



REPUBLIC OF KOSOVO

February 2021

2020 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF KOSOVO

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2020 Article IV consultation with the Republic of Kosovo, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 12, 2021 consideration of the staff report that concluded the Article IV consultation with the Republic of Kosovo.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 12, 2021 following discussions that ended on December 2, 2020, with the officials of the Republic of Kosovo on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 1, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Republic of Kosovo.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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IMF Executive Board Concludes 2020 Article IV Consultation with the Republic of Kosovo

FOR IMMEDIATE RELEASE

Washington, DC – February 17, 2021: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Kosovo.

Kosovo has been hit hard by the COVID-19 pandemic. Despite policy support, economic activity is estimated to have fallen 6 percent in 2020 on account of the combined effect of strict domestic containment measures and international travel restrictions.

The fiscal deficit increased to 7.7 percent of GDP, given the large fall in tax revenues and the implementation of mitigation and recovery measures of 4.2 percent of GDP. The current account deficit is estimated to have increased to 7.5 percent of GDP mainly due to a large decline in diaspora-related inflows, most notably in tourism. Gross international reserves declined but remain adequate in part due to the purchase under the IMF's Rapid Financing Instrument (RFI) in April 2020 and the use of other external financing. Banks have weathered the recession well to date, and the high pre-COVID19 liquidity levels and ample capital buffers bode well for the system's stability.

Economic activity is forecast to rebound by 4.5 percent in 2021 supported by continued fiscal stimulus, and the projected gradual relaxation of containment measures. The outlook remains subject to large uncertainty, and depends on the evolution of the pandemic, the speed of vaccinations, and political developments. The pandemic is expected to leave long-lasting scars. While nominal GDP is projected to return to pre-crisis levels by 2022, it will remain below the pre-crisis trend for a protracted period. A stronger implementation of structural reforms could mitigate these longer-term effects.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment²

Executive directors commended the authorities' swift and comprehensive policy response, which has helped mitigate the health, social, and economic impact of the pandemic. Directors considered that policies should remain broadly supportive and flexible given downside risks and uncertainty. Noting that the crisis compounded pre-existing vulnerabilities, Directors emphasized the importance of reinvigorating structural reforms to promote stronger, more inclusive growth.

Directors agreed that the immediate priority is to continue supporting the economy until the recovery is well entrenched, while improving the design, targeting, and transparency of support measures. They encouraged the authorities to firm up the financing program for 2021 to support the planned mitigation and recovery measures, as well as considering contingency plans. Directors underscored the need to revert to the fiscal rule as the policy anchor after the recovery has taken hold. They recommended focusing consolidation efforts on improving the targeting of social and economic transfers, revenue mobilization, and tax administration, supported by a comprehensive review of tax expenditures.

Directors welcomed the authorities' commitment to reform the social protection system, with a view to ensuring equitable access. They emphasized the importance of restraining public wage increases and assessing the sustainability of the current pension system before introducing any amendments.

Directors recognized the resilience of the banking system. They recommended that the authorities closely monitor bank asset quality, ensure transparency in reflecting losses once regulatory forbearance is lifted, and further strengthen the AML/CFT framework. They concurred that while capital standards should be preserved, capital buffers should be replenished gradually. Directors underscored the key role of effective governance at the central bank and encouraged the authorities to fill existing board vacancies as soon as possible.

Directors welcomed ongoing efforts to improve governance and modernize public sector administration. They welcomed the authorities' intention to conduct a special audit of COVID-related relief measures. Directors encouraged strengthening the management and supervision of public sector enterprises, and increasing the efficiency of public investment, and subsidies.

Directors emphasized the importance of accelerating structural reforms over the medium term, particularly to address human capital and infrastructure gaps, and improve the business environment.

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.IMF.org/external/np/sec/misc/qualifiers.htm>.

Kosovo: Selected Economic Indicators, 2017–25

(Percent, unless otherwise indicated)

Population: 1.8 million (2018)

Quota: SDR 82.6 million

Main exports: metals and mineral products (2019)

Key export markets: Albania, Germany, Italy, Macedonia, Montenegro and Switzerland (2019)

Per Capita GDP: €3,947 (2019)

Poverty rate: 3.6 percent (2017) 1/

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.			Projections		
Output and Employment	4.2	3.8	4.9	-6.0	4.5	5.5	4.0	4.0	4.0
Contribution to growth (percentage points of GDP)									
Consumption	1.5	5.2	1.6	0.8	2.3	3.4	2.6	2.6	2.6
Investment	1.5	2.3	1.9	-1.8	1.5	2.7	1.3	1.7	1.7
Net Exports	1.2	-3.7	1.4	-5.2	0.8	-0.6	0.1	-0.2	-0.2
Official unemployment (percent of workforce) 2/	30.5	29.6	25.9	24.6	...	...	...	...	...
Prices									
CPI, period average	1.5	1.1	2.7	0.2	0.3	1.5	1.7	1.9	1.9
CPI, end of period	0.5	2.9	1.2	-0.3	1.4	1.6	1.7	1.7	1.7
Real effective exchange rate (average; - =depreciation)	0.6	2.7	-0.1	0.0	...	...	...	...	...
General government budget (percent of GDP)									
Revenues and grants	26.5	26.4	26.8	25.1	26.6	26.2	26.2	26.1	26.2
Expenditures	27.9	29.2	29.6	32.8	32.5	29.1	28.6	28.7	28.7
Overall Balance (Fiscal rule) 3/	-1.3	-1.5	-0.7	-5.8	-4.9	-1.7	-1.6	-1.6	-1.5
Overall balance	-1.4	-2.9	-2.8	-7.7	-5.9	-2.9	-2.5	-2.6	-2.5
Stock of government bank balances	4.6	4.5	5.2	4.0	3.6	4.1	4.5	4.7	4.9
Total public debt 4/	16.2	17.0	17.6	24.5	28.7	30.4	31.7	32.9	34.1
Balance of Payments (percent of GDP)									
Current account balance, incl. official transfers	-5.4	-7.6	-5.5	-7.5	-6.4	-6.1	-5.2	-4.9	-4.8
<i>Of which:</i> Official transfers 5/	3.1	3.4	3.4	3.7	3.1	2.8	2.7	2.5	2.4
<i>Of which:</i> Remittance inflows	11.8	11.9	12.0	13.7	13.9	13.6	13.3	12.9	12.5
Financial account	-4.3	-5.0	-2.6	-7.8	-5.6	-4.7	-3.8	-3.5	-3.5
<i>Of which:</i> Direct investment, net	-3.3	-3.4	-2.8	-3.0	-3.2	-3.3	-3.2	-3.2	-3.2
Portfolio investment, net	0.2	-3.0	0.8	-0.5	0.3	0.5	0.1	-0.1	0.1
Errors and Omissions	1.3	2.7	3.0	-0.2	0.9	1.5	1.5	1.5	1.5
Financial Sector									
Non-performing loans (percent of total loans) 6/	3.1	2.5	1.9	2.5	...	...	...	...	...
Bank credit to the private sector (percent change)	11.5	10.8	10.0	6.5	9.1	10.3	7.5	7.5	7.0
Deposits of the private sector (percent change) 7/	5.3	9.3	15.6	11.2	4.1	9.3	7.5	7.2	6.7
Regulatory capital to risk weighted assets 6/	18.1	17.0	15.9	16.7	...	...	...	...	...
<i>Memorandum items:</i>									
GDP (millions of euros)	6,414	6,726	7,104	6,817	7,101	7,606	8,051	8,533	9,027
Real GDP growth per capita	3.4	4.1	4.5	-6.4	4.1	5.1	3.6	3.6	3.6

Sources: Kosovo authorities; and IMF staff estimates and projections.

1/ World Bank's Poverty headcount ratio at US\$3.20 a day (2011 PPP).

2/ 2020 as of Q3 2020.

3/ The Fiscal rule excludes capital investment financed by multilateral/bilateral projects contracted after 2015.

4/ Includes guarantees and beginning in 2020, Euro 120 million of debt with KPST. It does not include contingent debt of former Yugoslavia.

5/ Total foreign assistance excluding capital transfers.

6/ 2020 is as of November 2020.

7/ Projections assume that the increase in deposits due to early withdrawals from KPST accounts in 2020 is gradually withdrawn out of the banking sector in 2021.



REPUBLIC OF KOSOVO

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

February 1, 2021

KEY ISSUES

COVID-19 impact. Strict containment measures and international travel restrictions limited the health impact of the first wave, but the second and third waves have stretched the capacity of the health system and led to a reinstatement of containment measures. Despite policy support, GDP is estimated to have contracted by about 6 percent in 2020. The fiscal deficit soared to 7.7 percent, and the current account deficit increased to 7.5 percent of GDP mainly on account of decreases in diaspora-related inflows. The banking sector has remained stable. Economic activity is projected to rebound by 4.5 percent in 2021, but downside risks related with the uncertain course of the pandemic and the complex political situation are prevalent.

Policy challenges. Fiscal policy needs to continue to cushion income losses for households and firms, but strengthening the design, targeting, and transparency of measures remains essential. While the suspension of the fiscal rule over 2020–21 is warranted, it needs to be combined with a clearly communicated commitment for its gradual reinstatement when the economic recovery is entrenched. Financial policies should continue mitigating the shock to incomes without endangering banking sector stability. Bank capital standards should not be weakened but the Central Bank should exercise flexibility to allow banks more time to reconstitute capital buffers.

Rekindling structural reforms post-COVID-19. While preserving people's health and combating the recession are the near-term priorities, the pandemic exacerbated many pre-existing structural challenges. Addressing these remains essential to increase productivity and ensure that gains are evenly shared.

Approved By
Mahmood Pradhan
(EUR) and Daria
Zakharova (SPR)

The discussions took place remotely during September 23 – October 8, 2020, with further discussions during November 16 – December 2. The team consisted of Gabriel Di Bella (head), Oana Luca, Zhongxia Zhang, Xiao Liu, and Guillermo Tolosa (all EUR), and was assisted by Stephanie Eble, Selim Thaci and Amanda Edwards (Resident Representative Office). Merita Kernja, Agnesa Zalezakova and Rafaela Jarin assisted in the preparation of the report. The mission met with the Prime Minister, Mr. Hoti, the Minister of Finance, Ms. Bajrami, the Governor of the Central Bank, Mr. Mehmeti, and other senior officials and representatives of civil society. Mr. Mehmedi (OED) participated in most meetings.

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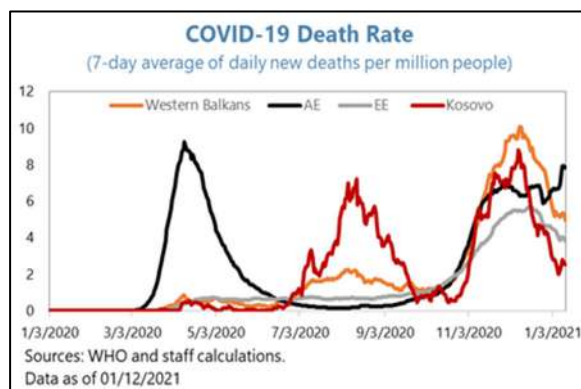
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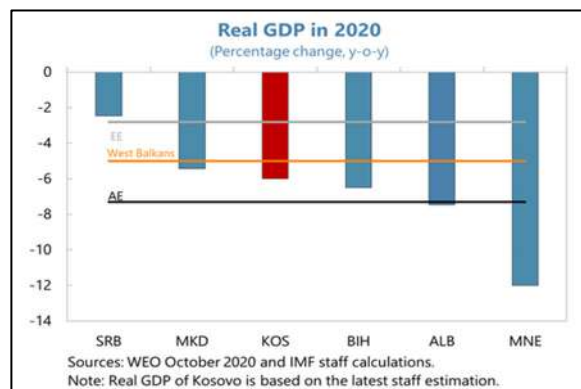
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CONTEXT: THE PANDEMIC'S HIGH SOCIO-ECONOMIC TOLL

1. Kosovo has been hit hard by the COVID-19 pandemic. Strict containment measures and international travel restrictions limited the impact on health of the first virus wave in March-June 2020. The easing of restrictions in June led to a strong second wave, though the reimposition of movement restrictions in July was effective in reducing the number of cases. Since late October, a third wave is ongoing, which is the strongest so far both in terms of cases and mortality rates. While the response of the health system has been broadly adequate, its capacity has been stretched. Kosovo's health infrastructure compares unfavorably with that of the region (Appendix I).



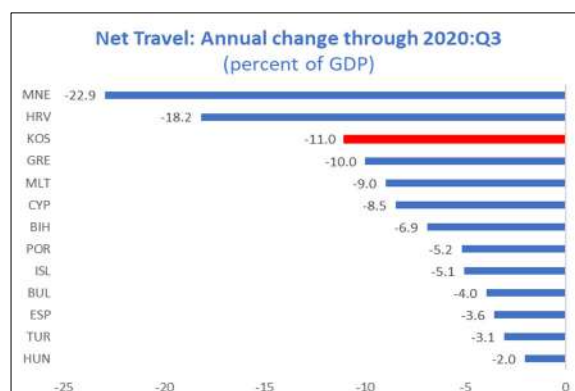
2. Despite policy support, GDP is estimated to have contracted by about 6 percent in 2020. Mobility restrictions led to plummeting economic activity in Q2:2020 (-10 percent y/y). The easing of restrictions in June led to a rebound in activity in Q3:2020, with GDP increasing about 3 percent on a sequential seasonally adjusted basis, cutting about 1/3rd of the second quarter losses. The timid recovery occurred on the back of a subdued summer tourism season, which saw diaspora-related travel contract by about 60 percent. Inflation declined to about -0.3 percent (y/y) in November, as the effect of weak economic activity was compounded by lower energy prices and the elimination of import tariffs from Serbia and Bosnia and Herzegovina in April 2020. The decline in activity is expected to be similar to the average of the Western Balkans' economies.



3. Kosovo's external position was severely affected. International travel restrictions and plummeting growth in countries where the diaspora resides (estimated at -6 percent for 2020) caused diaspora flows (tourism receipts, remittances and real estate purchases) to decline from around 38 percent of GDP in 2019 to less than 30 percent of GDP in 2020 (Box 1). The collapse was felt more intensely in net travel flows, where inter-annual receipts through Q3:2020 decreased by 11 percent of GDP, among the highest in Europe. Despite a decrease in imports and increases in

remittances through formal channels (about 10 percent y/y through October), the current account deficit is estimated to have widened to 7.5 percent of GDP. The higher deficit was financed by increased foreign debt (including a purchase under the IMF's Rapid Financing Instrument -RFI- for €51 million, 0.8 percent of GDP), and decreases in international reserves. Staff calculations suggest that Central Bank's (CBK) international reserves will end 2020 at just about the level considered appropriate by IMF reserve adequacy (RA) metrics.

Moreover, the results of the EBA-lite methodology suggest that the external position remained weaker than implied by medium-term fundamentals and desirable policy settings (Annex III).

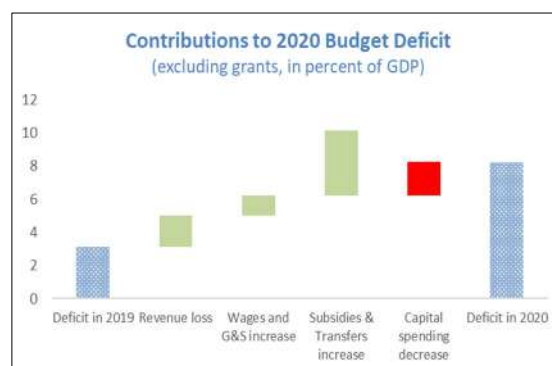


4. The authorities allowed a relaxation of the fiscal rule over 2020-21 to accommodate the implementation of support measures and that of the recession-induced loss of tax revenues. While fiscal revenues in 2020 declined by about 9 percent, primary spending increased by more than 6 percent, because of mitigation and recovery measures that led to a rise in subsidies and transfers of about 40 percent. As a result, the fiscal deficit soared to 7.7 percent of GDP (8.2 percent of GDP excluding grants). The “fiscal rule” deficit (that excludes capital investment financed by IFIs and bilateral sources contracted after 2015) posted 5.8 percent of GDP, significantly above the 2 percent of GDP deficit ceiling. The deficit was covered by net external financing of around 2.5 percent of GDP (budget-support grants and loans from the EU, lending from the Council of Europe, and financing from the IMF and the World Bank), net domestic debt placements of 2.5 percent of GDP, and decreases in government deposits of about €200 million (3 percent of GDP). Public debt increased to 24.5 percent of GDP at end-2020 (17.6 percent of GDP in 2019), given the large budgetary deficit, but also due to extra-budgetary transfers through the Kosovo Pension Savings Trust (KPST) of about 1.8 percent of GDP.

Kosovo: Summary of Fiscal Accounts					
(% change with respect equal period last year)					
2020					
	Q1	Q2	Q3	Q4	2020 (*)
Revenues	0.3	-22.4	-11.4	-2.6	-8.7
Direct Taxes	1.0	-22.2	-4.1	1.1	-8.7
VAT	1.7	-23.2	-13.3	-1.0	-8.7
Domestic VAT	-0.3	-17.7	-15.0	4.0	-6.4
Border VAT	2.8	-24.9	-12.6	-2.8	-9.6
Customs	-8.8	-36.6	-24.8	-16.5	-21.9
Excises	-0.4	-12.5	-16.7	-4.2	-8.4
Non-tax Rev.	-4.9	-41.9	-14.7	-8.3	-17.1
Primary Spending	-5.3	3.3	12.3	9.1	6.4
Wages	-0.3	8.5	8.7	7.4	7.0
G&S+Utilities	-6.4	-5.3	-1.1	7.0	0.6
Subs.- Transf.	-0.4	25.3	36.4	78.2	38.3
Investment	-37.0	-35.4	-4.8	-35.3	-28.6
Debt Service	33.9	76.7	55.3	49.7	54.6

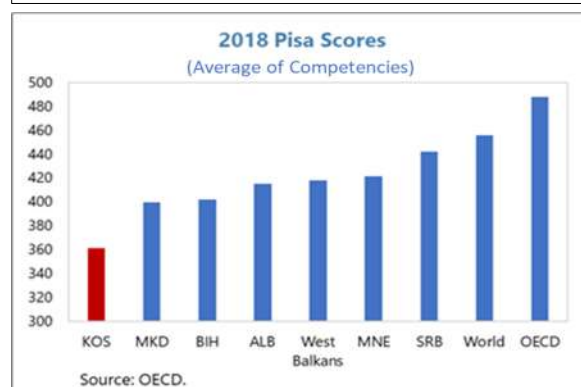
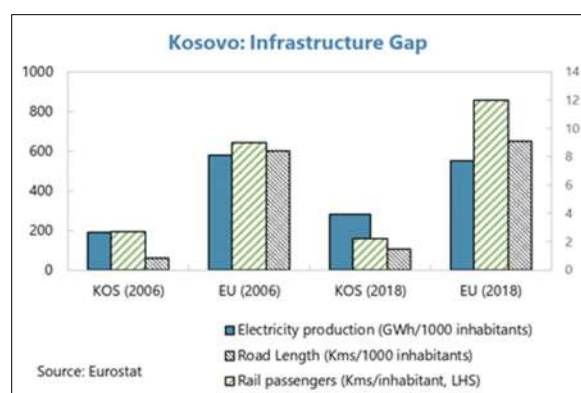
(*) Data is preliminary

5. Despite fears at the onset of the pandemic, bank deposits and lending have continued to grow, albeit at a lower rate than previous years. Strong pre-COVID-19 capital and liquidity buffers and low non-performing loans (NPLs, of less than 2 percent) contributed to



continuing stability in the banking sector. While deposits are estimated to have grown by around 11 percent in 2020, about 40 percent of such increase is due to KPST pension account withdrawals that were authorized as part of the COVID-19 relief package. In turn, lending is expected to have grown by around 6 percent. NPLs through November 2020 remained low (at 2.5 percent) given forbearance on the classification of restructured loans through end-September. Although the large market share of foreign-owned banks, the high liquidity levels and ample capital buffers bode well for the system's stability, pockets of vulnerabilities may show as forbearance is lifted up.

6. The pandemic has exacerbated many pre-existing structural challenges. Social distancing measures together with the need to refocus spending pushed public investment down by close to 30 percent in 2020. This compounded structural weaknesses in public investment management and will aggravate infrastructure gaps. The need to rely on remote learning combined with weaker infrastructure and lack of adequate equipment in many households will likely increase the education gap. As the health system worked at capacity for most of 2020, the quality of services further suffered. The disproportionate impact of the pandemic in high contact sectors where informality is prevalent (such as hospitality and tourism), fragmented and untargeted social and pension schemes, and government interventions that mainly focused on the formal sector, will lead to increased inequality. Low labor participation rates and high unemployment rates, and emigration, reflect both insufficient economic dynamism and failure to account for the large informal sector (of about 30 percent of GDP). These structural constraints have so far prevented faster per-capita income convergence, which stands at about 30 percent of the EU average (PPP terms).

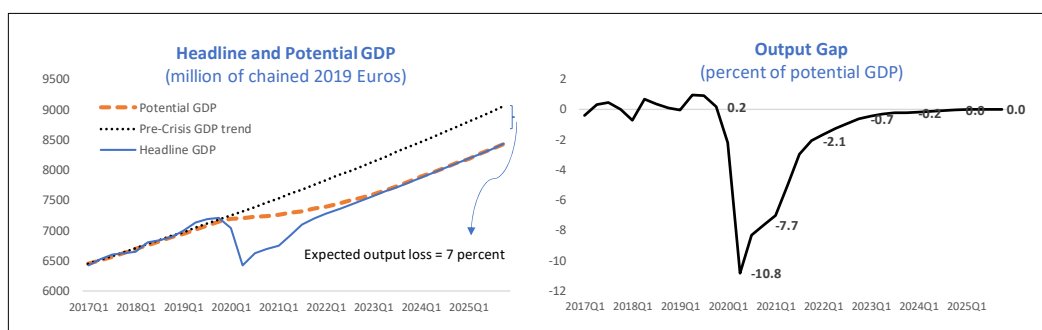


7. A complex political situation creates additional uncertainty. A succession of short-lived governments and caretaker administrations (which operate without Parliament) over 2019-20 have delayed or outright impeded the approval of key legislation. Following a complaint that the election of the government in mid-2020 had proceeded among legal irregularities, a ruling by the Constitutional Court in December 2020 led to the fall of the government, and a call for anticipated elections for mid-February 2021. Both the government and Parliament emerging from that election will have the difficult task to secure a special quorum of 80 MPs (out of 120 in Parliament) needed to elect a new President, a position that is vacant since last November. If the new Parliament is unable to elect a President, a repeat of the elections will be needed, adding to already high uncertainty.

OUTLOOK: GROWTH TO RESUME IN 2021 AMID HIGH UNCERTAINTY

8. Against the backdrop of continued policy support, staff project economic activity to rebound by 4.5 percent in 2021. The rebound in growth will contribute to partially close the output gap, which will nonetheless remain large. This forecast is predicated on a few assumptions, including: (i) fiscal support proceeds as envisaged in the 2021 budget; this requires the contracting of additional debt of around €160 million (2.3 percent of GDP) if fiscal buffers are to be preserved at prudent levels;¹ (ii) the rolling of the vaccine in the first half of 2021 allows for diaspora-related travel to begin recovering in the second half of the year; and (iii) the political situation stabilizes after the February elections. News about the vaccine have improved the growth prospects of Kosovo's international partners with respect to expectations in October 2020. Some recovery in diaspora-related tourism plus strong remittances should see the current account deficit decrease to 6.4 percent of GDP in 2021. Although the baseline assumes that the decline in international reserves stops, they are nonetheless projected to fall to about 95 percent of the IMF RA metric. Consumer inflation is projected to tick up but remain subdued, in line with expected developments in the Euro area.

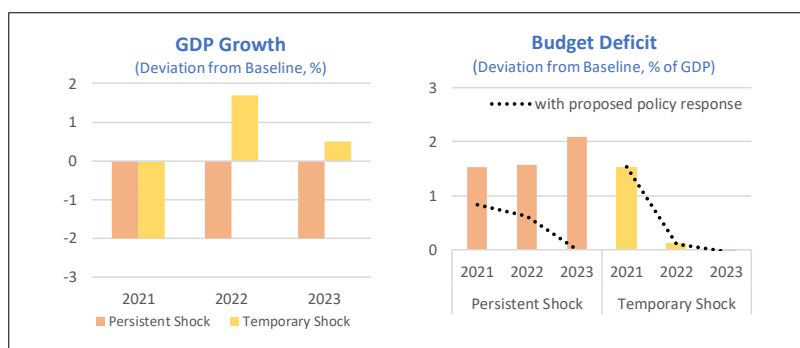
9. The pandemic will leave long-lasting scars. While nominal GDP is forecast to return to pre-crisis levels by 2022, it will remain below the pre-crisis trend. Staff project that potential GDP growth will average about 2 percent per year over 2020-22 (compared to 4 percent before the crisis). This reflects the destruction of firm-specific organizational capital associated with bankruptcies (especially in the hospitality sector, as diaspora-related travel is not expected to fully recover until 2024-25); slower capital accumulation; hysteresis effects for laid off workers; and a slower implementation of structural reforms due to political stalemate. Staff expect potential growth to slowly return to 4 percent per year in the medium term, as mobility fully recovers and the pace of structural reforms accelerate. Accordingly, the negative output gap is expected to significantly shrink in 2022 and to fully close in the medium-term. The recovery in diaspora-related travel will gradually reduce the current account deficit, which is expected to converge to about 5 percent of GDP by 2025, in line with the current account norm.



¹ Although the budget for 2021 envisages that this financing will come from IFIs, it is not yet committed.

10. The uncertainty surrounding the baseline is large and the risk of worse than projected outcomes remains sizable. The still-large number of new COVID-19 cases and political uncertainty may exert significant pressures, especially in the near term. Key risks revolve around the speed of the vaccine rollout. The shock will prove more persistent if external growth disappoints and international travel restrictions are extended. The uncertainty surrounding the course of the pandemic is compounded by domestic political risks: confidence could be further dented if the Parliament emerging from the upcoming elections is unable to swiftly elect a new President. In such a scenario, the absence of government may compromise Kosovo's ability to secure the financing required to implement the economic and recovery measures in the 2021 budget (Annex I).

11. In case downside risks materialize, the policy response will need to consider the persistence of the new adverse scenario. Staff discussed two scenarios, both characterized by a more protracted pandemic. In one of the scenarios GDP growth recovers quickly beginning in 2022, while in the other it remains persistently below the baseline over 2021-23 (Box 2). In absence of a policy response, the lower GDP growth leads to lower fiscal revenues and a larger budget deficit in 2021; however, if the shock is temporary, the budget deficit returns to its baseline level in 2022, while it stays above baseline if the shock is persistent. Staff recommended to accommodate the larger fiscal deficit through additional financing if the shock is temporary; the relaxed fiscal stance would support the economy while the extra financing would help preserve international reserves. If the shock is persistent, staff recommended to only partially accommodate the larger fiscal deficit over 2021–22 through additional financing, and to converge to the baseline fiscal deficit by 2023. This would preserve some fiscal accommodation in the short-term, protect international reserves, and contain the growth of the public debt ratio in the medium term. In case an adverse scenario materializes in 2021, staff advised the authorities to resort to independent analysis on the duration and nature of the shock.



Authorities' Views

12. The authorities broadly concurred with staff on the outlook and on the uncertainty that surrounds it. They explained that while they were initially more optimistic than staff regarding the impact of the pandemic on GDP growth for 2020, the stronger-than-expected reduction in diaspora-related travel persuaded them to revise down their projections. For 2021, they fully concurred with staff views as reflected in the budget's macroeconomic framework. The authorities further agreed on the need for policy to react cautiously should GDP growth in 2021 disappoints but

pointed out that assessing the temporary or persistent nature of a new shock may be complicated by the high uncertainty characterizing the COVID-19 environment.

POLICY DISCUSSIONS: MITIGATING THE EFFECTS OF THE PANDEMIC AND SUPPORTING ECONOMIC RECOVERY

Discussions focused on policies for 2020–21 to combat the health crisis and limit economic damage, and on reforms to strengthen economic governance and foster higher and inclusive growth.

A. Fiscal Policy: Combatting the Health Crisis and Cushioning Income Losses

13. Fiscal policy in 2020 aimed at addressing the urgent needs triggered by the pandemic.

A “Mitigation and Recovery Package” (MRP), of about 4.3 percent of GDP, included allocations for the health system (0.4 percent of GDP); wage bonuses for health and security workers for overtime and the increased risk faced in discharging their duties (0.5 percent of GDP), social transfers and subsidies to vulnerable households (1.6 percent of GDP), as well as support to firms in the form of salary subsidies and easier access to borrowing (including for POEs and farms, of around 1.7 percent of GDP), and capital spending (less than 0.1 percent of GDP). To stimulate aggregate demand, the MRP also allowed early withdrawals of up to 10 percent from KPST pension accounts (2.6 percent of GDP), a majority of which (1.8 percent of GDP) will be gradually reimbursed by the budget beginning in 2023 (Appendix II). Despite delays caused by political strife, the MRP was almost fully implemented. KPST withdrawals occurred late in 2020, and so should only have an impact on demand in 2021.

14. The 2021 budget intends to preserve health spending and accommodate further MRP measures.

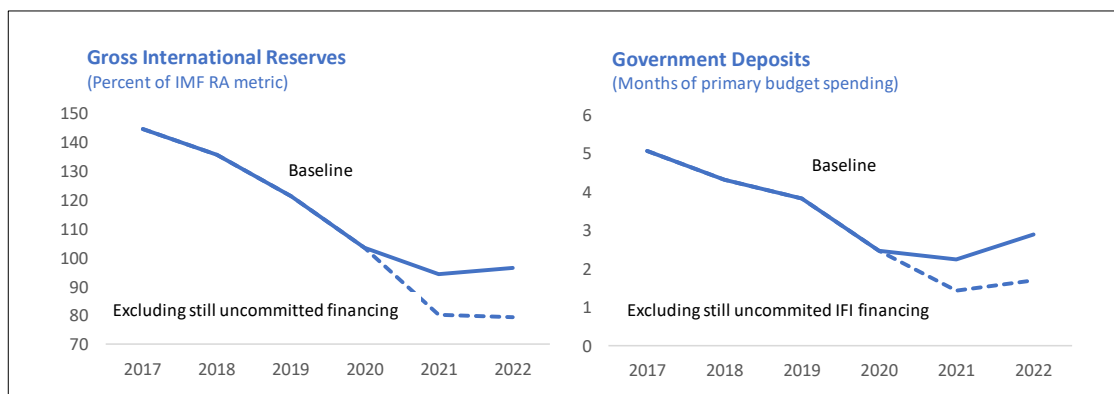
The MRP for 2021 (3.1 percent of GDP) includes allocations for goods and services in the health sector (0.7 percent of GDP, out of which €40 million – or 0.6 percent of GDP – for the procurement of COVID-19 vaccines), for transfers to households and firms (1.7 percent of GDP), and for capital spending in the health and education sectors (0.4 percent of GDP). Given the highly uncertain course of the pandemic, the budget also includes an allocation to address contingencies (0.3 percent of GDP). The overall deficit is projected at 5.9 percent of GDP (4.9 percent of GDP according to the fiscal rule definition).

