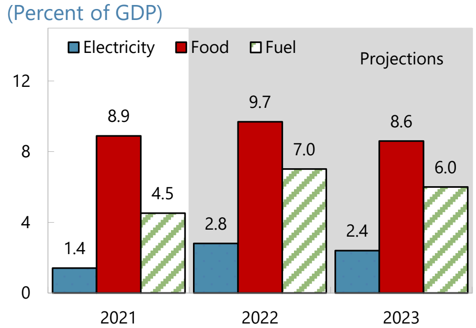
CONTEXT: FALLOUT FROM THE WAR IN UKRAINE WEIGHS ON ACTIVITY AND PUSHES INFLATION UP

1. Higher energy and food prices unleashed by Russia's war in Ukraine have pushed inflation up and are weighing on activity. The negative terms-of-trade shock (estimated at 5 percent of GDP) has impacted household real disposable income and private demand. Increased input costs have weighed on profits and delayed the implementation of investment, both public and private. Record high European electricity prices led to load shedding last August, compounding growth headwinds.

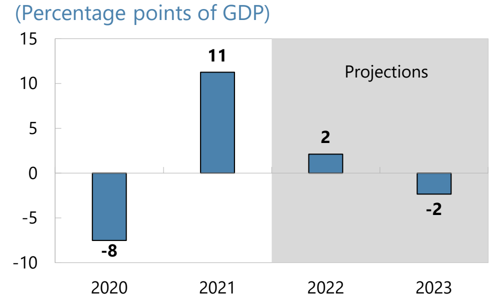
2. The cost-of-living crisis has largely shifted the policy focus to the short term. Wage growth has lagged inflation, giving rise to social protests and a teachers' strike that delayed the start of the school year. Inflation also led to costly proposals from different stakeholders, like allowing further withdrawals from the Kosovo's Pension Savings Trust (KPST), freezing electricity prices, or increasing war veteran benefits, that the government has opposed.[1] Progress in the dialogue with Serbia has been clouded by intermittent tensions in Kosovo's northern municipalities, which are mainly inhabited by ethnic Serbs.

Imports of Goods
(Percent of GDP)



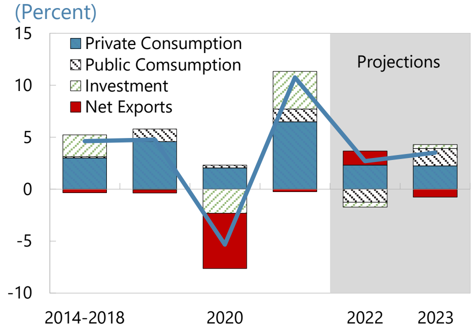
Sources: Haver Analytics and IMF staff calculations.

Change in Diaspora Support via Travel, Remittances and FDI
(Percentage points of GDP)



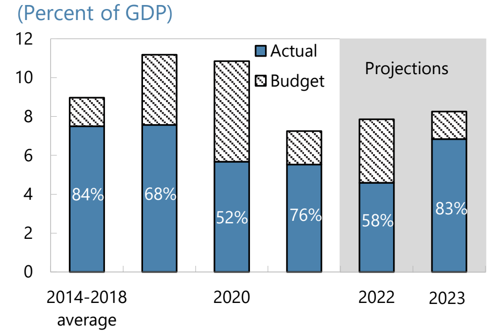
Sources: Kosovo Statistics Agency and IMF staff calculations.

Contributions to Real Growth
(Percent)



Sources: Haver Analytics, WEO and IMF staff calculations.

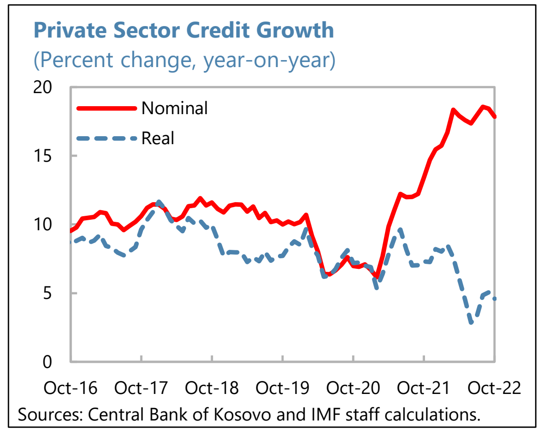
Government Capital Expenditure
(Percent of GDP)



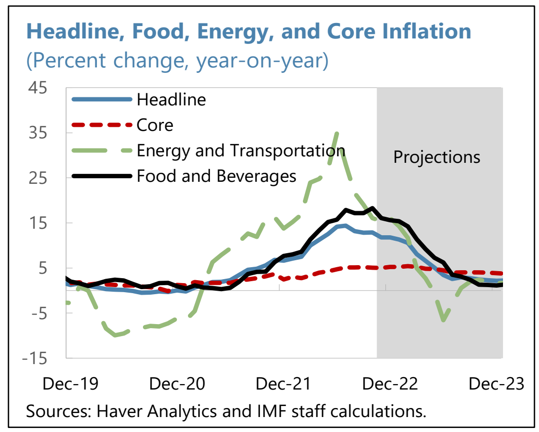
Sources: MoFLT and IMF staff calculations.

[1] A proposal to allow early withdrawals for up to 30 percent of KPST pension savings was rejected by Parliament in late March 2022. This proposal has recently resurfaced.

3. GDP growth is projected to have slowed to 2–3 percent in 2022, from nearly 11 percent in 2021. Growth decelerated to 4.9 percent in 2022:Q1 and further to 2.1 percent in 2022:Q2 (both y/y), mainly due to the impact of the terms-of-trade shock on private demand, a key growth driver in 2021. The deceleration mainly affected service activities (trade, transportation, and accommodation). Other factors also contributed to softer activity, including:



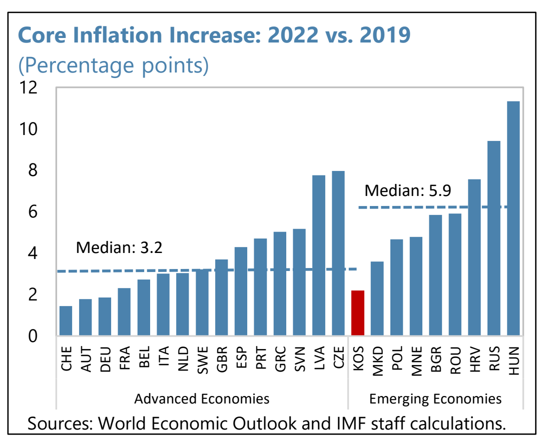
- **Decreasing gains from post-pandemic mobility normalization.** After its strong rebound by 11 percentage points (pp) of GDP in 2021, growth of diaspora-related inflows (tourism, remittances, and real estate purchases) eased substantially in 2022, to 2 pp of GDP.



- **A negative fiscal impulse.** The primary fiscal position was balanced in 2022, compared with a deficit of about 1 percent of GDP in 2021; this reflected solid fiscal revenues and a low implementation of the public investment program (PIP) that more than offset the increase in transfers to cushion the impact of higher food and energy prices.

- **Tighter financial conditions.** While credit to the private sector is assessed to have expanded by about 15 percent in nominal terms in 2022, real credit growth decelerated compared to 2021. Reflecting tighter euro area financial conditions, domestic government bond yields and lending rates have begun to creep up. Liquidity conditions tightened somewhat as bank deposit growth decelerated compared to 2021.

4. Inflation is projected to have increased to 11–12 percent in 2022 (from 3.3 percent in 2021), in line with the western Balkans' average (Box 1). After peaking at 14.2 percent (y/y) in July 2022, inflation declined, but nonetheless remains high. Higher food and energy prices contributed 80 percent of the inflation increase. While second-round effects have been moderate, core inflation increased to around 5 percent in the second half of 2022 (from 2.2 percent in 2021).



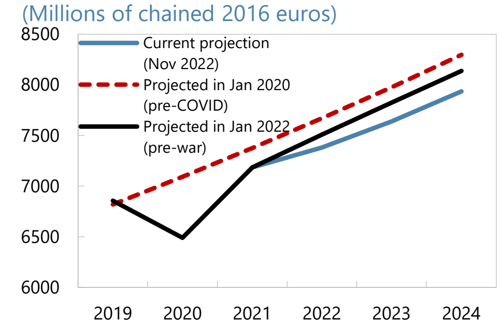
5. The terms-of-trade shock has led to a wider current account deficit (CAD). The CAD is projected to have widened to 10.4 percent of GDP in 2022, 1.7 pp of GDP higher than in 2021. This

was driven by increases in food and energy imports (4.5 pp of GDP) that more than offset the rise in tourism inflows (1.5 pp of GDP) and goods exports (1 pp of GDP). The CAD was financed by a decline in bank net foreign assets, diaspora real estate purchases, and decreased KPST investment outflows. As a result, gross international reserves (GIRs) remained broadly flat in nominal terms but are projected to have declined to 94 percent of the IMF's reserve adequacy metric (106 percent in 2021). The assessment using the IMF's EBA-lite model suggests that the external position in 2022 is weaker than the level implied by medium-term fundamentals and desirable policy settings, though this reflects to some extent the large increase in food and energy prices, a part of which is likely to be temporary (Annex III).

THE OUTLOOK: GROWTH TO MODERATELY RECOVER AMID EXTRAORDINARY UNCERTAINTY

6. Real GDP growth is expected to moderately recover to 3.5 percent in 2023, around Kosovo's potential of 3.5–4 percent. This forecast crucially depends on a baseline assumption that international commodity prices will ease in 2023.[2] It is also predicated on (i) a fiscal impulse of around 2 percent of GDP mainly driven by higher public investment, broadly in line with the 2023 budget; (ii) slightly lower diaspora inflows as a share of GDP; and (iii) continued net bank credit growth to the private sector. The output gap is expected to remain negative at about 0.5 percent of GDP.

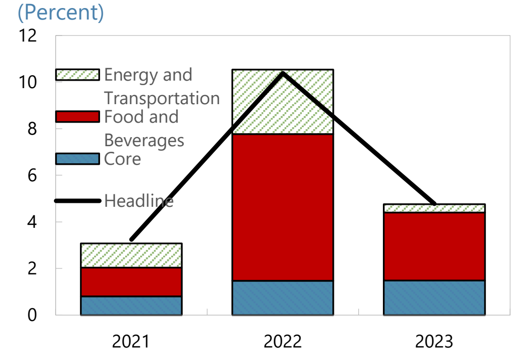
Projections for Real GDP: Pre-COVID, Pre-War in Ukraine, and Current
(Millions of chained 2016 euros)



Sources: Kosovo Agency of Statistics and IMF staff calculations.

7. After peaking in 2022, inflation is projected to decline to about 5 percent in 2023. The expected trajectory for inflation reflects the forecast baseline decline in international commodity prices. Still-moderate second round effects will drive core inflation gradually downwards to around 4 percent (y/y) by end-2023. The CAD is projected to narrow to 8 percent of GDP in 2023 as food and energy imports as a share of GDP decrease. GIRs are expected to remain broadly unchanged as percent of the IMF's reserve adequacy metric by end-2023 (Annex III).

Factors Contributing to Average Inflation
(Percent)



Sources: Haver Analytics and IMF staff calculations.

[2] Commodity prices refer to international food and energy prices.

8. Uncertainty remains exceptionally high, reflecting the war in Ukraine, with risks tilted to the downside for growth and to the upside for inflation (Annex I). Higher energy prices could lead to an inflation rebound and electricity rationing, negatively impacting growth. Weaker economic activity in Europe can negatively impact on diaspora-related flows. Lower growth and tighter financial conditions may also weigh on banks' asset quality and liquidity. On the upside, a faster PIP implementation can lead to stronger growth, as the baseline includes improved absorption rates, but not full implementation. In the medium term, foreign direct investment (FDI) could be higher if Kosovo benefits from European firms' "near shoring" efforts.

Authorities' Views

9. The authorities concurred with staff on factors shaping the outlook, but were confident that growth will be higher, and inflation lower in 2023. They agreed that the war in Ukraine poses significant challenges, including in the form of higher energy prices. They noted that diaspora inflows remained resilient in 2022, even after the large increase following mobility normalization in 2021. They acknowledged that public investment has proceeded more slowly than anticipated on account of higher project costs but emphasized that support to cushion the cost-of-living crisis has preserved private consumption. While they acknowledged that the war has heightened uncertainty, they expect activity to expand more briskly and inflation to normalize faster than forecast by staff. They agreed with staff on various downside risks, but they believe that good policies create additional upside risks, and so they see risks to be more balanced.

POLICY DISCUSSIONS: MITIGATING THE ENERGY PRICE SHOCK AND ADDRESSING LONG-STANDING GROWTH BOTTLENECKS

A. Fiscal Policy: Engineering a Soft Landing While Strengthening Spending Quality

10. The government appropriately cushioned the impact of the terms of trade shock on households and firms in 2022, though some measures could have been better targeted. A budget revision in April allocated 2.6 percent of GDP to wage and pension bonuses, social assistance top ups and energy and agriculture subsidies. In September, further transfers of 1.7 percent of GDP were announced.[3] While support to pensioners and for social assistance were well-targeted, transfers to workers and energy subsidies were not entirely directed to vulnerable households. In parallel, the implementation of the 4-year "Program of the Government of Kosovo" (PGK) announced in 2021 has proceeded more slowly than anticipated, in part because part of its envelope was redirected to provide social and other financial support. PGK measures to support employment

[3] The 2022 budget included contingent blanket allocations of 2 percent of GDP that were used to finance these measures. The rest was financed by revenue overperformance (1 percent of GDP) and PGK reallocations.

included a transfer to employers of up to 70 percent of their new employees' salaries (up to €300/month) for six months after hiring, with a cost of 0.1 percent of GDP.

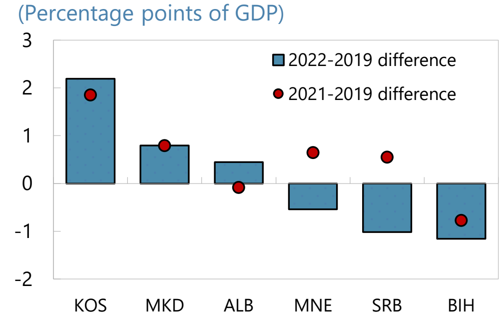
Measures to Mitigate the Impact of Higher Inflation in Kosovo
(Percent of GDP, 2022)

Energy Subsidies	**1.7**
To households (untargeted)	1.1
To incentivize demand compression by HHs	0.2
To firms operating in the sector	0.5
Agriculture Subsidies	**0.3**
To firms (Diesel, fertilizers)	0.2
To households	0.1
Transfers	**3.1**
Wage bonuses	0.9
Pension and Social assistance top-ups	1.6
compensation for higher project prices	0.6
Total	**5.2**
of which, in 2021	0.9
of which, in 2022	4.3

Source: Kosovar Authorities

11. Fiscal consolidation over 2021–22 has been the strongest among emerging European economies. While this has allowed to replenish government deposits and increase policy space to mitigate future shocks, a continuation of this consolidation pace risks a recession. The fiscal performance in 2022 reflected the following factors:

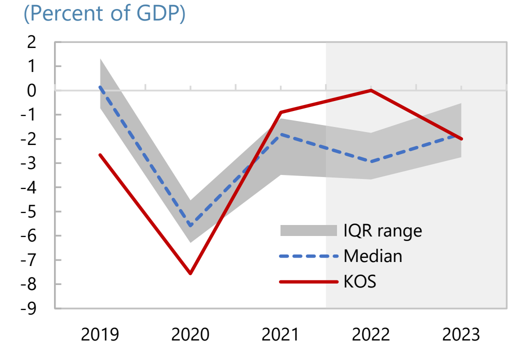
Changes in Taxes: 2019–22
(Percentage points of GDP)



Sources: World Economic Outlook, IMF and country statistics offices.

- **Budget revenues reached about 27.8 percent of GDP, similar to their level in 2021.** Tax revenues as a share of GDP increased by 0.2 pp of GDP from 2021. While VAT, personal (PIT), and corporate income taxes (CIT) jointly increased by 1.1 pp of GDP, excises and customs revenues jointly declined by 0.7 pp of GDP, given the impact of inflation on excises, and the continued implementation of FTAs with the European Union (EU) and Turkey. Non-tax revenues also declined by 0.5 pp of GDP, mainly on lower dividends from publicly-owned enterprises (POEs). Continued efforts to strengthen tax administration and progress in tackling informality contributed to revenue increases, as shown by the growth in registered workers and businesses and the progress in tax debt collection. Indeed, Kosovo has experienced the strongest tax revenue increase in the western Balkans over 2020–22 (by 2.2 pp of GDP compared to 2019).[4]

Emerging Europe: Primary Balance
(Percent of GDP)



Sources: World Economic Outlook and IMF staff calculations.

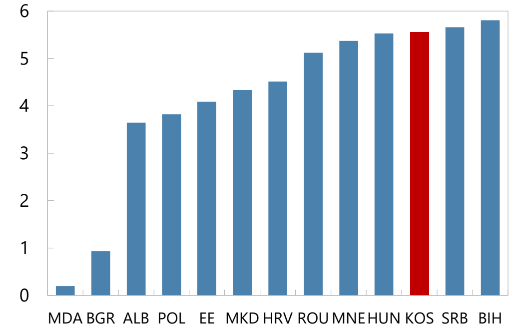
- **Primary spending declined to around 27.7 percent of GDP, around 1 pp of GDP below 2021.** This mainly reflected low PIP implementation (especially of externally-financed projects) and

[4] A selected issues paper analyzes the impact of formalization as a driver of the post-pandemic fiscal revenue gains in Kosovo.

compression of the wage bill pending implementation of the new law on public wages. Despite the latter, the share of current expenditures climbed to above 80 percent of primary spending (75 percent in 2019) due to increased subsidies and transfers, and higher prices of goods and services.

- **The deficit declined to 0.3 percent of GDP from 1.3 percent of GDP in 2021.** Gross financing needs were covered by rollover of maturing domestic debt, external project financing, and use of government deposits, which remain substantial (around 7 percent of GDP, including deposits of the Privatization Agency of Kosovo, PAK at end-2022). External budget support (from the World Bank and OPEC Fund jointly representing 1 percent of GDP) are awaiting approval by Parliament.

Fiscal Consolidation 2021–23
(Percentage points of GDP)



Sources: World Economic Outlook and IMF staff calculations.

