INTERNATIONAL MONETARY FUND

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# REPUBLIC OF KOSOVO

June 2023

## REQUEST FOR STAND-BY ARRANGEMENT AND AN ARRANGEMENT UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF KOSOVO

In the context of the Request for Stand-By Arrangement and an Arrangement Under the Resilience and Sustainability Facility, 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 May 25, 2023, following discussions that ended on March 24, 2023, with the officials of Republic of Kosovo on economic developments and policies underpinning the IMF arrangement under the Stand-By Arrangement. Based on information available at the time of these discussions, the staff report was completed on May 10, 2023.
- A **World Bank Assessment Letter for the Resilience and Sustainability Facility**
- 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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PRESS RELEASE

PR23/180

# IMF Executive Board Approves a New SDR 80.12 million Stand-By Arrangement and an SDR 61.95 million Resilience and Sustainability Facility Arrangement for Kosovo

**FOR IMMEDIATE RELEASE**

The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Staff will prepare a report that, subject to management approval, will be presented to the IMF's Executive Board for discussion and decision.

- The Executive Board of the International Monetary Fund (IMF) approved a 24-month precautionary Stand-By Arrangement (SBA) of SDR 80.12 million and an arrangement under the Resilience and Sustainability Facility (RSF) of SDR 61.95 million.
- The SBA is expected to be precautionary and will provide liquidity in case downside risks materialize, including from Russia's war in Ukraine.
- The RSF will provide affordable financing to support Kosovo's climate change mitigation and adaptation efforts, including through greener electricity production and more efficient energy use, and is expected to catalyze other climate financing. Kosovo is the first European country to access the RSF.

**Washington, DC – May 25, 2023:** The Executive Board of the IMF approved a 24-month precautionary SBA in the amount of SDR 80.12 million (around €100 million, 97 percent of quota) and an RSF in the amount of SDR 61.95 million (around €78 million, 75 percent of quota) to support Kosovo's economic policies. Kosovo is the first country in Europe to receive financing under the RSF.

Following a strong recovery from the COVID-19 pandemic, growth moderated in 2022 and inflation accelerated to double digit levels due mainly to the increase in international commodity prices brought on by Russia's war in Ukraine. The negative terms-of-trade shock adversely impacted households' disposable income and business profitability. Low public investment absorption, and tighter financial conditions also contributed to weaker growth. The authorities appropriately cushioned the shock, while rebuilding fiscal and international reserve buffers. The financial sector has weathered back-to-back shocks well and non-performing loans remain low. Addressing long-standing structural issues, such as closing infrastructure and governance gaps, reducing Kosovo's dependence on coal, and promoting energy efficiency, remain crucial for making medium-term growth higher and greener, and for reducing Kosovo's reliance on diaspora flows.

The IMF-supported program under the precautionary SBA will mitigate the materialization of downside risks and support structural reforms to strengthen fiscal and financial governance and enhance growth. The RSF arrangement will expand Kosovo's fiscal space for climate change mitigation and adaptation efforts, exploit synergies with other official support, and help catalyze private investment in green energy.

Following the Executive Board's discussion, Gita Gopinath, First Deputy Managing Director and Acting Chair of the Board, issued the following statement:

"I am pleased that the IMF's Executive Board has approved two new Fund arrangements for Kosovo, including a Stand-by Agreement and an arrangement under the Resilience and Sustainability Facility—the first in Europe.

After successfully overcoming the challenges posed by the COVID-19 pandemic, Kosovo's growth in 2022 was tempered by the fallout from Russia's war in Ukraine. Higher and more volatile commodity prices fueled inflation, and the negative terms-of-trade shock adversely impacted disposable incomes.

The authorities' prudent fiscal policies and broadly targeted support framework helped rebuild fiscal space while mitigating the impact of the cost-of-living crisis. A strong policy mix is now needed to sustain the recovery and achieve reform objectives. Abiding by the fiscal rule deficit ceiling will provide a moderate impulse to activity in 2023, helping the economy soft land, while contributing to the anchoring of public debt in the medium term. In addition, budgetary spending should strike a better balance between social transfers and promoting economic transformation, the size of blanket allocations should be reduced, and public investment absorption should be increased, while strengthening public investment management. Enhancing financial sector governance will require strengthening central bank governance and bolstering the central bank's capacity for financial sector surveillance.

Increasing medium-term growth prospects and reducing the country's dependence on diaspora flows will require advancing the structural reform agenda and closing infrastructure and governance gaps. Moreover, making growth greener requires reducing Kosovo's dependence on coal and increasing energy efficiency.

Against this backdrop, the IMF-supported program under the SBA—which the authorities intend to treat as precautionary given the absence of a balance of payments need in the baseline—will mitigate the materialization of downside risks, while policy actions will improve fiscal and financial governance and enhance growth. In turn, the RSF will support climate-change mitigation and adaptation actions, exploit synergies with other official support, and help catalyze private investment in green energy. The RSF aligns closely with Kosovo's new Energy Strategy for 2023–32, which was approved by Parliament earlier in 2023."

INTERNATIONAL MONETARY FUND

# REPUBLIC OF KOSOVO

May 10, 2023

## REQUEST FOR STAND-BY ARRANGEMENT AND AN ARRANGEMENT UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY

## EXECUTIVE SUMMARY


**Context.** After a strong recovery from the pandemic, higher international commodity prices moderated GDP growth in 2022, which posted 3.5 percent, while inflation exceeded 11 percent. Lower commodity prices in 2023 will provide much-needed relief to households and firms. This, together with supportive fiscal policy, especially higher public investment absorption, will underpin higher growth of about 4 percent, and lower inflation, which should slow to 5–6 percent. Risks continue to be mainly on the downside: higher commodity prices would lead to lower growth and higher inflation, and tighter financial conditions would weigh on bank asset quality and liquidity.

**SBA.** The proposed program will mitigate a materialization of downside risks. Actions would improve fiscal and financial governance and enhance growth. Key elements include:

- ***Strengthen Fiscal Governance.*** Support efforts to strengthen tax administration, reduce informality, enhance fiscal risk analysis, improve public financial management, and further strengthen fiscal transparency.
- ***Consolidate Financial Stability.*** Support efforts to strengthen the Central Bank of Kosovo's toolkit and governance guided by 2019 Financial Sector Stability Review (FSSR) advice.
- ***Address Structural Challenges.*** Support efforts to close infrastructure and governance gaps, including strengthening operations of publicly-owned enterprises.

**RSF.** The proposed program will support climate change mitigation and adaptation actions, including from the 2023–32 Energy Strategy, exploit synergies with other official support and help catalyze private investment in green energy. Key elements include:

- ***Increase Renewable Electricity.*** Support an increase of the share of renewables in the electricity matrix by improving the regulatory framework for private investment.
- ***Increase Energy Efficiency and Reduce Pollution.*** Complement efforts by other partners to decrease pollution from brown energy, while supporting efforts to enhance energy demand efficiency at the public and private sector levels.
- ***Protect Vulnerable Energy Consumers.*** Support efforts to implement a new, means-tested definition of vulnerable energy consumers.

Approved By:
**Mark Horton (EUR) and Eugenio Cerutti (SPR)**

Discussions took place in Pristina during March 8–24, 2023, with follow-up meetings during March 27–April 14. The team consisted of Gabriel Di Bella (head), Stephen Ayerst, Si Guo, and Ezgi Ozturk (all EUR) and was assisted by Stephanie Eble (Resident Representative for the Western Balkans) and Amanda Edwards and Selim Thaci (Resident Representative office). Merita Kernja assisted with mission organization. Sabiha Mohona provided research assistance, and Tina Kang assisted in the preparation of the report. Mr. Palotai (Executive Director) participated in several policy meetings. The mission met with Deputy Prime Minister Bislimi, Minister of Economy Rizvanolli, Minister of Environment and Infrastructure Aliu, Minister of Finance, Labor, and Transfers Murati, former Central Bank Governor Mehmeti, acting Central Bank Governor Nurboja, other senior officials and representatives of the business, civil society, and donor communities.

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# CONTEXT AND RECENT DEVELOPMENTS

1. **Higher and more volatile commodity prices unleashed by Russia's war in Ukraine have pushed inflation up, weighing on activity and increasing risks.** Inflation peaked at 14.4 percent (y/y) in July 2022, declined to 12.2 percent by end-2022, and though it further decreased to 7.6 percent in March 2023, it remains high. The negative terms-of-trade shock in 2022 adversely impacted household real disposable income, private consumption, business profits, and investment. The current account deficit (CAD) widened from 8.7 percent of GDP in 2021 to 10.5 percent last year, driven by increases in food and energy imports (5 percentage points –pp– of GDP) that more than offset the rise in tourism inflows (2 pp of GDP) and goods exports (1 pp of GDP). While easing of energy prices in 2023 has provided relief for Kosovo's balance of payments and energy sector, risks remain large.

2. **Growth slowed in 2022.** Preliminary data suggest that real GDP growth was 3.5 percent in 2022, down from 10.7 percent in 2021, in large part due to the impact of the terms-of-trade shock on private demand, a key growth driver in 2021. In this regard, private consumption growth decelerated significantly, and private investment growth turned negative. From the supply side, while manufacturing held well, retail and wholesale trade growth decelerated, and construction contracted. Preliminary evidence suggests that the decrease in private investment was mainly predicated on a decrease of starts of new housing units. Economic slack remains moderate, with output 0.5–1 percent below estimated potential GDP at end 2022. Other factors that contributed to weaker activity include:

- **Decreasing gains from post-pandemic mobility normalization.** After its strong rebound by 11 pp of GDP in 2021, the increase of diaspora-related inflows (tourism, remittances, and real estate purchases) more than halved in 2022, to 4 pp of GDP.

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

- **Tighter financial conditions.** While credit to the private sector expanded by 16 percent in nominal terms in 2022, real credit growth decelerated compared to 2021. Reflecting tighter euro area financial conditions, domestic government bond yields and lending rates have begun to creep up.

3. **After back-to-back shocks, the financial sector continues to exhibit significant resiliency.** After weathering the pandemic, the sector's performance has remained solid in the face of tighter euro area financial conditions and the war-induced terms-of-trade shock. The recent wave of bank failures in the US and Europe has, so far, not affected banks in Kosovo, but pockets of vulnerabilities remain that warrant strengthened supervision. Bank and microfinance institution profitability recovered in 2022 as economic activity rebounded to pre-pandemic levels. The NPL ratio (about 2 percent at end-2022) was close to historical lows even after the

pandemic-related regulatory relief measures expired in 2021, and the ratio of liquid assets-to-short-term liabilities remained above 35 percent. The performance of car insurance companies improved after increases in regulated premium rates and better control of operational expenses. The sector's capital adequacy ratio also improved after shareholders of a few insurers injected new capital following CBK supervisory action.

**4. As lower commodity prices eased the cost-of-living crisis in early 2023, the government is set to re-launch the reform effort.** The authorities have shown resolve to oppose costly proposals to address the cost-of-living crisis during 2022 (such as freezing electricity tariffs, increasing war veteran benefits, or allowing further withdrawals from Kosovo's Pension Savings Trust, KPST). In early 2023, a new Energy Strategy for 2023–32 was approved by Parliament, and a new law promoting renewable energy generation has passed public consultations. Further actions to strengthen public financial management, promote investment, and improve governance, many supported by donors, are expected to be prioritized in the government and parliamentary agendas for the rest of the year.

**5. The process to select a new Governor for the Central Bank of Kosovo (CBK) is ongoing**. The tenure of the previous Governor ended in March 2023. Until a decision is made by Parliament on his successor (expected for mid-2023), the Chairman of CBK's Board will be acting Governor, as mandated by the CBK's charter.[1]

**6. The government retains considerable popular support.** Intermittent tensions in Kosovo's northern municipalities, which are mainly inhabited by ethnic Serbs, have continued. Leaders from Kosovo and Serbia met in March 2023 to discuss an EU-sponsored plan to normalize relations, and while no documents were signed, the EU representatives indicated that agreements had been reached on steps for normalization of relations as part of both countries' EU accession paths.[2]

# OUTLOOK AND RISKS

**7. The moderate recovery expected for 2023–24 depends on a baseline assumption that international commodity prices will remain significantly lower than in 2022.** Growth is projected to pick up to around 4 percent per annum, around Kosovo's potential. This depends on a baseline assumption that international commodity prices will remain lower than in 2022 and also on: (i) return to the fiscal rule deficit ceiling; (ii) less-dynamic-but-still-resilient diaspora inflows as a share of GDP; (iii) continued growth in exports of goods and services; and (iv) net

[1] The process to select candidates was vetted by independent observers financed by UK's bilateral assistance. If the Assembly requests another set of candidates to be sent to Parliament, the selection process will again be vetted by independent observers.

[2] Relations with Serbia remain complex and are closely monitored by the EU and the US. Local developments garner media attention but have not led to wider tensions. While permanently resolving these tensions would support long-term growth potential, their impact on short-term economic activity is limited.

bank credit growth to the private sector.[3] After peaking in 2022, average inflation is projected to decline to 5–6 percent in 2023 and further to 2–3 percent in 2024. Moderate second round effects will drive core inflation gradually downwards to around 4 percent (y/y) by end-2023 and 2–3 percent by end-2024. The output gap is expected to close by 2024. Increasing medium-term growth requires moving past a model that relies on diaspora flows by addressing infrastructure and governance gaps and accelerating the green transition. The authorities' growth strategy broadly reflects these priorities. Advancing in the path to EU accession and in the full normalization of international relations would also help to increase growth potential.

8. **The current account deficit (CAD) is projected to narrow in 2023–24 with the projected decline in commodity prices.** Staff projects the CAD to decline to 7½ percent of GDP in 2023 and 7 percent in 2024 as food and energy imports as a share of GDP decrease. The CAD will be financed by diaspora flows—including FDI, bank deposits and informal remittances—, and official external financing. Gross international reserves (GIR) are projected to increase slightly in 2023–24, with reserves staying above 95 percent of the IMF reserve adequacy metric (Annex III).

**Kosovo: SBA Baseline and Adverse Scenarios**

| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 |
|---|---|---|---|---|---|---|---|
| **Commodity Price Index (2022 = 100)** | | | | | | | |
| Baseline | 100.0 | 82.1 | 79.5 | 77.5 | 76.2 | 75.6 | 75.6 |
| Adverse | 100.0 | 101.9 | 88.6 | 81.9 | 78.4 | 76.7 | 75.3 |
| **Real GDP Growth (percent)** | | | | | | | |
| Baseline | 3.5 | 3.8 | 4.0 | 4.0 | 3.9 | 3.8 | 3.8 |
| Adverse | 3.5 | 1.8 | 4.3 | 4.6 | 4.7 | 4.1 | 3.8 |
| **Average Inflation (percent)** | | | | | | | |
| Baseline | 11.7 | 5.6 | 3.1 | 2.8 | 2.0 | 2.0 | 2.0 |
| Adverse | 11.7 | 7.4 | 4.3 | 2.7 | 2.4 | 2.2 | 2.0 |
| **Current Account (percent of GDP)** | | | | | | | |
| Baseline | -10.5 | -7.3 | -7.0 | -6.5 | -6.0 | -5.5 | -5.3 |
| Adverse | -10.5 | -8.0 | -7.2 | -6.6 | -6.1 | -5.6 | -5.3 |
| **Fiscal Deficit (percent of GDP)** | | | | | | | |
| Baseline | 0.7 | 2.3 | 2.2 | 2.1 | 2.0 | 2.0 | 2.0 |
| Adverse | 0.7 | 2.8 | 2.6 | 2.3 | 2.1 | 2.0 | 2.0 |
| **Gross International Reserves (percent of IMF RA metric)** | | | | | | | |
| Baseline | 96.5 | 97.0 | 98.0 | 98.1 | 97.9 | 99.0 | 98.4 |
| Adverse | | | | | | | |
| Without SBA | 96.5 | 91.6 | 89.7 | 89.4 | 89.3 | 91.4 | 92.7 |
| With SBA | 96.5 | 94.9 | 95.7 | 95.0 | 94.6 | 96.3 | 97.4 |

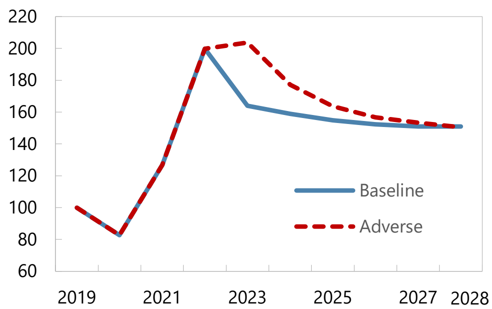
Source: IMF staff calculations

9. **Uncertainty remains high with risks tilted to the downside for growth and to the upside for inflation** (Annex V). Higher commodity prices, including because of an escalation of the war in Ukraine, could lead to more persistent inflation, lower private demand and growth, and larger fiscal financing needs (Box 1). Weaker activity in Europe could negatively affect diaspora-related inflows. Lower growth, tighter financial conditions, and decreases in real estate

[3] The fiscal rule was suspended during 2020–22 to provide room for pandemic-related expenditures. The deficit was higher than the 2 percent of GDP ceiling only in 2020. Computation of the deficit allows for the exclusion of externally-financed IFI and bilateral investment contracted after 2015. This exclusion aims to facilitate the closing of the infrastructure gap. It expires in 2025, if debt reaches 30 percent of GDP.

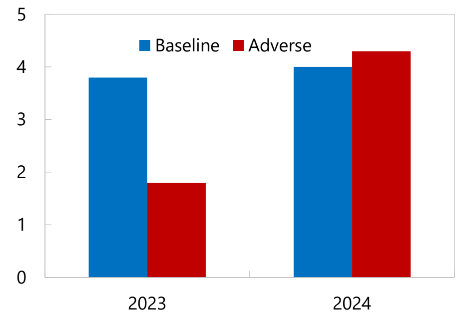
prices may also weigh on bank asset quality and liquidity. On the upside, faster PIP implementation could lead to stronger growth. Exports of goods and services, which have remained very resilient, may also surprise on the upside. In the medium term, FDI could be higher if Kosovo benefits from "near shoring" efforts of European firms.

**Kosovo: Commodity Price Level**
(Annual average, 2019=100)




Sources: World Economic Outlook and IMF staff projections.

**Kosovo: Real GDP Growth**
(Percent)




Sources: Haver Analytics and IMF staff projections.