15. Staff emphasized that mitigation and recovery measures should be well-designed, transparent, and targeted to those most in need. Staff highlighted that some of the transfers to private firms in 2020 (€60 million, 1 percent of GDP) were not sufficiently targeted, and advised the authorities to monitor their use for a survey of representative firms. Staff further advised that the design of large subsidies to agriculture (of about 1 percent of GDP in 2020, including planned recovery measures) needs to be strengthened to increase their transparency and effectiveness. Staff

argued that the early withdrawal of pension savings from KPST undermines “Pillar 2”, reduces future pensions, and limits the size of the domestic capital market, which has been an essential source for budgetary financing. Staff underscored the importance for the Auditor General to conduct a special audit of all MRP-related spending, to ensure that legislation preventing conflicts of interest in procurement is respected. More generally, staff highlighted that while Kosovo has made encouraging progress in centrally publishing all awarded procurement contracts, stronger action is needed to publish online their associated beneficial ownership information.

Kosovo Mitigation and Recovery Measures Against COVID-19	
Crisis management	The government responded promptly with lockdown measures and an allocation of €10 million to the Ministry of Health to cover the surge in PPE costs. A salary supplement of €300 was paid to public sector health and security workers with direct exposure to COVID-19 in April-May, and then again in July-December. Employees of grocery stores, bakeries and pharmacies, working during the lockdown received salary supplements of €100 in April-May.
Tax relief to firms	The filing of tax declarations was postponed until end-April 2020 for the 2019 annual CIT and PIT, the advanced quarterly payment of CIT and PIT, VAT liabilities for February-March 2020, and withholding tax for March 2020. Firms were also given the option to reschedule payments of previous tax debts. Additional measures included exemptions of VAT on imports of wheat and flour for March 25 - May 8.
Subsidies to firms	To retain employment, the government covered the cost of the employers’ pension contribution for 2 months. It also provided salary subsidies for new employees hired by businesses in sectors, and for categories of employees, most in need. Agricultural subsidies were increased.
Support to vulnerable households	Beneficiaries of the Social Assistance Scheme, a program targeted to the poorest, received double their regular benefits in April-June. Additional payments of €30 per month were made to all beneficiaries of social and pension schemes in April-June.
Support to POEs	Publicly owned enterprises (POEs) received budgetary support through subsidies to cover operating costs, lending, and the issuance of sovereign guarantees for loans from financial institutions.
Macro-prudential measures	In March, the CBK allowed a 3-month loan payment moratorium, which ended up reaching about 50 percent of loans, helping firms remain solvent in the face of liquidity shortages. A further CBK decision allowed for up to 1-year loan restructurings in June-September.
Stimulate aggregate demand	Legislation approved in December 2020 allowed early tax-free withdrawals of up to 10 percent of KPST individual pension accounts (estimated at €200 million), out of which around €120 million will be gradually reimbursed by the budget beginning in 2023.

16. Firming up the financing program for 2021 is essential for budget implementation and to preserve government deposits at reasonable levels. The financing program includes ambitious net domestic debt placements for 2.4 percent of GDP, confirmed external financing from the EU (budget support lending of €50 million, and grants for €11 million), and the Council of Europe (lending of €17 million); however, it also includes still uncommitted IFI lending for €160 million (2.3 percent of GDP). Securing the financing program is not only essential to allow for MRP implementation but also to preserve fiscal buffers, a key underpinning for Kosovo’s gross international reserves (GIRs).

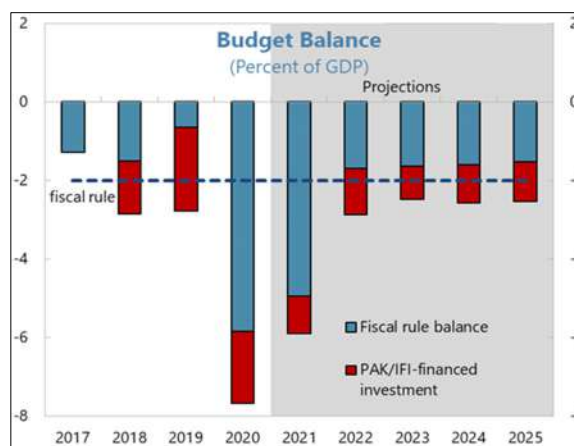


17. Staff urged the authorities to formulate contingent plans in case still-uncommitted financing does not materialize. Staff recommended the Ministry of Finance (MOF) to issue instructions requiring the pre-approval of spending on large ticket items at the commitment stage, as well as to strengthen cash management in order to mitigate the risk of accumulating arrears. If uncommitted financing is not forthcoming, staff recommended to reduce the fiscal deficit by decreasing tax expenditures and reprioritizing spending, with a view to reaching those most affected by the pandemic, while minimizing the use of government deposits. Preserving deposits at appropriate levels could prove instrumental if downside risks materialize.

18. The large increase of public debt over 2020-21 will require policy action to preserve the “investment clause” through 2025 as originally envisaged. While the computation of the fiscal rule allows to exclude “investment clause” spending (i.e., capital investment financed by IFIs and bilateral sources contracted after 2015), this exception is applicable provided public debt remains below 30 percent of GDP. However, staff projections suggest that public debt will hit this ceiling already in 2022, much earlier than originally planned. To preserve the “investment clause” through 2025 and keep room for Kosovo to close the infrastructure gap, staff suggested to raise the “investment clause” debt ceiling to the general debt ceiling of 40 percent of GDP. At the same time, staff strongly advised against increasing the general debt ceiling to 50 percent of GDP, as proposed by the government. Prematurely increasing the debt ceiling could lead to risky behavior, including in the negotiation of PPAs or PPPs, which can carry significant contingent liabilities.

19. While the suspension of the fiscal rule over 2020–21 is warranted, it needs to be combined with a commitment to a gradual consolidation path after the crisis abates.

Allowing fiscal stabilizers to work and creating room for the implementation of the MRP required a temporary suspension of the fiscal rule over 2020–21. Staff advised that beyond 2021, returning to the fiscal rule as the anchor for policy remains key. Enlarging the revenue base and gradually removing targeted support and refocusing social spending to protect the most vulnerable will be essential to that end. Staff highlighted the need to explore ways to offset the loss of fiscal revenues arising from the implementation of trade integration agreements (of around 0.6 percent of GDP by 2025; Box 3), including by reducing tax expenditures and improving the progressivity of income taxes. Increasing the capacity to absorb externally financed public investment is essential to limit the negative change in the fiscal stance.

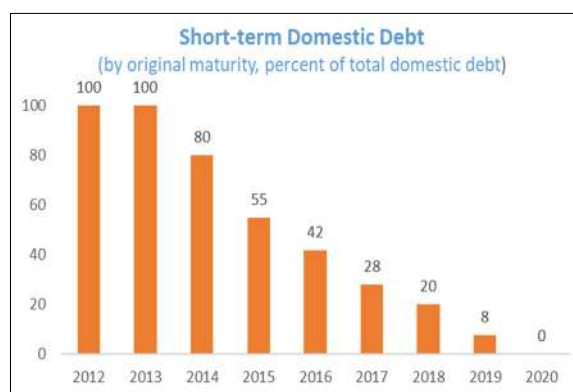


20. Public debt is projected to drift slowly upwards over 2022-25 but stabilize thereafter.

Debt increases in the baseline scenario will be driven by the use of the “investment clause” before its expiration in 2025.² Staff project that public debt should stabilize around its legal ceiling of 40 percent of GDP after 2025, when the 2 percent of GDP deficit ceiling becomes fully binding. Staff highlighted that though public debt remains sustainable, financing needs are relatively large. While resorting to the implementation of the fiscal rule beyond 2021 will keep public debt sustainable, staff urged to strengthen public debt management to limit the vulnerabilities arising from the absence of external market access. In this regard, staff welcomed recent progress to increase the average maturity of domestic debt and stressed the need to further diversify the investor base to include individuals (including the diaspora), private businesses, and insurance companies, which currently hold less than 5 percent of total domestic debt (Annex II).³

Authorities’ Views

21. The authorities agreed with most of staff’s messages but highlighted the many challenges they faced in policy design during the pandemic. While they agreed on the need for well-targeted, well-designed, and transparent



² This assumes that the “investment clause” debt ceiling is increased to 40 percent of GDP.

³ The early withdrawal from individual KPST accounts significantly increased deposits and the banking sector’s liquidity at end-2020. If the increase in these deposits proves stable, it may provide room for additional domestic debt placements in 2021.

policy interventions, they noted that in some cases they had to prioritize that the support arrived on time. With regards to staff's argument that KPST early withdrawals may set a wrong precedent, they pointed out that this was a one-off action justified on the need to swiftly inject liquidity to support aggregate demand. The authorities fully concurred with the need to conduct an *ex-post* audit of all resources spent in response to the COVID-19 crisis and will publish the results in the audit reports of the 2020 and 2021 budgets. Related to this, they requested IMF staff to assist them in the analysis of the legal procurement framework to allow for collection and publication of beneficial ownership information in public procurement. The authorities agreed with the importance of maintaining healthy fiscal buffers and noted that they expect to firm up still-uncommitted financing for 2021. Finally, they agreed that beyond 2021 and after the recovery is well entrenched, a reversal to the fiscal rule deficit should take place, in order to anchor the path for the public debt ratio.

B. Financial Policies: Mitigating the Shock without Endangering Banking Stability

22. Financial sector policies provided further support to cushion income losses and ensure a steady flow of credit. In March 2020, the CBK established a 3-month loan payment moratorium that reached about 50 percent of bank loans. A further decision in June allowed applications for up to 1-year loan extensions and restructuring, which at the closing of this window in September, reached around 20 percent of loans. These measures helped bank credit to grow by around 6 percent (y/y) through November 2020.

23. Moreover, the CBK allowed for regulatory forbearance on the classification of reprogrammed and restructured loans to alleviate the impact of the crisis on banks' balance sheets. To safeguard banks' capital position, dividend payments were suspended. While staff recognized that forbearance was warranted at the beginning of the crisis, they also encouraged the authorities to lift forbearance before end-2020 so that provisions transparently reflect developments in the loan portfolio.

24. Staff advised against weakening capital standards, while encouraging flexibility in supervisory action towards banks whose capital ratios fall below legal requirements. Staff argued that in such cases, the supervisor should work closely with bank shareholders to ensure that sound time-bound action plans are put in place for capital buffers to be replenished gradually. In that context, staff emphasized that the CBK also needs to engage with parent banks of foreign subsidiaries in case the need for capital injections emerges. Staff further underscored the need to strengthen the operational procedures for the use of the Emergency Liquidity Assistance (ELA).⁴

25. The transition to IFRS9 (at the beginning of 2020) as the standard to compute NPLs and guide provisioning has created some challenges. Staff emphasized the need for the CBK to

⁴ ELA reserves stand at around €100 million, insufficient to respond to a systemic shock. To address this risk, the CBK negotiated a €100 million repo line to borrow euro liquidity from the ECB against collateral consisting of euro-denominated marketable debt securities; this line will be available through March 2022.

continue developing its capacity to analyze banks' risk models. To that end, staff argued that credit quality should be assessed both according to IFRS9 and the five-bucket credit quality classification used until 2019. This should help the CBK analyze how banks' models (entailing subjective evaluations) compare with the simpler, and more objective, five-bucket classification; and, help flag any large deviations that may point at differences between needed and effective provisions.⁵

Authorities' Views

26. The authorities broadly concurred with staff assessments and policy recommendations. They noted that the CBK communicated to banks the need to classify loans according to their quality beginning at end-2020. They however noted that most foreign banks (which account for a large share of both deposits and lending in Kosovo) were provisioning prudently, following parent bank guidelines. They pointed out that they expect NPLs to rise during 2021, but that they anticipate that existing capital buffers will be enough to absorb the expected increase in credit write-offs, so there will be no need of extra capital injections. Authorities agreed with staff on the need to continue to refine their understanding of banks' models and expressed appreciation for IMF assistance in building their capacity in this area. Authorities pointed to the lack of operational procedures for an optimal policy response during the pandemic, particularly with respect to the use of the ELA and agreed for the need to have such procedures in place in a near future.

REFORMS TO STRENGTHEN ECONOMIC GOVERNANCE AND FOSTER HIGHER GROWTH

Fiscal Governance

27. Kosovo's revenue base is weakened by numerous exemptions and special tax regimes. Staff recommended to produce a tax expenditure review quantifying the size of the revenue forgone from exemptions and reduced rates as well as other tax incentives granted to businesses and households. Staff further argued that mobilizing revenue requires continued action to strengthen tax administration and stressed that efforts to collect tax debt should be intensified, including by consolidating all collection processes into one office and writing off uncollectible debt.

28. Finalizing the implementation of e-procurement and expanding the coverage of centralized procurement will increase the efficiency and transparency of public spending. Staff acknowledged that most e-procurement modules have been rolled out in full and that information on suppliers selected for all public tenders is available on-line, but noted the need to finalize the rolling out of pending modules to further strengthen transparency and to improve "value-for-

⁵ In September 2020 the CBK granted a new license to Credins (an Albanian bank), to operate in Kosovo as a foreign bank subsidiary. Credins is one of the largest banks in Albania (18 percent market share in lending and 15 percent market share in assets).

money". Staff urged to continue advancing on centralized procurement, so at least 20 percent of all goods and services are purchased following this modality by end-2021.

29. Promoting sustainable public employment and transparent and fair compensation remain key reforms that are still pending. Kosovo's public employment and compensation policies remain lax and uncoordinated and have caused the wage bill to increase steadily over the years. Reform efforts to foster a more predictable and fair wage grid resulted in a law (approved in 2019) that was repealed by the Constitutional Court. Staff urged the authorities to revise the repealed law with a view of salvaging the elements that improved transparency and compensation fairness, while discarding those that would have resulted in an unsustainably large wage bill, most notably an artificially high base wage coefficient. Staff advised for the MOF to have veto power on the filling of new vacancies and on the approval of new collective agreements.⁶

30. Social protection spending needs to be better targeted and expanded to foster inclusion and equal opportunity. Social protection spending is composed of transfers to people with disabilities (0.3 percent of GDP), as well as a general transfer for low income households under the social assistance scheme (SAS, 0.5 percent of GDP). Conducting a poverty-test will ensure that existing beneficiaries comply with eligibility criteria. As part of the poverty alleviation efforts, staff also recommended relaxing the qualifying child age limit in low-income, low-opportunity households covered by the SAS at an annual cost of 0.2 percent of GDP, starting in 2022. Finally, staff argued that finding the right balance between investment in early education and paid maternity leave will foster equal opportunity for women in the labor force.

31. The lack of a coherent social security strategy has led to a multiplicity of disparate and untargeted pension benefits that threaten fiscal sustainability. Several schemes that are fully financed by the budget ("Pillar 0") coexist with a mandatory defined-contribution scheme ("Pillar 2") managed by KPST (Appendix III). Benefits under "Pillar 0" have multiplied in recent years to reward actions during the war of independence. Many of these benefits are overly generous, poorly targeted, and have resulted in duplicate budgetary payments; for instance, pensions to war veterans of 1.1 percent of GDP have largely exceeded their legal spending ceiling of 0.7 percent of GDP. Staff strongly urged the authorities to undertake a holistic analysis of social security in Kosovo, with the aim to: (i) assess the long-term budgetary cost of existing pension benefits; (ii) assess the fairness of eligibility criteria for different pension benefits and identify double payments from different pension schemes or budgetary lines; (iii) analyze ways to streamline and integrate the system to strengthen its fairness and sustainability and minimize economic distortions; and (iv) preserve the integrity and independence of "Pillar 2".

32. The public investment strategy remains unfocused and the impact of public investment on growth is low. In line with the Public Investment Management Assessment's (PIMA) recommendations, staff urged to improve the planning, execution and *ex-post* audits of the Public

⁶ A public wage policy underpinned on sound standards is essential to sustain Kosovo's competitiveness. In recent years, public wage growth has outperformed that of the private sector; this has increased reservation wages, which are relatively high given significant diaspora-related flows.

investment Program (PIP), by formalizing project appraisal, selection, and monitoring procedures during and after the completion of projects. Staff further advised to consolidate sector strategies in the government's Integrated Planning System; create the obligation to report PPPs and POEs' investment through an annex in the budget; record assets, liabilities and fiscal risks related to PPPs, and the contingent liabilities arising from POEs' investments in the government's annual financial statements; include a schedule of multiannual commitments in the budget and financial statements; plan capital projects' costs comprehensively, by including a specific item for maintenance costs in the budget; and, establish quality control checks by the Budget Department for data entered by Budget Organizations in the PIP system. Staff further recommended to create a centralized executing unit for externally financed projects at the MOF to coordinate multiple units at the level of line ministries to speed up investment implementation.

Financial Governance

33. The authorities are taking steps to fill existing vacancies at the CBK's Board and review the CBK's organizational structure. Filling the vacancies is essential to ensure oversight on CBK's Executive Board, and for its policies to have adequate institutional backing, as highlighted by the recently concluded IMF's safeguards assessment. While the CBK's Executive Board has identified suitable candidates to fill the existing Board vacancies, the appointment of new members must await the constitution of a new Parliament. A review and update of the CBK's organizational structure is needed to assess the effectiveness of decision-making bodies and refresh their roles and responsibilities. Staff recommended that once the CBK Board resumes operations, it should ensure that the financial stability and macroprudential policy functions are adequately represented at the CBK's Executive Board. More generally, staff urged to move ahead with the implementation of other FSAP recommendations (Annex IV).

34. The legal basis for CBK's macroprudential policy powers needs to be strengthened. Staff highlighted that amendments to the law on banks and associated regulations are needed to strengthen CBK's macroprudential policy powers. Staff urged for stress test exercises to be integrated within the financial stability area, and for their results to be communicated to banks. Staff further recommended developing tools to assess credit risk based on granular data from the Credit Registry.

Improving the Performance of Public Sector Enterprises and Containing Fiscal Risks

35. Public Sector Enterprises (POEs) are inefficient and loss-making, and their oversight and fiscal risk reporting remain weak. Staff strongly urged to establish and develop performance agreements and quarterly risk assessments for high risk POEs; and to strengthen the institutional arrangement for POE oversight, through a functional review, led by the MOF, that assesses the most effective set up for managing POEs' fiscal risks. Staff argued that all POEs need to design restructuring plans aimed at ensuring cost competitiveness and financial viability, including the capacity to cover their investment needs.

36. An energy sector strategy that jointly assesses economic and environmental issues is needed. While revised renewable energy (RE) targets for 2030 aiming to promote RE investments were established, it is unclear how they align with the current pipeline of generation projects. Staff recommended the creation of a working group involving the regulator, and the ministries of finance and of economy to assess: (i) the expected impact on electricity tariffs of existing PPAs; (ii) plans to reduce, still large non-commercial losses; (iii) the scope to increase the share of RE supplied through the wholesale (competitive) market; and (iv) potential contingent fiscal costs embedded in current and planned PPAs.

Deepening International Integration

37. International integration will promote competition and pave the way to stronger institutions. The implementation of the Stabilization and Association Agreement (SAA) should allow for a gradual alignment of Kosovo's institutional framework with that of the EU, paving the way for better resolution of commercial disputes, a stronger cadaster system, lower informality, and less cumbersome administrative procedures and inspections (Boxes 3 and 4).

Strengthening Governance and Fighting Corruption

38. Efforts aiming at enhancing governance and reducing corruption should continue. In addition to improving fiscal governance and institutions (transparency, public investment and procurement, revenue administration, POE oversight), and in line with previous Article IV and SAA recommendations, staff urged the authorities to strengthen the rule of law, the anti-corruption apparatus, financial sector oversight, and address remaining deficiencies in the AML/CFT framework (Annex V).⁷

Authorities' Views

39. The authorities agreed on the need to rekindle the reform process and expressed confidence that the pace of reforms will accelerate in the coming months. They agreed that before introducing any new major tax initiatives, a diagnostic of the tax system is needed, for which they requested IMF assistance. They noted that the Tax agency (TAK) is committed to advance to "compliance risk management" as well as to set strategic performance targets. The authorities emphasized that they plan to roll out remaining e-procurement modules to cover the full procurement process; this should allow to transparently track the fulfillment of orders; and the receipt of goods and services in the conditions agreed on the tenders. The authorities concurred that holistic approaches to wage and compensation policies as well as to social security are needed and they requested IMF assistance in both areas. They concurred with staff on the need for the wage bill to operate within the existing legal ceiling, although they highlighted the challenges arising from wage pressures. Similarly, they noted the challenges to keep social security spending at bay in light of numerous social demands. The authorities agreed that establishing and developing performance

⁷ In line with commitments under the RFI, the authorities have shared information about MRP contents and implementation on a monthly basis, and plan to conduct special audits of MRP-related spending (¶¶15 and 19).

agreements and quarterly risk assessments for high risk POEs is important to improve their efficiency and sustainability.

STAFF APPRAISAL

40. Kosovo's people and its economy have been hit hard by the pandemic. Being heavily dependent on services and on diaspora-related inflows to generate foreign exchange, Kosovo's economy suffered greatly from the pandemic's induced international mobility restrictions. While the health system coped reasonably well, its capacity is stretched, suggesting the need for further investment in the sector.

41. Fiscal and financial policies have mitigated the impact of the shock on households and firms. Kosovo rightly used the available fiscal space to accommodate the workings of fiscal stabilizers and the implementation of mitigation and recovery measures. These measures supported the health sector's response to the pandemic, aimed to target those most affected by the crisis, and reduced the risk of costly avoidable bankruptcies.

42. Though the design and targeting of most interventions was broadly appropriate, efforts need to be intensified to ensure that scarce fiscal resources are used most effectively. Transfers to firms need to be well-targeted, transparent, and their use strongly regulated to avoid abuses and maximize their impact in sustaining employment, preventing bankruptcies, and ensuring that the payment chain is preserved. The Auditor General should conduct a special audit of all MRP-related spending, to ensure that legislation preventing conflicts of interest in procurement is respected.

43. Policy support should not be withdrawn prematurely. The budget for 2021 strikes an appropriate balance between continuing to support the economy while preserving fiscal buffers, which is essential to maintain confidence given the absence of external market access and Kosovo's unilaterally euroized economy. To achieve both objectives, the authorities still need to firm up uncommitted borrowing in the financing program for 2021. If uncommitted borrowing is not forthcoming, the authorities will need to reduce the fiscal deficit by reprioritizing spending, with a view to reaching those most affected by the pandemic, while minimizing the use of fiscal buffers. Preserving fiscal buffers is essential in case downside risks materialize.

44. Social security reforms should be actuarially sound and changes to public wage and employment policies should respect the legal wage bill ceiling. Creating additional pension benefits without an actuarial analysis of existing benefits or reforming public sector wage policies without proper budgetary impact analysis should be avoided. Any changes in wage or employment policies should respect the legal wage bill ceiling. Moreover, reforms to refocus social spending to protect the most vulnerable should start in earnest. Additional early withdrawals from KPST must be avoided. Importantly, the implementation of any reforms with significant medium-term budgetary costs should wait until the recovery is well entrenched.

- 45. Fiscal policy needs to be anchored by a credible consolidation path as the economic recovery is entrenched.** A clear communication strategy that highlights the temporary nature of current bonuses and transfers is needed. Unifying the “investment clause” and general debt ceilings at 40 percent of GDP is essential to create room to close the infrastructure gap. Increasing the debt ceiling to 50 percent of GDP should be avoided, as it can create risky behavior.
- 46. The CBK has maintained broadly adequate operational controls.** The recently concluded safeguards assessment found that while the CBK has a sound legal framework, governance arrangements have been disrupted by Board vacancies that result in a lack of a quorum. The absence of a functioning Board poses significant risks for the CBK and requires proactive engagement to expedite filling the vacancies. The external audit arrangements and financial reporting practices otherwise continue to be aligned with international standards.
- 47. The banking system remains strong but close supervision is needed.** Banks have been generally conservative and forward-looking in increasing provisions, and thus, the lifting of forbearance should not result in risks to financial stability. As forbearance is lifted, supervisory efforts should be made to ensure losses are transparently reflected. Without diluting prudential standards or accounting requirements, flexibility should be introduced for banks to use capital buffers so that they can continue to lend to viable firms.
- 48. While Kosovo’s external position remained weaker than implied by fundamentals and desirable policy settings, GIRs decreased in 2020 and are just at the level considered appropriate by IMF RA metrics.** The use of government deposits to finance the 2021 fiscal deficit would result in a further weakening of GIRs, increasing Kosovo’s vulnerability to shocks. The results of the EBA-lite methodology suggest that the external position was weaker than warranted by fundamentals in 2020, though a large part of the current account gap was explained by the cost of policy actions to address the pandemic, and thus, should be gradually reversed in the next few years.
- 49. Kosovo faces several structural constraints that have prevented faster income convergence, and the pandemic exacerbated many of these pre-existing challenges.** The impact of public investment remains low, and the quality of health and education spending lags regional standards. While combating the near-term recession is the priority, strengthening budget effectiveness, reducing human capital and infrastructure gaps, improving governance, and further enhancing international integration would create a more enabling growth environment.
- 50. The next Article IV consultation with Kosovo is expected to be conducted on the standard 12-month cycle.**

Box 1. The Pandemic’s Impact on Diaspora Flows

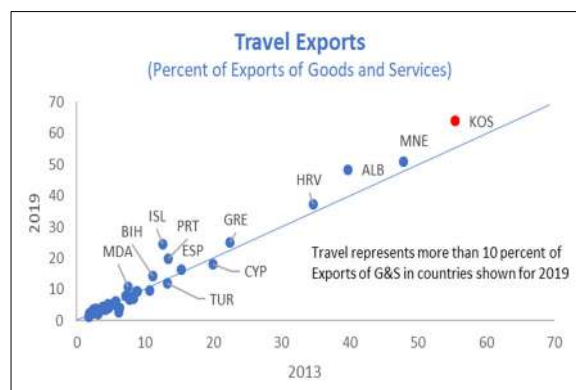
Travel restrictions and the global economic contraction will cost Kosovo about 8 percent of GDP in diaspora flows in 2020.

Strong emigration since the 1990s (especially to advanced Europe and the U.S.) is reflected in a migrant-resident ratio within the 30 – 40 percent range, one of the world’s highest.^{1, 2} Over 2018–19, staff assess that the deficit in residents’ transactions in the balance of payments (37 percent of GDP) was financed by an equivalent inflow from the diaspora in the form of tourism receipts, remittances, real estate purchases (recorded as FDI), and compensation of employees by repeated migrants. Kosovo’s tourism receipts accounted for close to 70 percent of its exports of goods and services in 2019, the highest such share in Europe. With data through Q3:2020, staff project that diaspora flows will contract to 29 percent of GDP in 2020. Travel restrictions negatively weighed on tourism and informal remittances (reflected in errors and omissions) but pushed official remittances upwards. Lower diaspora flows will also result in decreased real estate market transactions.

	Average 2018-19			2020 (P)		
	Total	Residents	Diaspora	Total	Residents	Diaspora
Current account	-6.5	-39.0	32.4	-7.5	-34.1	26.7
Balance on Goods and Services	-35.8	-44.4	8.6	-31.7	-41.0	9.3
Exports of Goods and Services	29.0	12.0	17.0	22.0	12.8	9.3
Imports of Goods and Services	56.4	56.4	0.0	53.7	53.7	0.0
Primary Income	1.9	-1.6	3.5	2.3	-1.3	3.6
Secondary Income	19.0	7.0	11.9	21.9	8.2	13.7
Official	3.4	3.4	0.0	3.7	3.7	0.0
Other	15.6	3.6	11.9	18.2	4.4	13.7
Capital account	-0.1	-0.1	0.0	-0.1	-0.1	0.0
Financial account	-3.8	-0.6	-3.2	-7.8	-5.3	-2.5
Direct investment, net	-3.1	0.1	-3.2	-3.0	-0.5	-2.5
Portfolio investment, net	-1.1	-1.1	0.0	-0.5	-0.5	0.0
Other investment, net	-1.0	-1.0	0.0	-3.1	-3.1	0.0
Reserve assets	1.3	1.3	0.0	-1.2	-1.2	0.0
Net errors and omissions	2.9	1.4	1.4	-0.2	-0.1	-0.1
Overall balance	0.0	-37.1	37.1	0.0	-29.1	29.1

Sources: Kosovo authorities; and IMF staff estimates and projections.
 1/ Staff used available data, and expert CBK judgement to identify diaspora-related flows. In particular, the diaspora is assumed to explain 92 percent of travel services receipts (diaspora-related tourism), and 100 percent of workers’ remittances. Compensation of employees (which is driven by seasonal migrants and thus not properly diaspora) is included as diaspora. Staff assumed that equity liabilities under foreign direct investment fully comprise real estate purchases by the diaspora. Finally, 50 percent of errors and omissions are assumed to be unrecorded remittances or equity investments not captured in other lines.

Staff project that diaspora flows will recover only gradually. The speed of recovery will be closely related with the course of the pandemic and mobility restrictions. While the recovery in 2021 will only be partial, it should be more forceful in 2022 provided the vaccine rollout allows international mobility to increase to more normal levels.



While diaspora flows have been essential to support domestic consumption and investment, they also create structural challenges.

Large diaspora flows led to an economic structure heavily biased to services, and where goods exports have remained low and concentrated in commodities. The Household Budget Survey suggest that 10 – 15 percent of the typical household’s income is originated in remittances, increasing the reservation wage and resulting in both lower labor force participation and higher unemployment rates. Real estate investment by the diaspora has fueled a construction boom in the capital over 2018 – 19 and increased the banking sector exposure to the sector.

^{1/} World Migration Report, 2020; International Organization for Migration, Geneva.
^{2/} *Migrimi Kosovar*; Kosovo Agency of Statistics, 2014; and, Republic of Kosovo, Migration Profile 2019.

Box 2. Adverse Scenarios: Characterization and Policy Response

The uncertainty surrounding the baseline is large and the risk of worse outcomes, sizable. This Box discusses two adverse scenarios predicated on a worse than expected pandemic. The “no policy response” impact of these shocks on selected macroeconomic variables assumes that the increased fiscal deficit is accommodated using fiscal buffers in 2021, and through increased debt beyond that.

- **Adverse Scenario – Persistent:** In line with the October 2020 World Economic Outlook, it assumes that the virus is more difficult to contain than currently assumed, leading to longer social distancing and partial lockdown measures. This results in a GDP growth that is weaker than the baseline by 2 pp/year in 2021-23.
- **Adverse Scenario – Temporary:** It assumes that GDP growth in 2021 disappoints as the pandemic takes more time to control, but that the situation normalizes thereafter. This results in a strong rebound in growth in 2022, and GDP converging to the baseline level in the medium term.

