

Republic of Kosovo: 2022 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Republic of Kosovo



REPUBLIC OF KOSOVO

January 2023

2022 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 2022 Article IV consultation with 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 January 25, 2023, consideration of the staff report that concluded the Article IV consultation with Finland.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 25, 2023, following discussions that ended on November 4, 2022, with the officials of Finland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 20, 2022.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Republic of Kosovo.

The documents listed below have been or will be separately released.

Selected Issues Paper

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 2022 Article IV Consultation with Kosovo

FOR IMMEDIATE RELEASE

Washington, DC – January 27, 2023: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Kosovo.

The increase in energy and food prices after Russia's war in Ukraine is weighing on private demand, activity, and inflation. Real GDP growth is estimated to have decelerated to 2.5–3 percent in 2022, after recovering by 10.7 percent in 2021. Average inflation reached more than 11 percent in 2022.

Fiscal consolidation that began in 2021 continued in 2022. The primary fiscal position is estimated to be balanced in 2022, compared with a deficit of about 1 percent of GDP in 2021. The tighter fiscal stance reflected solid fiscal revenue growth and low implementation of the public investment program (PIP) that offset the increase in transfers to lessen the impact of higher food and energy prices. In particular, the improvement in domestic tax collection reflected progress in strengthening tax administration and tackling informality. While credit to the private sector is estimated to have expanded by about 15 percent in nominal terms in 2022, real credit growth decelerated compared to 2021. Reflecting the tighter euro area financial conditions, domestic government bond yields and lending rates have begun to increase. With strong capital and liquidity buffers and low NPLs, the banking sector has remained resilient overall.

Economic activity is forecasted to grow at 3.5 percent in 2023, around Kosovo's potential of 3.5–4 percent. This forecast crucially depends on the assumption that international commodity prices will ease in 2023. Uncertainty around the outlook remains high; higher energy prices represent the main downside risk. Although sound fiscal and financial policies will help mitigate the impact of downside risks, structural reforms addressing infrastructure and governance gaps are essential to diversify Kosovo's growth engines and create the conditions for greener economic growth.

Executive Board Assessment²

Executive Directors noted that following an economic rebound, spillovers from Russia's war in Ukraine, including high food and energy prices and tightening financial conditions, are weighing on growth, and the outlook remains uncertain with risks tilted to the downside. Directors commended the authorities' swift policy response, which helped cushion the impact of the terms of trade shock on households and firms. Looking ahead, they encouraged

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.

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>.

continued commitment to prudent policies combined with a revitalized structural reform agenda to unlock growth. Continued close Fund engagement can help Kosovo advance its reform efforts and rebuild policy buffers.

Directors welcomed the authorities' efforts to replenish fiscal buffers. They agreed that a return to the fiscal rule deficit ceiling in 2023 could support a soft landing without exacerbating inflationary pressures. Directors emphasized that measures to mitigate the impact of higher energy prices should be temporary, well targeted, and encourage efficient energy use. While welcoming an increase in public investment, Directors urged the authorities to improve its absorption and address public investment management shortcomings. Directors commended the progress toward reducing informality and encouraged exploring additional revenue measures.

Directors recommended that public spending be better balanced between social transfers and promoting economic transformation and resilience. They agreed that the phased implementation of the law regulating public wages would ensure talent retention while keeping the wage bill within its legal ceiling. Directors emphasized that early withdrawals from Kosovo's Pension Savings Trust should be avoided.

Directors welcomed the resilience of the banking system, which has remained liquid and well-capitalized. Noting the uncertain outlook, they urged continued close monitoring of bank asset quality and liquidity and emphasized the importance of enhancing surveillance of the housing market. Directors welcomed the authorities' commitment to implement the recommendations from the 2019 Financial Sector Stability Review and 2021 Safeguards Assessment. They underscored the key role of an independent and accountable central bank in maintaining financial stability.

Directors urged the authorities to address infrastructure and governance gaps, further enhance transparency, and reduce corruption, which remain essential to improve Kosovo's business environment and increase potential growth. They called for addressing weaknesses in the AML/CFT framework. Directors also underscored the importance of boosting green energy generation capacity to increase energy security and decrease emissions.

It is expected that the next Article IV consultation with the Republic of Kosovo will be held on the standard 12-month cycle.