# PROPOSED STAND-BY ARRANGEMENT

*The precautionary SBA will anchor expectations, reduce uncertainty, help mitigate downside risks, and support the authorities' efforts to preserve macroeconomic stability. It will also improve the policy framework and enhance growth potential. The precautionary nature of the request is underpinned by absence of a financing gap and adequate reserve buffers in the baseline, coupled with the need to preserve international reserves if downside risks materialize.*

## A. Fiscal Policy: Preserving Macroeconomic Stability, Addressing Risks, and Strengthening Governance

*The SBA's macro-fiscal and fiscal governance components will underpin the fiscal rule's role as policy anchor, particularly if stress materializes, by supporting strengthening of tax administration, reducing informality, and improving public financial management and fiscal transparency.*

### Context

**10. Key challenges include better targeting of social-support measures, strengthening buffers, and addressing infrastructure and governance gaps**.

- **Social Support.** The government appropriately cushioned the impact of the terms-of-trade shock in 2022, although some measures could have been better targeted. While temporary support to pensioners and social assistance was well-targeted, transfers to workers and energy subsidies were not entirely directed to vulnerable households.

- **Government buffers** are adequate but could decrease swiftly if downside risks materialize. Higher-than-projected international commodity prices over 2023–24 could weaken activity and fiscal revenues, leading to additional financing needs. This would put pressure on government deposits, which constitute close to half of Kosovo's international reserves.[4] Lack of access to external bond markets compounds these vulnerabilities.

- **Infrastructure and governance gaps** have impeded faster income convergence. Health and education quality lags that of peers. Weaknesses in public investment management (PIM) weigh on the quality of investment, aggravating gaps.

## Fiscal Stance

**11. Fiscal policy in 2023–24 will be appropriately anchored by the fiscal rule deficit ceiling (proposed quantitative performance criterion, QPC)**. The 1.6 pp of GDP rise in the fiscal deficit in 2023 will provide a moderate impulse to activity, helping the economy soft land. The impact of the increase in the fiscal deficit on inflation is expected to be mild, as most of the deficit increase is projected to result from higher capital spending, which has a large import component and will ease supply bottlenecks. The fiscal stance will be neutral in 2024, in line with the projected zero output gap.[5]

- **Budget revenue (excluding grants)** in 2023–24 is projected to stay about unchanged at 2022 levels—27.7 percent of GDP on average. Sustained gains in formalization and improved activity will underpin moderate increases in direct taxes, which will offset decreases in indirect taxes due to lower customs revenues related to the implementation of FTAs with the European Union (EU) and Türkiye. Non-tax revenues will remain at pre-pandemic levels.[6]

- **Primary spending** will pick up by about 2 pp of GDP to 30.5 percent of GDP in 2023 on account of increased capital spending, and the implementation of the new law on public wages. Primary spending is projected to decline by about 1 pp of GDP in 2024, as temporary transfers are phased out.

- **Gross financing needs** over 2023–24 will be met by increases in the holdings of government securities by KPST and external budget support and project financing. Budget support in 2023 includes World Bank (WB) financing (€15 million from a recently approved Social Assistance System Reform Loan, and additional €60 million from a new DPF operation) and financing from the OPEC Fund for International Development (OFID, €38 million). EU budget support grants (of 0.9 percent of GDP, €86 million) will also contribute to finance budgetary

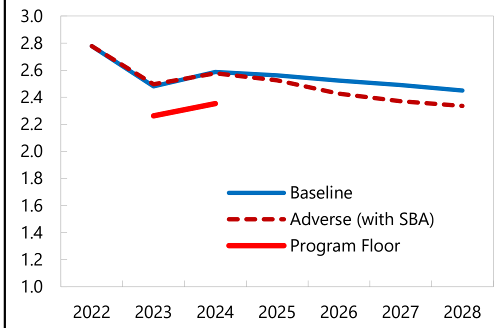
[4] Kosovo is a unilaterally euroized economy. As such, international reserves are mainly comprised of government deposits at the Central Bank and commercial bank reserves.

[5] While the overall deficit for 2023 is projected at 2.3 percent of GDP, the "fiscal rule" deficit is projected at 1.5 percent of GDP; this provides room for fiscal policy to accommodate the materialization of a downside risk scenario without reducing needed capital spending (Box 1). The discussion on the fiscal stance and the cyclical position of the economy is in line with the 2022 Kosovo's Article IV Consultation, of January 2023.

[6] Revenue projections assume that formalization gains over 2021–22 are permanent; revenues may be larger if additional reductions of informality result in further expansions of the tax base.

spending. Further WB budget support is also considered (€60 million DPF in 2024).[7] Public debt is assessed to be sustainable with the public debt-to-GDP ratio projected to stabilize around 30 percent of GDP by 2033 (compared to a ceiling of 40 percent) (Annex II). Under a precautionary arrangement with no disbursements, government deposits will remain at levels consistent with GIRs being around 95 percent of the IMF RA metric **(QPC)**.[8]

**Kosovo: Government Deposits**
(Months of primary spending)




Sources: Kosovar authorities and IMF staff calculations.

### Fiscal Policy and Financing Under a Downside Risk Scenario

**12. An increase in commodity prices would lead to higher fiscal and external financing needs in 2023–24.** A slowly-reversing, 20 percent increase in commodity prices with respect to the IMF's April 2023 *World Economic Outlook* (WEO) baseline would negatively impact economic activity, reopen the output gap, lower fiscal revenues, and increase fiscal and external financing needs.[9] Concretely for 2023, the CAD would increase to about 8 percent of GDP, real GDP growth would decrease to less than 2 percent, average inflation would climb to more than 7 percent, and domestic fiscal revenues would decline by about 0.5 percent of GDP, all compared with respect to the baseline. As the shock begins slowly reversing in 2024, and commodity prices return to the WEO baseline, the CAD and inflation would decline, and real GDP and fiscal revenue-to-GDP levels would gradually return to those in the baseline in the medium term (Box 1).

**13. In this scenario, the program will let fiscal stabilizers operate and the overall fiscal deficit to increase.** The higher fiscal deficit would cushion the shock on activity, and SBA cumulative purchases over 2023–24 of €100 million would allow to keep government buffers and international reserves at levels of around 95 percent of the IMF RA metric.[10] Unless warranted by an extreme shock, the program will use the fiscal rule's 2 percent of GDP ceiling as the general guide for policy. This will allow to preserve capital spending, and thus some deficit accommodation, while keeping primary current spending restrained to avoid breaching the deficit ceiling. While uncertainty remains quite large, the likelihood of a stronger and more

[7] The WB is working on a new DPF programmatic series to be delivered to the WB Board in FY24 (first operation) and FY25 (second operation), building on the earlier standalone DPF approved by the Board in FY23.

[8] Staff urged the authorities to continue working to obtain an international sovereign rating. This will pave the way for Kosovo to access international bond markets (Selected Issues Papers, 2021 Article IV Consultations).

[9] The shock could result from an intensification of geopolitical tensions, as per the updated GRAM (Annex V).

[10] Staff consider that reserve coverage of 90–95 percent of the IMF-RA metric is broadly adequate as it would be consistent with a ratio of bank liquid assets to short-term liabilities of around 35 percent on a residual basis, and a level of government deposits (including PAK) to domestically-financed expenditure of more than 2 months, both of which are higher than benchmarks recommended in the literature. Recognizing the idiosyncratic elements in dollarized or euroized economies, the discussion in "Assessing Reserve Adequacy—Specific Proposals", (IMF 2015) indicates that the IMF-RA metric should only be a reference for these economies. These considerations also justify the precautionary nature of the request.

permanent shock in energy markets appears lower than before the winter of 2022–23.[11] That said, the program consultation clause will allow to recalibrate policies should actual shocks prove extreme and more persistent than assumed under the program.[12]

**Kosovo: Budgetary Financing Needs**
(Euro million)

| | 2022 | 2023 | | | 2024 | | |
|---|---|---|---|---|---|---|---|
| | | Baseline | Adverse | | Baseline | Adverse | |
| | | | SBA | No SBA | | SBA | No SBA |
| **Gross Financing Needs** | **332** | **537** | **587** | **587** | **583** | **633** | **633** |
| Fiscal Deficit | 61 | 225 | 275 | 275 | 232 | 282 | 282 |
| Fiscal Rule Definition | | | | | | | |
| Amortization | 271 | 312 | 312 | 312 | 351 | 351 | 351 |
| External | 48 | 57 | 57 | 57 | 68 | 68 | 68 |
| Domestic | 223 | 255 | 255 | 255 | 283 | 283 | 283 |
| **Financing** | **332** | **537** | **587** | **587** | **583** | **633** | **633** |
| External Debt | 111 | 216 | 266 | 216 | 176 | 226 | 176 |
| Budget Support | 11 | 113 | 113 | 113 | 60 | 60 | 60 |
| Use of IMF resources | 0 | 0 | 50 | 0 | 0 | 50 | 0 |
| SBA | 0 | 0 | 50 | 0 | 0 | 50 | 0 |
| Project Finance | 100 | 103 | 103 | 103 | 116 | 116 | 116 |
| Gross Domestic Debt Placements | 219 | 348 | 348 | 348 | 445 | 445 | 445 |
| On Lending (net) | -20 | 12 | 12 | 12 | 11 | 11 | 11 |
| Government Deposits | 23 | -39 | -39 | 11 | -50 | -50 | 0 |
| Other | -1 | 0 | 0 | 0 | 1 | 1 | 1 |

Source: IMF staff calculations.

## Fiscal Governance

**14. Ongoing efforts to strengthen tax administration and reduce informality will help expand the tax base.** These efforts will increase fiscal space and partially offset the expected decline in customs revenues due to the implementation of regional and bilateral free trade agreements.

- **Tax Administration.** Tailoring enforcement and preventive actions to taxpayer circumstances and more effective use of risk analysis will continue to be priorities. The implementation of a new IT system is essential to support core operating needs and improve efficiency. The approval by the government of a new customs code that will bridge differences with EU legislation will be part of the program **(Structural Benchmark, SB, end-June 2023)**.

[11] This is highlighted, for instance, by recent IEA and Bruegel analysis.

[12] The materialization of additional bilateral budget support from the German and French development agencies (currently under discussion), would result in around €150 million of additional financing in 2024, which would add to IMF financing and allow to preserve international reserves at adequate levels.

Moreover, a new law on tax administration and procedures is expected to be approved by end-2023.

- **Reducing Informality.** Maintaining momentum in this area will help consolidate revenue gains. An updated action plan by the Tax Administration Agency of Kosovo (TAK) to continue reducing informality will describe actions, timeline, and expected outcomes **(SB end-July 2023)**.

- **Tax Policy and Expenditures.** Taxes on property have increased significantly (from a low base) following an update of property values. Moreover, new laws on property tax, on PIT, CIT, and VAT are expected to be approved by Parliament during 2023–24. These laws will review the current legal framework with the aim to eliminate inconsistencies and simplify provisions, which should result in easier collection and allow for a better identification of existing tax expenditures. The authorities also plan to analyze the impact of policies that recognize the negative spillovers of carbon emissions.

**15. The program will aim at achieving a better balance between public spending for social transfers and that for promoting economic transformation and resilience.** Improving the transparency, focus, and composition of public spending will increase the budget's growth impact. The consistency of the budget, the Medium-Term Expenditure Framework (MTEF) and other strategic documents will continue to be strengthened in line with past IMF recommendations.

- **Public Employment and Compensation Policies.** Implementation of the new law regulating public wages in 2023 will result in a warranted increase in nominal wages given the significant decreases in real wages over the last 2 years. The government announced, in January 2023, fiscally-responsible coefficient values for 2023–24 which will result in a wage bill that is in line with its legal ceiling.[13] The implementation of the public wage law will result in a more transparent salary structure, and contribute to improved governance, accountability, and transparency in the public sector's pay structure.

- **Improving PIP Composition and Absorption.** Efforts to lift implementation bottlenecks, including through paid land expropriations, an appropriate operation of the Procurement Review Body (PRB), and compensating contractors for higher project costs should lead to higher execution rates than those in recent years. To strengthen these efforts, the Ministry of Finance, Labor, and Transfers plans to issue circulars requiring budget organizations to include expropriations as part of project costs **(SB for end-June 2023).** This will gradually replace the current system of centralized expropriations, with one that ensures that no new projects can be submitted unless expropriations costs are budgeted for. Accelerating projects with high implementation rates, including through budget reallocations, will also help to enhance PIP absorption. Increasing allocations for health, education, and green energy remains essential, as

[13] The legal wage bill ceiling is calculated annually as the product between the previous year's wage bill and nominal GDP growth. The law started implementation in 2023:Q1. Implementation risks remain, however, as the Constitutional Court may repeal parts of the new law.

gaps in social infrastructure and unreliable electricity supply constrain growth. The SBA will adjust the fiscal overall balance target upwards if the implementation of externally-financed investment is lower than programmed.

- **Public Procurement.** Budget audit and IMF TA reports (including Public Investment Management Assessments, PIMA) have highlighted several shortcomings in PIP implementation, which reduce its effectiveness to support higher growth.[14] The approval by the government of a new Public Procurement Law will contribute to address many of these shortcomings.[15]

- **Blanket allocations for contingencies and targeting of temporary subsidies and transfers.** Large blanket allocations are opaque and increase policy discretion. The program includes a commitment not to increase blanket allocations during 2023 beyond those in the budget, and to decrease them to below 2 percent of GDP in the 2024 budget—a decrease of about 45 percent compared to 2023 **(indicative target, IT)**—and link them with specific risks.[16] Moreover, quarterly treasury reports will include a new section describing the rationale and intended impact, use and beneficiaries of these allocations to boost transparency and accountability **(SB end-July 2023)**. While cushioning the impact of the cost-of-living crisis is warranted, existing and potential beneficiaries of government support should comply with poverty tests. The Energy Regulatory Office (ERO) has increased electricity tariffs by about 15 percent in late March 2023 to ensure that the electricity sector's financial flows remain balanced without the need of blanket subsidies **(SBA prior action)**.[17]

- **Cost Effectiveness of Subsidies.** The effectiveness of subsidies to agriculture and publicly-owned enterprises (POEs) of about 1 percent of GDP can be increased. Better monitoring and analysis of transfers to POEs can help understand their impact and should result in lessons to improve subsidy design. The publication of POE financial data and analysis will be an action under the program **(SB for end-June 2024).** Staff will also analyze existing subsidies and transfers to propose possible KPIs with the aim of increasing their effectiveness.

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[14] Shortcomings identified in past budget audit and IMF TA reports include projects paid from other projects' budgetary allocations; unclear technical specifications; inadequate procurement procedures (e.g. splitting of tenders or lack of documentation); inadequate classification of expenditures; contracts exceeding the budget allocation; public investment in non-expropriated plots; delayed payment of invoices; overpayments; invoices received prior to the commitment of funds; and selection of ineligible economic operators.

[15] The law on establishing ownership registry, currently at the drafting stage, will make public contracts more transparent by publishing beneficial ownership identification of public contractors.

[16] Blanket allocations have been used as a form of risk management. They averaged more than 2 percent of GDP in the budgets of 2021–22 and 3.6 percent of GDP in 2023. The contingent allocation for 2024 would allow to implement targeted and temporary transfers should energy and/or food prices increase and permit to advance capital spending showing higher implementation rates.

[17] The financial position of the electricity sector has improved significantly over the last 4 months with the mild winter in Europe. The electricity import price so far in 2023 has averaged about €130 per MWh (compared to €270 per MWh in 2022), and electricity demand for heating has been lower than expected, reducing the reliance on imports. This considered, the only subsidies remaining are those for consumption of electricity of northern municipalities (currently around 0.2–0.3 percent of GDP). Tackling these subsidies requires an international understanding with Serbia, beyond of what the program can accomplish. The prior action has been already implemented.

- **Social Transfers Targeting and Sustainability.** Improving the targeting of transfers remains essential. The government will analyze any newly-proposed social scheme prior to its adoption to ensure that it is appropriately targeted and sustainable. Assessing the long-term budgetary cost of existing pension benefits is a pending task. Staff will use recently published demographic projections to analyze how budgetary space will evolve as Kosovo's population ages and present the conclusions to the authorities to draw joint conclusions and recommendations.

- **Monitoring and Containing Fiscal Risks.** Monitoring, analyzing, and managing fiscal risks from loans and guarantees to POEs, court cases (including of the Privatization Agency of Kosovo, PAK), PPPs, and more generally, from exogenous macroeconomic developments affecting the budget can be improved. This is in line with provisions of the new Public Debt Law adopted in December 2022, which calls for managing credit risks. To this end, the authorities have committed to produce a stand-alone annual fiscal risk analysis report starting with the 2024 budget **(SB for end-November 2023)**. This analysis will describe the main macroeconomic risks facing the budget and the economy more generally. It will also discuss credit risks, and the risks arising from the operation of POEs including from guaranteed loans.

## B. Financial Policies: Strengthening CBK Governance and Policy Toolkit

*The SBA will support efforts to continue strengthening the CBK's policy toolkit and governance. The 2019 Financial Sector Sustainability Review (FSSR) recommendations will guide the agenda.*

**16. The organizational structure of the Central Bank (CBK) needs to be reviewed.** This includes an analysis of the effectiveness of decision-making bodies, including membership of key committees. The review and update of the organizational structure of the CBK are needed to refresh roles and responsibilities to ensure the structure is clear. Clarifying the roles and responsibilities of the CBK Board is essential to ensure that it operates effectively and thus will be a key action under the program **(SB end-November 2023)**.[18]

**17. The legal framework governing the banking sector needs to be strengthened.** Adjusting the draft Law on Banks is needed to that end. A new draft law in line with the 2019 FSSR recommendations will be finalized by the government in 2023 **(SB end-November 2023)** and submitted to Parliament early next year **(SB end-January 2024)**. The new Bank Law will establish improved licensing criteria for banks, and refine standards for their operations, organization, and management, while strengthening consumer protection and the bank resolution framework.

[18] Kosovo's 2021 and 2022 Article IV consultations discuss CBK governance issues in detail. A follow up central bank governance workshop mission led by IMF experts will provide customized recommendations that will be considered in drafting the circular that will clarify roles and responsibilities of the CBK board. The mission is tentatively scheduled for mid-2023.

