, it will show the capacity of economic support institutions, both financial and public, to the extent that they are able to use the above-mentioned advantages to manage the economic situation.

9. Annex

Annex 1. Summary of measures of the Emergency Fiscal Package

Description of measures		No. of beneficiaries	Maximum amount (€)
1.	Double payment of the value of the social scheme (April-June).	100.564	7.65 million
2.	Additional payment of € 30 for all beneficiaries of social and pension schemes with payment under € 100 (April-June) provided that they are beneficiaries of only one scheme, including those who have been in the scheme since January this year, but have not reapplied.	167.768	13 million
3.1	Coverage of monthly salaries of employees with € 170 for the period April-May for companies in difficulties as a result of the state of emergency.	116.770	41 million
3.2	Rent subsidy of up to 50 percent for April-May for small and medium enterprises that are in difficulties.	14, 988	12 million
3.3	Coverage of the value of pension contributions for salaries related to the measures provided by this decision for April-May.	N/A	8 million
4.	Interest-free lending to public enterprises with financial difficulties to maintain liquidity with return until 31.12.2020.	N/A	20 million
5.	Financial support to Kosovo municipalities affected by the pandemic, as needed.	N/A	10 million
6.	Bonus payment, on top of the salary in the amount of € 300 for field workers and those directly exposed to the risk of infection in their work such as: medical staff, police officers, Correctional Service guards, firefighters, KSF staff, those working in the Quarantine-Students Center of Prishtina, inspectors, and others, for the month of April-May.	22.088	15 million
7.	Additional payment of € 100 for employees of grocery stores, bakeries, and pharmacies for April-May.	10.685	3 million
8.	Payment of monthly assistance of € 130 for citizens who lose their job due to the emergency situation for April-May.	5.559 households	4 million
9.	Support for initiatives and projects aimed at improving the lives of non-majority communities that have been hit hard by the pandemic.	N/A	2 million
10.	Provision of liquidity for: <ol style="list-style-type: none"> 1. Micro-enterprises and self-employed through programs of the Kosovo Credit Guarantee Fund, up to 10 thousand Euro, with a maturity of 24 months. Namely, 50 percent from KCGF and up to 30 percent from this measure. 2. Businesses/ companies authorized to provide basic services similar to public utility companies, with a return until 31.12.2020. 	N/A	15 million
11.	Increase of the budget for grants and subsidies of the Ministry of Agriculture, Forestry and Rural Development, to increase agricultural production.	N/A	5 million
12.	Increase of the budget for grants and subsidies of the Ministry of Culture, Youth and Sports.	N/A	5 million
13.	Support for Kosovo exporters after the end of the emergency situation.	N/A	10 million
14.	Financial support for companies that register their employees with an employment contract for at least one year during the emergency situation, with € 130 for the following two months after registration.	N/A	6 million
15.	Payment of monthly assistance in the amount of € 130 for citizens with severe social conditions who are not beneficiaries of any monthly income from the Kosovo budget for April-June. This includes occasional workers who do not have a stable job.	N/A	3 million

Source: Ministry of Finance and Transfers⁴⁴

Annex 2. Revenue and returns of the Kosovo Customs for the period
January-June 2020

Types of revenues	2018	2019	2020	Difference (2020/2019)	Difference % (2020/2019)
in millions of Euros					
Gross revenues	504.36	526.25	471.43	-54.83	-10%
VAT	263.02	271.07	240.47	-30.61	-11%
Customs duty on import	55.07	58.66	45.31	-13.36	-23%
Excise at borders	176.9	188.03	183.6	-4.43	-2%
Internal excise	7.26	4.67	0.09	-4.59	-98%
Others /1	2.11	3.82	1.97	-1.85	-48%
Returns	-3.79	-0.63	-0.65	-0.01	2%
VAT return	-0.26	-0.25	-0.41	-0.16	66%
Other returns /2	-3.53	-0.39	-0.24	0.15	-39%
Net revenues	500.57	526.62	470.78	-54.84	-10%

Source: Ministry of Finance and Transfers



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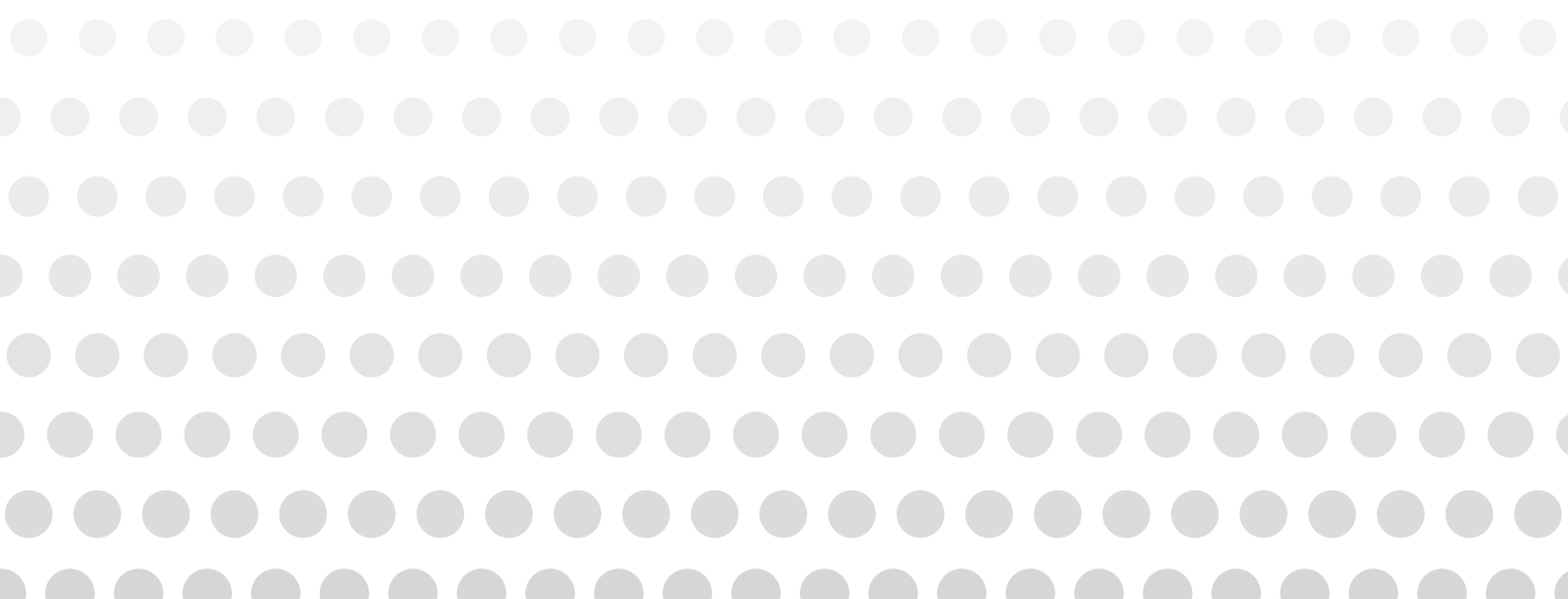
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