12. The 2023 budget appropriately envisages a return to the fiscal rule deficit ceiling of 2 percent of GDP.[5] The implied deficit rise will provide a fiscal impulse of about 2 pp of GDP, helping the economy soft land. Significant downside risks to growth also justify the planned policy stance. The impact of the impulse on inflation will be moderate, as most of the deficit increase is projected to result from higher capital spending, which will ease supply bottlenecks, and because the impulse from diaspora-related flows is projected to subside. Strong government buffers, space for KPST to increase purchase of government securities, increased EU grants (of 0.9 percent of GDP), and expected IFI and bilateral budget support will cover gross financing needs. Public debt is assessed to be sustainable with the public debt-to-GDP ratio projected to remain below the legal ceiling of 40 percent of GDP throughout the forecast horizon (Annex II).[6]

13. Public spending should be better balanced between social transfers and promoting economic transformation and resilience, while ensuring talent retention in key areas. This will require improving the transparency, focus, and composition of public spending. Concretely:

- **The implementation of the new law regulating public wages needs to begin in 2023.**[7] The law increases compensation fairness and reduces arbitrariness and the number of allowances. While the law strives to result in talent retention in key areas like health and information technology, it may not provide enough incentives to retain talent in public service regulation and in justice

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[5] The fiscal rule was suspended over 2020–22 to provide room for pandemic-related expenditures. However, the fiscal deficit was higher than the 2 percent of GDP ceiling only in 2020. The fiscal deficit ceiling excludes investment financed by donors and privatization revenues.

[6] Gross government debt is projected to have declined to 19.2 percent of GDP in 2022, from 22.5 percent of GDP in 2020.

[7] The legal wage bill ceiling is calculated annually as the product between the previous year's wage bill and nominal GDP growth.

administration. While the implementation of the law will result in a warranted increase in nominal wages for most sectors (including health and education), the value of wage coefficients should be set so the wage bill does not breach its legal ceiling, and that private sector competitiveness is not negatively affected. Too high public sector wages may crowd out private sector jobs at a time in which private firms are experiencing labor shortages in some areas. The phased implementation of the law over 2023–24 will ease its absorption by the budget.[8]

- **Blanket allocations for contingencies as a form of risk management need to be accompanied by a description of their possible use.** The budget for 2023 includes an allocation for contingencies of 3.5 percent of GDP, out of which 2.7 percent of GDP is not allocated to any specific program.[9] While heightened uncertainty justifies building contingency buffers, large blanket allocations are usually opaque and increase policy discretion. The budget documents should broadly describe the intended use of these allocations by spelling out the government's vision about the risks shaping the outlook. This would increase transparency and the overall usefulness of the budgetary process.

- **New and existing programs to mitigate the impact of surging energy costs need to be temporary and targeted.** These measures should be intended to smooth the pass-through of higher energy prices, and thus, need to be temporary and well targeted at vulnerable households and viable firms. Given inelastic domestic electricity supply, this calls for energy savings through more frequent pass-through rates to tariffs (from one to at least two per year), with higher tariffs for peak-hour consumption of non-vulnerable clients. This would allow flattening of intra-day electricity demand and reduce the sector's financial imbalance during the winter. Load shedding as a form of shock management should be the last resort given its high social and economic costs. Careful planning and strengthened dialogue among the main sector stakeholders are essential at the current juncture, given that international energy prices are expected to remain above their pre-war levels for the foreseeable future.

- **The increase in the public investment envelope is welcome, but the challenge remains to increase absorption.** Recent efforts to lift implementation bottlenecks, including through paid land expropriations, restoring the operation of the Public Procurement Body (PBB), and compensating contractors for higher project costs through mid-2023 (on an invoice-by-invoice basis), may help speed up execution rates. Accelerating projects with high implementation rates, including through budget reallocations, can also help. Increasing allocations for health and education (which jointly represent 12 percent of the investment envelope of the central government), and in green energy remains essential, as gaps in social infrastructure and unreliable domestic electricity supply constrain potential growth. Consistent progress in the implementation of

[8] Staff projections assume that the law will be implemented starting in 2023:H2.

[9] The budgets for the last two years include blanket allocations for contingencies averaging around 2 percent of GDP.

the 2018 IMF's Public Investment Management Assessment's (PIMA) recommendations can help address remaining shortcomings in this area.[10] If PIP implementation remains low, budget allocations for investment should be saved.

14. Continued progress in strengthening tax administration and tackling informality is commendable. Efforts to foster formalization have increased the tax base and expanded fiscal space. Exploring revenue measures, such as gradually raising CIT and PIT rates closer to regional averages, rationalizing exemptions and special regimes, applying excises on coal, and reporting tax expenditures, would further increase fiscal space, strengthen tax policy quality, and increase transparency. Gradual implementation of these measures is also needed to compensate for the expected decline in customs revenues due to regional and bilateral free trade agreements.[11]

15. While the government's balance sheet strengthened over 2021–22, it may deteriorate quickly if downside risks materialize. Higher international energy prices and lower-than-forecast domestic electricity supply may result in additional financing needs of 2–4 percent of GDP in 2023, though the final cross-sectoral impact would depend on the pass-through to domestic electricity tariffs (Box 2 and text table).[12] The impact can be higher if higher energy costs are also accompanied by load shedding, given its negative impact on output and fiscal revenues. Social tensions could lead to low pass-through rates of international energy prices to electricity tariffs, and demands to further increase wages, transfers, and subsidies. This can put pressure on government deposits and lead to budget reallocations out of needed capital spending. Moreover, political polarization can further delay the approval by Parliament of budget support operations (of 1 percent of GDP). In this context, a risk management approach to policy is essential, along with scenario analysis to identify contingency plans.

Ex-Ante Impact of an Adverse Scenario for the Electricity Sector in 2023 1/

	Full pass-through	No pass-through
Additional Inflation (percent)	1.5 - 2	0
Private Consumption (percent) 2/	-2	0
Government Subsidies (percent of GDP) 3/	1.6	4.6
EBITDA (percent) 4/	-3	0

Source: IMF staff calculations.

1/ The scenario considers a 50 percent increase in imported electricity prices and a 10 percent decrease in coal-based generation compared with 2022; the full pass-through column assumes that electricity tariffs are adjusted fully; the no pass-through column assumes that tariffs are left unchanged.

2/ Expressed as percentage of household private consumption of 2022

3/ Expressed as percentage of 2022 GDP

4/ Expressed as percentage of 2022 estimated gross profits before taxes, interest, amortization and depreciation

[10] To improve public investment management (PIM), the authorities have (i) introduced two new administrative instructions (AIs) in 2019 on project selection and definition of capital expenditures; (ii) started to introduce an interface between KFMIS and e-procurement to record multiannual commitments and improve commitment controls; and (iii) introduced regular preparation and updating of quarterly cash plans.

[11] Revenue projections assume that formalization gains over 2021–22 are permanent.

[12] A selected issues paper analyzes the short and medium-term challenges and opportunities for Kosovo's electricity sector.

Authorities' Views

16. **The authorities concurred that a return to the fiscal rule deficit in 2023 is appropriate and on the need to accelerate public investment implementation.** They agreed that the moderate fiscal impulse will support activity, with minimum impact on inflation. They noted that various policy initiatives will help accelerate PIP implementation, which was adversely affected by, *inter alia*, rising project costs. They concurred with the need to begin implementation of the new wage law in 2023 and committed to set values for wage coefficients consistent with keeping the wage bill below its legal ceiling. They noted staff concerns on the large size of blanket allocations for contingencies but emphasized that they are an indispensable tool in the current context of heightened uncertainty. They agreed, however, on the need for the budget documents to explain the government's views on factors shaping the outlook, including downside risks. The authorities also agreed on the need to target subsidies on the most vulnerable and reiterated their commitment to do so. They concurred with staff that policies should strive to achieve a more efficient energy use and noted that the government is preparing a package of measures to this end, including with support from the EU. The authorities expressed satisfaction with progress to reduce informality and agreed that it has been a significant force behind revenue growth. They concurred that exploring new revenue sources is important and explained that they continue working on possible avenues. They noted that the commitment to fiscal prudence has increased fiscal space to respond to downside risks and agreed on the need to secure contingent financing, including from the IMF.

B. Financial Policies: Strengthening Risk Monitoring While Improving the Sector's Regulatory and Governance Frameworks

17. **After back-to-back shocks, the financial sector continues to exhibit significant resiliency.** After weathering the pandemic, the sector's performance in the face of tighter euro area financial conditions and the war-induced terms of trade shock has remained solid, despite pockets of vulnerabilities. In parallel, the Central Bank of Kosovo (CBK) has continued improving its policy toolkit.

Banking Sector FSI
(Percent)

	2019 Q3	2022 Q3
Regulatory Capital-to-Risk Weighted Assets	16.5	15.8
NPL-to-Total assets	2.1	2.0
ROA	2.3	2.5
ROE	18.6	19.6
Liquid Assets-to-Total Assets	28.7	26.1

Source: Central Bank of Kosovo.

- **Bank and microfinance institution profitability recovered in 2021–22 as economic activity rebounded to pre-pandemic levels.** The NPL ratio (2 percent in October 2022) was close to historical lows despite the expiration of pandemic-related regulatory relief measures in 2021.

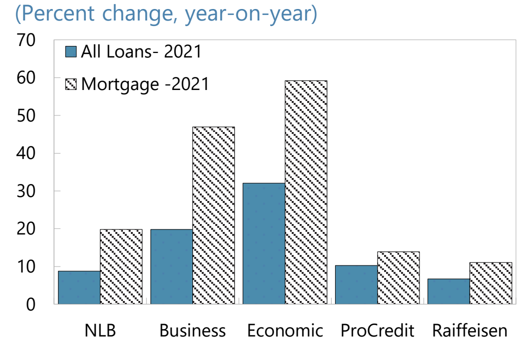
- **The performance of car insurance companies improved after increases in regulated premium rates and better control of operational expenses.** The sector's capital adequacy also improved after shareholders of a few insurers injected new capital following CBK supervisory action.

- **The CBK's ability to provide liquidity has strengthened and its financial position improved.** The CBK introduced intraday and overnight lending facilities during the pandemic and has tested operation of the 10-day repo facility. Rising euro area interest rates will increase the CBK's net interest income on foreign reserves and strengthen its financial position.

18. As growth decelerates and financial conditions tighten, the CBK should further strengthen monitoring of bank credit and liquidity and stand ready to take supervisory action. The main risks facing the sector include a weaker economic outlook, higher energy prices and electricity shortages, and reduced diaspora inflows, which would dampen deposit growth, tighten liquidity conditions, reduce firm earnings and private demand, and weigh on bank asset quality.

- **Improved monitoring of the residential housing sector is a priority.** Construction and real estate activities represent 80 and 19 percent of FDI and GDP, respectively. Data for Pristina suggests that construction permits (in square meters) increased about 35 percent in 2021, relative to 2019. Mortgage lending increased at double digit rates in 2021, and the pre-sale of units to finance housing construction has continued. However, risks arising from the weakening growth outlook appear not to have been reflected in bank asset quality. Strengthening housing sector surveillance, including through collecting price and leverage information from bank mortgage loan data, and by requesting banks to provide information on personal loans used for housing would allow for a better monitoring of sectoral exposures.

Total and Mortgage Loan Growth in 2021
(Percent change, year-on-year)



Sources: Published financial statements and IMF staff calculations.

- **Although banks have broadly become more forward-looking in assessing credit risks in line with IFRS-9 implementation, bank-by-bank capacity to do so varies greatly.** The CBK should consider these differences when evaluating bank credit quality assessments. Given the shifting macroeconomic environment, the CBK will need to pay particular attention to bank models and assumptions for credit, liquidity, and interest risks and stand ready to take supervisory action when warranted.

19. Continued implementation of the 2019 Financial Sector Stability Review (FSSR) and of the 2021 Safeguard Assessments (SA) recommendations remains essential. Restoring the functioning of the CBK Board, developing a strategy for consumer protection and financial literacy, implementing the risk-based supervision manual for the insurance sector, and adjusting car insurance premiums are all steps in the right direction. However, progress on other FSSR

recommendations has been limited (Annex IV). For instance, passing the draft banking law would provide the CBK more legal power in resolution and recovery, on consumer protection, and on supervision of branches of foreign banks. Though most SA recommendations have been implemented, further work is required to strengthen reserve and risk management and the internal audit function.

20. An independent, accountable, and fully functional central bank is critical for financial system stability. The process to appoint a new governor (with a 5-year tenure from March 2023) should focus on competency as the single most important factor for selection. Filling a deputy governor vacancy at the shortest delay is also important. Strengthening the CBK's organizational chart and clarifying the roles and responsibilities of the Board and Executive Board is essential going forward. Preserving the CBK financial autonomy is important for its effective independence. In this regard, CBK profits should be reserved, including to cover CBK costs during periods of low international interest rates, and increase the CBK's capacity to provide liquidity assistance.[13]

Authorities' Views

21. The authorities stressed the positive role that sound policies have played in keeping the financial sector resilient and committed to further strengthen the sector's regulatory and governance frameworks. They concurred that the main risks for the sector include weaker economic activity and diaspora inflows in real terms, higher energy prices, and electricity shortages. They agreed that heightened uncertainty justifies redoubling monitoring of bank models and assumptions to ensure that credit quality is appropriately reported. They noted that an amendment to credit registry regulation, which would improve the consistency of credit history data, is under preparation. They concurred on the need to collect housing market data to improve monitoring of this sector. They also agreed that CBK profits should be reserved to increase CBK's capacity to provide liquidity assistance. Finally, the authorities reiterated their commitment to continue implementing FSSR and SA recommendations.

C. Structural Policies: Closing Infrastructure and Governance Gaps to Foster New Growth Engines

22. Revitalizing the reform program calls for strengthening coordination within all levels of government and with the donor community. While progress in the implementation of structural reforms is needed in several areas, addressing infrastructure and governance gaps with respect to the EU remains essential, as they severely limit the emergence of new growth engines.[14]

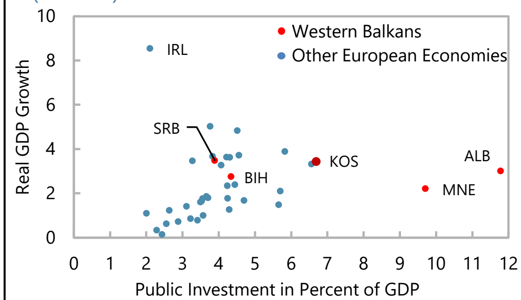
[13] A selected issues paper analyzes the impact of global interest rate cycles on the financial strength of the CBK and other central banks in the western Balkans.

[14] Illustrative estimates suggest that closing 50 percent of the current infrastructure gaps relative to the EU15 by 2030 could cost between 8.5 percent and 10 percent of GDP annually; see Anil et al. (2020) "Infrastructure in Central, Eastern, and Southeastern Europe: Benchmarking, Macroeconomic Impact, and Policy Issues", IMF Departmental Paper. A main objective of the government is to develop a national policy with clear principles and criteria for attracting investment.

These gaps leave Kosovo excessively reliant on diaspora-related flows, limiting income per capita convergence, and contributing to emigration.

23. Closing infrastructure gaps requires decisive action to improve public investment management (PIM). Many projects in the PIP do not undergo proper appraisal and selection. Implementation of both domestic and externally financed projects is delayed due to inadequate planning, land disputes due to incomplete specification of cadastral lines, litigation, capacity problems of the contracted private companies, unrealistic budget allocations, and ineffective and inefficient publicly owned enterprises. Project oversight is weak, impeding corrective action when needed. These issues also signal governance problems to potential investors, constraining FDI. Advancing implementation of the 2018 PIMA recommendations, including better alignment of national strategy documents with the budget, better planning, selection, analysis and oversight of projects, improved compliance of implementing units to rules and regulations, and a strengthened gatekeeper role for the Ministry of Finance would help address these shortcomings.

Public Investment and Real GDP Growth (2017–21)
(Percent)



Sources: Haver Analytics, IMF WEO and IMF staff calculations.

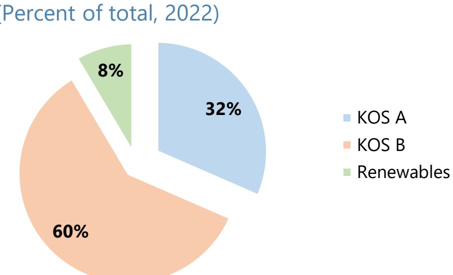
Kosovo's Infrastructure Gaps
(Percent of EU15 average)

Sectors	Kosovo	CESEE	EU 15 average
Transportation			
Roads density gap			
per 1000km2 of total land	-89.6	-27.8	1871 km per 1000 sq km area
per 1000km2 arable land	-91.6	-44.6	9469 km per 1000 sq km arable land
per 1000 people	-91.9	-12.4	13.9 km per 1000 people
ICT			
Fixed phone line subscription gap	-84.9	-43.2	382 per 1000 people
Mobile phone line subscription gap	-74.6	-1.5	1201 per 1000 people
Energy			
Electricity generation capacity gap	-61.7	-45.6	2323 MW per 1 million people
Health			
Number of hospital beds	-35.6	26.1	415 per 100.000 people

Source: Ari, A. et al., 2020, "Infrastructure in Central, Eastern, and Southeastern Europe: Benchmarking, Macroeconomic Impact, and Policy Issues," IMF Departmental Paper.

24. Boosting green energy generation capacity will both increase energy security and decrease Kosovo's emissions. Coal-based electricity generation results in CO_2 emissions per unit of output that are four times the EU average, with negative environmental and health spillovers. The EU's carbon border adjustment mechanism (CBAM) will require EU importers from 2026 to purchase carbon certificates, limiting Kosovo's attractiveness as an FDI destination. Creating a fund for renewal and expansion of domestic electricity capacity in green technologies, financed for instance, by the seasonal electricity export revenues during the summer and by donors, could provide the seed capital needed to start renewal of Kosovo's energy matrix. Reducing the electricity sector's financial

Electricity Generation by Source in Kosovo
(Percent of total, 2022)



Sources: Kosovo authorities and IMF staff calculations.
Note: KOS A and KOS B refer to state-owned coal-based generation plants ("Kosova A and B").

vulnerability is also paramount. This requires tackling non-technical losses through stronger penalization of theft, while continuing to seek options to implement the Brussels' agreement energy protocols. A gradual implementation of carbon pricing would strengthen price signals, promote a more efficient use of energy, and reduce carbon intensity.

25. Despite concrete progress, governance, and transparency gaps with the rest of Europe remain significant. The implementation of the e-procurement system to 100 percent of public contracts, the appointment of new commercial courts judges, the amendment of the law of the Prosecutorial Council, and the new draft laws on the State and Special Prosecutor's Offices are decisive steps forward to increase transparency, improve governance and strengthen trust in economic relations. The publication of audit reports on pandemic-related spending, and of updated money laundering typologies are also steps in the right direction.[15] While progress in these areas is commendable, the European Union continues to place Kosovo "at an early stage" in developing a well-functioning judicial system and in the fight against corruption. In this regard, hiring additional commercial court judges will help reduce the case backlog, increase economic security, and reduce informality. Establishing the beneficial ownership registry will further strengthen transparency and tackle conflicts of interest in public procurement. Closing AML/CFT gaps in line with FATF standards and building prosecution and law enforcement capacity to handle money laundering and conduct financial investigations, are also essential. The law on targeted international financial sanctions should also be implemented. A strong implementation of the EU's Stabilization and Association Agreement will speed institutional and regulatory convergence, contributing to unlocking FDI flows.[16]

26. Early withdrawals from KPST will undermine the pension system, create contingent fiscal liabilities, and compromise domestic financial market development. Early withdrawals would reduce KPST's assets and force their conversion into more liquid assets with lower expected returns. They will also adversely affect the state's financing capacity at a time where downside risks may lead to larger fiscal financing needs. Lower pension savings will lead to medium-term fiscal pressures to increase budget-financed basic pension or other benefits, with less resources for education, health, and infrastructure.

