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FIRST REVIEWS UNDER THE STAND-BY ARRANGEMENT AND THE ARRANGEMENT UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY AND REQUEST FOR MODIFICATION OF REFORM MEASURE—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF KOSOVO

In the context of the First Reviews Under the Stand-By Arrangement and the Arrangement Under the Resilience and Sustainability Facility and Request for Modification of Reform Measure, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 15, 2023, following discussions that ended on October 6, 2023, with the officials of Republic of Kosovo on economic developments and policies underpinning the IMF arrangement under the Stand-By Arrangement and Resilience Sustainability Facility. Based on information available at the time of these discussions, the staff report was completed on [date on page 1 of final report circulated].
- A **Statement by the Executive Director** for Republic of Kosovo.

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

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International Monetary Fund
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PRESS RELEASE

PR23/396

IMF Executive Board Completes the First Reviews of Kosovo's Stand-By and Resilience and Sustainability Facility Arrangements

FOR IMMEDIATE RELEASE

- The IMF Executive Board completed on November 15, 2023, the first reviews of Kosovo's Stand-By Arrangement (SBA) and Resilience and Sustainability Facility (RSF) arrangement, making available SDR 20.031 million (about €24.8 million) and SDR 30.976 million (about €38.4 million), of budget support under each facility, respectively.
- The authorities are making very good progress in implementing their policy agenda under the Fund-supported arrangements. The SBA continues to provide a key policy anchor, and the RSF continues to support Kosovo's climate change mitigation and adaptation efforts including by catalyzing additional climate financing.

Washington, DC: The Executive Board of the International Monetary Fund (IMF) completed today the first reviews of Kosovo's 24-month Stand-By Arrangement (SBA) and of Resilience and Sustainability Facility (RSF) Arrangement. Completion of these reviews makes available SDR 20.031 million (about €24.8 million) under the SBA and SDR 30.976 million (about €38.4 million) under the RSF arrangement.

Following the Executive Board's discussion, Mr. Okamura, Deputy Managing Director, and Acting Chair of the Board, issued the following statement:

Executive Board Assessment [1]

The Kosovo authorities have made significant progress in the implementation of their economic reform agenda. Growth has been strong despite global and regional headwinds and geopolitical tensions. Inflation is on a strong downward trend. Program performance under both the Stand-By Arrangement (SBA) and the Resilience and Sustainability Facility (RSF) has been strong.

Fiscal targets for June and September 2023 under the SBA were met comfortably, and all structural benchmarks have been implemented. The 2024 budget is in line with program targets and with Kosovo's rules-based fiscal framework. Reforms implemented in the context of the SBA have aimed to make the tax system more equitable, enhance tax compliance, improve fiscal risk assessment, and strengthen public investment management, fiscal transparency, and accountability.

The appointment of a new central bank governor in August has brought about renewed momentum for reform implementation. A new banking sector law is expected to be sent to the

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

National Assembly early in 2024. The Central Bank of Kosovo is also working to strengthen its governance structures, with Fund support.

The RSF has been instrumental in supporting Kosovo's ambitious climate change mitigation and adaptation efforts. All RSF-supported reform measures have been implemented as expected. RSF reform measures will reduce emissions and improve air quality by increasing the share of renewables in the energy mix, improving energy efficiency, and strengthening the functioning and regional integration of Kosovo's energy system and energy markets. A new law on renewable energy sources has been sent to the National Assembly and will pave the way for the attraction of private financing for green energy. Ongoing efforts to assess the potential impact of the European Union's forthcoming carbon border adjustment mechanism (CBAM) are commendable. Implementation of C-PIMA recommendations will facilitate, in time, public investment becoming more targeted, efficient, and climate resilient. The medium-term impact of these measures is expected to be positive and large, underscoring the benefits of RSF resources for Kosovo.

Kosovo: Selected Economic Indicators, 2019–24

(Percent, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024
				Est.	Proj.	
Real GDP growth 1/	4.8	-5.3	10.7	3.5	3.8	4.2
Contribution to growth (percentage points of GDP)						
Consumption	5.8	2.3	7.7	3.3	4.4	3.3
Private	4.6	2.0	6.5	3.5	2.6	2.7
Public	1.2	0.3	1.2	-0.2	1.8	0.6
Investment	-0.1	-2.3	3.6	-2.5	1.9	1.1
Net Exports	-0.3	-5.3	-0.2	2.7	-2.5	-0.2
Exports	2.2	-8.6	17.0	6.1	3.6	2.3
Imports	-2.5	3.3	-17.2	-3.4	-6.1	-2.5
Real growth rate (percent)						
Consumption	6.2	2.4	7.6	3.3	4.4	3.3
Private	5.6	2.5	7.3	4.0	3.0	3.2
Public	10.1	2.1	9.0	-1.5	14.2	3.9
Investment	2.9	-7.6	13.0	-6.8	2.5	4.0
Exports	7.6	-29.1	76.8	17.2	9.0	5.5
Imports	4.5	-6.0	31.4	4.9	9.2	3.6
Official unemployment (percent of workforce)	25.7	26.0	21.3	…	…	…
Price changes						
CPI, period average	2.7	0.2	3.3	11.7	5.0	3.5
GDP deflator	1.0	1.4	6.1	8.5	5.6	3.5
General government budget (percent of GDP)						
Revenues and grants	27.0	25.6	27.8	28.0	28.7	28.1
Expenditures	29.9	33.5	29.0	28.6	29.9	29.5
Of which: Wages and salaries	8.7	9.8	8.4	7.3	7.8	7.7
Subsidies and transfers	8.9	12.8	10.6	11.9	11.1	10.6
Capital expenditure	7.6	5.6	5.3	4.7	6.0	6.1
Overall Balance (Fiscal rule) 2/	-0.8	-6.5	-0.9	-0.4	-0.7	-0.7
Overall balance	-2.9	-7.8	-1.2	-0.6	-1.2	-1.4
Stock of freely available government bank balances	5.1	3.4	3.8	3.2	3.1	3.4
Total public debt 3/	17.7	22.5	21.6	20.0	19.9	20.6
Balance of Payments (percent of GDP)						
Current account balance, incl. official transfers	-5.7	-7.0	-8.7	-10.5	-8.1	-7.0
Of which: Official transfers 4/	3.4	4.1	2.9	3.3	3.6	3.1
Of which: Remittance inflows	12.1	14.5	14.5	13.7	13.6	13.5
Financial account	-2.3	-8.3	-4.6	-7.4	-5.8	-4.7
Of which: Direct investment, net	-2.7	-4.2	-4.0	-6.7	-5.1	-4.9
Portfolio investment, net	0.8	-1.2	3.5	1.5	0.1	1.1
Other investment, net	-1.8	-3.5	-6.2	-2.9	-1.8	-2.3
Reserve change	1.3	0.7	2.1	0.8	1.0	1.3
Errors and Omissions	3.5	-1.6	3.4	2.7	1.6	1.6
Savings-investment balances (percent of GDP)						
National savings	28.9	26.4	27.2	24.3	24.9	25.7
Public savings	4.4	-2.8	3.9	3.9	4.0	4.6
Private savings	24.5	29.3	23.3	20.4	20.9	21.1
Investment	34.6	33.4	36.0	34.8	33.0	32.7
Public investment	7.6	5.6	5.3	4.7	6.0	6.1
Private investment	27.0	27.8	30.6	30.2	27.0	26.6
Current account, including. official transfers	-5.7	-7.0	-8.7	-10.5	-8.1	-7.0
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	16.0	12.1	9.2
Deposits of the private sector (percent change)	15.6	10.9	12.4	12.8	10.4	8.6
Regulatory capital to risk weighted assets	15.9	16.5	16.1	14.8	…	…
Memorandum items:						
Foreign Reserves (millions of euros, IMF Definition)	1,142	1,149	1,293	1,370	1,478	1,623
Foreign Reserves (% of ARA metric)	126	120	107	96	95	95
GDP (millions of euros)	7,056	6,772	7,958	8,936	9,794	10,563
GDP per capita (euros)	3,959	3,766	4,499	5,049	5,531	5,963
Real GDP growth per capita	5.6	-6.2	12.6	3.5	3.7	4.1
Output gap (% of GDP)	1.2	-6.2	-0.5	-0.5	-0.5	-0.3
Population (million)	1.8	1.8	1.8	1.8	1.8	1.8

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

1/ While quarterly and annual national account data for 2022 report the same nominal GDP, the use of different deflators in the two sets of data result in different annual real growth rates (3.5 percent in quarterly data, 5.2 percent in annual data). Pending final 2022 data (expected for December 2023), the table reports real growth in quarterly data.

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/ It does not include contingent debt of former Yugoslavia. Beginning in 2020, it includes Euro 120 million of debt with KPST.

4/ Total foreign assistance excluding capital transfers.

INTERNATIONAL MONETARY FUND

REPUBLIC OF KOSOVO

October 30, 2023

FIRST REVIEWS UNDER THE STAND-BY ARRANGEMENT AND THE ARRANGEMENT UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY AND REQUEST FOR MODIFICATION OF REFORM MEASURE

EXECUTIVE SUMMARY

Context, Outlook, and Risks. GDP growth is expected to average 4 percent per annum over 2023–24 on lower international commodity prices, vigorous diaspora flows, and sound macroeconomic policies. Average inflation is projected to decline to about 5 percent in 2023 and 3½ percent in 2024. Risks to growth are balanced on the short-term, but on the downside in the medium-term, given the complex geopolitical scenario.

Program implementation. Program ownership remains strong. All quantitative performance criteria and indicative targets have been met. Structural benchmarks under the SBA and reform measures under the RSF have been implemented. Actions required for subsequent reviews are progressing as expected or have been strengthened.

- **SBA.** The SBA continues to provide a key policy anchor. Fiscal policy is projected to provide a moderate stimulus in 2023 and to be broadly neutral in 2024. The SBA has also been instrumental in supporting structural reforms to strengthen fiscal and financial governance. The normalization of CBK operations has provided new impetus for reform implementation.
- **RSF.** The RSF is laying the foundations for greener and more efficient energy markets and supporting reforms in other areas. The RSF increased the policy space to strengthen the regulatory framework to attract private investment into renewable energy, improve energy market functioning, expand green electricity generation, reduce air pollution and emissions, strengthen energy security, improve the targeting of energy subsidies, and increase preparedness for the implementation of carbon pricing.

Given prudent macroeconomic policies and strong program ownership and implementation, staff supports the authorities' request for completion of the first reviews under the SBA and RSF, the proposed modification of an RSF reform measure, and disbursements under the RSF. The authorities intend to continue treating the SBA as precautionary but may reevaluate this at the time of the second SBA review if external budgetary support fails to materialize as expected.

Approved By:
Mark Horton (EUR) and Peter Dohlman (SPR)

Discussions were held in Pristina during September 25–October 6, 2023, and continued virtually over October 9–13. The staff team comprised Gabriel Di Bella (head), Stephen Ayerst, Javier Kapsoli, Ezgi Ozturk (all EUR), Sebastián Sosa (Regional Resident Representative) and Selim Thaçi (IMF Kosovo office). Mërita Kernja (IMF Kosovo office) assisted the mission team in Pristina.
Sabiha Mohona provided research assistance and Tina Kang assisted the team at headquarters. The mission met with Deputy Prime Minister Bislimi, Minister of Economy Rizvanolli, Minister of Finance, Labor, and Transfers Murati, Central Bank Governor Ismaili, and other senior officials and representatives of the business and donor communities.

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CONTEXT

1. **Energy and food prices have dropped substantially from 2022 peaks and supply chains have normalized, but the cost of borrowing is increasing.** The decrease in commodity prices is a boon for Kosovo, a net importer of food and energy. While activity in countries where the Kosovar diaspora resides has slowed (e.g., Germany, Switzerland), the post-pandemic mobility normalization continues to drive tourism flows up. On the downside, the ECB's policy tightening is filtering through to bank lending rates in Kosovo's unilaterally-euroized economy.

2. **Geopolitical tensions continue to pose risks and keep uncertainty elevated.** Tensions in northern Kosovo have resurfaced since May. According to some international observers, these reflect, *inter-alia*, delays in establishing an "Association of Serb Municipalities" in four northern municipalities mainly inhabited by ethnic Serbs, as well as the operation of paramilitary groups in the area. In June, the EU imposed temporary, reversible penalty measures against Kosovo to promote faster de-escalation, including postponement of new financial support. The US has called both parties to de-escalate but has not reduced economic collaboration. The measures would be reversed should Kosovo suspend police operations in the vicinity of the municipal buildings in the north of Kosovo and conduct new local elections in the four municipalities. The measures are expected to have limited impact in the next 12–18 months, as they do not apply to projects or initiatives already underway, but they could have a significant long-term impact if sustained (Box 1).

3. **Political polarization, in part due to events in the north, may complicate the work of the National Assembly.** The government retains considerable popular support and can secure a quorum in the Assembly, which selected a new central bank (CBK) governor in mid-July and approved several laws, including on minimum wage increases. However, increased political differences may make it more difficult to secure the required 2/3 votes to authorize the contracting of new external debt.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

A. Recent Developments

4. **Inflation has decelerated rapidly driven by the decline in commodity prices**. After peaking at 14½ percent (y/y) in July 2022, headline inflation reached 2.4 percent (y/y) in July 2023. About 11 percentage points (ppt) of this decline were explained by lower food and energy price inflation (broadly in equal shares). However, higher international oil prices in August–September, fully passed-through to the pump, led to a rebound in headline inflation to 4.2 percent (y/y) in September 2023. Core inflation, which peaked at 5.8 percent (y/y) in January 2023, declined to 3.9 percent (y/y) in September 2023.

5. **Activity has remained strong.** Preliminary data suggest that real GDP growth was 3 percent (y/y) in 2023:H1. High frequency indicators show that good performance continued through the summer. This is explained by: (i) robust external demand—reflecting stronger diaspora-

related tourism inflows as well as emerging service exports in IT and business services; (ii) lower imports given lower commodity prices; (iii) increased investment despite relatively subdued private consumption; and (iv) a slightly expansionary fiscal position.[1]

6. **The external current account deficit (CAD) is narrowing.** The CAD was 5.2 percent of GDP in 2023:H1, compared to 7.2 percent of GDP in 2022:H1. The trade balance improved by about 2 ppt of GDP reflecting a decline in the value of fuel imports (1½ ppt of GDP) and strong tourism inflows (1 percent of GDP). Diaspora travel expanded by 21½ percent over 2022.[2] Moreover, IT and business services exports are showing increased dynamism. The primary income balance deteriorated by ½ ppt of GDP due to larger dividends paid to commercial banks' external parent companies.

7. **Fiscal operations thus far in 2023 have resulted in a small impulse.** Domestic revenues increased by about 0.5 ppt of GDP in the first 9 months compared to the same period in 2022. Primary spending increased by 0.9 ppt of GDP due to a higher wage bill and the new public salaries law, an increase in transfers, and a substantial increase in public investment program (PIP) implementation.[3] This resulted in a moderate fiscal impulse of 0.4 ppt of GDP.

8. **Credit growth has slowed but remains positive.** Growth of private sector credit (14½ percent y/y through June) was faster than that of private sector deposits (13 percent y/y). Both lending and deposit rates have inched up in line with ECB policy tightening.

B. Outlook and Risks

9. **Real GDP growth is expected at 3.8 percent in 2023 and 4.2 percent in 2024.** Activity in 2023 is underpinned by firm domestic demand: consumption is projected to recover on the increase in public sector wages and the decline in inflation; solid bank credit growth, a substantial increase in PIP implementation, and stronger-than-expected diaspora flows will support private investment. Keeping growth momentum in 2024 will depend on (i) international commodity prices remaining in line with the *IMF World Economic Outlook* baseline; (ii) a broadly-neutral fiscal stance in 2024; (iii) largely-stable diaspora inflows as a share of GDP; and (iv) continued net bank credit growth to the private sector. This should allow the relatively small output gap to close by end-2024. EU penalty measures are not expected to materially affect growth over 2023–24.

10. **Average inflation is projected to decline to about 5 percent in 2023, and to decrease further to around 3½ percent in 2024.** The forecast assumes that a significant share of the

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[1] Private consumption in 2022 was adversely impacted by declining real wages but is projected to recover in 2023.

[2] About 90 percent of tourism inflows are related to diaspora travel.

[3] The new public salaries law is an attempt to decompress the public sector payroll by setting basic wages based on ranked coefficients and standardizing the number and type of allowances received by public workers. This framework facilitates implementation of the fiscal rule and prevents an increase in the wage bill-to-GDP ratio as the monetary value of the coefficients is defined annually as part of the budget cycle.

disinflation ahead will be due to lower international commodity prices *vis-à-vis* 2022.[4] Over the medium term, inflation should gradually converge to about 2 percent, in line with the ECB's target. Core inflation is expected to decline gradually to 3 percent by end-2023, and to around 2 percent in 2024.

11. The CAD will narrow in 2023–24, but at a slower-than-programmed pace. Despite a pick-up in oil prices in 2023:Q3, lower commodity prices *vis-à-vis* 2022 will drive the CAD decline to 8.1 percent of GDP in 2023 (from 10.5 percent in 2022). This decline is slower than expected on account of higher dividend payments and lower goods exports than projected. The CAD is projected to decline further to 7 percent of GDP in 2024. Gross international reserves are projected to remain around above 95 percent of the IMF reserve adequacy (RA) metric.

Kosovo: SBA Baseline and Adverse Scenarios

	2022	2023	2024	2025	2026	2027	2028
Commodity Price Index (2022 = 100)							
Baseline	100.0	83.2	82.9	79.6	77.0	75.2	74.0
Adverse	100.0	83.2	99.4	87.4	81.1	77.7	74.0
Real GDP growth (percent)							
Baseline	3.5	3.8	4.2	4.0	3.9	3.8	3.8
Adverse	3.5	3.8	2.2	5.0	4.5	4.0	3.8
Average Inflation Index (2022 = 100)							
Baseline	100.0	105.0	108.6	111.1	113.2	115.5	117.8
Adverse	100.0	105.0	111.8	113.2	114.9	117.2	119.5
Current Account (percent of GDP)							
Baseline	-10.5	-8.1	-7.0	-6.7	-6.0	-5.2	-5.1
Adverse	-10.5	-8.1	-8.5	-7.4	-6.5	-6.0	-5.4
Fiscal Deficit (percent of GDP)							
Baseline	0.6	1.2	1.4	1.6	1.8	2.0	2.0
Adverse	0.6	1.2	1.9	1.9	1.9	2.1	2.0
Gross International Reserves (percent of IMF RA metric)							
Baseline	96	95	95	95	95	95	95
Adverse							
Without SBA	96	92	90	90	90	90	90
With SBA	96	92	96	95	95	95	94

Source: IMF staff calculations.

12. Risks to growth are balanced in the short-term but to the downside in the medium-term, while risks to inflation are mainly to the upside (Annex I).

- ***External Risks.*** While in the short-term, stronger-than-projected diaspora flows can support growth, a rebound in commodity prices could lead to renewed inflation, lower private demand and growth, and larger fiscal financing needs (Box 2). In the medium-term, weaker activity in

[4] Inflation in Kosovo averaged 5.7 percent in the first nine months of 2023 relative to the same period in 2022.

advanced European economies could weigh on diaspora-related inflows and external demand. Tighter financial conditions may weigh on banks' asset quality and liquidity.

- ***Domestic Risks.*** In the short-term, a smaller-than-projected fiscal impulse could dent growth; EU visa liberalization, which enters into force in January 2024, could lead to increased emigration, negatively impacting short-term demand and increasing the tightness of several labor market segments. On the upside, stronger service exports, both traditional and emerging, may lift demand and growth. In the medium term, continued tensions in the north may weigh on FDI, new donor financing, and tourism inflows. At the same time, the "near shoring" efforts of many European firms could lead to higher FDI and potential growth, especially if the dialogue with Serbia advances.

PROGRAM PERFORMANCE AND POLICY DISCUSSIONS

A. Stand-By Arrangement

The SBA will continue to anchor policies and help catalyze financing. In the absence of exogenous shocks or lower-than-programmed financing, the SBA will remain precautionary. Structural benchmarks will continue focusing on enhancing public financial management, containing fiscal risks, and strengthening revenue mobilization. On the financial sector, actions will focus on improving central bank and financial sector governance and banking supervision.

13. All quantitative performance criteria (QPCs) and indicative targets (ITs) for end-June and end-September 2023 were met. Available data suggests that QPCs and ITs for end-December appear to be on track. The structural reform agenda also made good progress; all structural benchmarks (SBs) for the first review were implemented and good progress was observed towards meeting the SBs upcoming in the next few months.

Fiscal Policies and Reforms

14. The SBA will continue to anchor fiscal policies over 2023–24. The budget deficit in 2023 is projected to be consistent with a fiscal impulse of about 1.1 ppt of GDP, lower than programmed, but still appropriate given stronger-than-projected external demand, a significant deceleration of inflation, and moderate slack. Moreover, the lower-than-programed fiscal deficit will crowd in bank credit, as net domestic government debt placements were also revised down. Importantly, there will be no reallocations from capital to current spending, nor significant reallocations within

Kosovo: Uses of the Budgetary Contingency Reserve
(As of June 2023)

	Euro Million
Energy Support	57.6
Defense Support	25.8
Access to Finance	16.5
Vulnerable Households	5.4
Investment Subsidies	5.0
Other	9.2
Total	**119.5**

Source: Kosovar Authorities.

current spending categories.[5] Fiscal data through end-September are in line with this assessment.[6] Concretely:

- ***Revenues.*** Domestic revenue performance has been strong, reflecting continued efforts to strengthen tax compliance and good activity levels. Direct taxes (PIT, CIT, property taxes) are growing briskly (20 percent y/y through September), as programmed. Domestic consumption taxes (domestic VAT, excises) are showing solid growth (10 percent, y/y), also in line with the program. Growth of VAT at customs has decelerated to 7 percent (y/y) given lower imported inflation, as expected. Collection of custom duties has overperformed through September.

- ***Expenditures.*** The wage bill, subsidies, and transfers are growing in line with the program. About 1/3 of annual contingent reserves has been allocated including to subsidies to finance energy-efficiency investment, youth employment, security spending, and higher pensions, the latter because of a June constitutional court ruling mandating increased benefits to pensioners with less than 15 years of contributions to the old Yugoslavian pension system (Box 3). Spending on goods, services, and utilities are growing in real terms, but less than in the program, in part due to the lower energy bill.[7] Capital expenditures are up 68 percent (y/y) through September on account of filling of vacancies at the procurement review body and implementation of measures to compensate contractors for increased inflation costs.[8]

Kosovo: SBA Quantitative Performance Criteria
(Millions of euros)

	2023							
	June Prog. Target	June Adj. Target	June Actual	Status	September Prog. Target	September Adj. Target	September Actual	Status
1. Quantitative performance criteria								
Floor on the Overall Balance of the General Government 1/	-113	-93	227	Met	-169	-132	295	Met
Floor on the Stock of General Government Deposits at CBK	576	572	769	Met	571	530	803	Met
2. Continuous performance criteria								
Ceiling on the accumulation of new external arrears on external debt contracted or guaranteed by the general government 2/	0	...	0	Met	0	...	0	Met
3. Indicative targets								
Ceiling on Contingent Budget Allocations 3/	358	...	358	Met	358	...	358	Met
Ceiling on Holdings of Government Debt by the CBK 2/	200	...	189	Met	200	...	179	Met

1/ Defined as cumulative flows over the fiscal year
2/ Applies on a continuous basis
3/ Defined as total budgetary contingent allocations; applies on a continuous basis. See paragraph 25 of the Technical Memorandum of Understanding.

[5] While public investment in 2023 is projected to increase by around 1–1.5 ppt of GDP *vis-à-vis* 2022, it will be nonetheless below program projections.

[6] Kosovo's fiscal reporting is on a cash-basis. Payments are strongly seasonal and accelerate in the last quarter. Strengthening fiscal reporting requires starting to use GFSM 2014 reporting standards and producing fiscal information on an accrual basis.

[7] This is the case despite the increase in oil prices observed in August–September 2023.

[8] The fiscal balance will be adjusted upwards if externally-financed investment is lower than programmed, per the SBA TMU.

15. The 2024 budget is consistent with program objectives and a broadly-neutral fiscal stance. The government submitted, in October, a 2024 budget consistent with the objectives of the SBA and RSF-supported programs (prior action). The budget is in line with Kosovo's fiscal rules and includes a blanket allocation that is below the SBA ceiling.[9] In particular:

- ***Wage Bill.*** The government started implementing a new public wage law in early 2023. The law provides a holistic approach to the management of public sector compensation and strives to achieve a fairer salary structure, including by streamlining the number of allowances. While implementation of the law will result in an increase of the wage bill of ½ ppt of GDP in 2023, the budget for 2024 defines a wage coefficient that will leave the wage bill about constant in GDP terms. The 2024 budgetary envelope covers basic wages, social security contributions and allowances as defined by the new law.[10]

- ***Subsidies and Transfers.*** The envelope for subsidies and transfers in the 2024 budget will decline by around ½ of ppt of GDP with respect to 2023 to about 10½ percent of GDP. This decline is predicated on the elimination of untargeted government electricity subsidies following the increase in electricity tariffs last March; as well as war veterans' benefits converging to its legal ceiling of 0.7 percent of GDP, which was made possible after their delinking from minimum wage increases.[11] The envelope for subsidies and transfers includes an allocation of €15 million to pay for the gross cost of the constitutional court ruling on contributory pensions, whose net impact is expected to be €6 million (Box 3). It also includes an allocation for a new means-tested subsidy to assist vulnerable energy consumers at an annual cost of €9 million (¶37).

- ***Discretionary Allocations.*** Large, opaque blanket allocations distort the transparency and accountability budgetary principles. Blanket allocations peaked during the pandemic and energy crises, as they were used as a buffer to attend the health emergency and cost-of-living crisis. While uncertainty remains significant, the 2024 budget reduces these contingencies to €132 million (1.3 percent of GDP, well below the SBA indicative ceiling of 2 percent of GDP). Blanket allocations in the 2024 budget aim to create room for a faster-than-expected implementation of capital projects, address unforeseen contingencies, and mitigate the materialization of other downside risks, including higher-than-projected international commodity prices. To foster transparency on use of these resources, treasury quarterly reports started in July to include a section describing their use, intended impact, rationale, and beneficiaries (SB, end-July).

16. Continued improvement in tax administration will expand the tax base and allow for sustained progress in reducing informality. The government adopted, in June, an updated Customs and Excise Code to further align it with the EU customs code and excise *acquis* (SB, end-

[9] The 2024 budget is also consistent with RSF RM1 scheduled for end-October 2023. Therefore, the prior action completed RM1.

[10] For more background, see the 2022 Article IV Consultation and the SBA-RSF program request.

[11] Delays to implement the Brussels Agreement electricity protocols continue to pose challenges to the electricity system operator (KOSTT), which needs to juggle the conflicting tasks of balancing the system before the European Network of Transmission System Operators for Electricity (ENTSO-e) while absorbing the financial losses resulting from unpaid electricity consumption in northern Kosovo.