Kosovo: Selected Economic Indicators, 2019–27									
	2019	2020	2021	2022	2023	2024	2025	2026	2027
			Est.	Proj.					
Real GDP growth	4.8	-5.3	10.7	2.7	3.5	3.9	3.9	3.6	3.5
Contribution to growth (percentage points of GDP)									
Consumption	5.8	2.3	7.7	1.1	3.9	2.9	2.6	2.6	2.6
Private	4.6	2.0	6.5	2.3	2.2	2.1	2.1	2.1	2.1
Public	1.2	0.3	1.2	-1.3	1.7	0.8	0.5	0.5	0.4
Investment	-0.1	-2.3	3.6	-0.5	0.4	1.6	1.5	1.2	1.1
Net Exports	-0.3	-5.3	-0.2	1.4	-0.8	-0.6	-0.2	-0.2	-0.1
Exports	2.2	-8.6	17.0	3.8	0.8	1.3	1.5	1.4	1.4
Imports	-2.5	3.3	-17.2	-2.4	-1.6	-1.9	-1.7	-1.6	-1.5
Real growth rate (percent)									
Consumption	6.2	2.4	7.5	1.1	4.0	2.9	2.7	2.7	2.7
Private	5.6	2.5	7.3	2.7	2.6	2.5	2.5	2.5	2.6
Public	10.1	2.1	9.0	-9.3	14.0	5.7	4.0	3.6	3.3
Investment	-0.2	-7.4	11.7	-1.5	1.2	5.4	5.1	4.1	3.5
Exports	7.6	-29.2	76.8	10.7	2.2	3.5	3.9	3.8	3.7
Imports	4.5	-6.0	31.5	3.7	2.4	2.9	2.7	2.5	2.4
Official unemployment (percent of workforce)	25.7	26.0	21.3	...	...	...	...	...	...
Price changes									
CPI, period average	2.7	0.2	3.3	11.6	4.9	2.5	2.1	1.9	2.0
GDP deflator	1.0	1.4	6.1	9.3	6.2	3.4	2.5	2.1	1.8
General government budget (percent of GDP)									
Revenues and grants	27.0	25.6	27.8	27.8	28.6	27.3	27.2	27.2	27.0
Expenditures	29.9	33.5	29.0	28.0	30.8	29.5	29.2	29.3	29.3
Of which: Wages and salaries	8.7	9.8	8.4	7.4	7.6	8.1	8.1	8.1	8.1
Subsidies and transfers	8.9	12.8	10.6	12.0	11.2	10.2	10.0	10.0	10.0
Capital expenditure	7.6	5.7	5.3	4.6	6.8	6.3	6.3	6.3	6.3
Overall Balance (Fiscal rule) 1/	-0.8	-6.6	-1.0	0.1	-1.1	-1.3	-1.2	-1.3	-1.5
Overall balance	-2.9	-7.9	-1.3	-0.3	-2.2	-2.1	-2.0	-2.1	-2.3
Stock of government bank balances	5.1	3.4	3.8	3.3	4.0	3.5	3.0	2.4	1.5
Total public debt 2/	17.7	22.5	21.6	19.2	20.6	21.0	21.4	21.9	22.3
Balance of Payments (percent of GDP)									
Current account balance, incl. official transfers	-5.7	-7.0	-8.7	-10.4	-8.0	-7.5	-7.1	-6.5	-6.3
Of which: Official transfers 3/	3.4	4.1	2.9	3.0	3.8	3.1	3.0	3.0	3.0
Of which: Remittance inflows	12.1	14.5	14.5	14.1	13.6	13.3	12.6	12.4	12.1
Financial account	-2.3	-8.3	-4.6	-6.9	-5.0	-5.1	-4.8	-4.2	-4.2
Of which: Direct investment, net	-2.7	-4.2	-4.0	-4.9	-4.2	-4.2	-4.0	-3.7	-3.5
Portfolio investment, net	0.8	-1.2	3.5	1.0	1.0	1.1	1.3	1.6	1.6
Other investment, net	-1.8	-3.5	-6.1	-3.2	-3.0	-2.2	-2.2	-2.1	-1.8
Reserve change	1.3	0.7	2.1	0.2	1.2	0.1	0.0	0.1	-0.5
Errors and Omissions	3.5	-1.6	3.4	3.3	2.7	2.1	2.0	2.0	1.9
Savings-investment balances (percent of GDP)									
National savings	28.9	26.4	27.2	25.7	26.5	27.0	27.5	28.2	28.4
Public savings	4.4	-2.8	3.8	4.1	3.5	4.2	4.3	4.2	4.0
Private savings	24.5	29.3	23.4	21.7	23.0	22.8	23.2	24.0	24.4
Investment	34.6	33.4	36.0	36.2	34.5	34.5	34.6	34.6	34.7
Public investment	7.6	5.7	5.3	4.6	6.8	6.3	6.3	6.3	6.3
Private investment	27.0	27.7	30.6	31.6	27.6	28.2	28.3	28.4	28.4
Current account, including, official transfers	-5.7	-7.0	-8.7	-10.4	-8.0	-7.5	-7.1	-6.5	-6.3
Financial Sector									
Non-performing loans (percent of total loans)	1.9	2.5	2.1	2.0	...	...	...	...	...
Bank credit to the private sector (percent change)	10.0	7.0	15.6	15.1	10.3	9.0	7.9	6.8	6.6
Deposits of the private sector (percent change)	15.6	10.9	12.4	8.6	7.5	7.7	7.3	6.6	6.4
Regulatory capital to risk weighted assets	15.9	16.5	16.1	15.8	...	...	...	...	...
<i>Memorandum items:</i>									
Foreign Reserves (millions of euros, IMF Definition)	1,142	1,149	1,293	1,310	1,420	1,426	1,427	1,430	1,367
Foreign Reserves (% of ARA metric)	126	119	106	94	94	88	82	76	69
GDP (millions of euros)	7,056	6,772	7,958	8,932	9,817	10,547	11,233	11,879	12,522
GDP (millions of euros; authorities' projections)	7,056	6,772	7,958	8,956	9,843	...	...	...	...
GDP per capita (euros)	3,959	3,766	4,499	5,055	5,561	5,980	6,376	6,749	7,121
Real GDP growth per capita	5.6	-6.2	12.6	2.8	3.6	4.0	4.0	3.7	3.6
Output gap (% of GDP)	1.2	-6.2	-0.5	-0.5	-0.5	-0.3	-0.1	0.0	0.0
Population (million)	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/ The "fiscal rule" caps the overall fiscal deficit at 2 percent of GDP, excluding investment financed with privatization receipts and donor financing contracted after 2015, as well as PAK-related current expenditure; the IMF calculates expenditures from carried-forward own-source revenue (OSR) as the difference in the municipal OSR stock.									
2/ It does not include contingent debt of former Yugoslavia. Beginning in 2020, it includes Euro 120 million of debt with KPST.									
3/ Total foreign assistance excluding capital transfers.									