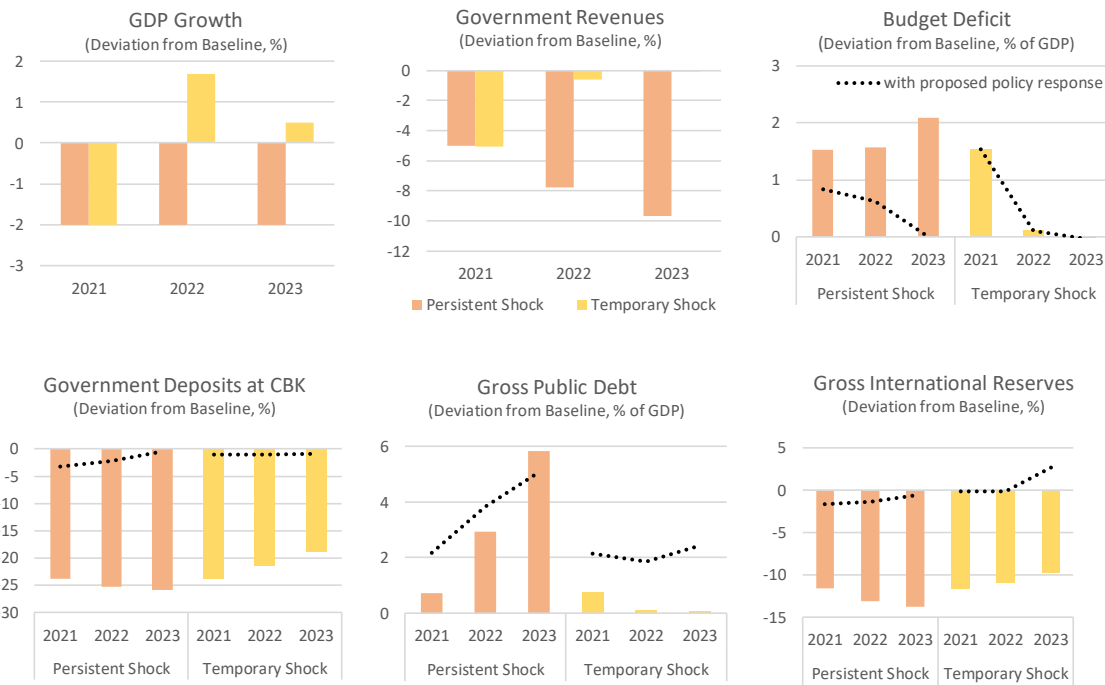
The policy response should be calibrated considering the expected duration of the shock. In case of no policy response, the lower GDP growth leads to lower fiscal revenues and a higher budget deficit in 2021. If the shock is temporary, the budget deficit returns to its baseline level in 2022, while it would stay above baseline over the medium term if the shock is persistent, causing the public debt ratio to drift upwards (Box 2 – Figure 1). Accordingly:

- **Policy Response – Temporary Shock:** The increased fiscal deficit can be accommodated through increased financing. The relaxed fiscal stance would support the economy, the extra financing would help preserving international reserve buffers, and the increase of public debt would be contained.
- **Policy Response – Persistent Shock:** The increased fiscal deficit over 2021 – 22 should be only partially accommodated through increased debt contracting, with a view to converge to the baseline fiscal deficit by 2023. This would preserve some fiscal accommodation in the short-term, protect international reserve buffers and contain the growth of the public debt ratio in the medium term.

Box 2. Adverse Scenarios: Characterization and Policy Response (concluded)

Figure 1. Scenario Analysis: Transitory and Persistent Shocks

(With and without proposed policy response)



Box 3. Kosovo's Efforts at International Integration

Though not a WTO member, Kosovo's participation in several free trade agreements (FTAs) reflect its decade-long efforts at trade liberalization. Kosovo's tariff code (based on the 2017 Harmonized

Commodity Description and Coding System (HS) and the EU Combined Nomenclature), comprises 10,191 tariff lines at the 10-digit level. FTAs (whose rules apply to about 80 percent of Kosovo's trade) provide the overall framework for regional cooperation and integration into European economic and political processes. For all other countries, Kosovo's applies a 10 percent uniform import tariff on 79 percent of tariff lines, and no tariff on the remaining lines. Kosovo is beneficiary of the generalized systems of preferences applied by Belarus, Japan, Kazakhstan, Norway, the Russian Federation, Switzerland, and the U.S.

The EU-Kosovo Stabilization and Association Agreement (SAA) sets to eliminate most tariffs by 2026.

The SAA (which became effective in April 2016) provides for the harmonization of Kosovo's legal and regulatory framework with EU law to prepare for accession negotiations. In 2020, 87 percent of Kosovo's tariff lines on imports from the EU are duty-free. The SAA was preceded (since 2000) by the Autonomous Trade Measures (ATM), which granted duty-free access to 90 percent of goods exported to the EU. Following Brexit, Kosovo signed (in December 2019) an FTA with the U.K., which is expected to enter into force in 2021.

Kosovo's Imports and Exports by Origin, 2018-2019		
	2018	2019
Exports, percent of total		
EU	30	36
CEFTA	47	43
Turkey	2	2
GSP	9	9
Sub-total	88	90
Total (million Euro)	368	383
Imports, percent of total		
EU	44	50
CEFTA	26	14
Turkey	10	12
Sub-total	79	77
Total (million Euro)	3,347	3,497

Trade within the Central European Free Trade Agreement (CEFTA) was fully liberalized in 2015, though Kosovo's imposition (in 2018) of a 100 percent import tariff on Serbia and Bosnia and Herzegovina represented a setback. CEFTA

members comprise Albania, Bosnia and Herzegovina, North Macedonia, Moldova, Montenegro, Serbia, and Kosovo (a member since 2007). The 100 percent tariff virtually stopped imports from Serbia and Bosnia and Herzegovina, and undermined trade cooperation efforts within the FTA. In a welcomed move, the tariff was eliminated in April 2020.

An FTA with Turkey (signed in 2013) became effective in 2019 after Kosovo's ratification. While Turkey immediately removed import tariffs on Kosovo for all industrial and most agricultural goods, Kosovo will eliminate tariffs over a 10-year period. Negotiations are ongoing to set the start date of tariff phase-out; Turkey's position is to set the start date in 2016, in par with the SAA.

The implementation of the EU-SSA and Turkey FTA will reduce fiscal revenues by 0.6 percent of GDP by 2025. Imports of goods into Kosovo are subject to customs duties, excise duties, and VAT. Custom duties amounted to €130 million in 2019. VAT and excise duties are calculated on the import values included custom duties.

Box 4. European Union Accession Process

The European Union-Kosovo Stabilization and Association Agreement (SAA) entered into force in April 2016. The SAA is the first contractual relationship between the European Union (EU) and Kosovo. It provides a framework for dialogue and cooperation on good governance and the rule of law, competitiveness and investment climate, and employment and education, among others, consistent with the EU's *acquis*. The SAA is expected to be progressively realized in 10 years. Annual reviews of implementation result in recommendations. The fifth-year review (in 2021) may modify the ensuing process of association based on a thorough progress evaluation. The 10th-year review (in 2026) may extend the process up to five years, through 2031. The SAA also establishes that the EU and Kosovo should gradually establish a free trade area over a maximum of 10 years (i.e., by 2026). To guide SAA implementation, the European Commission (EC) and Kosovo adopted the European Reform Agenda (ERA) in November 2016.

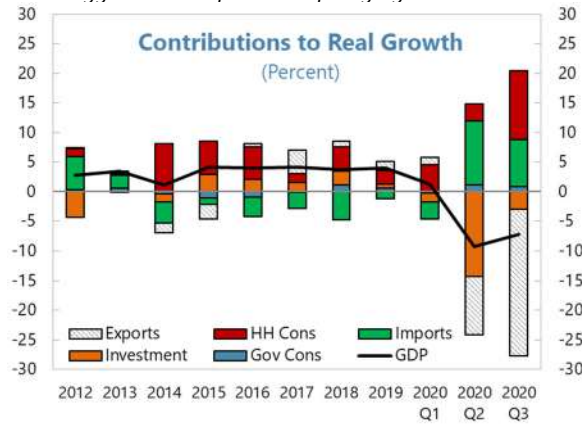
The 2020 SAA progress report recognizes advancement in reform implementation but highlights that Kosovo is still in an early stage in several areas. The report recognizes the impact of COVID-19 in the Western Balkans and the EU and highlights EU's efforts to support Kosovo and the region. Despite progress, the report concludes that Kosovo is at an early stage in developing a functioning market economy and in its capacity to cope with competitive pressure and market forces in the EU; that the excessive size of the government hampers its effectiveness and credibility; that the judicial system is still at an early stage; that the Assembly continues to operate in a polarized context resulting in frequent lack of quorum and delays in legislative activity; and that efforts in the fight against corruption, organized crime and money laundering need to be more effective.

The SAA commits Kosovo to continue engaging towards a sustainable improvement in relations with Serbia. The SAA states that policies should ensure that both countries continue their respective European paths and a gradual normalization of relations, while avoiding that either can block the other in these efforts. Kosovo's decision in early 2020 to lift the 100 percent tariff on imports from Serbia and Bosnia and Herzegovina was welcomed by the EC, as it allowed a resumption of the EU-facilitated Belgrade-Pristina dialogue. Kosovo and Serbia signed several economic agreements under the auspices of the U.S. in September 2020, which are expected to unlock bilateral infrastructure financing.

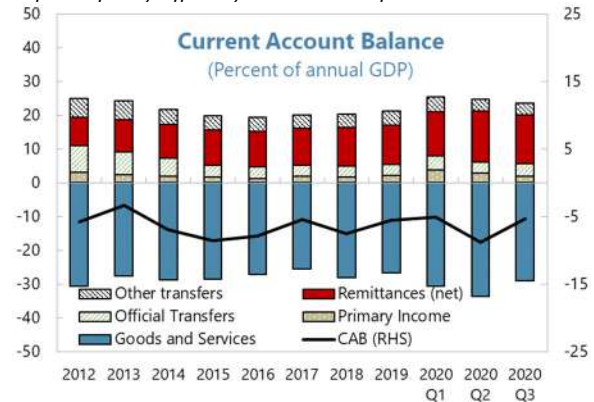
Kosovo remains the only Western Balkan Country with no visa-free access to the Schengen Area despite having met all benchmarks of the Visa Liberalization Roadmap. The EC started the process of visa liberalization for Kosovo in 2012. In July 2018, the EC confirmed that Kosovo had met the two outstanding visa liberalization requirements (the ratification of the border demarcation agreement with Montenegro, and a strengthened track-record in the fight against crime and corruption), thus fulfilling all benchmarks set out in the Visa Liberalization Roadmap. In March 2019, the European Parliament voted in support of the Commission's proposal in its first reading. However, the proposal is still pending for final approval at the European Council, where a few countries continue to express reservations.

Figure 1. Kosovo: Recent Economic Developments, 2012–2020

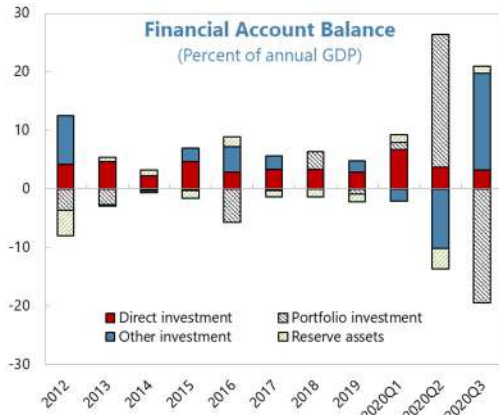
The COVID-19 outbreak has slowed economic activity, with sluggish consumption and plunging investment...



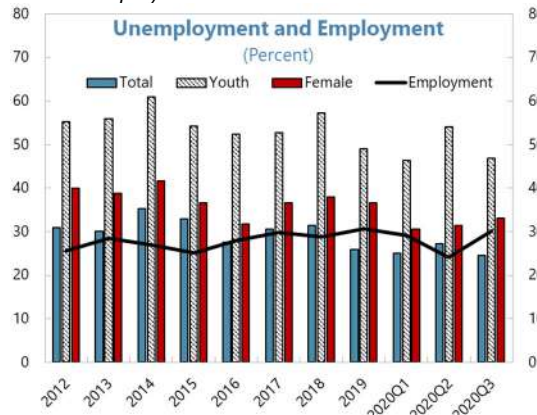
The current account deficit increased, and a large trade deficit is partly offset by remittance inflows...



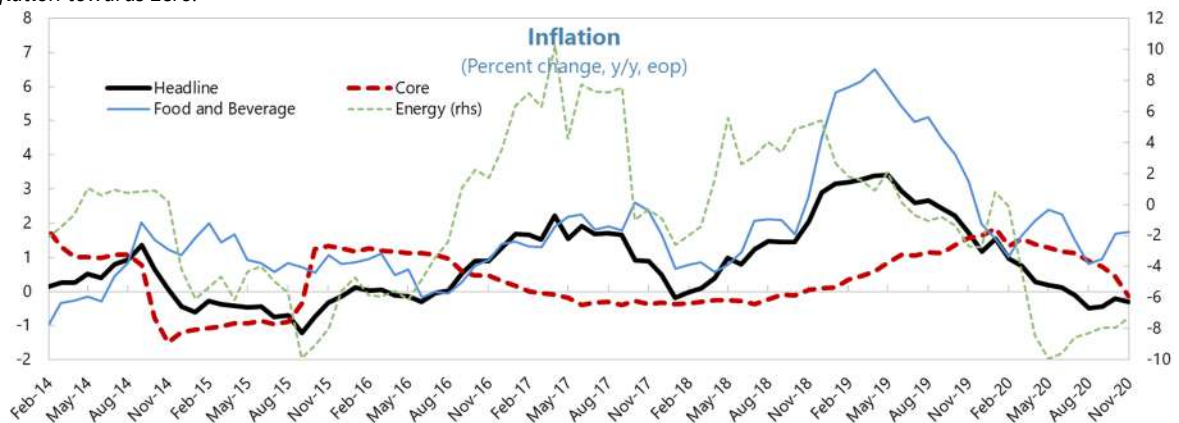
... and mainly financed by FDI and other investment.



The labor market situation is dire, with elevated youth and female unemployment....



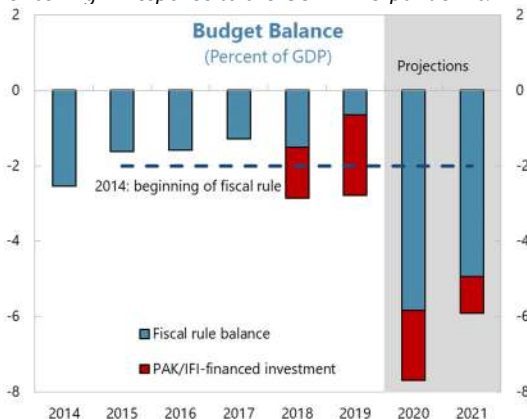
The temporary rise in inflation due to tariff on Serbian and Bosnia imports has faded and the economic fallout has pushed inflation towards zero.



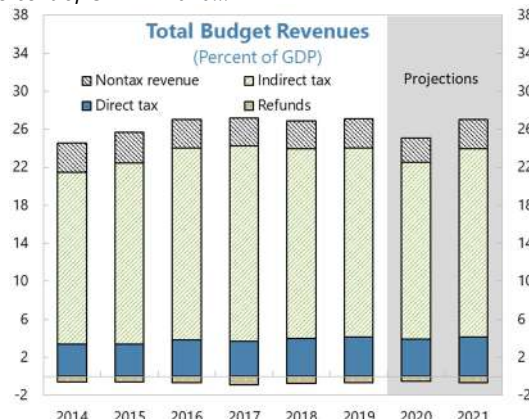
Sources: Haver Analytics; Kosovo Agency of Statistics; Central Bank of Kosovo; Haver; WEO; IMF staff estimates.

Figure 2. Kosovo: Fiscal Developments, 2014–2021

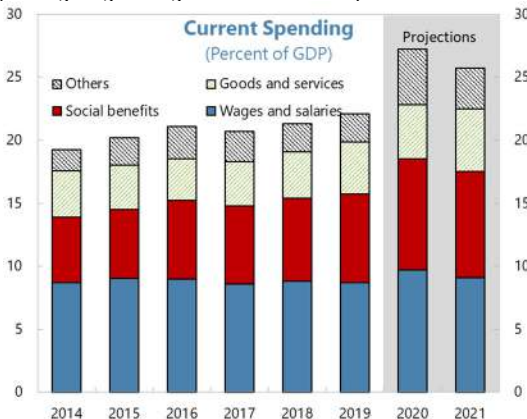
In 2020–21, the budget deficit will widen outside the “fiscal rule” ceiling in response to the COVID-19 pandemic.



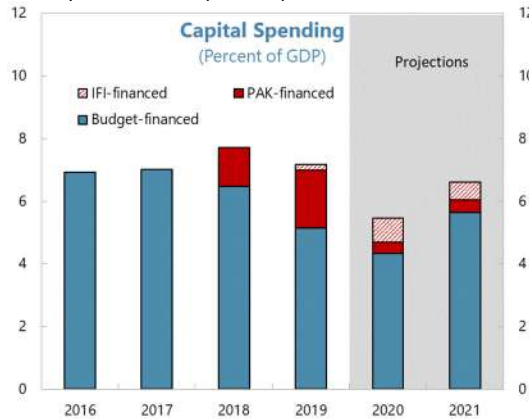
Total revenue collection is expected to fall by more than 1 percent of GDP in 2020...



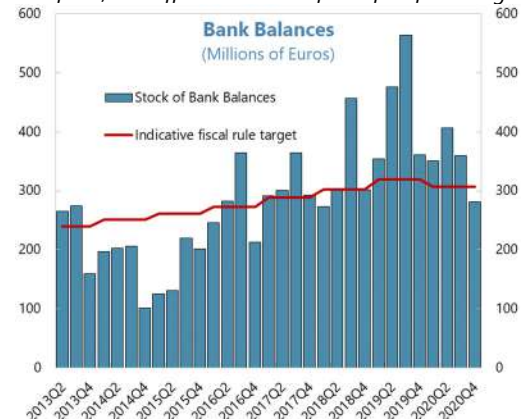
... and current expenditure to increase by 5 percent of GDP reflecting large mitigation and recovery measures.



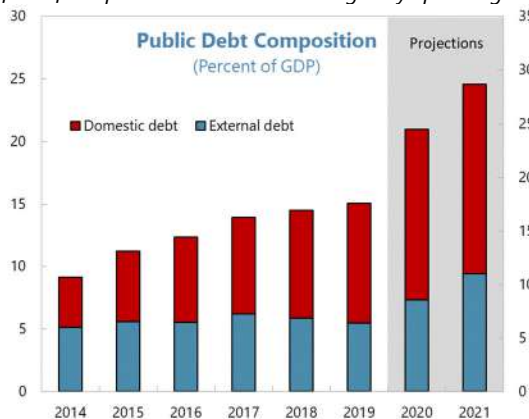
Capital investment in 2020 was well below historical levels to provide room for relief measures.



The bank balance decreased below the 4.5 percent of GDP floor, as buffers were used for deficit financing.



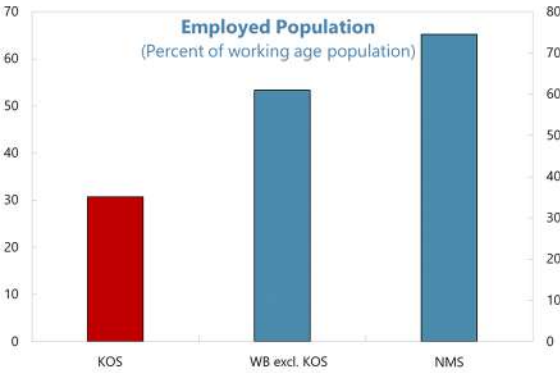
Public debt is to increase strongly in 2020–21 reflecting the effect of the pandemic and extra-budgetary spending.



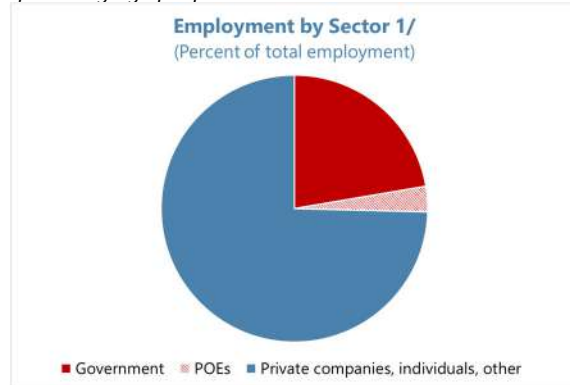
Sources: Country authorities; IMF staff estimates.

Figure 3. Kosovo: Labor Market, 2020

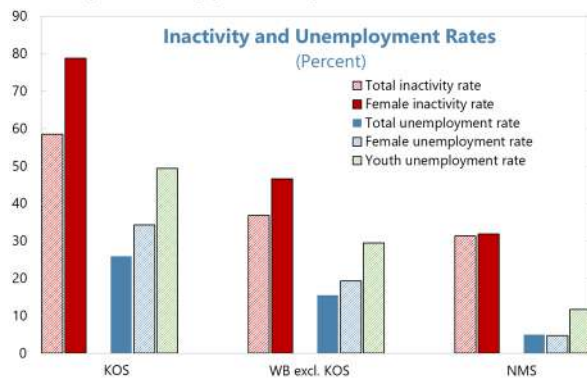
Kosovo has the lowest employment to working age population ratio in the region



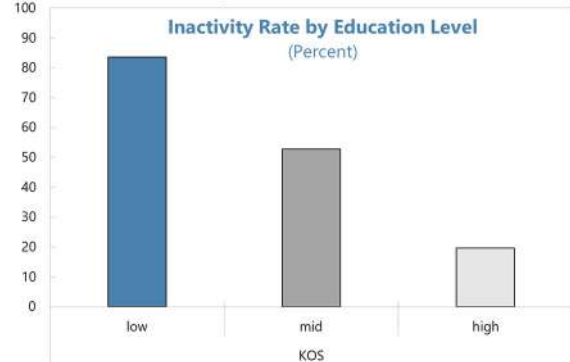
... and the general government employs a sizable number of working age people.



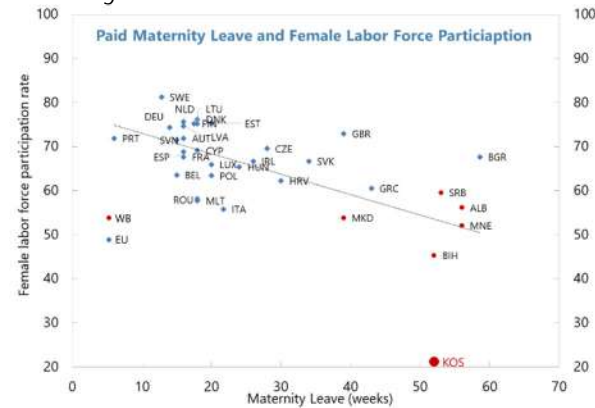
Inactivity and unemployment rates are high, with females and the youth being particularly vulnerable.



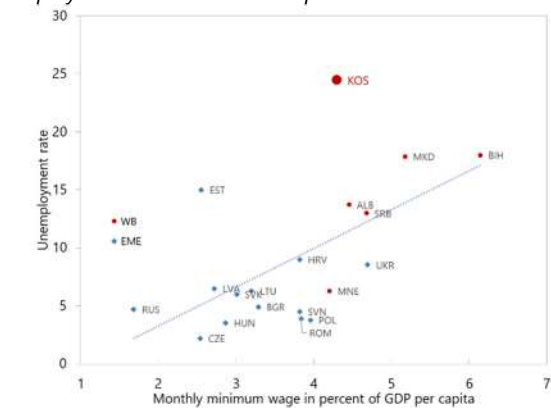
People with low education attainment present the highest rates of labor inactivity.



Social benefits such as the length of paid maternity leave remain high ...



...and minimum wages are relatively high, hurting employment and external competitiveness.

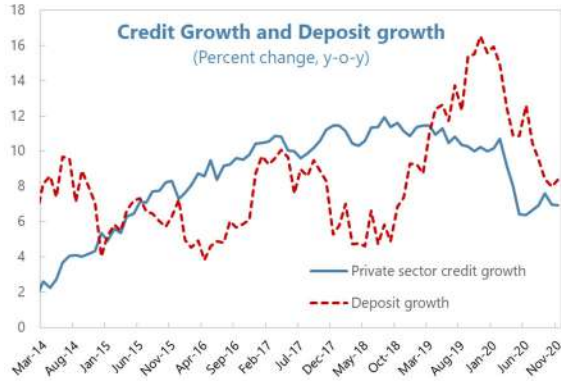


Sources: KAS; OECD; ILO; Eurostat; SEE Jobs Gateway Database; WEO and IMF staff estimates.

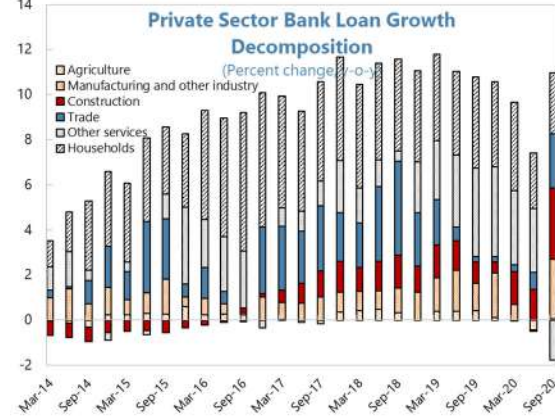
1/ Data refers to Kosovo Labor Force Survey 2017.

Figure 4. Kosovo: Banking Sector Overview, 2014–2020

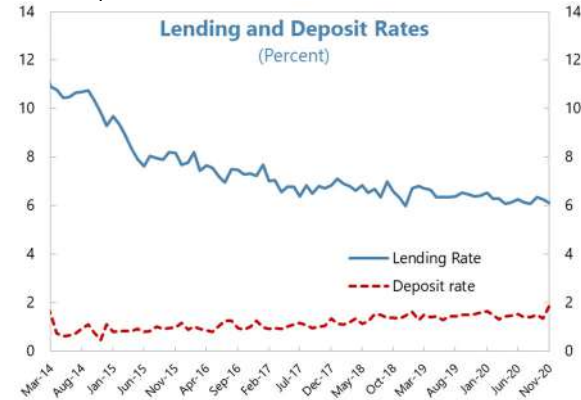
The COVID-19 crisis resulted in decreased credit and deposit growth.



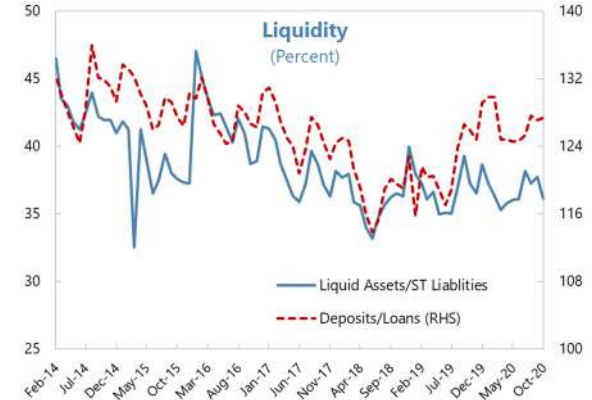
Credit expansion to households and services has decelerated strongly...



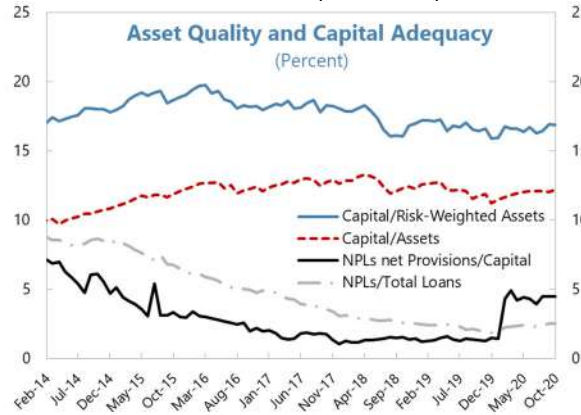
... while the lending rate is at the historically low level of around 6 percent.



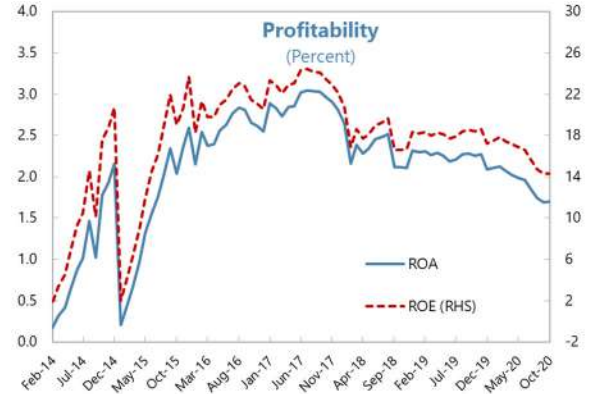
The liquidity ratios are stable



Banks' capital adequacy remains steady due to regulatory forbearance but NPLs increased prior to the pandemic...



... and profitability has so far trended down moderately.



Sources: Central Bank of Kosovo, IMF staff estimates.

Table 1. Kosovo: Select Economic Indicators, 2017–2025
(Percent, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.			Projections		
Real GDP growth	4.2	3.8	4.9	-6.0	4.5	5.5	4.0	4.0	4.0
Contribution to growth (percentage points of GDP)									
Consumption	1.5	5.2	1.6	0.8	2.3	3.4	2.6	2.6	2.6
Private	1.6	4.0	0.2	0.2	1.9	3.8	2.5	2.5	2.5
Public	-0.1	1.2	1.3	0.6	0.4	-0.4	0.1	0.1	0.1
Investment	1.5	2.3	1.9	-1.8	1.5	2.7	1.3	1.7	1.7
Net Exports	1.2	-3.7	1.4	-5.2	0.8	-0.6	0.1	-0.2	-0.2
Exports	4.0	1.0	4.5	-7.9	3.4	2.6	2.4	2.0	2.0
Imports	-2.8	-4.7	-3.1	2.7	-2.6	-3.2	-2.3	-2.3	-2.3
Real growth rate (percent)									
Consumption	1.5	5.4	1.6	1.1	2.1	3.4	2.7	2.7	2.7
Private	1.8	5.0	0.6	0.5	2.0	4.5	3.0	3.0	3.0
Public	-0.5	7.5	7.3	4.5	2.4	-2.8	0.5	0.5	0.5
Investment	5.6	8.1	6.5	-5.9	4.9	9.2	4.2	5.5	5.4
Exports	16.8	3.8	17.2	-26.7	14.5	10.0	9.0	7.2	7.0
Imports	5.4	9.0	5.6	-4.8	4.5	5.8	4.1	4.1	4.1
Official unemployment (percent of workforce) 1/	30.5	29.6	25.9	24.6	...	...	...	...	...
Price changes									
CPI, period average	1.5	1.1	2.7	0.2	0.3	1.5	1.7	1.9	1.9
GDP deflator	1.4	1.0	0.6	2.1	-0.3	1.5	1.8	1.9	1.7
Real effective exchange rate (average; -=depreciation)	0.6	2.7	-0.1	0.0	...	...	...	...	...
Terms of Trade	98	97	95	97	98	97	96	96	95
General government budget (percent of GDP)									
Revenues and grants	26.5	26.4	26.8	25.1	26.6	26.2	26.2	26.1	26.2
Expenditures	27.9	29.2	29.6	32.8	32.5	29.1	28.6	28.7	28.7
Of which: Wages and salaries	8.6	8.8	8.7	9.7	9.1	8.7	8.5	8.4	8.2
Subsidies and transfers	8.0	8.3	8.8	12.8	10.8	8.7	8.5	8.4	8.3
Capital and net lending	7.2	7.9	7.5	5.6	6.8	6.8	6.8	7.3	7.7
Overall Balance (Fiscal rule) 2/	-1.3	-1.5	-0.7	-5.8	-4.9	-1.7	-1.6	-1.6	-1.5
Overall balance	-1.4	-2.9	-2.8	-7.7	-5.9	-2.9	-2.5	-2.6	-2.5
Stock of government bank balances	4.6	4.5	5.2	4.0	3.6	4.1	4.5	4.7	4.9
Total public debt 3/	16.2	17.0	17.6	24.5	28.7	30.4	31.7	32.9	34.1
Balance of Payments (percent of GDP)									
Current account balance, incl. official transfers	-5.4	-7.6	-5.5	-7.5	-6.4	-6.1	-5.2	-4.9	-4.8
Of which: Official transfers 4/	3.1	3.4	3.4	3.7	3.1	2.8	2.7	2.5	2.4
Of which: Remittance inflows	11.8	11.9	12.0	13.7	13.9	13.6	13.3	12.9	12.5
Financial account	-4.3	-5.0	-2.6	-7.8	-5.6	-4.7	-3.8	-3.5	-3.5
Of which: Direct investment, net	-3.3	-3.4	-2.8	-3.0	-3.2	-3.3	-3.2	-3.2	-3.2
Portfolio investment, net	0.2	-3.0	0.8	-0.5	0.3	0.5	0.1	-0.1	0.1
Errors and Omissions	1.3	2.7	3.0	-0.2	0.9	1.5	1.5	1.5	1.5
Savings-investment balances (percent of GDP)									
National savings	19.8	18.5	21.2	18.3	20.3	22.0	23.1	24.0	24.7
Public savings	5.7	5.0	4.5	-2.6	0.7	3.9	4.3	4.7	5.2
Private savings	14.1	13.6	16.7	20.9	19.6	18.1	18.8	19.3	19.5
Investment	28.4	29.5	30.0	29.5	29.8	30.9	30.9	31.4	31.8
Public investment	7.2	7.9	7.5	5.6	6.8	6.8	6.8	7.3	7.7
Private investment	21.2	21.5	22.5	23.9	23.0	24.1	24.1	24.1	24.2
Current account, excl. official transfers	-8.5	-10.9	-8.9	-11.2	-9.5	-8.9	-7.9	-7.4	-7.2
Financial Sector									
Non-performing loans (percent of total loans) 5/	3.1	2.5	1.9	2.5	...	...	...	...	...
Bank credit to the private sector (percent change)	11.5	10.8	10.0	6.5	9.1	10.3	7.5	7.5	7.0
Deposits of the private sector (percent change) 6/	5.3	9.3	15.6	11.2	4.1	9.3	7.5	7.2	6.7
Regulatory capital to risk weighted assets 5/	18.1	17.0	15.9	16.7	...	...	...	...	...
<i>Memorandum items:</i>									
GDP (millions of euros)	6,414	6,726	7,104	6,817	7,101	7,606	8,051	8,533	9,027
GDP per capita (euros)	3,566	3,752	3,947	3,772	3,913	4,175	4,402	4,647	4,896
GNDI per capita (euros)	4,172	4,391	4,656	4,545	4,726	5,028	5,290	5,569	5,851
Real GDP growth per capita	3.4	4.1	4.5	-6.4	4.1	5.1	3.6	3.6	3.6
Population (millions)	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8

Sources: Kosovo authorities; and IMF staff estimates and projections.