Authorities' Views

27. The authorities highlighted advances to strengthen infrastructure and governance but concurred that further progress will make Kosovo more attractive for investors. The authorities reiterated their commitment to continue improving PIM with progress gradually helping close infrastructure gaps. On energy, they concurred on the urgency to increase green electricity generation to promote energy security and reduce GHG emissions. They clarified that they are

[15] To tackle corruption, a set of new anti-corruption laws were adopted in 2022, which aim at strengthening criminal proceedings, the mandate of the Agency for Prevision of Corruption, and the system of asset declaration. Implementing regulations will need to ensure a fair, transparent and accountable use of these laws.

[16] Kosovo formally applied for EU membership in mid-December 2022.

finalizing a coherent and comprehensive energy strategy with a clear and time-bound action plan, and that in this context, are considering tapping IMF's Resilience and Sustainability Trust financing. On governance, the authorities agreed that commercial courts will need to reduce the backlog and concurred with the positive impact this would have on formalization. On AML/CFT measures, they agreed on the importance of continued work on legislation, including the implementation of targeted international financial sanctions and the beneficial ownership registry. In this regard, they also noted that they will start reassessing high-risk sectors such as real estate and NGOs. Finally, the authorities reiterated their commitment to preserve KPST's integrity by avoiding new early withdrawals.

STAFF APPRAISAL

28. Fallout from the war in Ukraine is weighing on activity and has pushed inflation up. GDP growth slowed to 2–3 percent in 2022 due to the war-related terms of trade shock, decreasing gains from mobility normalization, a negative fiscal impulse, and tighter financial conditions. Higher energy and food prices pushed inflation to 11–12 percent, but second round effects have been moderate.

29. Activity is expected to moderately recover to 3.5 percent in 2023, and inflation to decline to about 5 percent, but these forecasts crucially depend on international commodity prices. The recovery is also predicated on a fiscal impulse of around 2 pp of GDP which will offset slightly lower diaspora inflows, and continued bank credit growth. Uncertainty around this baseline remains very high, with risks tilted to the downside for growth and to the upside for inflation.

30. The government appropriately cushioned the impact of the terms of trade shock on households and firms in 2022, but measures could have been better targeted. While support to pensioners and for social assistance was well-targeted, transfers to workers and energy subsidies were not entirely directed to vulnerable households.

31. Kosovo's pace of fiscal consolidation over 2021–22 was the strongest among emerging European economies. This was predicated on solid revenue performance, partly due to increased formalization, fiscal prudence, but also on a disappointingly low PIP implementation rate. Continuation of this consolidation pace would risk a recession. On the positive side, fiscal buffers have been replenished, increasing the government's capacity to respond if downside risks materialized.

32. The budget for 2023 appropriately envisages a return to the fiscal rule deficit ceiling. The implied deficit rise will provide a fiscal impulse of about 2 pp of GDP, helping the economy soft land, with only a moderate impact on inflation. Significant downside risks to growth also justify the planned policy stance. Strong government deposits and space for KPST to increase its holdings of government securities provide sufficient financing to cover baseline needs. Public debt is projected to remain below the legal ceiling of 40 percent of GDP throughout the 5-year projection horizon.

33. Public spending needs to be better balanced between social transfers and promoting economic transformation and resilience. The phased implementation of the law regulating public wages should begin in 2023 to ensure talent retention, but keeping the wage bill within its legal ceiling. While heightened uncertainty justifies contingency budgetary buffers, the budget documents should spell out the risks shaping the outlook. New and existing support to mitigate the impact of higher energy prices should be temporary, well targeted and encourage efficient energy use. Fiscal support should only be used to smooth the pass-through of higher electricity prices to vulnerable households and viable firms. While the increase in the public investment envelope is welcome, implementing the IMF's PIMA recommendations is essential to improve absorption and address PIM shortcomings. If PIP implementation remains low, investment budget allocations should be saved.

34. The government's balance sheet can deteriorate quickly if downside risks materialize. Higher energy prices and lower domestic electricity supply may result in lower activity and revenues, and in additional fiscal financing needs. Social tensions might lead to further wage increases, transfers, and subsidies. Political polarization may delay the approval of budget support. In this context, a risk management approach to policy is essential, including through securing additional contingent financing. Exploring revenue measures, such as gradually raising CIT and PIT rates closer to regional averages, and rationalizing exemptions, would further increase fiscal space.

35. The CBK should further strengthen the monitoring of banks' asset quality and liquidity. While the financial sector has remained resilient overall through back-to-back shocks, the shifting macroeconomic outlook calls to further strengthening credit risk monitoring taking into consideration bank-by-bank idiosyncratic risks and capacities. Also, the surveillance of the housing market needs improving, including through compiling housing market statistics utilizing bank loan data.

36. Implementing FSSR and SA recommendations is important to strengthen the financial sector's regulatory and governance frameworks. Finalizing the draft banking law would strengthen the bank resolution and recovery, and supervision frameworks. Clarifying the roles and responsibilities of the Board and the Executive Board is essential for the central bank to smoothly perform its mandate. CBK profits should be reserved to strengthen its equity position and its capacity to provide liquidity assistance.

37. Addressing infrastructure and governance gaps remains essential to support new growth engines. Revitalizing the reform program calls to further strengthen coordination within all levels of government and with the donor community. Closing infrastructure gaps requires decisive action to improve PIM. Boosting green energy generation capacity will both increase energy security and decrease emissions. Closing governance and transparency gaps and further reducing corruption requires strenghtening the judiciary and prosecution, improving transparency, tackling conflicts of interest in public procurement, and closing AML/CFT gaps. Early withdrawals from KPST should be avoided.

38. The next Article IV consultation is expected to be conducted on the standard 12-month cycle.

Box 1. Understanding the Recent Surge in Kosovo's Inflation

The increase in Kosovo's inflation mainly reflects the impact of higher international food and energy prices, especially after the start of the war in Ukraine. Kosovo is a net importer of food and energy, and as such, the pass-through rates of changes in the prices of these commodities is relatively high.

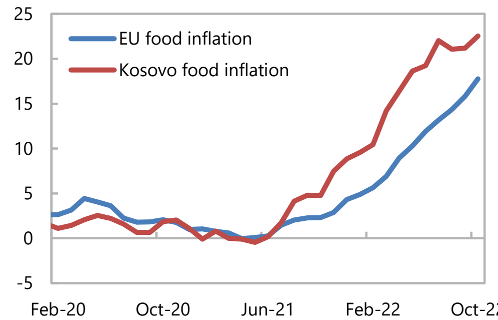
- ***Food and energy prices contributed 65 and 20 percent of the increase in inflation, respectively.*** The share of food in Kosovo's CPI basket is 46 percent compared to 22 percent in the EU, and it is larger than the total share of food and energy in the EU's CPI basket (39 percent). On energy, the increase in oil prices and derivatives played the largest role, as the increase in electricity tariffs in early 2022 only partially reflected the increase in European electricity prices and also because the use of natural gas in Kosovo is negligible.

- ***Second round effects have remained moderate.*** Core inflation increased by 2–2.5 pp, from 2 percent in 2021, partly because nominal wage growth has lagged inflation, especially for females. Accordingly, higher commodity prices are behind most of the inflation increase, with domestic factors playing a smaller role.

- **Empirical analysis suggests that international food prices play a large role in explaining inflation.** An augmented Phillips curve model relating inflation to its past and expected future values, economic slack, and foreign price developments suggest that 1 pp increase in international food prices leads to around 0.1 pp increase in headline and around 0.05 pp increase in core inflation. The model, however, does not suggest a strong correlation between increases in oil and natural gas prices and inflation, probably reflecting past price caps, excise tax changes, and profit margin limits.

Food Inflation

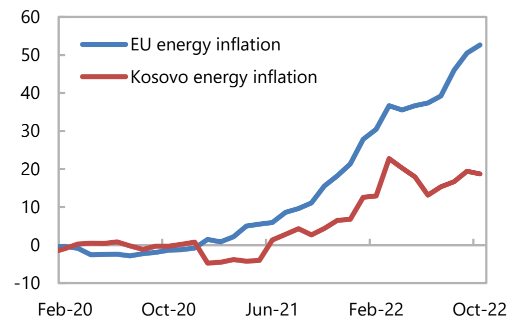
(Percent, year-on-year)



Sources: Haver Analytics and IMF staff calculations.

Energy, Gas and Other Fuels Inflation

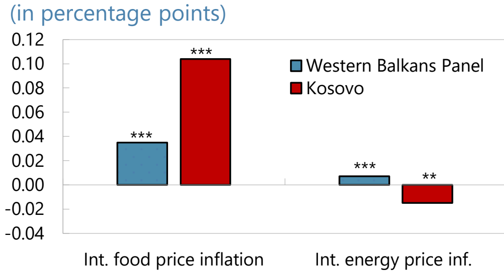
(Percent, year-on-year)



Sources: Haver Analytics and IMF staff calculations.

Impact of 1pp Increase of Commodity Prices on Inflation

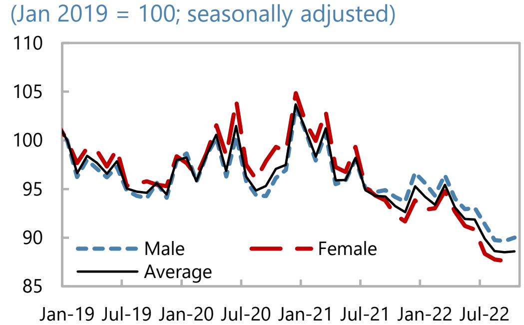
(in percentage points)



Sources: IMF staff calculations and Minasyan et al, forthcoming, "Inflation Dynamics in Western Balkans," IMF Working Paper.

Real Wage Comparison by Gender

(Jan 2019 = 100; seasonally adjusted)

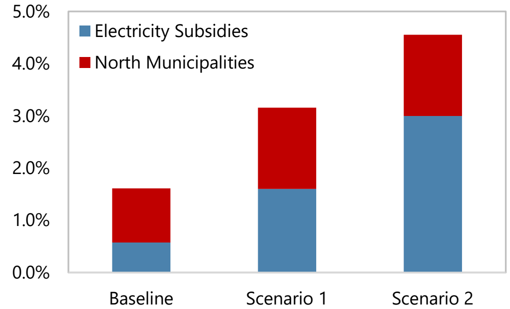


Sources: KPST and IMF staff calculations.

Box 2. Fiscal Impact of Energy-Related Downside Risks

Higher European electricity prices and lower domestic electricity supply may stress Kosovo's energy sector, economic activity, and the budget. To estimate this stress, a baseline scenario assumes that foreign electricity prices and domestic electricity supply and demand remain unchanged at 2022 levels. The fiscal cost of keeping electricity tariffs constant in the baseline would be about 1.5 percent of GDP in 2023. To evaluate the sensitivity of these results to different variables, the following scenarios are considered:

Fiscal Cost of Electricity Sector in Kosovo
(Alternative Scenarios, percent of GDP)



Sources: Kosovar Authorities and IMF staff calculations.

- Scenario 1 assumes a 50 percent increase in the external price of electricity in 2023. This would increase the fiscal cost to about 3 percent of GDP.
- Scenario 2 adds a 10 percent decrease in coal-based domestic electricity production to Scenario 1. In this case the fiscal cost would climb to 4.5 percent of GDP in 2023.

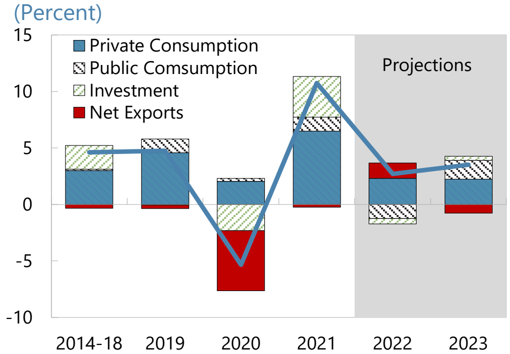
If energy downside risks materialize, the cost of electricity imports will likely be covered by a mix of subsidies and demand compression. Higher foreign electricity prices will likely lead once again to liquidity choke points and load shedding. Higher pass-through rates to domestic tariffs may contribute to demand compression, but would also increase inflation, impact consumption and firms' profits, and negatively affect activity.

The government's balance sheet may deteriorate quickly if energy and other downside risks materialize. The government could further tap domestic debt markets for 1–2 percent of GDP more than projected and use deposits for an additional 2 percent of GDP, but this would limit fiscal space for 2024. The government could use already approved external budget support of 0.5 percent of GDP. The latter would partially offset lower external budget support (of 1 percent of GDP) if their approval by Parliament was further delayed. A risk management approach to policy is essential, along with scenario analysis to identify contingency plans, including additional financing.

Figure 1. Kosovo: Real Sector Developments

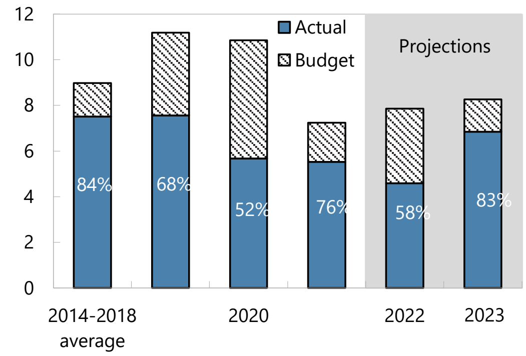
The terms of trade shock in 2022 is weighing on private demand and has weakened growth…

Contributions to Real Growth
(Percent)



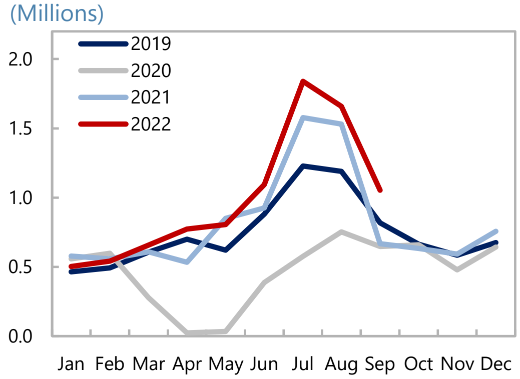
…and higher project costs led to a low implementation of the public investment program.

Government Capital Expenditure
(Percent of GDP)



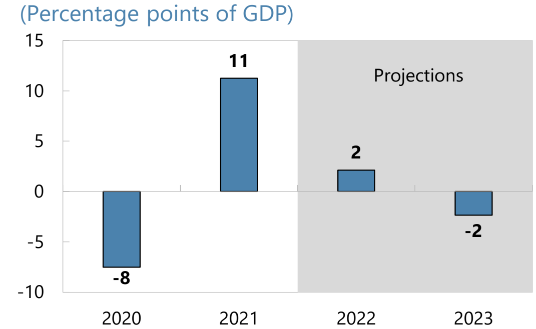
Diaspora flows have remained resilient…

Number of Passenger Arrivals
(Millions)



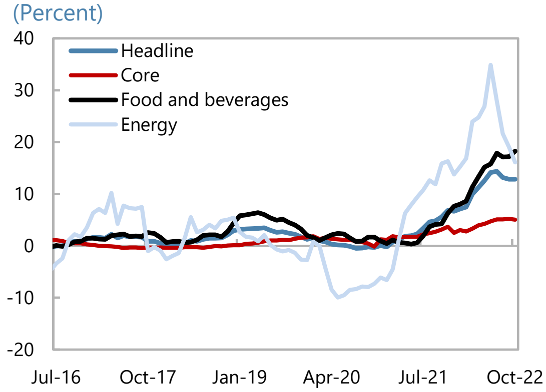
…but their contribution to growth will be weaker over 2022–23.

Change in Diaspora Support via Travel, Remittances and FDI
(Percentage points of GDP)



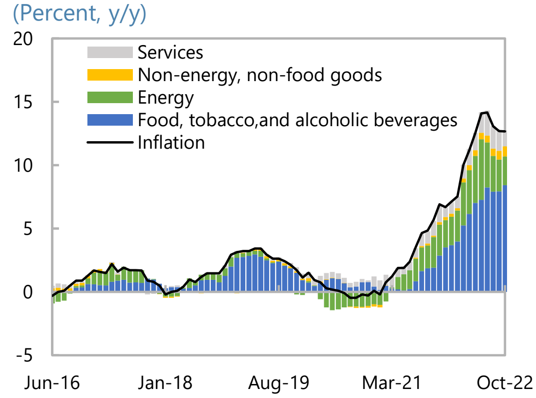
Inflation increased on the back of higher energy and food prices in 2022…

Inflation
(Percent)



…but core inflation, though higher, has remained moderate.

Inflation Decomposition
(Percent, y/y)

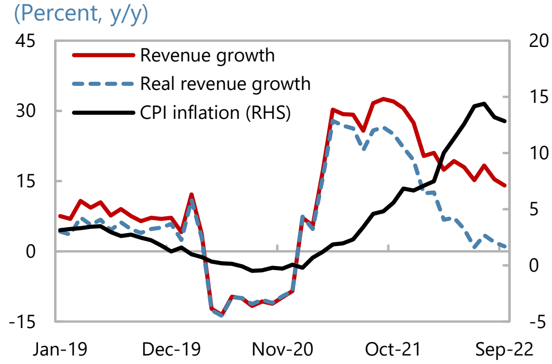


Sources: Haver Analytics, Ministry of Finance Labor and Transfers, Kosovo Agency of Statistics, Central Bank of Kosovo, *World Economic Outlook*, and IMF staff estimates.

Figure 2. Kosovo: Fiscal Developments

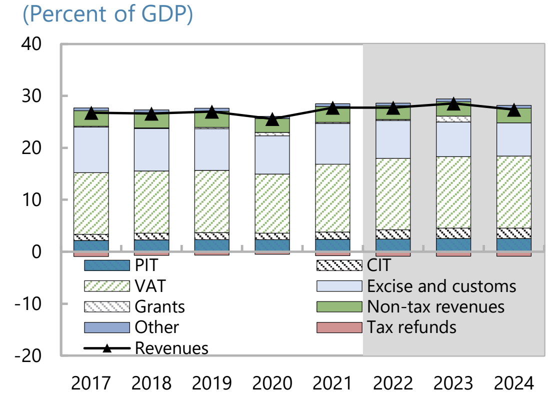
Real revenue growth surprised on the upside in 2021 and early 2022 but has recently weakened…

Revenue Growth
(Percent, y/y)



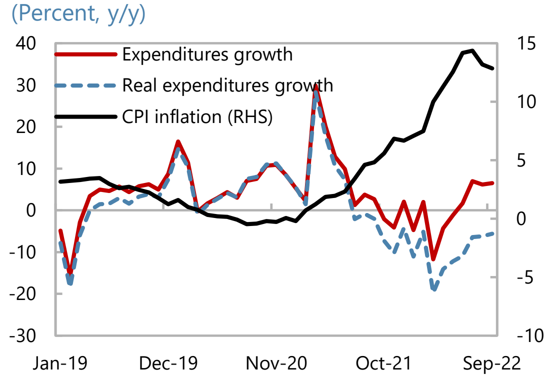
…with solid revenue-to-GDP ratios reflecting formalization efforts on VAT, CIT, and PIT collection.