June). To further mobilize revenues, the Tax Administration of Kosovo (TAK) adopted a new action plan to reduce informality (SB, end-July 2023).[12] The plan operationalizes the TAK's Strategic Plan for 2022–26 to strengthen revenue collection and reduce the tax gap. While the objective is to strengthen overall tax compliance, the main focus is on: (i) tackling non-declaration of income to identify persons who do not declare and pay PIT obligations correctly; and (ii) identifying high-income taxpayers that do not properly file PIT obligations by using information from different tax and financial institution databases. A new law on the administration of tax procedures is also being prepared to further strengthen tax compliance. Moreover, TAK has continued work to better customize enforcement and preventative actions to taxpayer types, use risk analysis more effectively, and is evaluating options to finalize implementation of a new IT system. Gains in tax compliance underpin planned budgetary revenues for 2024, which are programmed to stay about constant as a share of GDP, despite expected decreases in customs revenues on account of the implementation of free trade agreements with the EU and Türkiye, among others.[13] Moreover, the government is working on new laws on CIT, PIT, and VAT that abide by EU-SAA commitments; these laws eliminate inconsistencies, simplify administration, and allow to better identify tax expenditures.

17. Strengthening public investment management (PIM) remains essential to increase the growth yield of the budget. A Public Investment Management Assessment (PIMA) update in June assessed that while several previous recommendations have been implemented, significant work remains, particularly at the planning stage of the investment cycle. Strengthening project appraisal, investment planning, and the Ministry of Finance, Labor, and Transfers' (MFLT) review function are priorities. To strengthen PIM and improve PIP absorption, the MFLT approved in May a budget circular requiring budget organizations to include expropriation costs as part of project envelopes (SB, end-June). This will gradually replace the current system of centralized expropriations, with one that will ensure that no new projects can be included in the budget without accounting for expropriation costs. To accelerate the implementation of externally-financed projects, the MFLT has started to enforce that technical evaluation and documentation on new externally-financed projects are finalized before signing the corresponding financial agreements. To improve PIP effectiveness, the government is preparing a new procurement framework, including a new Public Procurement Law fully aligned with the EU *acquis.* The new law, to be sent to the Assembly by end-2023, aims to build on the recent developments on e-procurement to build an efficient, transparent, and accountable procurement system.[14]

18. Upgrading the operations of publicly-owned enterprises (POEs) is needed to improve public service provision. Improving POE corporate governance and timely monitoring and reporting should result in increased accountability and better service. The compilation, analysis, and

[12] The plan was announced on July 25, 2023 (https://www.atk-ks.org/en/notice-to-taxpayers-tak-implementing-the-project-non-declaration-of-income-in-pit/ and https://www.atk-ks.org/en/notice-to-taxpayers-tak-in-implementation-of-the-wealthy-persons-project/). TAK shared the action plan with IMF staff.

[13] Tax administration revenue gains over 2023–28 are projected at about 0.3–0.4 ppt of GDP, while custom revenue losses are projected to be 0.9–1.0 ppt of GDP over the same period.

[14] The low public debt-to GDP ratio suggest that there is space to increase debt-finance infrastructure spending; indeed, this is the objective of the "investment clause" in Kosovo's fiscal rule.

dissemination of POE financial data for 2023 will help strengthen POE transparency (end-June 2024 SB).[15] The law creating a Sovereign Fund (SF) was approved by the government in June and has passed the first reading in the Assembly. The SF would strengthen POE management and attract private capital, initially to the largest 5 POEs.[16] The SF will operate as an autonomous public institution under the Assembly, and it is not expected to result in below-market financing or directed lending from Kosovo's Pension Savings Trust (KPST).

Kosovo: Budgetary Financing Needs

(Euro million)

	2022	2023		2024		
		Baseline	Adverse 1/	Baseline	Adverse 1/ SBA	Adverse 1/ No SBA
Gross Financing Needs	**323**	**426**	**426**	**499**	**549**	**549**
Fiscal Deficit	52	116	116	150	200	200
Fiscal Rule Definition						
Amortization	271	310	310	349	349	349
External	48	55	55	67	67	67
Domestic	223	255	255	283	283	283
Financing	**323**	**426**	**426**	**500**	**549**	**549**
External Debt	111	226	188	193	283	193
Budget Support	11	146	108	102	102	102
Use of IMF resources	0	0	0	0	90	0
SBA	0	0	0	0	90	0
Project Finance	100	80	80	91	91	91
Gross Domestic Debt Placements	219	208	208	347	347	347
On Lending (net)	-38	11	11	10	10	10
Government Deposits	23	-20	18	-50	-91	-1
Other	9	0	0	0	0	0

Source: IMF staff calculations

1/ The impact of the higher commodity prices would affect fiscal revenues and the overall fiscal balance; the impact of lower-than-programmed financing is shown below the line.

19. **The program is fully-financed for 12 months and there are good financing prospects for the remainder of the program.** The overall fiscal deficit is projected to be below the program floor in both 2023 and 2024 (1.1 and 1.4 percent of GDP, respectively). EU measures do not affect program's financing as the SBA's baseline does not include EU or bilateral budget support.[17]

- ***For 2023,*** the WB's social assistance reform project loan (€15 million) was disbursed and the WB's Development Policy Operation (DPO) has been increased from US$60 million to US$100 million (about €90 million); OFID financing expected for 2023:Q3 (€38 million) is still programmed, but it has failed to pass parliamentary approval, and may fail to materialize permanently. Domestic debt issuance has normalized after the filling of KPST Board vacancies in

[15] In addition, the MFLT has been publishing, on a quarterly basis, economic and financial data for all 19 POEs.

[16] The SF's aim is to increase the value of Kosovo's main POEs, so they become attractive to private investors. This would lead to an improvement in public service provision and, more broadly, to better investment climate.

[17] About €67 million EU budgetary support grants were disbursed in 2023:Q2. While the remaining €8 million are expected in 2024, the program will consider them only after penalty measures are removed.

July; overall domestic debt issuance for 2023 is expected to roll-over debt maturing, given the stronger fiscal position and higher external financing.[18]

- ***For 2024,*** the program also includes a WB DPO with an envelope of about €90 million; and net domestic debt issuance of €100 million.[19] The government is discussing with the bilateral development agencies of France and Germany additional budget support (not currently in the program) of about €60 million. To increase the pool of available financing, the MFLT has started discussions to obtain an international credit rating.

20. While commodity prices have remained close to forecasts, still-high global uncertainty and the situation in the north warrant a deeper focus on fiscal risk analysis. The MFLT is preparing a stand-alone annual fiscal risk analysis report that will describe the main macroeconomic risks facing the budget and the economy more generally (SB, end-November 2023). This analysis will also discuss risks arising from the operation of POEs, contingencies, and arrears, among others. The MFLT is also strengthening fiscal risk analysis capacity with donor support.

21. Unless warranted by an extreme shock, the program will continue to use the fiscal rule's 2 percent of GDP deficit ceiling as the general guide for policy. The downside risk scenario under the precautionary SBA includes:

- ***An increase in international commodity prices compounded by lower external budgetary financing.*** A slowly-reversing 20 percent increase of commodity prices in 2024 would lead to lower GDP growth, a reopening of the output gap, lower fiscal revenues, and higher fiscal and external financing needs. The largest impact would occur in 2024, where GDP growth would be 1.5–2 pp lower than in the baseline. The more negative output gap would lead to lower fiscal revenues of about 0.5 ppt of GDP in 2024–25. Moreover, the adverse scenario assumes the non-materialization of OFID disbursements, which would lead to an additional financing need of 0.4 ppt of GDP. The combined shocks would open a financing gap of €88 million (about 0.9 ppt of GDP) in 2024.

- ***The SBA would allow reserves to remain adequate, anchoring expectations.*** If the terms-of-trade shock is assessed to be temporary, staff would recommend letting fiscal stabilizers operate and the overall fiscal deficit increase. SBA purchases in 2024 of around SDR70 million (out of an SBA envelope of SDR80 million) would keep government buffers at appropriate levels and international reserves to remain within 90–95 percent of the IMF RA metric, as in the baseline. This would also allow to preserve PIP and social spending. Parliamentary delays in approving WB

[18] The loan agreement with OFID has been signed and requires Assembly approval for disbursement. The government can continue to submit it to the Assembly until end-2023 and has until March 2024 to request a further formal extension. The authorities conveyed that they expect to take such decision in 2024:Q1.

[19] Most prior actions (9 out of 10) under the 2023 DPO have been met and the remaining action is expected to be met in the coming weeks, allowing WB Board discussion of the DPO. Staff provided an assessment letter for this operation. Moreover, discussions are well-advanced on the features of the DPO for 2024. The WB has indicated that Programmed disbursements for 2024 assume that the DPO will include a similar amount as that in 2023 from the "IDA20 Scale-up Window" (SUW).

financing would be treated as temporary, and accordingly, they will be absorbed through the SBA's adjusters. The program includes a consultation clause to recalibrate policies should shocks prove stronger and more persistent than expected under the program.

Financial Sector Policies and Reforms

22. **The banking system remains solid, although with pockets of vulnerabilities.** Bank liquidity and capitalization ratios remain above regulatory minima but have declined since 2022:H2. Tier1 capital to risk-weighted asset ratio was 13¾ percent in August 2023 (14 percent in August 2022) mainly due to increased dividend payments. The liquidity ratio (liquid assets to total assets) declined to 24¾ percent in August (26¾ percent in August 2022), as growth of private sector credit was faster than that of private sector deposits. Banks have absorbed the policy rate increase by raising loan and deposit rates, which has preserved bank profitability. While NPLs have so far remained low (at around 2 percent), tighter financial conditions may weigh on banks' asset quality and liquidity, in particular those with weaker risk analysis. [20]

23. **The Assembly selected a new CBK Governor in July, and the President ratified the appointment in mid-August.** The new governor immediately appointed an acting deputy governor, allowing the executive board to resume operations. The planned appointment of deputy governors by December will conclude the normalization of the CBK's main governance structures.[21]

24. **The normalization of CBK operations has provided new impetus for reform implementation.** In line with the 2019 Financial Sector Stability Review (FSSR) recommendations, the CBK Supervisory and Executive Boards are reviewing the effectiveness of decisions-making bodies and plan to issue new "Rules of Procedure" clarifying the roles and responsibilities of the CBK Supervisory Board in relation to the Executive Board, including by specifying ways to structure information requests, confidentiality, and secrecy arrangements (SB, end-November 2023).[22] The new rules will be drafted by the Executive Board, be approved by the Supervisory Board, and be fully in line with the CBK charter. Importantly, the new rules will establish safeguards to ensure that quorum of the Executive and Supervisory Boards is not impeded by failing to appoint their members on time.

25. **The CBK reaffirmed its commitment to advance in the implementation of the recent IMF Safeguards Assessment (SA).** The SA recommended medium-term reforms to strengthen governance and noted that despite progress in most areas, absence of an interdepartmental risk management body, lack of capacity, and cybersecurity remain challenges. To address these

[20] While higher interest rates have not led to an increase in the system's NPLs, smaller domestic banks may be more vulnerable to higher rates, given their relatively-lower standards in assessing credit risks. Stress tests in the IMF 2022 Financial Stability Report show that the banking system remains resilient to credit, market, and liquidity shocks.

[21] The CBK Executive Board's quorum is ensured by the new Governor and the acting deputy. The Supervisory Board is fully constituted.

[22] IMF MCM organized a workshop in July to assist the CBK in clarifying roles and responsibilities of different governance structures.

recommendations, the CBK plans to work on a systemic overview of all key oversight matters and is preparing a work program in that regard. The Audit Committee is working to strengthen its planning to exercise its responsibilities as established by the CBK charter. The CBK's Internal Audit Department is working on an action plan to strengthen IT audit skills and will include information on outstanding recommendations into its quarterly reports. In parallel, the CBK will strengthen the functioning of the Risk Management Department. To strengthen cyber resilience, the CBK is developing a new cybersecurity policy and framework and plans to recruit cybersecurity experts.[23]

26. Preserving the quality and liquidity of international reserves is crucial to ensure the CBK's role in maintaining financial stability. The CBK has continued managing its foreign reserves to ensure their liquidity, security and returns, in that order, in line with international best practice; and has kept its holdings of domestic government securities constant in nominal terms (indicative target). To strengthen the Emergency Liquidity Assistance (ELA) framework, the CBK has established a working group to review the appropriateness of its size, as well as its regulation and operations manual. The CBK is working on an IT solution to strengthen the functioning of the intraday, overnight, and REPO interbank liquidity markets, as part of central security depository (CSD) functionality improvements, including its interface with the clearing system. The CBK is also considering options to strengthen the available financing pool for deposit insurance purposes.[24]

27. Strengthening financial sector governance is a priority. The new CBK Executive Board has re-started work to finalize the draft Banking Sector Law, which will establish improved licensing criteria for banks, standards for their operations, organization, and management, and strengthen the bank resolution framework. The draft will be finished in November, be in line with international best practices (SB, end-November 2023), and be submitted to the Assembly in early 2024 (SB, end-January 2024). In parallel, the CBK is preparing new drafts laws on Microfinance and Non-Bank Financial Institutions and on Payment Services, with WB assistance. To improve financial inclusion, the CBK started implementing, in August, a regulation requiring banks to provide low-fee payment accounts with basic services. The CBK is monitoring its impact and will recalibrate if needed. Ongoing work on a draft law on Cadaster is expected to lower risks associated with mortgage lending and contribute to the development of this market segment.

28. Continued upgrading of the stress-testing framework is essential to better identify and monitor financial stability risks. The CBK is strengthening the top-down stress-testing framework to better identify financial stability risks, including credit concentration risks and liquidity risks, with IMF assistance. It is also developing internal rules formalizing the allocation of roles and responsibilities of stress-testing functions across the CBK departments and the dissemination of stress testing results. [25] Moreover, the Kosovo Agency of Statistics (KAS) in collaboration with the

[23] In line with the SA recommendations, the MFLT and the CBK signed, last July, an updated Memorandum of Understanding clarifying their respective responsibilities for servicing financial obligations to the IMF under the new arrangements.

[24] For instance, the renewal of external contingent financing lines or the negotiation of new ones.

[25] Work to strengthen climate-related data compilation is needed as a precondition to implement climate-risk stress testing.

CBK, is working to strengthen the surveillance of the housing sector. To that end, KAS produced a roadmap to create a residential property price index with the assistance of the IMF Statistics Department and has started the compilation of the required data to implement it (SB, end-September 2023).[26]

29. Closing AML/CFT gaps will strengthen Kosovo's transparency and governance credentials, with positive spillovers for FDI. Progress in this area over the last few years includes the publication of a money-laundering typology and strengthened cooperation between the Financial Investigation Unit (FIU), TAK, and customs. Moreover, the CBK signed an MOU with the FIU last July to facilitate exchange of information and build supervisory capacity to strengthen compliance with international standards. In parallel, the MFLT finalized a concept document analyzing changes needed in Kosovo's legislation to abide with EU directives regarding AML/CFT; this is a commitment under the Kosovo-EU SAA. The MFLT is also finalizing a new Law on Beneficial Ownership Registry that is expected to be sent to the Assembly in 2024:H1.[27]

B. Resilience and Sustainability Facility

RSF financing increases policy space to: strengthen the regulatory framework to attract private investment into renewable energy; improve energy market functioning; expand green electricity generation, with positive spillovers for energy security and air pollution and emissions reduction; implement well-targeted programs and subsidies to increase demand efficiency and support electricity consumption of vulnerable energy consumers, respectively; and increase preparedness for the implementation of the EU carbon border adjustment mechanism (CBAM) and of carbon pricing more generally.

30. The implementation of the RSF-supported program is off to a good start. All RSF reform measures (RMs) through October have been implemented. In addition, good progress was observed on RMs that are due in the coming months.

31. A new law on renewable energy sources, which transposes EU directives and defines a framework for competitive auctions, was submitted to the National Assembly in October (RM3, end-September 2023). The law, which reflects comments from donors, establishes a general framework to attract private capital into renewable energy using competitive auctions, regulates the use of public-private partnerships (PPP) to expand green energy capacity, establishes market prices as the reference for regulatory purposes, and defines and regulates the workings of electricity prosumers, among other provisions.[28] The law is expected to be approved by Parliament in 2024:H1.

[26] This roadmap has been published in KAS' website (https://askapi.rks-gov.net/Custom/92db7591-c858-4a52-a34c-cab637814895.pdf).

[27] The government is working on a new "National Strategy on Preventing and Fighting the Informal Economy, Anti-Money Laundering and the Financing of Terrorism and Financial Crimes" for 2024–28.

[28] In the context of energy, a prosumer generates their electricity (through e.g., solar panels) and also consume electricity from the grid when needed.

The Ministry of Economy is working on the secondary legislation and administrative instructions that will accompany the law.

32. Significant steps were taken to increase the share of green electricity generation. Kosovo's energy strategy aims to increase the share of renewable energy to 35 percent by 2031 (from 5 percent in 2022). This will require additional green generation capacity of around 1300 MW.[29] In this regard,

- The government launched last May, with USAID assistance, ***the first competitive pilot auction for 100 MW of solar capacity*** to be installed on public lands (RM5, end-May 2023). The auction was received with interest by domestic and foreign private investors, who will have until January 2024 to submit bids. The winning bid, which is expected to be announced in February 2024, will be awarded a 15-year power purchase agreement (PPA), the first of its kind established under a competitive mechanism in Kosovo. The additional capacity is expected to be in place by 2025.

- The government also signed, in early October, financing from the German International Cooperation Agency (KfW) for ***installation of 100 MW of solar capacity on Kosovo Energy Corporation (KEK) premises***. Project procurement is scheduled to start in 2024, with the new capacity in place by 2026. Total financing (€105 million) will include contributions from the European Investment Bank (EIB), the EU, and KEK, in addition to KfW.

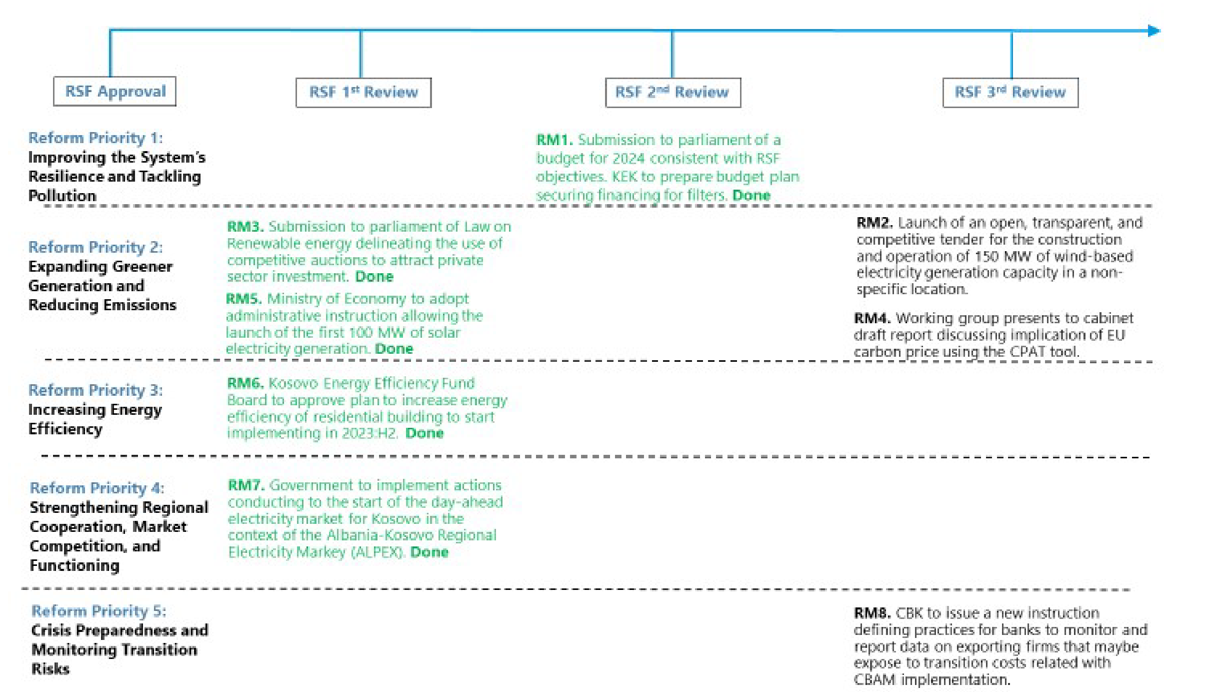
- Capitalizing on the lessons from the first competitive pilot auction, the Ministry of Economy will launch, with USAID assistance, ***the first competitive auction for 150 MW of wind generation*** in June 2024 (strengthened RM2, postponed to end-June 2024 from end-March 2024). To that end, the government presented in September a technical proposal describing the possible timeline, needed documentation, potential investor interest, alternative legal formats (including a PPP) and government co-financing options, to attract private capital to wind-based generation to a non-specific plot. While the technical details will be specified in the coming months, the government decided to go with a PPP where the private shareholder will operate and have the majority stake in the project. The successful bidder will be the one offering the most advantageous terms to the state, including with respect to the power purchase agreement (PPA) price, and on operating costs. The budget for 2024 includes a below-the-line allocation of €70 million in a sub-account of the Treasury Single Account to this end and defines that these resources will be transferred as on-lending to the entity that will hold the state's stake in the project (RM1, end-October 2023). The Ministry of Economy will present the draft tender terms, PPP proposal and associated technical documentation for the consideration of the PPP committee chaired by the MLFT by end-March 2024. The additional capacity is expected to be in place by 2026.

- The Ministry of Economy, with assistance from the Western Balkans Investment Framework (WBIF) has finalized a ***survey of public plots with potential for wind-based electricity***

[29] The government approved an administrative instruction on targets for renewables that articulates actions needed to reach Kosovo's renewable electricity capacity target of 1300 MW.

generation. The WB indicated capacity to mobilize funds and expertise to carry out additional studies, including the installation of wind measurement devices. After suitable measurements, the government intends to add these plots to the pipeline of possible green energy auctions.

Kosovo: RSF—Phasing of Reform Measures



33. Ongoing work by KEK at the "Kosova B" thermal power plant will allow a significant reduction of PM2.5 air concentration levels in Pristina and surrounding areas. KEK (a POE) finalized technical preparatory work that would allow the installation of filters in each of the two units of "Kosova B" to bring pollution levels from these units to EU standards.[30] Moreover, KEK's 2024 Budget Plan includes a contingent allocation of €12.5 million to complement EU financing for the installation of the filter in the B-2 Unit (RM1, end-October 2023). In parallel, the government is discussing with the EU ways that would secure the absorption of €70 million of the 2018 EU IPA grant for the installation of these filters at the shortest possible delays. As installing the filter in the B-2 unit requires stopping it over the spring and summer of 2024, KEK has upgraded maintenance of other domestic units to ensure their smooth operation in this period.

34. Kosovo's Energy Efficiency Fund (KEEF) has started implementing programs to increase energy efficiency in social multi-apartment buildings and private dwellings (RM6, end-July 2023). KEEF board approved in June a new plan to increase energy efficiency in residential buildings. According to the plan, KEEF is co-financing interventions to improve exterior and roof insulation and install more efficient heating systems, windows, and doors in private dwellings. Work in 16 social multi-apartment buildings has started and is expected to be finalized by end-2023; work

[30] This action will result in a significant decrease of pollution, as 80 percent in emissions result from coal-based electricity generation.

on additional 13 buildings is expected to be completed in 2024. Moreover, work in about 2000 private residences will be completed by early 2024. KEEF will collect data to assess the impact of the interventions and replicate those with the best socio-economic return.

35. The government approved all needed regulations for starting the day-ahead electricity market in Kosovo within the Albania-Kosovo Regional Electricity Market (ALPEX). This will strengthen regional integration and promote competition in electricity markets, which is essential to attract private investment. In this regard, the transmission system operator (KOSTT) transferred the rights for the organization of day-ahead and intra-day electricity market and the right for clearing and settlement to ALPEX. In addition, the MFLT issued an administrative instruction in June on the reverse-charge procedure for VAT declaration for electricity supply, which allows the tax treatment of ALPEX transactions on both sides of the border to be similar (RM7, end-June 2023). Finally, the Energy Regulatory Office (ERO) finished in September all needed regulatory amendments for ALPEX to start operating the day-ahead electricity market in Kosovo. The testing phase of the market platform is underway, with a dry-run programmed for November and the first trades to occur in December. As the market gains in depth and liquidity, market-determined prices will gradually replace those established by ERO as references in the competitive auctions to attract private capital to renewable energy generation. The market started operating in Albania earlier in 2023, as expected.

36. The government created an inter-ministerial group to analyze the impact of a gradual recognition of the negative externalities associated with brown-energy use. The working group includes representatives from the Ministries of Finance, Labor, and Transfers; Economy; Environment, Spatial Planning, and Infrastructure; and Industry, Entrepreneurship, and Trade; as well as from KOSTT and KEK. The group is using the IMF's Climate Policy Assessment Tool (CPAT) to assess the possible impact on emissions, pollution, activity, and inequality of a gradual recognition of the negative externalities of brown energy; to develop an understanding of the possible impact of the upcoming implementation of the EU Carbon Border Adjustment Mechanism (CBAM); and to increase Kosovo's preparedness to access the common energy market. IMF FAD has been assisting the working group, including through a workshop in October. The group will prepare a report describing alternative scenarios and policy options and will present it to the Cabinet in Q1:2024 (RM4, end-March 2024).

37. The design of electricity subsidies was revamped to better target budgetary support to vulnerable energy consumers. The MFLT finalized, with WB and Millennium Challenge Corporation (MCC) assistance, work to redefine the universe of vulnerable energy consumers. The program, at a net budgetary cost of €5 million in 2024, will subsidize part of the electricity bill for households with monthly incomes lower than €150 (i.e., the poverty line as defined by the WB), with the actual subsidy amount also considering household composition.[31] The 2024 budget includes an allocation to secure the implementation of this program (RM1, end-October 2023). The increase in electricity tariffs last March allowed to virtually eliminate blanket electricity subsidies.

[31] The subsidy is expected to reach around 50,000 households in the winter of 2023–24.

38. The CBK started work to strengthen bank monitoring and reporting of climate and transition risks, including related to CBAM (RM8, advanced to end-March 2024 from end-June 2024). The planned CBK instruction will allow to better identify climate change-related transition costs, especially the possible impact of CBAM implementation on Kosovo's exports and on bank credit quality.[32] The CBK is also upgrading the stress-testing framework to consider the impact of energy price increases and is taking steps to develop green financing in collaboration with donors. More broadly, the WB is assisting the CBK on identifying changes needed in the supervisory framework to improve the management of environmental and climate-related risks arising from the banking sector.[33]

39. Better integrating climate planning into the PIM framework is essential to support the green transition. An IMF Climate PIMA (C-PIMA), completed in June, recommended strengthening climate-aware planning; coordination among public entities on climate issues; climate impact and exposure of projects; identification of climate-related projects; and identification and management of climate fiscal risks to public infrastructure. The C-PIMA assessed that while climate-related factors are gaining prominence, Kosovo's climate-change strategy is still based on qualitative, rather than quantitative, goals (Box 4). The authorities welcomed the C-PIMA recommendations and are evaluating how to best prioritize and implement them. They indicated that the Climate Change Law enables the involvement of the Climate Change Council Secretariat to advise the central and local governments on how to include climate change mitigation and adaptation components in public projects. In parallel, the WB is preparing a "Country Climate and Development Report" (CCDR) for the western Balkans, which will provide a holistic analysis of climate change mitigation and adaptation challenges and priorities. The CCDR is expected to be finalized in 2024.