**18. Upgrading the stress-testing framework is essential to identify financial stability risks, more so after recent bank failures in Europe and the US.** This requires further fine-tuning of technical models associated with the CBK's top-down stress testing, developing internal rules that assign responsibility for inputs, and establishing internal and external dissemination rules. Work in these areas is ongoing with IMF assistance.

**19. Improving surveillance of the residential housing sector is a priority.**[19] Poor data impedes monitoring, including on risks to financial stability. Kosovo's Agency of Statistics (KAS) in collaboration with the CBK will work to strengthen surveillance of the residential housing sector. To that end, KAS will produce a roadmap to create a residential property price index and related surveillance data **(SB for end-September 2023)**.[20]

**20. Strengthening the CBK's ability to provide liquidity to banks in times of stress is important.** Unilateral euroization implies that the CBK's liquidity support capacity is limited. To preserve the international liquidity of foreign exchange reserves, the CBK will not increase its holdings of domestic government securities over 2023–24 **(Indicative Target)**; moreover, the 2021 SDR allocation will remain as part of the CBK's international reserves; this will strengthen the CBK's capacity to intervene in case of financial stress.

**21. Efforts to promote financial inclusion need to be underpinned by appropriate regulations.** A new regulation on basic banking services requires banks to provide payment accounts to adults at low monthly costs. Although the regulation's purpose is in line with the EU's Payment Accounts Directive, some requirements appear more generous to households than in other countries. Work on the Law on Microfinance Institutions also needs to advance promptly given their importance in financial inclusion.

## C. Reforms to Strengthen Economic Governance

*The SBA will support efforts to close infrastructure and governance gaps. These gaps leave Kosovo excessively reliant on diaspora-related inflows, slowing income per capita convergence, contributing to emigration, and severely limiting the emergence of new growth engines.*

**22. The PIP's effectiveness needs to be enhanced to address infrastructure gaps.** Improving the planning, execution, and ex-post audits of public investment by formalizing project appraisal, selection, and monitoring procedures remains essential. The authorities have agreed to conduct a PIMA update at the shortest delay to identify emerging challenges since the last update in 2018.[21] The Budget Department's quality control checks on data entered by budget organizations (BOs) in the PIP system would increase investment quality by preempting

[19] Construction and real estate activities represent 80 and 19 percent of FDI and GDP, respectively.

[20] A diagnostic mission from the IMF statistics department is tentatively scheduled for June 2023.

[21] A PIMA update (including the C-PIMA module) mission is scheduled for May 2023.

poor practices as identified by the auditor general and IMF staff.[22] Establishing and implementing clear protocols and procedures to implement the 2019 administrative instructions (AIs) on public investment management would also help improving PIP quality.[23]

**23. Shortcomings in POE operations constrain the quality of public services and increase fiscal risks.** The collection, analysis, and dissemination of POE financial data in an annual report would help identify challenges, monitor, and contain fiscal risks, and increase accountability **(SB end-June 2024).** Developing performance agreements, quarterly risk assessments, and strengthening the institutional arrangement for POE oversight would contribute to better performance.

**24. Continued efforts are needed to close AML/CFT gaps.** While publication of money laundering typologies in 2020, improved cooperation between the Financial Investigation Unit (FIU) and the taxation and customs authorities, and the approval of the Law on Implementation of Targeted International Financial Sanctions in 2021–22 are steps in the right direction, significant gaps remain. Work is ongoing on a concept-document analyzing legislative changes needed to align with the European Union's recommendations regarding anti-money laundering and countering the financing of terrorism (AML/CFT). This should allow finalization of amendments to the Law on Money Laundering and Terrorism Financing.[24]

# PROPOSED RSF ARRANGEMENT

*The RSF arrangement will support climate change mitigation and adaptation efforts to deliver higher and greener growth, as described by Kosovo's new 10-year energy sector strategy. The strategy jointly assesses economic and environmental needs and lays out actions to increase the share of renewables in energy generation while reducing that of coal, decrease emissions, tackle pollution, foster energy security, strengthen competition, and protect vulnerable energy consumers. The strategy is consistent with Kosovo's international commitments. The authorities have expressed a strong interest in designing additional reform measures that may unlock further RSF access; these reforms would reflect upcoming diagnostics, in particular the C-PIMA. The RSF is expected to*

[22] Auditor General's 2021 Report on the Government's Annual Financial Report on the Budget (August 2022).

[23] These AIs established principles for project selection and a definition of capital expenditures; introduced an interface between KFMIS and e-procurement to record multiannual commitments and improve commitment controls; and introduced regular preparation and updating of quarterly cash plans. Some of the actions taken to support their implementation have included the preparation of workshops for budget organizations to familiarize themselves with the AIs; the inclusion of POE-related fiscal risks in the budget documents; and strengthened monitoring of sector strategies and capital expenditures so budget documents are aligned with various strategic documents. The upcoming PIMA mission will allow to identify remaining challenges for the full implementation of these AIs.

[24] Amendments on the Law on Money Laundering and Terrorism Financing are needed to be fully aligned with the 4th and 5th EU directives on AML/CFT and the FATF recommendations. Amendments are currently at the drafting stage. The draft Law on Beneficial Ownership Registry will also support AML/CFT but it has not been approved by Parliament.

*exploit synergies with other official financing and catalyze further private financing for climate mitigation and adaptation efforts.*

**25. Kosovo's dependence on lignite for energy has resulted in excessive pollution and emissions.** Virtually-unlimited lignite reserves have led to coal-dependence for electricity generation. Outdated and unreliable power plants represent the largest source of Kosovo's emissions, and a significant source of pollution that negatively impacts air quality and health indices.[25] Unplanned outages have a negative impact on confidence and investment. Diagnostics indicate substantial potential for development of wind and solar-based electricity generation.

**26. Kosovo's path to EU membership (started in 2015) has led to comprehensive diagnostics on climate mitigation and adaptation challenges and a clear policy framework to address them.** Climate change challenges include high emissions and pollution due to the country's heavy reliance on coal; water scarcity; and environmental degradation. In addition, changed weather patterns are affecting crops and livestock (Annex I). The "2022 EU-Kosovo SAA Implementation Report" highlights the need to accelerate the energy transition, reduce air pollution, address wastewater and solid waste management, and improve water management, among other. To assess progress on policies, the report refers to the "Green Agenda for the Western Balkans" and its associated "Action Plan for the implementation of the Sofia Declaration, 2021–30", which is in line with the EU's "Green Deal".[26] Other analyses (including the "World Bank's Systematic Country Diagnostic Update" of 2022, and the OECD's "Multidimensional Review of the Western Balkans", also of 2022) are fully aligned with the EU's diagnostics and policy recommendations (Box 2). Staff expects the upcoming World Bank's "Country Climate and Development Report" (CCDR) for the Western Balkans to provide a holistic analysis of climate change mitigation and adaptation challenges and priorities, while reemphasizing the diagnostics and policy recommendations of recent studies. The World Bank assessment that accompanies this RSF request concurs with the main challenges described above.[27]

**27. The RSF will support the implementation of Kosovo's medium term energy strategy, which is a key building block of the country's mitigation and adaptation efforts.** Kosovo's has the fifth world's largest reserves of lignite, making coal-based electricity generation costs the cheapest in Europe. On the downside, coal-based generation is responsible for about 70 percent of GHG emissions and is to a great extent responsible for the high levels of Pristina's air pollution. The high carbon footprint, also due to inefficient energy use by both households and firms, reduces Kosovo's attractiveness as an FDI destination and increases transition costs in the run up to EU CBAM implementation. The RSF will add to efforts by other development

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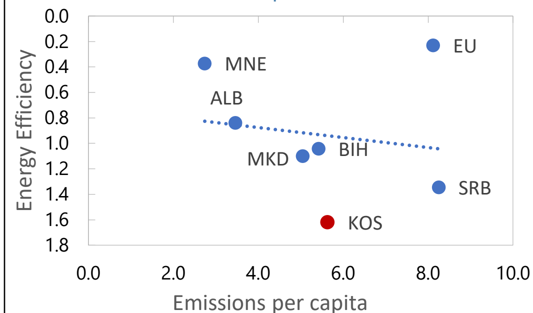
[25] The introduction of a carbon border price adjustment (CBAM) mechanism by the EU is expected to affect electricity, iron, steel, and other exports.

[26] The "Action Plan" includes policy guidelines to address challenges common to the western Balkan countries in the areas of decarbonization, circular economy, depollution, sustainable agriculture, and protection of nature and biodiversity. The EU SAA annual progress reports include Kosovo-specific policy recommendations in line with the "Action Plan".

[27] The World Bank's RSF assessment letter is published together with this request.

partners around Kosovo's energy strategy and its National Emissions Reduction Plan (NERP). By supporting all energy strategy's pillars, the RSF will exploit synergies with other official financing and help catalyze further private financing (Annex I). In particular,

**W. Balkans: Energy Efficiency and Emissions**
(GHG/GDP and GHG/Population)




Sources: WDI Database, country official statistics and IMF staff calculations.

- **Improving the System's Resilience and Tackling Pollution** (Pillar 1). In addition to investment in new generation, achieving this objective will require generation that is more reliable, flexible, and efficient, creating reserve services (of at least 170 MW) using batteries; decrease transmission and distribution losses; and ensure that Kosova B1–B2 and Kosova A3–A5 are more efficient and less-polluting to provide 540 MW for baseload and 360 MW of reserve capacity. These actions together with the increase of the share of renewable energy (Pillar 2) would result in a decline of emissions and pollution more in line with Kosovo's voluntary Nationally Determined Contributions (NDC) and EU's pollution standards. Importantly, the installation of filters would reduce PM2.5 emissions from Kosova B to levels aligned with EU standards, with positive spillovers for health costs (Annex I). While EU grants will pay for Kosova B new filters, Kosovo's Energy Corporation's (KEK, a POE) budget plan for 2024 will include an allocation to complement EU's financing to install the first of the filters in the B2 unit during 2024 **(Reform Measure—RM—for end-October 2023)**. KEK will ensure that the needed work for the installation of the filters is finished on time, and that supply remains adequate during the outage period.[28] Kosovo's energy strategy also envisages an analysis describing the proposed timeline and technical feasibility of decommissioning Kosova A4.

- **Expanding Greener Generation and Reducing Emissions** (Pillar 2). Reducing lignite-based electricity generation and emissions will require strongly expanding renewable generation. While the long-term objective is to fully replace coal, the 10-year objective is to increase the share of renewable energy to 35 percent by 2031. In line with these targets, the government will prepare a technical proposal delineating options and a timeline to add renewable electricity generation capacity of 100–150 MW to Kosovo's energy matrix, for which work will start in 2024 **(RMs for end-October 2023 and end-March 2024)**.[29] To catalyze private investment to green energy, the authorities plan to conduct a first pilot competitive auction for 100 MW of solar electricity generation to be installed in public lands before end-2023. This will require defining the auction's terms of reference through an administrative instruction of the Minister of Economy

[28] While the EU has secured financing for the procurement and installation of the filters per se, these have not been installed so far in part because installing them requires Kosovo B to stop operating and this creates a financing need that goes beyond the installation of the filters. While KEK has accumulated sufficient liquidity to ensure the implementation of this RM, additional external financing could also be considered to this end.

[29] The reference for end-October 2023 refers to the allocation in the 2024 budget to start the implementation of such project; the reference for end-March 2024 refers to the technical proposal itself.

which will be in line with best international practice **(RM end-May 2023)**. More generally, the authorities will submit to Parliament a new Renewable Energy Law that transposes Kosovo's energy commitments with the EU and defines, among other elements, the general framework to attract private capital into renewable energy using competitive auctions **(RM end-September 2023)**.[30] This will complement the implementation of climate policies more generally.[31] To analyze the impact of a gradual recognition of the negative externalities associated with the use of brown energy, the authorities plan to create a working group with representatives from the Ministries of Finance, Labor, and Transfers; of Economy; and of Spatial Planning, Environment, and Infrastructure that will use state-of-the-art techniques, including the IMF's Climate Policy Assessment Tool (CPAT) to assess the possible impact on emissions, pollution, activity, and inequality, of the implementation of carbon pricing and of integration with the EU's common electricity market. The working group will prepare a report describing alternative scenarios and policy options that will be presented to the Cabinet in the first quarter of 2024 **(RM for end-March 2024)**.[32] This work will strengthen the authorities' capacity to analyze carbon pricing and other carbon-related policies. Moreover, the analysis will also strengthen their preparedness to draft a carbon pricing regulation, in line with the country's energy strategy.[33]

- **Increasing Energy Efficiency** (Pillar 3). Increased demand efficiency together with greener generation (Pillar 2) would lead to a less energy-intensive economy, less emissions and pollution, and lower import dependency. To that end, the Kosovo's Energy Efficiency Fund (EEF) will prepare a program with actions to increase the energy efficiency of households' residential units and buildings which will start implementation in 2023:H2 **(RM end-July 2023)**. The identification of the plan's main priorities so they are phased in first is expected to increase the impact of this action.

- **Strengthening Regional Cooperation and Market Functioning** (Pillar 4). The implementation of the EU's Energy Community Treaty by 2030 and market integration with Albania through the day-ahead and intraday markets, starting in 2024, should lead to a more competitive electricity market, strengthening supply security. In line with this, Kosovo's electricity market operator (KOSTT) has transferred the rights for the organization of day-ahead and intra-day electricity market, as well as the right for clearing and settlement, to the recently created

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[30] The draft Law on Renewable Energy provides a level playing field for renewable energy producers through a transparent, non-discriminatory competitive bidding process. The draft Law also defines the principles that incentivize consumers to produce, store, and sell the surplus of electricity generated from renewable energy sources.

[31] A draft law on climate change has been drafted and passed public consultations. The law is expected to be sent to Parliament in 2023:H2. The approval of such law is part of the action matrix under the WB DPO operations for 2023–24, currently under discussion.

[32] The use of CPAT will allow to analyze different carbon tax and emission reduction paths and the use of feebates, among other. IMF staff will assist the authorities in the use of this tool.

[33] Kosovo's energy strategy for 2023–32 establishes the intention to "complete preparations for the introduction of a carbon pricing system" by 2025, and a target of "integration into the EU ETS" for 2031.

regional electricity market between Albania and Kosovo (ALPEX).[34] In addition, the Ministry of Finance, Labor, and Transfers will issue an administrative instruction on the reverse charge procedure for VAT declaration for electricity supply, so the tax treatment of ALPEX transactions on both sides of the border is similar **(RM for end-June 2023).** These actions will allow ALPEX to start operating the day-ahead electricity market in Kosovo in the third quarter of 2023. Market determined reference prices will gradually replace those established by ERO in the competitive auctions to attract private capital to renewable energy generation.

- **Protecting and Empowering Consumers** (Pillar 5). Supporting affordability will be underpinned by preparing a plan to support vulnerable households' energy consumption, in collaboration with the World Bank. The plan will require to carefully define the households that will benefit from social tariffs to ensure that they are means tested. The budget for 2024 will include an allocation to start implementing this plan **(RM end-October 2023).** To empower consumers and support energy efficiency, the government will start implementing in the winter 2023–24 an annual energy awareness and information campaign.

**28. The RSF will also support other adaptation efforts.** The institutional framework needs strengthening to combat climate change and its impacts. The planned C-PIMA (in the context of the broader PIMA update in FY24) would help identifying actions to gradually shift toward greener and more resilient public investment. Enhancing top-down stress testing to account for energy price shocks would improve crisis preparedness. Monitoring and reporting data on exporting firms that may be exposed to CBAM-related transition costs would allow to better assess risks and to tailor adaptation efforts; this action will be part of the program **(RM end-June 2024)**.[35] This, in turn, is expected to ease financing conditions and catalyze private funding.

# PROGRAM MODALITIES

**29. RSF Arrangement and Concurrent Precautionary SBA Arrangement.** The proposed RSF arrangement and concurrent 24-month precautionary SBA are in line with the authorities' request. The SBA's primary role will be to mitigate the impact of downside risks by preserving GIRs in an adverse scenario and support targeted reforms. This would contribute to anchor expectations and reduce uncertainty. In turn, the RSF will bolster the authorities' efforts to accelerate the green transition, decrease emissions and pollution, and help exploit synergies with other donor support and catalyze additional private investment. Despite virtually unlimited coal reserves and cheap electricity, Kosovo's energy strategy sets the objective to gradually phase out coal-based generation. The RSF will create fiscal space that the authorities will use to implement reform measures, including to expand renewable electricity capacity.

[34] KOSTT refers to Kosovo's Electricity Transmission Company.

[35] Assuming a tax of €100 per tCO2e, preliminary staff estimates suggest that CBAM implementation could lower Kosovo's exports to the EU by about 1–2 percent of GDP per year starting in 2026 depending on the coverage of the carbon taxes (Annex I).

**30. Access, Phasing, and Review Schedule.** Proposed access for the precautionary SBA arrangement is SDR 80.122 million (97 percent of quota) and proposed access for the RSF arrangement is SDR 61.95 million (75 percent of quota). Kosovo is eligible for RSF financing. Both SBA and RSF access levels are justified on the strength of the proposed policy actions, low public debt ratios and adequate capacity to repay the Fund. SBA access is further justified by the need to preserve adequate reserve buffers. RSF access is also justified by the financing needs required to implement climate mitigation and adaptation policies, which is compounded by Kosovo's lack of market access (Annex I). Both programs would have four semi-annual reviews and the first test date would be end-June 2023; RSF's phasing will consider the implementation of each reform measure to be equivalent to 9.4 percent of quota (Table 12). The authorities have expressed a strong interest to access additional RSF resources. To that end they are committed to design additional reform measures that may unlock further RSF access. These additional measures would tackle concrete mitigation and adaptation targets and could be drawn, for instance, from the upcoming C-PIMA.

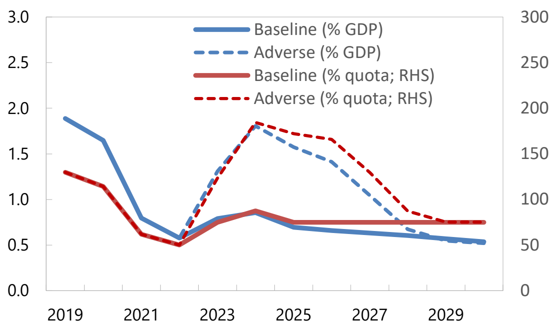
**31. Program conditionality will support the authorities' reform agenda.** The program includes quarterly quantitative targets (QPCs for end-June and end-December and ITs for end-March and end-September) covering the general government overall balance, the general government deposits at the CBK, a continuous target on the non-accumulation of external debt arrears, and indicative targets covering contingent budgetary spending, and Central Bank holdings of government debt (Table 9). The specifics of prior actions and structural benchmarks under the SBA are described in Table 10. The specifics of RSF reform measures are described in Table 11. The Technical Memorandum of Understanding and Memorandum of Economic and Financial Policies are included as Appendix I.