Revenue Composition
(Percent of GDP)



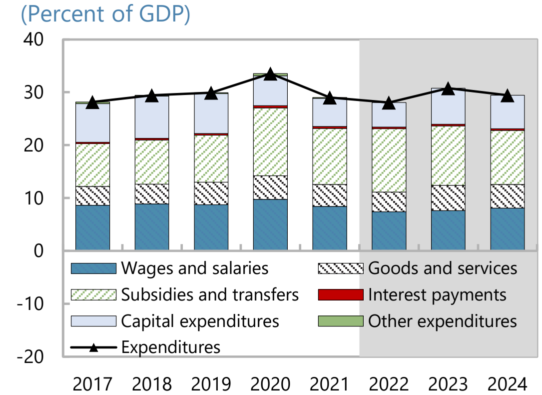
Expenditure growth has been weak in 2022…

Expenditure Growth
(Percent, y/y)



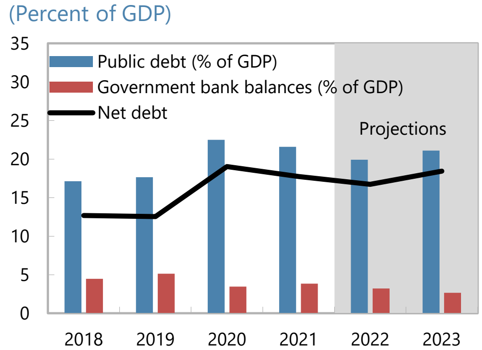
…mainly due to lower-than-budgeted capital spending and real wage bill compression.

Expenditure Composition
(Percent of GDP)



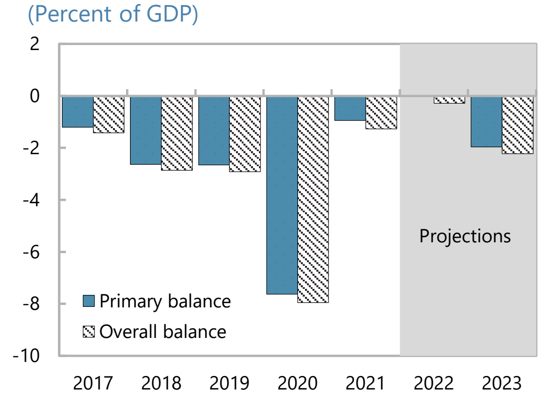
The government's balance sheet strengthened over 2021–22…

Public Debt and Government Bank Balance
(Percent of GDP)



…with fiscal space allowing a moderate fiscal impulse in 2023.

Fiscal Balance
(Percent of GDP)

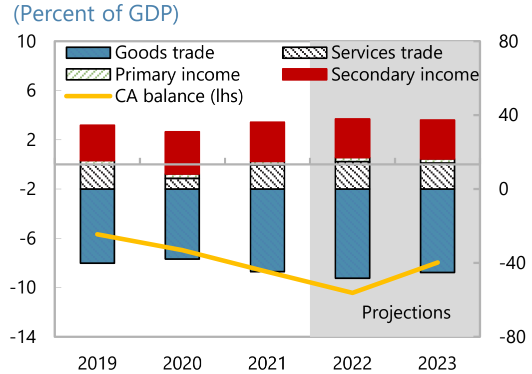


Sources: Ministry of Finance, Labor, and Transfers, Central Bank of Kosovo, and IMF staff calculations.

Figure 3. Kosovo: External Sector Developments

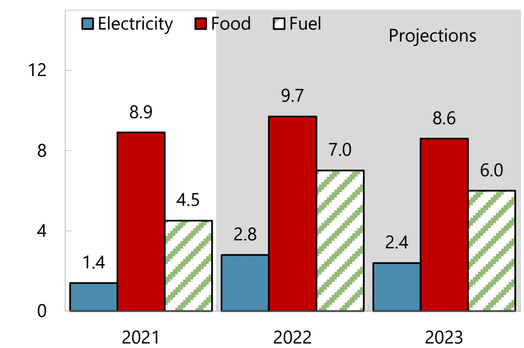
The current account and trade deficits widened in 2022,

Contribution to the Current Account
(Percent of GDP)



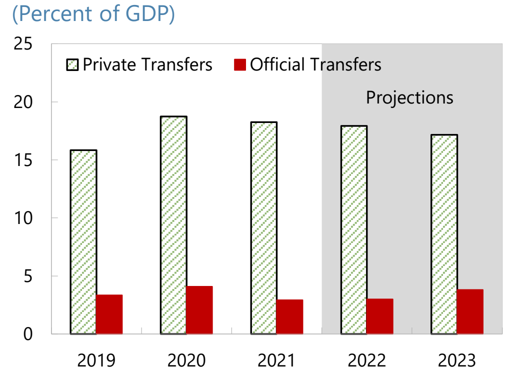
...due to the impact of higher food and energy prices on the import bill...

Imports of Goods
(Percent of GDP)



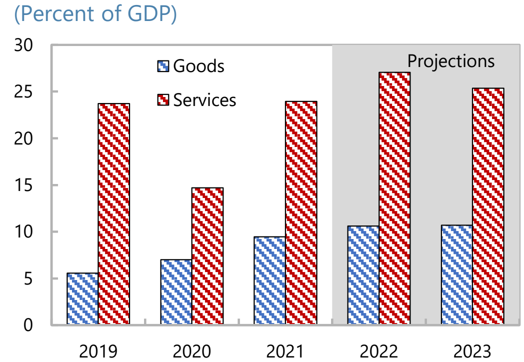
...and weaker remittance growth...

Secondary Income Transfers
(Percent of GDP)



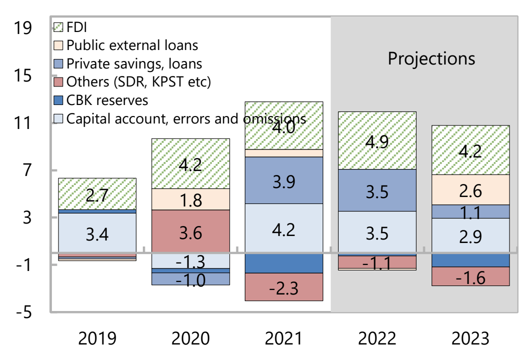
...that more than offset the rise of exports of goods and services.

Exports of Goods and Services
(Percent of GDP)



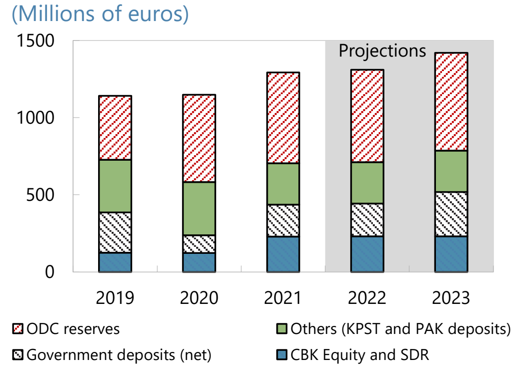
The wider current account deficit will be mainly financed by FDI, informal remittances, and private savings.

Financing of Current Account
(Percent of GDP)



International reserves remained flat in 2022 and will continue to be broadly adequate in 2023.

CBK Reserve Assets: Sources of Funding 1/
(Millions of euros)



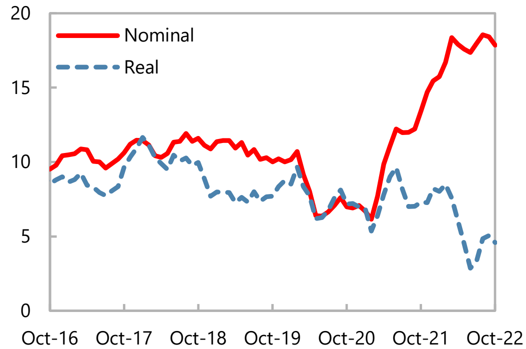
Sources: Haver Analytics, Kosovo Agency of Statistics, Ministry of Finance, Labor and Transfers, Pristina International Airport, *World Economic Outlook*. and IMF staff estimates.

1/ Government deposits are net of CBK's holdings of government securities. Other deposits mainly include deposits of KPST and PAK.

Figure 4. Kosovo: Financial Sector Developments

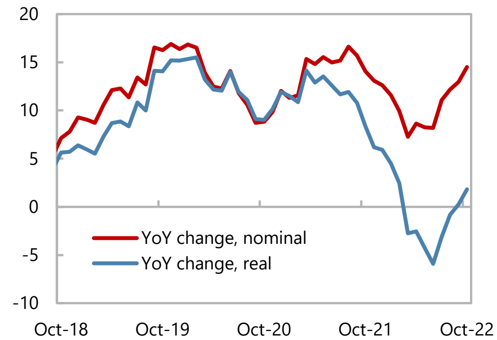
Real credit growth to the private sector decelerated significantly in 2022…

Private Sector Credit Growth
(Percent change, year-on-year)



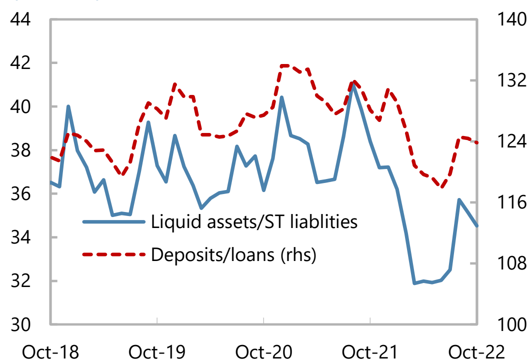
…and while highly seasonal reflecting diaspora inflows, deposit growth also declined in real terms.

Bank's Deposits
(Percent)



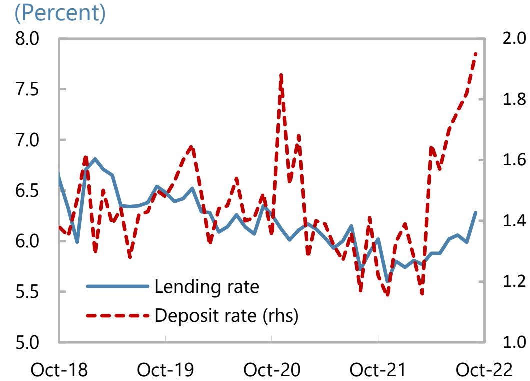
Accordingly, liquidity conditions have tightened…

Liquidity
(Percent)



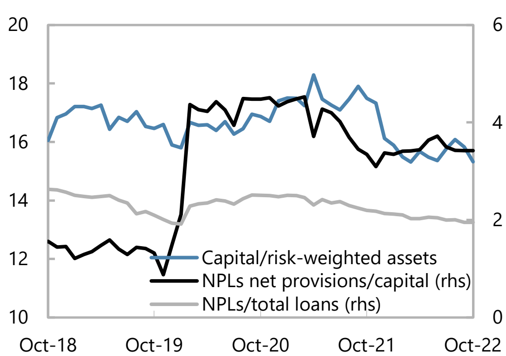
…and interest rates began increasing also reflecting tighter financial conditions in the euro area.

Lending and Deposit Rates
(Percent)



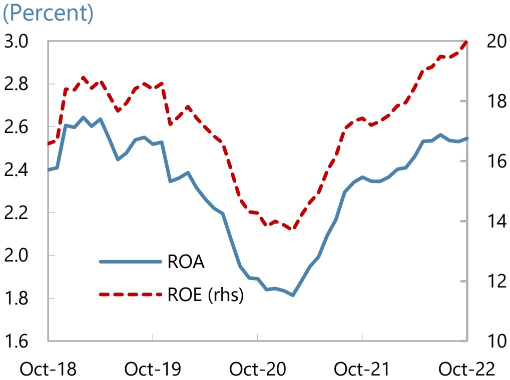
NPLs remain low and capital buffers remained adequate despite banks resuming profit distribution…

Asset Quality and Capital Adequacy
(Percent)



…as profitability recovered to pre-pandemic levels in 2022.

Profitability
(Percent)



Sources: Central Bank of Kosovo and IMF staff estimates.

Table 1. Kosovo: Selected Economic Indicators, 2019–27

(Percent, unless otherwise indicated)

	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	...	...	...	...	...
Memorandum items:									
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 contigent debt of former Yugoslavia. Beginning in 2020, it includes Euro 120 million of debt with KPST.

3/ Total foreign assistance excluding capital transfers.

Table 2. Kosovo: Consolidated Government Budget, 2019–27[1]

(Including donor designated grants and PAK operations; millions of euros)

	2019	2020	2021	2022		2023		2024	2025	2026	2027
	Act.	Act.	Act.	2022 Revised Budget	Proj.	2023 Draft Budget	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue and grants	**1,905**	**1,736**	**2,209**	**2,430**	**2,479**	**2,884**	**2,804**	**2,883**	**3,057**	**3,225**	**3,378**
Revenue	1,885	1,693	2,192	2,408	2,457	2,787	2,695	2,883	3,057	3,225	3,378
Taxes	1,662	1,507	1,948	2,169	2,214	2,525	2,414	2,577	2,730	2,882	3,016
Direct taxes	292	267	342	393	418	505	488	528	563	595	627
of which: Personal income tax	166	158	190	213	218	263	251	272	289	306	323
of which: Corporate income tax	95	85	114	136	162	193	194	211	225	238	250
of which: Property tax	27	23	36	41	36	45	40	43	45	48	51
Other	5	1	2	3	3	4	3	3	3	4	4
Indirect taxes	1,415	1,273	1,665	1,838	1,873	2,097	2,012	2,139	2,264	2,389	2,496
VAT	846	770	1,038	1,176	1,228	1,387	1,350	1,459	1,553	1,644	1,732
Excise	435	398	501	525	512	571	530	556	594	634	668
Customs	130	102	125	134	133	139	127	121	112	108	92
Other	4	3	1	3	0	1	4	4	4	4	4
Tax refunds	-46	-33	-59	-62	-77	-76	-86	-91	-96	-102	-108
Nontax revenues	217	183	238	239	236	261	273	297	316	334	352
Other revenue	7	3	7	...	7	...	8	9	10	10	10
Grants	19	43	17	23	23	98	110	0	0	0	0
Budget support	12	34	0	11	11	86	98	0	0	0	0
Project grants (DDGs)	8	9	17	12	12	12	12	0	0	0	0
Expenditure	**2,111**	**2,270**	**2,311**	**2,898**	**2,504**	**3,212**	**3,023**	**3,107**	**3,283**	**3,475**	**3,666**
Current expenditure	1,578	1,886	1,887	2,141	2,093	2,342	2,351	2,438	2,570	2,729	2,875
Wages and salaries	617	661	668	671	660	746	746	854	909	961	1,013
Goods and services	298	302	332	404	336	493	471	474	505	534	563
Subsidies and transfers	628	868	843	1,045	1,069	1,098	1,103	1,075	1,120	1,190	1,250
Current reserves	0	0	0	21	0	5	0	0	0	0	0
DDGs and other expenditure	5	0	0	12	0	12	0	0	0	0	0
Interest payments	23	27	31	41	28	47	31	35	36	43	49
Interest - internal	11	17	21	...	14	...	17	18	18	22	26
of which: on external debt	12	10	10	...	14	...	14	17	19	21	23
Other net PAK expenditure	6	24	13	...	0	...	0	0	0	0	0
Capital expenditure	534	384	424	704	411	811	672	670	713	746	791
Budget-financed	366	270	386	570	381	681	540	580	620	650	690
PAK-financed	132	54	0	21	0	0	0	0	0	0	0
External	36	60	38	194	31	200	132	90	93	96	101
Non-Investment Clause	21	31	15	80	1	71	20	5	3	1	1
of which: "Investment Clause"	13	26	13	113	30	129	112	84	90	95	100
Fiscal balances											
Primary balance	-188	-512	-75	-429	-1	-284	-192	-192	-192	-208	-242
Interest income, net	-19	-26	-32	-38	-36	-43	-41	-45	-48	-48	-47
Overall balance	**-207**	**-534**	**-101**	**-467**	**-25**	**-328**	**-219**	**-224**	**-226**	**-250**	**-288**
"Fiscal rule" deductions from the overall balance	151	128	20	134	30	129	112	84	90	95	101
Overall balance ('Fiscal rule" definition) 2/	**-55**	**-447**	**-82**	**-332**	**5**	**-197**	**-107**	**-140**	**-137**	**-155**	**-188**
Overall cyclically adjusted balance	-255	-430	-104	...	-32	...	-311	-213	-222	-250	-288
Statistical discrepancy	1	1	1	...	0	...	0	-1	-1	-1	-1
Financing	**205**	**533**	**100**	**467**	**25**	**326**	**219**	**225**	**227**	**251**	**289**
Foreign financing (net)	-10	127	44	360	-15	368	251	67	58	57	35
Budget Support	0	156	79	230	0	223	138	0	0	0	0
External Financing for Projects	39	59	44	194	35	200	153	108	110	113	117
Amortization of external debt	-50	-89	-79	-63	-50	-55	-39	-41	-52	-56	-82
Domestic financing (net)	216	406	56	57	40	56	-32	158	169	193	254
Net Domestic debt issuance	115	170	145	71	9	68	58	126	134	141	149
Change in CBK deposits	43	211	-100	-47	15	-98	-90	31	35	52	104
PAK Deposits	113	84	7	0	5	0	5	5	5	5	5
Other Financing (Net POE and other)	13	15	3	11	16	38	0	1	0	1	1
Equity (Privatization)	44	12	8	21	0	0	0	0	0	0	0
Memorandum items											
Overall balance (MOF) 3/	-208	-518	-102	-467	-44	-326	-239	-233	-236	-260	-298
Pandemic-related fiscal measures	...	296	310	...	...	...	...	...	...	...	...
Bank balance of the general government	362	233	306	388	295	423	390	364	334	287	188
Of which: ELA	46	46	46	46	46	46	46	46	46	46	47
Total public debt 4/	1,247	1,523	1,717	1,683	1,712	2,152	2,021	2,214	2,407	2,604	2,788
External debt	452	557	607	577	593	926	844	911	970	1,027	1,062
Of which: onlending	50	43	46	...	42	...	53	64	75	86	96
Of which: guarantees	43	32	31	...	32	...	32	32	32	32	32
Domestic debt	795	965	1,110	1,106	1,119	1,226	1,177	1,303	1,437	1,578	1,726

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

1/ It does not yet reflect the GFSM 2014 methodology.