40. Medium-term benefits of RSF and C-PIMA implementation are potentially very large (Annex II). Staff used the CPAT to assess the impact of RSF interventions and the "Debt-Investment-Growth, and Natural Disasters" model (DIGNAD) to gauge the possible impact of C-PIMA-like policies.

- ***RSF RM Potential Gains.*** Staff calibrated the CPAT to gauge the welfare benefits of RSF RMs (installation of filters in the thermal power plant, new capacity in green electricity generation, and improved energy efficiency in residential buildings). Interventions are contrasted with a business-as-usual baseline in which no actions are taken. Staff find that in steady state, the direct welfare benefits of the RSF RMs can be around 1 percent of GDP per year, which through 2050 and expressed in present value terms represent gains in excess of 10 percent of GDP.[34]

[32] The CBK instruction will include its implementation timeline.

[33] The Ministry of Environment, Spatial Planning, and Infrastructure conducted a preliminary Flood Risk Assessment, which analyzed 834 cadastral zones and is working to produce Flood Risk and Flood Hazard Maps for areas where agriculture production, economic activity and livelihoods may be seriously affected by floods. This work will enable a better assessment of flood risks, including by the insurance and banking sectors.

[34] Only the discounted present value through 2050 of the forgone coal-linked emissions due to the RSF-related effective increase in green generation of 250 MW valued at the current EU ETS price (of about €90–100 per ton of CO_2 equivalent) would result in gains of that order of magnitude.

- ***C-PIMA Potential Gains.*** Staff calibrated the DIGNAD in three scenarios: (i) a baseline with an extreme climate event without adaptation investment; (ii) a similar scenario with adaptation investment at unchanged investment efficiency; and (iii) a similar scenario with both adaptation investment and increased investment efficiency. The scenarios show that climate change adaptation policies can reduce the impact on growth of an extreme climate event by ½.

PROGRAM MODALITIES

41. Existing quantitative performance criteria (QPCs), indicative targets (ITs) and structural benchmarks (SBs) under the SBA remain unchanged. Indicative targets for June and December 2024 are proposed to be converted to QPCs for those dates. Submission to the National Assembly, by end-October, of a 2024 budget consistent with SBA and RSF objectives is a prior action for first review consideration. The TMU was revised to update SBA program assumptions and relevant data and to define the new prior action.

42. RSF RMs remain broadly the same, but the timing of two RMs was switched, without affecting RSF phasing. The decision by the government to launch the first competitive auction for 150 MW of wind-based electricity generation considerably strengthened RM2, but it will require to postpone implementation from March to June 2024. At the same time, the CBK has already started preparing an instruction that will allow to better identify climate change-related transition costs, and now plans to have it ready by March, instead of June 2024. The switching of the timing of the RMs preserves the original RSF phasing. The TMU has been revised to describe the strengthened RM2 and the timing change of RM2 and RM8.

43. All SBA QPCs and SBs and RSF RMs corresponding to the first reviews have been met. Prudent macroeconomic management suggests that end-2023 QPCs and ITs are within reach. Good progress was also observed towards meeting SBs and RMs due in the next few months. Subject to the approval by the IMF Executive Board, the completion of the first reviews will make available an additional SDR 20.031 million (€24.6 million) under the SBA and SDR 30.976 million (about €38 million) under the RSF. The authorities intend to continue treating the SBA as precautionary but may reevaluate this decision at the time of the second SBA review if currently budgeted external support for 2023 fails to materialize.

44. The Fund is providing TA in several areas to support reform implementation. FAD is assisting on carbon pricing, PIM, and tax administration; STA is assisting on national accounts and price statistics; MCM is providing assistance on financial sector governance and stress testing.

45. The government remains committed to improving climate planning and advancing in the green transition. In this regard, they are evaluating whether additional RSF financing could be useful to support the implementation of the recently concluded C-PIMA recommendations as well as those of the upcoming CCDR for the Western Balkans.

46. Kosovo's capacity to repay the Fund remains adequate. If the precautionary SBA is disbursed in full, Kosovo's debt and debt service to the IMF would peak in 2024 at 1 and 0.2 ppt of

GDP, respectively, and decrease thereafter. Risks revolve around terms-of-trade shocks and are mitigated by Kosovo's strong track record in repaying the Fund and by low medium-term risk of debt distress. Kosovo's obligations to the IMF in the adverse scenario would be much lower than in peers.

STAFF APPRAISAL

47. While growth has remained strong and inflation has decreased significantly, risks remain. GDP growth is expected to average about 4 percent over 2023–24 on lower international commodity prices, robust diaspora flows, and sound macroeconomic policies. Inflation is projected to decline to about 5 percent in 2023 and further to 3 percent in 2024. Risks to growth are balanced in the short-term, but on the downside in the medium-term given a complex geopolitical context, including limited progress in dialogue with Serbia. In this regard, EU penalty measures to promote faster de-escalation are not expected to affect the short-term outlook but may have an impact if sustained longer. Global geopolitical tensions keep international energy and food markets volatile and create upside risks to inflation. Higher ECB policy rates are being passed-through to domestic rates, and though the financial sector has remained resilient, pockets of vulnerabilities remain.

48. The SBA has continued to provide a key policy anchor. Fiscal policy in 2023 is projected to provide a moderate stimulus as needed, and the 2024 budget is consistent with a broadly-neutral stance, as called for by the SBA. The quality of the budget process has strengthened with the larger-than-programmed decline in blanket allocations in next year's budget. International reserves are projected to remain at around 95 percent of the IMF RA metric. The CBK has continued to manage reserves prudently and kept its holdings of government debt unchanged.

49. The SBA has also been instrumental in supporting structural reforms to strengthen fiscal and financial governance. The implementation of structural benchmarks under the SBA are enhancing public financial management, containing fiscal risks, and strengthening revenue mobilization. On the financial sector, actions will improve central bank and financial sector governance and banking supervision. The normalization of CBK operations has provided an important new impetus for reform implementation.

50. The RSF is laying the foundations of greener and more efficient energy markets in Kosovo. The RSF has increased the policy space to strengthen the regulatory framework to attract private investment into green energy, improve energy market functioning, reduce emissions, and air pollution, strengthen energy security, improve the targeting of energy subsidies, and increase preparedness for the implementation of carbon pricing.

51. The authorities' program ownership remains strong. All QPCs and ITs have been met and available data suggests that end-2023 QTs are within reach. SBA SBs and RSF RMs have been implemented, and actions required for subsequent reviews are progressing as expected or have been strengthened. The authorities intend to continue treating the SBA as precautionary but may reevaluate this decision at the time of the second SBA review if currently budgeted external support for 2023 fails to materialize.

52. Staff supports the authorities' request for completion of the first reviews under the SBA and RSF, the proposed modification of a reform measure under the RSF, and disbursements under the RSF. Given prudent macroeconomic management, the implementation of structural benchmarks and reform measures agreed under the SBA and RSF and continued strong ownership of the Fund-supported programs, staff supports the completion of the reviews. Given the considerable strengthening of RSF RM2, staff also supports the corresponding modification.

Box 1. Kosovo-Serbia Tensions and EU Measures

Tensions in northern Kosovo, which escalated in May 2023, continue to represent a challenge. Periods of rising tensions followed by de-escalation have been a constant since 2008. According to some international observers, reasons behind the recent escalation include delays in establishing an "Association of Serb Municipalities" (ASM), a boycott of municipal elections in four northern municipalities, and more recently, the operation of paramilitary groups in the north.

To promote faster de-escalation efforts the EU announced, in June, reversible and temporary punitive measures against Kosovo.[1] Measures include:

A temporary suspension of meetings involving high-level EU officials in the context of the EU Stabilization and Association Agreement (SAA);

Exclusion of Kosovo from high-level meetings and suspension of high-level bilateral meetings, except those to address the crisis in the north;

A halt of new programming funds from the Instrument for Pre-Accession Assistance and financing out of the Western Balkans Investment Framework.

In July, Kosovo and the EU agreed on de-escalation steps. These include better collaboration with the resident NATO peacekeeping force (KFOR), a reduction of police presence in the north, and the holding of new elections for mayors in four northern municipalities mainly inhabited by ethnic Serbs. Kosovo has started implementing these measures, including through an administrative instruction allowing citizens to petition for new local elections. No specific date has been announced for holding new municipal elections, however.

EU measures are unlikely to impact the economy in the short term but could bite if sustained for longer. Kosovo's programs with the IMF will not be impacted as already-agreed financing is not affected, and SBA financing mostly relies on IFI disbursements. If measures persist, however, new bilateral assistance will likely decrease. Continued tensions might negatively affect the country's image, weighing on tourism flows, FDI and growth. Tensions in the north could also deepen domestic political polarization.

[1] The US has not suspended economic collaboration.

Box 2. Updated Adverse Scenario

Ongoing geopolitical tensions make a negative terms-of-trade (TOT) shock the most suitable to characterize an adverse scenario, given Kosovo's status as net food and energy importer. While commodity prices have remained broadly aligned with projections in 2023, the updated adverse scenario considers an increase in international food and energy prices of 20 pp *vis-a-vis* the baseline. The scenario also assumes that commodity prices begin to gradually revert to the baseline in 2025, while staying higher than the baseline throughout 2028. The *ex-ante* impact of such a shock would be around 2.5–3 pp of GDP.

The shock would lead to lower GDP growth, a reopening of the output gap, lower fiscal revenues, and higher fiscal and external financing needs. The largest negative impact would occur in 2024, where GDP growth would be 1.5–2 pp lower than in the baseline. The more negative output gap would affect fiscal revenues, which would be lower than the baseline by about 0.5 pp of GDP in 2024–25. As the SBA would aim to protect PIP and social transfers, this would open a financing gap of €50 million per year in 2024–25. With the TOT shock assumed to gradually reverse beginning in 2025, real GDP and fiscal revenues would gradually converge to those in the baseline.

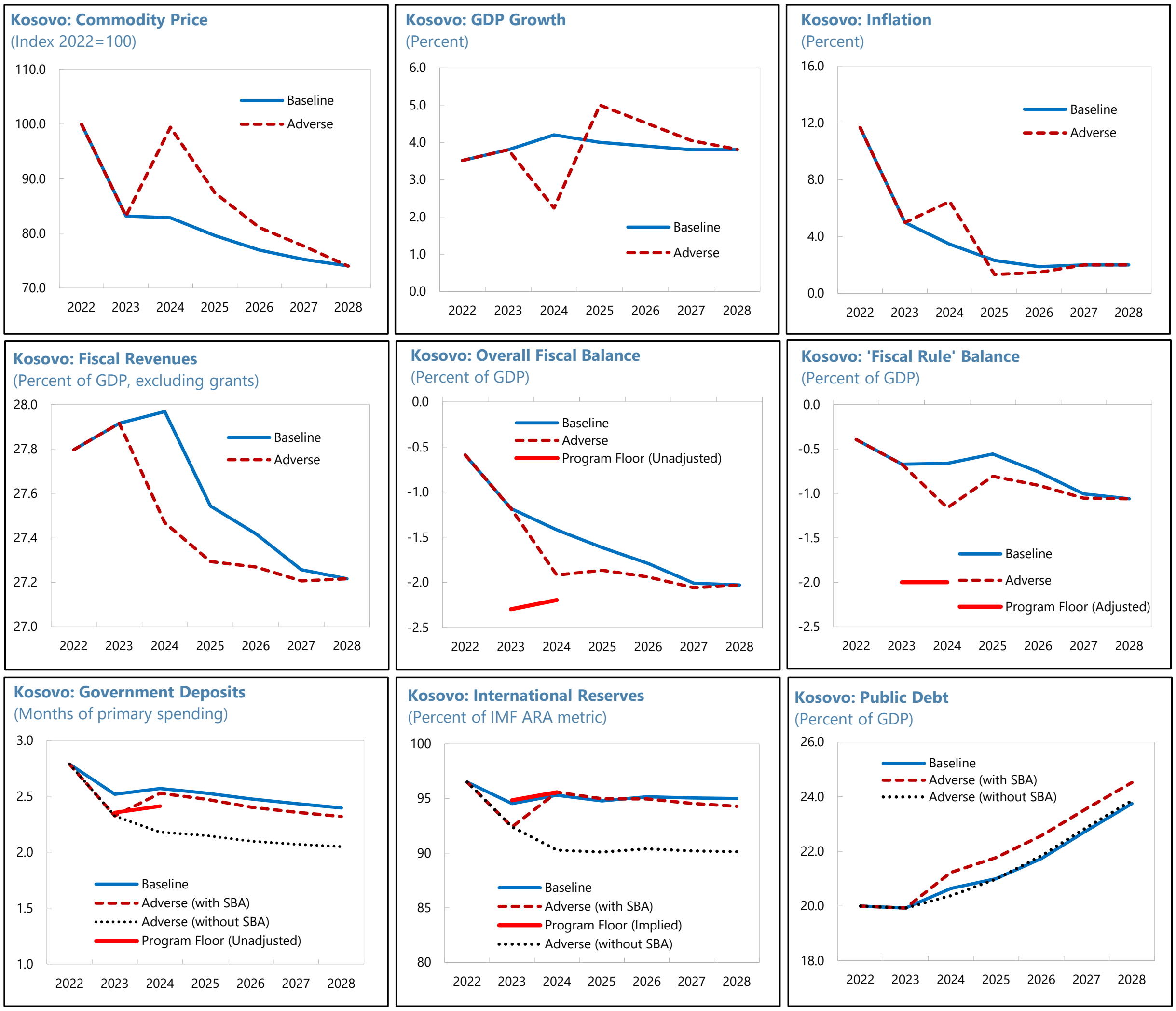
In such scenario SBA financing would allow international reserves to remain at adequate levels, contributing to anchor expectations. If the shock is temporary, staff will recommend letting fiscal stabilizers operate and the overall fiscal deficit increase. SBA purchases in 2024 of €50 million (SDR 40 million) would allow to keep government buffers and international reserves at levels of around 90–95 percent of the IMF RA metric, as in the baseline. The government continues to negotiate additional support from German and French bilateral agencies (AFD and KfW) for about €60 million that would bring reserves to around 100 percent of the IMF RA metric providing further insurance to downside risks.

Failing to secure the parliamentary qualified majority required to approve new external financing is a risk. This can temporarily affect assumed financing. OFID financing (€38 million) is still programmed, but the political opposition expressed reservations to approve it. An SBA purchase could be considered to preserve international reserves if the government decides to permanently withdraw OFID financing from the Assembly. Delays to approve budget support for 2023–24 could also temporarily increase financing needs.

The simultaneous materialization of a terms of trade shock with other shocks would compound the negative impact of the increase in commodity prices. Higher international electricity prices and lower-than-forecast domestic electricity supply may result in an *ex-ante* shock of around 3–4 percent of GDP, compounding financing needs, though the final cross-sectoral impact would depend on the pass-through to domestic electricity tariffs. Further needs may also arise if the planned installation of filters in Kosova B thermal power plant results in longer than projected plant outages and load shedding.

The program includes consultation clause to mitigate the high uncertainty characterizing the outlook. This clause allows to recalibrate policies should shocks prove stronger and more persistent than expected under the program. The fiscal rule's 2 percent of GDP ceiling will continue to be the general guide for policy. This protects capital spending, and allows some deficit accommodation, while keeping current spending at bay to avoid breaching the deficit ceiling.

Box 2—Figure 1. Updated Adverse Scenario: Characterization and Policy Response



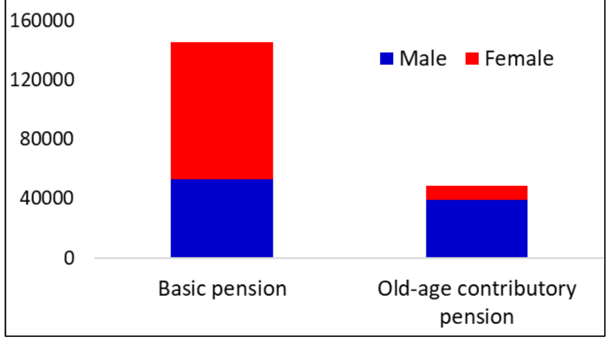
Sources: IMF staff calculations and Kosovar Authorities.

Box 3. The Fiscal Impact of the Recent Constitutional Court Ruling on Pensions

Background. Kosovo pension scheme is a multi-pillar system comprising: (i) A non-contributory pension ("basic pension"), which functions as an old-age social-protection floor; (ii) pensions paid to contributors to the former Yugoslav pension system; and (iii) a fully-funded system based on individual capitalization accounts managed by the Kosovo Pensions Savings Trust (KPST).

In July 2023, the constitutional court ruled that workers other than teachers should receive a pension for work during Kosovo's independence war. Based on that ruling, "the Law on Pension Schemes Financed by the State" was amended to recognize Kosovo's war period (1989–99) as accrued working time for receiving entitlements. Therefore, workers with 5–14 years of contributions are now eligible for a partial pension, based on the years prior to 1999 in which they made contributions. Before the ruling, this period was only recognized for teachers; other workers had to have 15 or more years of effective contributions to receive a pension. The ruling implies that no one younger than 57 years old as of 2023 (i.e., born in 1966) will be able to benefit from it. This is the case as to have 15 or less years of contributions in the old Yugoslavian system, a worker had to begin working in 1984 (Kosovo became independent in 1999). Moreover, there will be no new entries to the system after 2031, when the youngest beneficiaries turn 65, which is Kosovo pension age.

Kosovo: Number of Basic and Old-Age Contributory Pensioners, 2023:M5



The ruling is expected to have an annual budgetary cost of €8–37 million (0.1–0.2 percent of GDP) in 2023–31. The cost of the ruling comprises: (i) the additional cost on account of pensioners migrating from the basic pension system; and (ii) the cost of pensioners that now qualify for a pension. As part of the contingent allocation in the 3-year budget (2023–25) was to plan for this contingency, the ruling will not impact the SBA program. The cost of the ruling is projected to be about €8 million in 2023, €18 million in 2024, and will peak at €37 million in 2031.

(i) **Pensioners' switching from basic pensions.** The cost one pensioner's switching from the Basic Pension (currently €100/month) is calculated at about €200/month (compared to €209/month average for contributory pensions in 2022, and an additional cost of €100/month). As of end-September, 11,608 basic pensioners applied to switch to partial old-age contributory pension. Of them, 9,128 applicants have 5 to 14 years of experience with paid contributions prior to 1999, making them eligible for partial pension provided that the sum of the years with contributions and the years within the 1989–99 period counting from the date of their dismissal is equal to at least 15 years. The partial contributory pension is estimated based on the number of years of paid contribution. For instance, if a person with 5 years of paid contribution can provide a proof of 10 years of dismissal from work during war period, then she would get 1/3 of the old-age contributory pension that belongs to her education tier. The cost of pensioners switching from basic pension is projected at €15.9 million per year. For 2023, this cost will be half at €8 million, as the pensioners will only be paid for the second half of the year (July-December 2023).

Box 3. The Fiscal Impact of the Recent Constitutional Court Ruling on Pensions (Concluded)

(i) **New pensioners.** Residents who turn 65 in the next 8 years will now qualify for a pension under the new rules. Assuming that 10 percent of population who turn 65 apply for partial old-age pension in 2024–31, with a male-female distribution of 82 percent and 18 percent, respectively, the total annual cost of these pensions would be €2.3–2.8 million/year in 2024–31 (i.e., a top-up of €0.7–0.9 million/year compared to the cost of just paying the basic old-age pension). With the cost of switching from basic pension in 2023 of €15.9 million, total cost as all partial old-age contributory pensions would be around €18 million in 2024, and peak at €37 million in 2031. After 2031, all new population turning 65 would only qualify for basic pension.

Netting out the cost of forgone basic old-age pension, this ruling is expected to have €3–12 million additional cost compared to the cost of just paying the basic old-age pension. Given that to receive this pension, the ruling's beneficiaries will need to forgo their basic old-age pension, the net cost of the ruling will amount to €3 million in 2023, €6 million in 2024, and peak at €12 million in 2031.

Box 3. Table 1. Budgetary Cost of New Partial Old-Age contributory Pension

A. Pensioners Switching from the Basic Pension Scheme				B. Additional Cost of Population Reaching Retirement Age (65)			
Years of paid contribution	**Number of applicants**	**Prorated annual pension (euro)**	**Total cost (euro million)**	**Year**	**New Pensioners (number)**	**Cost of new pensioners (euro million)**	**Total cost (euro million)**
5	307	800	0.2	2023:H2			7.9
6	347	960	0.3	2024	1,317	2.3	18.2
7	483	1,120	0.5	2025	1,382	2.4	20.6
8	710	1,280	0.9	2026	1,446	2.5	23.1
9	886	1,440	1.3	2027	1,495	2.6	25.7
10	1,136	1,600	1.8	2028	1,525	2.7	28.4
11	933	1,760	1.6	2029	1,554	2.7	31.1
12	1,104	1,920	2.1	2030	1,598	2.8	33.9
13	1,277	2,080	2.7	2031	1,639	2.9	36.7
14	1,945	2,240	4.4				
Total	9,128		15.9		21,083		225.6

Source: Kosovar authorities and IMF staff estimates and projections.

Notes: The average partial old-age contributory pension is projected to be proportional to the number of years of work experience prior to 1999, with a maximum pension of €200/month. New old-age contributory pensions are projected to represent 10 percent of population reaching 65; the gender of new pensioners is assumed to be similar to those currently existing (about 80 percent males); their pro-rated annual pension is assumed at €145/month. The total cost of the ruling over 2024-31 is the sum of the cost of switching and the cost of new pensioners. In 2023, the cost will be paid only in the second half of the year.

Box 4. Kosovo's Climate PIMA

A recent IMF Climate Public Investment and Management Assessment PIMA (C-PIMA) assesses the management of climate-related infrastructure in Kosovo. The C-PIMA was part of a broader PIMA mission which identified reform areas in project appraisal, project selection, and portfolio management and oversight. The C-PIMA made recommendations across five areas:

- **Climate-Aware Planning** (Priority: High). Kosovo's public investment strategy is increasingly considering climate-related factors and climate goals in sectoral planning. Reforms in Kosovo's legal system and spatial planning have led to increased attention on climate-related risks in projects. Efforts should be made to identify and quantify sectoral contributions to climate targets, prepare costed investment plans, and to strengthen administrative capacity and raise awareness. Guidance and training should be undertaken for public bodies on integrating climate change into public investment planning. A handbook should be prepared on incorporating climate resilience and adaptability in sectoral planning and project preparation.

- **Coordination Between Entities** (Priority: Medium). Climate change-related public investment should be coordinated across all government levels. The budget guidelines should incorporate climate tagging and practice. POEs' investment should be assessed for climate impact and mitigation. Climate change issues should be embedded into the national public investment processes. The roles and responsibilities of key institutions involved in climate change should be clarified.

- **Project Appraisal and Selection** (Priority: High). The climate impact and exposure of projects should be understood prior to approval. An appraisal and selection framework consistent with climate goals should be implemented. The PIP manual and Administrative Instruction on the selection of capital projects should be updated to reflect climate-related selection. Climate considerations should be incorporated into sector working groups' screening processes when filtering projects for the project pipeline.

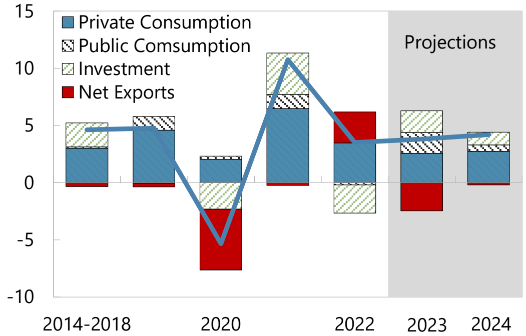
- **Budgeting and Portfolio Management** (Priority: High). The portfolio of climate-related investment projects should be effectively managed at all stages of the project cycle, to avoid future over-spending on asset maintenance costs, or faster depreciation of the public infrastructure. Identifying climate-related projects in budget documents, conducting ex-post reviews of the impact of investment projects on climate adaptation and mitigation, and addressing climate-related risks in asset management policies and practices should be adopted in budgeting, review, and asset maintenance. Asset management policies should be formalized, along with methodologies for estimating maintenance needs and mechanisms for assessing climate-related risks.

- **Risk Management** (Priority: Medium). Identifying and managing climate fiscal risks to public infrastructure should be an integral part of the government's risk management. The government should develop and publish a disaster risk management strategy, develop mechanisms to absorb the cost of climate-related damages, and analyze climate-related risks to public infrastructure assets. In this regard, the Emergency Management Agency, under the Ministry of Internal Affairs is developing a new national disaster risk management strategy. There is a general contingency appropriation in the annual budget to meet the costs of climate-related damages, but no specific ex-ante financing mechanism nor disaster insurance schemes.

Figure 1. Kosovo: Real Sector Developments

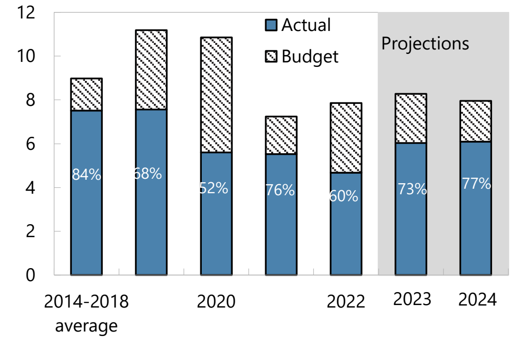
GDP growth in 2023–24 will post 4 percent on average given stronger investment and solid consumption growth…

Contributions to Real Growth
(Percent)



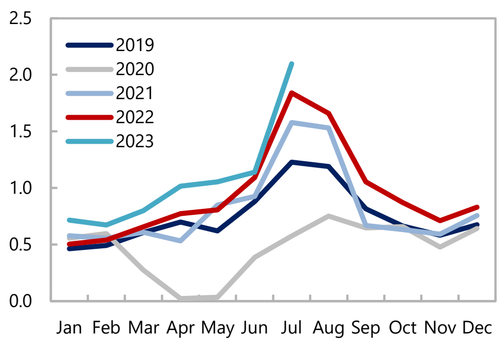
…public investment absorption is projected to accelerate significantly in 2023…

Government Capital Expenditure
(Percent of GDP)



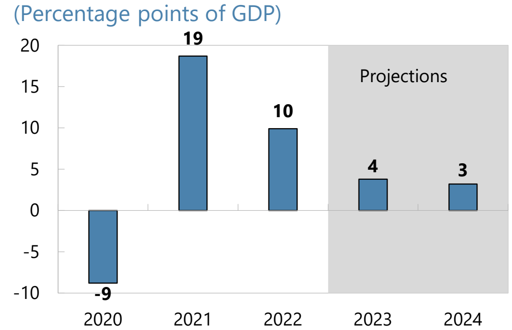
…and diaspora-related tourism will keep supporting economic activity and demand…

Number of Passenger Arrivals
(Millions)



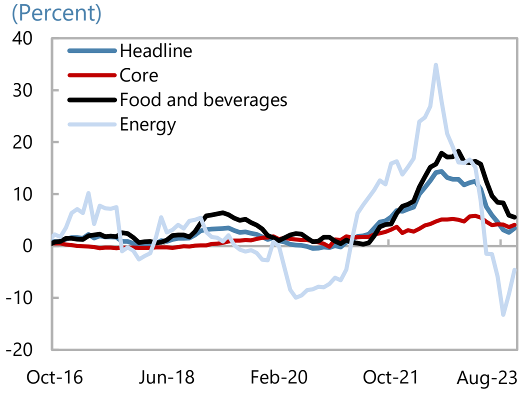
…though the overall contribution to growth of diaspora-related flows is expected to moderate.