**32. The RSF arrangement is expected to catalyze additional private financing and exploit synergies with other official financing.** Good implementation of the RSF's RMs will signal Kosovo's commitment to advance in addressing climate change mitigation and adaptation challenges in line with the *EU Acquis*. This could unlock further funds in the context of the EU's "Economic and Investment Plan for the Western Balkans", which aims to mobilize investments for transport, energy, and green and digital transition. Private flows could also be mobilized through a clearer and more predictable medium term pricing framework, stronger market competition, as well by competitive auctions for renewable energy generation, all areas that are supported by the RSF's RMs.

**33. Risks to the proposed program are broadly contained.** The proposed SBs and RMs are drawn from approved government programs and strategies or from laws that have been adopted by the government or whose drafting is in an advanced stage. Moreover, the focus has been on those actions for which background or preparatory work has already begun to ensure that proposed RMs and SBs are ambitious, yet realistic. This ensures the required level of ownership for program implementation. Moreover, the government has a strong popular mandate and Parliament position.[36] Risks to implementation are mainly derived from the possible impact of stronger than assumed external shocks. The program mitigates the risk of larger than programmed economic shocks with a consultation clause (Box 1).

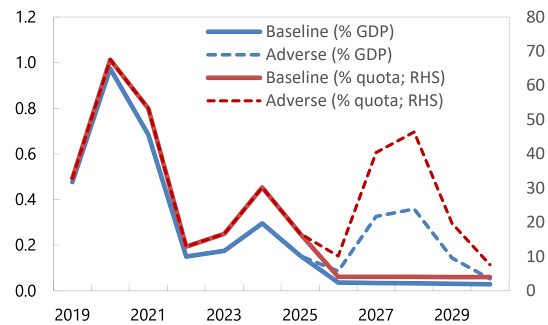
**34. Safeguards Assessment.** An update of the 2021 safeguards assessment (SA) has been initiated and is expected to be completed before the first program review. Most of previous recommendations were implemented, and good progress has been made on the remaining recommendations in the areas of internal audit, risk, and reserve management, including through technical assistance from the Fund. As there is a process underway to appoint a new Governor, the updated SA will review the CBK's governance arrangements.[37]

**Kosovo: IMF Credit Outstanding**
(Percent of GDP and of IMF Quota)




Sources: IMF staff calculations.

**Kosovo: IMF Repayment Obligations**
(Percent of GDP and of IMF Quota)




Sources: IMF staff calculations.

**35. The capacity to repay the Fund is assessed to be adequate.** If the SBA remains precautionary (as assumed in the baseline scenario), Kosovo's debt to the IMF would peak at 0.8 percent of GDP in 2024 (far below the 2019 level) and decrease thereafter. Debt service to the Fund would also peak in 2024 (0.3 percent of GDP) and decrease thereafter to about ½ of 0.1 percent of GDP. RSF repayments would kick in 2032 but debt service would remain low in GDP terms. Debt to the IMF would be higher in an adverse scenario characterized by higher commodity prices but would nonetheless remain moderate. Debt would peak in 2025 at 169 percent of quota (1.6 percent of GDP, far below the absolute peak of 2.6 percent in 2018), with repayment obligations peaking at 0.3 percent of GDP in 2028. Stocks and repayment schedules in both scenarios would be the same after 2029. Risks mainly revolve around terms of trade shocks. Risks are mitigated by Kosovo's strong track record in repaying the Fund and by low medium-term risk of debt distress (Annex II). Kosovo's current and prospective obligations to the IMF in the adverse scenario would be much lower than those of other IMF debtors (Table 8b).[38]

[36] While the government has a strong position in Parliament (58 out of 120 MPs), it is not enough to secure quorum (61 MPs).

[37] The CBK and MOF have agreed on signing an MOU specifying their respective responsibilities for debt service to the Fund.

[38] The share of IMF debt to public external debt is similar to that for other debtors, though in the case of Kosovo this mainly reflects the lack of market access.

# STAFF APPRAISAL

**36. After emerging strongly from the COVID-19 pandemic, the fallout from the war in Ukraine has moderated Kosovo's growth in 2022.** The combination of broadly targeted support coupled with an overall prudent fiscal policy stance allowed to rebuild fiscal space, while mitigating the impact of the cost-of-living crisis. While domestic borrowing costs are contained and the risk of public debt distress remains low, the implementation of the public investment program has remained low, constraining the emergence of new growth engines, and keeping the economy largely dependent of diaspora-related inflows.

**37. Higher, greener, and more inclusive medium-term growth requires improving the policy framework and decisively implementing structural reforms.** Addressing infrastructure and governance gaps remains essential to support new growth engines. Revitalizing the reform program calls to further strengthen coordination within all levels of government and with donors. Closing social and economic infrastructure gaps requires improving Public Investment Management at the shortest delays. Boosting green energy generation capacity, increasing energy demand efficiency, and strengthening competition in electricity markets will increase energy security, decrease emissions, and attract private investment into the sector. Closing governance and transparency gaps and further reducing corruption requires, *inter alia*, closing AML/CFT gaps. Early withdrawals from KPST should be avoided.

**38. Keeping fiscal policy strongly anchored around the fiscal rule deficit ceiling is critical to safeguard debt sustainability.** The implementation of the fiscal rule in 2023 will provide a moderate fiscal impulse, helping the economy soft land, with only a modest impact on inflation. Downside risks to growth also justify this policy stance. However, public spending needs to be better balanced between social transfers and promoting economic transformation and resilience. While heightened uncertainty has broadly justified contingency budgetary buffers, these need to be gradually reduced as sources of potential stress gradually dissipate. The increase in electricity tariffs and the elimination of blanket electricity subsidies are welcomed but should be complemented with a review of the definition of vulnerable energy consumers, to ensure that they are means-tested. While the increase in the public investment envelope is welcome, the corresponding budget allocations should be saved if investment implementation remains low. The planned PIMA update will provide a revamped road map to organize reform efforts to strengthen public investment management going forward.

**39. Strengthening financial sector governance remains a priority.** While, on aggregate, the financial sector remains resilient, heightened uncertainty calls to further strengthening credit risk monitoring, taking into consideration bank-by-bank idiosyncratic risks and capacities. In this regard, improving the surveillance of the housing market is key. Implementing FSSR and SA recommendations is important to strengthen the financial sector's regulatory and governance frameworks. Finalizing the draft Banking Law would strengthen the bank resolution and recovery, and supervision frameworks. Clarifying the roles and responsibilities of its Board and Executive Board is essential for the CBK to smoothly perform its mandate. The process to choose the new

CBK governor should be transparent and ensure that the best possible candidates are proposed to Parliament. This process should be finalized by mid-2023.

**40. The SBA and the RSF provide appropriate instruments to support the authorities' proposed program.** Given the absence of a balance of payments need in the baseline, the authorities' intention to treat the SBA as precautionary is adequate. Kosovo has no sovereign arrears to bilateral creditors, and adequate financing assurances are in place. In parallel, staff considers that the SBA demonstrates Kosovo's strong commitment to advance the reform agenda while keeping sound macroeconomic policies. In turn, the RSF reform measures will support Kosovo's efforts for climate change mitigation and adaptation. Staff encourage the authorities to leverage the RSF to scale up green investments as well as catalyze further climate financing from private sector sources. Based on the authorities' strong program and continued commitment to policies and reforms, staff supports the request for a new 24-month SBA, and support under an RSF arrangement.

## Box 1. Kosovo: Adverse Scenario

**The war in Ukraine makes a negative terms-of-trade (TOT) shock the most appropriate to characterize an adverse scenario.** A TOT shock would negatively impact Kosovo given its status as net food and energy importer. Concretely, the adverse scenario considers commodity price levels in 2023 that are 20 pp higher than in the baseline. The scenario further assumes that commodity prices gradually revert to the baseline beginning in 2024, but with commodity prices staying higher than in the baseline through 2028. Both international energy and food prices are assumed to be higher. The *ex-ante* impact of such a shock in the value of imports of food and energy would be around 3 pp of GDP in 2023.

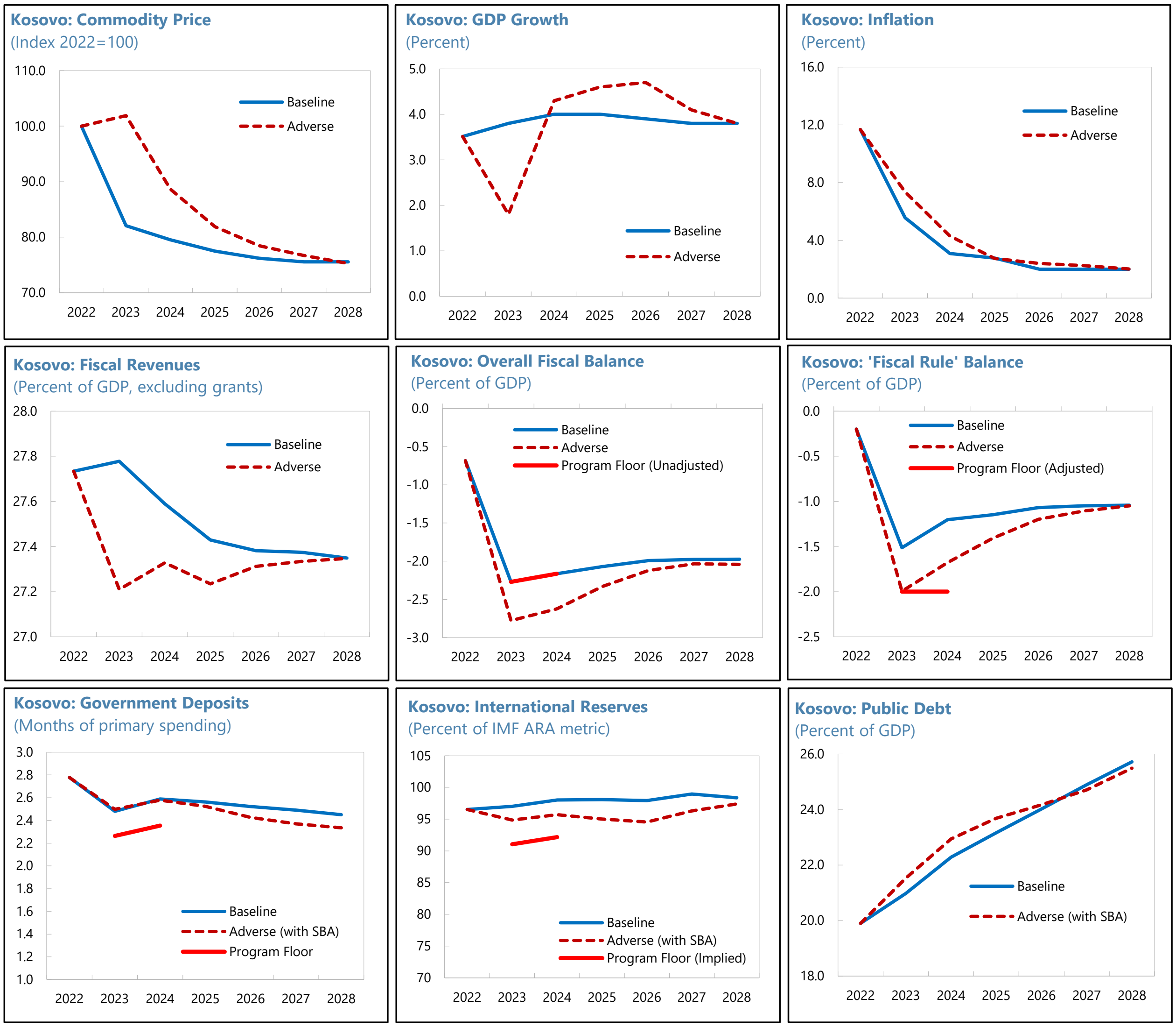
**The shock would lead to lower GDP growth, a reopening of the output gap, lower fiscal revenues, and higher fiscal and external financing needs.** The largest negative impact would occur in 2023, where GDP growth would be 2 pp lower than in the baseline. The more negative output gap would affect fiscal revenue buoyancy, which would be lower than in the baseline by about 0.5 pp of GDP in both 2023 and 2024. As the program will help preserve fiscal expenditures to protect the PIP and social transfers, this would open a financing gap of €50 million per year in 2023–24. With the TOT shock assumed to gradually reverse beginning in 2024, real GDP and fiscal revenues would gradually converge to those in the baseline by 2028.

**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 over 2023–24 of €100 million (SDR 80.122 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 is currently negotiating additional budget support from German and French bilateral agencies (AFD and KfW) for a total of about €150 million in 2024 that would allow to bring reserves to 100 percent of the IMF RA metric, providing further insurance if downside risks materialize.

**The simultaneous materialization of a TOT shock with other shocks would compound the negative impact of the increase in commodity prices.** For instance, higher international electricity prices and lower-than-forecast domestic electricity supply may result in an *ex-ante* shock of around 3.5–4 percent of GDP, compounding financing needs, though the final cross-sectoral impact would depend on the pass-through to domestic electricity tariffs. Even further needs may also arise if the planned installation of filters in Kosova B thermal power plant (scheduled to start in 2024 and to continue in 2025) results in longer than projected plant outages. The impact could be higher if higher energy costs are also accompanied by load shedding, given its negative impact on output and fiscal revenues. Delays in the approval of budget support operations for 2023 (of 1–2 percent of GDP) could also increase fiscal financing needs.

**The program will include a consultation clause to mitigate the high uncertainty characterizing the outlook.** This clause would allow 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 be used as a general guide for policy. This would protect capital spending, and allow some deficit accommodation, while keeping spending at bay to avoid breaching the deficit ceiling.

## Box 1. Figure 1. Adverse Scenarios: Characterization and Policy Response




Sources: IMF staff calculations and Kosovar Authorities.

## Box 2. Kosovo: Mitigation and Adaptation Challenges: How RSF Reform Measures are Aligned with the "Green Agenda" for the Western Balkans

***Kosovo's Climate Mitigation and Adaptation Challenges***

**The Stabilization and Association process with the European Union (EU-Kosovo SAA) has provided real-time diagnostics of Kosovo's key climate mitigation and adaptation challenges since 2016.**[1] The original agreement (2015) and annual progress reports (latest October 2022) provide a comprehensive and up-to-date analysis of Kosovo's climate and environmental sustainability challenges, as well as recommendations for Kosovo's legal framework and practices to converge to those in the *EU Acquis.* A summary of challenges includes:

- **Energy.** Kosovo's electricity system is highly dependent on two aging and highly polluting lignite-fired thermal power plants, which cause serious health and environmental hazards. Climate change mitigation efforts call to mobilize new investments in renewable energy to accelerate the green transition, including by decommissioning parts of the Kosova A thermal power plant. This should allow aligning emissions with the ceilings established under the National Emission Reduction Plan. Mitigation also requires reducing the carbon footprint of households, firms, and the public sector, through increased efficiency of buildings and industrial processes. This would also help firms adapt to more stringent EU-standards, especially associated with the implementation of the Carbon Border Adjustment Mechanism (CBAM), scheduled to start in 2026. Regularly publishing environmental statistics, such as energy efficiency indicators and greenhouse gas emission statistics, is important.
- **Air Pollution.** Air quality is a major health threat. Coal-based electricity production and the use of wood and coal for domestic heating are the main drivers of SO2, NOx and PM2.5. In addition to accelerating the green transition, mitigation requires investment to increase demand efficiency and in alternative heating forms. Another priority is developing and adopting air quality plans for zones in which pollutant levels clearly exceed limit values. This requires, *inter alia*, the environmental upgrade of the Kosova B thermal power plant to decrease pollution levels to EU-standards through the installation of state-of-the-art filters.
- **Transportation.** Further work is needed for strategies, action plans, and legislation in the transport sector to be in line with the principles and objectives of the Green Agenda for the Western Balkans.
- **Waste Management.** Untreated sewage and discharge remain the main sources of water pollution, particularly in rivers. While the number of illegal dumpsites has decreased by ½ since 2019, they continue to be the main source of land contamination, especially in rural areas. The legal framework should be strengthened to include the extended producer responsibility and the polluter pays principle
- **Water Management.** The monitoring and management of water protection zones needs to be enhanced. Increasing water sustainability calls for improvements in wastewater and solid waste management. Upgrading infrastructure is important to improve water availability and storage. Adaptation requires strengthening flood planning and completing flood risk hazard maps.

### Box 2. Kosovo: Climate Mitigation and Adaptation Challenges (continued)

- **Nature Protection**. Priorities include to improve the surveillance of protected areas, including through combatting illegal hunting and logging, and by protecting critically endangered species. Fighting illegal logging remains important to prevent deforestation and reduce air pollution.
- **Natural Disaster Management.** Improving preparedness to respond to large-scale disasters requires strengthening risk assessments, better coordination between the central and local levels, and the preparation of disaster response plans.

***The EU's Climate Policy: The Benchmark for Kosovo and the Region***

**Kosovo is a signatory of the "Sofia Declaration" of 2020 establishing the "Green Agenda for the Western Balkans."** The declaration emphasizes the importance of accelerating the green transition and addressing the challenges of climate change, air and water pollution, and loss of biodiversity. Kosovo is also a signatory of the subsequent "Action Plan for the implementation of the Sofia Declaration on the Green Agenda for the Western Balkans, 2021–30" (of 2021), which outlines actions to achieve the Green Agenda's objectives. The "Agenda" and "Action Plan" are fully in line with the "EU Green Deal" and constitute the benchmark against which the EU assesses Kosovo's policies in the context of the EU-Kosovo SAA.