2/ 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.

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

4/ 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.

Table 3. Kosovo: Consolidated Government Budget, 2019–27[1]

(Including donor designated grants and PAK operations; percent of GDP)

	2019	2020	2021	2022		2023		2024	2025	2026	2027
	Act.	Act.	Act.	2022 Rev. Budget	Proj.	2023 Draft Budget			Proj.		
Revenue and grants	**27.0**	**25.6**	**27.8**	**27.2**	**27.8**	**29.4**	**28.6**	**27.3**	**27.2**	**27.2**	**27.0**
Revenue	26.7	25.0	27.5	27.0	27.5	28.4	27.4	27.3	27.2	27.2	27.0
Taxes	23.6	22.3	24.5	24.3	24.8	25.7	24.6	24.4	24.3	24.3	24.1
Direct taxes	4.1	3.9	4.3	4.4	4.7	5.1	5.0	5.0	5.0	5.0	5.0
of which: Personal income tax	2.3	2.3	2.4	2.4	2.4	2.7	2.6	2.6	2.6	2.6	2.6
of which: Corporate income tax	1.3	1.3	1.4	1.5	1.8	2.0	2.0	2.0	2.0	2.0	2.0
of which: Property tax	0.4	0.3	0.5	0.5	0.4	0.5	0.4	0.4	0.4	0.4	0.4
Indirect taxes	20.1	18.8	20.9	20.6	21.0	21.4	20.5	20.3	20.2	20.1	19.9
VAT	12.0	11.4	13.0	13.2	13.8	14.1	13.8	13.8	13.8	13.8	13.8
Excise	6.2	5.9	6.3	5.9	5.7	5.8	5.4	5.3	5.3	5.3	5.3
Customs	1.8	1.5	1.6	1.5	1.5	1.4	1.3	1.1	1.0	0.9	0.7
Tax refunds	-0.6	-0.5	-0.7	-0.7	-0.9	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9
Nontax revenues	3.1	2.7	3.0	2.7	2.6	2.7	2.8	2.8	2.8	2.8	2.8
Other revenue	0.1	0.1	0.1	...	0.1	...	0.1	0.1	0.1	0.1	0.1
Grants	0.3	0.6	0.2	0.3	0.3	1.0	1.1	0.0	0.0	0.0	0.0
Budget support	0.2	0.5	0.0	0.1	0.1	0.9	1.0	0.0	0.0	0.0	0.0
Project grants (DDGs)	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Expenditure	**29.9**	**33.5**	**29.0**	**32.4**	**28.0**	**32.7**	**30.8**	**29.5**	**29.2**	**29.3**	**29.3**
Current expenditure	22.4	27.8	23.7	24.0	23.4	23.9	23.9	23.1	22.9	23.0	23.0
Wages and salaries	8.7	9.8	8.4	7.5	7.4	7.6	7.6	8.1	8.1	8.1	8.1
Goods and services	4.2	4.5	4.2	4.5	3.8	5.0	4.8	4.5	4.5	4.5	4.5
Subsidies and transfers	8.9	12.8	10.6	11.7	12.0	11.2	11.2	10.2	10.0	10.0	10.0
Current reserves	0.0	0.0	0.0	0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0
DDGs and other expenditure	0.1	0.0	0.0	...	0.0	...	0.0	0.0	0.0	0.0	0.0
Interest payments	0.3	0.4	0.4	0.5	0.3	0.5	0.3	0.3	0.3	0.4	0.4
of which: on external debt	0.2	0.1	0.1	...	0.2	...	0.1	0.2	0.2	0.2	0.2
Other net PAK expenditure	0.1	0.4	0.2	...	0.0	...	0.0	0.0	0.0	0.0	0.0
Capital expenditure	7.6	5.7	5.3	7.9	4.6	8.3	6.8	6.3	6.3	6.3	6.3
Budget-financed	5.2	4.0	4.9	6.4	4.3	6.9	5.5	5.5	5.5	5.5	5.5
PAK-financed	1.9	0.8	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	0.5	0.9	0.5	2.2	0.3	2.0	1.3	0.9	0.8	0.8	0.8
Non-Investment Clause	0.3	0.5	0.2	0.9	0.0	0.7	0.2	0.1	0.0	0.0	0.0
of which: "Investment Clause"	0.2	0.4	0.2	1.3	0.3	1.3	1.1	0.8	0.8	0.8	0.8
Fiscal balances											
Primary balance	-2.7	-7.6	-0.9	-4.8	0.0	-2.9	-2.0	-1.8	-1.7	-1.8	-1.9
Overall balance	**-2.9**	**-7.9**	**-1.3**	**-5.2**	**-0.3**	**-3.3**	**-2.2**	**-2.1**	**-2.0**	**-2.1**	**-2.3**
"Fiscal rule" deductions from the overall balance	2.1	1.9	0.2	1.5	0.3	1.3	1.1	0.8	0.8	0.8	0.8
Overall balance ('Fiscal rule" definition) 2/	**-0.8**	**-6.6**	**-1.0**	**-3.7**	**0.1**	**-2.0**	**-1.1**	**-1.3**	**-1.2**	**-1.3**	**-1.5**
Overall cyclically adjusted balance	-3.6	-6.3	-1.3	...	-0.4	...	-3.2	-2.0	-2.0	-2.1	-2.3
Statistical discrepancy	0.0	0.0	0.0	...	0.0	...	0.0	0.0	0.0	0.0	0.0
Financing	**2.9**	**7.9**	**1.3**	**5.2**	**0.3**	**3.3**	**2.2**	**2.1**	**2.0**	**2.1**	**2.3**
Foreign financing (net)	-0.1	1.9	0.6	4.0	-0.2	3.7	2.6	0.6	0.5	0.5	0.3
Budget Support	0.0	2.3	1.0	2.6	0.0	2.3	1.4	0.0	0.0	0.0	0.0
External Financing for Projects	0.6	0.9	0.6	2.2	0.4	2.0	1.6	1.0	1.0	1.0	0.9
Amortization of external debt	-0.7	-1.3	-1.0	-0.7	-0.6	-0.6	-0.4	-0.4	-0.5	-0.5	-0.7
Domestic financing (net)	3.1	6.0	0.7	0.6	0.4	0.6	-0.3	1.5	1.5	1.6	2.0
Net Domestic debt issuance	1.6	2.5	1.8	0.8	0.1	0.7	0.6	1.2	1.2	1.2	1.2
Change in CBK deposits	0.6	3.1	-1.3	-0.5	0.2	-1.0	-0.9	0.3	0.3	0.4	0.8
Change in GG Deposits at the CBK (TSA)	-1.0	1.9	-1.3	0.0	0.1	0.0	-1.0	0.2	0.3	0.4	0.8
PAK Deposits	1.6	1.2	0.1	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Other Financing (Net POE and other)	0.2	0.2	0.0	0.1	0.2	0.4	0.0	0.0	0.0	0.0	0.0
Equity (Privatization)	0.6	0.2	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items											
Overall balance (MOF) 3/	-2.9	-7.6	-1.3	-5.2	-0.5	-3.3	-2.4	-2.2	-2.1	-2.2	-2.4
Pandemic-related fiscal measures	...	4.4	3.9	...	...	...	...	...	...	...	...
Bank balance of the general government	5.1	3.4	3.8	4.3	3.3	4.3	4.0	3.5	3.0	2.4	1.5
Of which: ELA	0.7	0.7	0.6	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Total public debt 4/	17.7	22.5	21.6	18.8	19.2	21.9	20.6	21.0	21.4	21.9	22.3
External debt	6.4	8.2	7.6	6.5	6.6	9.4	8.6	8.6	8.6	8.6	8.5
Of which: onlending	0.7	0.6	0.6	...	0.5	...	0.5	0.6	0.7	0.7	0.8
Of which: guarantees	0.6	0.5	0.4	...	0.4	...	0.3	0.3	0.3	0.3	0.3
Domestic debt	11.3	14.3	13.9	12.4	12.5	12.5	12.0	12.4	12.8	13.3	13.8

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

1/ It does not yet reflect the GFSM 2014 methodology.

2/ 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.

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

4/ 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.

Table 4. Kosovo: Central Government Cashflow Table 2019–27

(Millions of Euros, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
						Proj.			
Financing Needs	501	822	342	351	487	478	522	504	607
Overall balance	-207	-534	-101	-25	-219	-224	-226	-250	-288
Amortization	294	289	241	326	268	254	296	255	318
External	50	89	79	50	39	41	52	56	82
Domestic	245	200	162	276	229	213	245	199	237
Financing Sources	499	822	341	351	488	479	523	505	608
External Debt	39	215	123	35	290	108	110	113	117
Budget Support	0	156	79	0	138	0	0	0	0
of which: IMF	0	52	…	…	…	…	…	…	…
of which: other including EU and IFIs	…	…	160	57	37	0	0	0	0
External Financing for Projects	39	59	44	35	153	108	110	113	117
Investment Clause (2016 and after)	14	26	13	30	112	84	90	95	100
Non-Investment Clause	21	31	15	1	20	5	3	1	1
Disbursements for on-lending	4	3	16	5	21	18	17	17	16
Domestic Debt	460	606	218	316	197	371	413	392	491
Gross Domestic Debt Placements	360	370	307	285	287	339	378	339	385
KPST one-off financing	0	0	0	0	0	0	0	0	0
Other Financing (Net POE)	13	15	3	16	0	1	0	1	1
Commercial Bank Deposits	0	-1	-2	0	0	0	0	0	0
Equity (Privatization, PAK and other)	44	12	8	0	0	0	0	0	0
CBK deposits (-=increase)	43	211	-100	15	-90	31	35	52	104
PAK deposits	113	84	7	5	5	5	5	5	5
TSA	-70	127	-106	10	-95	26	30	47	99
Errors and Omissions	1	1	1	0	0	-1	-1	-1	-1

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

Table 5. Kosovo: Balance of Payments 2019–27

(Millions of Euros, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
						Proj.			
Current account	-400	-472	-695	-932	-783	-791	-795	-768	-791
Balance on Goods and Services	-1,915	-2,182	-2,532	-3,007	-3,069	-3,128	-3,186	-3,262	-3,376
Goods Balance	-2,840	-2,573	-3,567	-4,323	-4,447	-4,588	-4,763	-4,918	-5,096
Exports, f.o.b.	393	475	753	947	1,050	1,139	1,213	1,295	1,377
Imports, f.o.b.	3,233	3,048	4,320	5,270	5,498	5,727	5,976	6,213	6,474
Services Balance	925	392	1,035	1,317	1,378	1,460	1,577	1,656	1,721
Receipts	1,674	995	1,906	2,418	2,491	2,634	2,794	2,943	3,077
Payments	749	603	871	1,102	1,113	1,174	1,217	1,287	1,356
Primary Income	161	164	151	205	227	238	247	250	254
Compensation of employees, net	257	262	263	330	363	390	416	440	451
Investment income, net	-92	-95	-110	-122	-133	-150	-166	-187	-194
Secondary Income	1,354	1,545	1,686	1,869	2,058	2,099	2,144	2,244	2,331
Government, net	237	277	234	268	373	327	337	356	376
Other transfers (including remittances), net	1,118	1,269	1,453	1,601	1,685	1,772	1,807	1,888	1,956
Capital account	-9	17	62	25	26	28	29	30	32
Financial account	-163	-561	-363	-617	-494	-542	-540	-495	-520
Direct investment, net	-188	-287	-320	-435	-409	-442	-447	-443	-442
Assets	66	59	100	101	72	54	59	62	65
Liabilities	255	346	421	536	481	496	505	505	507
Portfolio investment, net	59	-82	277	85	97	120	146	184	206
Other investment, net	-129	-239	-488	-288	-297	-232	-245	-245	-225
Reserve assets	95	46	169	21	115	12	6	8	-58
Net errors and omissions 1/	246	-106	270	290	263	222	226	242	239
Overall balance	0	0	0	0	0	0	0	0	0
				(In percent of GDP)					
Current account, incl. official transfers	-5.7	-7.0	-8.7	-10.4	-8.0	-7.5	-7.1	-6.5	-6.3
Balance on Goods and Services	-27.1	-32.2	-31.8	-33.7	-31.3	-29.7	-28.4	-27.5	-27.0
Exports of Goods	5.6	7.0	9.5	10.6	10.7	10.8	10.8	10.9	11.0
Exports of Services	23.7	14.7	24.0	27.1	25.4	25.0	24.9	24.8	24.6
Imports of Goods	45.8	45.0	54.3	59.0	56.0	54.3	53.2	52.3	51.7
Imports of Services	10.6	8.9	10.9	12.3	11.3	11.1	10.8	10.8	10.8
Primary Income	2.3	2.4	1.9	2.3	2.3	2.3	2.2	2.1	2.0
Secondary Income	19.2	22.8	21.2	20.9	21.0	19.9	19.1	18.9	18.6
Capital account	-0.1	0.3	0.8	0.3	0.3	0.3	0.3	0.3	0.3
Financial account	-2.3	-8.3	-4.6	-6.9	-5.0	-5.1	-4.8	-4.2	-4.2
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 assets	1.3	0.7	2.1	0.2	1.2	0.1	0.0	0.1	-0.5
Net errors and omissions 1/	3.5	-1.6	3.4	3.3	2.7	2.1	2.0	2.0	1.9
Memorandum items:									
Public debt service to export ratio (percent)	3.0	6.7	3.4	1.9	1.5	1.5	1.8	1.8	2.3
Public debt service to exports and remittances (percent)	2.1	4.0	2.3	1.4	1.1	1.1	1.3	1.3	1.7
External public and private debt (percent of GDP) 2/	31.2	37.2	37.4	36.2	36.2	36.1	36.2	36.4	36.3
Net foreign assets of CBK 3/	938	969	1,061	1,087	1,210	1,244	1,258	1,261	1,198
Gross international reserves 3/	1,142	1,149	1,293	1,310	1,420	1,426	1,427	1,430	1,367
Gross international reserves in months of prospective imports 3/	3.8	2.7	2.4	2.4	2.5	2.4	2.3	2.3	2.3
Gross international reserves, excl. PAK and KPST deposits at CBK 3/	864	900	1,100	1,121	1,236	1,248	1,253	1,262	1,204

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. Central Bank and Commercial Bank Survey 2019–27

(Millions of Euros, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
						Proj.			
Central Bank									
Net foreign assets	938	969	1,061	1,087	1,210	1,244	1,258	1,261	1,198
Foreign assets	1,219	1,223	1,370	1,384	1,494	1,500	1,501	1,504	1,441
Foreign liabilities	281	254	310	297	284	257	243	243	243
Net domestic assets	-420	-211	-335	-346	-429	-405	-364	-312	-187
Net claims on central government	-421	-213	-347	-357	-441	-416	-375	-323	-200
Claims on central government	316	314	280	253	260	253	260	260	279
Of which: government securities	184	201	214	200	220	240	260	260	280
Liabilities to central government	738	527	626	611	701	670	635	583	479
PAK (privatization) fund	275	191	185	180	175	170	165	160	155
Government deposits	444	317	423	413	508	482	452	405	305
Of which: bank balance	361	258	358	402	442	475	505	535	563
IMF subscription	18	18	18	18	18	18	18	18	18
Claims on other sectors	1	2	11	11	11	11	11	11	11
Monetary base	468	706	667	682	722	779	834	889	949
Liabilities to other depository corporations	415	566	589	599	634	686	736	786	841
Deposits included in broad money	53	139	78	83	88	93	98	103	108
Other items, net 1/	51	52	58	58	59	60	62	62	64
Commercial banks									
Net foreign assets	639	843	836	785	744	738	745	787	828
Assets	866	1,117	1,107	1,045	1,009	1,009	1,022	1,063	1,108
Liabilities	-227	-274	-271	-260	-265	-271	-277	-277	-280
Net domestic assets	3,629	3,908	4,462	4,975	5,465	5,957	6,442	6,873	7,320
Claims on the CBK	415	566	589	599	634	686	736	786	841
Net claims on the central government	275	240	297	255	285	315	355	370	380
Claims on central government	287	254	311	270	300	330	370	390	400
Liabilities to central government	-13	-14	-15	-15	-15	-15	-15	-20	-20
Net claims on other public entities	-88	-140	-170	-191	-210	-226	-240	-254	-267
Claims on other public entities	3	4	0	0	0	0	0	0	0
Liabilities to other public entities	-92	-143	-170	-191	-210	-226	-240	-254	-267
Credit to private sector	3,028	3,241	3,747	4,312	4,755	5,182	5,592	5,971	6,366
Deposits of the private sector	3,688	4,091	4,597	4,990	5,367	5,782	6,205	6,615	7,040
Demand deposits	2,225	2,597	3,090	3,318	3,560	3,840	4,128	4,408	4,689
Time deposits	1,463	1,493	1,508	1,673	1,807	1,943	2,076	2,207	2,351
Other items, net 1/	580	661	701	769	842	913	983	1,045	1,108
Memorandum items:									
Broad money (12-month percent change)	11.9	15.3	12.1	7.6	7.4	7.8	7.4	6.7	6.5
Gross international reserves, excl. PAK and KPST deposits at CBK	864	900	1,100	1,121	1,236	1,248	1,253	1,262	1,204
Deposits of the private sector (12-month percent change)	15.6	10.9	12.4	8.6	7.5	7.7	7.3	6.6	6.4
Credit to the private sector (12-month 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 of GDP)	52.3	60.4	57.8	55.9	54.7	54.8	55.2	55.7	56.2
Credit to the private sector (percent of GDP)	42.9	47.9	47.1	48.3	48.4	49.1	49.8	50.3	50.8
Required reserves of commercial banks	327	367	416	454	491	526	562	600	600
Excess reserves of commercial banks	187	302	188	201	214	219	232	244	244

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

1/ Includes shares and other equity.

Table 7. Kosovo: Selected Financial Soundness Indicators, 2019–22[1]

(Percent, unless otherwise indicated)

	2019	2020	2021	2022
Total Assets (% GDP) 2/	67.5	79.1	74.9	74.3
Capital adequacy				
Regulatory capital to risk weighted assets	15.9	16.5	16.1	15.8
Tier 1 capital to risk weighted assets	14.2	14.7	13.7	13.8
Capital to assets	11.2	11.7	11.1	9.6
Asset quality				
NPL to total loans	1.9	2.5	2.1	2.0
NPL net of provisions to capital	1.5	4.6	3.4	3.4
Large exposures to capital	81.8	89.5	89.8	83.1
Liquidity				
Liquid assets to total assets	28.8	30.1	28.8	26.1
Deposits to loans	129.2	133.9	131.6	124.8
Liquid assets to short-term liabilities	38.7	40.4	37.2	35.1
Profitability				
Return on average assets	2.1	1.7	2.2	2.5
Return on average equity	17.2	14.0	17.6	19.6
Interest margin to gross income	80.6	79.2	76.0	76.0
Non-interest expense to gross income	48.1	46.1	45.3	41.4
Market risk				
Net open currency position to capital	4.7	3.5	1.5	1.1

Sources: Central Bank of the Republic of Kosovo.