REPUBLIC OF KOSOVO

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

December 20, 2022

KEY ISSUES

Context. The increase in energy and food prices after Russia's war in Ukraine is weighing on private demand, activity, and inflation. Real GDP growth has decelerated to 2–3 percent in 2022, after recovering by 10.7 percent in 2021, and inflation increased to more than 11 percent. Growth is projected to moderately pick up to 3.5 percent in 2023, and inflation to decline to 5 percent, though these forecasts crucially depend on the assumption that international commodity prices will ease. Uncertainty remains high, with risks to the downside for growth and to the upside for inflation.

Key Recommendations:

- **Fiscal policy.** The budget for 2023 appropriately envisages a return to the fiscal rule deficit ceiling. With underspending in 2022, the 2023 budget is expected to provide an impulse of about 2 percentage points of GDP, helping the economy soft land, with only a moderate impact on inflation. Implementation of the law regulating public wages should begin in 2023 to ensure talent retention but keeping the wage bill within its legal ceiling. The budget should spell out the intended use of large blanket allocations for contingencies. Support to mitigate the impact of higher energy prices should be temporary, targeted, and encourage efficiency in energy use. More generally, public spending needs to be better balanced between social transfers and promoting economic transformation and resilience, which calls for further improving public investment management.
- **Financial policy.** While the financial sector has remained resilient through the pandemic and the war in Ukraine, the shifting macroeconomic outlook calls for further strengthening credit risk monitoring, accounting for bank-by-bank idiosyncratic risks and capacities and improving the surveillance of the housing market. Work towards strengthening the financial sector's regulatory and governance frameworks remains a priority.
- **Structural reforms.** Addressing infrastructure and governance gaps is essential to support new growth engines. Revitalizing the reform program requires strengthening coordination among and across all levels of government. Boosting green energy will increase energy security and decrease greenhouse gas emissions. Early withdrawals from the pension system should be avoided.

Approved By
Mark Horton (EUR)
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The discussions took place in Pristina during October 25–November 4, 2022. The team consisted of Gabriel Di Bella (head), Stephen Ayerst, Si Guo, Ezgi Ozturk, (all EUR), and was assisted by Stephanie Eble, Amanda Edwards, and Selim Thaci (Resident Representative Office). Merita Kernja assisted in the mission organization. Sabiha Mohona provided research assistance and Tina Kang assisted in the preparation of the report. The mission met with Deputy Prime Minister Bislimi, Minister of Finance, Labor and Transfers Murati, Central Bank Governor Mehmeti, other senior officials and representatives of the business, civil society, and donor communities.

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