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



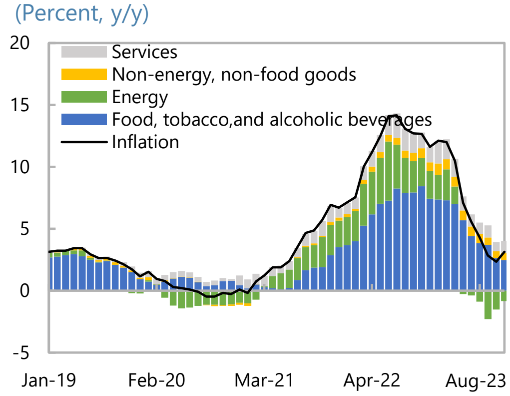
Headline inflation increased with higher energy and food prices in 2022…

Inflation
(Percent)



…core inflation, though higher, has remained moderate.

Inflation Decomposition
(Percent, y/y)

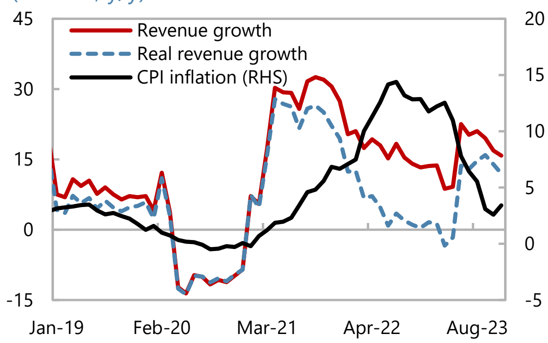


Sources: Haver Analytics, Ministry of Finance Labor and Transfers, Kosovo Agency of Statistics, Central Bank of Kosovo, *World Economic Outlook*, and IMF staff estimates.

Figure 2. Kosovo: Fiscal Developments

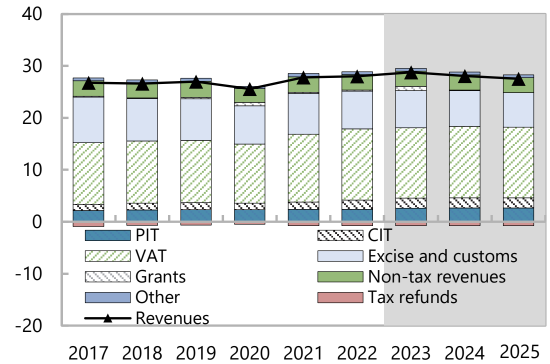
Revenue growth has been strong in 2023:H1…

Revenue Growth
(Percent, y/y)



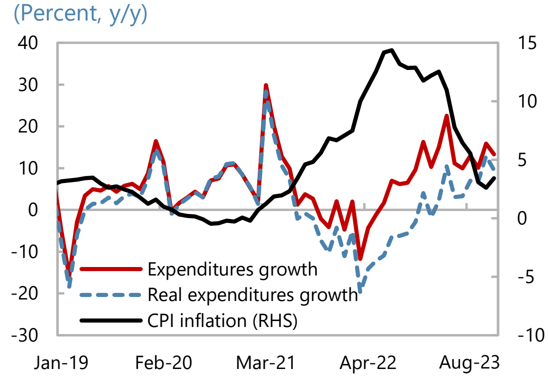
…due to continuous efforts to strengthen tax compliance.

Revenue Composition
(Percent of GDP)



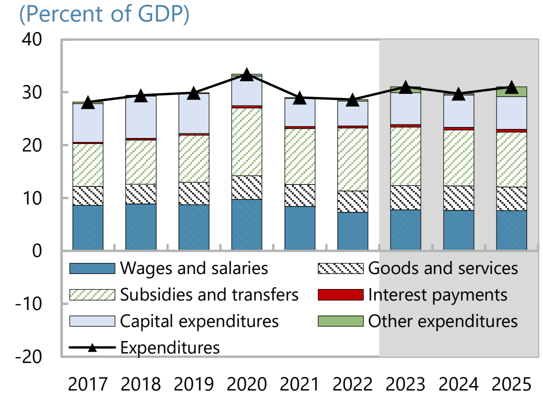
Expenditure growth has moderated…

Expenditure Growth
(Percent, y/y)



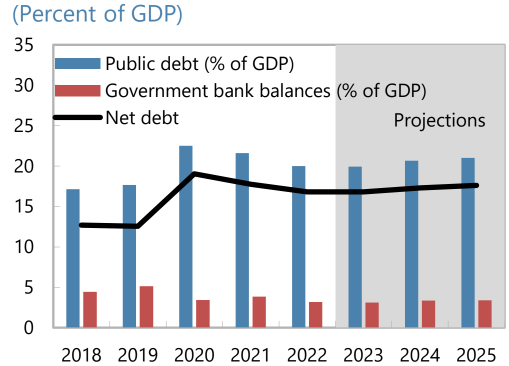
…but the implementation of the public investment program is projected to improve.

Expenditure Composition
(Percent of GDP)



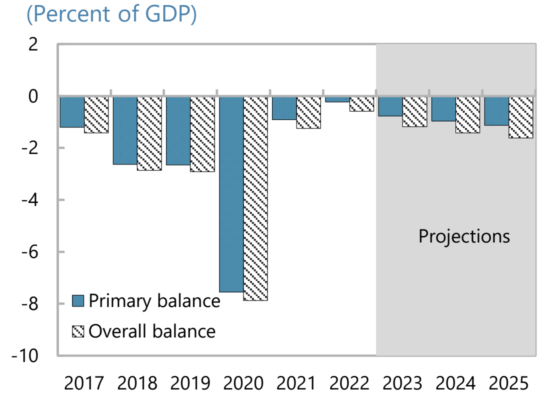
Public debt remains low and sustainable…

Public Debt and Government Bank Balance
(Percent of GDP)



…with the fiscal position in 2023–25 expected to be within the fiscal rule limits.

Fiscal Balance
(Percent of GDP)

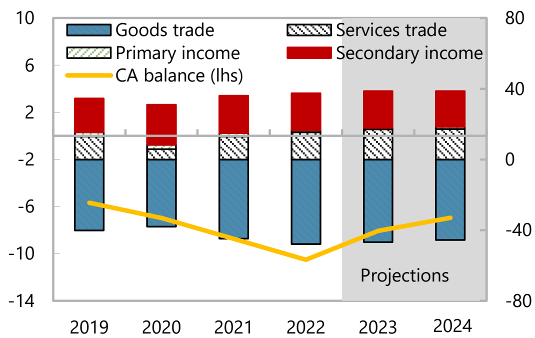


Sources: Ministry of Finance, Labor, and Transfers, Central Bank of Kosovo, and IMF staff calculations.

Figure 3. Kosovo: External Sector Developments

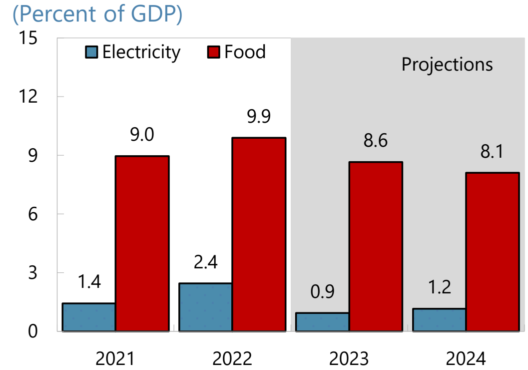
The current account deficit is projected to narrow in 2023–24…

Kosovo: Contributions to the Current Account Balance
(Percent of GDP)



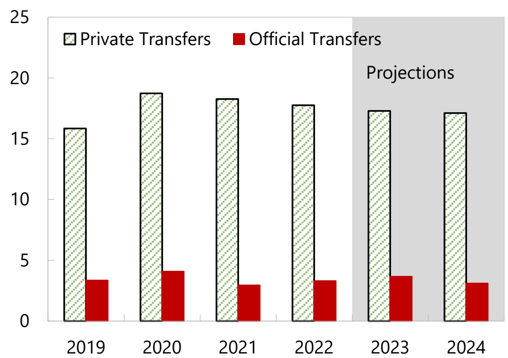
…given decreases in international commodity prices…

Imports of Goods
(Percent of GDP)



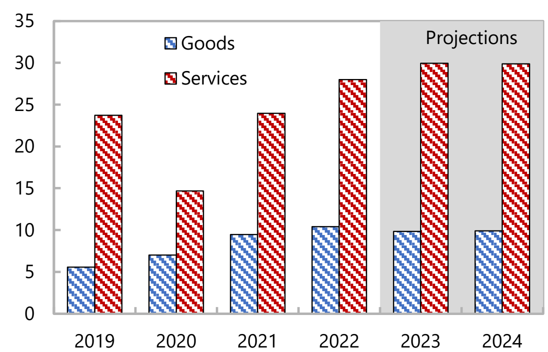
Remittances are expected to remain stable as share of GDP…

Secondary Income Transfers
(Percent of GDP)



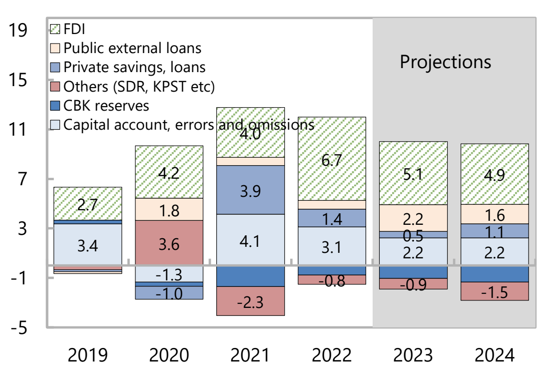
…as well as exports of goods and services.

Exports of Goods and Services
(Percent of GDP)



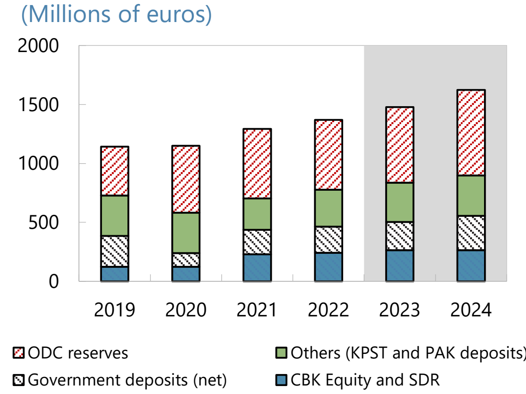
The current account will be mainly financed by FDI and public external loans…

Financing of Current Account
(Percent of GDP)



…with international reserves expected to remain close to IMF reserve adequacy metric benchmarks.

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

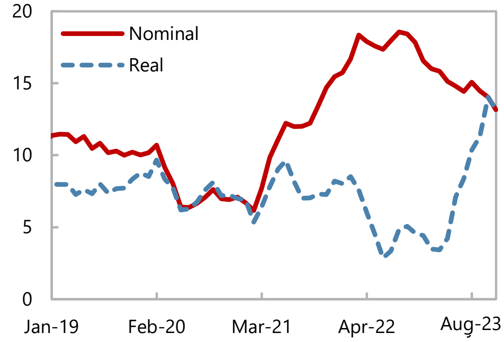


Sources: Haver Analytics, Kosovo Agency of Statistics, Ministry of Finance, Labor and Transfers, Pristina International Airport, *World Economic Outlook*. and IMF staff estimates.

Figure 4. Kosovo: Financial Sector Developments

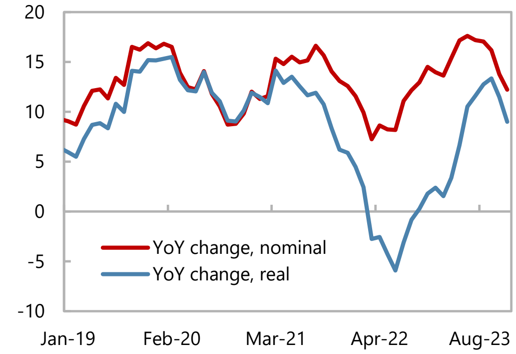
Real credit growth to the private sector rebounded in 2023

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



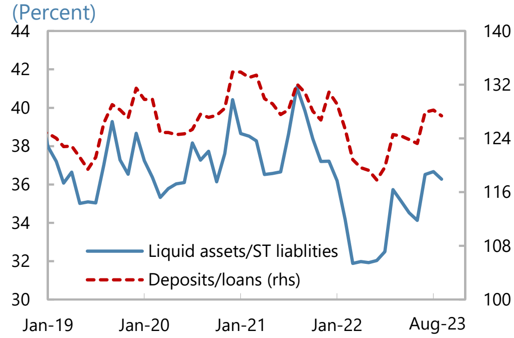
…and real deposit growth has also recovered…

Bank's Deposits
(Percent)



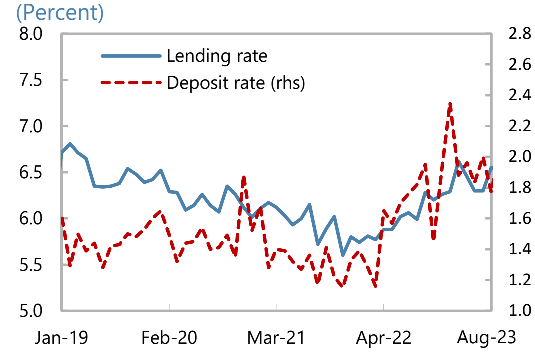
Bank liquidity ratios remain comfortable though they declined compared to 2019–21.

Liquidity
(Percent)



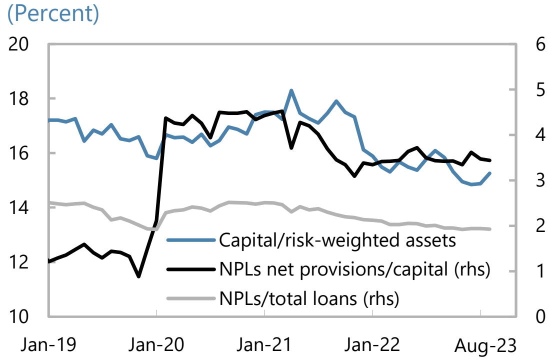
Interest rates are increasing reflecting tighter financial conditions in the euro area.

Lending and Deposit Rates
(Percent)



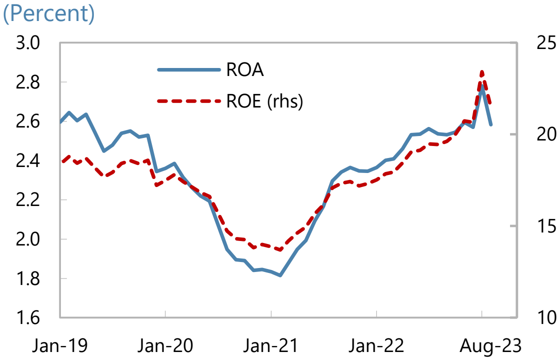
NPLs remain low and capital buffers remain adequate despite banks resuming profit distribution…

Asset Quality and Capital Adequacy
(Percent)



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

Profitability
(Percent)



Sources: Central Bank of Kosovo and IMF staff estimates.

Table 1. Kosovo: Selected Economics Indicators, 2019–28

(Percent, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Est.			Proj.			
Real GDP growth 1/	4.8	-5.3	10.7	3.5	3.8	4.2	4.0	3.9	3.8	3.8
Contribution to growth (percentage points of GDP)										
Consumption	5.8	2.3	7.7	3.3	4.4	3.3	3.0	3.1	3.0	3.0
Private	4.6	2.0	6.5	3.5	2.6	2.7	2.5	2.4	2.4	2.4
Public	1.2	0.3	1.2	-0.2	1.8	0.6	0.4	0.6	0.6	0.6
Investment	-0.1	-2.3	3.6	-2.5	1.9	1.1	2.7	1.7	1.5	2.3
Net Exports	-0.3	-5.3	-0.2	2.7	-2.5	-0.2	-1.7	-0.8	-0.7	-1.5
Exports	2.2	-8.6	17.0	6.1	3.6	2.3	2.2	1.8	1.7	0.1
Imports	-2.5	3.3	-17.2	-3.4	-6.1	-2.5	-3.9	-2.7	-2.4	-1.6
Real growth rate (percent)										
Consumption	6.2	2.4	7.6	3.3	4.4	3.3	3.0	3.1	3.1	3.1
Private	5.6	2.5	7.3	4.0	3.0	3.2	3.0	2.9	2.9	2.9
Public	10.1	2.1	9.0	-1.5	14.2	3.9	2.9	4.5	4.3	4.2
Investment	2.9	-7.6	13.0	-6.8	2.5	4.0	9.8	5.8	4.9	7.7
Exports	7.6	-29.1	76.8	17.2	9.0	5.5	5.3	4.3	3.9	0.1
Imports	4.5	-6.0	31.4	4.9	9.2	3.6	5.7	3.8	3.4	2.3
Official unemployment (percent of workforce)	25.7	26.0	21.3	…	…	…	…	…	…	…
Price changes										
CPI, period average	2.7	0.2	3.3	11.7	5.0	3.5	2.3	1.9	2.0	2.0
GDP deflator	1.0	1.4	6.1	8.5	5.6	3.5	3.5	2.2	2.0	2.0
General government budget (percent of GDP)										
Revenues and grants	27.0	25.6	27.8	28.0	28.7	28.1	27.5	27.4	27.3	27.2
Expenditures	29.9	33.5	29.0	28.6	29.9	29.5	29.2	29.2	29.3	29.2
Of which: Wages and salaries	8.7	9.8	8.4	7.3	7.8	7.7	7.6	7.6	7.6	7.6
Subsidies and transfers	8.9	12.8	10.6	11.9	11.1	10.6	10.4	10.2	10.1	10.1
Capital expenditure	7.6	5.6	5.3	4.7	6.0	6.1	6.2	6.3	6.5	6.4
Overall Balance (Fiscal rule) 2/	-0.8	-6.5	-0.9	-0.4	-0.7	-0.7	-0.6	-0.8	-1.0	-1.1
Overall balance	-2.9	-7.8	-1.2	-0.6	-1.2	-1.4	-1.6	-1.8	-2.0	-2.0
Stock of freely available government bank balances	5.1	3.4	3.8	3.2	3.1	3.4	3.4	3.4	3.5	3.5
Total public debt 3/	17.7	22.5	21.6	20.0	19.9	20.6	21.0	21.7	22.8	23.7
Balance of Payments (percent of GDP)										
Current account balance, incl. official transfers	-5.7	-7.0	-8.7	-10.5	-8.1	-7.0	-6.7	-6.0	-5.2	-5.1
Of which: Official transfers 4/	3.4	4.1	2.9	3.3	3.6	3.1	3.0	3.0	3.0	3.0
Of which: Remittance inflows	12.1	14.5	14.5	13.7	13.6	13.5	13.5	13.1	12.6	12.6
Financial account	-2.3	-8.3	-4.6	-7.4	-5.8	-4.7	-4.6	-3.9	-3.2	-3.1
Of which: Direct investment, net	-2.7	-4.2	-4.0	-6.7	-5.1	-4.9	-4.9	-4.7	-4.5	-4.4
Portfolio investment, net	0.8	-1.2	3.5	1.5	0.1	1.1	1.2	1.2	1.6	1.7
Other investment, net	-1.8	-3.5	-6.2	-2.9	-1.8	-2.3	-2.0	-1.5	-1.0	-1.0
Reserve change	1.3	0.7	2.1	0.8	1.0	1.3	1.1	1.0	0.7	0.6
Errors and Omissions	3.5	-1.6	3.4	2.7	1.6	1.6	1.5	1.5	1.4	1.5
Savings-investment balances (percent of GDP)										
National savings	28.9	26.4	27.2	24.3	24.9	25.7	27.2	28.2	29.0	30.2
Public savings	4.4	-2.8	3.9	3.9	4.0	4.6	4.6	4.6	4.4	4.4
Private savings	24.5	29.3	23.3	20.4	20.9	21.1	22.6	23.6	24.5	25.8
Investment	34.6	33.4	36.0	34.8	33.0	32.7	33.9	34.1	34.2	35.3
Public investment	7.6	5.6	5.3	4.7	6.0	6.1	6.2	6.3	6.5	6.4
Private investment	27.0	27.8	30.6	30.2	27.0	26.6	27.7	27.8	27.8	28.9
Current account, including. official transfers	-5.7	-7.0	-8.7	-10.5	-8.1	-7.0	-6.7	-6.0	-5.2	-5.1
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	16.0	12.1	9.2	8.1	6.1	6.0	6.0
Deposits of the private sector (percent change)	15.6	10.9	12.4	12.8	10.4	8.6	8.3	6.8	6.5	6.5
Regulatory capital to risk weighted assets	15.9	16.5	16.1	14.8	…	…	…	…	…	…
Memorandum items:										
Foreign Reserves (millions of euros, IMF Definition)	1,142	1,149	1,293	1,370	1,478	1,623	1,749	1,869	1,956	2,042
Foreign Reserves (% of ARA metric)	126	120	107	96	95	95	95	95	95	95
GDP (millions of euros)	7,056	6,772	7,958	8,936	9,794	10,563	11,366	12,067	12,775	13,520
GDP (millions of euros; projections in 2024 budget)	7,056	6,772	7,958	8,936	9,794	10,563	…	…	…	…
GDP per capita (euros)	3,959	3,766	4,499	5,049	5,531	5,963	6,412	6,805	7,200	7,616
Real GDP growth per capita	5.6	-6.2	12.6	3.5	3.7	4.1	3.9	3.8	3.7	3.7
Output gap (% of GDP)	1.2	-6.2	-0.5	-0.5	-0.5	-0.3	-0.1	0.0	0.0	0.0
Population (million)	1.8	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/ While quarterly and annual national account data for 2022 report the same nominal GDP, the use of different deflators in the two sets of data result in different annual real growth rates (3.5 percent in quarterly data, 5.2 percent in annual data). Pending final 2022 data (expected for December 2023), the table reports real growth in quarterly data.

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/ It does not include contigent debt of former Yugoslavia. Beginning in 2020, it includes Euro 120 million of debt with KPST.

4/ Total foreign assistance excluding capital transfers.

Table 2. Kosovo: Consolidated Government Budget, 2019–28 (Euro million)[1]

(Including donor designated grants and PAK operations)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	Act.	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue and grants	**1,905**	**1,736**	**2,212**	**2,504**	**2,815**	**2,964**	**3,130**	**3,309**	**3,482**	**3,680**
Revenue	1,885	1,693	2,195	2,484	2,734	2,954	3,130	3,309	3,482	3,680
Taxes	1,662	1,507	1,948	2,217	2,450	2,644	2,805	2,957	3,104	3,272
Direct taxes	292	267	342	414	499	546	589	633	672	711
of which: Personal income tax	166	158	190	216	255	280	302	324	344	365
of which: Corporate income tax	95	85	114	160	190	208	224	241	256	271
of which: Property tax	27	23	36	35	50	54	58	61	65	69
Other	5	1	2	4	4	5	5	6	6	6
Indirect taxes	1,415	1,273	1,665	1,870	2,027	2,178	2,301	2,414	2,525	2,660
VAT	846	770	1,038	1,220	1,329	1,450	1,543	1,622	1,710	1,820
Excise	435	398	501	517	548	596	641	681	721	763
Customs	130	102	125	133	150	133	116	111	95	77
Other	4	3	1	0	0	0	0	0	0	0
Tax refunds	-46	-33	-59	-67	-76	-80	-85	-89	-94	-99
Nontax revenues	223	186	247	267	284	310	326	352	378	407
Other revenue	7	3	9	7	2	2	2	2	2	2
Grants	19	43	17	20	81	10	0	0	0	0
Budget support	12	34	0	10	68	0	0	0	0	0
Project grants (DDGs)	8	9	17	10	14	10	0	0	0	0
Expenditure	**2,111**	**2,265**	**2,311**	**2,556**	**2,931**	**3,114**	**3,314**	**3,525**	**3,739**	**3,954**
Current expenditure	1,578	1,886	1,887	2,137	2,340	2,470	2,612	2,759	2,915	3,084
Wages and salaries	617	661	668	653	760	810	864	917	971	1,028
Goods and services	298	302	332	359	450	490	511	543	575	608
Subsidies and transfers	628	868	843	1,064	1,085	1,120	1,180	1,225	1,290	1,365
Current reserves	0	0	0	0	0	0	0	0	0	0
DDGs and other expenditure	5	0	0	0	0	0	0	0	0	0
Interest payments	23	26	31	35	45	50	56	74	79	83
Interest - internal	11	17	21	25	28	28	32	47	49	51
of which: on external debt	12	10	10	10	16	22	24	27	30	32
Other net PAK expenditure	6	24	13	25	0	0	0	0	0	0
Capital expenditure	534	380	424	419	591	644	702	766	824	870
Budget-financed	366	265	364	323	510	550	580	640	695	745
PAK-financed	132	54	0	0	0	0	0	0	0	0
External	36	60	60	97	81	94	122	126	129	125
of which: Non-Investment Clause	21	31	31	70	22	4	2	1	1	0
of which: "Investment Clause"	13	26	20	17	50	80	120	125	128	124
Fiscal balances										
Primary balance	-188	-507	-72	-21	-75	-102	-128	-143	-179	-192
Interest income, net	-19	-26	-32	-36	-41	-45	-48	-48	-47	-46
Overall balance	**-207**	**-529**	**-99**	**-52**	**-116**	**-150**	**-184**	**-216**	**-257**	**-274**
"Fiscal rule" deductions from the overall balance	151	128	27	17	50	80	120	125	129	126
Overall balance ('Fiscal rule" definition) 2/	**-55**	**-443**	**-72**	**-35**	**-66**	**-70**	**-63**	**-91**	**-128**	**-150**
Overall cyclically adjusted balance	-255	-425	-101	-56	-179	-148	-180	-216	-257	-274
Statistical discrepancy	1	-4	-9	1	0	-1	0	0	-1	-1
Financing	**205**	**533**	**108**	**51**	**116**	**151**	**184**	**216**	**257**	**275**
Foreign financing (net)	-10	127	44	63	210	164	69	82	59	33
Budget Support	0	156	67	11	184	140	0	0	0	0
External Financing for Projects	39	59	56	100	80	91	132	137	143	140
Amortization of external debt	-50	-89	-79	-48	-55	-67	-63	-55	-84	-107
Domestic financing (net)	216	406	63	-12	-94	-14	115	134	199	242
Net Domestic debt issuance	115	170	145	-4	-47	64	138	154	225	270
Change in CBK deposits	43	211	-100	23	-20	-50	-31	-26	-31	-30
Change in GG Deposits at the CBK (TSA)	-70	127	-106	4	-20	-50	-31	-26	-31	-30
PAK Deposits	113	84	7	19	0	0	0	0	0	0
Other Financing (Net POE and other)	13	15	13	-38	-27	-28	8	6	4	3
Equity (Privatization)	44	12	6	6	0	0	0	0	0	0
Memorandum items										
Overall balance (MOF) 3/	-208	-513	-102	-34	-121	-151	-185	-218	-258	-276
Pandemic-related fiscal measures	…	296	310	…	…	…	…	…	…	…
Freely available bank balance of the general government	362	233	306	284	304	355	385	411	441	472
Of which: ELA	46	46	46	46	46	46	46	46	47	48
Total public debt 4/	1,247	1,523	1,717	1,787	1,952	2,180	2,387	2,623	2,907	3,211
External debt	452	557	607	671	883	1,047	1,116	1,198	1,256	1,290
Of which: onlending	50	43	46	47	46	45	49	54	62	71
Of which: guarantees	43	32	31	30	32	32	32	32	32	33
Domestic debt	795	965	1,110	1,116	1,069	1,133	1,271	1,425	1,651	1,920