1/ 2020 as of Q3 2020.

2/ The Fiscal rule excludes capital investment financed by multilateral/bilateral projects contracted after 2015.

3/ Includes guarantees and beginning in 2020, Euro 120 million of debt with KPST. It does not include contingent debt of former Yugoslavia.

4/ Total foreign assistance excluding capital transfers.

5/ 2020 is as of November 2020.

6/ Projections assume that the increase in deposits due to early withdrawals from KPST accounts in 2020 is gradually withdrawn out of the banking sector in 2021.

Table 2. Kosovo: Consolidated Government Budget, 2017–2025 1/
(Including donor designated grants and PAK operational expenditure, millions of euros)

	2017	2018	2019	2020		2021		2022		2023	2024	2025
	Actual			Budget	Prel. 6/	Budget	Proj.	Proj.	Proj. Authorities	Proj.	Proj.	Proj.
Revenue and grants	1,700	1,775	1,905	1,788	1,712	1,888	1,888	2,002	1,992	2,106	2,229	2,365
Revenue	1,692	1,766	1,886	1,754	1,678	1,878	1,877	1,992	1,992	2,106	2,229	2,365
Taxes	1,496	1,564	1,662	1,565	1,501	1,678	1,652	1,767	1,748	1,846	1,951	2,067
Direct taxes	238	268	292	282	266	304	297	319	321	343	366	391
of which: Personal income tax	137	153	166	160	157	171	168	174	182	194	208	222
of which: Corporate income tax	75	87	95	90	85	98	97	100	105	112	120	128
of which: Property tax	22	24	27	29	22	30	27	40	29	31	33	35
Indirect taxes	1,315	1,344	1,415	1,322	1,268	1,419	1,402	1,496	1,485	1,564	1,649	1,746
VAT	756	799	846	790	768	862	856	913	918	978	1,044	1,116
Excise	432	419	435	423	397	425	421	441	449	473	499	527
Customs	126	124	130	106	101	128	122	138	115	109	102	99
Tax refunds	-58	-48	-46	-40	-33	-46	-46	-48	-57	-61	-65	-69
Nontax revenues	190	195	217	189	177	200	220	225	236	252	269	287
Other revenue	6	8	7	0	0	...	5	...	7	8	9	10
Grants	8	8	20	34	34	11	11	11	0	0	0	0
Budget support	0	0	12	34	34	11	11	11	0	0	0	0
Project grants (DDGs)	8	8	8	12	0	12	0	12	0	0	0	0
Expenditure	1,789	1,967	2,103	2,620	2,235	2,454	2,307	2,376	2,210	2,306	2,450	2,593
Current expenditure	1,328	1,433	1,569	1,885	1,855	1,828	1,825	1,697	1,694	1,759	1,828	1,899
Wages and salaries	550	592	616	619	661	626	644	642	662	688	716	744
Goods and services	226	250	294	314	295	314	353	346	331	338	346	352
Subsidies and transfers	512	558	627	651	870	639	770	654	660	688	718	751
Pension and social assistance	397	442	503	...	601	...	601	...	527	552	579	609
Other transfers and subsidies	115	116	124	...	269	...	169	...	134	136	139	141
Current reserves	0	0	0	38	0	33	21	6	0	0	0	0
DDGs and other expenditure	6	6	5	...	0	...	0	...	0	0	0	0
Recovery program 2/	0	0	0	295	...	220	...	...	0	0	0	0
Interest payments	19	19	23	30	29	39	37	49	40	45	49	52
of which: on external debt	12	12	12	...	15	...	20	-248	21	23	23	24
Other net PAK expenditure	14	9	3	...	0	...	0	...	0	0	0	0
Capital expenditure	461	533	534	735	380	626	483	679	516	547	621	694
Budget-financed	449	435	366	403	296	403	400	490	420	472	531	597
PAK-financed	0	84	132	185	24	28	30	0	0	0	0	0
External	12	15	36	148	60	195	53	189	96	75	90	97
of which: "Investment Clause"	0	0	13	148	52	195	39	189	89	69	83	91
Fiscal balances												
Primary balance	-74	-177	-179	-806	-497	-491	-388	-327	-182	-159	-175	-181
Overall balance	-88	-192	-198	-832	-523	-566	-420	-374	-218	-200	-220	-228
<i>Overall cyclically adjusted balance</i>	-98	-201	-239	...	-426	...	-346	...	-195	-194	-218	-228
Overall balance ("Fiscal rule" definition) 3/	-82	-102	-46	-500	-398	-337	-351	-179	-129	-132	-137	-138
<i>"Fiscal rule" deductions from the overall balance</i>	6	90	151	381	125	229	69	195	89	69	83	91
Financing	87	195	199	832	523	567	420	375	218	201	221	229
Foreign financing (net)	98	-10	-11	321	140	344	199	228	107	75	33	6
Budget Support	95	0	0	152	168	105	225	60	57	37	0	0
External Financing for Projects	22	12	39	274	65	239	58	235	102	82	98	106
Amortization of external debt	-59	-22	-50	-105	-93	-96	-84	-66	-52	-43	-65	-100
Domestic financing (net)	29	206	211	510	384	223	221	147	111	125	188	223
Net Domestic debt issuance	95	105	115	170	169	170	170	150	167	166	226	258
Change in CBK deposits	-93	48	43	377	210	106	27	8	-89	-64	-48	-33
Change in GG Deposits at the CBK (TSA)	-83	-35	-70	192	136	72	17	2	-64	-49	-43	-38
PAK Deposits	-10	83	113	185	74	34	10	6	-25	-15	-5	5
Other Financing (Net POE and other)	-1	17	13	-36	4	-53	4	-11	3	3	0	-3
Equity (Privatization)	31	18	41	...	0	...	20	...	30	20	10	0
Memorandum items												
Overall balance (MOF) 4/	-78	-190	-201	-451	-523	-566	-425	-375	-225	-208	-229	-238
Bank balance of the general government	292	302	370	214	276	227	258	225	312	361	404	442
Of which: ELA	46	46	46	...	46	...	46	...	46	46	46	46
Total public debt 5/	1,041	1,140	1,248	1,682	1,670	2,015	2,036	2,384	2,309	2,551	2,810	3,075
External debt	466	460	453	720	585	883	782	1,102	888	964	997	1,004
Of which: onlending	57	52	50	...	46	...	42	...	38	36	36	38
Of which: guarantees	44	44	44	...	44	...	44	...	44	44	44	44
Domestic debt	575	680	795	962	1,085	1,132	1,254	1,282	1,421	1,588	1,814	2,072

Sources: Kosovo authorities; and IMF staff estimates and projections.

1/ Does not yet reflect the GFSM 2014 methodology.

2/ For staff projections, recovery program measures are directly incorporated in the expenditure lines. These add up to Euro 288 million in 2020 and Euro 220 million in 2021.

3/ For fiscal rule purposes, IFI and PAK-financed projects post-July 2015, as well as PAK-related current expenditure, are excluded from the fiscal deficit; in the IMF presentation, expenditures from carried-forward own-source revenue (OSR) are calculated as the annual difference between the municipal OSR stocks in consecutive years.

4/ Excludes DDGs, revenues held in trust, and additional net PAK expenditure.

5/ The stock of public debt no longer includes the former Yugoslavia debt, which has been reclassified as a contingent liability. Beginning in 2020, it includes Euro 120 million of debt with KPST.

6/ Based on preliminary revenue and expenditure data as of end-December 2020 and the 2020 Budget.

Table 3. Kosovo: Consolidated Government Budget, 2017–2025 1/
(Including donor designated grants and PAK operational expenditure, percent of GDP)

	2017	2018	2019	2020		2021		2022		2023	2024	2025
	Actual			Budget	Prel. 6/	Budget	Proj.	Proj. Authorities	Proj.	Proj.	Proj.	Proj.
Revenue and grants	26.5	26.4	26.8	25.7	25.1	26.4	26.6	26.7	26.2	26.2	26.1	26.2
Revenue	26.4	26.3	26.5	25.2	24.6	26.2	26.4	26.5	26.2	26.2	26.1	26.2
Taxes	23.3	23.2	23.4	22.5	22.0	23.4	23.3	23.5	23.0	22.9	22.9	22.9
Direct taxes	3.7	4.0	4.1	4.1	3.9	4.2	4.2	4.2	4.2	4.3	4.3	4.3
<i>of which:</i>												
Personal income tax	2.1	2.3	2.3	2.3	2.3	2.4	2.4	2.3	2.4	2.4	2.4	2.5
Corporate income tax	1.2	1.3	1.3	1.3	1.2	1.4	1.4	1.3	1.4	1.4	1.4	1.4
Property tax	0.3	0.4	0.4	0.4	0.3	0.4	0.4	0.5	0.4	0.4	0.4	0.4
Indirect taxes	20.5	20.0	19.9	19.0	18.6	19.8	19.7	19.9	19.5	19.4	19.3	19.3
VAT	11.8	11.9	11.9	11.4	11.3	12.0	12.1	12.2	12.1	12.1	12.2	12.4
Excise	6.7	6.2	6.1	6.1	5.8	5.9	5.9	5.9	5.9	5.9	5.9	5.8
Customs	2.0	1.8	1.8	1.5	1.5	1.8	1.7	1.8	1.5	1.4	1.2	1.1
Tax refunds	-0.9	-0.7	-0.6	-0.6	-0.5	-0.6	-0.7	-0.6	-0.7	-0.8	-0.8	-0.8
Nontax revenues	3.0	2.9	3.1	2.7	2.6	2.8	3.1	3.0	3.1	3.1	3.2	3.2
Other revenue	0.1	0.1	0.1	0.0	0.0	...	0.1	...	0.1	0.1	0.1	0.1
Grants	0.1	0.1	0.3	0.5	0.5	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Budget support	0.0	0.0	0.2	0.5	0.5	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Project grants (DDGs)	0.1	0.1	0.1	0.2	0.0	0.2	0.0	0.2	0.0	0.0	0.0	0.0
Expenditure	27.9	29.2	29.6	37.6	32.8	34.3	32.5	31.6	29.1	28.6	28.7	28.7
Current expenditure	20.7	21.3	22.1	27.1	27.2	25.5	25.7	22.6	22.3	21.9	21.4	21.0
Wages and salaries	8.6	8.8	8.7	8.9	9.7	8.7	9.1	8.5	8.7	8.5	8.4	8.2
Goods and services	3.5	3.7	4.1	4.5	4.3	4.4	5.0	4.6	4.4	4.2	4.1	3.9
Subsidies and transfers	8.0	8.3	8.8	9.4	12.8	8.9	10.8	8.7	8.7	8.5	8.4	8.3
Current reserves	0.0	0.0	0.0	0.6	0.0	0.5	0.3	0.1	0.0	0.0	0.0	0.0
DDGs and other expenditure	0.1	0.1	0.1	...	0.0	...	0.0	...	0.0	0.0	0.0	0.0
Recovery program 2/	0.0	0.0	0.0	4.2	...	3.1	...	...	0.0	0.0	0.0	0.0
Interest payments	0.3	0.3	0.3	0.4	0.4	0.5	0.5	0.7	0.5	0.6	0.6	0.6
<i>of which:</i>												
on external debt	0.2	0.2	0.2	...	0.2	...	0.3	-3.3	0.3	0.3	0.3	0.3
Other net PAK expenditure	0.2	0.1	0.0	...	0.0	...	0.0	...	0.0	0.0	0.0	0.0
Capital expenditure	7.2	7.9	7.5	10.6	5.6	8.7	6.8	9.0	6.8	6.8	7.3	7.7
Budget-financed	7.0	6.5	5.1	5.8	4.3	5.6	5.6	6.5	5.5	5.9	6.2	6.6
PAK-financed	0.0	1.2	1.9	2.7	0.4	0.4	0.4	0.0	0.0	0.0	0.0	0.0
External	0.2	0.2	0.5	2.1	0.9	2.7	0.7	2.5	1.3	0.9	1.1	1.1
<i>of which: "Investment Clause"</i>	0.0	0.0	0.2	2.1	0.8	2.7	0.5	2.5	1.2	0.9	1.0	1.0
Fiscal balances												
Primary balance	-1.2	-2.6	-2.5	-11.6	-7.3	-6.9	-5.5	-4.4	-2.4	-2.0	-2.1	-2.0
Overall balance	-1.4	-2.9	-2.8	-12.0	-7.7	-7.9	-5.9	-5.0	-2.9	-2.5	-2.6	-2.5
<i>Overall cyclically adjusted balance</i>	<i>-1.5</i>	<i>-3.0</i>	<i>-3.4</i>	<i>...</i>	<i>-5.8</i>	<i>...</i>	<i>-4.9</i>	<i>...</i>	<i>-2.6</i>	<i>-2.4</i>	<i>-2.6</i>	<i>-2.5</i>
Overall balance ("Fiscal rule" definition) 3/	-1.3	-1.5	-0.7	-7.2	-5.8	-4.7	-4.9	-2.4	-1.7	-1.6	-1.6	-1.5
<i>"Fiscal rule" deductions from the overall balance</i>	<i>0.1</i>	<i>1.3</i>	<i>2.1</i>	<i>5.5</i>	<i>1.8</i>	<i>3.2</i>	<i>1.0</i>	<i>2.6</i>	<i>1.2</i>	<i>0.9</i>	<i>1.0</i>	<i>1.0</i>
Financing	1.4	2.9	2.8	11.9	7.7	7.9	5.9	5.0	2.9	2.5	2.6	2.5
Foreign financing (net)	0.9	-0.2	-0.2	4.6	2.0	4.8	2.8	3.0	1.4	0.9	0.4	0.1
Budget Support	1.5	0.0	0.0	2.2	2.5	1.5	3.2	0.8	0.7	0.5	0.0	0.0
External Financing for Projects	0.3	0.2	0.6	3.9	1.0	3.3	0.8	3.1	1.3	1.0	1.1	1.2
Amortization of external debt	-0.9	-0.3	-0.7	-1.5	-1.4	-1.3	-1.2	-0.9	-0.7	-0.5	-0.8	-1.1
Domestic financing (net)	0.5	3.1	3.0	7.3	5.6	3.1	3.1	2.0	1.5	1.6	2.2	2.5
Net Domestic debt issuance	1.5	1.6	1.6	2.4	2.5	2.4	2.4	2.0	2.2	2.1	2.6	2.9
Change in CBK deposits	-1.4	0.7	0.6	5.4	3.1	1.5	0.4	0.1	-1.2	-0.8	-0.6	-0.4
Change in GG Deposits at the CBK (TSA)	-1.3	-0.5	-1.0	2.8	2.0	1.0	0.2	0.0	-0.8	-0.6	-0.5	-0.4
PAK Deposits	-0.2	1.2	1.6	2.7	1.1	0.5	0.1	0.1	-0.3	-0.2	-0.1	0.1
Other Financing (Net POE and other)	0.0	0.3	0.2	-0.5	0.1	-0.7	0.1	-0.2	0.0	0.0	0.0	0.0
Equity (Privatization)	0.5	0.3	0.6	...	0.0	...	0.3	...	0.4	0.2	0.1	0.0
Memorandum items												
Overall balance (MOF) 4/	-1.2	-2.8	-2.8	-6.5	-7.7	-7.9	-6.0	-5.0	-3.0	-2.6	-2.7	-2.6
Bank balance of the general government	4.6	4.5	5.2	3.1	4.0	3.2	3.6	3.0	4.1	4.5	4.7	4.9
<i>Of which: ELA</i>	<i>0.7</i>	<i>0.7</i>	<i>0.6</i>	<i>...</i>	<i>0.7</i>	<i>...</i>	<i>0.6</i>	<i>...</i>	<i>0.6</i>	<i>0.6</i>	<i>0.5</i>	<i>0.5</i>
Total public debt 5/	16.2	17.0	17.6	24.2	24.5	28.1	28.7	31.7	30.4	31.7	32.9	34.1
External debt	7.3	6.8	6.4	10.3	8.6	12.3	11.0	14.7	11.7	12.0	11.7	11.1
<i>Of which: onlending</i>	<i>0.9</i>	<i>0.8</i>	<i>0.7</i>	<i>...</i>	<i>0.7</i>	<i>...</i>	<i>0.6</i>	<i>...</i>	<i>0.5</i>	<i>0.4</i>	<i>0.4</i>	<i>0.4</i>
<i>Of which: guarantees</i>	<i>0.7</i>	<i>0.7</i>	<i>0.6</i>	<i>...</i>	<i>0.6</i>	<i>...</i>	<i>0.6</i>	<i>...</i>	<i>0.6</i>	<i>0.5</i>	<i>0.5</i>	<i>0.5</i>
Domestic debt	9.0	10.1	11.2	13.8	15.9	15.8	17.7	17.1	18.7	19.7	21.3	22.9
Nominal GDP (millions of euros)	6,414	6,726	7,104	6,961	6,817	7,160	7,101	7,508	7,606	8,051	8,533	9,027

Sources: Kosovo authorities; and IMF staff estimates and projections.

1/ Does not yet reflect the GFSM 2014 methodology.

2/ For staff projections, recovery program measures are directly incorporated in the expenditure lines. These add up to 4.2 percent of GDP in 2020 and 3.1 percent of GDP in 2021.

3/ For fiscal rule purposes, IFI and PAK-financed projects post-July 2015, as well as PAK-related current expenditure, are excluded from the fiscal deficit; in the IMF presentation, expenditures from carried-forward own-source revenue (OSR) are calculated as the annual difference between the municipal OSR stocks in consecutive years.

4/ Excludes DDGs, revenues held in trust, and additional net PAK expenditure.

5/ The stock of public debt no longer includes the former Yugoslavia debt, which has been reclassified as a contingent liability. Beginning in 2020, it includes Euro 120 million of debt with KPST.

6/ Based on preliminary revenue and expenditure data as of end-December 2020 and the 2020 Budget.

Table 4. Kosovo: General Government Cashflow, 2017–2025
(Millions of euros, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Actual			Prel.	Projections				
Financing Needs	432	534	492	816	665	541	591	617	702
Overall balance	-88	-192	-198	-523	-420	-218	-200	-220	-228
Amortization	344	342	295	293	246	323	391	396	474
External	59	22	50	93	84	52	43	65	100
Domestic	285	320	245	200	162	271	348	331	374
Financing Sources	431	537	494	816	666	541	592	617	702
External Debt	117	12	39	233	283	159	119	98	106
Budget Support	95	0	0	168	225	57	37	0	0
of which: IMF	95	0	0	50	...	...	...	...	...
of which: still uncommitted	...	...	...	...	160	57	37	0	0
External Financing for Projects	22	12	39	65	58	102	82	98	106
Investment Clause (2016 and after)	0	0	14	52	39	89	69	83	91
Non-Investment Clause	8	11	21	8	14	7	7	7	7
Disbursements for on-lending	14	0	4	4	5	6	7	7	8
Domestic Debt	314	526	455	583	383	382	473	519	596
Gross Domestic Debt Placements	380	425	360	369	332	438	514	557	632
KPST one-off financing	0	12	0	0	0	0	0	0	0
Other Financing (Net POE)	-1	17	13	4	4	3	3	0	-3
Commercial Bank Deposits	-3	6	-3	0	0	0	0	0	0
Equity (Privatization, PAK and other)	31	18	41	0	20	30	20	10	0
CBK deposits (-=increase)	-93	48	43	210	27	-89	-64	-48	-33
PAK deposits	-10	83	113	74	10	-25	-15	-5	5
TSA	-83	-35	-70	136	17	-64	-49	-43	-38
Errors and Omissions	1.4	-3.7	-1.9	0	0	0	0	0	0

Sources: Kosovo authorities; and IMF staff estimates and projections.

Table 5. Kosovo: Balance of Payments, 2017–2025
(Millions of euros, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	
				Est.		Projections				
Current account	-349	-509	-392	-509	-452	-462	-417	-416	-433	
Balance on Goods and Services	-1,637	-1,882	-1,908	-2,162	-2,149	-2,229	-2,257	-2,323	-2,407	
Goods Balance	-2,464	-2,738	-2,840	-2,559	-2,698	-2,873	-3,019	-3,184	-3,372	
Exports, f.o.b.	378	377	393	453	482	498	523	545	565	
Imports, f.o.b.	2,843	3,114	3,233	3,012	3,180	3,371	3,541	3,729	3,937	
Services Balance	827	856	932	397	549	645	762	861	964	
Receipts	1,359	1,562	1,676	1,049	1,275	1,425	1,585	1,731	1,885	
Payments	531	706	744	652	726	780	823	870	921	
Primary Income	127	113	154	158	168	174	186	197	208	
Compensation of employees, net	217	237	257	249	263	278	293	309	326	
Investment income, net	-86	-121	-99	-88	-91	-100	-104	-109	-115	
Secondary Income	1,161	1,260	1,362	1,495	1,529	1,593	1,655	1,710	1,767	
Government, net	200	226	240	255	223	214	216	214	214	
Other transfers (including remittances), net	961	1,034	1,123	1,240	1,306	1,379	1,439	1,496	1,552	
Capital account	-12	-11	-8	-9	-9	-10	-10	-11	-11	
Financial account	-276	-336	-185	-534	-398	-360	-305	-300	-312	
Direct investment, net	-212	-226	-201	-208	-228	-249	-262	-276	-291	
Assets	43	46	66	47	48	50	53	56	59	
Liabilities	255	272	266	254	276	299	315	332	350	
Portfolio investment, net	15	-200	59	-32	20	37	5	-6	7	
Other investment, net	-149	3	-139	-211	-207	-245	-135	-105	-122	
Reserve assets	70	87	95	-83	17	98	88	87	94	
Net errors and omissions 1/	84	184	215	-16	64	111	122	126	132	
Overall balance	0	0	0	0	0	0	0	0	0	
				(In percent of GDP)						
Current account, incl. official transfers	-5.4	-7.6	-5.5	-7.5	-6.4	-6.1	-5.2	-4.9	-4.8	
Balance on Goods and Services	-25.5	-28.0	-26.9	-31.7	-30.3	-29.3	-28.0	-27.2	-26.7	
Primary Income	2.0	1.7	2.2	2.3	2.4	2.3	2.3	2.3	2.3	
Secondary Income	18.1	18.7	19.2	21.9	21.5	20.9	20.6	20.0	19.6	
Capital account	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	
Financial account	-4.3	-5.0	-2.6	-7.8	-5.6	-4.7	-3.8	-3.5	-3.5	
Direct investment, net	-3.3	-3.4	-2.8	-3.0	-3.2	-3.3	-3.2	-3.2	-3.2	
Portfolio investment, net	0.2	-3.0	0.8	-0.5	0.3	0.5	0.1	-0.1	0.1	
Other investment, net	-2.3	0.1	-2.0	-3.1	-2.9	-3.2	-1.7	-1.2	-1.4	
Reserve assets	1.1	1.3	1.3	-1.2	0.2	1.3	1.1	1.0	1.0	
Net errors and omissions 1/	1.3	2.7	3.0	-0.2	0.9	1.5	1.5	1.5	1.5	
<i>Memorandum items:</i>										
Public debt service to export ratio (percent)	4.1	1.8	3.0	7.2	5.9	3.8	3.1	3.9	5.0	
Public debt service to exports and remittances (percent)	2.8	1.3	2.1	4.4	3.8	2.5	2.1	2.6	3.5	
External public and private debt (percent of GDP) 2/	21.6	21.5	21.9	25.3	27.8	30.1	31.0	31.2	31.4	
Net foreign assets of CBK 3/	939	934	938	815	764	840	917	1,034	1,139	
Gross international reserves 3/	1,168	1,164	1,142	997	1,004	1,127	1,230	1,322	1,410	
Gross international reserves in months of prospective imports 3/	3.7	3.5	3.7	3.1	2.9	3.1	3.2	3.3	...	
Gross international reserves, excl. PAK and KPST deposits at CBK 3/	683	769	864	781	798	896	983	1,070	1,164	

Sources: Kosovo authorities; and IMF staff estimates and projections.

1/ Errors and omissions are thought to be mostly comprised of unidentified private remittances and unidentified FDI.

2/ The former Yugoslavia debt has been reclassified as a contingent liability and is no longer included in the stock of public debt.

3/ CBK's NFA and GIR data exclude CBK's holdings of Kosovar government securities.

Table 6. Kosovo: Central Bank and Commercial Bank Survey, 2017–2025
(Percent, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Est.	Projections				
Depository Corporations									
Net foreign assets 1/	1,418	1,422	1,577	1,615	1,421	1,542	1,632	1,738	1,842
Net domestic assets	2,535	2,857	3,209	3,617	4,032	4,399	4,721	5,043	5,403
Central Bank									
Net foreign assets 1/	939	934	938	815	764	840	917	1,034	1,139
Foreign assets 1/	1,243	1,240	1,219	1,078	1,087	1,209	1,312	1,403	1,492
Foreign liabilities	303	306	281	263	322	369	394	370	353
Net domestic assets	-464	-430	-420	-252	-177	-219	-257	-330	-380
Net claims on central government	-474	-432	-421	-254	-178	-221	-259	-331	-381
Claims on central government	355	349	316	274	323	369	395	370	353
Of which: government securities	194	189	184	161	151	151	151	151	151
Liabilities to central government	828	781	738	528	501	590	653	701	734
PAK (privatization) fund	471	388	275	201	191	216	231	236	231
Government deposits	340	375	444	308	291	355	404	447	484
Of which: bank balance	274	302	361	260	320	342	362	384	406
IMF subscription	17	18	18	18	18	18	18	18	18
Claims on other sectors	10	2	1	1	1	1	1	1	1
Monetary base	428	455	468	514	539	574	614	659	714
Liabilities to other depository corporations	332	343	415	455	478	507	542	582	632
Deposits included in broad money	97	112	53	59	61	67	72	77	82
Other items, net 2/	48	49	51	50	49	48	46	46	47
Commercial banks									
Net foreign assets	479	488	639	799	657	701	715	704	703
Assets	710	692	866	1,016	877	931	944	939	939
Liabilities	-231	-204	-227	-217	-220	-229	-229	-235	-236
Net domestic assets	2,999	3,286	3,629	3,869	4,209	4,618	4,979	5,373	5,783
Claims on the CBK	331	343	415	455	478	507	542	582	632
Net claims on the central government	234	247	275	275	302	325	367	413	465
Claims on central government	243	257	287	287	314	338	379	425	478
Liabilities to central government	-10	-10	-13	-13	-13	-13	-13	-13	-13
Net claims on other public entities	-48	-55	-88	-85	-88	-95	-100	-106	-112
Claims on other public entities	2	4	3	4	4	4	4	4	4
Liabilities to other public entities	-50	-59	-92	-88	-92	-99	-104	-111	-117
Credit to private sector	2,483	2,751	3,028	3,224	3,518	3,880	4,170	4,485	4,798
Deposits of the private sector	2,919	3,190	3,688	4,099	4,269	4,668	5,018	5,378	5,739
Demand deposits	1,754	1,913	2,225	2,565	2,625	2,878	3,104	3,333	3,562
Time deposits	1,165	1,277	1,463	1,534	1,643	1,789	1,914	2,045	2,177
Other items, net 2/	559	584	580	569	597	651	675	699	746
<i>Memorandum items:</i>									
Gross international reserves, excl. PAK and KPST deposits at CBK 1/	683	769	864	781	798	896	983	1,070	1,164
Deposits of the private sector (12-month percent change)	5.3	9.3	15.6	11.2	4.1	9.3	7.5	7.2	6.7
Credit to the private sector (12-month percent change)	11.5	10.8	10.0	6.5	9.1	10.3	7.5	7.5	7.0
Deposits of the private sector (percent of GDP) 3/	45.5	47.4	51.9	60.1	60.1	61.4	62.3	63.0	63.6
Credit to the private sector (percent of GDP)	38.7	40.9	42.6	47.3	49.5	51.0	51.8	52.6	53.2
Mandatory reserves of commercial banks at the CBK 3/	136	149	172	191	199	218	234	251	268
Excess reserves of commercial banks at the CBK 4/	196	195	243	264	279	289	308	331	364

Sources: Kosovo authorities; and IMF staff estimates and projections.

1/ Data have been revised to reclassify the CBK's holdings of Kosovar government securities as claims on the central government.

2/ Includes shares and other equity.

3/ Projections assume that the increase in deposits due to early withdrawals from KPST accounts in 2020 is gradually withdrawn out of the banking sector in 2021.

4/ Projections are made using the 2017 ratio of mandatory reserves to deposits.

Table 7. Kosovo: Financial Soundness Indicators, 2017–2020 1/
(Percent, unless otherwise indicated)

	2017	2018	2019	2020
Structure				
Number of banks	10	10	10	11
Foreign 2/	8	8	8	9
Share of total assets	88.1	86.8	86.7	86.4
Domestic	2	2	2	2
Share of total assets	11.9	13.2	13.3	13.6
Capital adequacy				
Regulatory capital to risk weighted assets	18.1	17.0	15.9	16.7
Tier 1 capital to risk weighted assets	16.2	15.5	14.2	14.8
Capital to assets	12.6	12.2	11.2	12.2
Asset quality				
NPL to total loans 3/	3.1	2.5	1.9	2.5
NPL net of provisions to capital	1.1	1.5	1.5	4.5
Large exposures to capital	81.7	65.9	81.8	92.5
Sectoral breakdown of loans				
Agriculture	2.2	2.5	2.0	2.0
Manufacturing	9.8	9.9	10.2	9.9
Trade	32.7	31.8	32.0	28.4
Other services	12.5	13.2	13.0	23.5
Construction	5.5	5.7	5.7	7.7
Households	36.2	36.3	36.3	28.5
Liquidity				
Liquid assets to total assets	28.9	29.0	28.8	27.8
Deposits to loans	124.4	122.8	129.2	128.4
Liquid assets to short-term liabilities 4/	38.2	40.0	38.7	37.6
Profitability				
Return on average assets	2.5	2.3	2.1	1.6
Return on average equity	19.4	18.3	17.2	13.8
Interest margin to gross income	71.2	78.4	80.6	79.7
Non-interest expense to gross income	46.5	48.2	48.1	45.7
Market risk				
Net open currency position to tier 1 capital	1.2	3.8	4.7	0.8

Sources: Central Bank of the Republic of Kosovo

1/ Figures shown for 2020 correspond to end-November. Calculations do not include the bank (BKP) in liquidation process.