- **Objectives.** In the area of climate change, the plan focuses on transitioning the region to a low-carbon economy, increasing renewable energy production, and improving energy efficiency. In the circular economy, the plan aims to improve resource efficiency, promote sustainable consumption and production, and reduce waste. The biodiversity priority area focuses on conserving and restoring ecosystems and promoting sustainable land use. The air quality priority area aims to reduce air pollution and its negative impact on public health. The water management priority area aims to improve water quality and quantity, reduce water pollution, and enhance water efficiency. Finally, the environmental governance priority area focuses on strengthening the legal and institutional framework for environmental protection, promoting citizen participation and awareness, and improving environmental data and monitoring.
- **Concrete and Measurable Actions.** The plan outlines a set of specific and measurable actions including concrete timelines, indicators, and expected outcomes. Actions include legislative and institutional reforms, capacity building, awareness-raising, pilot projects, and investments. The plan also includes a monitoring and evaluation framework.
- **Western Balkan countries' legislation and implementation still needs aligning with the "Agenda's" goals in many areas.** While long-term objectives are generally aligned (i.e., carbon neutrality by 2050) intermediate targets differ in terms of measurement, base year, and ambition. Kosovo's voluntary GHG reductions target implies a decrease in emissions of 1.4 percent annually through 2030, higher than the Western Balkans average, despite having the lowest GDP per capita in the region.[2] That said, the 2022 SAA Progress Report argues that work is ongoing to adopt revised strategies, action plans, and legislation to ensure their coherence with the Green Agenda's objectives. In addition, the report argues that sustained political commitment and improved capacity will be needed for their timely finalization and implementation.

## Box 2. Kosovo: Climate Mitigation and Adaptation Challenges (concluded)

***How is the RSF aligned with the "Agenda"?***

**Reform Measures Under the RSF and the "Green Agenda"**

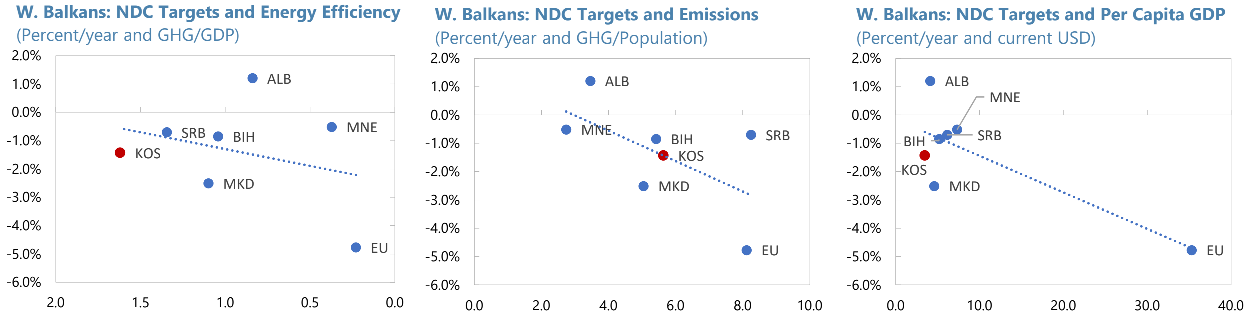
| | Measure | Action in the Green Agenda |
|---|---|---|
| **Proposed Reform Measures** | | |
| RM1 | Submission to Parliament of a Budget for 2024 consistent with RSF objectives (allocations for expansion of renewable energy and for implementation of new definition of vulnerable energy consumers); KEK to prepare budget plan securing financing to secure the installation of filters in one unit of Kosova B in 2024. | Actions 16, 37, 37a, 38 |
| RM2 | Government to finish technical proposal to add 100 – 150 MW of wind or solar PVC capacity to Kosovo's energy matrix to start implementation in 2024 | Actions 6, 13 |
| RM3 | Submission to Parliament of Law on Renewable Energy delineating the use of competitive auctions to attract private sector investment in renewable electricity generation | Actions 8, 13 |
| RM4 | Working Grou presents to Cabinet report discussing implications of EU carbon price initiatives for Kosovo, using CPAT tool | Actions 5, 14 |
| RM5 | Ministry of Economy adopts Administrative Instruction allowing the launch (during 2023) of first auction for 100 MW of solar electricity generation | Actions 6, 13 |
| RM6 | Kosovo Energy Efficiency Fund Board to approve plan, with clearly established priorities, to increase energy efficiency of residential buildings to start implementation in 2023:H2. | Actions 10, 11, 12 |
| RM7 | Government implementing actions conducive to the start of the day-ahead electricity market for Kosovo from September 2023 in the context of ALPEX | Actions 8, 13 |
| RM8 | Central Bank to issue regulation defining practices for banks to monitor and report data on exporting firms that may be exposed to transition costs related with CBAM implementation | Actions 4 |

**The proposed RSF measures are fully aligned with policy actions in the "Green Agenda for the western Balkans".** In line with the "Sofia Declaration" the "Agenda" includes 5 pillars (Decarbonization, Circular Economy, Depollution, Sustainable Agriculture, and Biodiversity). Given the RSF proposed focus on green energy and tackling pollution, the proposed RSF reform measures are mainly mapped to the "Agenda's" actions on "Decarbonization" (pillar 1 of the "Agenda") and "Depollution" (pillar 3 of the "Agenda").

1/ The EU's diagnostic is in line with the "World Bank's Systematic Country Diagnostic Update Report" of 2022 as well as with the OECD's "Multidimensional Review of the Western Balkans", also of 2022.

2/ Kosovo is not a signatory to the Paris Agreement given that it is not a member of the United Nations. Kosovo's current GHG reduction target reflects ongoing work by the Ministry of Environment to update Kosovo's Climate Change Strategy and Action Plan for 2022–32 (to replace the previous one for 2019–28), scheduled to be finalized by mid-2023 with the assistance of GIZ (German Agency for international cooperation). While the updated strategy is being finalized, Kosovo's National Climate Change Council publicly announced the new target in 2022.

## Box 2. Figure 1. GHG Reduction Targets




Sources: WDI Database, country official statistics, and IMF staff calculations.

| | Base Year | Target Variable | Effective Target (2030 vs 2010–15; approx.) |
|---|---|---|---|
| Albania 1/ | 2016 | GHG emissions with LULUCF | Increase of 1.2 percent/year in the NDC scenario |
| Bosnia and Herzegovina | 2014 & 1990 | GHG emissions without LULUCF | Decrease of 0.9 percent/year in the baseline scenario and of 2.5 percent/year in upside |
| Kosovo 2/ | 2016 | GHG emissions without LULUCF | Decrease of 1.4 percent/year |
| Montenegro | 1990 | GHG emissions without LULUCF | Decrease of 0.5 percent/year |
| North Macedonia | 1990 | GHG emissions with LULUCF | Decrease of 2.5 percent/year |
| Serbia | 2010 & 1990 | GHG emissions without LULUCF | Decrease of 0.7 percent/year |
| European Union | 1990 | GHG emissions without LULUCF | Decrease of 4.8 percent/year |

Source: UNFCCC, EAA, national authorities, and IMF staff calculations.

1/ The GHG reduction is with respect to a 'business as usual' scenario in 2030.

2/ Kosovo is not a signatory to the Paris Agreement given that it is not a member of the United Nations. Kosovo's current GHG reduction target reflects work to update Kosovo's Climate Change Strategy and Action Plan for 2022–2032. While the updated strategy is being finalized, Kosovo's National Climate Change Council publicly announced the new target in 2022; the current target compares with a decline of 7–14 percent by 2028 with respect to a BAU scenario, as included in the Climate Change Strategy for 2019–2028.

Note: LULUCF stands for land-use, land-use change, and forestry.

## Table 1. Kosovo: Selected Economic Indicators, 2019–28

(Percent, unless otherwise indicated)

| | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Est. | | | Proj. | | | |
| **Real GDP growth** | 4.8 | -5.3 | 10.7 | 3.5 | 3.8 | 4.0 | 4.0 | 3.9 | 3.8 | 3.8 |
| Contribution to growth (percentage points of GDP) | | | | | | | | | | |
| Consumption | 5.8 | 2.3 | 7.7 | 3.3 | 4.7 | 2.7 | 3.1 | 3.0 | 3.0 | 2.9 |
| Private | 4.6 | 2.0 | 6.5 | 3.5 | 2.6 | 2.6 | 2.5 | 2.4 | 2.4 | 2.4 |
| Public | 1.2 | 0.3 | 1.2 | -0.2 | 2.2 | 0.1 | 0.6 | 0.6 | 0.5 | 0.5 |
| Investment | -0.1 | -2.3 | 3.6 | -2.5 | 2.1 | 2.3 | 1.7 | 1.7 | 1.7 | 1.7 |
| Net Exports | -0.3 | -5.3 | -0.2 | 2.7 | -3.0 | -1.0 | -0.8 | -0.8 | -0.8 | -0.8 |
| Exports | 2.2 | -8.6 | 17.0 | 6.1 | 1.8 | 1.9 | 1.9 | 1.6 | 1.6 | 1.6 |
| Imports | -2.5 | 3.3 | -17.2 | -3.4 | -4.8 | -3.0 | -2.7 | -2.4 | -2.4 | -2.4 |
| Real growth rate (percent) | | | | | | | | | | |
| Consumption | 6.2 | 2.4 | 7.6 | 3.3 | 4.8 | 2.7 | 3.2 | 3.1 | 3.0 | 3.0 |
| Private | 5.6 | 2.5 | 7.3 | 4.0 | 3.0 | 3.0 | 3.0 | 2.9 | 2.9 | 2.9 |
| Public | 10.1 | 2.1 | 9.0 | -1.5 | 16.9 | 0.8 | 4.3 | 4.2 | 3.9 | 3.7 |
| Investment | 2.9 | -7.6 | 13.0 | -6.8 | 3.1 | 8.4 | 5.7 | 5.8 | 5.5 | 5.6 |
| Exports | 7.6 | -29.1 | 76.8 | 17.2 | 4.4 | 4.8 | 4.6 | 4.0 | 4.0 | 4.0 |
| Imports | 4.5 | -6.0 | 31.4 | 4.9 | 7.2 | 4.3 | 3.9 | 3.6 | 3.6 | 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 | 5.6 | 3.1 | 2.8 | 2.0 | 2.0 | 2.0 |
| GDP deflator | 1.0 | 1.4 | 6.1 | 8.7 | 6.4 | 4.1 | 2.6 | 2.0 | 1.9 | 1.9 |
| **General government budget (percent of GDP)** | | | | | | | | | | |
| Revenues and grants | 27.0 | 25.6 | 27.8 | 28.0 | 28.8 | 27.6 | 27.4 | 27.4 | 27.4 | 27.3 |
| Expenditures | 29.9 | 33.5 | 29.0 | 28.6 | 31.0 | 29.8 | 29.5 | 29.4 | 29.4 | 29.3 |
| *Of which:* Wages and salaries | 8.7 | 9.8 | 8.4 | 7.3 | 7.6 | 7.6 | 7.6 | 7.6 | 7.6 | 7.6 |
| Subsidies and transfers | 8.9 | 12.8 | 10.6 | 11.9 | 11.2 | 10.7 | 10.3 | 10.1 | 10.1 | 10.1 |
| Capital expenditure | 7.6 | 5.6 | 5.3 | 4.7 | 6.9 | 6.5 | 6.5 | 6.5 | 6.5 | 6.5 |
| Overall Balance (Fiscal rule) 1/ | -0.8 | -6.5 | -1.0 | -0.2 | -1.5 | -1.2 | -1.1 | -1.1 | -1.0 | -1.1 |
| Overall balance | -2.9 | -7.8 | -1.2 | -0.7 | -2.3 | -2.2 | -2.1 | -2.0 | -2.0 | -2.0 |
| Stock of freely available government bank balances | 5.1 | 3.4 | 3.8 | 3.2 | 3.4 | 3.6 | 3.6 | 3.7 | 3.7 | 3.7 |
| Total public debt 2/ | 17.7 | 22.5 | 21.6 | 19.9 | 21.0 | 22.3 | 23.2 | 24.0 | 24.9 | 25.7 |
| **Balance of Payments (percent of GDP)** | | | | | | | | | | |
| Current account balance, incl. official transfers | -5.7 | -7.0 | -8.7 | -10.5 | -7.3 | -7.0 | -6.5 | -6.0 | -5.5 | -5.3 |
| *Of which:* Official transfers 3/ | 3.4 | 4.1 | 2.9 | 3.3 | 3.8 | 3.1 | 3.0 | 3.0 | 3.0 | 3.0 |
| *Of which:* Remittance inflows | 12.1 | 14.5 | 14.5 | 13.7 | 13.6 | 13.4 | 13.0 | 12.7 | 12.5 | 12.4 |
| Financial account | -2.3 | -8.3 | -4.6 | -7.4 | -5.0 | -4.7 | -4.2 | -3.7 | -3.2 | -3.0 |
| *Of which:* Direct investment, net | -2.7 | -4.2 | -4.0 | -6.7 | -5.2 | -5.2 | -5.1 | -4.6 | -4.1 | -4.1 |
| Portfolio investment, net | 0.8 | -1.2 | 3.5 | 1.5 | 1.2 | 1.1 | 1.1 | 1.1 | 1.0 | 1.2 |
| Other investment, net | -1.8 | -3.5 | -6.2 | -2.9 | -2.0 | -1.7 | -0.9 | -1.0 | -1.0 | -0.7 |
| Reserve change | 1.3 | 0.7 | 2.1 | 0.8 | 1.0 | 1.2 | 0.8 | 0.7 | 0.9 | 0.6 |
| Errors and Omissions | 3.5 | -1.6 | 3.4 | 2.7 | 2.0 | 2.0 | 2.0 | 2.0 | 1.9 | 2.0 |
| **Savings-investment balances (percent of GDP)** | | | | | | | | | | |
| National savings | 28.9 | 26.4 | 27.2 | 24.3 | 26.2 | 27.2 | 28.0 | 28.8 | 29.5 | 30.0 |
| Public savings | 4.4 | -2.8 | 3.9 | 3.8 | 3.6 | 4.3 | 4.4 | 4.5 | 4.5 | 4.5 |
| Private savings | 24.5 | 29.3 | 23.3 | 20.5 | 22.6 | 22.9 | 23.6 | 24.3 | 25.0 | 25.5 |
| Investment | 34.6 | 33.4 | 36.0 | 34.8 | 33.5 | 34.2 | 34.4 | 34.8 | 35.0 | 35.3 |
| Public investment | 7.6 | 5.6 | 5.3 | 4.7 | 6.9 | 6.5 | 6.5 | 6.5 | 6.5 | 6.5 |
| Private investment | 27.0 | 27.8 | 30.6 | 30.1 | 26.6 | 27.7 | 27.9 | 28.3 | 28.5 | 28.8 |
| Current account, including. official transfers | -5.7 | -7.0 | -8.7 | -10.5 | -7.3 | -7.0 | -6.5 | -6.0 | -5.5 | -5.3 |
| **Financial Sector** | | | | | | | | | | |
| Non-performing loans (percent of total loans) | 1.9 | 2.5 | 2.1 | 1.9 | … | … | … | … | … | … |
| Bank credit to the private sector (percent change) | 10.0 | 7.0 | 15.6 | 16.0 | 12.2 | 9.9 | 8.2 | 7.2 | 7.2 | 7.2 |
| Deposits of the private sector (percent change) | 15.6 | 10.9 | 12.4 | 12.8 | 9.1 | 8.6 | 7.5 | 6.8 | 6.7 | 6.7 |
| 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 | 1,371 | 1,480 | 1,610 | 1,706 | 1,797 | 1,908 | 1,994 |
| Foreign Reserves (% of ARA metric) | 126 | 120 | 107 | 97 | 97 | 98 | 98 | 98 | 99 | 98 |
| GDP (millions of euros) | 7,056 | 6,772 | 7,958 | 8,955 | 9,886 | 10,700 | 11,412 | 12,090 | 12,792 | 13,537 |
| GDP (millions of euros; projections in 2023 budget) | 7,056 | 6,772 | 7,958 | 8,956 | 9,843 | 10,605 | 11,401 | … | … | … |
| GDP per capita (euros) | 3,959 | 3,766 | 4,499 | 5,060 | 5,583 | 6,040 | 6,439 | 6,817 | 7,210 | 7,626 |
| Real GDP growth per capita | 5.6 | -6.2 | 12.6 | 3.5 | 3.7 | 3.9 | 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/ The "fiscal rule" caps the overall fiscal deficit at 2 percent of GDP, excluding investment financed with privatization receipts and donor financing contracted after 2015, as well as PAK-related current expenditure; the IMF calculates expenditures from carried-forward own-source revenue (OSR) as the difference in the municipal OSR stock.

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

3/ Total foreign assistance excluding capital transfers.