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, 2019–28 (Percent of GDP)[1]

(Including donor designated grants and PAK operations)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	Act.	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue and grants	**27.0**	**25.6**	**27.8**	**28.0**	**28.7**	**28.1**	**27.5**	**27.4**	**27.3**	**27.2**
Revenue	26.7	25.0	27.6	27.8	27.9	28.0	27.5	27.4	27.3	27.2
Taxes	23.6	22.3	24.5	24.8	25.0	25.0	24.7	24.5	24.3	24.2
Direct taxes	4.1	3.9	4.3	4.6	5.1	5.2	5.2	5.2	5.3	5.3
of which: Personal income tax	2.3	2.3	2.4	2.4	2.6	2.6	2.7	2.7	2.7	2.7
of which: Corporate income tax	1.3	1.3	1.4	1.8	1.9	2.0	2.0	2.0	2.0	2.0
of which: Property tax	0.4	0.3	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.5
Indirect taxes	20.1	18.8	20.9	20.9	20.7	20.6	20.2	20.0	19.8	19.7
VAT	12.0	11.4	13.0	13.7	13.6	13.7	13.6	13.4	13.4	13.5
Excise	6.2	5.9	6.3	5.8	5.6	5.6	5.6	5.6	5.6	5.6
Customs	1.8	1.5	1.6	1.5	1.5	1.3	1.0	0.9	0.7	0.6
Tax refunds	-0.6	-0.5	-0.7	-0.8	-0.8	-0.8	-0.7	-0.7	-0.7	-0.7
Nontax revenues	3.2	2.8	3.1	3.0	2.9	2.9	2.9	2.9	3.0	3.0
Other revenue	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.3	0.6	0.2	0.2	0.8	0.1	0.0	0.0	0.0	0.0
Budget support	0.2	0.5	0.0	0.1	0.7	0.0	0.0	0.0	0.0	0.0
Project grants (DDGs)	0.1	0.1	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Expenditure	**29.9**	**33.5**	**29.0**	**28.6**	**29.9**	**29.5**	**29.2**	**29.2**	**29.3**	**29.2**
Current expenditure	22.4	27.8	23.7	23.9	23.9	23.4	23.0	22.9	22.8	22.8
Wages and salaries	8.7	9.8	8.4	7.3	7.8	7.7	7.6	7.6	7.6	7.6
Goods and services	4.2	4.5	4.2	4.0	4.6	4.6	4.5	4.5	4.5	4.5
Subsidies and transfers	8.9	12.8	10.6	11.9	11.1	10.6	10.4	10.2	10.1	10.1
Current reserves	0.0	0.0	0.0	0.0	0.0	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	0.0
Interest payments	0.3	0.4	0.4	0.4	0.5	0.5	0.5	0.6	0.6	0.6
of which: on external debt	0.2	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Other net PAK expenditure	0.1	0.4	0.2	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	7.6	5.6	5.3	4.7	6.0	6.1	6.2	6.3	6.5	6.4
Budget-financed	5.2	3.9	4.6	3.6	5.2	5.2	5.1	5.3	5.4	5.5
PAK-financed	1.9	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External	0.5	0.9	0.8	1.1	0.8	0.9	1.1	1.0	1.0	0.9
Non-Investment Clause	0.3	0.5	0.4	0.8	0.2	0.0	0.0	0.0	0.0	0.0
of which: "Investment Clause"	0.2	0.4	0.3	0.2	0.5	0.8	1.1	1.0	1.0	0.9
Fiscal balances										
Primary balance	-2.7	-7.5	-0.9	-0.2	-0.8	-1.0	-1.1	-1.2	-1.4	-1.4
Overall balance	**-2.9**	**-7.8**	**-1.2**	**-0.6**	**-1.2**	**-1.4**	**-1.6**	**-1.8**	**-2.0**	**-2.0**
"Fiscal rule" deductions from the overall balance	2.1	1.9	0.3	0.2	0.5	0.8	1.1	1.0	1.0	0.9
Overall balance ('Fiscal rule" definition) 2/	**-0.8**	**-6.5**	**-0.9**	**-0.4**	**-0.7**	**-0.7**	**-0.6**	**-0.8**	**-1.0**	**-1.1**
Overall cyclically adjusted balance	-3.6	-6.3	-1.3	-0.6	-1.8	-1.4	-1.6	-1.8	-2.0	-2.0
Statistical discrepancy	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	**2.9**	**7.9**	**1.4**	**0.6**	**1.2**	**1.4**	**1.6**	**1.8**	**2.0**	**2.0**
Foreign financing (net)	-0.1	1.9	0.6	0.7	2.1	1.6	0.6	0.7	0.5	0.2
Budget Support	0.0	2.3	0.8	0.1	1.9	1.3	0.0	0.0	0.0	0.0
External Financing for Projects	0.6	0.9	0.7	1.1	0.8	0.9	1.2	1.1	1.1	1.0
Amortization of external debt	-0.7	-1.3	-1.0	-0.5	-0.6	-0.6	-0.6	-0.5	-0.7	-0.8
Domestic financing (net)	3.1	6.0	0.8	-0.1	-1.0	-0.1	1.0	1.1	1.6	1.8
Net Domestic debt issuance	1.6	2.5	1.8	0.0	-0.5	0.6	1.2	1.3	1.8	2.0
Change in CBK deposits	0.6	3.1	-1.3	0.3	-0.2	-0.5	-0.3	-0.2	-0.2	-0.2
Change in GG Deposits at the CBK (TSA)	-1.0	1.9	-1.3	0.0	-0.2	-0.5	-0.3	-0.2	-0.2	-0.2
PAK Deposits	1.6	1.2	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Other Financing (Net POE and other)	0.2	0.2	0.2	-0.4	-0.3	-0.3	0.1	0.0	0.0	0.0
Equity (Privatization)	0.6	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items										
Overall balance (MOF) 3/	-2.9	-7.6	-1.3	-0.4	-1.2	-1.4	-1.6	-1.8	-2.0	-2.0
Pandemic-related fiscal measures	…	4.4	3.9	…	…	…	…	…	…	…
Bank balance of the general government	5.1	3.4	3.8	3.2	3.1	3.4	3.4	3.4	3.5	3.5
Of which: ELA	0.7	0.7	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Total public debt 4/	17.7	22.5	21.6	20.0	19.9	20.6	21.0	21.7	22.8	23.7
External debt	6.4	8.2	7.6	7.5	9.0	9.9	9.8	9.9	9.8	9.5
Of which: onlending	0.7	0.6	0.6	0.5	0.5	0.4	0.4	0.4	0.5	0.5
Of which: guarantees	0.6	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.2	0.2
Domestic debt	11.3	14.3	13.9	12.5	10.9	10.7	11.2	11.8	12.9	14.2

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 2019–28

(Millions of euros, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Est.			Proj.			
Financing Needs	501	818	340	323	426	499	516	497	628	715
Overall balance	-207	-529	-99	-52	-116	-150	-184	-216	-257	-274
Amortization	294	289	241	271	310	349	333	281	371	441
External	50	89	79	48	55	67	63	55	84	107
Domestic	245	200	162	223	255	283	269	226	287	333
Financing Sources	499	822	349	322	426	500	517	497	629	716
External Debt	39	215	123	111	264	231	132	137	143	140
Budget Support	0	104	67	11	146	102	0	0	0	0
External Financing for Projects	39	59	56	100	80	91	132	137	143	140
Investment Clause (2016 and after)	14	26	20	17	50	80	120	125	128	124
Non-Investment Clause	21	31	31	70	22	4	2	1	1	0
Disbursements for on-lending	4	3	5	13	8	6	10	12	14	15
Use of IMF Credit	0	52	0	0	38	38	0	0	0	0
of which: RFI	0	52	0	0	…	…	…	…	…	…
of which: RSF	0	0	0	0	38	38	0	…	…	…
Domestic Debt	460	606	225	211	161	269	384	360	486	576
Gross Domestic Debt Placements	360	370	307	219	208	347	407	380	513	603
KPST one-off financing	0	0	0	0	0	0	0	0	0	0
Other Financing (Net POE)	13	15	13	-38	-27	-28	8	6	4	3
Commercial Bank Deposits	0	-1	0	0	0	0	0	0	0	0
Equity (Privatization, PAK and other)	44	12	6	6	0	0	0	0	0	0
CBK deposits (-=increase)	43	211	-100	23	-20	-50	-31	-26	-31	-30
PAK deposits	113	84	7	19	0	0	0	0	0	0
TSA	-70	127	-106	4	-20	-50	-31	-26	-31	-30
Errors and Omissions	1	-4	-9	1	0	-1	0	0	-1	-1

Sources: Kosovo authorities and IMF staff estimates and projections.

Notes: Budget support excludes IMF's precautionary SBA.

Table 5. Kosovo: Balance of Payments 2019–28

(Millions of euros, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Est.			Proj.			
Current account	-400	-472	-695	-940	-791	-736	-763	-718	-667	-695
Balance on Goods and Services	-1,915	-2,182	-2,532	-2,912	-2,911	-2,990	-3,173	-3,238	-3,292	-3,485
Goods Balance	-2,840	-2,573	-3,567	-4,287	-4,583	-4,817	-5,132	-5,347	-5,555	-5,753
Exports, f.o.b.	393	475	753	932	965	1,046	1,107	1,170	1,242	1,331
Imports, f.o.b.	3,233	3,048	4,320	5,219	5,547	5,863	6,240	6,516	6,796	7,084
Services Balance	925	392	1,035	1,375	1,672	1,827	1,960	2,109	2,263	2,268
Receipts	1,674	995	1,906	2,503	2,934	3,156	3,373	3,581	3,787	3,799
Payments	749	603	871	1,127	1,261	1,329	1,413	1,472	1,524	1,531
Primary Income	161	164	151	90	70	119	131	151	179	202
Compensation of employees, net	257	262	263	287	305	332	358	381	406	430
Investment income, net	-92	-95	-110	-197	-234	-212	-225	-229	-225	-227
Secondary Income	1,354	1,545	1,686	1,882	2,050	2,135	2,278	2,369	2,445	2,589
Government, net	237	277	234	296	357	327	341	362	383	406
Other transfers (including remittances), net	1,118	1,269	1,453	1,586	1,693	1,807	1,937	2,007	2,062	2,183
Capital account	-9	17	62	38	59	62	65	68	72	75
Financial account	-163	-562	-365	-661	-571	-500	-526	-474	-415	-417
Direct investment, net	-188	-287	-320	-603	-500	-517	-556	-564	-579	-594
Assets	66	59	100	176	200	216	232	246	261	276
Liabilities	255	346	421	778	700	732	788	811	840	870
Portfolio investment, net	59	-82	277	136	5	115	133	147	201	226
Other investment, net	-129	-240	-491	-261	-178	-239	-229	-176	-123	-136
Reserve assets	95	46	169	68	101	140	126	121	87	86
Net errors and omissions 1/	246	-107	267	241	160	174	172	176	181	203
				(In percent of GDP)						
Current account, incl. official transfers	-5.7	-7.0	-8.7	-10.5	-8.1	-7.0	-6.7	-6.0	-5.2	-5.1
Balance on Goods and Services	-27.1	-32.2	-31.8	-32.6	-29.7	-28.3	-27.9	-26.8	-25.8	-25.8
Exports of Goods	5.6	7.0	9.5	10.4	9.8	9.9	9.7	9.7	9.7	9.8
Exports of Services	23.7	14.7	24.0	28.0	30.0	29.9	29.7	29.7	29.6	28.1
Imports of Goods	45.8	45.0	54.3	58.4	56.6	55.5	54.9	54.0	53.2	52.4
Imports of Services	10.6	8.9	10.9	12.6	12.9	12.6	12.4	12.2	11.9	11.3
Primary Income	2.3	2.4	1.9	1.0	0.7	1.1	1.2	1.2	1.4	1.5
Secondary Income	19.2	22.8	21.2	21.1	20.9	20.2	20.0	19.6	19.1	19.1
Capital account	-0.1	0.3	0.8	0.4	0.6	0.6	0.6	0.6	0.6	0.6
Financial account	-2.3	-8.3	-4.6	-7.4	-5.8	-4.7	-4.6	-3.9	-3.2	-3.1
Direct investment, net	-2.7	-4.2	-4.0	-6.7	-5.1	-4.9	-4.9	-4.7	-4.5	-4.4
Portfolio investment, net	0.8	-1.2	3.5	1.5	0.1	1.1	1.2	1.2	1.6	1.7
Other investment, net	-1.8	-3.5	-6.2	-2.9	-1.8	-2.3	-2.0	-1.5	-1.0	-1.0
Reserve assets	1.3	0.7	2.1	0.8	1.0	1.3	1.1	1.0	0.7	0.6
Net errors and omissions 1/	3.5	-1.6	3.4	2.7	1.6	1.6	1.5	1.5	1.4	1.5
Memorandum items:										
Public debt service to export ratio (percent)	3.0	6.7	3.4	1.7	1.8	2.1	2.0	1.7	2.3	2.7
Public debt service to exports and remittances (percent)	2.1	4.0	2.3	1.3	1.4	1.6	1.5	1.3	1.7	2.0
External public and private debt (percent of GDP) 2/	31.2	37.0	37.1	38.3	37.3	37.2	37.0	36.6	35.5	34.8
Net foreign assets of CBK 3/	938	969	1,061	1,147	1,233	1,365	1,503	1,624	1,710	1,795
Gross international reserves 3/	1,142	1,149	1,293	1,370	1,478	1,623	1,749	1,869	1,956	2,042
Gross international reserves in months of prospective imports 3/	3.8	2.7	2.4	2.4	2.5	2.5	2.6	2.6	2.6	2.6
Gross international reserves, excl. PAK and KPST deposits at CBK 3/	864	900	1,100	1,176	1,277	1,417	1,543	1,663	1,750	1,836
RSF-related imports (Euro million) 4/	---	---	---	---	38	38	0	---	---	---

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 domestic government securities.

4/ It reflects staff estimates of the cost associated with RSF RM implementation. Pending their use, RSF resources will not be counted towards GIRs.

Table 6. Kosovo: Central Bank and Commercial Bank Survey, 2019–28

(Millions of euros, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Proj.					
Central Bank										
Net foreign assets	938	969	1,061	1,147	1,233	1,365	1,503	1,624	1,710	1,795
Foreign assets	1,219	1,223	1,370	1,449	1,557	1,702	1,828	1,948	2,034	2,120
Foreign liabilities	281	254	310	302	325	337	325	325	325	325
Net domestic assets	-420	-211	-335	-353	-346	-384	-427	-452	-483	-514
Net claims on central government	-421	-213	-347	-355	-349	-386	-429	-455	-486	-517
Claims on central government	316	314	280	248	275	288	275	276	275	275
Of which: government securities	184	201	216	197	200	200	200	200	200	200
Liabilities to central government	738	527	626	604	624	674	705	730	761	791
PAK (privatization) fund	275	191	185	166	166	166	166	166	166	166
Government deposits	444	317	423	420	440	490	521	546	577	607
IMF subscription	18	18	18	18	18	18	18	18	18	18
Claims on other sectors	1	2	11	2	2	2	2	2	2	2
Monetary base	468	706	667	726	792	886	980	1,074	1,128	1,182
Liabilities to other depository corporations	415	566	589	594	640	725	815	905	955	1,005
Deposits included in broad money	53	139	78	132	152	161	165	169	173	177
Other items, net 1/	50	52	58	67	94	95	96	97	98	99
Commercial banks										
Net foreign assets	639	843	836	1,023	1,068	1,066	1,096	1,142	1,223	1,321
Assets	866	1,117	1,107	1,338	1,376	1,374	1,404	1,449	1,530	1,628
Liabilities	-227	-274	-271	-315	-308	-307	-308	-308	-308	-308
Net domestic assets	3,629	3,908	4,462	4,954	5,518	6,088	6,648	7,121	7,571	8,038
Claims on the CBK	415	566	589	592	640	725	815	905	955	1,005
Net claims on the central government	275	240	297	251	266	326	386	436	486	536
Claims on central government	287	254	311	265	280	340	400	450	500	550
Liabilities to central government	-13	-14	-15	-14	-14	-14	-14	-14	-14	-14
Net claims on other public entities	-88	-140	-170	-235	-258	-278	-299	-317	-333	-353
Claims on other public entities	3	4	0	0	0	0	0	0	0	0
Liabilities to other public entities	-92	-143	-170	-235	-258	-278	-299	-317	-333	-353
Credit to private sector	3,028	3,241	3,747	4,346	4,870	5,315	5,746	6,097	6,464	6,850
Deposits of the private sector	3,688	4,091	4,597	5,184	5,721	6,211	6,724	7,181	7,648	8,145
Demand deposits	2,225	2,597	3,090	3,371	3,727	4,048	4,386	4,688	5,001	5,329
Time deposits	1,463	1,493	1,508	1,813	1,993	2,163	2,339	2,493	2,647	2,816
Other items, net 2/	580	661	701	793	865	944	1,020	1,082	1,146	1,214
Memorandum items:										
Broad money (12-month percent change)	11.9	15.3	12.1	11.3	10.6	8.5	8.2	6.8	6.4	6.5
Gross international reserves, excl. PAK and KPST deposits at CBK	864	900	1,100	1,176	1,277	1,417	1,543	1,663	1,750	1,836
Deposits of the private sector (12-month percent change)	15.6	10.9	12.4	12.8	10.4	8.6	8.3	6.8	6.5	6.5
Credit to the private sector (12-month percent change)	10.0	7.0	15.6	16.0	12.1	9.2	8.1	6.1	6.0	6.0
Deposits of the private sector (percent of GDP)	52.3	60.4	57.8	58.0	58.4	58.8	59.2	59.5	59.9	60.2
Credit to the private sector (percent of GDP)	42.9	47.9	47.1	48.6	49.7	50.3	50.6	50.5	50.6	50.7
Excess reserves of commercial banks	187	302	287	231	282	308	326	346	379	383

Sources: Kosovo authorities and IMF staff estimates and projections.

1/ Includes shares and other equity.

2/ Includes shares, other equity, and deposits from central government, local governments and POEs.

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

(Percent, unless otherwise indicated)

	2019	2020	2021	2022
Total Assets (% GDP) 1/	67.5	79.1	74.9	77.8
Capital adequacy				
Regulatory capital to risk weighted assets	15.9	16.5	16.1	14.8
Tier 1 capital to risk weighted assets	14.2	14.7	13.7	12.8
Capital to assets	11.2	11.7	11.1	8.9
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	3.6
Large exposures to capital	81.8	89.5	89.8	104.1
Liquidity				
Liquid assets to total assets	28.8	30.1	28.8	26.8
Deposits to loans	129.2	133.9	131.6	129.8
Liquid assets to short-term liabilities	38.7	40.4	37.2	36.5
Profitability				
Return on average assets	2.1	1.7	2.2	2.6
Return on average equity	17.2	14.0	17.6	20.7
Interest margin to gross income	80.6	79.2	76.0	76.7
Non-interest expense to gross income	48.1	46.1	45.3	43.8
Market risk				
Net open currency position to capital	4.7	3.5	1.5	2.3

Source: Central Bank of the Republic of Kosovo.

1/ Includes all other depository corporations.

Table 8. Kosovo: Indicators of Fund Credit, 2022–45

(In millions of SDR, unless otherwise indicated)

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045
Existing and prospective Fund credit																								
Disbursements	0.0	71.0	57.7	13.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GRA 1/ 2/	0.0	40.1	26.7	13.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
RSF	0.0	31.0	31.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock of existing and prospective Fund credit	41.3	102.0	139.1	142.1	142.1	115.4	77.0	63.6	61.9	61.9	61.9	61.9	58.4	52.2	46.0	39.8	33.6	27.4	21.2	15.0	8.8	2.6	0.0	0.0
GRA	41.3	71.0	77.1	80.1	80.1	53.4	15.0	1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
RSF	0.0	31.0	62.0	62.0	62.0	62.0	62.0	62.0	62.0	62.0	62.0	62.0	58.5	52.3	46.1	39.9	33.7	27.5	21.3	15.1	8.9	2.7	0.0	0.0
Obligations																								
Principal/repurchases	9.9	10.3	20.6	10.3	0.0	26.7	38.4	13.4	1.7	0.0	0.0	0.0	3.5	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	2.7	0.0
GRA 1/ 2/	9.9	10.3	20.6	10.3	0.0	26.7	38.4	13.4	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
RSF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.5	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	2.7	0.0
Charges and interest	0.8	2.4	6.2	7.5	7.5	7.1	5.6	4.0	3.5	3.5	3.5	3.5	3.4	3.2	2.9	2.6	2.3	2.0	1.6	1.3	1.0	0.7	0.4	0.4
GRA 1/ 2/	0.8	2.2	4.1	4.4	4.4	4.0	2.5	0.9	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
RSF	0.0	0.2	2.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	2.8	2.5	2.2	1.9	1.6	1.3	1.0	0.7	0.4	0.1	0.0
Fund obligations (repurchases and charges) in percent of																								
Quota	12.9	15.4	32.5	21.6	9.1	40.9	53.2	21.0	6.2	4.2	4.2	4.2	8.4	11.4	11.0	10.6	10.2	9.9	9.5	9.1	8.7	8.4	3.8	0.4
GDP	0.1	0.1	0.2	0.1	0.1	0.2	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	0.2	0.3	0.5	0.3	0.1	0.5	0.7	0.3	0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Gross international reserves	0.6	0.7	1.3	0.8	0.3	1.4	1.7	0.7	0.2	0.1	0.1	0.1	0.2	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.0
Government revenue	0.3	0.4	0.7	0.5	0.2	0.8	1.0	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0
External debt service, public	14.5	14.6	24.8	16.6	7.4	24.0	25.2	9.6	2.7	1.7	1.6	1.5	3.1	4.1	3.8	4.3	3.9	3.6	3.4	3.1	3.0	2.8	1.3	0.1
Fund credit outstanding in percent of																								
Quota	50.0	123.5	168.3	172.0	172.0	139.7	93.2	77.0	75.0	75.0	75.0	75.0	70.7	63.2	55.7	48.2	40.7	33.2	25.7	18.2	10.7	3.2	0.0	0.0
GDP	0.4	0.9	1.1	1.0	1.0	0.7	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Exports of goods and services	1.0	2.1	2.7	2.6	2.4	1.8	1.2	0.9	0.9	0.8	0.8	0.7	0.6	0.5	0.5	0.4	0.3	0.2	0.2	0.1	0.1	0.0	0.0	0.0
Gross international reserves	2.4	5.6	7.0	6.6	6.2	4.7	3.0	2.4	2.3	2.2	2.2	2.1	1.9	1.7	1.4	1.2	1.0	0.8	0.6	0.4	0.2	0.1	0.0	0.0
Government revenue	1.3	3.0	3.8	3.7	3.5	2.7	1.7	1.3	1.2	1.2	1.1	1.1	0.9	0.8	0.7	0.6	0.4	0.3	0.3	0.2	0.1	0.0	0.0	0.0
External public, debt	4.9	9.4	10.8	10.4	9.6	7.4	4.8	3.9	3.7	3.6	3.5	3.4	3.1	2.7	2.4	2.0	1.6	1.3	1.0	0.7	0.4	0.1	0.0	0.0
Memorandum items																								
Quota (SDR million)	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6	82.6
Gross domestic product (Euro million)	8,936	9,794	10,563	11,366	12,067	12,775	13,520	14,061	14,623	15,208	15,817	16,449	17,107	17,791	18,503	19,243	20,013	20,813	21,646	22,512	23,412	24,349	25,323	26,336
Exports of goods and services (Euro million)	3,434	3,898	4,202	4,480	4,750	5,028	5,130	5,438	5,765	6,110	6,477	6,866	7,278	7,714	8,177	8,668	9,188	9,739	10,324	10,943	11,600	12,295	13,033	13,815
Gross international reserves (Euro million)	1,370	1,478	1,623	1,749	1,869	1,956	2,042	2,103	2,166	2,231	2,298	2,367	2,438	2,512	2,587	2,664	2,744	2,827	2,912	2,999	3,089	3,182	3,277	3,375
Government revenue (Euro million)	2,504	2,815	2,964	3,130	3,309	3,482	3,680	3,864	4,057	4,260	4,473	4,696	4,931	5,178	5,436	5,708	5,994	6,293	6,608	6,938	7,285	7,650	8,032	8,434
External debt service, public (Euro million)	59	71	88	88	82	114	139	144	153	163	174	184	178	184	193	163	172	179	186	194	194	194	194	194
Total external debt, public (Euro million)	671	883	1,047	1,116	1,198	1,256	1,290	1,296	1,343	1,386	1,424	1,455	1,496	1,532	1,559	1,609	1,650	1,684	1,711	1,690	1,690	1,690	1,690	1,690

Source: IMF staff estimates and projections.

1/ Based on the projection as of October 19, 2023. Charges and interest calculations are preliminary. It includes prospective purchases under the precautionary SBA. Kosovo belongs to the RST interest group C. Based on the RST rate of interest of 5.109 percent as of October 19, 2023.

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

Table 9. Kosovo: Proposed Quantitative Performance Criteria, 2023–24

(Millions of euros, unless otherwise indicated)

	2023							2024			
	June		June	September		September	December	March	June	September	December
	Prog. Target	Adj. Target	Actual	Ind. Target	Adj. Target	Actual	Prog. Target	Ind. Target	Proposed Prog. Target	Ind. Target	Proposed Prog. Target
1. Quantitative performance criteria											
Floor on the Overall Balance of the General Government 1/	-113	-93	227	-169	-132	295	-225	-58	-116	-174	-232
Floor on the Stock of General Government Deposits at CBK	576	572	769	571	530	803	566	579	591	604	616
2. Continuous performance criteria											
Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government 2/	0	…	0	0	0	0	0	0	0	0	0
3. Indicative targets											
Ceiling on Contingent Budget Allocations 3/	358	…	358	358	…	358	358	210	210	210	210
Ceiling on Holdings of Government Debt by the CBK 2/	200	…	189	200	…	179	200	200	200	200	200

1/ Defined as cumulative flows over the fiscal year
2/ Applies on a continuous basis
3/ Defined as total budgetary contingent allocations; applies on a continuous basis. See paragraph 25 of the Technical Memorandum of Understanding.