2/ Figures include foreign branches and foreign subsidiaries.

3/ Loans classified as doubtful or loss.

4/ Short-term liabilities are deposits, short-term borrowing, and other liabilities (up to one year maturity).

Table 8. Kosovo: Indicators of Capacity to Repay the Fund, 2017–2025
(Percent, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Prel.		Projections			
Fund obligations based on existing credit (in SDR millions)									
Principal	33.2	3.5	24.6	54.3	43.1	9.9	10.3	20.7	10.3
Charges and interest 1/	1.9	2.6	2.5	2.1	1.2	0.5	0.4	0.3	0.1
Total obligations based on existing credit									
In millions of SDRs	35.0	6.1	27.1	56.4	44.3	10.4	10.8	20.9	10.4
In millions of Euros	41.9	7.4	33.7	67.6	52.7	12.4	12.8	24.9	12.4
In percent of gross international reserves	3.6	0.6	2.9	6.8	5.2	1.1	1.0	1.9	0.9
In percent of exports of goods and services	2.4	0.4	1.6	4.5	3.0	0.6	0.6	1.1	0.5
In percent of debt service	59.3	21.5	53.8	62.5	51.0	17.1	19.4	28.1	10.0
In percent of GDP	0.7	0.1	0.5	1.0	0.7	0.2	0.2	0.3	0.1
In percent of quota	42.4	7.3	32.8	68.2	53.6	12.6	13.0	25.3	12.6
Outstanding Fund credit based on existing credit									
In millions of SDRs	135.4	131.9	107.3	94.3	51.2	41.3	31.0	10.3	0.0
In millions of Euros	161.9	160.5	133.1	113.2	60.9	49.1	36.8	12.3	0.0
In percent of gross international reserves	13.9	13.8	11.7	11.3	6.1	4.4	3.0	0.9	0.0
In percent of exports of goods and services	9.3	8.3	6.4	7.5	3.5	2.6	1.7	0.5	0.0
In percent of debt service	229.1	467.4	212.8	104.6	59.0	67.4	55.8	13.9	0.0
In percent of GDP	2.5	2.4	1.9	1.7	0.9	0.6	0.5	0.1	0.0
In percent of quota	163.9	159.7	129.9	114.2	62.0	50.0	37.5	12.5	0.0
Net use of Fund credit (millions of SDRs)									
Disbursements and purchases	79.2	0.0	0.0	41.3	...	...	...	...	...
Repayments and repurchases	33.2	3.5	24.6	54.3	43.1	9.9	10.3	20.7	10.3
Memorandum items:									
Gross international reserves (in millions of Euros)	1,168	1,164	1,142	997	1,004	1,127	1,230	1,322	1,410
Exports of goods and services (in millions of Euros)	1,737	1,938	2,069	1,502	1,757	1,923	2,108	2,276	2,450
Debt service (in millions of Euros) 2/	71	34	63	108	103	73	66	89	124
Quota (in SDR millions)	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6
Euro/SDR Exchange Rate	1.20	1.22	1.24	1.20	1.19	1.19	1.19	1.19	1.19

Source: IMF staff estimates and projections.

1/ Based on the rate of charge of 1.05 as of January 14, 2021. Charges and interest calculations are preliminary.

2/ Total public external debt service, including IMF repayment.

Annex I. Risk Assessment Matrix ^{1/}

	Source of Risks and Relative Likelihood	Impact if Realized	Recommended Policy Response
Global risks	Prolonged pandemic and asynchronous progress. (Medium)	<ul style="list-style-type: none"> The virus proves harder to eradicate, requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable. In contrast, if containment is faster, confidence and activity should be boosted. (High) Limited access and longer-than-expected vaccine deployment (combined with lower policy space) prompts a reassessment of Kosovo's growth prospects. (High) 	<ul style="list-style-type: none"> Strengthen contingency planning. Use external support where possible to finance additional healthcare spending and other support measures but be prepared to reprioritize spending and reduce tax expenditures if deficit reducing measures are needed. Accelerate broad-based structural reforms to boost competitiveness and gradually reduce the dependency on diaspora-related flows by increasing exports and domestic production.
	Widespread social discontent and political instability. (High)	<ul style="list-style-type: none"> Social tensions erupt as the pandemic and inadequate policy response cause socio-economic hardship, or due to unequal access to vaccines. Growing political polarization and instability weaken policymaking and confidence. For Kosovo, this could lead to a more difficult European path. (High) 	<ul style="list-style-type: none"> Continue to implement the EU-SAA and diversify export markets. Improve the business environment to support growth in exports and investment.
Domestic risks	Widened fiscal deficit due to pandemic-related recovery measures and/or lower revenues (High)	<ul style="list-style-type: none"> Fiscal risks may arise both from rising debt levels and lower fiscal buffers. Lower revenues may lead to the emergence of expenditure arrears. (Medium) 	<ul style="list-style-type: none"> Securing additional financing should preserve fiscal buffers at reasonable levels. Additional financing should allow fiscal stabilizers to work and provide space to implement needed mitigation and recovery measures.
	The domestic political stalemate intensifies (High)	<ul style="list-style-type: none"> The Parliament arising from the upcoming elections is unable to elect a new President. The absence of Parliament slows progress in the implementation of structural reforms and complicates securing new financing and the implementation of recovery measures. (High) 	<ul style="list-style-type: none"> The caretaker government needs to exercise caution in the implementation of the budget until there is clarity regarding uncommitted financing. Technical work required as a foundation for pending reforms in PIM, wage policy and employment, and social security should continue.
	Intensification of financial sector vulnerabilities. (Medium)	<ul style="list-style-type: none"> A large surge in non-performing loans could lower capital adequacy levels, affecting the stability of smaller banks and the ability of the system to extend credit to the private sector (High) 	<ul style="list-style-type: none"> The CBK needs to tightly monitor the quality of loan portfolios and show flexibility if gaps arise in the capital position of some banks. Quorum in the CBK Board needs to be restored to allow the CBK to swiftly implement or adapt regulations if needed.

¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex II. Debt Sustainability Analysis

General government debt is projected to increase on account of a large deficit in 2020–21 reflecting the impact of COVID-19, with large fiscal and external financing needs assumed to be closed by drawing down existing reserves and accessing financing from international financial institutions (IFIs). Debt is assessed as sustainable in the baseline and stress scenarios. Risks result from shocks to growth and contingent liabilities, and from an increasingly reduced capacity of the domestic market to absorb higher government debt, as Kosovo does not have external market access. Extending the maturity of debt and diversifying the sources of financing remain key policy priorities to contain financing risks.

A. Key Assumptions

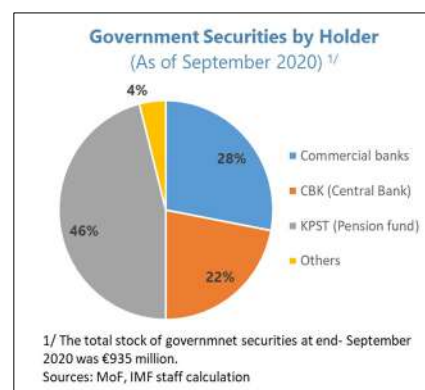
- 1. Macroeconomic assumptions.** Real GDP is expected to contract by 6 percent in 2020, 9.5 pp below the pre-pandemic baseline, largely due to a near-cessation of diaspora-related travel and sharp demand and supply shocks on account of aggressive virus containment measures. Though growth is projected to recover toward the pre-COVID-19 baseline of 4 percent in the medium term, the pandemic will leave long-lasting scars in the form of a permanent output loss of about 7 percent with respect to the pre-crisis trend. Headline average inflation is projected at 0.2 percent in 2020, gradually increasing to 1.9 percent over the medium term. The headline fiscal deficit is projected to increase to 7.7 and 5.9 percent of GDP in 2020 and 2021, respectively, due to revenue losses and pandemic-related support measures, and to gradually converge to the 2 percent of GDP fiscal rule deficit through the medium-term. This is expected for 2026, after the expiration of the fiscal rule’s “investment clause” in 2025.
- 2. Public debt.** Public debt consists of general government debt and explicit guarantees issued by the government. Contingent liabilities arising from the privatization process (about 1.5 percent of GDP) and POE debt (around 2–3 percent of GDP) are not included. Beginning in 2020, the public debt stock includes €120 million of debt with KPST, reflecting the government’s legal commitment to replenish early withdrawals of pensions savings on accounts with a balance of less than €10,000. At end-2020, domestic debt made up about 2/3 of total debt. External public debt is largely with multilaterals (IDA, EIB, EBRD, EU, and the IMF), and is denominated either in SDRs or Euros.
- 3. Financing assumptions.** Fiscal financing needs in 2020 were covered by drawdowns from government bank balances (€200 million), IFI financing from the IMF (€51 million under the RFI) and the World Bank (€44 million), EU financing (€50 million corresponding to the first tranche under the Macro Financial Assistance, MFA, of €100 million), the Council of Europe (€17.5 million corresponding to the first tranche under total lending assistance of €35 million), EU grants (€34 million), and a sizable issuance of domestic government bonds (€170 million on a net basis). The financing program for 2021 includes the second tranche of both lending from the EU and the Council of Europe, but it also includes about €160 million of still-uncommitted financing from multilateral sources. Beyond 2021, gross financing needs are expected to decrease, in line with fiscal consolidation. While the analysis assumes additional budget support from IFIs (€57 million and €37 million in 2022 and 2023 respectively), reflecting the authorities’ intentions, most external financing is expected to be

associated with investment projects. Accordingly, the budget is expected to primarily rely on domestic financing sources. In this regard, the analysis assumes that over the forecast period, the average maturity of domestic debt would gradually increase from about 3.5 years in 2019 to 4.5 years in 2025.

B. Public DSA

4. General government debt is projected to increase over the medium term but remain sustainable. Reflecting the sizable fiscal deficits expected over 2020 – 21, the debt stock is projected to almost double from 17.6 percent of GDP in 2019 to around 34.1 percent of GDP in 2025. Beyond 2021, the increase in debt reflects the assumption of a moderate increase in absorption capacity of IFI financing for new capital investments. Importantly, the analysis assumes that the “investment clause” under the fiscal rule will remain in effect, which will require the government to unify the “investment clause” debt ceiling (currently at 30 percent of GDP), with the legal ceiling of 40 percent of GDP on total debt.

5. While gross financing needs are projected to remain below the sustainability threshold, a few vulnerabilities may emerge. After peaking at close to 14 percent of GDP in 2020, gross financing needs are expected to moderate to 9.4 percent of GDP in 2021 and then decline and situate within the 7 - 8 percent of GDP range over 2022 – 25.¹ Resorting to the implementation of the fiscal rule beyond 2021 and increasing the average maturity of domestic debt should limit the vulnerabilities arising from the absence of external market access. In this regard, the government should aim to diversify the investor base (to include individuals, private businesses, and insurance companies, which currently hold less than 5 percent of the total domestic debt), while gradually reducing CBK holdings of government securities and limiting KPST’s exposure to no more than 30 percent of its assets, in line with its legal ceiling. New instruments could also be explored, such as retail or external bonds, provided Kosovo makes progress in strengthening public financial management.



6. Stress tests indicate that public debt should stay largely below the high-risk threshold of 65 percent of GDP. Contingent liabilities stemming from POEs (modeled at 5 percent of GDP) and PAK (1.5 percent of GDP), could lift the debt ratio to 36 percent of GDP. Nevertheless, in none of the stress test scenarios does public debt level breach the high-risk threshold of 65 percent of GDP. Gross financing needs do not exceed the threshold either. The standard heat map and debt profile vulnerabilities analysis further suggest that public debt held by non-residents constitutes a limited vulnerability at the beginning of the forecast period, declining over time as the composition of debt

¹ Gross financing needs for 2020 include those arising from budgetary sources (12 percent of GDP) and extra-budgetary sources (near 2 percent of GDP).

increasingly shifts toward domestic debt (baseline scenario). Gross external requirements are above the upper early warning threshold of 15 percent of GDP for 2019 and over the projection period. However, this largely reflects short-term trade debt and intra-firm financing of around 9 percent of GDP.

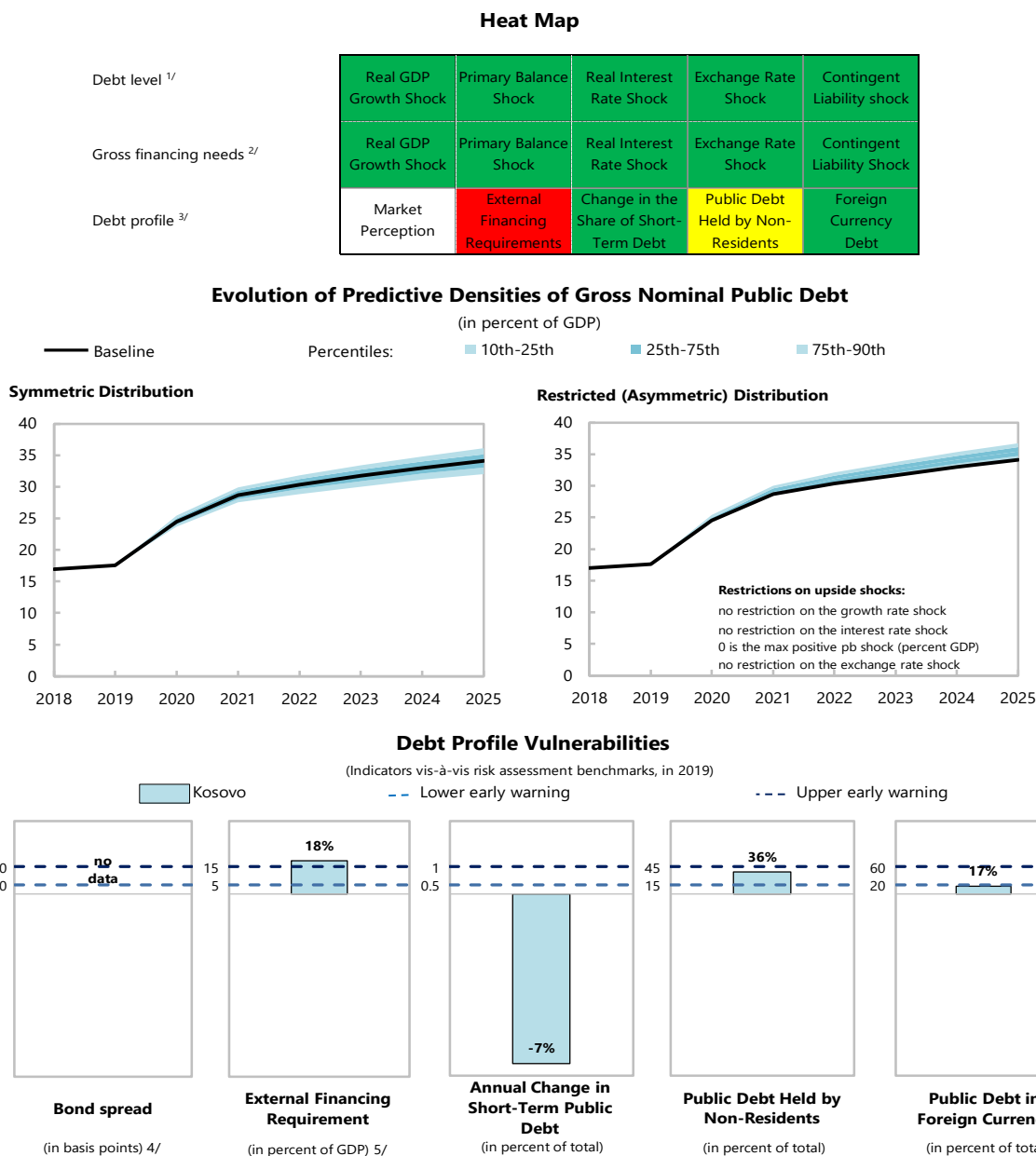
7. Staff projections show that fiscal adjustment largely occurs only after the recovery is entrenched. The analysis suggests that fiscal policy is supportive during the worse of the downturn, and that the fiscal adjustment is postponed for 2022 and beyond, after the recovery is well entrenched (Figure 2b).

C. External DSA

8. The external debt-to-GDP ratio is expected to increase by 10 pp of GDP through 2025. Cumulated net external public borrowing in 2020 – 23 is expected at more than 9 percent of GDP reflecting a sharp step-up in IFI and other multilateral loans contracted in response to the pandemic. Public external debt will increase to about 10 percent of GDP by 2025 also on account of moderate absorption of IFIs-financed investment. Most external public debt at end-2020 continues to be held by IFIs and other multilateral creditors (85 percent). About 1/2 of the external public debt is denominated in euros, followed by SDRs (IMF and IDA loans). External private debt is mainly composed of short-term trade financing and FDI intercompany lending.

9. External debt remains sustainable under a range of shocks. The external debt path is mainly sensitive to the non-interest current account shock and to a combined macroeconomic shock. The shock to the current account of one-half standard deviation in 2021 – 25 (around 1½ percent of GDP) would lead to an increase in the external debt of about 7 pp relative to the baseline scenario, to 41 percent of GDP by 2025. Similarly, a permanent shock of one-fourth standard deviation to interest rates, growth, and current account balance would lead to an increase in the external debt of 4 pp.

Figure 1. Kosovo: Public Sector Debt Sustainability Analysis (DSA) — Risk Assessment



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

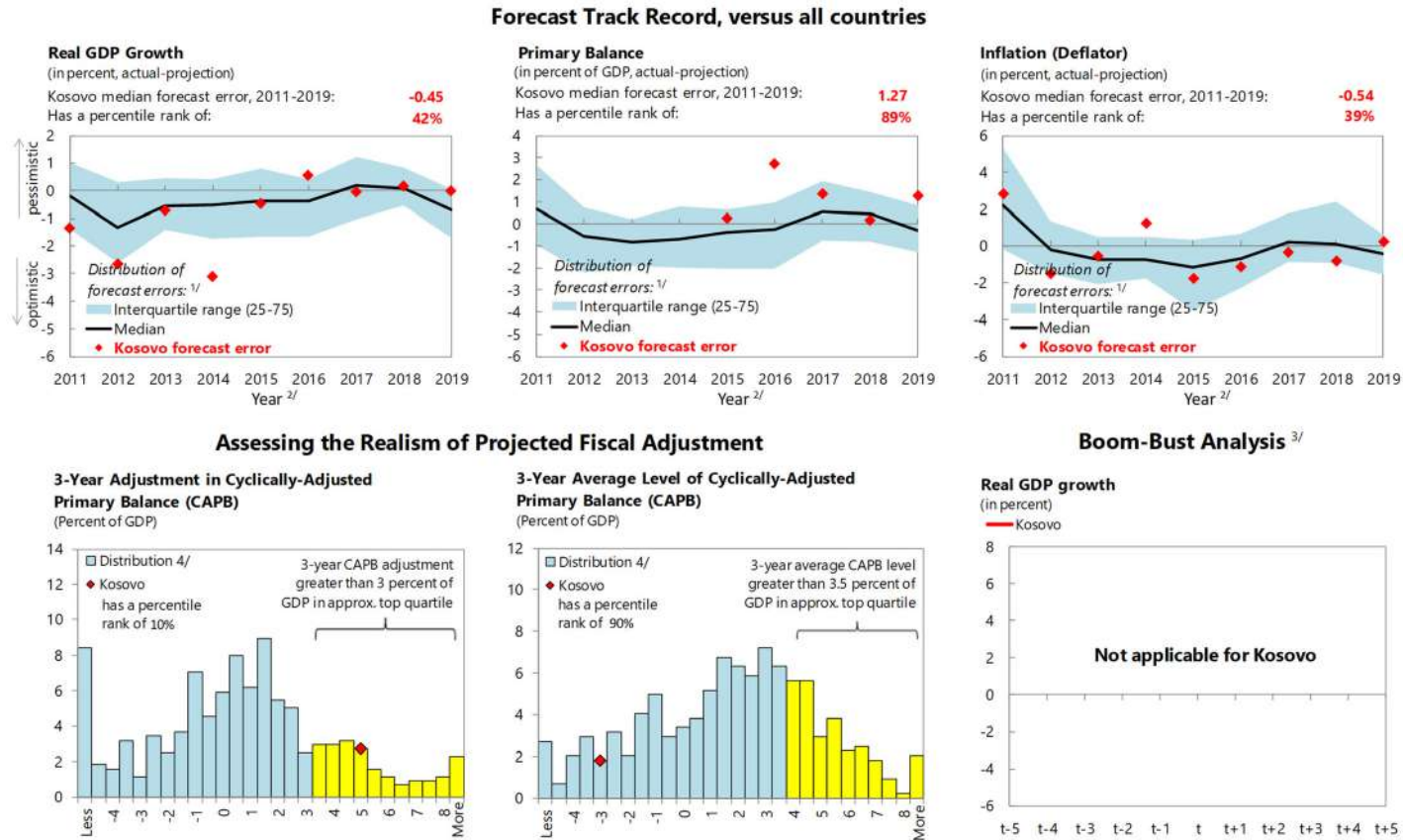
2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white. Lower and upper risk-assessment benchmarks are: 200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 17-Oct-20 through 15-Jan-21.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 2. Kosovo: Public DSA — Realism of Baseline Assumptions



Source: IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Kosovo, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 3. Kosovo: Public DSA — Baseline Scenario

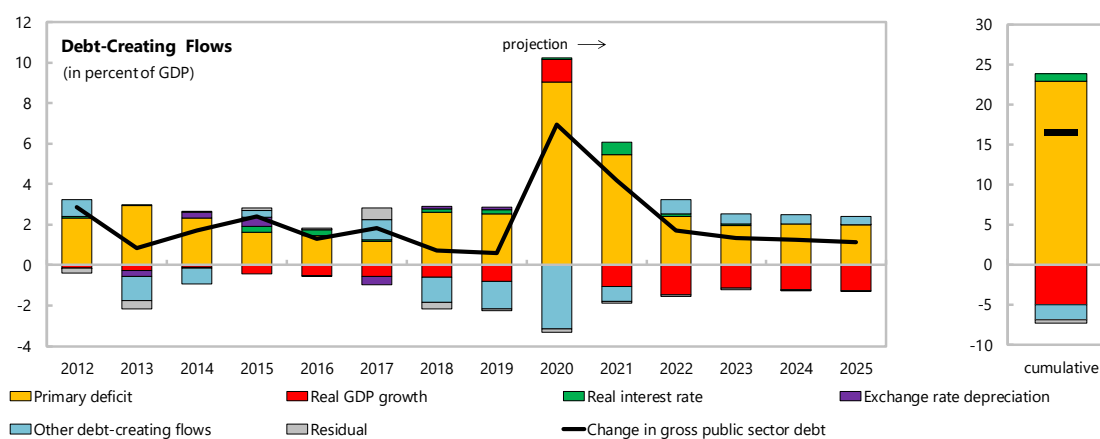
(Percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators^{1/}

	Actual			Projections						As of Jan 15, 2021		
	2013-2017 ^{2/}	2018	2019	2020	2021	2022	2023	2024	2025			
Nominal gross public debt	12.7	17.0	17.6	24.5	28.7	30.4	31.7	32.9	34.1	Sovereign Spreads		
Of which: guarantees	0.3	0.7	0.6	0.6	0.6	0.6	0.5	0.5	0.5	EMBIG (bp) 3/		
Public gross financing needs	7.6	7.9	6.9	13.7	9.4	7.1	7.4	7.2	7.8	5Y CDS (bp)		
Real GDP growth (in percent)	3.4	3.8	4.9	-6.0	4.5	5.5	4.0	4.0	4.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	1.4	1.0	0.6	2.1	-0.3	1.5	1.8	1.9	1.7	Moody's	n.a.	n.a.
Nominal GDP growth (in percent)	4.9	4.9	5.6	-4.0	4.2	7.1	5.8	6.0	5.8	S&Ps	n.a.	n.a.
Effective interest rate (in percent) ^{4/}	2.6	1.9	2.1	2.3	2.3	2.1	2.0	2.0	1.8	Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2013-2017	2018	2019	2020	2021	2022	2023	2024	2025		
Change in gross public sector debt	1.6	0.7	0.6	6.9	4.2	1.7	1.3	1.2	1.1	16.5	
Identified debt-creating flows	1.5	1.1	0.7	7.1	4.3	1.8	1.4	1.3	1.2	17.0	
Primary deficit	1.9	2.6	2.5	9.1	5.5	2.4	2.0	2.1	2.0	22.9	-0.8
Primary (noninterest) revenue and grants	25.3	26.3	26.8	25.1	26.5	26.1	26.1	26.1	26.2	156.1	
Primary (noninterest) expenditure	27.2	29.0	29.3	34.1	32.0	28.5	28.1	28.1	28.2	179.0	
Automatic debt dynamics ^{5/}	-0.2	-0.3	-0.4	1.2	-0.4	-1.3	-1.1	-1.2	-1.2	-4.2	
Interest rate/growth differential ^{6/}	-0.2	-0.5	-0.6	1.2	-0.4	-1.3	-1.1	-1.2	-1.2	-4.2	
Of which: real interest rate	0.1	0.1	0.2	0.1	0.6	0.1	0.1	0.0	0.0	0.9	
Of which: real GDP growth	-0.4	-0.6	-0.8	1.1	-1.1	-1.5	-1.1	-1.2	-1.2	-5.0	
Exchange rate depreciation ^{7/}	0.0	0.1	0.1	...	...	...	...	...	...	...
Other identified debt-creating flows	-0.1	-1.2	-1.4	-3.1	-0.7	0.7	0.5	0.4	0.4	-1.8	
Privatization/ other financing (negative)	-0.1	-0.5	-0.8	-0.1	-0.3	-0.4	-0.3	-0.1	0.0	-1.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Change in GG Deposits at the CBK (negative)	-0.1	-0.7	-0.6	-3.1	-0.4	1.2	0.8	0.6	0.4	-0.6	
Residual, including asset changes ^{8/}	0.1	-0.3	-0.1	-0.2	-0.1	-0.1	-0.1	0.0	0.0	-0.5	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as guaranteed loans and international loans subordinated by the Ministry of Finance to companies providing essential public services.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

 5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)] / (1+g+\pi+grt)$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

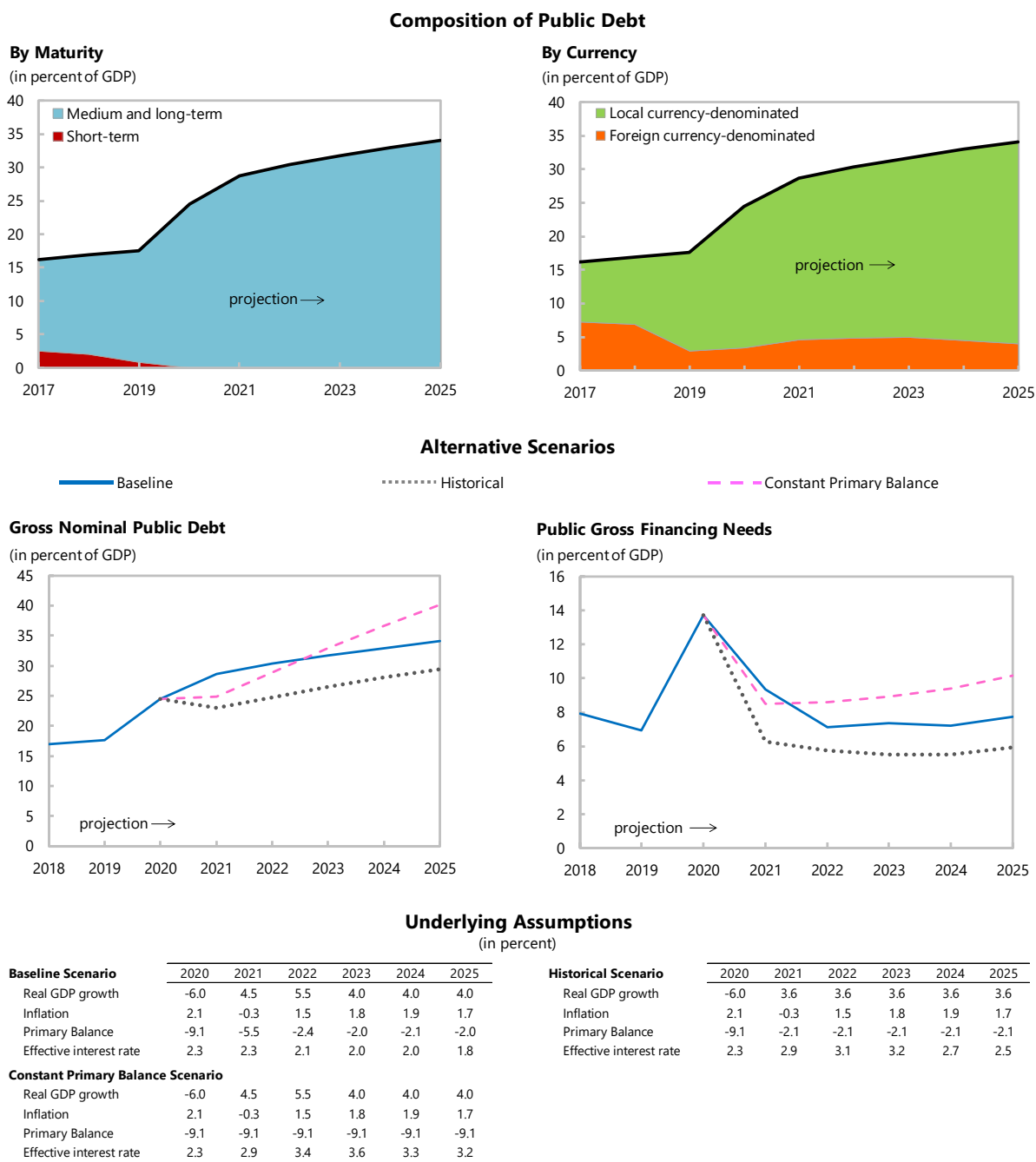
 6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

 7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

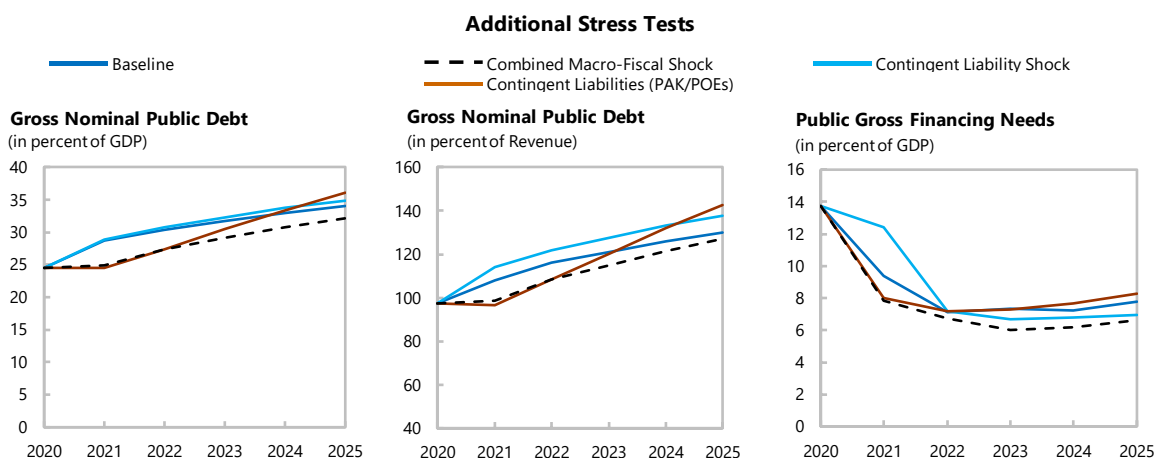
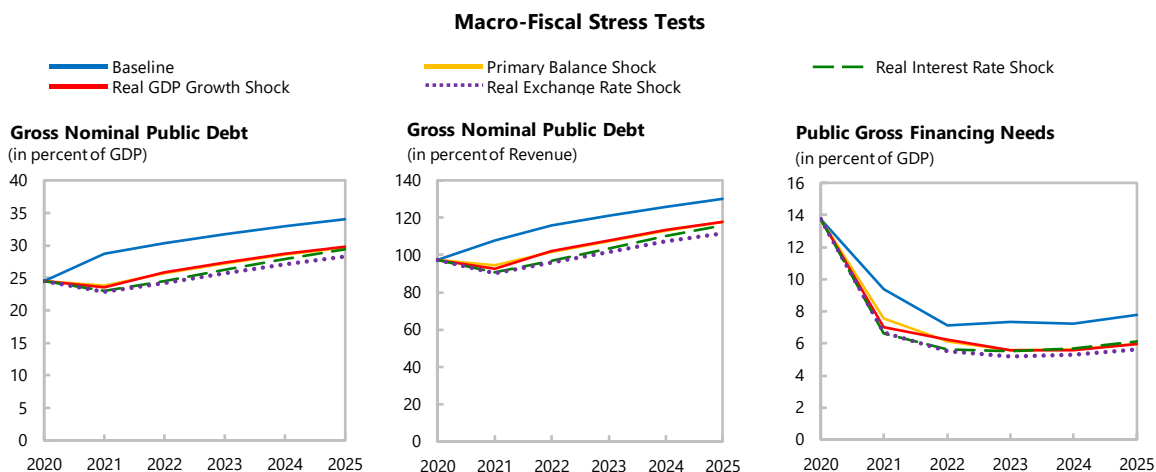
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 4. Kosovo: Public DSA — Composition of Public Debt and Alternative Scenarios



Source: IMF staff.