1/ Figures shown for 2022 correspond to data as of September 2022.

2/ Includes all other depository corporations.

Table 8. Kosovo: Indicators of Fund Credit, 2019–27

	2019	2020	2021	2022	2023	2024	2025	2026	2027
						Proj.			
Repayments (in SDR millions)									
Principal	24.6	54.3	43.1	9.9	10.3	20.7	10.3	0.0	0.0
Charges and interest 1/	2.5	2.1	1.2	0.5	0.4	0.2	0.1	0.0	0.0
Total repayment obligations based on existing and prospective credit									
In millions of SDRs	27.1	56.4	44.3	10.4	10.8	20.9	10.4	0.0	0.0
In millions of Euros	33.7	66.6	54.8	13.5	14.0	27.2	13.5	0.0	0.0
In percent of gross international reserves	2.9	5.8	4.2	1.0	1.0	1.9	0.9	0.0	0.0
In percent of exports of goods and services	1.6	4.5	2.1	0.4	0.4	0.7	0.3	0.0	0.0
In percent of debt service	54.3	67.5	61.4	21.0	26.3	46.7	19.3	0.0	0.0
In percent of GDP	0.5	1.0	0.7	0.2	0.1	0.3	0.1	0.0	0.0
In percent of quota	32.8	68.2	53.6	12.6	13.0	25.3	12.6	0.0	0.0
Outstanding Fund credit based on existing and prospective credit									
In millions of SDRs	107.3	94.3	51.2	41.3	31.0	10.3	0.0	0.0	0.0
In millions of Euros	133.1	111.4	63.3	53.5	40.3	13.4	0.0	0.0	0.0
In percent of gross international reserves	11.7	9.7	4.9	4.1	2.8	0.9	0.0	0.0	0.0
In percent of exports of goods and services	6.4	7.6	2.4	1.6	1.1	0.4	0.0	0.0	0.0
In percent of debt service	214.9	113.0	71.0	82.9	75.5	23.1	0.0	0.0	0.0
In percent of GDP	1.9	1.6	0.8	0.6	0.4	0.1	0.0	0.0	0.0
In percent of quota	129.9	114.2	62.0	50.0	37.5	12.5	0.0	0.0	0.0
Net use of Fund credit (millions of SDRs)									
Disbursements and purchases	0.0	41.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	24.6	54.3	43.1	9.9	10.3	20.7	10.3	0.0	0.0
Memorandum items:									
Gross international reserves (in millions of Euros)	1,142	1,149	1,293	1,310	1,420	1,426	1,427	1,430	1,367
Exports of goods and services (in millions of Euros)	2,068	1,470	2,659	3,365	3,541	3,773	4,007	4,238	4,454
Debt service (in millions of Euros) 2/	62	99	89	65	53	58	70	77	104
Quota (in SDR millions)	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6

Source: IMF staff estimates and projections.

1/ Based on the projection as of November 1, 2022. 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	Expected Impact	Policy Responses
	Global Risks	
High **Commodity price shocks.** A combination of continuing supply disruptions (e.g., due to geopolitical conflict and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability.	High Higher energy and food prices will transmit to consumer prices and dampen household disposable income, leading to lower consumption growth. Higher energy prices will also increase firms' input costs, negatively impacting profits and investment plans.	• Targeted and temporary fiscal measures to support vulnerable households and viable firms. • Improve reliability of domestic electricity production and promote energy savings through higher pass-through rates of international electricity prices for non-vulnerable clients, especially for peak-hour consumption.
High **Intensifying spillovers from the war in Ukraine.** Further sanctions and increased uncertainty exacerbate trade and financial disruptions and commodity price volatility, with Europe, LICs, and commodity-importing EMs among the worst hit.	High No direct impact is expected due to limited linkages with Russia and Ukraine. However, an escalation of the war in Ukraine would affect Kosovo through higher commodity prices, extended supply disruptions, tighter financial conditions, and lower growth in countries where the diaspora resides, limiting tourism flows and remittances.	• Targeted and temporary policies to cope with additional commodity price shocks. • Accelerate broad-based structural reforms to boost competitiveness, green the coal-based energy matrix, and gradually reduce the dependency on diaspora-related flows by increasing exports and domestic production. • Promote energy savings through higher pass-through rates of international electricity prices for non-vulnerable clients, especially for peak-hour consumption.
High **Abrupt global slowdown or recession.** Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright recessions in some countries, spillovers through trade and financial channels, and downward pressures on some commodity prices. The fallout from the war in Ukraine is exacerbated by a gas shutoff by Russia, resulting in acute gas shortages and further supply disruptions, which triggers an EU recession. A sharp tightening of global financial conditions combined with volatile commodity prices leads to spiking risk premia in EMDEs, widening of external imbalances and fiscal pressures, capital outflows, sudden stops, and debt and financial crises.	High An economic slowdown in Europe will weigh on Kosovo's growth through reduced consumption, investment, and lower diaspora flows that may lead to a higher current account deficit. While a gas shutoff to Europe would not affect Kosovo directly, it will impact the country through higher European electricity prices, as Kosovo is an electricity importer.	• Targeted and temporary policies to cope with additional shock, with higher pass-through of international electricity prices to non-vulnerable consumers. • Accelerate broad-based structural reforms, including greening the energy matrix and reducing diaspora dependency through policies to increase exports and domestic production. • Further strengthen the monitoring of financial risks and establish contingency plans to address fiscal risks.
Medium **Local COVID-19 outbreaks.** The emergence of more contagious vaccine-resistant variants forces new lockdowns and/or inhibit trade and activity. This results in extended supply chain disruptions, slower growth, capital outflows, and debt distress in some EMDEs.	High New lockdowns would hamper economic activity through lower tourist arrivals and domestic mobility. Supply chain disruptions would fuel inflation.	• Promote booster shots for vulnerable and ensure good vaccination rates for the population at large. • Prepare contingency fiscal and financial plans on how to mitigate the impact of a new outbreak, building on the domestic and international lessons of the pandemic.

[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.

Domestic Risks		
High **Lower-than-planned PIP execution leads to softer demand and delays in needed infrastructure.** Higher project costs and PIM shortcomings delay PIP implementation, further delaying needed investment in social and economic infrastructure, and decreasing aggregate demand.	**High** Low PIP implementation rates would result in continued infrastructure gaps, constraining Kosovo's potential to attract foreign direct investment. In the short term, lower aggregate demand risks a recession.	• Prioritize investment projects with good implementation rates, especially in education and health, and in green energy. • Improve planning, transparency, monitoring, and auditing of capital investment projects, and strengthen the gatekeeper role of the Ministry of Finance.
High **The cost-of-living crisis results in renewed social tensions.** Eroded household real disposable income on the back of higher energy and food prices lead to an increase in social discontent of both private and public sector workers.	**High** Strikes can result in social and economic losses. Social discontent can lead to costly policy proposals.	• Minimum wage increases as planned, should be implemented as soon as possible, but delinking it from other transfers. • The public wage law should start implementation in 2023 but keeping the wage bill within its legal ceiling.
High **Higher European electricity prices lead to load shedding.** Higher international prices can lead to choke points in electricity distribution, and power cuts. Load shedding can be more persistent if unreliable domestic electricity supply falters.	**High** Power outages could weigh on production, and adversely affect investment and consumption. Higher electricity prices can also result in additional fiscal costs.	• Increase the frequency of tariff increases and of subsidy payments. • Create a fund for the greening of the electricity generation matrix. Improve reliability of domestic electricity production. • Promote energy savings through higher pass-through rates of international electricity prices for non-vulnerable clients, especially for peak-hour consumption.
Medium **Rising tensions with Serbia.** Despite continuing political dialogue, tensions in Kosovo's northern municipalities intensify.	**High** Continued delays in the dialogue with Serbia can negatively affect investors' perceptions and FDI inflows.	• Continue to strongly implement the EU-Kosovo Stabilization and Association Agreement. • Strive to implement all parts of the Brussels agreement of 2013.

Annex II. Debt Sustainability Analysis

The public debt to GDP ratio declined in 2022 on the back of solid fiscal revenues and a low implementation of the public investment program. Gross financing needs are projected to average about 5 percent of GDP over the forecast horizon. Debt is assessed as sustainable in the baseline and stress scenarios. Risks result from shocks to growth and other macro-fiscal variables, and from an increasingly limited 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 financing sources remain key policy priorities.

Key Assumptions

1. Macroeconomic assumptions. GDP growth is projected to have declined to 2.7 percent, from about 11 percent in 2021, and to recover to 3.5 percent in 2023. Inflation is projected to decline to around 5 percent in 2023 (from more than 11 percent in 2022), given the baseline assumption of lower commodity prices. The primary fiscal deficit is expected to increase to 2 percent of GDP in 2023 (from about balance in 2022), and to average around 2 percent in the through the medium-term.

2. Public debt. Public debt consists of consolidated general government debt and guarantees. PAK-related contingent liabilities (of about 2 percent of GDP) and POEs gross debt (estimated at around 5 percent of GDP) are not included.[1] However, as the central government on-lends to POEs, general government debt already includes about 50 percent of POE debt. Domestic debt (12.5 percent of GDP at end-2022) constitutes the largest portion of public debt (19.2 percent of GDP). External public debt is largely owed to multilaterals (IDA, EIB, EBRD, and the IMF), and denominated in SDRs and Euro. Around 99 percent of public debt has a maturity of 2 years or more.

3. Financing assumptions. Gross financing needs in 2022 were covered by external project financing and by rollover of maturing domestic debt. Government deposits at CBK at end-2022 (6.8 percent of GDP) include those of the Privatization Agency of Kosovo (PAK, 2 percent of GDP), earmarked deposits, including of Municipalities (1.1 percent of GDP), and freely available cash (3.3 percent of GDP). Financing in the medium-term will come from external budget support, further net domestic placements (of around 1–1.5 percent of GDP per year), and external project financing.

Public DSA

4. General government debt is projected to be around 21 percent of GDP, on average, over the forecast horizon, well below the debt limit (40 percent of GDP).[2] The public debt ratio,

[1] PAK-related contingent liabilities reflect potential claims related to the privatization of socially owned enterprises (SOEs).

[2] The current fiscal rule on debt limit includes: (1) a general limit on public debt at 40 percent of GDP; (2) a "debt-brake" mechanism, such that when debt exceeds 30 percent of GDP, the "investment clause" will expire and all capital expenditure (including capital expenditure financed by donors and privatization receipts) will be counted towards the 2 percent-of-GDP deficit ceiling.

which averaged around 16 percent of GDP between 2015–19, is expected to moderately increase to 22.3 percent of GDP by 2027 on the back of a return to the fiscal rule deficit target beginning in 2023. Domestic public debt is projected to reach 13.8 percent of GDP by 2027, with external public debt reaching 8.5 percent. Government deposits at the end of the projection period are projected at 3.8 percent of GDP (including deposits from Municipalities and PAK).

5. Gross financing needs remain below the sustainability threshold, though vulnerabilities linked with the lack of market access remain. Gross financing needs (GFNs) in 2023–27 are projected to be around 4–5 percent of GDP. Vulnerabilities remain concentrated in the narrow base of the domestic debt stock. As of end-2022, commercial banks held 24 percent of domestic debt (down from 36 percent at end-2019), whereas KPST's holdings increased to around 50 percent (up from 38 percent at end-2019); individuals, private businesses and insurance companies jointly held around 7 percent, with the rest held by the Central Bank (18 percent). Sticking to the fiscal rule and increasing the average maturity of domestic debt should contribute to manage vulnerabilities arising from the absence of external market access. While there is still room for KPST to increase government debt holdings, the government should aim to diversify the investor base. Obtaining a rating for government securities from a reputable international rating agency would contribute to this end. Keeping CBK holdings of government securities unchanged and limiting KPST's exposure to government securities to no more than 30 percent of its assets is also important going forward.

6. Standardized tests indicate that the public debt to GDP ratio will remain at manageable levels over the forecast horizon. Standardized GDP growth shocks result in the public debt ratio reaching 31 percent of GDP by 2027, with GFNs peaking at 7 percent of GDP in 2024. A combined macro-fiscal shock (including shocks to real GDP, primary balance, real interest rate, and real exchange rate), results in the public debt ratio reaching 33 percent of GDP in 2027, and GFNs peaking at 8 percent of in 2027. Contingent liability shocks, which may stem from POEs (modeled at 5 percent of GDP) and PAK (about 2 percent of GDP) would not lead to significant stress. This is the case because PAK contingent liabilities are hedged by PAK deposits at the Central Bank (of about 2 percent of GDP) and because about ½ of POE debt is with the central government.

External DSA

7. The external debt-to-GDP ratio is expected to remain broadly stable in the projection period. External debt increased by about 6 percent of GDP in 2020–21, in part due to the increase of public external debt to support pandemic-related measures in 2020. The increase in external private debt during 2020–21 was mainly in the form of long-term debt to the energy sector. The external debt-to-GDP ratio is projected to remain broadly stable in the medium term as the current account deficit narrows and the need for private external debt financing declines.

Annex II. Figure 1. Kosovo Public DSA—Baseline Scenario

(Percent of GDP unless otherwise indicated)

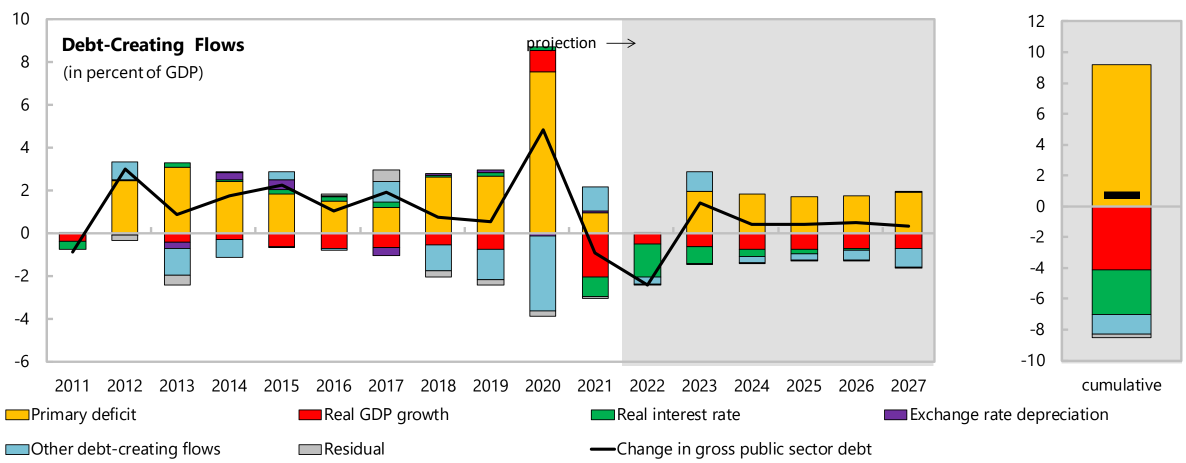
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2015-2019 [2/]	2020	2021	2022	2023	2024	2025	2026	2027
Nominal gross public debt	15.8	22.5	21.6	19.2	20.6	21.0	21.4	21.9	22.3
Of which: guarantees	0.5	0.5	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Public gross financing needs	7.5	12.1	4.3	3.9	5.0	4.5	4.7	4.3	4.9
Real GDP growth (in percent)	4.9	-5.3	10.7	2.7	3.5	3.9	3.9	3.6	3.5
Inflation (GDP deflator, in percent)	0.9	1.4	6.1	9.3	6.2	3.4	2.5	2.1	1.8
Nominal GDP growth (in percent)	5.8	-4.0	17.5	12.2	9.9	7.4	6.5	5.8	5.4
Effective interest rate (in percent) [4/]	2.3	2.2	2.1	1.7	1.8	1.8	1.7	1.9	2.0

As of December 01, 2022		
Sovereign Spreads		
EMBIG (bp) 3/		n.a.
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	n.a.	n.a.
Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2015-2019	2020	2021	2022	2023	2024	2025	2026	2027	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.3	4.8	-0.9	-2.4	1.4	0.4	0.4	0.5	0.3	0.7	
Identified debt-creating flows	1.3	5.1	-0.8	-2.4	1.5	0.4	0.4	0.5	0.4	0.9	
Primary deficit	2.0	7.6	0.9	0.0	2.0	1.8	1.7	1.8	1.9	9.2	-1.6
Primary (noninterest) revenue and grants	26.5	25.6	27.7	27.7	28.5	27.3	27.2	27.1	27.0	164.8	
Primary (noninterest) expenditure	28.5	33.1	28.6	27.7	30.5	29.1	28.9	28.9	28.9	174.0	
Automatic debt dynamics [5/]	-0.4	1.0	-2.9	-2.0	-1.4	-1.1	-0.9	-0.8	-0.7	-7.0	
Interest rate/growth differential [6/]	-0.5	1.1	-3.0	-2.0	-1.4	-1.1	-0.9	-0.8	-0.7	-7.0	
Of which: real interest rate	0.2	0.2	-0.9	-1.5	-0.8	-0.3	-0.2	-0.1	0.0	-2.9	
Of which: real GDP growth	-0.7	1.0	-2.1	-0.5	-0.6	-0.7	-0.8	-0.7	-0.7	-4.1	
Exchange rate depreciation [7/]	0.1	-0.1	0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.3	-3.5	1.1	-0.3	0.9	-0.3	-0.3	-0.4	-0.8	-1.3	
Privatization/ other financing (negative)	-0.3	-0.4	-0.1	-0.2	0.0	0.0	0.0	0.0	0.0	-0.2	
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)	0.0	-3.1	1.3	-0.2	0.9	-0.3	-0.3	-0.4	-0.8	-1.1	
Residual, including asset changes [8/]	0.0	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	-0.2	



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 - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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).