Table 10. Kosovo: Prior Actions and Structural Benchmarks Under the SBA

	Measure	Timeframe	Status
Proposed Prior Actions			
1	The government submits a budget for 2024 consistent with RSF and SBA objectives; KEK budget plan for 2024 includes an allocation to complement EU financing for the installation of a filter in the B-2 unit	Before end-October 2023	Met
Structural Benchmarks			
Fiscal Governance			
1	Government starts publishing publicly-owned enterprises' (POEs) annual financial reports; and quarterly data on POE performance.	June 2024	Ongoing
2	Government starts publishing within the Treasury quarterly report, the rationale and intended impact, use and beneficiaries of contingency allocations to boost transparency	July 2023	Met
3	Government starts publishing annual fiscal risk analysis together with budget submission to Parliament	November 2023	Ongoing
4	Government approves new Customs Code	June 2023	Met
5	Tax administration agency (TAK) adopts new action plan to reduce informality	July 2023	Met
6	The Ministry of Finance, Labor, and Transfers, to adopt budget circulars making expropriation costs a mandatory item for the submission of projects financed with both domestic and external resources.	June 2023	Met
Financial Sector Governance			
1	KAS to finalize roadmap to produce a residential housing price index and compile related surveillance data in collaboration with CBK	September 2023	Met
2	Finalization of draft Banking Sector Law in line with FSSR recommendations	November 2023	Ongoing
3	Finalization of new "Rules of Procedure" clarifying roles and responsibilities of the CBK Supervisory Board in relation to the Executive Board based on Kosovo's legal framework	November 2023	Ongoing
4	Submission to Parliament of Banking Sector Law in line with FSSR recommendations	January 2024	Ongoing

Table 11. Kosovo: Reform Measures Under the RSF

	Measure	Timeframe	Status
Reform Measures			
Improving the System's Resilience and Tackling Pollution; Protecting and Empowering Consumers (Energy Pillars 1 and 5)			
RM1	Submission to Parliament of a Budget for 2024 consistent with RSF objectives (allocations for expansion of renewable energy and for implementation of new definition of vulnerable energy consumers); KEK to prepare budget plan securing financing to secure the installation of filters in one unit of Kosova B in 2024.	October 2023	Met
Expanding Greener Generation and Reducing Emissions (Energy Pillar 2)			
RM2	The government will launch by end-June 2024 an open, transparent, and competitive tender for the construction and operation of 150 MW of wind-based electricity generation capacity in a non-specific location.	June 2024	Ongoing
RM3	Submission to Parliament of Law on Renewable Energy delineating the use of competitive auctions to attract private sector investment in renewable electricity generation	September 2023	Met
RM4	Working group presents to Cabinet draft report discussing implications of EU carbon price initiatives for Kosovo, using CPAT tool.	March 2024	Ongoing
RM5	Ministry of Economy to adopt Administrative Instruction allowing the launching of first auction for 100 MW of solar electricity generation during 2023 to be financed by the private sector	May 2023	Met
Increasing Energy Efficiency (Energy Pillar 3)			
RM6	Kosovo Energy Efficiency Fund Board to approve plan to increase energy efficiency of residential buildings to start implementation in 2023:H2	July 2023	Met
Strengthening Regional Cooperation, Market Competition and Functioning (Energy Pillar 4)			
RM7	Government to implement actions conducive to the start of the day-ahead electricity market for Kosovo from September 2023 in the context of the Albania-Kosovo Regional Electricity Market (ALPEX).	June 2023	Met
Crisis Preparedness and Monitoring Transition Risks			
RM8	Central Bank to issue new instruction defining practices for banks to monitor and report data on exporting firms that may be exposed to transition costs related with CBAM implementation	March 2024	Ongoing

Table 12. Kosovo: Schedule of Reviews and Purchases/Disbursements Under the SBA and RSF

(Amount of purchase/disbursement)

	Available on or after	Amount of Purchase (millions of SDRs) Total	Percent of Quota Total	Conditions
	May 25, 2023	20.031	24.3%	Board approval of the SBA
	May 25, 2023			Board approval of the RSF
	Precautionary Stand-By Arrangement 1/			
1.	October 15, 2023	20.031	24.3%	First Review and Observance of SBs and QPCs for end-June 2023
2.	February 20, 2024	13.354	16.2%	Second Review and Observance of SBs and QPCs for end-December 2023
3.	September 15, 2024	13.354	16.2%	Third Review and Observance of SBs and QPCs for end-June 2024
4.	February 20, 2025	13.352	16.2%	Fourth Review and Observance of SBs and QPCs for end-December 2024
	Total	80.122	97.0%	
	Resilience and Sustainability Facility Arrangement			
1.	October 15, 2023	7.744	9.4%	Observance of RM 5
2.	October 15, 2023	7.744	9.4%	Observance of RM 6
3.	October 15, 2023	7.744	9.4%	Observance of RM 7
4.	October 15, 2023	7.744	9.4%	Observance of RM 3
5.	February 20, 2024	7.744	9.4%	Observance of RM 1
6.	September 15, 2024	7.744	9.4%	Observance of RM 2
7.	September 15, 2024	7.744	9.4%	Observance of RM 4
8.	September 15, 2024	7.742	9.4%	Observance of RM 8
	Total	61.950	75.0%	

Source: IMF staff estimates.

1/ The authorities indicated that they do not intend to make these purchases unless unexpected financing gaps arise.

Annex I. Risk Assessment Matrix

A. Global Risks (July 21, 2023)[1]

Source of Risks and Relative Likelihood	Expected Impact	Policy Responses
	Conjunctural risks	
High **Intensification of regional conflict(s).** Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, FDI and financial flows, and payment systems, and lead to refugee flows.	**High** The direct impact is expected to be minimal due to limited linkages with Russia and Ukraine. However, an escalation of the war would affect Kosovo through higher commodity prices, supply disruptions, tighter financial conditions, and lower growth in countries where the diaspora resides, limiting tourism flows and remittances. By the same token, an intensification of the conflict in the Middle East can disrupt oil supply chains resulting in higher oil prices.	• Design well-targeted and temporary policy interventions to support households to cope with additional commodity price shocks. • Promote energy savings through higher pass-through rates of international electricity prices for non-vulnerable clients, especially for peak-hour consumption. • Accelerate broad-based structural reforms to boost competitiveness, expand renewable energy production, and gradually reduce the dependency on diaspora-related flows by increasing exports and domestic production.
High **Commodity price volatility.** A succession of supply disruptions (e.g., due to conflicts and export restrictions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, contagion effects, 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.	• Design targeted and temporary policies to cope with additional commodity price shocks. • Accelerate broad-based structural reforms to boost competitiveness, make the energy matrix greener, and increase public investment absorption. • Promote energy savings through well-designed measures to increase efficiency in the use of energy; and by passing through international electricity prices for non-vulnerable clients, especially for peak-hour consumption.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. 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. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Source of Risks and Relative Likelihood	Expected Impact	Policy Responses
Medium **Abrupt global slowdown or recession.** Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and markets fragmentation. • **U.S.:** Amid tight labor markets, supply disruptions and/or commodity price shocks, inflation remains elevated, prompting the Fed to keep rates higher for longer and resulting in dollar strengthening, a more abrupt financial and housing market correction, and "hard landing". • **Europe:** Intensifying fallout from the war in Ukraine, worsening energy crisis and supply disruptions, and monetary tightening exacerbate economic downturns and housing market corrections. • **China:** Greater-than-expected economic disruptions from COVID resurgence, rising geopolitical tensions, and/or a sharper-than-expected slowdown in the property sector disrupt economic activity. **EMDEs:** A new bout of global financial tightening, possibly combined with volatile commodity prices, leads to spiking risk premia, debt distress, widening of external imbalances, fiscal pressures, and sudden stops.	**High** An economic slowdown in Europe will weigh on Kosovo's growth through reduced consumption, investment, and lower diaspora flows, weighing on the strength of Kosovo's external inflows.	• Design targeted and temporary policies to cope with shocks. • 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 **Monetary policy miscalibration.** Amid high economic uncertainty and volatility, major central banks slow monetary policy tightening or pivot to loosen monetary policy stance prematurely, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets.	**Medium** Increased inflation could lead to increase social discontent in Kosovo.	• Design targeted and temporary policies to cope with additional commodity price shocks. • Fiscal transfers should be more targeted to better mitigate the impact of inflation on the most vulnerable.
Medium **Systemic financial instability.** Sharp swings in real interest rates, risk premia, and assets repricing amid economic slowdowns and policy shifts trigger insolvencies in countries with weak banks or non-bank financial institutions, causing markets dislocations and adverse cross-border spillovers.	**Medium** Increased financial market volatility in the euro area can result in increased interest rates and risk premia for Kosovo.	• Strengthen the capacity of the CBK to monitor bank credit and liquidity risks; Stand ready to take supervisory actions. • Strengthen CBK Governance and finalize the appointment of CBK Executive Board members. • Improve the monitoring of key sectors such as the real estate sector.

Source of Risks and Relative Likelihood	Expected Impact	Policy Responses
Medium **Sovereign debt distress.** Domino effects of higher global interest rates, a growth slowdown in AEs, and/or disorderly debt events in some EMDEs spillover to other highly indebted countries, resulting in capital outflows, an increase in risk premia, and loss of market access	**Medium** Kosovo's debt remains moderately low (around 20 percent) and is projected to remain well-within the country's debt limit in the medium term.	• Strengthen debt management and continue working towards obtaining a sovereign risk rating.
Medium **Social discontent.** Supply shocks, high inflation, real wage drops, and spillovers from crises in other countries worsen inequality, trigger social unrest, and give rise to financing pressures and damaging populist policies with possible spillovers to other EMDEs. This exacerbates imbalances, slows growth, and triggers market repricing.	**High** Social discontent can result in economic losses as well as in costly policy proposals.	• Finalize the assessment of possible beneficiaries of veteran benefits. Establish clear and sustainable indexing mechanism for this and other social transfers. • More broadly, transfer programs should be strengthened to target the budget's assistance on the vulnerable.
Structural Risks		
High **Deepening geo-economic fragmentation.** Broader and deeper conflict(s) and weakened international cooperation result in a more rapid reconfiguration of trade and FDI, supply disruptions, protectionism, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth.	**Medium** A global economic slowdown due to geo-economic fragmentation will weigh on Kosovo's growth through reduced consumption, investment, and lower diaspora flows that may lead to a higher current account deficit.	• Design targeted and temporary policies to cope with additional shocks. • Accelerate broad-based structural reforms, including greening the energy matrix and reducing diaspora dependency through policies to increase exports and domestic production.
Medium **Cyberthreats.** Cyberattacks on physical or digital infrastructure (including digital currency and crypto assets ecosystems) or misuse of AI technologies trigger financial and economic instability.	**Medium** Sharp financial market fluctuations can disrupt the normal operation of corporates and financial institutions.	• Improve the physical and regulatory infrastructure to monitor and mitigate cyberthreats. Have contingent plans to address tail-event scenarios.
Medium **Extreme climate events.** Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.	**Medium** Kosovo is prone to several natural hazards (droughts, wildfires, landslides, and floods), that can inflict considerable damage to economic activity, lead to fiscal costs, and affect vulnerable populations. Extreme climate events at the global level affect Kosovo through higher food prices.	• Continue work on the National Environment and Climate Plan. • Strengthen preparedness through contingent fiscal and financial plans to mitigate the impact of climate events. Maintain appropriate fiscal buffers to ensure capacity to respond swiftly. • Improve the targeting of transfer programs to ensure that support only reach the most vulnerable households. • Implement PIMA and C-PIMA recommendations.

Structural Risks		
Medium **Disorderly energy transition.** Disorderly shift to net-zero emissions (e.g., owing to shortages in critical metals) and climate policy uncertainty cause supply disruptions, stranded assets, market volatility, and subdued investment and growth.	**Medium** Stricter trade regulations, such as CBAM, could negatively affect Kosovo's growth prospects, as well as the country's attractiveness to foreign investors.	• Continue work on the National Environment and Climate Plan. • Expand green generation and invest in reducing emissions and increasing energy efficiency. Strengthen regional cooperation, market competition, and functioning of the electricity market. • Strengthen in-house planning and analysis on carbon pricing and feebate design, including through the use of CPAT.

B. Domestic Risks

Source of Risks and Relative Likelihood	Expected Impact	Policy Responses
Geopolitical Risks		
High **Intensification of tensions in northern Kosovo.** Heightened tensions in Kosovo's northern municipalities leads to a continuation of EU measures.	**High** Tensions in Kosovo's northern municipalities delay progress in the dialogue with Serbia. This may lead to a continuation of EU measures, constraining access to EU and bilateral financing.	• Continue abiding by the EU-sponsored dialogue and implement EU-SAA provisions.
Climate-Related Risks		
Medium **Longer-than-programmed electricity outages.** The combination of higher-than-projected electricity prices and longer-than-expected electricity outages (e.g., due to the installation of filters in "Kosova B" thermal power plant) can lead to load shedding, higher tariffs, and increased fiscal deficits.	**High** Higher electricity tariffs will increase inflation and dampen household disposable income, leading to lower consumption growth. They will also increase firms' input costs, negatively impacting profits and investment plans.	• Proactively address any bottlenecks that would affect the project timeline, including by intensively liaising with EU partners. • Promote energy savings through well-designed measures to increase energy efficiency; and by passing through international prices to non-vulnerable clients, for peak-hour consumption.
Fiscal Risks		
Low **The cost of legal action on pensions and wages increases fiscal pressures.** The cost of recent changes in the pensions paid by the state and legal action on the public wage law increase budgetary costs.	**Low** Increased payments may lead to cascading requests by other stakeholders, such as war Veterans.	• Plan for fiscal contingencies and risks, through a well-designed fiscal risk analysis. • The implementing regulations of Law on Pensions should be finalized and well communicated.

Annex II. Potential Benefits of Climate Change Mitigation and Adaptation Policies[1]

1. **Kosovo suffers from one of the worst air qualities in Europe.** As about 90 percent of electricity generation stems from two antiquated lignite-burning plants, the concentration of fine particulate matter pollution (MP2.5) in cities across Kosovo is well above the WHO recommended guideline (5 µ/m3). Air pollution is a direct threat to human health, as it increases morbidity and mortality from cardiovascular and respiratory diseases (WHO, 2021). Recently Greenstone and Hasenkopf (2023) found that Kosovars life expectancy would increase by about 1½ years if the levels of air pollution could be reduced to the WHO guideline.

2. **Additionally, climate change is leading to more recurrent extreme natural events.** Based on the UN World Risk Index—which measures the exposure to natural disasters and the capacity to cope with them—the western Balkans has a higher risk index (2.5) than Europe (2.1), although both are below the riskiest regions in the world, America (10) and Asia (5.9). The economic, social, and fiscal costs natural disasters in Kosovo can delay other much-needed interventions, including those to close social spending gaps (World Bank, 2023).

3. **The potential health co-benefits and damage reduction associated with climate change mitigation policies in Kosovo are very large.** Reducing greenhouse gas (GHG) emissions would, e.g., lead to better air quality and less air pollution (Hamilton, Brahmbatt, and Liu, 2017). Parry and others (2014) provide estimations of health benefits of reducing coal use as well as the damages it causes. Preliminary figures for Kosovo using cross-country estimates suggest that reducing emissions by 50 percent could lead to economic gains of about 7 percent of GDP, 2.5 percent of GDP from health co-benefits and 4.6 percent of GDP from reduction in damages. The climate change mitigation policies in Kosovo's RSF explicitly aim at reducing pollution and emissions.

4. **Using the IMF-WB climate policy assessment tool (CPAT), staff provides an approximate quantification of the welfare benefits of RSF RMs.** Staff design three sets of experiments related to the installation of coal filters, solar and wind investment, and residential infrastructure improvements. These experiments are discussed in detail below. The experiments are contrasted with a business-as-usual baseline in which no actions are taken.

- ***Coal filters.*** As part of RM1, new filters will be installed in the "Kosova B" thermal power plant. The experiment assumes that pollution stemming from coal power plants will be reduced by 50 percent, relative to current values, starting in 2025.

- ***Solar and wind-based new electricity capacity.*** As part of RM3 and RM5, the Kosovar government has submitted to parliament a law on renewable energy that defines the use of competitive auctions to promote private investment in green generation; in 2023:H1 the

[1] Prepared by Stephen Ayerst and Javier Kapsoli. The authors would like to thank Karlygash Zhunussova and Victor Mylonas (IMF) and Paulina Schulz Antipa (World Bank), who completed CPAT data gaps allowing its use for Kosovo.

government launched an auction for 100MW of new solar-based electricity generation capacity and plans to launch an additional auction for 150MW of wind energy capacity; both are expected to be on-line in 2025–26. Moreover, an additional 100MW of solar energy capacity is expected to come online in 2026, as the result of already agreed financing with bilateral and multilateral donors. The pipeline of green projects together with the strengthened legal framework are expected to catalyze further investment in wind and solar energy, which staff assumes at around 50MW per annum.[2]

- ***Residential infrastructure improvements***. As part of RM6, the Energy Efficiency Fund Board has approved a plan to increase energy efficiency of residential buildings. The fund has begun implementing infrastructure improvements that are expected to improve energy efficiency for around 2,700 households. In addition, actions by the Ministry of Economy are expected to reach around 9,000 households. Together, this comprises around 2 percent of the total number of households and these reforms are expected to continue. The experiment assumes infrastructure improvements affecting 2 percent of households per annum and an improvement in demand efficiency in the margin of around 50 percent.

5. Staff find that the direct welfare benefits of the RSF RMs are substantial and note that the indirect benefits are potentially larger. The annual long-run direct monetized welfare benefits of the RMs are estimated at around 1.2 percent of GDP across the three experiments, or 12-24 percent of GDP in net present value terms.[3] The direct benefits are driven by climate benefits from lower greenhouse gas and other pollutants, air pollution co-benefits stemming from improved health outcomes, and improved demand efficiency. In addition, indirect benefits not considered by the CPAT model—such as progress towards EU accession requirements, lowering the potential impacts of carbon price and tax shocks—cannot be understated and back-of-the-envelope calculations indicate that indirect benefits are of similar or larger magnitude than the direct benefits of the RMs.

6. Installation of coal filters will substantially cut pollution improving health outcomes in the short and long run. Currently, over 3,000 annual deaths are attributable to air pollutant-related causes in Kosovo. The installation of filters in Kosova B are expected to cut the particulate matter (PM) content of air resulting from lignite coal use in the power sector by half. The direct monetized welfare benefits of installing coal filters are estimated at around 0.5 percent of GDP, per year, driven by air pollution co-benefits. CPAT projects that, per year, the coal filter installation will lead to more than 100 fewer pollution-related deaths and around 350 fewer years lived with disability, leading to higher quality of life and a healthier workforce. The benefits of reduced pollution are also expected to strengthen over time as new generations are born into a lower pollution environment and benefit

[2] The conversion rate of capacity into energy generation is assumed to be 30 – 40 percent for the experiments.

[3] Net present value of welfare is calculated as the annual monetized welfare benefit discounted at a rate of 5 to 10 percent. The welfare benefits are the sum of the three individual experiments. While this neglects potential crowding out of benefits from the three reforms, this unlikely to change the overall welfare impact given the initially high pollution in Kosovo. The direct costs of the reforms are assumed to be an order of magnitude smaller than the benefits (around 3 – 5 percent of GDP depending on the assumed cost per MW of new capacity).

from longer life expectancies and lower risks of morbidity. Finally, while not directly modeled, reducing pollution can benefit Kosovo by improving its attractiveness for FDI and tourism.

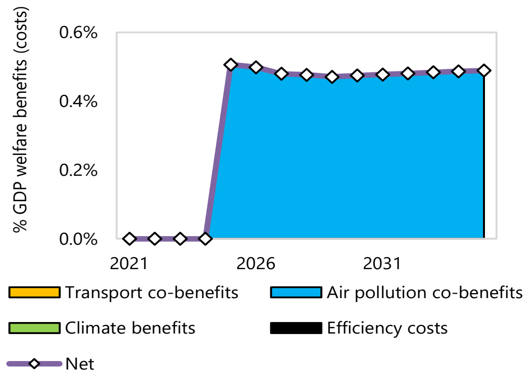
7. Solar and wind investment will reduce emissions, improve health outcomes, and support Kosovo's green energy transition. The direct monetized welfare benefits of improving solar and wind energy capacity are expected to grow to around 0.5 percent of GDP/year, driven by a combination of climate benefits (around two thirds) and air pollution co-benefits (around one third). The program envisages a gradual increase in renewable energy as solar and wind auctions take place. The switch away from lignite coal will lower emissions and pollution, helping Kosovo reach its climate goals and improve health outcomes.[4] Lower pollution is projected to reduce pollution-related deaths by up to 25 per year and improve morbidity.

8. The indirect benefits of RSF RMs (including supporting EU accession, reducing the potential impact of carbon taxes, and the introduction of a framework to attract green investment) are substantial, potentially outweighing the direct benefits. As part of the EU accession process, Kosovo is required to conform to the EU's carbon emission standards and tax treatment. This is expected to include an approximately 100 Euro per carbon ton tax on emissions Increasing solar and wind capacity would allow Kosovo to partially avoid this taxation and would also help in the near term, as programs such as the EU CBAM enter into effect. In the medium-term, these trends will be supported by the law on Renewable Energy Sources, an RSF RM, which provides a framework to attract private investment into solar and wind-based energy generation.

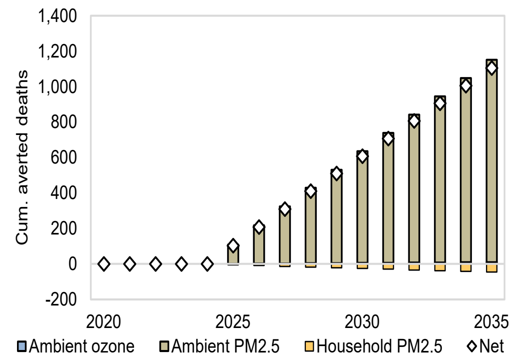
[4] The social cost of carbon is assumed to be 75 USD per ton of CO2.

Annex II Figure 1. Quantification of RSF Reform Measures

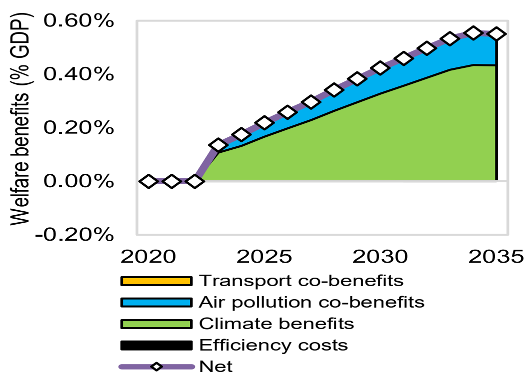
Installation of coal filters improves welfare from air pollution co-benefits…



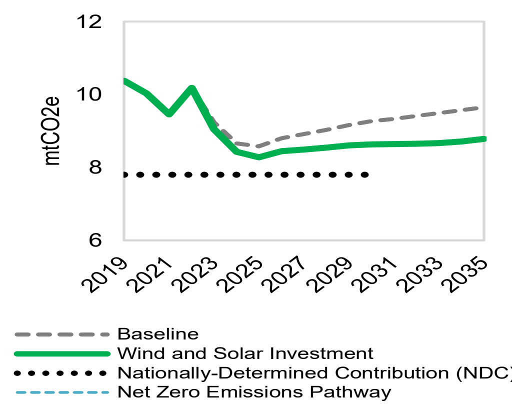
…due to averting pollution-related deaths.



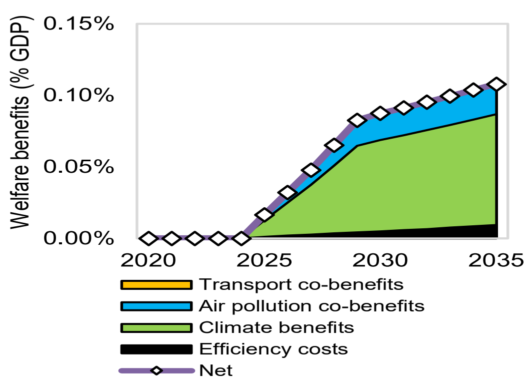
Solar and wind investment increase welfare through climate benefits and air pollution co-benefits…



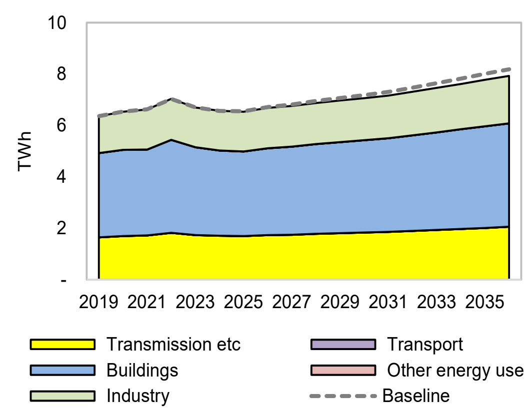
…driven by lower GHG emissions.



Residential infrastructure improvements increase welfare from climate benefits, air pollution co-benefits, and efficiency gains…

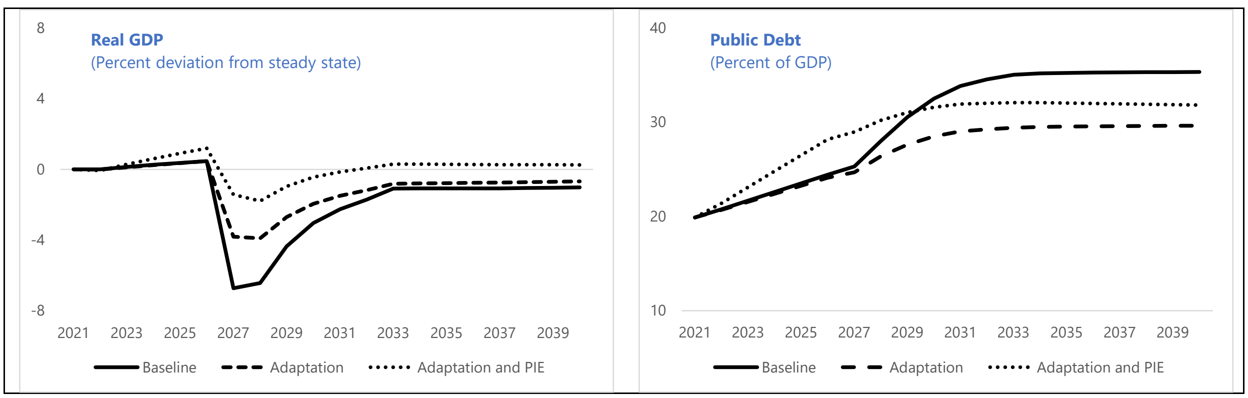


…stemming from lower total energy demand.



9. Increased demand efficiency stemming from residential infrastructure improvements is expected to decrease energy demand leading to improved outcomes across multiple channels. The direct monetized welfare benefits of increasing demand efficiency are estimated at around 0.1 percent of GDP driven by climate benefits (around two thirds), increased efficiency, and air pollution co-benefits. All three channels stem from the lower energy usage of residential households allowing the economy to reduce reliance on lignite coal. Lower lignite coal use leads to a reduction in greenhouse gas and other pollutant emissions, improving health outcomes.

10. Moreover, scenario analysis using the DIGNAD model shows that the benefits of climate change-resilient infrastructure can also be significant. Marto, Papageorgiou, and Klyuev (2018) develops a DSGE model to assess how a small open economy can cope with the impact of natural disasters by investing in climate-resilient infrastructure. The Debt-Investment-Growth, and Natural Disasters (DIGNAD) model is an empirical application of such a model where parameters are calibrated to the features of a specific economy. Using DIGNAD, staff calibrated three scenarios for Kosovo: (i) a baseline featuring an extreme climate event without adaptation investment; (ii) a scenario incorporating adaptation investment at unchanged investment efficiency; and (iii) a scenario incorporating both adaptation investment and increased investment efficiency. The scenarios show that investing on adaptation accelerates the recovery to the pre-shock GDP and reduces fiscal costs with respect to a business-as-usual scenario in the order of 50 percent; outcomes are even better if these efforts are coupled with policies to boost public investment efficiency such the ones recommended in the last combined PIMA and C-PIMA report.