Figure 5. Kosovo: Public DSA — Stress Tests

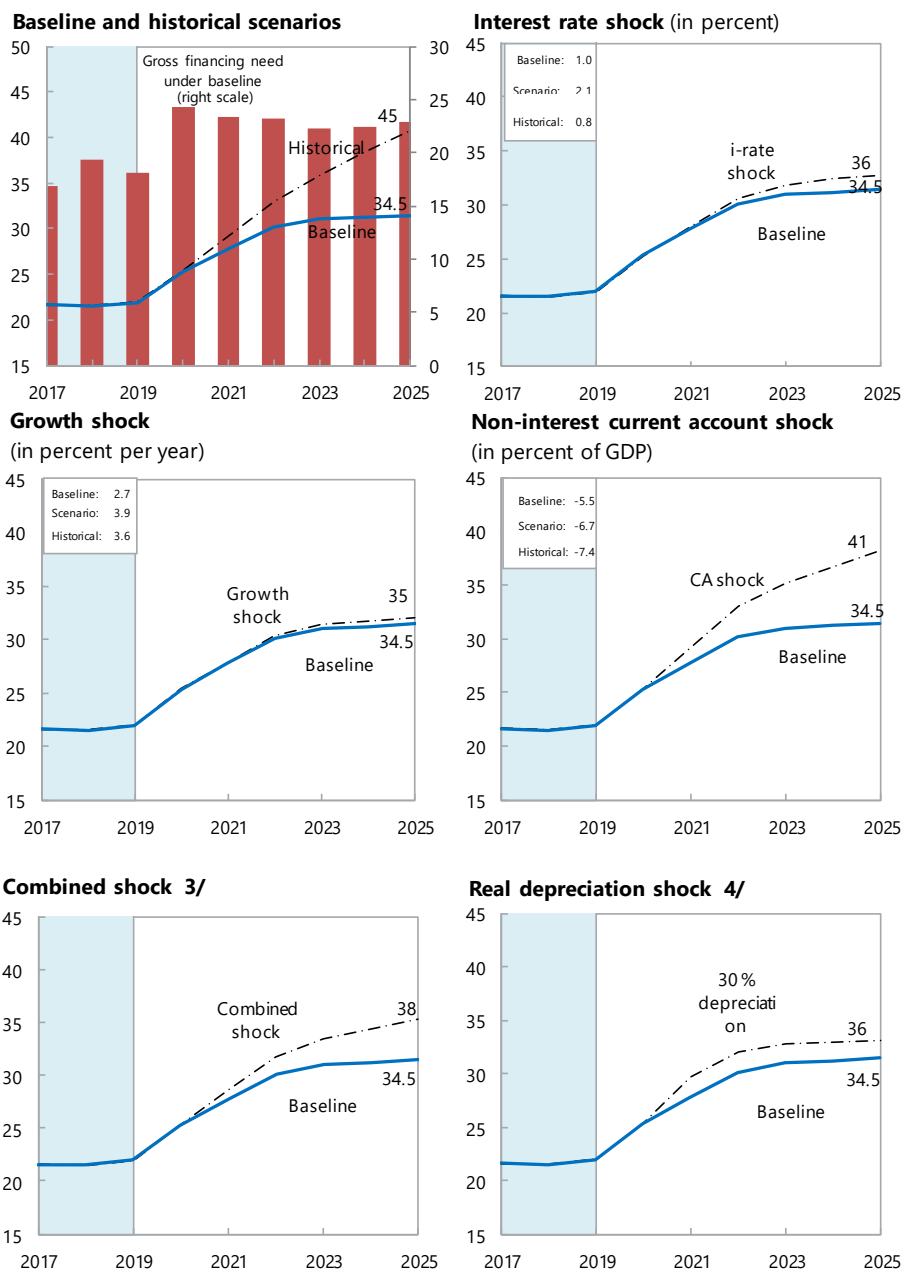


Underlying Assumptions (in percent)

	2020	2021	2022	2023	2024	2025
Primary Balance Shock						
Real GDP growth	-6.0	4.5	5.5	4.0	4.0	4.0
Inflation	2.1	-0.3	1.5	1.8	1.9	1.7
Primary balance	-9.1	-7.3	-3.9	-2.2	-2.1	-2.0
Effective interest rate	2.3	2.9	3.4	3.6	3.2	3.0
Real Interest Rate Shock						
Real GDP growth	-6.0	4.5	5.5	4.0	4.0	4.0
Inflation	2.1	-0.3	1.5	1.8	1.9	1.7
Primary balance	-9.1	-5.5	-2.4	-2.0	-2.1	-2.0
Effective interest rate	2.3	2.9	4.0	4.5	4.2	4.2
Combined Shock						
Real GDP growth	-6.0	3.5	4.5	4.0	4.0	4.0
Inflation	2.1	-0.6	1.3	1.8	1.9	1.7
Primary balance	-9.1	-7.3	-3.9	-2.2	-2.1	-2.0
Effective interest rate	2.3	2.9	4.0	4.5	4.3	4.2
Real GDP Growth Shock						
Real GDP growth	-6.0	3.5	4.5	4.0	4.0	4.0
Inflation	2.1	-0.6	1.3	1.8	1.9	1.7
Primary balance	-9.1	-5.9	-3.1	-2.0	-2.1	-2.0
Effective interest rate	2.3	2.9	3.4	3.6	3.2	3.0
Real Exchange Rate Shock						
Real GDP growth	-6.0	4.5	5.5	4.0	4.0	4.0
Inflation	2.1	2.3	1.5	1.8	1.9	1.7
Primary balance	-9.1	-5.5	-2.4	-2.0	-2.1	-2.0
Effective interest rate	2.3	2.9	3.3	3.5	3.1	2.9
Contingent Liability Shock						
Real GDP growth	-6.0	3.5	4.5	4.0	4.0	4.0
Inflation	2.1	-0.6	1.3	1.8	1.9	1.7
Primary balance	-9.1	-11.1	-2.4	-2.0	-2.1	-2.0
Effective interest rate	2.3	3.6	4.1	4.1	3.6	3.3

Source: IMF staff.

Figure 6. Kosovo: External Debt Sustainability: Bound Tests ^{1/2/}
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
 1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
 2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
 3/ Permanent 1/4 standard deviation shocks are applied to interest rate, growth rate, and current account balance.
 4/ One-time real depreciation of 30 percent occurs in 2021.

Table 1. Kosovo: External Debt Sustainability Framework, 2017-2025
(In percent of GDP, unless otherwise indicated)

	Actual			Projections						Debt-stabilizing non-interest current account 6/ -4.7
	2017	2018	2019	2020	2021	2022	2023	2024	2025	
1 Baseline: External debt	21.6	21.5	21.9	25.3	27.8	30.1	31.0	31.2	31.4	
2 Change in external debt	2.3	-0.1	0.4	3.7	2.4	2.3	0.9	0.2	0.3	
3 Identified external debt-creating flows (4+8+9)	1.0	2.9	1.9	5.8	2.1	1.4	0.8	0.5	0.4	
4 Current account deficit, excluding interest payments	5.2	7.4	5.3	7.2	6.1	5.8	4.9	4.6	4.5	
5 Deficit in balance of goods and services	25.5	28.0	26.9	31.7	30.3	29.3	28.0	27.2	26.7	
6 Exports	27.1	28.8	29.1	22.0	24.7	25.3	26.2	26.7	27.1	
7 Imports	52.6	56.8	56.0	53.7	55.0	54.6	54.2	53.9	53.8	
8 Net non-debt creating capital inflows (negative)	-3.3	-3.4	-2.8	-3.0	-3.2	-3.3	-3.2	-3.2	-3.2	
9 Automatic debt dynamics 1/	-1.0	-1.1	-0.6	1.6	-0.8	-1.1	-0.9	-0.9	-0.9	
10 Contribution from nominal interest rate	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	
11 Contribution from real GDP growth	-0.8	-0.8	-1.1	1.3	-1.0	-1.4	-1.1	-1.2	-1.2	
12 Contribution from price and exchange rate changes 2/	-0.4	-0.6	0.3	...	...	...	...	...	...
13 Residual, incl. change in gross foreign assets (2-3) 3/	1.3	-3.0	-1.5	-2.4	0.3	1.0	0.1	-0.3	-0.1	
External debt-to-exports ratio (in percent)	79.8	74.6	75.3	115.0	112.2	119.1	118.3	116.8	115.8	
Gross external financing need (in millions of USD) 4/	1215	1531	1444	1658	1661	1767	1797	1911	2068	
in percent of GDP	16.8	19.3	18.2	21.4	19.6	19.3	18.4	18.5	18.9	
Scenario with key variables at their historical averages 5/				25.3	29.2	33.0	35.9	38.3	40.7	-5.5
Key Macroeconomic Assumptions Underlying Baseline										
				10-Year Historical Average	10-Year Standard Deviation					
Real GDP growth (in percent)	4.2	3.8	4.9	3.6	1.0	-6.0	4.5	5.5	4.0	4.0
GDP deflator in EUR (change in percent)	3.5	5.7	-4.6	0.1	7.5	3.8	4.8	2.4	2.2	2.1
Nominal external interest rate (in percent)	1.0	0.9	0.8	0.8	0.5	1.0	1.2	1.1	1.0	0.9
Growth of exports (in percent)	23.2	16.7	1.2	10.0	14.9	-26.2	22.9	10.3	10.1	8.2
Growth of imports (in percent)	11.4	18.5	-1.3	4.8	11.2	-6.4	12.1	7.1	5.6	5.6
Current account balance, excluding interest payments	-5.2	-7.4	-5.3	-7.4	2.9	-7.2	-6.1	-5.8	-4.9	-4.6
Net non-debt creating capital inflows	3.3	3.4	2.8	4.4	1.9	3.0	3.2	3.3	3.2	3.2

1/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; g = real GDP growth rate; e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

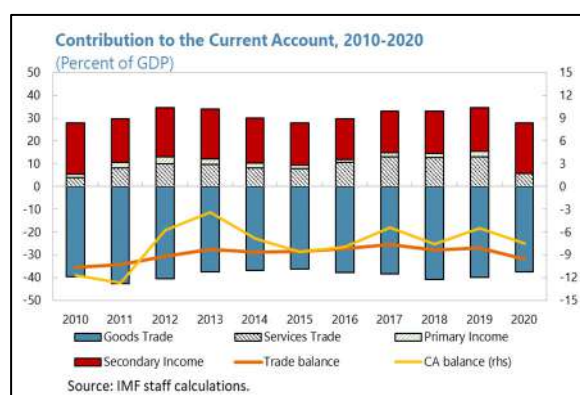
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex III. External Sector Assessment

A prudent use of government bank balances and privatization receipts is necessary to preserve international reserves at levels in line with IMF reserve adequacy metrics, which is essential to anchor expectations in Kosovo's unilaterally euroized economy. Once the crisis has passed, structural reforms should help increasing efficiency and promoting stronger exports of goods and services and contribute to bring the current account to a level consistent with fundamentals. In line with this, the EBA-lite methodology suggests that the external position remained weaker than implied by medium-term fundamentals and desirable policy settings in 2020.

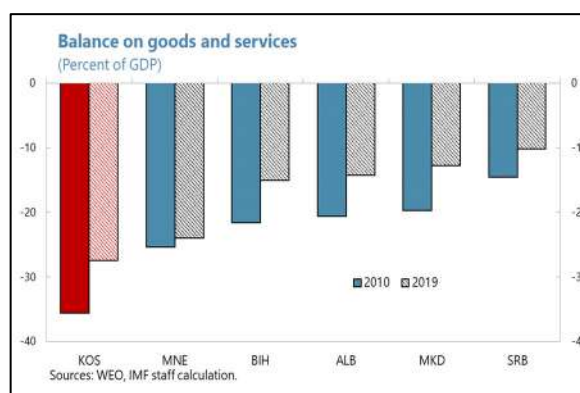
A. External Balance

1. Kosovo's large current account deficit in 2020 reflects both the COVID-19 impact and structural factors.¹ The current account deficit is estimated to have increased from 5.5 percent of GDP in 2019 to 7.5 percent in 2020, given the implementation of mitigation and recovery measures and a significant decrease in diaspora-related flows (Table 1).² This reflects a current account structure that is mainly shaped by flows originating in the Kosovar diaspora: A large trade deficit in goods is financed by diaspora-related inflows in tourism, remittances, compensation of employees, FDI in real estate, and other unaccounted diaspora-related flows reflected in relatively large errors and omissions.



2. The crisis led to a decrease in the deficit in the goods balance, but in a sizable deterioration in the balance of services.

- The trade deficit in goods is estimated to have declined to 37.5 percent of GDP (40 percent in 2019), driven by both decreasing imports and increasing exports.** Good imports are estimated to have decreased by close to 7 percent, reflecting a decrease both in import volumes (about 2 percent) and lower import prices. In turn, good exports recovered in 2020, as external sales of metals rebounded with Ferronickel (an Albanian company) strongly increasing production and redirecting exports to Albania.



¹ Projections for 2020 reflect actual data through Q3:2020.

² In September 2019, the CBK published a revision of BOP data from Q1:2017 to Q2:2019 that includes a better estimation of diaspora-related tourism inflows.

- **The surplus in the services balance is estimated to have contracted to 5.8 percent of GDP (13.1 percent in 2019).** This mainly reflects the decrease in diaspora related tourism, as international mobility restrictions negatively weighed on the number of visitors, which declined by about 60 percent through Q3:2020.

- The pre-crisis deficit in the balance of goods and services (26.9 percent of GDP in 2019) was significantly larger than the regional average (15.3 percent of GDP).

3. The deficit in the balance of goods and services for 2020 was financed by remittances, FDI inflows, IFI and other multilateral public debt, and by a decline in international reserves. Concretely:

- The increase in recorded remittances offset the decrease in unrecorded remittances (13.6 percent of GDP in 2020, almost unchanged with respect to 2019).

- Compensation of employees is assessed to have remained virtually unchanged at 3.7 percent of GDP in 2020.

- Net FDI inflows benefitted from reinvested earnings by foreign bank subsidiaries, which did not pay dividends in 2020. Accordingly, FDI is estimated at 3.2 percent of GDP (3 percent of GDP in 2019), also driven by some real-estate investment.

- Portfolio investment is estimated to have reversed its sign in 2020, as KPST repatriated funds to finance early withdrawals authorized in the context of the COVID-19 relief package. Accordingly, net portfolio investment is estimated at 0.5 percent of GDP (compared to outflows of 0.8 percent of GDP in 2019).

- The financing of the fiscal deficit resulted in inflows of 3.1 percent of GDP in 2020 (up from 2 percent of GDP in 2019).

- Finally, GIRs (CBK definition) are estimated to have decreased by 1.2 percent of GDP in 2020 (compared to an increase of 1.5 percent of GDP in 2019).

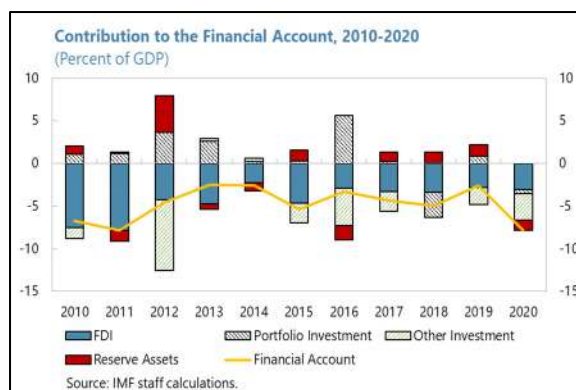
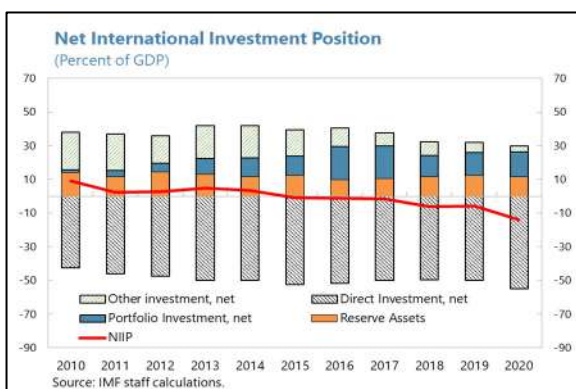


Table 1. Kosovo: Balance of Payments
(Millions of euros, unless otherwise indicated)

	2019	2020	2021	2020/19	2021/20
		Est.	Proj.	(percent)	(percent)
Current account	-392	-509	-452		
<i>percent of GDP</i>	-5.5	-7.5	-6.4		
Goods Balance	-2,840	-2,559	-2,698		
<i>percent of GDP</i>	-40.0	-37.5	-38.0		
Exports, f.o.b.	393	453	482	15.2	6.3
Imports, f.o.b.	3,233	3,012	3,180	-6.9	5.6
Services Balance	932	397	549		
<i>percent of GDP</i>	13.1	5.8	7.7		
Receipts	1,676	1,049	1,275	-37.4	21.6
Payments	744	652	726	-12.4	11.5
Primary Income	154	158	168		
Compensation of employees, net	257	249	263	-3.0	5.5
<i>percent of GDP</i>	3.6	3.7	3.7		
Secondary Income	1,362	1,495	1,529		
Workers' remittances (net)	822	907	954	10.4	5.2
Capital account	-8	-9	-9		
Financial account	-185	-534	-398		
Direct investment, net	-201	-208	-228		
<i>percent of GDP</i>	-2.8	-3.0	-3.2		
Portfolio investment, net	59	-32	20		
<i>percent of GDP</i>	0.8	-0.5	0.3		
Other investment, net	-139	-211	-207		
<i>percent of GDP</i>	-2.0	-3.1	-2.9		
Reserve assets	95	-83	17		
Net errors and omissions 1/	215	-16	64		
<i>percent of GDP</i>	3.0	-0.2	0.9		
Memorandum items:					
Remittances (percent of GDP) 2/	13.5	13.6	14.3		

Sources: Kosovo authorities; and IMF staff estimates and projections.
1/ Errors and omissions are mostly comprised of unidentified private remittances and unidentified FDI.
2/ Gross Remittances including 1/2 of net errors and omissions



4. The negative Net International Investment Position (NIIP) is assessed to have further deteriorated in 2020. The decline was mainly predicated on a decrease of KPST and CBK external assets and increases in public debt.

5. Outlook. The current account balance is projected to improve in 2021 as travel restrictions are gradually lifted, and growth rebounds in Advanced Europe, pushing tourism receipts upwards. The rebound of growth will result in a slight deterioration in the balance of goods, as both imports and exports increase. The financing structure is expected to continue relying on multilateral official sources and FDI. The NIIP is expected to continue deteriorating partly on account of IFI disbursements for budget support and project financing.

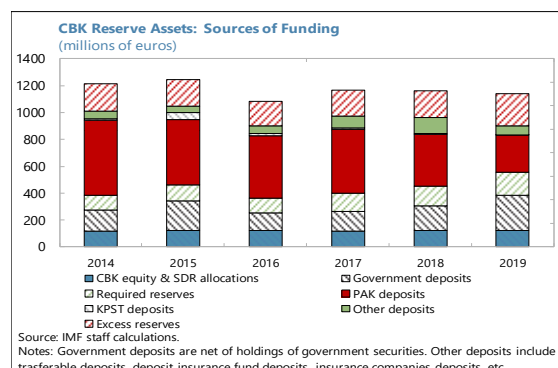
B. Real Exchange Rate (EBA-Lite) Assessment

6. Kosovo's external position remains weaker than implied by medium-term fundamentals and desirable policy settings. Based on the EBA-lite methodology, the CA model results in a CA norm of -4.8 percent of GDP, yielding a CA gap of -2.9 percent of GDP for 2020, and suggesting a REER overvaluation of about 10 percent (similar to that in the 2018 Article IV).³ A large portion of the current account gap is due to the cost of COVID-19 relief measures, which drove the fiscal and current account deficits upwards, and also due to mobility restrictions, which constrained tourism flows. Accordingly, staff assess that a large part of the gap will self-correct as the pandemic is brought under control, as suggested by medium-term projections. The ES approach yields both a lower current account gap and REER overvaluation (of -1.3 percent of GDP and 4.5 percent, respectively).⁴

Table 2. Kosovo: Model Estimates for 2020
(in percent of GDP, unless otherwise indicated)

	CA model	ES model
CA (Projected at end-2020)	-7.5	
Cyclical Contributions (from model)	0.4	
Cyclically adjusted CA	-7.7	
CA (Norm, from model) 1/	-4.8	-5.2
Cyclically adjusted CA Norm	-5.2	
CA-Gap	-2.9	-1.3
of which, Policy gap	5.3	
Elasticity	-0.27	
REER Gap	10.7	4.5

1/ Cyclically adjusted, including multilateral consistency adjustments



C. Reserve Adequacy Assessment

7. CBK's gross international reserves are mainly funded by government deposits, and commercial banks' reserves. At end-2019, the liability counterpart of reserves (16 percent of GDP)

³ The EBA-lite methodology can be found here: <https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/07/03/The-Revised-EBA-Lite-Methodology-47088>.

⁴ Given Kosovo's investment needs, staff assume that continued FDI and donor inflows will keep deteriorating the NIIP until it stabilizes at -50 percent of GDP in 2040. The short time series available for Kosovo (13 years of data) do not allow the estimation of a reliable REER model for Kosovo.

was composed by PAK deposits (€275 million), TSA deposits (€444 million), and Banks' mandatory and excess reserves (€415 million).

8. GIRs adequacy using standard rules of thumb deteriorated in 2020. Kosovo's GIR adequacy is assessed using standard and alternative GIR definitions (Table 3):

- **Standard definition:** GIR includes the sum of nonresidents' currency and deposits, securities, monetary gold and SDR, reserve position in the Fund, and other items.
- **CBK's definition:** Standard GIR net of PAK and KPST deposits.
- **Staff's alternative definition:** Standard GIR net of banks' excess reserves.

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Prel.			Projections		
Standard Definition of GIR									
Import cover (months of next year's imports)	3.7	3.5	3.7	3.1	2.9	3.1	3.2	3.3	...
Reserves to short-term external debt (%)	168	167	152	129	123	129	132	134	135
Reserves to Broad Money (%)	39	36	31	24	23	24	24	24	24
Conservative (CBK) Definition of GIR									
Import cover (months of next year's imports)	2.1	2.3	2.8	2.4	2.3	2.5	2.6	2.6	...
Reserves to short-term external debt (%)	98	110	115	101	98	102	106	108	112
Reserves to Broad Money (%)	23	24	23	19	18	19	19	20	20
GIR, net of banks' excess reserves									
Import cover (months of next year's imports)	3.1	2.9	2.9	2.3	2.1	2.3	2.4	2.4	...
Reserves to short-term external debt (%)	140	138	119	95	89	96	99	100	100
Reserves to Broad Money (%)	33	30	24	18	17	18	18	18	18

Source: IMF staff calculations.

9. Using the standard definition, GIRs are assessed to have declined from around 120 percent of the IMF RA metric in 2019, to 103 percent in 2020.⁵ The main force driving this decline was the use of about €200 million of government deposits to finance the 2020 fiscal deficit. IMF (2011) suggests the following reserve adequacy (RA) metric for an economy with fixed exchange rate:

$$RA = 10\% X + 30\% STD + 10\% BM + 20\% OPL,$$

where X is export revenues, STD is short-term external debt, BM is broad money and OPL is other external liabilities.⁶ Using more conservative GIR definitions, the coverage of the IMF RA metric is lower (Table 4). To complement the analysis above, a modified RA metric can be used to reflect Kosovo's reliance on remittance inflows (R) and to account for the risk of domestic deposit (D) outflows in a euroized economy:⁷

⁵ IMF (2011) Assessing Reserve Adequacy, IMF Policy Paper.

⁶ Short-term external debt includes short-term bank financial liabilities and other sectors. Medium and long-term financial debt and equity includes liabilities originated from the general government and FDI.

⁷ The weight on total deposits was increased from 10 to 15 percent to reflect the absence of a lender of last resort.

$$RA = 10\% (X+R) + 30\% STD + 15\% D + 20\% OPL.$$

Using this modified RA metric suggests that Kosovo’s GIRs are at a lower-than-adequate level.

Table 4. Kosovo: Reserve Adequacy Metrics for Dollarized and Euroized Economies

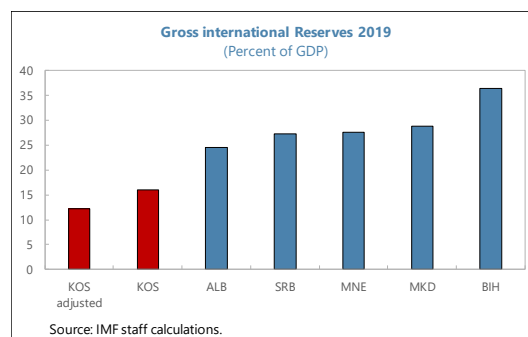
	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Prel.	Projections				
Standard GIR (millions of euros)	1168	1164	1142	997	1004	1127	1230	1322	1410
Percent of RA metric	144	136	121	103	94	96	98	98	99
Percent of RA modified metric	113	106	94	79	73	75	76	76	77
Conservative GIR (millions of euros)	683	769	864	781	798	896	983	1070	1164
Percent of RA metric	84	90	92	81	75	77	78	80	82
Percent of RA modified metric	66	70	71	62	58	59	61	62	64
GIR, net of excess reserves (millions of euros)	973	964	899	734	726	838	922	990	1046
Percent of RA metric	120	112	96	76	68	72	73	74	73
Percent of RA modified metric	94	88	74	58	53	56	57	57	57

Source: IMF staff calculations.

10. While GIRs metrics have deteriorated in recent years, Kosovo has shown capacity to absorb a moderate to severe fiscal financing and bank liquidity shocks. As a euroized economy lacking a lender of last resort, reserve adequacy should also be assessed by their capacity to mitigate shocks to fiscal financing and for banks’ emergency liquidity assistance (ELA).

11. Fiscal buffers. IMF (2013) suggests that a rule of thumb for the minimum size of fiscal reserves is one month of spending plus debt service, which in Kosovo would amount to about €299 million (4.4 percent of GDP).⁸ This compares with an actual figure in 2020 of €278 million (excluding ELA) or 4 percent of GDP.

12. Bank liquidity buffers. The first line of defense in case of a shock to the banking sector are the banks’ own liquid assets (30 percent of short-term liabilities in 2019).⁹ ELA reserves stand at around €100 million in 2020, insufficient to respond to a systemic shock. To address this risk, the CBK negotiated a repo line to borrow euro liquidity from the ECB (via Deutsche Bundesbank), against collateral consisting of euro-denominated marketable debt securities issued by Euro Area governments and supranational institutions of €100 million. The repo line will remain in place until March 2022, unless an extension is decided. In this context, the capacity of foreign subsidiaries to withstand a deposit run is stronger than that of domestically owned banks.



⁸ See Kosovo 2013 Article IV Consultation, Selected Issues Papers.

⁹ Government securities are not considered liquid assets because of a still-shallow secondary market. Short-term Bank liabilities exclude term deposits, despite the absence of legal impediments to withdraw them prior to maturity.

Annex IV. 2019 FSSR Main Recommendations and Implementation Status

Recommendations	Status
Short Term (within 12 months of FSSR):	
<ul style="list-style-type: none"> Restart the process to appoint a fourth non-executive member to the Central Bank Board in accordance with the central bank law. 	<ul style="list-style-type: none"> In progress. The CBK has selected candidates for the vacant position at the CBK Board. Submission to Parliament will need to wait for elections.
<ul style="list-style-type: none"> Review the effectiveness of the operation of the Central Bank Board. 	<ul style="list-style-type: none"> Incomplete. A TA mission on central bank governance is planned for February 2021 to review the effectiveness of decision-making bodies at the CBK, including membership of key committees.
<ul style="list-style-type: none"> Enhance the composition of the Executive Board and review its effectiveness. 	<ul style="list-style-type: none"> Not yet started. The CBK has not initiated the process to supplement the Executive Board with a fourth voting member (a third Deputy Governor) to ensure balanced decision-making and the representation of all departments. This process cannot happen until quorum at the CBK Board is restored.
<ul style="list-style-type: none"> Review and update the organizational structure of the CBK and refresh documented roles and responsibilities to ensure the structure is clear. 	<ul style="list-style-type: none"> Incomplete. A follow-up TA mission on central bank governance is planned in 2021 to review the CB structure and incorporate the findings from the previous missions.
<ul style="list-style-type: none"> Remove any remaining doubt concerning the protection of CBK staff while discharging their duties in good faith. 	<ul style="list-style-type: none"> Not yet started. The CBK has not amended its internal rule on the indemnification of staff costs in legal proceedings by providing unconditional support for staff in these circumstances.
<ul style="list-style-type: none"> Require full professional history of directors and senior management, as well as for principal shareholders of the proposed bank in applications for licenses. 	<ul style="list-style-type: none"> In progress. The draft law on banks requires business and professional history for the past ten years, instead of full history.
<ul style="list-style-type: none"> Intensify efforts with the ECB to participate in the Raiffeisen supervisory college and to be party to its resolution and recovery plans. 	<ul style="list-style-type: none"> Not yet started. The CBK has not participated in the supervisory college of Raiffeisen, nor is the CBK party to its resolution and recovery plans. In addition, the CBK has not signed MoU with the Austrian authorities.