## Table 2. Kosovo: Consolidated Government Budget, 2019–28 (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** | **2,844** | **2,952** | **3,130** | **3,316** | **3,502** | **3,702** |
| Revenue | 1,885 | 1,693 | 2,195 | 2,484 | 2,746 | 2,952 | 3,130 | 3,316 | 3,502 | 3,702 |
| Taxes | 1,662 | 1,507 | 1,948 | 2,217 | 2,457 | 2,633 | 2,792 | 2,949 | 3,103 | 3,270 |
| Direct taxes | 292 | 267 | 342 | 414 | 490 | 535 | 573 | 609 | 647 | 689 |
| *of which:* Personal income tax | 166 | 158 | 190 | 216 | 251 | 273 | 291 | 308 | 326 | 345 |
| *of which:* Corporate income tax | 95 | 85 | 114 | 160 | 193 | 210 | 224 | 238 | 252 | 266 |
| *of which:* Property tax | 27 | 23 | 36 | 35 | 42 | 47 | 53 | 58 | 65 | 72 |
| Other | 5 | 1 | 2 | 4 | 4 | 5 | 5 | 5 | 5 | 6 |
| Indirect taxes | 1,415 | 1,273 | 1,665 | 1,870 | 2,054 | 2,191 | 2,317 | 2,444 | 2,566 | 2,697 |
| VAT | 846 | 770 | 1,038 | 1,220 | 1,369 | 1,480 | 1,579 | 1,674 | 1,771 | 1,876 |
| Excise | 435 | 398 | 501 | 517 | 553 | 587 | 622 | 659 | 697 | 741 |
| Customs | 130 | 102 | 125 | 133 | 128 | 120 | 112 | 108 | 94 | 77 |
| Other | 4 | 3 | 1 | 0 | 4 | 4 | 4 | 4 | 4 | 4 |
| Tax refunds | -46 | -33 | -59 | -67 | -87 | -92 | -98 | -104 | -110 | -117 |
| Nontax revenues | 223 | 186 | 247 | 267 | 289 | 319 | 338 | 367 | 399 | 432 |
| Other revenue | 7 | 3 | 9 | 11 | 8 | 9 | 10 | 10 | 10 | 10 |
| Grants | 19 | 43 | 17 | 20 | 98 | 0 | 0 | 0 | 0 | 0 |
| Budget support | 12 | 34 | 0 | 10 | 86 | 0 | 0 | 0 | 0 | 0 |
| Project grants (DDGs) | 8 | 9 | 17 | 10 | 12 | 0 | 0 | 0 | 0 | 0 |
| **Expenditure** | **2,111** | **2,265** | **2,311** | **2,565** | **3,068** | **3,184** | **3,367** | **3,557** | **3,755** | **3,969** |
| Current expenditure | 1,578 | 1,886 | 1,887 | 2,142 | 2,389 | 2,490 | 2,624 | 2,769 | 2,925 | 3,095 |
| Wages and salaries | 617 | 661 | 668 | 653 | 747 | 813 | 867 | 919 | 972 | 1,029 |
| Goods and services | 298 | 302 | 332 | 363 | 492 | 482 | 514 | 544 | 576 | 609 |
| Subsidies and transfers | 628 | 868 | 843 | 1,065 | 1,103 | 1,140 | 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 | 48 | 56 | 63 | 81 | 88 | 92 |
| Interest - internal | 11 | 17 | 21 | 25 | 28 | 32 | 38 | 54 | 58 | 60 |
| *of which:* on external debt | 12 | 10 | 10 | 10 | 20 | 24 | 25 | 27 | 30 | 32 |
| Other net PAK expenditure | 6 | 24 | 13 | 25 | 0 | 0 | 0 | 0 | 0 | 0 |
| Capital expenditure | 534 | 380 | 424 | 423 | 679 | 693 | 743 | 788 | 829 | 875 |
| Budget-financed | 366 | 265 | 386 | 317 | 572 | 585 | 635 | 675 | 710 | 755 |
| PAK-financed | 132 | 54 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| External | 36 | 60 | 38 | 105 | 106 | 108 | 108 | 113 | 119 | 120 |
| *of which:* Non-Investment Clause | 21 | 31 | 15 | 52 | 19 | 5 | 3 | 1 | 1 | 0 |
| *of which:* "Investment Clause" | 13 | 26 | 13 | 44 | 75 | 103 | 105 | 112 | 119 | 119 |
| **Fiscal balances** | | | | | | | | | | |
| **Primary balance** | -188 | -507 | -72 | -31 | -181 | -178 | -175 | -161 | -167 | -177 |
| Interest income, net | -19 | -26 | -32 | -36 | -41 | -45 | -48 | -48 | -47 | -46 |
| **Overall balance** | **-207** | **-529** | **-99** | **-61** | **-225** | **-232** | **-236** | **-241** | **-253** | **-267** |
| *"Fiscal rule" deductions from the overall balance* | 151 | 128 | 20 | 44 | 75 | 103 | 105 | 112 | 120 | 121 |
| **Overall balance ('Fiscal rule" definition) 2/** | **-55** | **-443** | **-79** | **-18** | **-150** | **-129** | **-131** | **-129** | **-134** | **-148** |
| Overall cyclically adjusted balance | -255 | -425 | -101 | -65 | -304 | -220 | -232 | -241 | -253 | -267 |
| Statistical discrepancy | 1 | -4 | 2 | -8 | 0 | 0 | 0 | 0 | -1 | -1 |
| **Financing** | **205** | **533** | **97** | **69** | **225** | **232** | **237** | **241** | **254** | **268** |
| Foreign financing (net) | -10 | 127 | 44 | 63 | 197 | 147 | 52 | 67 | 52 | 37 |
| Budget Support | 0 | 156 | 79 | 11 | 152 | 99 | 0 | 0 | 0 | 0 |
| External Financing for Projects | 39 | 59 | 44 | 100 | 103 | 116 | 118 | 124 | 133 | 135 |
| Amortization of external debt | -50 | -89 | -79 | -48 | -57 | -68 | -65 | -58 | -81 | -98 |
| Domestic financing (net) | 216 | 406 | 53 | 7 | 27 | 84 | 184 | 175 | 202 | 231 |
| Net Domestic debt issuance | 115 | 170 | 145 | -4 | 93 | 163 | 207 | 194 | 228 | 258 |
| Change in CBK deposits | 43 | 211 | -100 | 23 | -39 | -50 | -31 | -26 | -31 | -30 |
| Change in GG Deposits at the CBK (TSA) | -70 | 127 | -106 | 4 | -39 | -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 | 3 | -20 | -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 | -47 | -233 | -241 | -246 | -251 | -263 | -277 |
| Pandemic-related fiscal measures | ... | 296 | 310 | ... | ... | ... | ... | ... | ... | ... |
| Freely available bank balance of the general government | 362 | 233 | 306 | 284 | 335 | 385 | 416 | 442 | 472 | 502 |
| *Of which:* ELA | 46 | 46 | 46 | 46 | 46 | 46 | 46 | 46 | 47 | 48 |
| Total public debt 4/ | 1,247 | 1,523 | 1,717 | 1,782 | 2,074 | 2,384 | 2,643 | 2,904 | 3,184 | 3,480 |
| External debt | 452 | 557 | 607 | 671 | 870 | 1,018 | 1,070 | 1,136 | 1,188 | 1,227 |
| *Of which:* onlending | 50 | 43 | 46 | 47 | 46 | 46 | 50 | 55 | 63 | 71 |
| *Of which:* guarantees | 43 | 32 | 31 | 30 | 32 | 32 | 32 | 32 | 32 | 33 |
| Domestic debt | 795 | 965 | 1,110 | 1,111 | 1,204 | 1,366 | 1,574 | 1,768 | 1,996 | 2,254 |

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** | **28.8** | **27.6** | **27.4** | **27.4** | **27.4** | **27.3** |
| Revenue | 26.7 | 25.0 | 27.6 | 27.7 | 27.8 | 27.6 | 27.4 | 27.4 | 27.4 | 27.3 |
| Taxes | 23.6 | 22.3 | 24.5 | 24.8 | 24.9 | 24.6 | 24.5 | 24.4 | 24.3 | 24.2 |
| Direct taxes | 4.1 | 3.9 | 4.3 | 4.6 | 5.0 | 5.0 | 5.0 | 5.0 | 5.1 | 5.1 |
| *of which:* Personal income tax | 2.3 | 2.3 | 2.4 | 2.4 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| *of which:* Corporate income tax | 1.3 | 1.3 | 1.4 | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| *of which:* Property tax | 0.4 | 0.3 | 0.5 | 0.4 | 0.4 | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 |
| Indirect taxes | 20.1 | 18.8 | 20.9 | 20.9 | 20.8 | 20.5 | 20.3 | 20.2 | 20.1 | 19.9 |
| VAT | 12.0 | 11.4 | 13.0 | 13.6 | 13.8 | 13.8 | 13.8 | 13.8 | 13.8 | 13.9 |
| Excise | 6.2 | 5.9 | 6.3 | 5.8 | 5.6 | 5.5 | 5.4 | 5.4 | 5.4 | 5.5 |
| Customs | 1.8 | 1.5 | 1.6 | 1.5 | 1.3 | 1.1 | 1.0 | 0.9 | 0.7 | 0.6 |
| Tax refunds | -0.6 | -0.5 | -0.7 | -0.7 | -0.9 | -0.9 | -0.9 | -0.9 | -0.9 | -0.9 |
| Nontax revenues | 3.2 | 2.8 | 3.1 | 3.0 | 2.9 | 3.0 | 3.0 | 3.0 | 3.1 | 3.2 |
| Other revenue | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Grants | 0.3 | 0.6 | 0.2 | 0.2 | 1.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Budget support | 0.2 | 0.5 | 0.0 | 0.1 | 0.9 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Project grants (DDGs) | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| | | | | | | | | | | |
| **Expenditure** | **29.9** | **33.5** | **29.0** | **28.6** | **31.0** | **29.8** | **29.5** | **29.4** | **29.4** | **29.3** |
| Current expenditure | 22.4 | 27.8 | 23.7 | 23.9 | 24.2 | 23.3 | 23.0 | 22.9 | 22.9 | 22.9 |
| Wages and salaries | 8.7 | 9.8 | 8.4 | 7.3 | 7.6 | 7.6 | 7.6 | 7.6 | 7.6 | 7.6 |
| Goods and services | 4.2 | 4.5 | 4.2 | 4.1 | 5.0 | 4.5 | 4.5 | 4.5 | 4.5 | 4.5 |
| Subsidies and transfers | 8.9 | 12.8 | 10.6 | 11.9 | 11.2 | 10.7 | 10.3 | 10.1 | 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 | 0.6 | 0.7 | 0.7 | 0.7 |
| *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 | 6.9 | 6.5 | 6.5 | 6.5 | 6.5 | 6.5 |
| Budget-financed | 5.2 | 3.9 | 4.9 | 3.5 | 5.8 | 5.5 | 5.6 | 5.6 | 5.6 | 5.6 |
| 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 | 0.5 | 1.2 | 1.1 | 1.0 | 0.9 | 0.9 | 0.9 | 0.9 |
| Non-Investment Clause | 0.3 | 0.5 | 0.2 | 0.6 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| *of which:* "Investment Clause" | 0.2 | 0.4 | 0.2 | 0.5 | 0.8 | 1.0 | 0.9 | 0.9 | 0.9 | 0.9 |
| | | | | | | | | | | |
| **Fiscal balances** | | | | | | | | | | |
| **Primary balance** | -2.7 | -7.5 | -0.9 | -0.3 | -1.8 | -1.7 | -1.5 | -1.3 | -1.3 | -1.3 |
| **Overall balance** | **-2.9** | **-7.8** | **-1.2** | **-0.7** | **-2.3** | **-2.2** | **-2.1** | **-2.0** | **-2.0** | **-2.0** |
| *"Fiscal rule" deductions from the overall balance* | 2.1 | 1.9 | 0.2 | 0.5 | 0.8 | 1.0 | 0.9 | 0.9 | 0.9 | 0.9 |
| **Overall balance ('Fiscal rule" definition) 2/** | **-0.8** | **-6.5** | **-1.0** | **-0.2** | **-1.5** | **-1.2** | **-1.1** | **-1.1** | **-1.0** | **-1.1** |
| Overall cyclically adjusted balance | -3.6 | -6.3 | -1.3 | -0.7 | -3.1 | -2.1 | -2.0 | -2.0 | -2.0 | -2.0 |
| Statistical discrepancy | 0.0 | -0.1 | 0.0 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| | | | | | | | | | | |
| **Financing** | **2.9** | **7.9** | **1.2** | **0.8** | **2.3** | **2.2** | **2.1** | **2.0** | **2.0** | **2.0** |
| Foreign financing (net) | -0.1 | 1.9 | 0.6 | 0.7 | 2.0 | 1.4 | 0.5 | 0.6 | 0.4 | 0.3 |
| Budget Support | 0.0 | 2.3 | 1.0 | 0.1 | 1.5 | 0.9 | 0.0 | 0.0 | 0.0 | 0.0 |
| External Financing for Projects | 0.6 | 0.9 | 0.6 | 1.1 | 1.0 | 1.1 | 1.0 | 1.0 | 1.0 | 1.0 |
| Amortization of external debt | -0.7 | -1.3 | -1.0 | -0.5 | -0.6 | -0.6 | -0.6 | -0.5 | -0.6 | -0.7 |
| | | | | | | | | | | |
| Domestic financing (net) | 3.1 | 6.0 | 0.7 | 0.1 | 0.3 | 0.8 | 1.6 | 1.4 | 1.6 | 1.7 |
| Net Domestic debt issuance | 1.6 | 2.5 | 1.8 | 0.0 | 0.9 | 1.5 | 1.8 | 1.6 | 1.8 | 1.9 |
| Change in CBK deposits | 0.6 | 3.1 | -1.3 | 0.3 | -0.4 | -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 | -0.4 | -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 | 0.0 | -0.2 | -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 | -0.5 | -2.4 | -2.2 | -2.2 | -2.1 | -2.1 | -2.0 |
| Pandemic-related fiscal measures | … | 4.4 | 3.9 | … | … | … | … | … | … | … |
| Bank balance of the general government | 5.1 | 3.4 | 3.8 | 3.2 | 3.4 | 3.6 | 3.6 | 3.7 | 3.7 | 3.7 |
| *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 | 19.9 | 21.0 | 22.3 | 23.2 | 24.0 | 24.9 | 25.7 |
| External debt | 6.4 | 8.2 | 7.6 | 7.5 | 8.8 | 9.5 | 9.4 | 9.4 | 9.3 | 9.1 |
| *Of which:* onlending | 0.7 | 0.6 | 0.6 | 0.5 | 0.5 | 0.4 | 0.4 | 0.5 | 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 | 12.4 | 12.2 | 12.8 | 13.8 | 14.6 | 15.6 | 16.7 |