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Annex III. Collaboration with World Bank and European Reconstruction and Development Bank Under the SBA and RSF Arrangements

1. Staff has been in close collaboration with the World Bank (WB) and the European Reconstruction and Development Bank (EBRD) to share knowledge and expertise. Under the SBA, the WB-IMF collaborated on areas such as tax policy and administration, reducing informality, public procurement, targeting of temporary subsidies and transfers. For example, WB's Fiscal Policy, Competitiveness and Green Growth Development Policy Operation (DPO) series under preparation has key measures on tax administration and procedures, which complemented SBA structural benchmarks on approval of a new customs code (SB, end-June 2023) and updated action plan on reducing informality (SB end-July 2023); moreover, staff commented on the new Law on Tax Administration and Procedures, one of the DPO-2023 prior actions.

2. WB and EBRD technical expertise and financing are instrumental to support Kosovo's climate change mitigation and adaptation agenda. The WB has been providing support for strengthening climate change resilience and preparedness, environmental sustainability, renewable energy, energy efficiency and climate change policy, as well as strengthening waste management and enhancing the national capacity for managing water resources. The EBRD has been promoting competitiveness in renewable energy, energy efficiency, decarbonization, as well as water and waste management.

3. RSF reform measures complement and strengthen the work of other development partners. Close coordination between the RSF reform measures (RM) and the key measures of the WB's DPO, backed by EBRD's investment projects, ensures parallel and complementary conditionality across these institutions. Some examples include:

- **The WB's upcoming DPO** (the pillar on supporting reforms to promote greener and sustainable growth) is designed around the following key measures: establishing a program to provide targeted financial support to vulnerable consumers in the electricity sector *(complementing RM1 of the RSF);* improving energy efficiency by streamlining the process and enforcement of energy performance certifications (EPCs) for buildings *(complementing RM6 of the RSF);* establishing a legal framework for the transition to market-based support mechanisms in the renewable power generation sector to diversify the energy supply mix towards renewables and while phasing out of coal *(complementing RM2, RM3, and RM5 of the RSF);* discouraging the use of lightweight plastic carrier bags that contribute to environmental degradation.

- **The EBRD**, with approximately €200 million in public and private sector investments in Kosovo dedicated to use for climate mitigation and adaptation, or other environmental benefit, has the following financing and technical assistance activities: investment in the construction of the country's first-ever utility-scale wind project and its largest wind generation plant – the 32.4 MW Kitka plant and the 105MW Bajgora facility; supporting policy reform to develop a best-practice framework for renewable energy in Kosovo, in line with international best practice *(supporting* *the implementation of RM2)*; supporting the design of a competitive bidding process for renewable energy projects *(supporting the implementation of RM5);* supporting the preparatory work on the legislation for energy efficiency through assistance on preparation and drafting of a national Buildings Renovation Strategy and transposition of eco-design and energy labelling requirements *(supporting the implementation of RM3);* financing energy efficiency improvements of up to 150 municipally owned buildings in Pristina and Prizren, implemented with EU investment grants under Regional Energy Efficiency Program *(supporting the implementation of RM3)*; providing loans and incentives to residents and SMEs to invest in high-performing energy-efficient technologies and renewable energy investments (to date, €81 million has been signed under the green SME and energy efficiency lines for the residential sector) *(supporting the implementation of RM3);* financing and technical assistance to the district heating company to introduce solar thermal technology and improve their financial and operational efficiency and performance.

Appendix I. Letter of Intent

Prishtinë, October 30, 2023

Ms. Kristalina Georgieva
The Managing Director
International Monetary Fund
Washington, D.C.

Dear Ms. Georgieva:

The Government and the Central Bank of the Republic of Kosovo remain committed to upholding sound macroeconomic policies while making progress in implementing the reforms endorsed in the SBA and RSF arrangements approved by the IMF Executive Board on May 25, 2023, which aim to boost potential growth, reduce inequality, and address the consequences of climate change through the mitigation and adaptation efforts.

Throughout 2023, our government implemented policies to support increased energy efficiency and advance the green transition, promote youth employment, strengthen compensation policies in the public sector, improve the absorption of the public investment program, and promote a better targeting of social programs. Throughout the implementation of these policies, our government has maintained a robust fiscal position, given our commitment to prudent policies and to strengthening tax compliance.

In addition, our government implemented fiscal structural reforms aimed at enhancing public financial management, containing fiscal risks, and strengthening revenue mobilization. To this end, we started publishing the rationale, impact, and beneficiaries of contingent budget allocations within the treasury quarterly report, adopted a budget circular making expropriation costs a mandatory item for the submission of investment projects, and approved a new customs code to bridge differences with EU legislation. To reduce informality, the Tax Administration (TAK) adopted a new action plan. In parallel, the Central Bank is implementing reforms to strengthen financial governance and improve supervision, including through the creation of a residential house price index, in collaboration with Kosovo Agency of Statistics (KAS).

Furthermore, we have dedicated strong efforts to advancing our climate change agenda, optimizing our energy mix with a focus on renewables, and improving energy efficiency. Our government implemented actions to launch the day-ahead electricity market for Kosovo in the context of Albania-Kosovo Regional Electricity Market (ALPEX) and launched the first auction for 100 MW of solar electricity generation during 2023 to be financed by the private sector; to increase energy efficiency in residential buildings starting in 2023, the Energy Efficiency Fund Board approved a new plan. Importantly, the government is also working on a tender to attract private capital into wind-based electricity generation, which would add capacity of 150 MW.

The Government and the Central Bank of Kosovo request the completion of the first reviews of the SBA and the RSF arrangements based on the full implementation of both programs' targets and reforms. All end-June quantitative performance criteria (QPC) and all indicative targets (IT) and, and all indicative quantitative targets for September were met. All structural benchmarks under the SBA and all reform measures under the RSF envisaged for the first reviews were completed. In the attached update of the Memorandum of Economic and Financial Policies (MEFP), we update our achievements and further policy steps and reforms needed to meet our IMF-supported SBA and RSF program objectives. We will continue to treat the SBA arrangement as precautionary, but we may consider making purchases if downside risks materialize, including if programmed external financing fails to materialize.

The Government and the Central Bank of Kosovo will maintain close policy dialogue with the IMF to achieve the program objectives and will consult with the IMF in advance of any revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultations. We are ready to provide IMF staff with the data and information required to monitor the implementation of these two programs. In keeping with our policy of transparency, we consent to the IMF's publication of this letter, the MEFP, the Technical Memorandum of Understanding (TMU), and the accompanying Executive Board documents.

Sincerely yours,

/S/

Albin Kurti
Prime Minister

/S/

Hekuran Murati
Minister of Finance, Labor, and Transfers

/S/

Ahmet Ismaili
Central Bank Governor

Attachments (2)

Attachment I. Memorandum of Economic and Financial Policies

This memorandum supplements our memorandum dated on May 9, 2023, provides updated information on recent developments, details our achievements, and discusses further policy steps and reforms to meet our program objectives.

I. MACROECONOMIC CONDITIONS

1. **Lower food and energy prices have driven inflation sharply down.** Decreasing international food and energy prices have supported a strong decline in inflation. After peaking at 14.5 percent (y/y) in July 2022, (average) headline inflation is projected at about 5 percent in 2023 and 3.5 percent in 2024. However, the observed volatility in commodity prices (especially of energy) on the back of the ongoing geopolitical tensions suggest that there may be upside risks to inflation. Core inflation (excluding volatile food and energy prices) is projected at around 4 percent in 2023 and 3 percent in 2024.

2. **Economic activity is expected to remain solid.** High export growth (especially of services) will support growth of about 3–4 percent in 2023. The dynamism in the export of services is grounded not only on diaspora-related tourism, but also on IT and business services. A moderate fiscal impulse, mainly driven by an increase in public investment, will also bolster domestic demand. The momentum in economic activity is expected to continue in 2024, with real GDP growth projected in the 4–5 percent range. The current account deficit is projected to decline to about 8 percent of GDP in 2023 (from 10.5 percent in 2022). Risks to growth are balanced, with downside risks dominated by possible increases in commodity prices, and upside risks associated with a higher implementation of the public investment program (PIP) and stronger-than-projected export of services. These factors suggest, however, that the balance of risks for inflation is to the upside. To continue strengthening the timeliness and reliability of our national accounts and price data, the Kosovo Agency of Statistics (KAS) has requested technical assistance from the IMF, which will take place in 2023:Q4.

II. POLICY FRAMEWORK AND REFORMS UNDER THE STAND-BY ARRANGEMENT

3. **We have made significant progress in the implementation of the ambitious reform agenda under the SBA-supported program.** The reform agenda aims to further strengthen fiscal, financial, and economic governance, maintain financial stability, gradually close infrastructure gaps, tackle informality, and promote new growth engines.

Fiscal Policies and Reforms

4. **The 2024 budget is consistent with our rules-based fiscal framework and program commitments.** Our fiscal policy for 2024 will be anchored by the fiscal rule deficit ceiling, and the budget for 2024 that was submitted to the National Assembly in October is in line with the program

(*prior action*).[1] This is expected to result in a broadly-neutral fiscal stance, as we expect the fiscal deficit for 2023 to reach about 1 percent of GDP, above the program floor *(quantitative performance criterion)*. Budgetary performance in 2023 and projected for 2024 is underpinned on solid revenue growth, as well as improved public investment program (PIP) absorption and the implementation of the new public wage law. We will continue to exercise prudency in the management of current primary spending.

5. Continued improvement in tax administration will expand the tax base and allow for sustained progress in reducing informality. The government adopted, in June 2023, an updated Customs and Excise Code to further align it with the European Union customs code and excise *acquis* (*Structural Benchmark, SB, for end-June 2023*). To further mobilize revenues, the Tax Administration of Kosovo (TAK) adopted a new action plan to reduce informality (*SB for end-July 2023*).[2] The plan operationalizes the mandate of TAK's Strategic Plan for 2022–26 to strengthen revenue collection and reduce tax gaps. It comprises two main work lines: (i) tackling non-declaration of income to identify persons who do not declare and pay PIT obligations correctly; and (ii) identifying high-income taxpayers not properly filing PIT obligations by using information from different tax and financial institutions databases. Moreover, TAK has continued work to better customize enforcement and preventative actions for different taxpayers, use risks analysis more effectively, and evaluate options to finalize the implementation of the new TAK's IT system at the shortest possible delays. This work will allow to keep fiscal revenues constant as a share of GDP despite of expected decreases in customs revenues due to the implementation of free trade agreements with the EU and Türkiye, among others.

6. We started implementing the new public wage law in 2023. The public wage law provides a holistic approach to the management of employee compensation in the public sector as well to decompress a previously unequitable salary structure. The Law sets basic wages as the product of ranked coefficients multiplied by their corresponding monetary value. The Law also standardizes allowances by defining them clearly. In this regard, the budget for 2024 defines a wage coefficient that results in a budgeted wage bill of 7.6 percent of GDP, within its legal ceiling. The budgetary envelope is sufficient to cover basic wages, social security contributions and allowances as defined by the new law.

7. Further improving the targeting of government subsidies and transfers remains a priority. The increase in electricity tariffs last March has ensured that the electricity sector's financial flows will remain balanced in 2023, without the need of blanket government subsidies. The government, in collaboration with the World Bank (WB), has revised the definition of vulnerable energy consumers to ensure that beneficiaries are chosen based on means-testing procedures. The government intends to start implementing the new definition in the winter of 2023–24 at an annual

[1] This action encompasses Reform Measure 1 under the RSF. See update of the technical memorandum of understanding (TMU).

[2] The plan was announced on July 25, 2023 (https://www.atk-ks.org/en/notice-to-taxpayers-tak-implementing-the-project-non-declaration-of-income-in-pit/ and https://www.atk-ks.org/en/notice-to-taxpayers-tak-in-implementation-of-the-wealthy-persons-project/). TAK shared the action plan with IMF staff.

cost of €9 million.[3] Moreover, any newly-proposed social scheme will be targeted and sustainable. In this regard, the results of the upcoming Census will provide valuable data for designing targeted and effective social schemes and benefits. The envelope for subsidies and transfers in the 2024 budget will amount to 10 percent of GDP, including an allocation of €15 million for the cost of the constitutional court ruling on contributory pensions. We assess the cost of this ruling in 2023 at €7 million.

8. Closing infrastructure gaps will help our country create new growth engines. Measures taken by the government to compensate contractors for the cost of inflation have unlocked PIP absorption in 2023. In addition, we have taken measures to improve the PIP absorption, including a budget circular approved in May requiring budget organizations to include needed expropriation costs as part of project envelopes (*SB for end-June 2023*). This will gradually replace the current system of centralized expropriations, with one that will ensure that no new projects can be included in the budget without accounting for expropriations costs. To improve PIP effectiveness, the government is preparing a new procurement framework, including a new Public Procurement Law fully aligned with the EU *acquis*. The new law aims to build on the recent developments on e-procurement to build an efficient, transparent, and accountable procurement system. The new draft law is expected to be approved by the government by end-2023. We also plan to invest heavily on capacity development—with IFI assistance—to increase the number of specialized professionals to avoid bottlenecks and delays. Moreover, an update of the Public Investment Management Assessment (PIMA) was completed in June 2023 (see also Section III). The report commends Kosovo on the progress achieved so far but also emphasizes that further improvement in investment planning would be beneficial. Implementing more robust pre-feasibility and feasibility studies would strengthen the quality and effectiveness of public investment. The PIMA also highlights the need to strengthen coordination with municipalities and publicly-owned enterprises (POEs) to implement the National Development Plan. We remain fully committed to the implementation of PIMA recommendations including on strengthening the prioritization, planning, execution, and *ex-post* monitoring of public investment. In particular, we will strive to accelerate the implementation of projects under the investment clause, and to ensure that evaluation and technical project documentation on new externally-financed projects, is appropriately finalized before signing the corresponding financial agreements.

9. Strengthening the operations of POEs will translate into better public service provision for our citizens. Strengthening POE operations should also contribute to mitigate fiscal risks. The collection analysis, and dissemination of POE financial data can help us identify challenges, monitor, and contain fiscal risks, and increase accountability. We have been publishing, on a quarterly basis, economic and financial data for all 19 POEs; and will ensure that a POE annual report including financial data of the previous year is published within the second quarter of the following year (*SB for end-June 2024*). We also have been publishing information on government on-lending to POEs in our treasury quarterly financial report. We will continue to use this information to strengthen our fiscal risks assessment and recommend corrective actions if needed (see ¶11). To strengthen POE

[3] The net budgetary cost of the new program will be about €5 million, as it will replace existing energy subsidies with an annual cost of €4 million.

management and attract private capital, the largest 5 POEs (out of 19 total POEs) will be transferred to a new Sovereign Fund (SF) that will operate as an autonomous public institution under the Assembly. The law creating the SF was approved by the government in June and has passed the first reading in the Assembly. The SF will not create contingent liabilities for the state and will not result in below market financing from Kosovo's Pension Savings Trust (KPST) or directed lending from this institution.

10. We will continue strengthening the efficiency and effectiveness of public spending. Contingency budgetary allocations peaked during the pandemic and energy crisis, as these provided needed flexibility to react to unforeseen fiscal needs. While uncertainty remains significant, the budget for 2024 will reduce these contingencies to about €132 million, about 1.3 percent of GDP, well below the SBA ceiling of 2 percent of GDP (*indicative target*). To foster transparency on the use of these allocations, treasury quarterly reports started in July to include a section describing their use, intended impact and rationale, and beneficiaries (*SB for end-July 2023*). As of June 2023, we have used €120 million from our contingency reserves mainly to support our Economic Recovery Program (€90 million) and energy contingencies (€25 million). Contingent budgetary allocations in 2024 create room for a faster-than-expected implementation of capital projects, but also mitigate the materialization of downside risks, including higher than expected international commodity prices.

11. We remain committed to monitoring and containing fiscal risks, as well as to strengthening the quality of government statistics. Starting with the 2024 budget, we will produce a stand-alone annual fiscal risk analysis report (*SB for end-November 2023*). This analysis will succinctly describe the main macroeconomic risks facing the budget and the economy more generally. It will also discuss other risks, such as those arising from the operation of POEs, other shocks with potential fiscal impact, and arrears, among other. To strengthen our fiscal risks assessment, we will continue to consult with the Fund and other donors. To strengthen fiscal reporting, we will continue to work, with IMF assistance, on the implementation of a plan that would allow us to begin disseminating fiscal accounts using the GFSM 2014 reporting standards.

12. Our program for 2023–24 is fully financed in the baseline. Prudent fiscal policy over 2021–22 allowed us to replenish fiscal buffers. For 2023, domestic fiscal revenues will be complemented by EU budget support and other grants of about €81 million; in addition, our financing program for 2023 includes budget support from the WB (a Development Policy Operation, DPO), of €90 million and already-approved social assistance reform project of €15 million), and disbursements from the OPEC Fund for International Development (OFID) €38 million. Net domestic debt placements for 2023 will ensure that government deposits at the Central Bank remain above the program floor. The filling of vacancies in Kosovo's Pensions Savings Trust (KPST) Board last July, has allowed the pension fund to re-enter domestic debt markets in August. For 2024, the financing program includes a WB DPO of €90 million and net positive domestic debt placements of about

€100 million.[4] This would allow international reserves to remain at about 95 percent of recommended IMF reserve adequacy metric and government deposits to remain above the program floor (*quantitative performance criterion*).

13. The precautionary SBA also mitigates downside risks. While available financing and existing fiscal buffers ensure program financing and adequate international reserve levels in the baseline, an increase of commodity prices would lead to lower economic growth, lower fiscal revenues, and higher financing needs. For instance, we assess that a 20 percent increase in commodity prices would result in additional budgetary financing needs of around €50 million in 2024; a financing gap may also arise if planned external budget support operations fail to materialize. The precautionary SBA helps mitigate these risks. The government is working with other development partners (including the bilateral development agencies of France and Germany) to identify additional budget support of about €60 million for 2024. These policies should allow government deposits at the Central Bank of Kosovo (CBK) to remain at adequate levels even in more adverse economic scenarios. While we will continue to treat the SBA as precautionary through the first SBA review, we will reevaluate this decision at the time of the second SBA review if currently budgeted external support for 2023 fails to materialize.

14. More generally, we remain strongly committed to the implementation of sound economic policies. To ensure a successful implementation of our program, we will not introduce generalized tax cuts or new tax exemptions (including amnesty schemes) or accumulate payment arrears. In line with Kosovo's strong track record, we will remain current on external debt service on public and publicly guaranteed external debt (*quantitative performance criterion*). We will also ensure the free movement of goods at the border in line with our international commitments, with due regard to transparency and national security considerations.

Financial Sector Policies and Reforms

15. The Assembly selected a new Central Bank Governor last July. President Osmani decreed the appointment in mid-August. The new governor immediately appointed an acting deputy governor, allowing the executive board to resume operations. The appointment of deputy governors by December will conclude the normalization of the operation of CBK's main governance structures.

16. Reviewing and updating the CBK's organizational structure will ensure its effective and efficient operation. In line with the 2019 Financial Sector Stability Review (FSSR) recommendations, the CBK non-executive and executive boards will review the effectiveness of decisions-making bodies and issue "Rules of Procedure" clarifying the roles and responsibilities of the CBK Board (including its interactions with risk management and internal audit committees) and specifying ways to structure information requests, confidentiality, and secrecy arrangements (*SB for*

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[4] The programmed World Bank disbursements for 2024 assume that the DPO will include a similar amount as that in 2023 from the "IDA20 Scale-up Window" (SUW).

end-November 2023).[5] Most importantly, the new Rules will establish safeguards to ensure that quorum of the executive and non-executive boards is preserved at all times. These Rules will be drafted by the executive board and will be approved by the non-executive board and will be fully in line with the CBK charter.

17. **The IMF recently concluded an updated safeguards assessment of the CBK.** In line with the assessment's recommendations, we will adopt an annual work program which will include fundamental and systemic discussions of all key oversight matters as required by the CBK charter. In parallel, the Audit Committee will strengthen its planning to exercise its responsibilities as established by the CBK charter. Moreover, the CBK's Internal Audit Department will adopt an action plan to strengthen IT audit skills and will include information on outstanding recommendations into its quarterly reports. In parallel, the CBK will strengthen the functioning of the risk management department. Finally, the CBK Board will approve an action plan to strengthen cyber resilience, including the recruitment of experts in cybersecurity, and the development of a cybersecurity policy and framework. In line with the safeguards assessment recommendations, the Minister of Finance, Labor, and Transfers and the CBK Governor signed, last July, an updated Memorandum of Understanding clarifying their respective responsibilities for servicing financial obligations to the IMF under the new arrangements.

18. **We will continue to preserve international liquidity buffers to strengthen the CBK's role in preserving financial stability.** To preserve the liquidity of foreign exchange reserves, the CBK will continue to keep its holdings of domestic government securities constant in nominal terms over 2023–24 (*indicative target*). Moreover, the CBK is committed to continue managing its foreign reserves in line with best international practices so to ensure liquidity, security and returns, in that order. The CBK has established a working review to review the Emergency Liquidity Assistance (ELA) framework, including its regulation and operations manual. The CBK and the Ministry of Finance, Labor and Transfers are discussing on how to strengthen the size of the ELA. In addition, the CBK is working on an IT solution to strengthen the functioning of the intraday, overnights and REPO interbank liquidity markets, as part of central security depository (CSD) functionality improvements, including its interface with the clearing system. Moreover, we will continue working on options to strengthen the financing pool available for deposit insurance purposes.

19. **Strengthening the governance of the financial sector is an essential priority of the CBK.** We plan to finalize a new Banking Sector Law establishing improved licensing criteria for banks, and standards for their operations, organization, and management, while strengthening the bank resolution framework. The draft will be finished by end-November and will be in line with international best practices (*SB for end-November 2023*); the draft will be submitted to the Assembly in early 2024 (*SB for end-January 2024*). In parallel, we are working towards finalizing the new Law on Microfinance Institutions and the new Law on Payment Services. To improve financial inclusion, we started implementing, in August, a regulation requiring banks to provide accounts with basic services. The CBK is monitoring its impact and will recalibrate it if needed.

[5] A team from the IMF's Monetary and Capital Markets Department organized in July a workshop at the CBK to assist in clarifying roles and responsibilities of different CBK governance structures.

20. We will continue to improve our capacity to effectively monitor and analyze financial sector risks. The performance of the banking sector has remains strong, with bank liquidity and capitalization ratios above regulatory minima and NPLs low at about 2 percent on average. Going forward, tighter financial conditions may weigh on banks' asset quality and liquidity. We are working to upgrade the CBK's top-down stress testing framework to identify financial stability risks, with IMF assistance. We are also developing internal rules formalizing the allocation of roles and responsibilities of stress testing functions across the CBK departments and the dissemination of stress testing results. Moreover, KAS in collaboration with the CBK, is working to strengthen the surveillance of the residential housing sector. In this regard, KAS has produced a roadmap to create a housing price index and related surveillance data with the assistance of the IMF's Statistics Department and has started the compilation of the required data for implementation (*SB for end-September 2023*).[6] Approving the law on cadaster will support the development of mortgage credit by lowering the risk of this lending type.

21. We will continue with our efforts to enhance AML/CFT functions. Since 2020, we have published a money laundering typology and strengthened the cooperation between the Financial Investigation Unit (FIU) and tax and customs authorities. The CBK signed an MOU with the FIU in July in the spirit of cooperation and mutual interest and aims to facilitate the exchange of information and the building of supervisory capacities for compliance with international standards. Moreover, the Ministry of Finance, Transfers, and Labor finalized the work on a concept document analyzing the changes needed in Kosovo's legislation to abide with EU directives regarding AML/CFT. Also, the new Law on Beneficial Ownership Registry is being finalized and ready to be sent to the Assembly soon.[7]

III. POLICY FRAMEWORK AND REFORMS UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY ARRANGEMENT

22. The RSF program supports the implementation of our energy and climate reform agenda. RSF financing has expanded our fiscal space to implement actions aimed at increasing the share of renewables in energy generation, decreasing emissions and pollution, fostering energy security, strengthening competition in electricity markets, and protecting vulnerable energy consumers.

23. We are committed to advance in the implementation of climate mitigation and adaptation policies. As part of the implementation of our energy strategy for 2022–31, the government has approved the Law on Climate Change, and we expect approval by the National Assembly by end-2023, which strengthens the Climate Change Council, its Secretariat, as well as the Climate Science Advisory Board. Importantly, this law has enabled us to prepare the "Climate

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[6] This roadmap has been published in KAS' website (https://askapi.rks-gov.net/Custom/92db7591-c858-4a52-a34c-cab637814895.pdf).

[7] The government is working on a new "National Strategy on Preventing and Fighting the Informal Economy, Anti-Money Laundering and the Financing of Terrorism and Financial Crimes" for 2024–28 that articulates our efforts in these areas.

Change Adaptation Strategy" and the "National Energy and Climate Plan" (NECP). A first NECP draft has been submitted, in June, to the Energy Community Secretariat. These efforts reflect our commitment to accelerate the green transition and reduce emissions and pollution and are in line with our European roadmap in the context of the Sofia Declaration and the Green Agenda for the western Balkans. In parallel, the authorities are evaluating options to ensure a smooth transition out of coal.

24. The government approved in early October a law on renewable energy sources that transposes EU directives and defines a framework for competitive auctions (*Reform Measure, RM, for end-September 2023*). The law establishes a general framework to attract private capital into renewable energy using competitive auctions and allows the construction of new renewable electricity capacity through public-private partnerships (PPP), among other provisions. The law is expected to be approved by Parliament in the first half of 2024. The Ministry of Economy has begun working on the secondary legislation and administrative instructions that will accompany the law.

25. We have taken steps to increase the share of green electricity generation. Our aim is to increase the renewable energy share to 35 percent by 2031, from around 5 percent in 2022, which will require added electricity generation capacity of around 1300 MW, as called by our energy strategy. To this end, the government has approved an administrative instruction on targets for renewables that articulates actions needed to reach such targets. In addition, the Ministry of Economy, with assistance from the Western Balkans Investment Framework, has finalized a survey of public plots with potential for wind-based electricity generation. In this regard, the WB has expressed interest to mobilize funds and expertise to carry out additional studies, including the installation of measurement devices in these plots. After suitable measurements, these plots would add to the pipeline of possible green energy auctions. Moreover:

- To attract private financing into renewable electricity production we launched, in May 2023, a first competitive auction for 100 MW of solar electricity generation to be installed in public lands with support from USAID (*RM for end-May 2023*). Investors have until January 2024, to submit bids, and we expect to announce the auction's results in February 2024.

- The government signed in October a loan agreement with the German International Cooperation Agency (KfW) for the installation of 100 MW of solar electricity generation capacity in Kosovo Energy Corporation (KEK) premises. The procurement process for this project is scheduled to start in 2024. Total financing would amount to about €105 million and include funds from KfW, the European Investment Bank (EIB), the Western Balkans Investment Facility (WBIF), and KEK.