Recommendations	Status
<ul style="list-style-type: none"> Establish supervisory procedures during periods of stress and conduct periodic tests on the operational procedures for granting of ELA. 	<ul style="list-style-type: none"> In progress. The Banking Supervision Department's emergency decision-making processes and the role of supervision in the event of a bank request for ELA has not been formalized and periodically tested. The CBK is preparing a parallel regulation on the Liquidity Adjustment Facility, which staff recommend to clearly delineate from ELA.
<ul style="list-style-type: none"> Update the premium rate pricing of the mandatory MTPL product and develop a process to regularly review the pricing as risk factors evolve. 	<ul style="list-style-type: none"> In progress. In 2019, the CBK has allowed insurance companies to adjust the MTPL tariff in line with inflation. However, staff recommend that pricing should be based on both the probability of the occurrence and the estimated costs of claims.
<ul style="list-style-type: none"> Assess the viability for the insurance industry of continuing to apply the taxes and fees, and obligations to pay for claims related to uninsured drivers. 	<ul style="list-style-type: none"> In progress. Starting from 2019, the insurance industry is no longer required to pay a 1 percent premium contribution to the Red Cross.
<ul style="list-style-type: none"> Implement the risk-based insurance supervision manual that has been developed. 	<ul style="list-style-type: none"> In progress. The risk-based supervision manual was approved on January 1, 2020. IMF TA on risk-based supervision implementation, diagnostics and training will support CBK's capacity in this area.
<ul style="list-style-type: none"> Review the CBK's institutional arrangements and governance in support of financial stability and macroprudential policy. 	<ul style="list-style-type: none"> Not yet started. Currently, decision-making itself is reserved to a small Executive Board consisting of the Governor and two Deputy Governors. The Governor (instead of a Deputy Governor) has so far exercised executive responsibilities for macroprudential oversight.
<ul style="list-style-type: none"> Complete a full review of macroprudential data gaps and develop a strategy to close them. 	<ul style="list-style-type: none"> In progress. The World Bank's FinSAC is providing TA on data gaps.
<ul style="list-style-type: none"> Ask the Government to establish a cross-agency task force on the development of capital markets. 	<ul style="list-style-type: none"> Not yet started.
<ul style="list-style-type: none"> Establish a National Strategy on Financial Inclusion. 	<ul style="list-style-type: none"> In progress. The CBK has developed a strategy for consumer protection and financial literacy, but there is no comprehensive financial inclusion strategy at the national level.
<ul style="list-style-type: none"> Harmonize reporting of FSIs and address remaining methodological issues. 	<ul style="list-style-type: none"> In progress. The CBK is working on addressing the issues found by the FSSR assessment.

Recommendations	Status
Medium Term (within one to three years of FSSR):	
<ul style="list-style-type: none"> Integrate stress tests exercises with the financial stability area and communicate the results to the banks. 	<ul style="list-style-type: none"> Incomplete. There are planned TA missions under the FSSR TA roadmap for 2021 and 2022.
<ul style="list-style-type: none"> Develop tools for a more thorough assessment of credit risk, based on granular data from the Credit Registry. 	<ul style="list-style-type: none"> Incomplete. The Credit Registry, which operates within the CBK, records detailed credit information at the individual loan level. Currently, there is no plan to use such data for credit risk assessment.
<ul style="list-style-type: none"> Reconsider crisis management processes for the insurance industry, particularly appointing CBK employees as administrators and liquidators. 	<ul style="list-style-type: none"> In progress. The CBK has intended to develop new approaches to crisis management that does not involve the use of CBK employees. The CBK is preparing a new regulation on liquidation of insurers.
<ul style="list-style-type: none"> Amend the central bank law to strengthen the legal basis for CBK's macroprudential policy powers. 	<ul style="list-style-type: none"> Incomplete. The CBK intends to provide macroprudential policy with a stronger legal foundation through amendments to the law on banks and associated regulations. However, an amendment to the central bank law has not been initiated.
<ul style="list-style-type: none"> Assist the Ministry of Finance in drafting key pieces of capital markets legislation in order to provide a sound framework. 	<ul style="list-style-type: none"> Not yet started.
<ul style="list-style-type: none"> Ensure methodological consistencies of monetary statistics with international standards. 	<ul style="list-style-type: none"> In progress. The authorities received TA from the IMF on Monetary and Financial Statistics (MFS) in August 2019. Priority recommendations are supposed to be implemented this year.

Areas	Recommendations	Status
Fiscal policy and governance: Improve productivity of spending, broaden revenue, and strengthen fiscal institutions	Mixed compliance	
	Continue to observe the “fiscal rule”	Broad compliance. The 2019 budget execution was in line with the fiscal rule and the bank balance was kept above 4.5 percent of GDP. The original 2020 budget was drafted to meet the fiscal rule deficit, the wage bill ceiling, and the bank balance floor. As a temporary measure in response to the COVID-19 pandemic, the fiscal rules were relaxed through end-2021 to increase the fiscal rule deficit ceiling to 6.5 percent of GDP and reduce the floor on bank balances to 3 percent of GDP. Emergency legislation allows the use of PAK funds for COVID-19 relief spending.
	Keep public sector wages within the limits of the wage bill rule	Broad compliance. The wage bill stayed within the wage bill rule limit in 2019. However, implementing regulations for the new salary law on public officials, adopted in 2019, were delayed through 2020 increasing the uncertainty of the final cost. In June 2020, the Constitutional Court ruled the salary law unconstitutional acting on a complaint of the Ombudsman and asked for parliamentary amendments to the Law on Public Officials, before it could enter fully into force.
Reform social benefits schemes and avoid any new untargeted schemes	Weak compliance. The long overdue war veteran benefit reform remains stalled, with spending in 2020 about 0.4 percent of GDP above the legal ceiling of 0.7 percent. Existing reform proposals add further complexity to the system, and their intertemporal budgetary cost (which has not been assessed) could negatively weigh on fiscal sustainability.	

	Improve the efficiency of spending and the public investment framework	Weak compliance. In 2019, absorption of donor-financed investment under the “investment clause” was small. Overall execution of capital projects continued to be slow, with high seasonality in the last quarter of the year. No ex-post audits of major investment projects have been initiated, and the public investment framework needs strengthening to ensure alignment of national strategies with the budget through multi-annual planning.
	Accelerate reforms with revenue administration and mobilization	Partial compliance. TAK has made good progress in streamlining its function-based organization structures, embracing modern compliance risk management (with a pilot in the construction sector), scaling up tax debt compliance, strengthening the tax audit, and improving the VAT refund process. Changes to the CIT legislation allowing tax credits for sponsorship activities introduced a window for revenue risks in 2020. The authorities are still to engage in a more comprehensive cost-benefit assessment of tax expenditures.
	Strengthen fiscal institutions and governance	Partial compliance. The 2019 MTEF enhanced the analysis of fiscal risks and included reconciliations between different MTEF vintages but continued to rely on unrealistic revenue projections. A draft law on POEs, which aims to improve financial oversight and accountability as well as the financial performance of the sector, was submitted to the government but returned. Most modules of e-procurement have been rolled out in full, but the coverage of centralized procurement has stalled; progress is needed to ensure value-for-money.
Address labor market rigidities	Weak compliance	
	Upgrade skills and reduce skills mismatches, and reform social benefits	Weak compliance. Both the enrollment in Vocational Training Centers and the gross rate of child enrolment at pre-school and pre-primary levels for all age groups increased since the last Article IV. However, as in the last assessment, action plans and sector strategies to improve education and labor market outcomes have been adopted, but reforms to increase preschool enrollment rates, improve the quality of teaching staff, modernize curricula and textbooks,

		upgrade vocational education and training programs, strengthen accreditation and professional standards, and improve labor market intermediation remain at an early stage.
	Contain wage pressures	Weak compliance. No progress has been made to re-establish the rules-based minimum wage setting mechanism established in 2013. Notwithstanding this, the authorities so far have abstained from any discretionary increases.
	Mixed compliance	
Reduce the costs of doing business and improve governance	Strengthen the rule of law, including in the areas of contract enforcement and property rights	Partial compliance. Progress has been made in terms of private enforcement agents and amendments to the Law on Execution Procedure. However, there has been no new recruitment of PEAs to fill in remaining positions and the PEA monitoring unit is yet to be created. The creation of a commercial court is still under consideration. The reform of property registration and cadaster system has seen progress with the implementation of the Kosovo Geoportal where data is updated regularly (http://geoportal.rks-gov.net/en/search). More is to be done to strengthen the Kosovo Cadaster Agency's institutional framework and technical infrastructure and complete privatization of public houses.
	Judiciary reforms to fight organized crime and high-level corruption	Partial compliance. The revised law on asset confiscation and whistle-blowers was adopted in line with the EC recommendations in 2019. The amended Law on the State Prosecutor has been partially implemented, with only 15 out of a planned number of prosecutors being recruited to the Special Prosecution Office. The Assembly adopted the revised Criminal Code but has yet to adopt the new Criminal Procedure Code, which includes provisions on the suspension of public officials indicted for corruption. Kosovo has made limited progress in the fight against corruption. Notable delays pertain to the investigation and prosecution of high-level cases and the confiscation of assets originating from corruption activities. Strong political will and a robust criminal justice response are necessary for meaningful progress in this area.

		Mixed compliance
Financial sector: access to credit	Reduce structural impediments to lending	Partial compliance. Broad-based credit growth before the 2020 COVID-19 pandemic reflected in part the easing of supply constraints as reforms made the claims enforcement system more effective. Yet, further steps such as creating a commercial court and developing a housing price index are needed to strengthen contract enforcement and reduce information asymmetries.
	Address remaining deficiencies in the AML/CFT framework	Weak compliance. Technical compliance has improved in some areas and progress has been made under PECK II on drafting and implementing reforms to the legal framework and institutional capacities. Nevertheless, the effectiveness of the AML/CFT regime remains highly unsatisfactory. A divided supervisory framework impedes the effectiveness of the AML/CFT supervision in the financial sector and the volume of money laundering and terrorist financing (ML/TF) cases ultimately prosecuted and adjudicated remains negligibly low. With regards to TF and proliferation, continuous non-compliance with international sanctions regimes persists. In particular, the legislative framework on the prevention of ML/TF still needs to be aligned with the FATF standards and the EU <i>acquis</i> , including with respect to the introduction of sanctions for TF, requirements for beneficial owner identification and implementation on targeted financial sanctions mechanisms.

Appendix I. COVID-19 in the Western Balkans: How Does Kosovo Compare?¹

Health Impact (Figure 1)

1. In line with other Western Balkan Countries (WBCs), Kosovo implemented strict lockdown measures early in the crisis and managed to contain first wave infection rates at low levels. Lockdown measures (including stay at home orders and suspension of public transportation) started in early March when daily new cases were below 10 per million. This allowed Kosovo (and WBCs more generally) to contain the spread of the virus relatively well, with the average daily infection rate peaking in April at less than half the peak rate observed in advanced European economies (AE).

2. Following the lockdown relaxation in May-June, a second, more severe wave of infections emerged in Kosovo (and WBCs) during the summer, while a third, stronger wave is ongoing since late October. With various containment measures reintroduced (like nightly curfews), infection rates declined again in recent weeks. As of mid-January 2021, the number of daily new cases stood at 147 per million (higher than the summer's peak of 132, but below the most recent peak of 412 in November). This compares to a recent average of 234 per million in WBCs. While Kosovo's cumulative number of reported cases is below the regional level, its testing rate is less than half of the WBC's average (231,000 per million). Testing in AE averages 597,000 per million.

3. During the ongoing third wave, mortality rates in the WBCs peaked at levels higher than those in the rest of Europe but have recently declined. This reflected higher infection rates and both lower testing and weaker health care capacities in WBCs. While mortality rates in WBCs during the third wave were initially lower than those in AE, they picked up rapidly. Kosovo's mortality rate increased to 2.5 percent of reported cases, above the averages for both the WBCs and AE. Bosnia and Herzegovina and North Macedonia also report mortality rates higher than AE's average. As of mid-January, the 7-day average of daily confirmed COVID-19 deaths stood at 5 per million in WBCs compared to around 8 per million in AE and 4 per million in Europe's emerging market economies (EE).

4. Kosovo falls behind regional peers on health infrastructure. The number of intensive care unit (ICU) beds is lower on a per capita basis than in other WBCs, and only a fraction of those in Germany and other AE countries. Regarding respirators, though some WBCs (including Kosovo) have been able to increase their number, they are still insufficient. Strengthen health infrastructure remains crucial to both improve the quality of service during the pandemic and curb the spread of the virus.

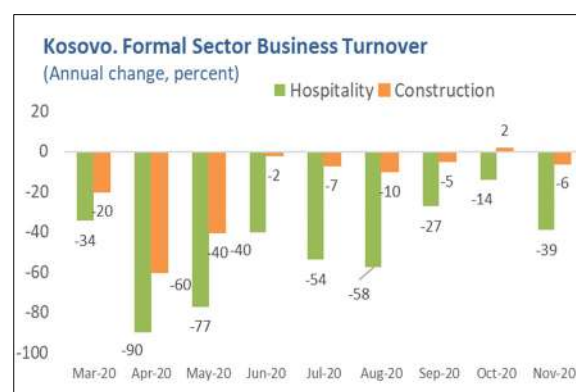
¹ This appendix was prepared by Amanda Edwards and Xiao Liu.

Macroeconomic Impact (Figure 2)

5. The pandemic has hit the economies of Kosovo and other WBCs hard. Real GDP through Q3:2020 declined by a median of 4.9 percent (y/y) in the WBCs, with Kosovo's GDP contracting by 7.3 percent (y/y). Despite still large annual decreases, economic activity in all WBCs (with the exception of Montenegro) rebounded on a sequential seasonally adjusted basis in Q3:2020, while available data suggests that the recovery subsided in Q4:2020.

6. Hospitality and construction have been among the hardest hit sectors across the region.

Business turnover in Kosovo's hospitality sector dropped by about 40 percent (y/y) through November 2020, with a decrease of 10 percent (y/y) in the construction sector over the same period. Turnover in the hospitality sector timidly picked up during the summer but contracted again since the latest round of containment measures. In contrast, the increase in construction activity has broadly held during the second half of 2020.



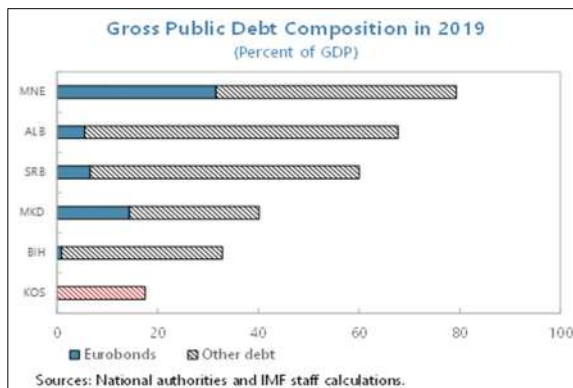
7. Kosovo's GDP is expected to contract 6 percent in 2020 similar to the WBCs median (6.2 percent). This compares with an expected contraction of 7.3 percent in AE and 2.8 percent for EE. For 2021, Kosovo's GDP rebound is projected at 4.5 percent, slightly below a median of 5.2 percent for WBCs. Relative to pre-COVID projections, the output loss in Kosovo through 2021 is projected at 9.2 percentage points (pp) compared to a median for WBCs of 8.4 pp, and output losses of 6.2 pp in AE and 3.9 pp in EE.²

8. Despite initial concerns, banking sector deposits have remained stable both in Kosovo and other WBCs. Data through November 2020 show that lending levels have also withstood relatively well, due in large part to the regulatory forbearance measures in the region.

9. Kosovo's emergency fiscal package in 2020 comprised measures amounting to 4.3 percent of GDP. This is broadly in line with the median size of fiscal support in other WBCs. In comparison, Kosovo's COVID-19 package contained fewer guarantees, i.e. contingent costs, compared to peers. Kosovo's 2021 budget includes additional measures for about 3 percent of GDP, while other WBCs are also envisaging new COVID-19 fiscal measures, including additional resources to health care and reserve funds in case of need. The implementation of relief packages combined with significant fiscal revenue losses (a median of 11.4 percent for WBCs) pushed fiscal deficits and

² These projections are in line with the January 2021 WEO update.

public debt ratios higher in 2020. Kosovo’s public debt is estimated to have reached 24.5 percent of GDP at end-2020 (up from 17.5 percent of GDP in 2019), which is still relatively low compared to a regional median of about 55 percent in 2020 (up from 46.5 percent in 2019).³ The level and composition of public debt differs considerably between WBCs. However, unlike other WBCs, Kosovo does not have a sovereign rating and thus has no access to the Eurobond market.

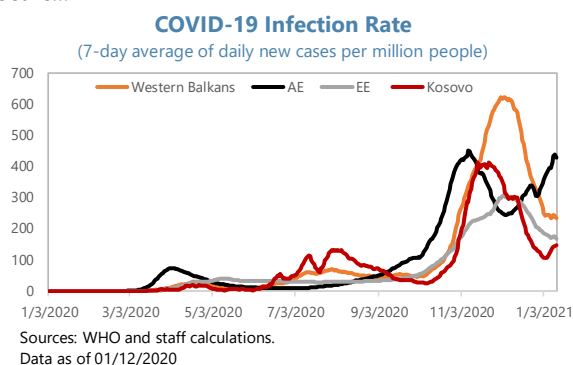


10. While foreign exchange reserves are assessed to have remained broadly stable in most WBCs, they will decrease in Kosovo. Thanks to financial assistance from IFIs (including the IMF’s RFI and the World Bank) and EU support and successful Eurobond issuances in the cases of Albania, North Macedonia, Montenegro and Serbia, international reserves in most WBCs are expected to remain broadly stable. In Kosovo, however, the use of government deposits (for about 3 percent of GDP) to finance the 2020 fiscal deficit led to a decrease in gross international reserves to a level just in line with the IMF reserve adequacy metric (See Annex III).

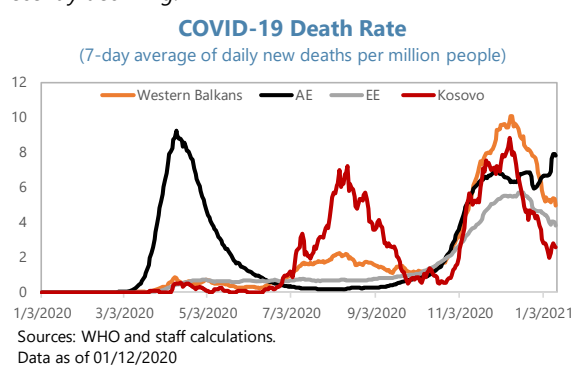
³ Figures are preliminary.

Figure 1. Kosovo: Health Impact of COVID-19

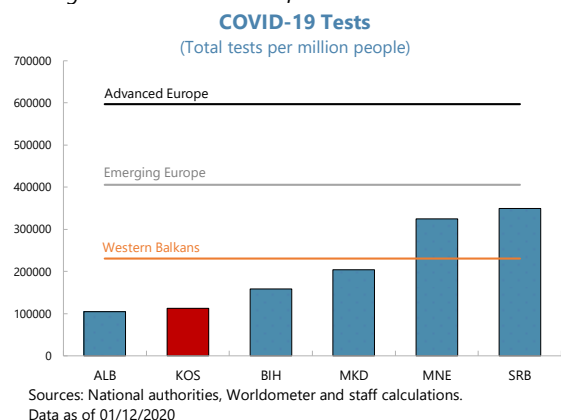
Infection rates in WBCs have recently declined from record peaks...



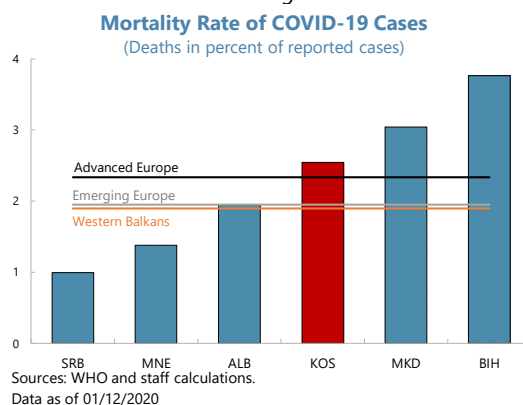
...with mortality rates both in WBCs and Kosovo also recently declining.



Kosovo's testing rate has remained significantly below the regional level and that of AE and EE.



After initially relatively low levels, Kosovo's total mortality rate has increased above the regional and AE level.



The relevant health care capacities have been increased since the start of the crisis, but they remain stretched.

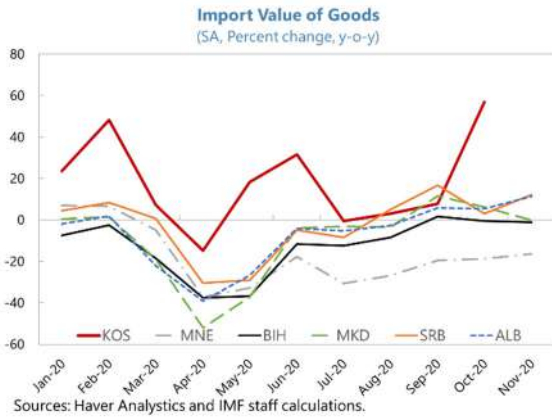
	Population in million	Total number of beds in infectious disease clinics	Total number of intensive care beds	Total number of available intensive care beds	Total number of respirators (at the outbreak)	Total number of respirators (now)
Albania	2.87	553	230	201	155	304
Bosnia and Herzegovina	3.50	n/a	n/a	n/a	n/a	n/a
Kosovo	1.80	120	180 - 200	n/a	122	202
North Macedonia \1	2.08	250	595	111	120	180
Montenegro	0.62	n/a	160	n/a	n/a	n/a
Serbia	6.96	n/a	n/a	n/a	950	declared secret

Sources: National authorities and WHO.

Note: Data as of December 8, 2020. \1 North Macedonia: The number of intensive care beds refers to "inpatient beds for COVID patients" including a new mobile facility with 70 COVID beds with no ICU beds.

Figure 2. Kosovo: Economic Impact of COVID-19

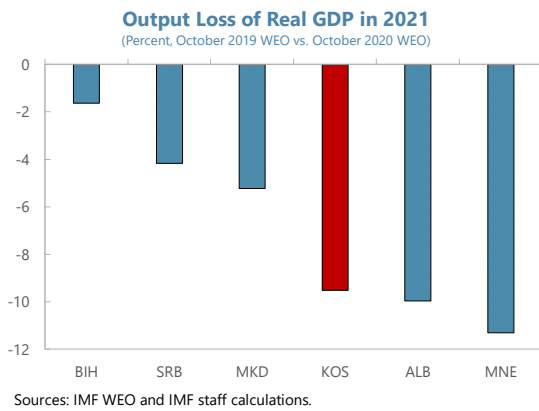
Imports of goods declined reflecting weakened economic activity.



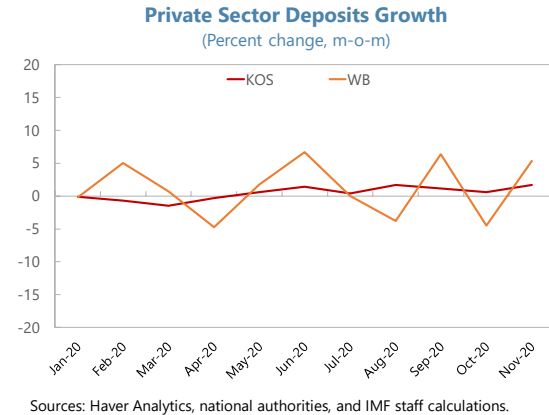
Tourist arrivals declined due to mobility restrictions, negatively affecting the hospitality sector...



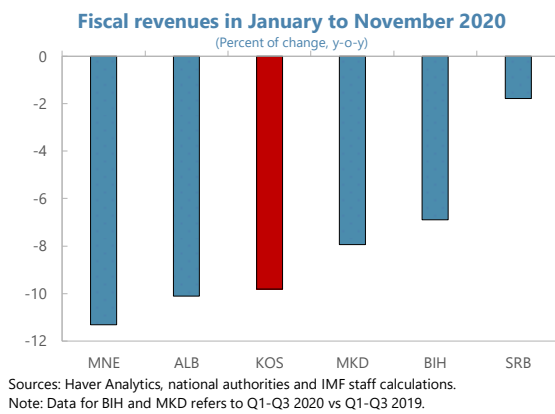
Although economic activity will significantly drop...



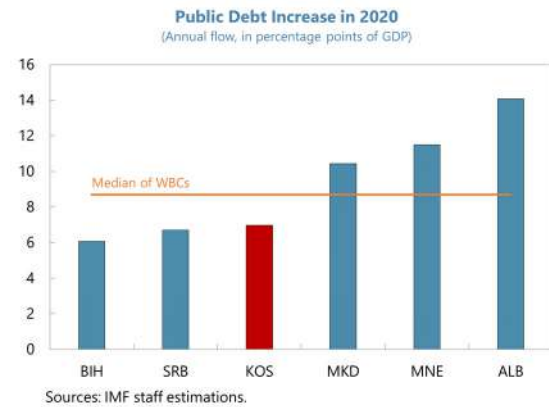
...banking sector deposits have remained stable.



Government revenues will contract sharply...



...pushing public debt upwards.



Appendix II. Policy Response to the COVID-19 Pandemic¹

1. At the onset of the pandemic (in March 2020), the government swiftly announced a €180 million emergency fiscal package to support the most affected firms and households.

Measures included increased social transfers and subsidies to vulnerable households and pensioners (through double monthly social assistance benefits and additional payments to beneficiaries of social and pensions schemes with less than €100 in benefits); bonus payments for public sector workers in health and security and for workers in food stores, bakeries and pharmacies; subsidies to businesses for rental expenses and employee salaries in March and April; and financial support to local level governments.

2. In June 2020 the government introduced additional allocations in the 2020 mid-year budget review to support mitigate the pandemic and jumpstart the recovery. The additional measures envisaged further support to private sector firms (including farms) and POEs. To support credit, the measures included an increase in the guaranteed portion of loans sponsored by the Kosovo Credit Guarantee Fund from 50 percent to 80 percent, while improving selection criteria. To stimulate aggregate demand, the measures allowed early withdrawals of up to 10 percent of KPST individual pension accounts (estimated at €200 million), a majority of which will be gradually reimbursed by the budget beginning in 2023. Despite delays caused by political strife, the MRP was largely implemented in 2020. At the end of 2020, total budgetary spending on COVID-19 measures amounted to €288 million while extra-budgetary spending with KPST withdrawals was €184 million.

3. In addition, the Central Bank's (CBK) policy actions provided relief to both banks and borrowers and ensured for credit to continue flowing. In March, the CBK allowed a 3-month loan payment moratorium, which reached about 50 percent of loans, helping firms remain solvent in the face of liquidity shortages. A further CBK decision in June allowed loan restructurings of up to one year, to enable borrowers to meet their financial obligations and return to normal business activity without facing a downgrade of their credit rating.

	Budget		Executed	
	Euro million	% of GDP	Euro million	% of GDP
Total Mitigation and Recovery Measures				
Total	294.6	4.3	287.3	4.2
Goods and Services	27.7	0.4	23.8	0.3
Wages and salaries	34.0	0.5	34.0	0.5
Capital expenditures	1.5	0.0	0.6	0.0
Utilities	0.2	0.0	0.2	0.0
Subsidies and transfers	231.1	3.4	228.8	3.4
Recovery Package (August - December 2020)				
Total	122.4	1.8	118.2	1.7
Goods and Services	6.8	0.1	4.0	0.1
Wages and salaries	0.2	0.0	0.2	0.0
Capital expenditures	0.0	0.0	0.0	0.0
Utilities	0.1	0.0	0.1	0.0
Subsidies and transfers	115.3	1.7	113.9	1.7
Mitigation Package (March - July 2020)				
Total	172.2	2.5	169.1	2.5
Goods and Services	20.9	0.3	19.7	0.3
Wages and salaries	33.8	0.5	33.8	0.5
Capital expenditures	1.5	0.0	0.6	0.0
Utilities	0.1	0.0	0.1	0.0
Subsidies and transfers	115.8	1.7	114.8	1.7

Source: IMF staff calculations and Kosovar authorities

¹ Prepared by Oana Luca and Selim Thaci.

Kosovo: Mitigation and Recovery Measures Implemented in Response to COVID-19 in 2020

Tax Revenue Measures

- Postponement of tax declarations until end-April 2020 for: annual statement corporate income tax and personal income tax for 2019; advanced quarterly payment for CIT and PIT; VAT declaration for February and March 2020; withholding tax declaration for March 2020.
- Exemptions of VAT on imports of wheat and flour during March 25 - May 8, 2020.

Health and Social Sector measures

- Allocation to the Ministry of Health for personal protective equipment (PPE) and facilities (€11 million).
- Other allocations for goods and services (€18 million).
- Financial support for youth employment, civil society organizations, and cultural, artistic and sports activities (€2.5 million).
- Increase in transfers for regional development programs to support balanced regional development (€1 million).
- Transfers to minority communities for projects and initiatives so support livelihoods and their economic activity (€1 million).
- Support for projects and initiatives to improve the position of women in society and the economy (€1 million).
- Support to Kosovo municipalities to manage the situation created by the COVID-19 pandemic (€1 million).

Measures Supporting Individuals and Households

- Subsidies to businesses affected by the pandemic to pay salaries in March - April (€170 per month/worker, €47 million).
- Additional payment (€30/month) to all beneficiaries of social and pension schemes receiving monthly payments of less than €100/month for April-June (€7.5 million) and October-December (€7.5 million).
- Salary bonus for workers in the health and security sectors with direct exposure to COVID-19 infection risk for April-June and August-December (€34 million).
- Salary bonus (€100/month) for employees of grocery stores, bakeries and pharmacies with direct exposure to COVID-19 infection risk for April-May (€3 million).
- Subsidies to businesses affected by the pandemic to pay salaries for new employees hired (€5 million).
- Financial support to cover the cost of insurance policy premiums (€3 million).

Measures Supporting Firms

- Recapitalization of the Kosovo Credit Guarantee Fund to increase the guaranteed portion of new loans (€21 million).
- Unconditional subsidies to formal businesses (allocated proportionally by business size, €60 million).
- Subsidies to business to cover for rental expenses during April-May (€10 million).
- Subsidies to businesses to cover the employer's pension contribution of 5 percent of gross wages for April-May (€5 million).
- Increase budgetary transfers to support programs in agriculture (€12 million).
- Subsidies to POEs to cover minimum operating costs (€11.5 million).
- Other subsidies and transfers (€26 million).
- Support for POEs investments through issuance of sovereign guarantees for loans by financial institutions.

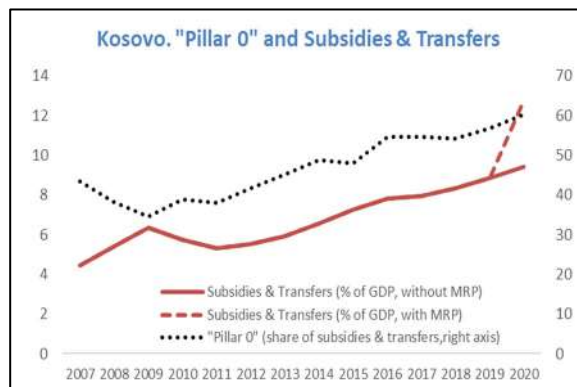
Monetary and Financial Measures

- Postponement of payments of loan instalments for businesses and individuals for March – June 2020. Regulatory forbearance on loan provisions and capital requirements on reprogrammed loans.
- Up to 1-year Bank loan reprogramming allowed for July – September 2020.