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

## 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 | 332 | 537 | 582 | 592 | 574 | 659 | 776 |
| Overall balance | -207 | -529 | -99 | -61 | -225 | -232 | -236 | -241 | -253 | -267 |
| Amortization | 294 | 289 | 241 | 271 | 312 | 350 | 356 | 333 | 406 | 509 |
| External | 50 | 89 | 79 | 48 | 57 | 68 | 65 | 58 | 81 | 98 |
| Domestic | 245 | 200 | 162 | 223 | 255 | 283 | 290 | 275 | 325 | 411 |
| **Financing Sources** | 499 | 822 | 338 | 340 | 537 | 582 | 592 | 575 | 660 | 777 |
| External Debt | 39 | 215 | 123 | 111 | 254 | 215 | 118 | 124 | 133 | 135 |
| Budget Support | 0 | 104 | 79 | 11 | 113 | 60 | 0 | 0 | 0 | 0 |
| External Financing for Projects | 39 | 59 | 44 | 100 | 103 | 116 | 118 | 124 | 133 | 135 |
| Investment Clause (2016 and after) | 14 | 26 | 13 | 44 | 75 | 103 | 105 | 112 | 119 | 119 |
| Non-Investment Clause | 21 | 31 | 15 | 52 | 19 | 5 | 3 | 1 | 1 | 0 |
| Disbursements for on-lending | 4 | 3 | 16 | 5 | 8 | 8 | 10 | 11 | 13 | 15 |
| Use of IMF Credit | 0 | 52 | 0 | 0 | 39 | 39 | 0 | 0 | 0 | 0 |
| of which: RFI | 0 | 52 | 0 | 0 | … | … | … | … | … | … |
| of which: RSF | 0 | 0 | 0 | 0 | 39 | 39 | 0 | … | … | … |
| Domestic Debt | 460 | 606 | 215 | 229 | 283 | 367 | 475 | 450 | 527 | 642 |
| Gross Domestic Debt Placements | 360 | 370 | 307 | 219 | 348 | 445 | 498 | 470 | 554 | 669 |
| KPST one-off financing | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Financing (Net POE) | 13 | 15 | 3 | -20 | -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 | -39 | -50 | -31 | -26 | -31 | -30 |
| PAK deposits | 113 | 84 | 7 | 19 | 0 | 0 | 0 | 0 | 0 | 0 |
| TSA | -70 | 127 | -106 | 4 | -39 | -50 | -31 | -26 | -31 | -30 |
| Errors and Omissions | 1 | -4 | 2 | -8 | 0 | 0 | 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 | -726 | -746 | -737 | -724 | -698 | -712 |
| Balance on Goods and Services | -1,915 | -2,182 | -2,532 | -2,912 | -2,916 | -3,056 | -3,146 | -3,246 | -3,354 | -3,502 |
| Goods Balance | -2,840 | -2,573 | -3,567 | -4,287 | -4,419 | -4,707 | -4,890 | -5,096 | -5,336 | -5,628 |
| Exports, f.o.b. | 393 | 475 | 753 | 932 | 988 | 1,060 | 1,153 | 1,245 | 1,347 | 1,438 |
| Imports, f.o.b. | 3,233 | 3,048 | 4,320 | 5,219 | 5,408 | 5,767 | 6,043 | 6,341 | 6,684 | 7,066 |
| Services Balance | 925 | 392 | 1,035 | 1,375 | 1,504 | 1,651 | 1,744 | 1,851 | 1,983 | 2,126 |
| Receipts | 1,674 | 995 | 1,906 | 2,503 | 2,727 | 2,921 | 3,093 | 3,252 | 3,418 | 3,612 |
| Payments | 749 | 603 | 871 | 1,127 | 1,223 | 1,270 | 1,349 | 1,401 | 1,435 | 1,485 |
| Primary Income | 161 | 164 | 151 | 90 | 109 | 162 | 178 | 194 | 218 | 222 |
| Compensation of employees, net | 257 | 262 | 263 | 287 | 346 | 385 | 411 | 435 | 461 | 474 |
| Investment income, net | -92 | -95 | -110 | -197 | -236 | -222 | -232 | -240 | -242 | -251 |
| Secondary Income | 1,354 | 1,545 | 1,686 | 1,882 | 2,081 | 2,148 | 2,231 | 2,328 | 2,438 | 2,568 |
| Government, net | 237 | 277 | 234 | 296 | 373 | 332 | 342 | 363 | 384 | 406 |
| Other transfers (including remittances), net | 1,118 | 1,269 | 1,453 | 1,586 | 1,707 | 1,817 | 1,889 | 1,965 | 2,055 | 2,162 |
| **Capital account** | -9 | 17 | 62 | 38 | 36 | 37 | 39 | 41 | 43 | 46 |
| **Financial account** | -163 | -562 | -365 | -661 | -495 | -499 | -474 | -444 | -412 | -399 |
| Direct investment, net | -188 | -287 | -320 | -603 | -518 | -552 | -587 | -550 | -525 | -556 |
| Assets | 66 | 59 | 100 | 176 | 75 | 58 | 64 | 66 | 70 | 74 |
| Liabilities | 255 | 346 | 421 | 778 | 593 | 610 | 651 | 617 | 595 | 629 |
| Portfolio investment, net | 59 | -82 | 277 | 136 | 115 | 114 | 124 | 134 | 133 | 164 |
| Other investment, net | -129 | -240 | -491 | -261 | -195 | -187 | -107 | -118 | -131 | -94 |
| Reserve assets | 95 | 46 | 169 | 68 | 103 | 125 | 96 | 91 | 112 | 86 |
| Net errors and omissions 1/ | 246 | -107 | 267 | 241 | 196 | 209 | 223 | 238 | 242 | 267 |
| | | | | (In percent of GDP) | | | | | | |
| **Current account, incl. official transfers** | -5.7 | -7.0 | -8.7 | -10.5 | -7.3 | -7.0 | -6.5 | -6.0 | -5.5 | -5.3 |
| Balance on Goods and Services | -27.1 | -32.2 | -31.8 | -32.5 | -29.5 | -28.6 | -27.6 | -26.8 | -26.2 | -25.9 |
| Exports of Goods | 5.6 | 7.0 | 9.5 | 10.4 | 10.0 | 9.9 | 10.1 | 10.3 | 10.5 | 10.6 |
| Exports of Services | 23.7 | 14.7 | 24.0 | 27.9 | 27.6 | 27.3 | 27.1 | 26.9 | 26.7 | 26.7 |
| Imports of Goods | 45.8 | 45.0 | 54.3 | 58.3 | 54.7 | 53.9 | 53.0 | 52.5 | 52.3 | 52.2 |
| Imports of Services | 10.6 | 8.9 | 10.9 | 12.6 | 12.4 | 11.9 | 11.8 | 11.6 | 11.2 | 11.0 |
| Primary Income | 2.3 | 2.4 | 1.9 | 1.0 | 1.1 | 1.5 | 1.6 | 1.6 | 1.7 | 1.6 |
| Secondary Income | 19.2 | 22.8 | 21.2 | 21.0 | 21.0 | 20.1 | 19.6 | 19.3 | 19.1 | 19.0 |
| **Capital account** | -0.1 | 0.3 | 0.8 | 0.4 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 |
| **Financial account** | -2.3 | -8.3 | -4.6 | -7.4 | -5.0 | -4.7 | -4.2 | -3.7 | -3.2 | -3.0 |
| Direct investment, net | -2.7 | -4.2 | -4.0 | -6.7 | -5.2 | -5.2 | -5.1 | -4.6 | -4.1 | -4.1 |
| Portfolio investment, net | 0.8 | -1.2 | 3.5 | 1.5 | 1.2 | 1.1 | 1.1 | 1.1 | 1.0 | 1.2 |
| Other investment, net | -1.8 | -3.5 | -6.2 | -2.9 | -2.0 | -1.7 | -0.9 | -1.0 | -1.0 | -0.7 |
| Reserve assets | 1.3 | 0.7 | 2.1 | 0.8 | 1.0 | 1.2 | 0.8 | 0.7 | 0.9 | 0.6 |
| Net errors and omissions 1/ | 3.5 | -1.6 | 3.4 | 2.7 | 2.0 | 2.0 | 2.0 | 2.0 | 1.9 | 2.0 |
| *Memorandum items:* | | | | | | | | | | |
| Public debt service to export ratio (percent) | 3.0 | 6.7 | 3.4 | 1.7 | 2.1 | 2.3 | 2.1 | 1.9 | 2.3 | 2.6 |
| Public debt service to exports and remittances (percent) | 2.1 | 4.0 | 2.3 | 1.3 | 1.5 | 1.7 | 1.6 | 1.4 | 1.7 | 1.9 |
| External public and private debt (percent of GDP) 2/ | 31.2 | 37.0 | 37.1 | 38.2 | 36.5 | 35.7 | 34.5 | 33.7 | 32.7 | 31.8 |
| Net foreign assets of CBK 3/ | 938 | 969 | 1,061 | 1,147 | 1,230 | 1,347 | 1,455 | 1,545 | 1,655 | 1,741 |
| Gross international reserves 3/ | 1,142 | 1,149 | 1,293 | 1,371 | 1,480 | 1,610 | 1,706 | 1,797 | 1,908 | 1,994 |
| Gross international reserves in months of prospective imports 3/ | 3.8 | 2.7 | 2.4 | 2.5 | 2.5 | 2.6 | 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 | 1,279 | 1,405 | 1,500 | 1,591 | 1,702 | 1,789 |
| RSF-related imports (Euro million) 4/ | --- | --- | --- | --- | 39 | 39 | 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/ 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 | 1,230 | 1,347 | 1,455 | 1,545 | 1,655 | 1,741 |
| Foreign assets | 1,219 | 1,223 | 1,370 | 1,449 | 1,558 | 1,688 | 1,783 | 1,873 | 1,983 | 2,069 |
| Foreign liabilities | 281 | 254 | 310 | 302 | 328 | 341 | 328 | 328 | 328 | 328 |
| Net domestic assets | -420 | -211 | -335 | -353 | -363 | -399 | -442 | -467 | -498 | -528 |
| Net claims on central government | -421 | -213 | -347 | -355 | -365 | -402 | -445 | -470 | -500 | -531 |
| Claims on central government | 316 | 314 | 280 | 248 | 278 | 291 | 279 | 279 | 279 | 279 |
| Of which: government securities | 184 | 201 | 216 | 197 | 200 | 200 | 200 | 200 | 200 | 200 |
| Liabilities to central government | 738 | 527 | 626 | 604 | 642 | 693 | 723 | 749 | 779 | 810 |
| PAK (privatization) fund | 275 | 191 | 185 | 166 | 166 | 166 | 166 | 166 | 166 | 166 |
| Government deposits | 444 | 317 | 423 | 420 | 458 | 509 | 539 | 565 | 595 | 626 |
| 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 | 798 | 877 | 941 | 1,005 | 1,084 | 1,138 |
| Liabilities to other depository corporations | 415 | 566 | 589 | 594 | 652 | 722 | 782 | 842 | 917 | 967 |
| Deposits included in broad money | 53 | 139 | 78 | 132 | 146 | 155 | 159 | 163 | 167 | 171 |
| Other items, net 1/ | 50 | 52 | 58 | 68 | 69 | 70 | 71 | 72 | 73 | 74 |
| **Commercial banks** | | | | | | | | | | |
| Net foreign assets | 639 | 843 | 836 | 1,023 | 1,014 | 992 | 988 | 1,005 | 998 | 1,021 |
| Assets | 866 | 1,117 | 1,107 | 1,338 | 1,300 | 1,286 | 1,290 | 1,309 | 1,308 | 1,330 |
| Liabilities | -227 | -274 | -271 | -315 | -286 | -294 | -302 | -304 | -310 | -309 |
| Net domestic assets | 3,629 | 3,908 | 4,462 | 4,954 | 5,535 | 6,128 | 6,669 | 7,172 | 7,728 | 8,287 |
| Claims on the CBK | 415 | 566 | 589 | 592 | 652 | 722 | 782 | 842 | 917 | 967 |
| Net claims on the central government | 275 | 240 | 297 | 251 | 266 | 326 | 386 | 430 | 480 | 530 |
| 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 | -20 | -20 | -20 |
| Net claims on other public entities | -88 | -140 | -170 | -235 | -259 | -281 | -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 | -259 | -281 | -299 | -317 | -333 | -353 |
| Credit to private sector | 3,028 | 3,241 | 3,747 | 4,346 | 4,876 | 5,361 | 5,800 | 6,217 | 6,663 | 7,142 |
| Deposits of the private sector | 3,688 | 4,091 | 4,597 | 5,184 | 5,655 | 6,142 | 6,602 | 7,049 | 7,521 | 8,022 |
| Demand deposits | 2,225 | 2,597 | 3,090 | 3,371 | 3,672 | 3,990 | 4,297 | 4,596 | 4,914 | 5,247 |
| Time deposits | 1,463 | 1,493 | 1,508 | 1,813 | 1,983 | 2,153 | 2,305 | 2,454 | 2,607 | 2,775 |
| Other items, net 2/ | 580 | 661 | 701 | 793 | 894 | 978 | 1,055 | 1,128 | 1,205 | 1,287 |
| *Memorandum items:* | | | | | | | | | | |
| Broad money (12-month percent change) | 11.9 | 15.3 | 12.1 | 11.3 | 9.1 | 8.6 | 7.5 | 6.8 | 6.6 | 6.6 |
| Gross international reserves, excl. PAK and KPST deposits at CBK | 864 | 900 | 1,100 | 1,176 | 1,279 | 1,405 | 1,500 | 1,591 | 1,702 | 1,789 |
| Deposits of the private sector (12-month percent change) | 15.6 | 10.9 | 12.4 | 12.8 | 9.1 | 8.6 | 7.5 | 6.8 | 6.7 | 6.7 |
| Credit to the private sector (12-month percent change) | 10.0 | 7.0 | 15.6 | 16.0 | 12.2 | 9.9 | 8.2 | 7.2 | 7.2 | 7.2 |
| Deposits of the private sector (percent of GDP) | 52.3 | 60.4 | 57.8 | 57.9 | 57.2 | 57.4 | 57.8 | 58.3 | 58.8 | 59.3 |
| Credit to the private sector (percent of GDP) | 42.9 | 47.9 | 47.1 | 48.5 | 49.3 | 50.1 | 50.8 | 51.4 | 52.1 | 52.8 |
| 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[1]

(Percent, unless otherwise indicated)

| | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|
| Total Assets (% GDP) 1/ | 67.5 | 79.1 | 74.9 | 77.7 |
| 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 | 1.9 |
| 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 8a. Kosovo: Indicators of Fund Credit, 2022–45

(In millions of SDRs, 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 (SDR million)** | | | | | | | | | | | | | | | | | | | | | | | | |
| **Disbursements** | 0.00 | 71.04 | 57.68 | 13.35 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| GRA 1/ 2/ | 0.00 | 40.06 | 26.71 | 13.35 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| RSF | 0.00 | 30.98 | 30.98 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| **Stock of existing and prospective Fund credit** | 41.30 | 102.01 | 139.05 | 142.08 | 137.07 | 113.70 | 80.31 | 63.62 | 61.95 | 61.95 | 61.95 | 61.95 | 58.85 | 52.66 | 46.46 | 40.27 | 34.07 | 27.88 | 21.68 | 15.49 | 9.29 | 3.10 | 0.00 | 0.00 |
| GRA | 41.30 | 71.04 | 77.10 | 80.12 | 75.12 | 51.75 | 18.36 | 1.67 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| RSF | 0.00 | 30.98 | 61.95 | 61.95 | 61.95 | 61.95 | 61.95 | 61.95 | 61.95 | 61.95 | 61.95 | 61.95 | 58.85 | 52.66 | 46.46 | 40.27 | 34.07 | 27.88 | 21.68 | 15.49 | 9.29 | 3.10 | 0.00 | 0.00 |
| **Obligations** | | | | | | | | | | | | | | | | | | | | | | | | |
| **Principal (repayments/repurchases)** | 9.90 | 10.33 | 20.65 | 10.33 | 5.01 | 23.37 | 33.39 | 16.69 | 1.67 | 0.00 | 0.00 | 0.00 | 3.10 | 6.20 | 6.20 | 6.20 | 6.20 | 6.20 | 6.20 | 6.20 | 6.20 | 6.20 | 3.10 | 0.00 |
| GRA 1/ 2/ | 9.90 | 10.33 | 20.65 | 10.33 | 5.01 | 23.37 | 33.39 | 16.69 | 1.67 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| RSF | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 3.10 | 6.20 | 6.20 | 6.20 | 6.20 | 6.20 | 6.20 | 6.20 | 6.20 | 6.20 | 3.10 | 0.00 |
| **Charges and interest** | 0.78 | 2.57 | 5.32 | 6.93 | 6.86 | 6.84 | 6.82 | 6.78 | 3.13 | 3.11 | 3.11 | 3.11 | 3.04 | 2.82 | 2.53 | 2.24 | 1.95 | 1.66 | 1.37 | 1.08 | 0.79 | 0.50 | 0.28 | 0.20 |
| GRA 1/ 2/ | 0.78 | 2.57 | 3.50 | 4.02 | 3.95 | 3.93 | 3.91 | 3.87 | 0.22 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 |
| RSF | 0.00 | 0.00 | 1.82 | 2.91 | 2.91 | 2.91 | 2.91 | 2.91 | 2.91 | 2.91 | 2.91 | 2.91 | 2.84 | 2.62 | 2.33 | 2.04 | 1.75 | 1.46 | 1.16 | 0.87 | 0.58 | 0.29 | 0.07 | 0.00 |
| **Fund obligations (repurchases and charges) in percent of:** | | | | | | | | | | | | | | | | | | | | | | | | |
| Quota | 12.9 | 15.6 | 31.4 | 20.9 | 14.4 | 36.6 | 48.7 | 28.4 | 5.8 | 3.8 | 3.8 | 3.8 | 7.4 | 10.9 | 10.6 | 10.2 | 9.9 | 9.5 | 9.2 | 8.8 | 8.5 | 8.1 | 4.1 | 0.2 |
| GDP | 0.2 | 0.2 | 0.3 | 0.2 | 0.1 | 0.3 | 0.4 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Exports of goods and services | 0.4 | 0.4 | 0.8 | 0.5 | 0.3 | 0.8 | 1.0 | 0.6 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 |
| Gross international reserves | 1.0 | 1.1 | 2.0 | 1.3 | 0.9 | 2.1 | 2.7 | 1.5 | 0.3 | 0.2 | 0.2 | 0.2 | 0.3 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 | 0.0 |
| Government revenue | 0.5 | 0.6 | 1.1 | 0.7 | 0.5 | 1.1 | 1.4 | 0.8 | 0.2 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 |
| External debt service, public | 23.0 | 21.1 | 36.1 | 24.5 | 18.0 | 35.5 | 40.9 | 22.4 | 4.3 | 2.6 | 2.4 | 2.3 | 4.6 | 6.5 | 6.0 | 6.9 | 6.3 | 5.8 | 5.4 | 4.9 | 4.4 | 4.0 | 1.9 | 0.1 |
| **Fund credit outstanding in percent of:** | | | | | | | | | | | | | | | | | | | | | | | | |
| Quota | 50.0 | 114.47 | 158.3 | 168.9 | 160.1 | 128.8 | 92.6 | 77.0 | 75.0 | 75.0 | 75.0 | 75.0 | 70.9 | 63.7 | 56.2 | 48.7 | 41.2 | 33.7 | 26.2 | 18.7 | 11.2 | 3.7 | 0.4 | 0.0 |
| GDP | 0.6 | 1.3 | 1.6 | 1.6 | 1.5 | 1.2 | 0.8 | 0.6 | 0.5 | 0.5 | 0.5 | 0.5 | 0.4 | 0.3 | 0.3 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Exports of goods and services | 1.5 | 3.4 | 4.4 | 4.3 | 3.9 | 3.1 | 2.1 | 1.6 | 1.4 | 1.4 | 1.3 | 1.2 | 1.1 | 0.9 | 0.8 | 0.6 | 0.5 | 0.4 | 0.3 | 0.2 | 0.1 | 0.0 | 0.0 | 0.0 |
| Gross international reserves | 3.8 | 8.7 | 10.9 | 10.6 | 9.8 | 7.8 | 5.3 | 4.0 | 3.7 | 3.4 | 3.3 | 3.1 | 2.7 | 2.3 | 1.9 | 1.6 | 1.3 | 1.0 | 0.7 | 0.5 | 0.3 | 0.1 | 0.0 | 0.0 |
| Government revenue | 2.1 | 4.5 | 6.0 | 5.8 | 5.3 | 4.2 | 2.9 | 2.1 | 2.0 | 1.9 | 1.8 | 1.7 | 1.5 | 1.3 | 1.0 | 0.9 | 0.7 | 0.5 | 0.4 | 0.3 | 0.1 | 0.0 | 0.0 | 0.0 |
| External debt, public | 7.7 | 14.8 | 17.3 | 17.0 | 15.5 | 12.5 | 8.7 | 6.6 | 6.2 | 6.0 | 5.8 | 5.6 | 5.2 | 4.5 | 3.9 | 3.3 | 2.7 | 2.2 | 1.7 | 1.2 | 0.7 | 0.2 | 0.0 | 0.0 |
| **Memorandum items:** | | | | | | | | | | | | | | | | | | | | | | | | |
| Quota (SDR million) | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 | 82.60 |
| Gross domestic product (USD million) | 9,437 | 10,507 | 11,282 | 11,992 | 12,655 | 13,320 | 13,946 | 14,714 | 15,596 | 16,532 | 17,524 | 18,576 | 19,690 | 20,871 | 22,124 | 23,451 | 24,858 | 26,350 | 27,931 | 29,607 | 31,383 | 33,266 | 35,262 | 37,378 |
| Exports of goods and services (USD million) | 3,619 | 3,949 | 4,198 | 4,461 | 4,707 | 4,962 | 5,202 | 5,489 | 5,818 | 6,167 | 6,537 | 6,929 | 7,345 | 7,786 | 8,253 | 8,748 | 9,273 | 9,829 | 10,419 | 11,044 | 11,707 | 12,409 | 13,154 | 13,943 |
| Gross international reserves (USD million) | 1,451 | 1,565 | 1,695 | 1,790 | 1,877 | 1,977 | 2,045 | 2,168 | 2,298 | 2,436 | 2,582 | 2,737 | 2,901 | 3,075 | 3,260 | 3,455 | 3,663 | 3,882 | 4,115 | 4,362 | 4,624 | 4,901 | 5,195 | 5,507 |
| Government revenue (USD million) | 2,638 | 3,022 | 3,113 | 3,289 | 3,471 | 3,646 | 3,814 | 4,024 | 4,265 | 4,521 | 4,793 | 5,080 | 5,385 | 5,708 | 6,051 | 6,414 | 6,799 | 7,206 | 7,639 | 8,097 | 8,583 | 9,098 | 9,644 | 10,222 |
| External debt service, public (USD million) | 62 | 81 | 96 | 95 | 89 | 115 | 133 | 142 | 152 | 162 | 173 | 184 | 182 | 188 | 197 | 167 | 176 | 184 | 191 | 199 | 216 | 229 | 243 | 258 |
| Total external debt, public (USD million) | 710 | 920 | 1,071 | 1,122 | 1,187 | 1,231 | 1,258 | 1,308 | 1,362 | 1,411 | 1,455 | 1,492 | 1,534 | 1,571 | 1,598 | 1,650 | 1,692 | 1,727 | 1,755 | 1,733 | 1,883 | 1,996 | 2,116 | 2,243 |

Source: IMF staff calculations.

1/ Based on the projection as of April 27, 2023. Charges and interest calculations are preliminary. It includes prospective disbursements of precautionary SBA. Kosovo belongs to the RST interest Group C. Based on the RST rate of interest of 4.698 percent as of April 27, 2023.