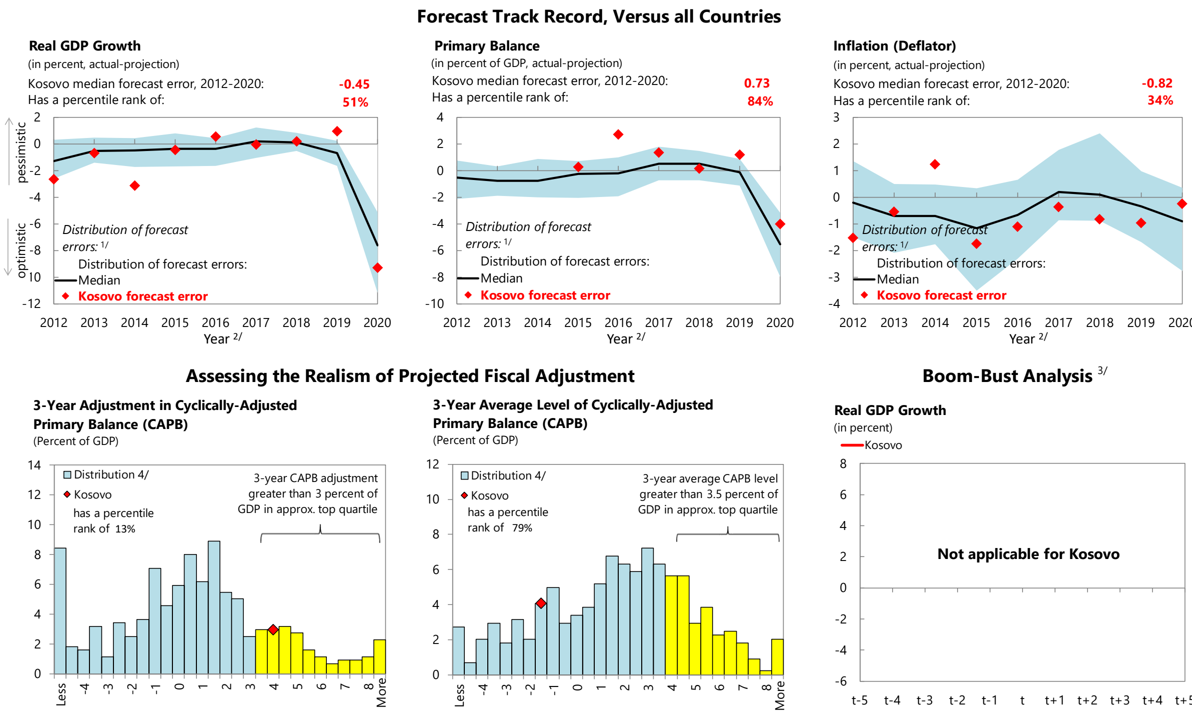
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

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.

Annex II. 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.

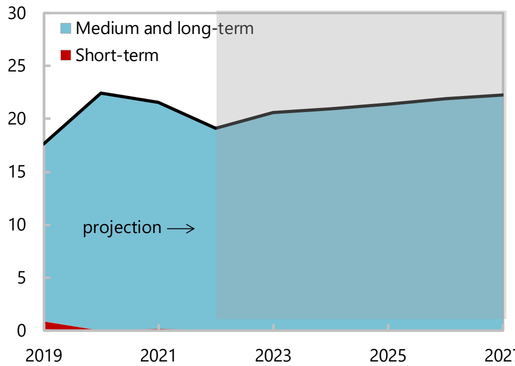
3/ Not applicable for Kosovo, as it meets neither the positive output gap criterion nor the private credit growth criterion.

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

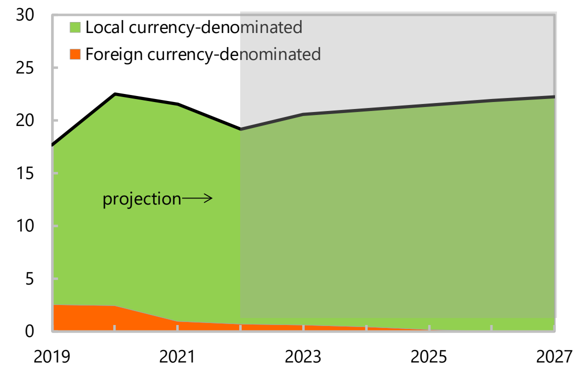
Annex II. Figure 3. Kosovo Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



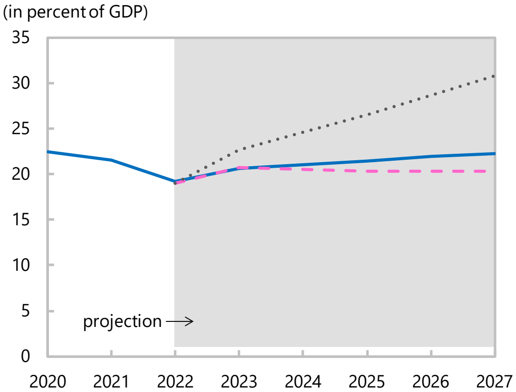
By Currency
(in percent of GDP)



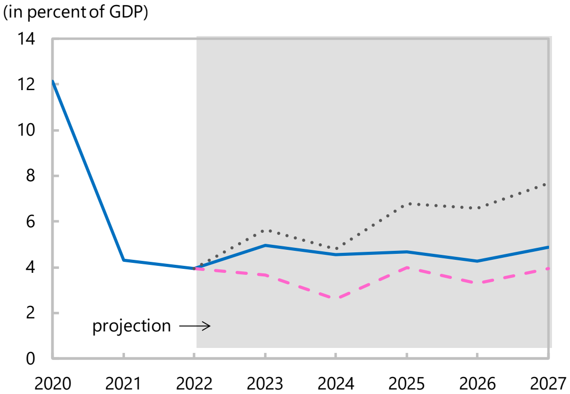
Alternative Scenarios

Baseline ····· Historical – – Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

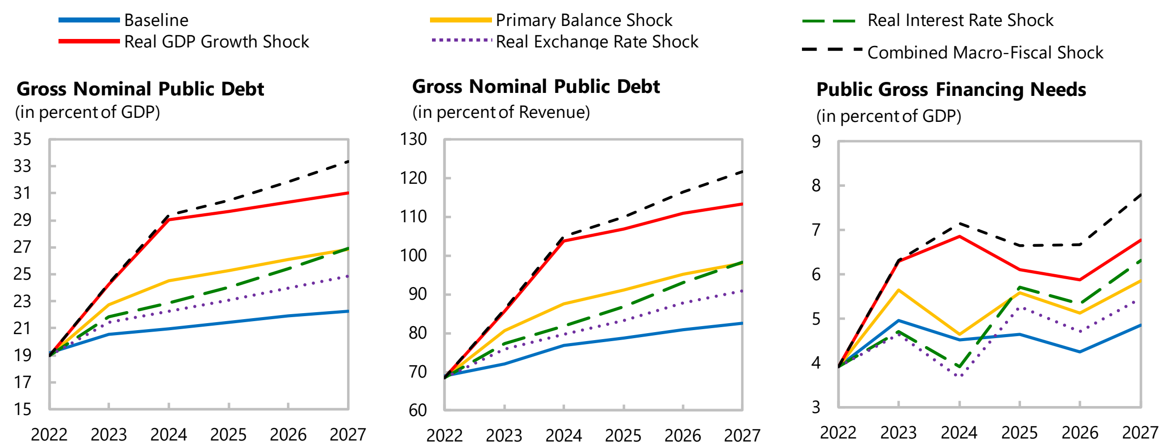
Baseline Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	2.7	3.5	3.9	3.9	3.6	3.5
Inflation	9.3	6.2	3.4	2.5	2.1	1.8
Primary Balance	0.0	-2.0	-1.8	-1.7	-1.8	-1.9
Effective interest rate	1.7	1.8	1.8	1.7	1.9	2.0
Constant Primary Balance Scenario						
Real GDP growth	2.7	3.5	3.9	3.9	3.6	3.5
Inflation	9.3	6.2	3.4	2.5	2.1	1.8
Primary Balance	0.0	0.0	0.0	0.0	0.0	0.0
Effective interest rate	1.7	1.7	1.6	1.4	1.6	1.6

Historical Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	2.7	4.0	4.0	4.0	4.0	4.0
Inflation	9.3	6.2	3.4	2.5	2.1	1.8
Primary Balance	0.0	-2.6	-2.6	-2.6	-2.6	-2.6
Effective interest rate	1.7	1.7	2.4	2.8	3.3	3.6

Source: IMF staff.

Annex II. Figure 4. Kosovo Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	2.7	3.5	3.9	3.9	3.6	3.5
Inflation	9.3	6.2	3.4	2.5	2.1	1.8
Primary balance	0.0	-2.9	-2.8	-1.7	-1.8	-1.9
Effective interest rate	1.7	1.7	1.7	1.5	1.6	1.6
Real Interest Rate Shock						
Real GDP growth	2.7	3.5	3.9	3.9	3.6	3.5
Inflation	9.3	6.2	3.4	2.5	2.1	1.8
Primary balance	0.0	-2.0	-1.8	-1.7	-1.8	-1.9
Effective interest rate	1.7	1.7	2.7	3.2	3.9	4.3
Combined Shock						
Real GDP growth	2.7	-0.6	-0.2	3.9	3.6	3.5
Inflation	9.3	5.2	2.4	2.5	2.1	1.8
Primary balance	0.0	-3.5	-4.9	-1.7	-1.8	-1.9
Effective interest rate	1.7	1.7	2.9	3.5	4.2	4.5

Real GDP Growth Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	2.7	-0.6	-0.2	3.9	3.6	3.5
Inflation	9.3	5.2	2.4	2.5	2.1	1.8
Primary balance	0.0	-3.5	-4.9	-1.7	-1.8	-1.9
Effective interest rate	1.7	1.7	1.7	1.7	1.7	1.7
Real Exchange Rate Shock						
Real GDP growth	2.7	3.5	3.9	3.9	3.6	3.5
Inflation	9.3	8.8	3.4	2.5	2.1	1.8
Primary balance	0.0	-2.0	-1.8	-1.7	-1.8	-1.9
Effective interest rate	1.7	1.7	1.6	1.4	1.6	1.6

Source: IMF staff.

Annex II. Table 1. Kosovo: External Debt Sustainability Framework, 2017–27

(In percent of GDP, unless otherwise indicated)

		Actual					10-Year	10-Year	Projections						
		2017	2018	2019	2020	2021	Historical Average	Standard Deviation	2022	2023	2024	2025	2026	2027	Debt-stabilizing non-interest current account 6/
1	**Baseline: External debt**	32.9	30.5	31.2	37.2	37.4			**36.2**	**36.2**	**36.1**	**36.2**	**36.4**	**36.3**	**-3.5**
2	Change in external debt	-0.5	-2.3	0.7	6.0	0.2			-1.3	0.0	-0.1	0.1	0.2	-0.1	
3	Identified external debt-creating flows (4+8+9)	0.7	-0.3	2.2	2.8	2.7			5.6	3.6	3.1	3.1	3.0	3.2	
4	Current account deficit, excluding interest payments	5.2	7.4	5.4	6.8	8.7			10.3	7.8	7.2	6.8	6.2	6.0	
5	Deficit in balance of goods and services	25.8	28.2	27.1	32.2	31.8			33.7	31.3	29.7	28.4	27.5	27.0	
6	Exports	27.3	29.1	29.3	21.7	33.4			37.7	36.1	35.8	35.7	35.7	35.6	
7	Imports	53.1	57.3	56.4	53.9	65.2			71.3	67.3	65.4	64.0	63.1	62.5	
8	Net non-debt creating capital inflows (negative)	-3.1	-6.4	-1.8	-5.4	-0.5			-3.9	-3.2	-3.0	-2.7	-2.2	-1.9	
9	Automatic debt dynamics 1/	-1.4	-1.3	-1.4	1.4	-5.5			-0.8	-0.9	-1.0	-1.1	-0.9	-0.9	
10	Contribution from nominal interest rate	0.3	0.3	0.2	0.1	0.0			0.1	0.2	0.3	0.3	0.3	0.3	
11	Contribution from real GDP growth	-1.5	-1.1	-1.4	1.7	-3.4			-0.9	-1.2	-1.3	-1.3	-1.2	-1.2	
12	Contribution from price and exchange rate changes 2/	-0.1	-0.5	-0.3	-0.4	-2.1			...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	-1.2	-2.0	-1.5	3.1	-2.5			-6.9	-3.6	-3.2	-3.0	-2.9	-3.3	
	External debt-to-exports ratio (in percent)	120.2	105.0	106.4	171.2	112.0			96.0	100.3	100.9	101.5	102.0	102.1	
	Gross external financing need (in millions of euros) 4/	1222.8	1484.1	1366.1	1514.9	1825.2			2306.8	2320.4	2400.1	2495.7	2543.8	2626.7	
	in percent of GDP	19.2	22.2	19.4	22.4	22.9			25.8	23.6	22.8	22.2	21.4	21.0	
	Scenario with key variables at their historical averages 5/								**36.2**	**37.0**	**37.3**	**37.5**	**37.7**	**37.3**	**-4.1**
	Key Macroeconomic Assumptions Underlying Baseline														
	Real GDP growth (in percent)	4.8	3.4	4.8	-5.3	10.7	4.0	4.1	2.7	3.5	3.9	3.9	3.6	3.5	
	GDP deflator in Euro (change in percent)	0.4	1.5	1.0	1.4	6.1	1.7	1.8	9.3	6.2	3.4	2.5	2.1	1.8	
	Nominal external interest rate (in percent)	1.0	0.9	0.8	0.4	0.1	0.9	0.4	0.4	0.6	0.9	0.8	0.9	0.8	
	Growth of exports (Euro terms, in percent)	20.8	11.6	6.7	-28.9	80.9	11.6	27.7	26.6	5.2	6.5	6.2	5.8	5.1	
	Growth of imports (Euro terms, in percent)	9.2	13.2	4.2	-8.3	42.2	7.1	13.9	22.7	3.7	4.4	4.2	4.3	4.4	
	Current account balance, excluding interest payments	-5.2	-7.4	-5.4	-6.8	-8.7	-6.5	1.7	-10.3	-7.8	-7.2	-6.8	-6.2	-6.0	
	Net non-debt creating capital inflows	3.1	6.4	1.8	5.4	0.5	2.4	2.7	3.9	3.2	3.0	2.7	2.2	1.9	

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; r = change in domestic GDP deflator in US dollar terms, 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.

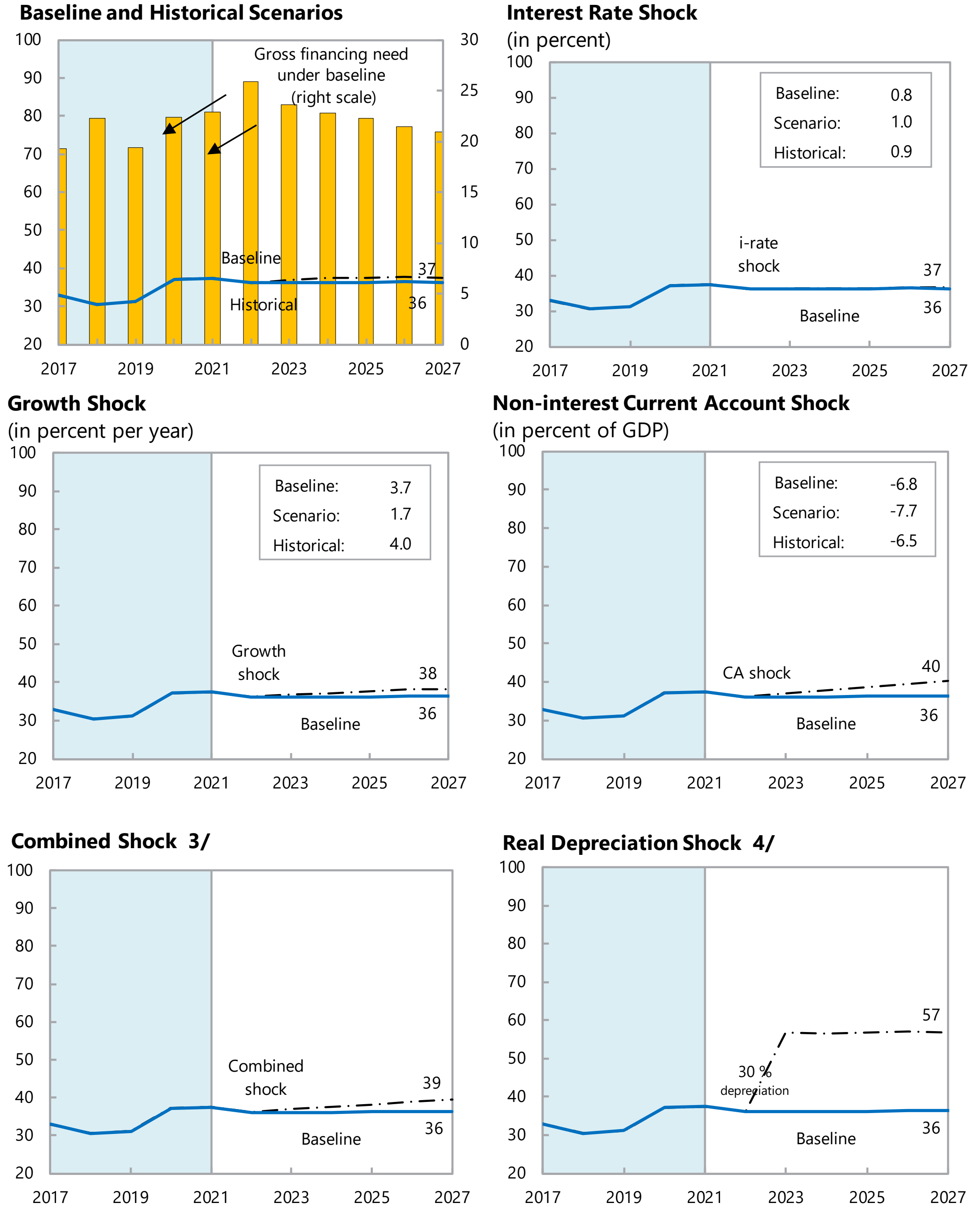
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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 II. Figure 5. 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 applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2023.

Annex III. External Sector Assessment

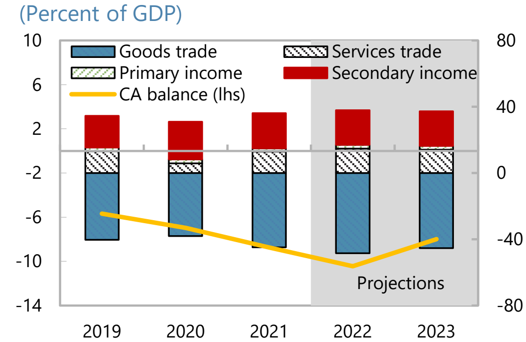
The current account deficit is projected to widen in 2022, driven by higher food and energy prices. The deficit will be financed by continued FDI in real estate, unrecorded travel credit and remittances (reflected in errors and omissions), and the drawdown of private savings. Excluding temporary factors, the external position of Kosovo is projected to be weaker than the level implied by fundamentals and desirable policies in 2022. At 94 percent, the level of gross international reserves in 2022 is projected to be slightly below the level considered adequate based on the IMF's reserve adequacy metric.

External Balance

1. **Kosovo's current account deficit is projected to have widened to 10.4 percent of GDP in 2022 (8.7 percent in 2021).** Concretely:

- **The goods trade deficit is projected to have widened by 3.6 pp of GDP in 2022 due to higher energy and food prices.** The value of goods imports is projected to have risen by 4.7 pp of GDP, driven by the increase in the value of imports of food, fuels, and electricity; other imports as a share of GDP slightly declined in 2022. Despite the decline in nickel exports, total exports of goods are projected to have increased by 1.1 pp of GDP on the back of exports of furniture, plastic, and rubber products.[1]

Contribution to the Current Account
(Percent of GDP)



Sources: Haver Analytics and IMF staff calculations.