Appendix III. Kosovo’s Pension System: Challenges and Areas for Reform¹

Background

1. Kosovo’s pension system consists of three pillars and includes several special programs. The core of the system consists of a budget-financed (“Pillar 0”) uniform benefit to every Kosovar citizen older than 65 years, and an individual account defined contribution pension scheme (“Pillar 2”), managed by the Kosovo Pension Savings Trust (KPST). While “Pillar 0” ensures an old age pay to cover the cost of a basic consumption basket, “Pillar 2” provides a supplementary income from savings during the beneficiary’s active work life.² The system is completed by a “Pillar 3” consisting of voluntary individual or employer-sponsored pension schemes, but its importance is limited.



2. Pensions under “Pillar 0” have contributed to drive budgetary subsidies and transfers upwards during the last few years. Subsidies and transfers represented the most dynamic spending category during the last decade, in part due to increased “Pillar 0” spending, which more than doubled (as a share of GDP) since Kosovo’s independence. While subsidies and transfers have increased from about 5.5 percent of GDP in 2010 to 9.4 percent of GDP in 2020 (excluding COVID-19 related measures), the share of “Pillar 0” in subsidies and transfers increased from 40 to 60 percent. “Pillar 0” currently reaches about 200,000 beneficiaries at a cost of about 5.7 percent of GDP.

	2007-10	2011-15	2016-19	2020
Social Security	2.11	2.73	4.53	5.66
Old-age Pensions	2.03	2.61	3.36	4.33
Basic pensions	1.37	1.67	1.87	2.43
“Contributory” pensions	0.66	0.94	1.49	1.90
Special regimes	0.08	0.12	1.17	1.33
Trepça pensions	0.07	0.07	0.06	0.05
KPC and KSF Pensions	0.01	0.02	0.04	0.07
Pensions for war veterans	0.00	0.02	1.01	1.13
Early retirement due to work-related disability	0.00	0.00	0.00	0.00
Payments to survivors of “contributory” pensions	0.00	0.00	0.04	0.06
Memorandum				
Subsidies and Transfers	5.49	6.12	8.23	12.73
excluding COVID-19 mitigation and recovery measures	--	--	--	9.39

Source: Kosovar authorities and IMF staff calculations

3. Pensions under “Pillar 0” are either for old age (beneficiaries older than 65) or fall under one of the numerous special regimes. Most beneficiaries of “Pillar 0” pensions receive old-age pensions, which represented about 4.3 percent of GDP in 2020. Old age pensions include:

¹ Prepared by Oana Luca and Selim Thaci.

² “Pillar 0” is covered by the law “On Pension Schemes Financed by the State” No.04/L-131. Since 2016, the law disallows beneficiaries of any of these pensions to receive more than one pension (Art 16).

- **Basic pension** (€90/month). All resident citizens aged 65 and older without any other transfers paid through the Ministry of Labor and Social Welfare (MLSW) are eligible. Semi-annual, in-person registration is necessary for a continuation of benefits.
- **“Contributory” pension** (avg. €206/month). Resident citizens aged 65 and older who made social security contributions for at least 15 years prior to 1999 are eligible. Before 2016, the contributory pension was a flat monthly payment of €140/month. From 2016 on, beneficiaries receive an increased monthly payment (of €158–230) depending on educational attainment as a proxy for work experience. Semi-annual, in-person, registration is necessary for a continuation of benefits. Despite their name, they are fully funded by the budget. Beginning in 2019, they also include a special pension for teachers who taught during 1990–99 (avg. €67/month).

4. The number of special pension regimes has increased significantly in the last few years. While their combined budgetary cost was 0.2 percent of GDP in 2015, it increased to about 1.3 percent of GDP in 2020. These pensions reach a much more limited number of beneficiaries and their benefits are in most cases higher than the basic pension. Special regimes include:

- **Early pension for Trepča miners** (€150/month). Former miners aged 50–65 who reside in Kosovo, with at least 10 years of contributions, who are not employed or self-employed, and have a work-related disability higher than 50 percent are eligible.
- **Kosovo Protection Corps (KPC) pension** (avg. €236/month). Payable to individuals aged 45 and older with at least 5 years of service at KPC.³ Pensions amount to 50 percent of the 3-year average salary of the last three years for those aged 45–50, and 70 percent for those above 50.
- **Kosovo Security Forces (KSF) pension** (avg. €386/month). Payable to individuals aged 50 and older with at least 20 years of service at KSF. Pensions amount to 40 percent of the of the last gross salary plus 2 percent for each year of service, up to a maximum of 60 percent.
- **KLA war veteran pension** (€170/month). They benefit Kosovar and foreign Kosovo Liberation Army (KLA) members, who remained active until the end of the war, regardless of age. Those with active employment are not eligible for this benefit. However, enforcing the law defining this pension (of 2016) requires a categorization of veterans that has not yet been completed. Thus, the pension is currently paid regardless of whether beneficiaries continues to work.
- **Work disability pension** (€75/month). Individuals with a 100 percent work-related disability (or professional illness) are eligible for early retirement since 2018.

³ The Kosovo Protection Corps (KPC) preceded the formation of the Kosovo Security Forces (KSF). After the creation of the KSF, the KPC was abolished.

- **Family pension** (€75/month). Available since 2018 to surviving family members of individuals who either contributed 15 years before 1999 or had a 100 percent work-related disability.

5. Spending on special regimes is dominated by KLA war veteran pensions. While legislation caps these benefits at 0.7 percent of GDP, actual payments have consistently exceeded this cap (1.1 percent of GDP in 2020). Expenditures on war-related benefits payable to working age people take up a large portion of social transfers. Indeed, these benefits have significantly increased in the last few years, representing about 20 percent of Subsidies and Transfers in 2020 (up from about 5 percent a decade ago).⁴



6. “Pillar 2” is a mandatory defined-contribution (DC) scheme managed by the Kosovo Pension Saving Trust (KPST). It is funded by a worker contribution of 5 percent of her gross salary, matched by a 5 percent employer contribution.⁵ Beneficiaries of “Pillar 2” pensions can receive any pension from “Pillar 0” (including special schemes) provided they are eligible. “Pillar 2” comprises 380,000 active contributors of an average age of 41 years (as of December 2019), almost double the number a decade and a half before. About 26 percent of contributors are employees of budget organizations. The distribution of account holdings is heavily skewed toward those with small savings: 80 percent of total contributors account for less than 30 percent of KPST’s total assets and feature an average savings balance of less than €4,800. Half of the contributor population have savings below €1,000. In 2019, there were about 7,900 pension beneficiaries already withdrawing from their pension accounts.

7. Despite challenges related with large informality, KPST’s pension accounts represented 30 percent of GDP in 2019. This makes KPST the largest player in Kosovo’s domestic capital markets. Asset management is regulated by bylaws that ensure that concentration, liquidity and solvency risks are minimized. Quarterly reports inform on the number of accounts, beneficiaries and assets under management. Unlike “Pillar 2” pension funds in many countries, KPST portfolio returns are not compromised by large operational costs and administration fees, which are kept at

⁴ In addition to pensions to war veterans, transfers to families and individuals affected by the independence war encompass several programs including, compensation to families of those fallen in the war; compensation to war invalids (the largest such program at 0.6 percent of GDP in 2020); and compensation to civilian war invalids.

⁵ KPST operates under Law no. 04/L-101 on Pension Funds of Kosovo 2012, together with its subsequent amendments.

reasonable low levels. The decision by the government to allow for 10 percent early withdrawals resulted in KPST's assets to remain unchanged at end-2020 at about €2 billion.⁶

8. "Pillar 3" consists of voluntary supplemental, individual or employer-sponsored pension schemes. There are two types of supplementary funds (Supplementary Employee Fund and a Supplementary Individual Fund FONDI), but their assets are very small.

Current Challenges

9. The multiplicity of non-contributory "Pillar 0" schemes has introduced undesired challenges. The large number of "Pillar 0" benefits has endangered the sustainability of public finances by creating many unfunded liabilities, negatively affected income distribution and paved the way for pressures for further changes to the pension system. Adding new schemes has put under strain the system's simplicity and efficiency. At a cost of 1.1 percent of GDP in 2020, the KLA War Veterans' Pension has swiftly become the third largest item in budgetary subsidies and transfers, only surpassed by basic pensions (2.4 percent of GDP) and contributory pensions (1.9 percent of GDP).

10. The different pension schemes primarily reflect the political bargaining power of the potential beneficiaries, with socio-economic needs playing a limited role (IMF, 2016). The existing and planned schemes are not governed by an overarching social policy vision and architecture. Regulations are often inconsistent, presenting contradictory provisions. Although the law forbids it, many beneficiaries receive duplicate benefits, conspiring against the system's fairness. Controls over benefits paid to Kosovars residing abroad remain inadequate (in particular for special pensions). The lack of an overarching social policy vision leads to similar risks being treated differently by various schemes.

11. The greatest challenge in the short and medium term will be to cope with pressures to introduce new special regimes or to relax the eligibility criteria of those already in place. The myriad of special regimes that have been introduced in the last few years has resulted in multiple demands to create new special regimes or to further relax those already in place. Of concern are demands to allow for early retirement and special pensions by the police, as well as to decrease the number of contribution years to be eligible for a "contributory" pension.

12. A few initiatives under analysis may further complicate social security in Kosovo. The MLSW has been considering the incorporation of a "pay-as-you go" benefit to be funded by an increase of contributions of 1.5 pp to be paid by both workers and employers (i.e., a "Pillar 1"). This initiative (as well as other proposed initiatives that relax eligibility criteria of existing schemes, e.g., to widen the eligibility of the "contributory" pension to citizens who contributed for less than 15 years

⁶ In absence of early withdrawals, KPST's assets under management at end-2020 would have amounted to about €2.2 billion (or more than 32 percent of GDP).

prior to 1999) have not been analyzed using long-term actuarial tables, and thus, the capacity of the budget to finance them is in question.

13. Disability assessment methods and eligibility benchmarks are not uniformly applied.

This increases the pressure on social assistance benefits and compresses the fiscal space to provide basic pensions that would cover the minimum consumption basket. While permanent disability pension beneficiaries need a reassessment every 1, 3, and 5 years, establishing a 100 percent disability, war disability pension beneficiaries need only a one-time assessment for partial disability at the application stage. Family pensions provide permanent (instead of temporary) benefits to working age survivors. Pensions for former KSF and KPC are not determined based on contributions.

14. An additional challenge would be to further align Pillar 2's payout period with life expectancy.

The payout of KPST should be based on the life-expectancy at the point of retirement, suggesting that the payout period could be extended from the current 10 years to possibly 15 years, while the risk of longevity would be covered by the basic and "contributory" pensions.⁷ The low level of benefits and short payout period for today's recipients does not fully result from poor design rather than from short contribution histories and weak enforcement of contribution payments.

Policy Recommendations: A Summary

15. In the short-term, the authorities should refrain from introducing new special regimes or to relax the eligibility criteria of those already in place.

This is particularly important given the large uncertainty about the course of the pandemic and the speed of economic recovery, which can weigh on fiscal space. The creation of further special regimes or the relaxation of existing regimes will put further pressure on the budget, limiting the room for targeted basic pensions and social assistance, and more generally, for other spending, including capital projects. In particular, the coverage of the social assistance scheme and the level of benefits are inadequate, with only one-third of the bottom quintile receiving any cash benefits, and with benefit levels insufficient to meet basic needs in the case of most family types (IMF, 2016).

16. Any reforms to social security (including the introduction of new benefits) should await an analysis assessing the medium to long-term budgetary cost of existing schemes.

Kosovo's legislation mandates that before the introduction of a new social security (or social assistance) scheme, a 3-year costing projection needs to be prepared. This is clearly insufficient as social security (and social assistance) schemes usually commit budgetary spending for decades. Therefore, both existing pension schemes and proposed initiatives to reform the pension system lack actuarial analysis. If a reform is carried forward, it should be holistic, with measures fitting into a well-articulated policy vision and that are not introduced in a piecemeal fashion. In broad terms, any

⁷ Pensioners decide whether to receive 0 – 20 percent of savings in a lump-sum. There is an initial withdrawal of €2001 or 1 percent of the pension balance (whichever is lower), and then monthly payments until savings are fully depleted.

reform should consider the multiple objectives of encouraging employment, adequately protecting the poor, ensuring fiscal sustainability and enabling fast and effective administration.

17. Increases in pension contributions should only proceed only after a comprehensive tax policy diagnostic. The last such analysis (of 2012) needs to be urgently updated. Although wage taxes remain relatively low, with earnings-related contributions limited to KPST, any increases in contributions should consider the possible impact on employment informality, as well as the space to accommodate the planned increases to finance the new health insurance scheme.

18. In order to preserve fiscal space and to curtail inequities, regulations governing war-related pensions need to be revised. Authorities should look into eligibility periods, introduce a nominal ceiling on total benefits received, and place a cap on monthly withdrawals to ensure longer withdrawal eligibility. Moreover, their pending categorization should proceed in the shortest delays to ensure that the budgetary cost of these pensions abide with the 0.7 percent of GDP ceiling. In the case of all pensions, eligibility should be limited to resident citizens for which the introduction of strict residency controls is needed. Most specially and given the budgetary importance of “contributory” pensions, the (fixed) number of possible beneficiaries should be assessed, in order to have an estimate of the timing in which the budgetary cost of these benefits will peak.

19. Further policy actions that undermine “Pillar 2” should be avoided. In addition to being regressive from an income distribution perspective, allowing the withdrawals of 10 percent of savings to stimulate aggregate demand undermined “Pillar 2”'s integrity. It is essential to avoid a repeat of this or similar actions in the future.

References

IMF (2016), “Kosovo. Enhancing Social Protection Cash Benefits”, March. Washington, DC.



REPUBLIC OF KOSOVO

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

February 1, 2021

Prepared By

The European Department
(in consultation with other departments)

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FUND RELATIONS

(As of July 31, 2020)

Membership Status:

Joined: June 29, 2009; Article XIV.

General Resources Account:	SDR Million	Percent Quota
Quota	82.60	100.00
Fund holdings of currency	180.17	218.12
Reserve Tranche Position	20.07	24.29

SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	55.37	100.00
Holdings	50.08	90.45

Outstanding Purchases and Loans:	SDR Million	Percent Quota
Stand-By Arrangements	76.33	92.4
Emergency Assistance ¹	41.3	50.00

Latest Financial Arrangements: Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	July 29, 2015	August 4, 2017	147.50	135.40
Stand-By	April 27, 2012	December 26, 2013	90.97	78.22
Stand-By	July 21, 2010	January 20, 2012	92.66	18.76

Outright Loans:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
RFI	Apr 10, 2020	Apr 15, 2020	41.30	41.30

Overdue Obligations and Projected Payments to Fund ²

(SDR Million; based on existing use of resources and present holdings of SDRs):

¹ Emergency Assistance may include ENDA, EPCA, and RFI.

² When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

	Forthcoming				
	2020	2021	2022	2023	2024
Principal	23.31	43.11	9.90	10.33	20.65
Charges/Interest	0.65	0.87	0.50	0.43	0.24
Total	23.96	43.98	10.40	10.75	20.89

Implementation of HIPC Initiative: Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

As of February 4, 2015, the Post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

Safeguards Assessments

The update safeguards assessment, conducted in connection with the Rapid Financing Instrument approved in April 2020 [and a prospective Extended Fund Facility arrangement], found that the CBK continues to maintain broad operational controls and all recommendations from the previous safeguards assessment have been implemented. However, recent Board vacancies have resulted in the lack of a quorum and the absence of a functioning Board poses substantial governance and oversight risks for the central bank. The CBK Act protects the autonomy of the central bank, and the audit mechanisms and financial reporting practices continue to be aligned with international standards. The implementation of the risk management framework is advancing.

Exchange Arrangements

The de jure and de facto exchange rate arrangement is one of no separate legal tender. Since unilateral adoption of the euro, this currency is a legal tender in Kosovo and circulates freely. Kosovo is not part of the euro area and the CBK is not part of the European System of Central Banks. Kosovo is an Article VIII member and does not maintain exchange restrictions or multiple currency practices, except for restrictions maintained solely for reasons of international or national security, which have been notified to the Fund pursuant to Decision No. 144.

Previous Article IV Consultation

The last Article IV consultation was concluded on October 8th, 2020. Going forward, it is expected that Kosovo will be on a 12-month cycle.

FSAP and ROSC Participation

An FSAP mission was conducted during September 19–October 2, 2012. The FSSA included the ROSC for compliance with Basel Core Principles. Kosovo has not had a data or a fiscal transparency ROSC.

Technical Assistance

Since 1999, the Fund has provided technical assistance and policy advice to UNMIK and, since September 2008, to Kosovo. Technical assistance has centered on the Fund's core competencies, notably in the areas of fiscal policy, the banking and payments systems, and macroeconomic statistics. Assistance has also contributed to developing key aspects of the legal and institutional framework needed for a market economy. More recently, TA has been provided on the following issues:

Statistics

- Government Finance Statistics (November 2018; March, June and October 2019; February 2020)
- Monetary and Financial Statistics (August 2019)

Fiscal Sector

- Tax Administration - Compliance Risk Management (November 2018); Review Process of Tax Administration Reform (March 2019); Tax Administration Modernization (January 2020); Tax Debt Collection (May 2020); IT Reform Implementation (September 2020)
- Public Financial Management - Medium-term expenditure framework and Fiscal Management (February 2019; September 2020); Budget Costing and Fiscal Risk Management (November 2019); Fiscal Risk Disclosure (October 2020);

Monetary and Financial Sectors

- Financial Sector Stability Review (January, April and October 2019; July 2020)

Resident Representative

Ms. Eble from regional office for the West Balkans took up her post on June 14, 2019 and oversees Kosovo's local office.

RELATIONS TO OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

EBRD: <https://www.ebrd.com/work-with-us/project-finance/project-summary-documents.html?1=1&filterCountry=Kosovo>

European Investment Bank:
<http://www.eib.org/en/projects/pipelines/?d=&f=&st=&r=3&c=XK&se=>

World Bank: <https://www.worldbank.org/en/country/kosovo/overview>

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
<p>General: Data provision is adequate for surveillance. However, the statistical agencies still suffer from considerable shortages of financial and human resources.</p>
<p>National Accounts: Through intensive TA from the European Commission (Twinning Project), improvements have been made to the national accounts, but significant weaknesses remain. Compilation methods used for annual national accounts (ANA) are broadly in line with the 2008 SNA/ESA2010. The quality and timeliness of annual nominal and real GDP data has been improved, and data on GDP by economic activity and by expenditure are now published simultaneously in an excel format on the web-site of the Kosovo Statistical Agency with a delay of 10 months. Although quarterly national accounts series provide a first estimate of the annual GDP by April every year, it would be advisable to further reduce the time lag in the dissemination of ANA. Quarterly GDP data can be inconsistent with annual data (upon publication), requiring significant revisions, and improvements in methodology are required. Kosovo needs to improve existing and develop additional high-frequency (monthly) indicators, with priority given to indicators relevant to Kosovo's economy such as wholesale and retail trade data and services.</p>
<p>Labor Markets: Reliable labor force data is challenging given the large share of the informal economy, although quarterly labor data began to be published in 2016.</p>
<p>Consumer Price Index: A monthly Consumer Price Index (CPI) has been produced since 2002 and is published on a monthly basis (with a lag of 13 days). The index uses a Classification of Individual Consumption according to Purpose (COICOP)-compatible item classification with 352 elementary aggregates. A new index was introduced in December 2014, with new weights largely based on National Accounts data aimed at bringing the CPI in line with the European Harmonized Index of Consumer Prices (HICP). It targets all products and services purchased by all households (resident and non-resident) in Kosovo. HICP is now available from January 2010 onward. The HICP was rebased from 2002 to 2015 in January 2016. Both CPI and HICP are used to measure consumer inflation, the latter enabling comparisons between member states within the EU. Kosovo receives TA from Eurostat.</p>
<p>Government Finance Statistics (GFS): Monthly reports on budget execution of the general government (central government and municipalities) on a cash basis are provided five weeks after the end of each month. GFS are broadly compiled following the GFSM 2001/GFSM 2014 framework, concepts, and definitions. However, Budget classification is not consistent with GFSM 2014 because: (i) data is on cash basis, not accrual; (ii) lending for policy purposes (similar to subsidies) is included after calculating the primary balance; (iii) capital transfers should be included in current expenditure instead of capital expenditure; (iv) memorandum of understanding (MOU) should be properly classified depending on their final purpose; (v) annual</p>

budget documents should specify both current and capital spending related to individual projects. While data is generally adequate, strengthening monitoring and disclosure of arrears will be important.

Monetary and Financial Statistics: Monetary data are compiled broadly consistent with the IMF's *Monetary and Financial Statistics Manual and Compilation Guide 2016 (MFSMCG)*. The CBK reports monetary data monthly, using Standardized Report Forms for the central bank, other depository corporations, and other financial corporations, which are published in the *International Financial Statistics*. Due to difficulties with obtaining adequate source data needed for estimation of Euro currency in circulation, the CBK ceased compiling currency in circulation in 2006, underreporting broad money.

Financial Sector Surveillance: The CBK reports Financial Soundness Indicators (FSIs) monthly according to the *Compilation Guide on Financial Soundness Indicators*. FSIs including all 12 core indicators and 7 encouraged indicators for deposit takers are available through IMF's FSI webpage.

External Sector Statistics: CBK provides to STA quarterly balance of payments and international investment position data following the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* starting with 2013: Q1 reference data. Authorities also participate in: a) the Coordinated Direct Investment Survey with inward and outward data starting with 2010; b) the Coordinated Portfolio Investment Survey with annual data starting from December 2010 and semiannual data starting from June 2013, including encouraged items (currency of denomination, sector of the holder, sector of the issuer, and cross-sector classification); and the Quarterly External Debt Statistics. Direction of trade data are available on a monthly basis. Overall, the accuracy, periodicity, and timeliness of external sector statistics have improved due to authorities' efforts and with technical assistance from STA. The authorities are currently working towards reporting the international reserves and foreign currency liquidity template.

II. Data Standards and Quality

The country participates in the enhanced General Data Dissemination System (e-GDDS) and a National Summary Data Page regularly disseminates e-GDDS data to the public since May 11, 2017.

Kosovo has not had a Data ROSC.

Kosovo—Table of Common Indicators Required for Surveillance
(As of January 21, 2021)

	Date of Latest Observation	Date Received/ Reported Online	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷
Exchange Rates	N/A	N/A	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	Jul 31/2020	Nov/2020	M	M	M
Reserve/Base Money	Jul 31/2020	Nov/2020	M	M	M
Broad Money	Jul 31/2020	Nov/2020	M	M	M
Central Bank Balance Sheet ¹	Jul 31/2020	Nov/2020	M	M	M
Consolidated Balance Sheet of the Banking System	Jul 31/2020	Nov/2020	M	M	M
Interest Rates ²	Jul 31/2020	Nov/2020	M	M	M
Consumer Price Index	Nov30/2020	Dec/2020	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ —General Government ⁴	Dec31/2020	Dec/2020	D	D	M
Revenue, Expenditure, Balance and Composition of Financing ³ —Central Government	Dec 31/2020	Dec/2020	D	D	M
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	Oct 30/2020	Dec/2020	Q	Q	Q
External Current Account Balance	Sep 30/2020	Nov/2020	Q	Q	Q
Exports and Imports of Goods	Nov 30/2020	Dec/2020	M	M	M
GDP/GNP ⁸	Sept 30/2020	Dec/2020	Q	Q	Q
Gross External Debt	Sep 30/2020	Nov/2020	Q	Q	Q
International Investment Position ⁶	Sep 30/2020	Nov/2020	Q	Q	Q
<p>¹ CBK's NFA and GIR data have been revised for the period 09/2015 - 07/2018 to exclude the CBK's holdings of Kosovar government securities. CBK balance sheet and survey data have been revised for the period 09/2015 - 07/2018 to reclassify the CBK's holdings of Kosovar government securities as claims on the central government.</p> <p>² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.</p> <p>³ Foreign, domestic bank, and domestic nonbank financing.</p> <p>⁴ The general government consists of the central government (budgetary and extra budgetary funds) and local governments (municipalities).</p> <p>⁵ Including currency and maturity composition.</p> <p>⁶ Includes external gross financial asset and liability positions vis-à-vis nonresidents.</p> <p>⁷ Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I), and not available (NA).</p> <p>⁸ GNDI data not available.</p>					

**Statement by Mr. Daniel Palotai, Executive Director on Republic of Kosovo
February 12, 2021**

On behalf of the Kosovar authorities, I would like to thank the Mission Chief for Kosovo, Gabriel Di Bella and his entire team for the very constructive and productive discussions. While the results achieved by the authorities in many areas were confirmed by staff, many opportunities for further reforms and improvements were identified. The authorities broadly share staff's assessments and recommendations.

COVID-19 response

At the onset of the pandemic, the Kosovo Government took decisive measures to contain the spread of the virus, including domestic and international travel restrictions. However, after easing those restrictions, infections spread rather quickly across the country and various restrictive measures were re-introduced to ease the pressure on the health sector.

To limit the economic and social impact on citizens and businesses, the government designed and implemented targeted support schemes. This led to a significant increase in government spending, and thus, to a higher budget deficit and public debt. Nevertheless, the fiscal position remains healthy, with public debt well below the regional median at around 24.5 percent of GDP, while the performance of the financial sector remains strong and the structural reform agenda continues to be a priority, despite political challenges.

Economic performance

Following economic growth of 4.9 percent in 2019, the authorities estimate negative GDP growth of around -6.7 percent (staff estimates a GDP growth of -6 percent) for 2020, due to the significant impact of disrupted international trade, reduced production capacities, and a sharp decrease in business turnover.

Overall, investments are estimated to have dropped by almost 20 percent; exports by 18 percent; imports by around 10 percent, whereas consumption remained stable, given the government's targeted cash support. Within total exports and imports, services suffered the most, in particular diaspora-tourism receipts, due to international travel restrictions.

Despite the decrease in imports and increases in the inflow of remittances by 14.8 percent, the current account deficit increased from 5.5 percent to around 7.5 percent of GDP. This increase was financed by external borrowing, including a purchase under the IMF's Rapid Financing Instrument of Euro 51 million, 0.8 percent of GDP, and drawing down international reserves.

With respect to the outlook, the authorities project a speedy recovery, with significant contribution from planned budget spending in various recovery-related programs. Nevertheless, given the continuing health challenges and uncertainties around the timing of COVID-19 vaccines, the initial growth estimates may be subject to downward revisions. The difference of

the authorities' projection of GDP growth of 5.2 percent, compared to Fund staff's 4.5 percent estimates, can partly be explained with the timing of the projections, with the authorities having completed their projections earlier in the context of the 2021 budget process. The main drivers of growth are expected to be exports, especially services, and private investments, which are supported by a projected increase in credit activity. Beyond 2021, growth is expected to stabilize at around 4 percent.

Given the overall drop in demand during 2020, inflation remained relatively stable and is expected to increase, in line with the revival of the economy and the recovery of imports to pre-COVID levels of 2.0 percent in 2021.

Public finances

Despite the challenges in 2020, the authorities remain fully committed to maintain and further strengthen fiscal discipline. Budget revenues were close to 9 percent lower than in 2019, due to the slower economic activity. Taxes contributed the most to this decline, with border tax collection being 11 percent lower than in 2019, partly reflecting the drop in imports. On the other hand, budget expenditures increased, due to the government's COVID-related programs to support businesses and citizens, and additional allocations to the health sector as well as other institutions involved in fighting the pandemic. Compared with 2019, primary spending increased by around 6.5 percent in 2020. The most significant increase occurred within subsidies and transfers, which were 38 percent higher than in 2019, as COVID-related expenditures were included under this category. Contrary to transfers, execution of capital investments was significantly lower than budgeted, partly due to COVID-restrictions, but mainly due to the political environment.

The primary deficit surpassed significantly the 2 percent deficit rule, which was temporarily relaxed by the Assembly, to accommodate the challenging circumstances, with the explicit intention to gradually return to the rule by 2023. While the primary deficit was above 7 percent, this also includes spending financed externally by IFIs as well as spending funded by privatization proceeds, both excluded from the deficit rule of 2 percent. Hence, the deficit, as per the legal rule, was lower (5.8 percent).

The authorities introduced legal changes to allow contributors of the second pillar pension system (defined-contribution scheme managed by the Kosovo Savings Pension Trust (KPST)), to withdraw 10 percent of their assets (roughly EUR 200 million), as part of the government's efforts to increase aggregate demand. While the assets under management of the KPST are not included in the consolidated government financial accounts, the government has pledged to reimburse a portion of the withdrawn assets in future years, thus creating a future liability.

Within the 2021 budget, the authorities have planned to continue with targeted support to the private sector, via the 'economic recovery program'. However, there is a need for additional financing to close the deficit gap, and importantly, to keep adequate fiscal buffers and this will be addressed in the coming months.

Going forward, to continue with the planned investments in a number of priority sectors and to close infrastructure gaps, the authorities have agreed with staff to amend the so called ‘investment clause’ which allows the government to budget beyond the 2 percent deficit rule for capital projects financed by IFIs. Given that this ‘clause’ will expire if the stock of debt reaches 30 percent, which risks materializing due to the pandemic, the threshold will be increased to 40 percent. On the ‘regular’ deficit, the authorities are committed to returning gradually to the original rule of 2 percent deficit.

Financial sector

The reforms implemented by the Central Bank of Kosovo (CBK) in previous years, which focused on strengthening the financial safety net and banking supervisory framework, helped mitigate the pressures from the pandemic. Many of the reforms implemented have been designed with IMF support, and the CBK remains committed to continue strengthening its capacities and systems, including by implementing FSSR recommendations.

Overall, the financial sector managed to perform well, with the banking sector growing by more than 12 percent; deposits which comprise more than 90 percent of liabilities increased by 11.5 percent and outstanding loans by 7 percent. At the end of 2020, the capital adequacy ratio stood at 16.7 percent. To ease the pressure on businesses and citizens, the CBK introduced a temporary moratorium on loan repayments. Further relaxation on restructuring requirements for loans were introduced, by allowing lending institutions, based on individual requests, to restructure repayment schedules. Such restructurings were exempted from the requirement to lower the grade with respect to non-performing loans classification, thus also exempted from provisioning. Nevertheless, in December 2020, all banks were required to apply pre-COVID requirements, and the preliminary data signal a healthy loan portfolio, with the probability of a slight increase in non-performing loans (NPL) in the months to come. At the end of 2020, NPL stood at 2.63 percent whereas the ratio of provisions to NPL was 143.27 percent.

Economic governance and financial sector reforms

The authorities remain committed to implementing ongoing structural reforms as well as to design and implement new reforms. The authorities have expressed their interest to conduct a general review of the current tax policy and identify potential improvements in collaboration with Fund staff. On revenue administration, efforts will continue to improve performance, with a focus on digitalization, and shifting to a risk-based approach in auditing.

Over the past years, many different social schemes were introduced. The authorities are committed to reviewing the existing schemes, to ensure consistency, consider long-term implications of existing and future schemes, ensure fair treatment for all, and avoid an ad-hoc approach to addressing the needs of individual groups.

While progress has been made with the implementation of e-procurement, efforts will focus on improving operational aspects of this reform, including transparency in the procurement of public goods. Given the decision of the Constitutional court to repeal the law on salaries for

public sector employees, the priority is to make the compensation policy of public servants more transparent and fair, in line with staff recommendations.

To improve corporate governance of Publicly Owned Enterprises (POE), which currently pose large fiscal risks to the government, the authorities have agreed with staff to establish and develop performance and quarterly risk assessments for high risk POEs and strengthen the institutional arrangement for POE oversight.

Possible request for a program

We wish to note that in December 2020 technical discussions for a UCT program were successfully concluded with staff, but given political developments, discussions were put on hold, until new institutions are created. In this context, it is likely that following the general elections in mid-February, the new government will approach the Fund to negotiate a possible program.