



# 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)

### CONTENTS

FUND RELATIONS	<u>2</u>
RELATIONS TO OTHER INTERNATIONAL FINANCIAL INSTITUTIONS	<u>5</u>
STATISTICAL ISSUES	<u>6</u>

## 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 <sup>1</sup>	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 <sup>2</sup>

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

<sup>1</sup> Emergency Assistance may include ENDA, EPCA, and RFI.

<sup>2</sup> 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
<b>Principal</b>	23.31	43.11	9.90	10.33	20.65
<b>Charges/Interest</b>	0.65	0.87	0.50	0.43	0.24
<b>Total</b>	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

**General:** Data provision is adequate for surveillance. However, the statistical agencies still suffer from considerable shortages of financial and human resources.

**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.

**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.

**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.

**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

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 <sup>7</sup>	Frequency of Reporting <sup>7</sup>	Frequency of Publication <sup>7</sup>
Exchange Rates	N/A	N/A	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	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 <sup>1</sup>	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 <sup>2</sup>	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 <sup>3</sup> —General Government <sup>4</sup>	Dec31/2020	Dec/2020	D	D	M
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> —Central Government	Dec 31/2020	Dec/2020	D	D	M
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	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 <sup>8</sup>	Sept 30/2020	Dec/2020	Q	Q	Q
Gross External Debt	Sep 30/2020	Nov/2020	Q	Q	Q
International Investment Position <sup>6</sup>	Sep 30/2020	Nov/2020	Q	Q	Q
<p><sup>1</sup> 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><sup>2</sup> Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.</p> <p><sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.</p> <p><sup>4</sup> The general government consists of the central government (budgetary and extra budgetary funds) and local governments (municipalities).</p> <p><sup>5</sup> Including currency and maturity composition.</p> <p><sup>6</sup> Includes external gross financial asset and liability positions vis-à-vis nonresidents.</p> <p><sup>7</sup> Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I), and not available (NA).</p> <p><sup>8</sup> 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