- **The balance of services is projected to have increased by 1.7 pp of GDP.** This was driven by higher travel credits, which account for three fourths of total exports of services.

- **Primary and secondary income balances are jointly projected to remain broadly unchanged.** The primary income balance increased by 0.4 pp of GDP, returning to its pre-pandemic level. The increase in primary income balance was offset by the decline in remittances within secondary income.

2. **The current account deficit in 2022 will be mainly financed by FDI, drawdown of banks' net foreign assets, and external loans.** More specifically:

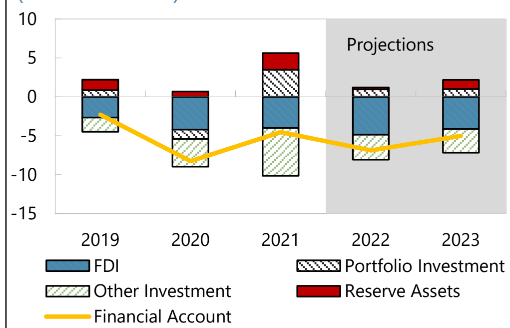
- **Net FDI inflows** are projected to have increased moderately (by 0.9 percent of GDP) on the back of diaspora's real estate investments.

[1] The production of nickel has been suspended since October 2021 due to the rise in electricity prices.

- **Net portfolio investment** showed outflows estimated at 1 percent of GDP in 2022. Kosovo has no recorded portfolio investment liabilities, and its portfolio investment assets mainly include overseas security investments by KPST and commercial banks. In 2022, as domestic residents utilized their savings to cushion the impact of higher energy and food prices, net portfolio investment outflows are projected have been smaller than in 2021 (3.5 percent of GDP).

- **Net other investment** is projected to have shown inflows of 3.2 percent of GDP in 2022. This mainly reflected net inflows from private external loans, trade credits, and the decline in commercial banks' non-portfolio investment assets.

Contribution to the Financial Account
(Percent of GDP)



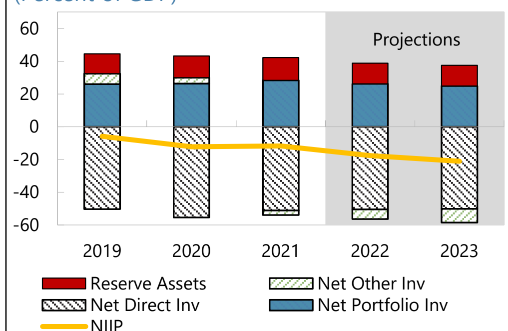
Sources: Haver Analytics and IMF staff calculations.

3. Errors and omissions are projected to have reached 3.3 percent of GDP. These reflect informal inflows in the form of remittances, FDI and travel spending.

4. The Net International Investment Position (NIIP) is projected to have declined from -11.8 percent of GDP in 2021 to -17.6 percent of GDP in 2022. This is in line with the sizable current account deficit in 2022.

5. In the medium term, current account deficits are projected to narrow as commodity prices normalize. The structural pattern of goods trade deficits broadly offset by services trade surpluses is likely to persist. The NIIP is expected to continue declining in the medium term.

Net International Investment Position
(Percent of GDP)

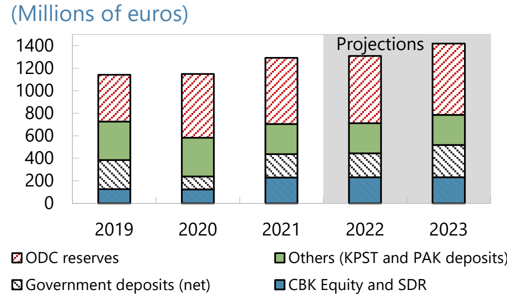


Sources: Haver Analytics and IMF staff calculations.

Assessment of the External Position

6. Kosovo's external position in 2022 is projected to be weaker than the level implied by medium-term fundamentals and desirable policy settings. The current balance (CAB) in 2022 is projected to have reached -10.4 percent of GDP. The cyclically adjusted CAB after multilateral consistency adjustment is -9.1 percent of GDP. The CAB norm estimated by the EBA-Lite CA model is -5.7 percent of GDP. The comparison of adjusted CAB and norm yields a CA gap of close to -3.5 percent of GDP, equivalent to

CBK Reserve Assets: Sources of Funding 1/
(Millions of euros)



Sources: Central Bank of Kosovo, IMF staff calculations.
1/ Government deposits are net of CBK's holdings of government securities. Other deposits mainly include deposits of KPST and PAK.

a REER overvaluation of about 12 percent.[2] A large portion of the CA gap is attributed to model residuals, possibly reflecting factors that are not accounted by the model such as the large errors and omissions (3.3 percent of GDP).[3]

Annex III. Table 1. Kosovo: EBA-Lite Result (2022)

	CA model 1/	REER model 1/
	(in percent of GDP)	
CA-Actual	**-10.4**	
Cyclical contributions (from model) (-)	-0.7	
Natural disasters and conflicts (-)	-0.5	
Adjusted CA	**-9.1**	
CA Norm (from model) 2/	**-5.7**	
Adjustments to the norm (-)	0.0	
Adjusted CA Norm	**-5.7**	
CA Gap	**-3.5**	**-1.3**
o/w Relative policy gap	5.2	
Elasticity	-0.3	
REER Gap (in percent)	**11.9**	**4.4**

1/ Based on the EBA-lite 3.0 methodology
2/ Cyclically adjusted, including multilateral consistency adjustments.

Reserve Adequacy Assessment

7. **The CBK's gross international reserves are mainly funded by central government's deposits and commercial banks' reserves.** GIRs are projected to increase slightly to €1.31 billion at end-2022 (from €1.29 billion as of end-2021). The projected slight increase in GIRs reflects the slight decline in treasury deposits and the increase in commercial banks' reserves.

8. **GIR adequacy using standard rules of thumb is projected to weaken slightly in 2022.** Kosovo's GIR adequacy assessment using standard and alternative GIR definitions is shown in Table 2.

- **Standard definition:** GIR includes the sum of nonresidents' currency and deposits, securities, monetary gold and SDR, reserve position in the Fund, and other items.

[2] The results from the "REER model" suggest a smaller REER gap, but the short time series available for Kosovo (14 years) make the conclusions from this approach less robust. The EBA-lite methodology can be found at https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/07/03/The-Revised-EBA-Lite-Methodology-47088.

[3] It should be noted that accurately identifying temporary factors that affect CAB can be difficult, and there can be additional temporary factors besides oil prices that drive up the current account deficits in 2022. For example, the high electricity import prices observed in 2022:Q2–Q3 can at least partially be treated as "temporary" factors. If all these factors are removed, the cyclically adjusted CAB will be higher than -6.6 percent of GDP, and the external position can potentially be "moderately" weaker than (or even broadly in line with) the fundamentals under desirable policy settings.

- **CBK's definition:** Standard GIR net of PAK and KPST deposits.
- **Staff's alternative definition:** Standard GIR net of banks' excess reserves.

Annex III. Table 2. Kosovo: Traditional Reserve Adequacy Ratios

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
								Projections			
Standard Definition of GIR											
Import cover (months of next year's imports)	3.7	3.5	3.8	2.7	2.4	2.4	2.5	2.4	2.3	2.2	2.0
Reserves to short-term external debt (%)	168	167	152	147	132	118	127	122	117	113	104
Reserves to Broad Money (%)	42	38	34	29	29	28	28	26	24	23	20
Conservative (CBK) Definition of GIR											
Import cover (months of next year's imports)	2.1	2.3	2.8	2.1	2.1	2.0	2.1	2.1	2.0	1.9	1.8
Reserves to short-term external debt (%)	98	110	115	115	113	101	111	107	103	100	91
Reserves to Broad Money (%)	24	25	25	23	25	24	24	23	21	20	18
GIR, Net of Banks' Excess Reserves											
Import cover (months of next year's imports)	3.2	3.1	3.1	2.0	1.9	1.9	2.0	1.9	1.8	1.7	1.4
Reserves to short-term external debt (%)	147	146	127	108	103	95	104	99	94	90	74
Reserves to Broad Money (%)	37	34	28	22	23	22	23	21	20	18	15

Source: IMF staff calculations.

9. GIRs are projected to have declined from 106 percent of the IMF RA metric in 2021 to 94 percent by end-2022.[4] 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.[5] 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: [6]

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

Using both standard and modified RA metrics, Kosovo's GIRs are considered lower than adequate level (100 percent of the metric). The assessment crucially relies on the projection that treasury deposits will decline in 2022.

10. While the reserve adequacy metric is projected to deteriorate in the medium term, 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

[4] IMF (2011) Assessing Reserve Adequacy, IMF Policy Paper.

[5] 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.

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

assessed by their capacity to mitigate shocks to fiscal financing and for banks' emergency liquidity assistance (ELA).

Annex III. Table 3. Kosovo: Reserve Adequacy Metrics for Dollarized and Euroized Economies

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
						Projections					
Standard GIR (Millions of euros)	1168	1164	1142	1149	1293	1310	1420	1426	1427	1430	1367
Percent of RA metric	147	139	126	119	106	94	94	88	82	76	69
Percent of RA modified metric	116	109	98	91	83	75	75	70	65	61	55
Conservative GIR (Millions of euros)	683	769	864	900	1100	1121	1236	1248	1253	1262	1204
Percent of RA metric	86	92	95	93	90	81	82	77	72	67	61
Percent of RA modified metric	68	72	74	72	71	64	65	61	57	54	49
GIR, Net of Excess Reserves (Millions of euros)	1026	1021	955	847	1008	1052	1162	1155	1145	1137	980
Percent of RA metric	129	122	105	88	83	76	77	71	65	61	49
Percent of RA modified metric	102	96	82	67	65	60	61	57	52	49	40

Source: IMF staff calculations.

- **Fiscal buffers.** The government's usable bank balances are projected to be 3.3 percent of GDP by end-2022, sufficient for 1.2 months of spending plus debt service. Government deposits including PAK and earmarked deposits are about 7 percent of GDP.

- **Bank liquidity buffers.** Kosovo banks generally have high liquidity ratios, and it is expected that the largest banks would receive liquidity support from their parent groups in emergency times. However, banks' ability to respond to a system-wide liquidity shock is limited by (i) some liquid assets are in the form of Kosovo government bonds, which may not be immediately tradable; and (ii) the coverage of the deposit insurance is not high enough to substantially reduce the risks of bank runs. The CBK's GIRs excluding commercial banks' deposits are about 15 percent of banks' short-term liabilities, which should be sufficient to absorb a moderate to severe liquidity shock.[7]

[7] In addition, to address the potential liquidity risks during the pandemic, 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 expire in early 2023.

Annex IV. 2019 FSSR Main Recommendations and Implementation Status

Recommendations	Status
Short Term (within 12 months of FSSR)	
Restart the process to fill the vacancies of the CBK Board in accordance with the central bank law.	**Completed.** Three vacancies at the CBK Board have been filled in December 2021 and June 2022.
Review the effectiveness of the operation of the Central Bank Board.	**In progress.** A virtual TA mission on central bank governance took place in July-August 2021 and April 2022 to review the effectiveness of decision-making bodies at the CBK, including membership of key committees. The next step is for the CBK Board to have an on-site board workshop (with the Fund's assistance) to discuss and agree its future ways of operation.
Enhance the composition of the Executive Board and review its effectiveness.	**In progress.** The CBK has just initiated the process to supplement the Executive Board with a fourth voting member to ensure balanced decision-making and the representation of all departments.
Review and update the organizational structure of the CBK and refresh documented roles and responsibilities to ensure the structure is clear.	**In progress.** The CBK proposed an updated organizational structure for discussions at the CBK Board.
Remove any remaining doubt concerning the protection of CBK staff while discharging their duties in good faith.	**In progress.** The CBK has initiated the process of amending its internal rule on the indemnification of staff costs in legal proceedings by providing unconditional support for staff in these circumstances.
Require full professional history of directors and senior management, as well as for principal shareholders of the proposed bank in applications for licenses.	**In progress.** The draft law on banks will require the entire business and professional history for the directors and senior management.
Intensify efforts with the ECB to participate in the Raiffeisen supervisory college and to be party to its resolution and recovery plans.	**In progress.** The CBK has made multiple attempts to participate in the Raiffeisen supervisory college, but unsuccessfully so far.
Establish supervisory procedures during periods of stress and conduct periodic tests on the operational procedures for granting of ELA.	**In progress.** The CBK is planning to conduct a liquidity crisis simulation exercise to test the capacity of the current framework to deal with potential liquidity assistance requests from banks.
Update the premium rate pricing of the mandatory MTPL product and develop a process to regularly review the pricing as risk factors evolve.	**In progress.** In 2019, the CBK has allowed insurance companies to adjust the MTPL tariff in line with inflation. A new risk-based model for pricing the MTPL tariffs is being developed in cooperation with the World Bank.

Recommendations	Status
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.	**Completed.** Starting from 2019, the insurance industry is no longer required to pay a 1 percent premium contribution to the Red Cross. The 5 percent tax on gross premium was eliminated.
Implement the risk-based insurance supervision manual that has been developed.	**Completed.** 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.
Review the CBK's institutional arrangements and governance in support of financial stability and macroprudential policy.	**In progress.** The decision-making itself is reserved to Executive Board consisting of the Governor and Deputy Governor(s). As of September 2022, two Deputy Governor positions are vacant, though one position has been filled on a temporary basis through June 2023. The Governor has so far exercised executive responsibilities for macroprudential oversight.
Complete a full review of macroprudential data gaps and develop a strategy to close them.	**In progress.** The review of the macroprudential data gaps has started. The review will be followed by the strategy to close the gaps derived from the review.
Ask the Government to establish a cross-agency task force on the development of capital markets.	**Not yet started.**
Establish a National Strategy on Financial Inclusion.	**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.
Harmonize reporting of FSIs and address remaining methodological issues.	**In progress.** The FSI definitions are broadly in line with IMF guidelines. The main remaining issue to be addressed is the treatment of Kosovo government securities in calculating liquidity assets reported to IMF Statistics Department.
Medium Term (within one to three years of FSSR)	
Integrate stress tests exercises with the financial stability area and communicate the results to the banks.	**In progress.** The Economic Analysis and Financial Stability Department (EAFSD) and the Banking Supervision Department (BSD) have integrated the stress test models into a single model, which is compiled by the EAFSD with direct contribution from the BSD. The next stage includes the communication and discussions of the results with banks.
Develop tools for a more thorough assessment of credit risk, based on granular data from the Credit Registry.	**In progress.** The Credit Registry, which operates within the CBK, records detailed credit information at the individual loan level. The CBK has initiated the process of amending the Credit Registry's framework to include more detailed information regarding individual loans.

Recommendations	Status
Reconsider crisis management processes for the insurance industry, particularly appointing CBK employees as administrators and liquidators.	**In progress.** The CBK has appointed central bank employees as administrators and liquidators given the lack of the necessary competencies in the domestic labor market. The CBK has tried in the past to recruit liquidators from the market, but the interested candidates did not meet the required conditions. Therefore, the CBK will need a longer period to implement the recommendation; in cases where potential external candidates do not meet the required criteria, it will continue to use internal resources.
Amend the central bank law to strengthen the legal basis for CBK's macroprudential policy powers.	**In progress.** 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.
Ensure methodological consistencies of monetary statistics with international standards.	**In progress.** For monetary statistics, the CBK has implemented the recommendation "increasing periodicity of 4SR to monthly". The CBK is working on addressing the other issues found by the FSSR assessment, including correcting misclassification in terms of financial instruments, sectors, and currencies, recording revaluation for 1SR, and estimating and reporting euro currency in circulation.

Annex V. Implementation of Past Article IV Recommendations

Areas	Recommendations	Status
	Partial progress	
Fiscal policy and governance: **Improve productivity of spending, broaden revenue, and strengthen fiscal institutions**	Fiscal policy to return to a more supportive stance.	Although new measures were adopted in response to surging energy and food prices, they mainly replaced the pandemic-related programs while the implementation of the public investment program has significantly lagged.
	Keep public sector wages within the limits of the wage bill rule	Public wages have been within the limit of the legal wage bill ceiling (the ceiling is calculated annually as the product between the previous year's wage bill and nominal GDP growth). The new Law on Public Wages, expected to be implemented in mid-2023, will raise the public wage bill substantially. The value of wage coefficients and total wage bill under the new Law on Public Wages have not been determined as of November 2022.
	Improve the efficiency of spending and the public investment framework	Overall, there has been little progress. The absorption of donor-financed investment under the "investment clause" continues to be low. Overall execution of capital projects continued to be slow, with high payment 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.
	Strengthen fiscal institutions, governance, and fiscal risk management	Disclosure of fiscal risks has been strengthened as a section on POEs was included in the Fiscal Risk Statements that accompanied the annual budget and the MTEF. The work on the law on POEs started in 2018 and a concept note on the law is prepared in early 2022.
	Limited progress	
	Strengthen focus, composition, and transparency of public spending	Some of the new social transfers have been targeted, such as one-off cash payments to pensioners or students, whereas some others have not been well targeted. The budget has contingency reserves allocated to address downside risks; however, this allocation has been too large and opaque. There is a need for strengthening the targeting of social safety net spending.

Address labor market rigidities	**Limited progress**	
	Upgrade skills and reduce skills mismatches, and reform social benefits	Broad plans to increase the number of teachers and provide scholarships have been announced, but concrete measures to implement these plans have not been released. Furthermore, reforms to modernize curricula and textbooks, upgrade vocational education and training programs, strengthen accreditation and professional standard, and improve labor market intermediation remain at an early stage.
Reduce the costs of doing business and improve governance	**Partial progress**	
	Increase efficiency and fairness of the justice system.	With new appointments, there are now around 15 commercial court judges. The authorities plan to add 55 new judges to the system, which currently has around 390 judges in total.
	Judiciary reforms to fight organized crime and high-level corruption	To tackle corruption, a set of new anti-corruption laws were adopted in 2022, which aim at strengthening criminal proceedings, the anti-corruption agency, and asset declaration. These laws include: the Law on Declaration, Origin and Control of Assets and Gifts; the Law on the Corruption Prevention Agency; and the Law on the Kosovo Prosecutorial Council.
Financial sector: strengthen credit monitoring	**Partial progress**	
	Implement the recommendations of the 2019 FSSR and 2020 Safeguards' Assessment	Despite some progress in restoring the functioning of the CBK Board, risk-based supervision and the premium increases in the vehicle insurance sector and developing a strategy for consumer protection and financial literacy, the implementation of other FSSR recommendations has been limited.
	Address remaining deficiencies in the AML/CFT framework	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 *acquis*, including with respect to the introduction of sanctions for TF, requirements for beneficial owner identification and implementation on targeted financial sanctions mechanisms.