- Capitalizing on the lessons from the first competitive auction launched earlier in 2023, we will launch, with USAID assistance, an open, competitive, and transparent tender to build 150 MW of wind-based electricity generation in June 2024 and have requested the corresponding modification of that reform measure (*RM for end-June 2024*). To that end, we will commit resources for about €70 million to attract private capital into wind-based generation through a PPP. The successful bidder will be that offering the most advantageous terms to the state. To that end, the Ministry of Finance, Transfers, and Labor created, in June 2023, a sub-account under the Treasury Single Account to earmark resources for the expansion of renewable electricity capacity, and clearly defined the procedures for spending these resources in the 2024 budget law (*RM for end-October 2023*).[8] We will present all documents belonging to the auction and associated PPP to the PPP committee chaired by the Minister of Finance, Labor, and Transfers in March 2024.

26. Strengthening regional integration and promoting competition in electricity markets is an essential part of our plan to attract private investment. After the transmission system operator (KOSTT) transferred the rights for the organization of day-ahead and intra-day electricity market and the right for clearing and settlement to the regional electricity market between Albania and Kosovo (ALPEX), the Ministry of Finance, Labor, and Transfers issued an administrative instruction, in June, on the reverse charge procedure for VAT declaration for electricity supply. This allows the tax treatment of ALPEX transactions on both sides of the border to be similar (*RM for end-June 2023*). Moreover, the Energy Regulatory Office (ERO) has finished, in September, all needed regulations for ALPEX to start operations of the day-ahead electricity market in Kosovo. The testing phase of the market platform is underway, with a dry run in November and the first trades to occur in December. As the market gains in depth and liquidity, market determined reference prices will gradually replace those established by ERO in the competitive auctions to attract private capital to renewable energy generation.

27. Increasing energy efficiency and reducing emissions requires to gradually start accounting for the negative externalities of brown energy use. To analyze the impact of a gradual recognition of these externalities, the Government of Kosovo created, in June, a working group with representatives from the Ministries of Finance, Labor, and Transfers; Economy; Environment, Spatial Planning, and Infrastructure; and Industry, Entrepreneurship, and Trade, as well as from KOSTT and KEK. The working group is using the IMF's Climate Policy Assessment Tool (CPAT) to assess the possible impact on emissions, pollution, activity, and inequality of a gradual recognition of the negative externalities of brown energy use. This work will also allow to develop an understanding of the possible impact of the upcoming implementation of the Carbon Border Adjustment Mechanism (CBAM). Experts from the IMF are assisting the working group and provided a CPAT workshop in October. The working group will prepare a report describing alternative scenarios and policy options and will present it to the Cabinet in the first quarter of 2024 (*RM for end-March 2024*). This analysis will increase our preparedness as we steadily advance towards integrating into the common energy market.

28. In parallel, Kosovo's Energy Efficiency Fund (KEEF) has begun implementing programs to increase energy efficiency in social multi-apartment buildings and in private homes. To increase energy efficiency in residential buildings, the Energy Efficiency Fund Board approved a new plan in June. According to the plan, KEEF will co-finance, through EU grants, interventions to

[8] This reform measure is encompassed by a prior action to submit to the National Assembly a budget for 2024 consistent with SBA and RSF objectives. See TMU update and footnote 1 of this MEFP update.

improve exterior and roof insulation and install more efficient heating systems, windows, and doors in private dwellings. Work in 16 social multi-apartment buildings is expected to be finalized by end-2023, and work on additional 13 buildings is expected to be completed in 2024. Moreover, work in about 2000 private residences will be completed by early 2024. KEEF will collect data to assess the impact of the interventions and replicate those with the best socio-economic return.

29. Reducing air pollution is one of our main priorities. To this end, KEK is finalizing technical preparatory work that would allow the installation of filters in each of the units of "Kosova B" power plan over 2024-25 to bring pollution levels from these units to EU standards.[9] Technical work has been completed on the first unit (Kosova B2) and is on track for the second (Kosova B1). KEK's 2024 Budget Plan includes a contingent allocation of €12.5 million to complement secured EU financing for the installation of the filter in the B2 Unit (*RM for end-October 2023*); the value of the contingent allocation is indicative and may change pending agreement in this matter with our EU partners. The government of Kosovo will liaise intensively with their EU partners to explore ways that would secure the absorption of €70 million of a 2018 EU IPA grant for the installation of these filters at the shortest possible delays. As installing the filter requires stopping operations of the unit over the spring and summer of 2024, KEK intends to secure the operation of other domestic units during this period and seek agreements with regional electricity providers to ensure a smooth electricity supply. A similar process will be followed to secure the installation of the filter in the B1 Unit.

30. We have revamped the design of budgetary electricity subsidies to ensure that they are targeted to support vulnerable energy consumers. In collaboration with the WB, the Millennium Challenge Corporation (MCC) and the EU, we have finalized work to redefine the universe of vulnerable energy consumers to ensure that lower-income households have access to adequate levels of electricity consumption without jeopardizing other basic needs. The program aims to subsidize part of the electricity bill for households with monthly incomes lower than €150/household (equivalent to the poverty line as defined by the WB) and considers the household composition. By end-September around 50,000 households had applied to receive this subsidy (see ¶7). The budget for 2024 includes an allocation that will secure the implementation of this program (*RM for end-October 2023*).[10] Moreover, the increase in electricity prices last March has allowed us to virtually eliminate blanket electricity subsidies. While import electricity prices have eased in 2023, we intend to minimize the use of untargeted subsidies should electricity prices rebound to 2022 levels, including by ensuring that the permanent component of price signals is passed through to non-vulnerable consumers.

31. We plan to integrate climate planning into public investment management framework to support the green transition. An IMF Climate Public Investment Management Assessment (C-PIMA) was completed in June. The report welcomes that climate goals are becoming a larger part of our planning but notes that further improvements would be valuable, including on identifying and quantifying sectoral contributions of climate targets, preparing costed investment plans, and

[9] This action will result in a decrease of pollution in and around Pristina, as 80 percent in emissions are the result of coal burning for electricity generation.

[10] See footnote 8.

strengthening administrative capacity and raising awareness by integrating climate training into public investment planning. Integrating climate goals into project appraisal and selection as well as budgeting and portfolio management are also key reform objectives. Moreover, the WB is preparing a "Country Climate and Development Report" (CCDR) for the western Balkans, which is expected to be finalized in the first few months of 2024. Our government remains fully committed to improving climate planning and may consider requesting an RSF augmentation to support the implementation of C-PIMA and CCDR recommendations, as well as to continue advancing in the green transition. The Climate Change Law also enables the involvement of the Climate Change Council Secretariat to advise the central government and municipalities on how to include climate change mitigation and adaptation components in public projects.

32. **The CBK will start collecting data on the possible impact of the Carbon Border Adjustment Mechanism (CBAM) on Kosovo's exports.** The CBK has started working on an instruction to standardize bank practices to monitor and report data related to climate risks, including transition risks related to CBAM implementation (*RM for end-March 2024*). This will allow to better identify climate change-related transition costs in Kosovo's banking sector. The CBK is also working to upgrade the stress testing framework to consider the impact of energy price increases and take the necessary steps to develop green financing in collaboration with our international partners. Moreover, to better manage environmental and climate-related risks arising from the banking sector, the CBK, in collaboration with the WB, is working to strengthen the regulatory and supervision framework.

33. **Flood risk management has become ever more important given the impact of climate change.** We are committed to increase public awareness on flood risk and take necessary steps to address and mitigate its economic impacts. To this end, the Ministry of Environment, Spatial Planning, and Infrastructure conducted, with German Cooperation Agency (GIZ) and WBIF assistance, a preliminary Flood Risk Assessment, which analyzed 834 cadastral zones. Following such assessment, the Ministry of Environment, Spatial Planning, and Infrastructure is now working to produce Flood Risk and Flood Hazard Maps for areas where agriculture production, economic activity and livelihoods may be seriously affected by floods. This work will enable a better assessment of flood risks, including by the insurance and banking sectors.

IV. PROGRAM MONITORING

34. **Program implementation will continue to be monitored through quantitative performance criteria, indicative targets, a continuous performance criterion, prior actions, structural benchmarks, and RST reform measures.** The program features reviews every six months. The quantitative performance criteria for end-December 2023, end-June 2024 and end-December 2024, and indicative targets for end-March and end-September 2024, along with continuous quantitative performance criteria, and other indicative targets, are set out in Table 1. The SBA prior actions and structural benchmarks are set out in Table 2. RSF reform measures are set out in Table 3. The attached updated TMU describes the definitions and methods to be used to assess program performance and information requirements to ensure adequate monitoring of the targets.

Table 1. Kosovo: Proposed Quantitative Performance Criteria, 2023–24

(Millions of euros, unless otherwise indicated)

	2023							2024			
	June		June	September		September	December	March	June	September	December
	Prog. Target	Adj. Target	Actual	Ind. Target	Adj. Target	Actual	Prog. Target	Ind. Target	Proposed Prog. Target	Ind. Target	Proposed Prog. Target
1. Quantitative performance criteria											
Floor on the Overall Balance of the General Government 1/	-113	-93	227	-169	-132	295	-225	-58	-116	-174	-232
Floor on the Stock of General Government Deposits at CBK	576	572	769	571	530	803	566	579	591	604	616
2. Continuous performance criteria											
Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government 2/	0	...	0	0	0	0	0	0	0	0	0
3. Indicative targets											
Ceiling on Contingent Budget Allocations 3/	358	...	358	358	...	358	358	210	210	210	210
Ceiling on Holdings of Government Debt by the CBK 2/	200	...	189	200	...	179	200	200	200	200	200

1/ Defined as cumulative flows over the fiscal year

2/ Applies on a continuous basis

3/ Defined as total budgetary contingent allocations; applies on a continuous basis. See paragraph 25 of the Technical Memorandum of Understanding.

Table 2. Kosovo: Prior Actions and Structural Benchmarks Under the SBA

	Measure	Timeframe	Status
Proposed Prior Actions			
1	The government submits a budget for 2024 consistent with RSF and SBA objectives; KEK budget plan for 2024 includes an allocation to complement EU financing for the installation of a filter in the B-2 unit	Before end-October 2023	Met
Structural Benchmarks			
Fiscal Governance			
1	Government starts publishing publicly-owned enterprises' (POEs) annual financial reports; and quarterly data on POE performance.	June 2024	Ongoing
2	Government starts publishing within the Treasury quarterly report, the rationale and intended impact, use and beneficiaries of contingency allocations to boost transparency	July 2023	Met
3	Government starts publishing annual fiscal risk analysis together with budget submission to Parliament	November 2023	Ongoing
4	Government approves new Customs Code	June 2023	Met
5	Tax administration agency (TAK) adopts new action plan to reduce informality	July 2023	Met
6	The Ministry of Finance, Labor, and Transfers, to adopt budget circulars making expropriation costs a mandatory item for the submission of projects financed with both domestic and external resources.	June 2023	Met
Financial Sector Governance			
1	KAS to finalize roadmap to produce a residential housing price index and compile related surveillance data in collaboration with CBK	September 2023	Met
2	Finalization of draft Banking Sector Law in line with FSSR recommendations	November 2023	Ongoing
3	Finalization of new "Rules of Procedure" clarifying roles and responsibilities of the CBK Supervisory Board in relation to the Executive Board based on Kosovo's legal framework	November 2023	Ongoing
4	Submission to Parliament of Banking Sector Law in line with FSSR recommendations	January 2024	Ongoing

Table 3. Kosovo: Reform Measures Under the RSF

	Measure	Timeframe	Status
Reform Measures			
Improving the System's Resilience and Tackling Pollution; Protecting and Empowering Consumers (Energy Pillars 1 and 5)			
RM1	Submission to Parliament of a Budget for 2024 consistent with RSF objectives (allocations for expansion of renewable energy and for implementation of new definition of vulnerable energy consumers); KEK to prepare budget plan securing financing to secure the installation of filters in one unit of Kosova B in 2024.	October 2023	Met
Expanding Greener Generation and Reducing Emissions (Energy Pillar 2)			
RM2	The government will launch by end-June 2024 an open, transparent, and competitive tender for the construction and operation of 150 MW of wind-based electricity generation capacity in a non-specific location.	June 2024	Ongoing
RM3	Submission to Parliament of Law on Renewable Energy delineating the use of competitive auctions to attract private sector investment in renewable electricity generation	September 2023	Met
RM4	Working group presents to Cabinet draft report discussing implications of EU carbon price initiatives for Kosovo, using CPAT tool.	March 2024	Ongoing
RM5	Ministry of Economy to adopt Administrative Instruction allowing the launching of first auction for 100 MW of solar electricity generation during 2023 to be financed by the private sector	May 2023	Met
Increasing Energy Efficiency (Energy Pillar 3)			
RM6	Kosovo Energy Efficiency Fund Board to approve plan to increase energy efficiency of residential buildings to start implementation in 2023:H2	July 2023	Met
Strengthening Regional Cooperation, Market Competition and Functioning (Energy Pillar 4)			
RM7	Government to implement actions conducive to the start of the day-ahead electricity market for Kosovo from September 2023 in the context of the Albania-Kosovo Regional Electricity Market (ALPEX).	June 2023	Met
Crisis Preparedness and Monitoring Transition Risks			
RM8	Central Bank to issue new instruction defining practices for banks to monitor and report data on exporting firms that may be exposed to transition costs related with CBAM implementation	March 2024	Ongoing

Attachment II. Technical Memorandum of Understanding

This technical memorandum of understanding (TMU) supplements the TMU dated on May 9, 2023, by further defining and (or) clarifying structural benchmarks under the SBA and reform measures under the RSF. It also updates macroeconomic data as needed. All definitions remain as in the TMU dated May 9, 2023 (TMU-Program), unless modified below.

I. SBA QUANTITATIVE PERFORMANCE CRITERIA

1. Program exchange rates. For the purposes of the program, the exchange rates of the Euro for the duration of the program are those shown in Table 1 of this TMU.

2. Balance of Accounts Payable. For reference, the balance of accounts payable at end-2022 was €23.7 million; that at end-June 2023 was €28.9 million; and that at end-September 2023 was €24.6 million.

3. External Disbursements Under the Investment Clause. Target Investment Clause (IC)-linked external project disbursements are specified in Table 1 of this TMU. The adjuster on the deviations between actual and target disbursements of external project loans under the IC will consider:

I. This excess will be capped at €50 million in 2024, which represents the difference between programmed and targeted amounts, as shown in Table 1 of this TMU.

II. Fall short of program projections, the floor will be adjusted upwards by 100 percent of the shortfall in IC-linked external project financing.

4. External Budget Support Grants. Programmed external budget support grants are specified in Table 1 of this TMU.

5. Budget Support Loans. Programmed disbursements of external budgetary support loans are specified in Table 1 of this TMU.

6. Downside Risk Scenario. If because of increased international commodity prices, lower exports of goods and services, a pandemic resurgence, or the materialization of any other major, purely exogenous, downside risk, domestic fiscal revenues (i.e., fiscal revenues excluding budget support grants and DDGs) are lower than programmed, the floor defined in ¶6 of TMU-Program will be adjusted downwards by 100 percent of the shortfall, with the shortfall capped at €50 million in 2024.

7. GG Deposits. For reference, GG deposits at the end-2022 were €585.5 million, comprised by €419.7 million in the TSA and €15.9 million in PAK deposits. GG deposits at end-June 2023 were €768.5 million, comprised by €602.4 million in the TSA and €166.1 million in PAK deposits. GG deposits at end-September 2023 were €803.1 million, comprised by €620.3 million in the TSA and

€163.5 million in PAK deposits. Adjusters to GG deposits will be calculated on a cumulated basis from the start of the program.

Table 1. Stand-By Arrangement: Relevant Economic Assumptions
(Cumulative annual flows in euro million, unless otherwise indicated)

	2023	2024			
	Q4	Q1	Q2	Q3	Q4
External Budget Support Grants	86	0	0	0	0
Budget Support Loans					
World Bank	105	0	0	0	90
OFID	38	0	0	0	0
Net PAK Balance	0	0	0	0	0
Domestic Fiscal Revenues	2,734	739	1,477	2,216	2,954
Primary Current Expenditure	2,295	605	1,210	1,815	2,420
Investment Clause Capital Spending					
Programmed	75	20	40	60	80
Target	129	33	65	98	130
Memorandum					
Nominal GDP (full year, Euro million)	9,794				10,563
Euro-SDR Exchange Rate (year average)	1.230				1.230
Euro-USD Exchange Rate (year average)	0.919				0.914
Euro-SDR Exchange Rate (end of period)	1.220				1.230
Euro-USD Exchange Rate (end of period)	0.915				0.913

8. **Downside Risk Scenario.** If budget support loans are disbursed as programmed but a downside risk scenario materializes, the government intends to make purchases under the SBA to preserve the level of government deposits and international reserves. In case of a simultaneous materialization of a downside risk scenario and lower than programmed budget support disbursements, the floor defined in ¶14 of TMU-Program will be adjusted downwards by the difference between (i) domestic revenue plus budget support shortfalls; and (ii) SBA purchases, with a cap of €50 million in 2024.

9. **Net PAK Balance.** If actual net PAK balance is lower than programmed, the floor defined in ¶14 TMU-Program will be adjusted downwards by the shortfall, with this shortfall capped at €20 million for 2024. Shortfalls will not include pure transfers to successor agencies or institutions.

10. Central Bank of Kosovo (CBK) holdings of Kosovo government securities. For reference, the stock of government securities held by the CBK at end-2022 was €197.2 million; at end-June 2023 it was €189.3 million; and at end-September 2023 it was €179.2 million.

11. Contingent Budget Allocations. Contingent allocations in the budget for 2024 as submitted to the National Assembly in the fourth quarter of 2023 include those in the following budgetary lines: "Contingencies in the Ministry of Finance, Labor and Transfers" (€25 million), "Energy Contingencies" (€7.5 million), "Economic Recovery Program" (€88.2 million), and "Unforeseen Expenditures" (€11.7 million), for a total of €132.4 million.

II. SBA CONSULTATION CLAUSE

12. SBA Consultation Clause. The upcoming 2024 IMF *World Economic Outlook* updates will be used as key inputs to determine the temporary or persistent nature of any shock. The objective in all cases will be to ensure a targeted fiscal response while preserving international reserve buffers.

III. SBA PRIOR ACTIONS AND STRUCTURAL BENCHMARKS AND RSF REFORM MEASURES

13. The Government of Kosovo will submit to the National Assembly, by end-October 2023, a budget for 2024 that is in line with the SBA and RSF-supported programs (prior action). The budget for 2024 will be in line with the fiscal rule; the wage bill will be in line with its legal ceiling; contingent budget allocations will be below their program ceiling; will include an allocation to secure implementation of transfers to vulnerable energy consumers in line with redefined criteria to select such consumers agreed with the World Bank. The 2024 budget will include a clause specifying that €70 million will be deposited in the sub-account of the TSA created in June 2023 to add wind-based electricity generation capacity for 150 MW (as defined in ¶40 of TMU-Program); the budget will specify that these funds will serve exclusively this purpose, and thus, that they could not be reallocated. Moreover, KEK's Budget Plan for 2024 includes an allocation of €12.5 million to complement EU financing for the installation of the first of the filters in the B2 unit of "Kosova B". KEK's commitment will be informed through a letter from KEK's management to the Minister of Economy and will be published in KEK's website.[1]

14. The quarterly report of the Treasury will continue to include a section describing the rationale and intended impact, use and beneficiaries of contingency allocations. Contingent allocations for 2023 include those in ¶25 of TMU-Program, those in ¶10 above for 2024, and any other created subsequently to address a contingent need.

15. KAS finalized the roadmap to produce a residential housing price index and has significantly advanced in the compilation of data, in collaboration with CBK. Compilation of

[1] This action encompasses RM1 under the RSF.

remaining residential housing data is ongoing from real estate agencies, on-line real estate portals, the cadaster, and public notaries, and will be finished by December 2023.

16. Finalization of "Rules of Procedure" clarifying roles and responsibilities of CBK Supervisory Board based on Kosovo's legal framework. The Executive and Supervisory Boards of the CBK will review the effectiveness of decision-making bodies and issue new "Rules of procedure" clarifying the roles and responsibilities of the CBK Supervisory Board (including its interactions with risk management and internal audit committees) and specify ways to structure information requests, confidentiality, and secrecy arrangements. Most importantly, the new Rules will establish safeguards to ensure that quorum of the Executive and Supervisory Boards is always preserved. These Rules will be drafted by the Executive board and will be approved by the Supervisory Board and will be fully in line with the CBK charter. The new Rules will incorporate recommendations of the Financial Sector Stability Review (FSSR) assessment of 2019 and subsequent capacity building missions. The new Rules will be published at the CBK's website.

17. The CBK will issue an instruction for banks to monitor and report data on firms that may be exposed to transition costs related with the Carbon Border Adjustment Mechanism (CBAM) implementation. To that end, the CBK will issue an instruction to standardize bank practices to monitor and report data related to climate risks, including transition risks related to CBAM implementation. The regulation will be published in CBK's website and be ready by end-March 2024.

18. The government will launch by end-June 2024 an open, transparent, and competitive tender for the construction and operation of 150 MW of wind-based electricity generation capacity in a non-specific location. After analyzing the advantages and disadvantages of different options, the government presented, in September 2023, an analysis proposing the construction of 150 MW of wind-based electricity generation using budgetary resources of €70 million to attract private capital into green generation and capitalizing the lessons from the first competitive auction launched earlier in 2023. The government, with support from USAID and in consultation with the IMF, will prepare all relevant technical documentation for said project and present it to the PPP committee by end-March 2024. The committee will have up to a maximum of 60 days to consider the proposal. The technical proposal, in line with Kosovo's PPP law, will define a PPP for said project whose private partner will be chosen through an open, transparent, and competitive tender. The technical documentation will define the entity that will hold the state's share on the PPP and will define how the resources deposited in the treasury sub-account defined in ¶12 will be transferred to the project.[2] After approval by the PPP Committee, the government will, by end-June 2024, launch an open, transparent, and competitive tender to select the state's private partner in said PPP. The successful bidder will be that with the most advantageous offer for the state overall.

[2] This would give the state the possibility of establishing a revolving fund that could be used to finance further green electricity generation projects in the future.

Statement by Mr. Daniel Palotai on Republic of Kosovo
November 15, 2023

On behalf of the Kosovo authorities, we would like to thank Management and staff for the comprehensive discussions and express our appreciation for the report.

As highlighted in the staff report, implementation of the Stand-By Arrangement (SBA) and the arrangement under the Resilience and Sustainability Facility (RSF) is progressing as planned, with all quantitative performance criteria and indicative targets having been met. Also, structural benchmarks under the SBA and reform measures under the RSF have been successfully implemented. Given Kosovo's good fiscal and financial performance, the authorities intend to continue treating the SBA as precautionary and remain strongly committed to implementing reforms under both the SBA and RSF.

Recent Developments

<u>Data point to solid growth in 2023:</u> Based on the authorities' most recent forecasts, real GDP is expected to grow by around 4 percent in 2023. An accelerated execution of the public sector investment budget, combined with increased exports, robust private sector consumption and investments, are expected to be the main growth contributors. Credit activity, which as of September 2023 grew by 13 percent, and diaspora-related financing, continue to be important sources of private-sector aggregate demand. Inflation data for the last months suggest that CPI has stabilized at around 3 percent, down from double digits in January and February 2023.

<u>Kosovo's fiscal position remains strong:</u> Budget revenues continue to perform well for the third year in a row, on the back of significant tax increases. Based on y-o-y (January-September) data, indirect taxes increased by 35, 13 and 9 percent in 2021, 2022 and 2023, respectively, whereas direct taxes had an even larger increase (33, 22 and 20 percent, respectively). Although still at a low level, property tax collection is improving considerably, as demonstrated by a 47 percent increase during 2023. This strong revenue performance reflects both a dynamic private sector as well as the impact of the government's actions to formalize economic activity.

Budget spending has also increased in 2023. While cumulative spending up to September increased by 9 percent compared to the previous year, it is encouraging that expenditures for capital projects increased by 67 percent. Implementation of the new wage bill and actions taken to improve the management of public investments have contributed to increased expenditures. Good revenue performance, combined with prudent planning and execution of the budget have led to a much lower budget deficit (down from 7.8 percent in 2020 to 1.2 percent in 2021 and 0.6 percent in 2022).

Estimates for 2023 suggest that the budget deficit may be slightly higher than in 2022, but still below the 2 percent legal limit. Given the recent years' budget outcome, public debt has declined from around 22 percent of GDP in 2020, to 20 percent in 2022 and by the end of 2023, it is expected to be at around 19 percent.

Financial sector performance remains solid: The financial sector continues to be stable and remains an important source of financing for private sector demand with a steadily expanding banking industry. Lending to both, businesses and households continues to increase, whereas the quality of the loan portfolio remains very good. Higher cost of financing in 2023, seemed to have translated into higher lending rates. Therefore, the sector continues to be profitable and well-capitalized. In line with the 2019 Financial Sector Stability Review (FSSR) recommendations, efforts to improve internal structures and systems as well as legal and regulatory frameworks for the sector continue. To improve licensing criteria for banks, standards and operations and to strengthen banks' resolution frameworks, the Central Bank has begun work on the drafting of the banking sector law. In addition, to better identify risks to the sector, the framework for stress-testing is being reviewed and depending on the findings, it will be upgraded. Following successful voting procedures in July, in August the President of Kosovo signed the appointment of the new Central Bank Governor.

Outlook and Risks

Looking ahead, the authorities project an average economic growth of around 4.5 percent for the medium term, with the main drivers expected to be investments and exports, as well as consumption. While this year, spending in public investment is picking up, the full impact of government actions to improve the overall budget efficiency in capital projects is expected to take hold in 2024 and onwards. Credit activity in the private sector is expected to continue supporting investments, whereas diaspora inflows will be an important source for household consumption. Also, inflation is expected to decline further, while to a large extent still subject to developments in global commodity prices.

While short-term risks are balanced, uncertainties persist, including pertaining to the external economic environment, regional and global geopolitical developments. Also, despite a relatively quiet situation in northern Kosovo, after the September attacks by paramilitary groups, a lasting solution could positively impact economic and fiscal outcomes.

Structural Reforms

During the past months, the authorities have implemented important structural reforms, including those supported under the SBA and RSF. The work and efforts to improve tax collection continued, with the Tax Administration approving a detailed action plan to tackle informality and reduce the tax gap. The Government recently approved a new customs code that further aligns customs work with that of the EU legislation. Further efforts will continue, including through the introduction of additional digital solutions for taxpayers, and the implementation of a risk-based approach to tax inspections. On budgeting, the authorities plan to integrate climate planning into the public investment management framework to support the green transition. In this context, the reform program will benefit from the IMF's Climate Public Investment Management Assessment (C-PIMA) completed in June this year and the World Bank's Country Climate and Development Report (CCDR) for the western Balkans, which is expected to be finalized in the early months of 2024. Furthermore, measures to guide fiscal discipline by the implementation of the budget balance and wage bill rules are already included in the 2024 budget.

On energy efficiency and green transition, good progress has been made, including with the support of partners. A new law on renewable energy sources, which establishes a general framework for attracting private capital into renewable energy, was approved by the Government, and submitted to the National Assembly for further processing. In parallel, several steps have been taken to increase green electricity generation, including the launch of competitive auctions for solar capacities; installation of 100 MWs of solar capacity in public sector buildings; implementation of programs to increase efficiency in social multi-apartment buildings and private dwellings. Also, the Central Bank started with the work to strengthen the monitoring and reporting of climate aspects and green transition of the financial sector.