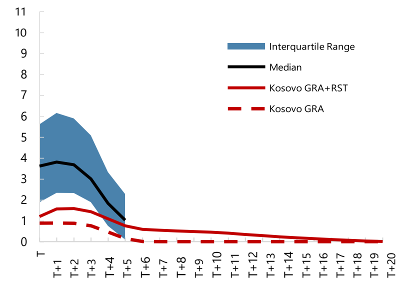
2/ Beginning in 2023 it includes disbursements and debt service of the new SBA arrangement. As the authorities intend to treat the SBA as precautionary, these disbursements would not occur in the baseline scenario.

## Table 8b. Kosovo: Capacity to Repay Indicators Compared to GRA-Only Borrowing Countries, All Programs

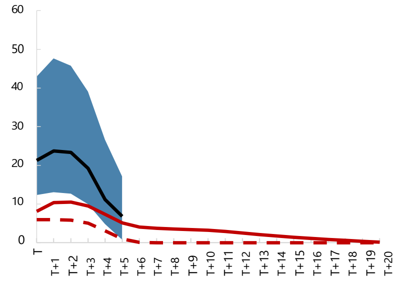
(In percent of the indicated variable)

### A. IMF Credit Outstanding

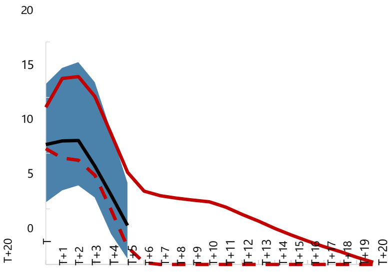
**Percent of GDP**




**Percent of Gross International Reserves**

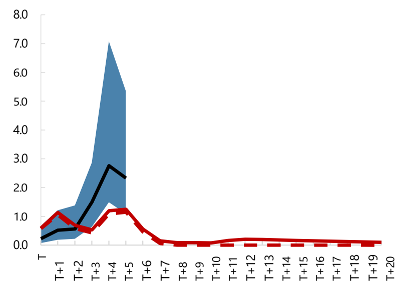


**Percent of Public External Debt**

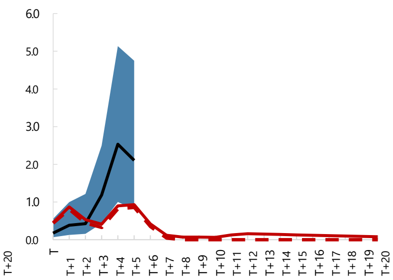


### B. Total Debt Service to the Fund

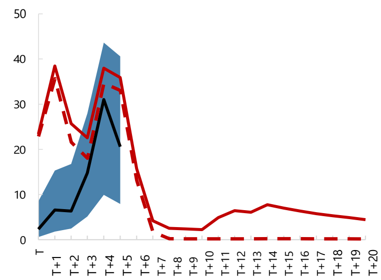
**Percent of Government Revenue**



**Percent of Exports of Goods and Services**

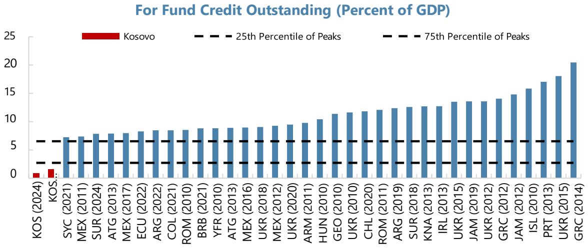


**Percent of Public External Debt Service**

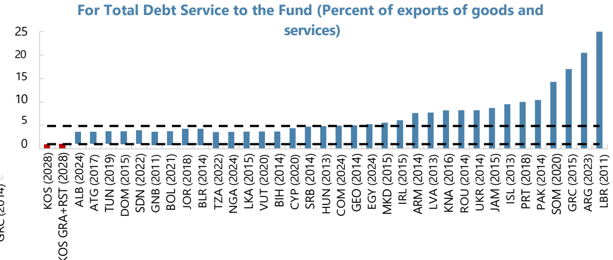


### C. Largest Peaks

**For Fund Credit Outstanding (Percent of GDP)**




**For Total Debt Service to the Fund (Percent of exports of goods and services)**



Sources: IMF Finance Department, World Economic Outlook.

Notes:
1) T = date of GRA arrangement approval.
2) Red lines/bars indicate the CtR indicator for the arrangement of interest.
3) The median, interquartile range, and comparator bars reflect all RFIs and UCT arrangements approved under the GRA (excluding blending arrangements) between 2008 and 2022.
4) Countries in the control group with multiple RFIs and/or GRA arrangements are entered as separate events in the database.
5) Comparator series is for GRA arrangements only and runs up to T+5.
6) Total Debt Service to the Fund consists of GRA, RST and SDR-related obligations. Reflects prospective payments, including for the current year.
7) All charts use data at the time of program approval with the exception of the chart on the right-hand side of section C, which uses ex-post data due to data limitations.
8) In section C charts, Kosovo is not among the 35 largest peaks and is illustrated for the purposes of comparison only.
9) Indicators compared to GRA only borrowing countries, all programs.

## Table 9. Kosovo: Proposed Quantitative Performance Criteria and Indicative Targets, 2023–24

(Millions of euros unless otherwise indicated)

| | 2023 | | | 2024 | | | |
|---|---|---|---|---|---|---|---|
| | June | September | December | March | June | September | December |
| | Prog. Target | Ind. Target | Prog. Target | Ind. Target | Ind. Target | Ind. Target | Ind. Target |
| **1. Quantitative performance criteria** | | | | | | | |
| Floor on the Overall Balance of the General Government 1/ | (113) | (169) | (225) | (58) | (116) | (174) | (232) |
| Floor on the Stock of General Government Deposits at CBK | 576 | 571 | 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 |
| **3. Indicative targets** | | | | | | | |
| Ceiling on Contingent Budget Allocations 3/ | 358 | 358 | 358 | 210 | 210 | 210 | 210 |
| Ceiling on Holdings of Government Debt by the CBK 2/ | 200 | 200 | 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: Proposed Prior Actions and Structural Benchmarks Under the SBA

| | Measure | Timeframe |
|---|---|---|
| **Proposed Prior Actions** | | |
| 1 | The ERO to adjust electricity tariffs so the electricity sector's financial flows remain balanced in 2023 with no blanket subsidies | Before end-April 2023 |
| **Proposed Structural Benchmarks** | | |
| ***Fiscal Governance*** | | |
| 1 | Government starts publishing publicly-owned enterprises' (POEs) annual financial reports; and quarterly data on POE performance. | June 2024 |
| 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 |
| 3 | Government starts publishing annual fiscal risk analysis together with budget submission to Parliament | November 2023 |
| 4 | Government approves new Customs Code | June 2023 |
| 5 | Tax administration agency (TAK) adopts new action plan to reduce informality | July 2023 |
| 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 |
| ***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 |
| 2 | Finalization of draft Banking Sector Law in line with FSSR recommendations | November 2023 |
| 3 | Finalization of circular clarifying roles and responsibilities of Central Bank Board based on Kosovo's legal framework | November 2023 |
| 4 | Submission to Parliament of Banking Sector Law in line with FSSR recommendations | January 2024 |

## Table 11. Kosovo: Reform Measures Under the RSF

| | Measure | Timeframe |
|---|---|---|
| **Proposed 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 |
| ***Expanding Greener Generation and Reducing Emissions (Energy Pillar 2)*** | | |
| RM2 | Government to finish technical proposal to add 100 – 150 MW of wind or solar PVPs capacity to Kosovo's energy matrix to start implementation in 2024 | March 2024 |
| 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 |
| RM4 | Working group presents to Cabinet draft report discussing implications of EU carbon price initiatives for Kosovo, using CPAT tool. | March 2024 |
| 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 |
| ***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 |
| ***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 |
| ***Crisis Preparedness and Monitoring Transition Risks*** | | |
| RM8 | Central Bank to issue regulation defining practices for banks to monitor and report data on exporting firms that may be exposed to transition costs related with CBAM implementation | June 2024 |

## Table 12. Proposed Schedule of Reviews and Purchases 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 Fund 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.

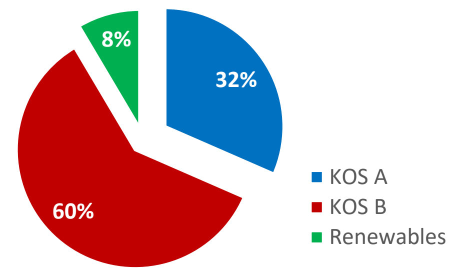
1/ The authorities indicated that they do not intend to make these purchases unless unexpected financing gaps arise.

# Annex I. Reducing Emissions and Pollution from Kosovo's Electricity Sector[1]

## A. Context: Electricity Generation as the Driving Force Behind Kosovo's Emissions and Pollution

1. **Kosovo's electricity generation relies heavily on coal-fired plants.** Lignite-based electricity generation represents more than 90 percent of supply with the rest produced by wind farms, hydro-generation and to a small extent, solar farms. Natural gas use is virtually inexistent, with no distribution network for residential or commercial consumers. Although interconnection with gas pipelines reaching Serbia and North Macedonia is possible, there is none. Accordingly, coal-based electricity is currently the sole option for Kosovo's baseload.

**Kosovo: Total Electricity Supply in 2022**
(Percent of Total)




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

2. **While Kosovo's renewable electricity generation was added recently, coal-based generation units have continued operating beyond their expected lifetime.** "Kosova A" units (A3–A5) are from the early 1970s and "Kosova B" units (B1–B2) from the early 1980s.[2] Heat rates, which measure the energy needed from lignite's combustion (in BTUs) to generate one KWh of electricity are high, resulting in an average efficiency ratio of around 30 percent.[3] This is 50–60 percent lower than achieved by more modern technologies and larger plants. Kosovo's plants' efficiency is also negatively impacted by lignite, which contains a larger share of water compared with other forms of coal.

**Kosovo: Electricity Generation Matrix**
(In megawatts)

| | Start of operation | Installed Capacity | Available Capacity | Filter Technology (Year) |
|---|---|---|---|---|
| Coal (Lignite) | | | | |
| Kosova A1 | 1962 | 56 | Decomissioned | |
| Kosova A2 | 1964 | 124 | Decomissioned | |
| Kosova A3 | 1970 | 200 | 135 | 2012 |
| Kosova A4 | 1971 | 200 | 135 | 2013 |
| Kosova A5 | 1975 | 210 | 135 | 2012 |
| Kosova B1 | 1983 | 339 | 260 | 1983 |
| Kosova B2 | 1984 | 339 | 260 | 1984 |
| Wind | 2020-22 | 140 | 140 | … |
| Hydro | | | | |
| Reservoir | 1979 | 35 | 35 | … |
| Run of the River | 2016-21 | 65 | 30 | … |
| Solar PVC | 2018-21 | 10 | 10 | … |
| Total 1/ | | 1538 | 1140 | |

Sources: Kosovar authorities and IMF staff calculations.
1/ Total installed capacity excludes decommissioned units.

3. **Inefficient coal-based generation is behind most of Kosovo's greenhouse gas (GHG) emissions.** While per capita emissions are still relatively low when compared with the EU 27's average, this mainly reflects the difference in per capita GDP

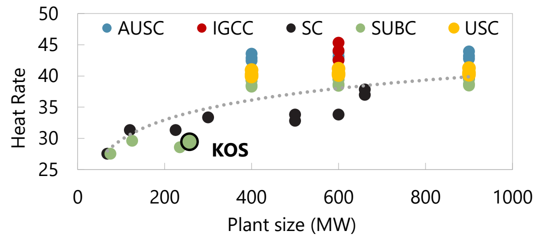
[1] Prepared by Gabriel Di Bella and Selim Thaci.

[2] Kosova A has two additional units (A1–A2) from the early 1960s. These units have stopped operating in the early 2000s.

[3] According to the IEA, the largest performance penalties apply for plants older than 29 years, for plants with capacity between 200–400 MW, and for lignite-fired plants.

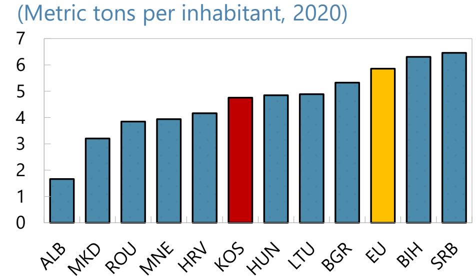
levels. In contrast, Kosovo's energy Intensity is about twice as large that of the EU 27. The use of lignite, the small scale of production units, and obsolescence all result in low efficiency rates and high emissions. Indeed, electricity generation represents about 70 percent of all Kosovo's GHG emissions.

**Coal-Fired Electricity Plant Efficiency**
(Heat Rate, percent)




Sources: IMF staff calculations; Sargent and Lundy (2009); Government of India (2013); and KEK.
Note: AUSC: Advanced Ultra Super Critical; USC: Ultra Super Critical; SC: Super Critical; SUBC: Sub Critical; IGCC: Integrated Gasification Combined Cycle

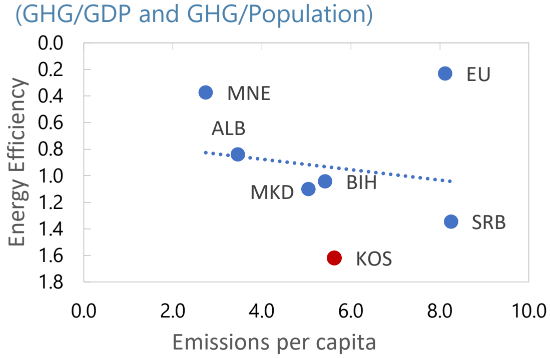
**Kosovo: CO2 Emissions**
(Metric tons per inhabitant, 2020)




Source: Global Carbon Budget 2022 and IMF staff calculations.
Note: CO2 emissions in 2020 were exceptionally low due to the COVID pandemic mobility restrictions

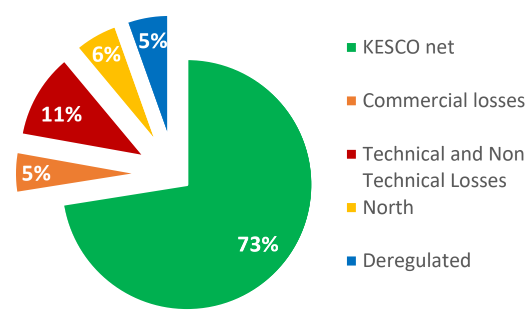
4. **Given its use for household and district heating in Pristina, electricity demand is highly seasonal.** This results in winter hourly loads that are about twice as large as those in the summer.[4] Demand in the "regulated" market accounts for about 90 percent of the load, while the "deregulated" market, composed by a few large firms that procure their electricity mostly through imports, accounts for another 5 percent; the remaining 5 percent is from "unregulated" consumers from four northern municipalities, from whom Kosovo has been unable to collect fees since the early 2000s. Moreover, around 11–12 pp of the regulated market are technical and non-technical losses of distribution, and another 5 pp are commercial losses. Overall, more than 20 percent of Kosovo's electricity consumption is either not billed or billed but not collected.

**W. Balkans: Energy Efficiency and Emissions**
(GHG/GDP and GHG/Population)




Sources: WDI Database, country official statistics and IMF staff calculations.

**Kosovo: Total Electricity Demand in 2022**
(Percent of Total)



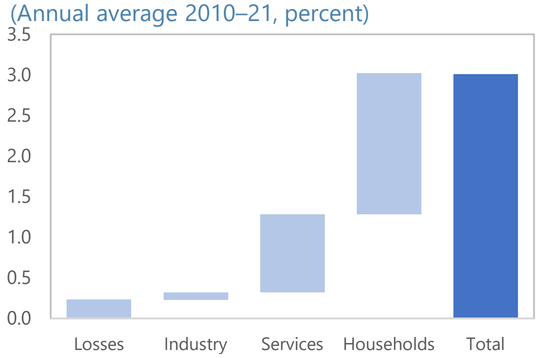

Sources: Kosovar authorities and IMF staff calculations

[4] Despite supply volatility on account of reliability issues of both Kosova A and B, this load pattern results in electricity imports in the winter and exports in the summer.

**5. Household consumption (especially for heating) and services have driven electricity demand growth over the last decade.** Household consumption constitutes around 60 percent of demand, followed by public and private services (20 percent), agriculture and industry (18 percent) and public lighting (2 percent). Electricity demand growth (3 percent per year on average over 2010–21) has lagged real GDP growth (around 4 percent), in large part due to a reduction in demand by the iron and steel industry. In contrast, household demand has grown at a rate in line with GDP and electricity demand by services has grown 50 percent faster than GDP. This, to a large extent, reflects poor demand efficiency, including of appliances and inadequate building insulation.

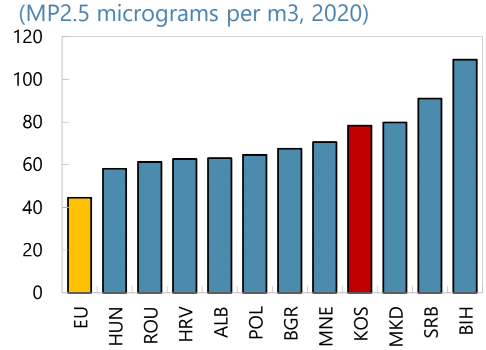
**6. Coal-based electricity generation is also a significant source of pollution.** The burning of lignite for heating is an important cause of largescale pollution and the source of dust (PM2.5), nitrogen oxides (NOx) and Sulphur dioxide (SO2) emissions. As both Kosova A and B are located near Pristina, the air quality in the capital is poor especially in the winter months, when the air quality index (AQI) has been, on average, on levels deemed unhealthy or worse.[5] Measurement of PM2.5 in and NOx emissions by Kosova B1 and B2 are many times above the levels required by the EU's large combustion plant (LCP) and industrial emissions directives (IED) and exceed the World Health Organization air quality guidelines.[6] This is the case as dust filters (electrostatic precipitators, ESPs) have not been replaced in Kosova B units since this plant started operation in the early 1980s.

**Kosovo: Electricity Demand Growth**
(Annual average 2010–21, percent)




Sources: Eurostat and IMF staff calculations.

**Kosovo: Air Pollution**
(MP2.5 micrograms per m3, 2020)




Sources: European Environment Agency and IMF staff calculations

## B. Kosovo's Energy Strategy (2023–32)

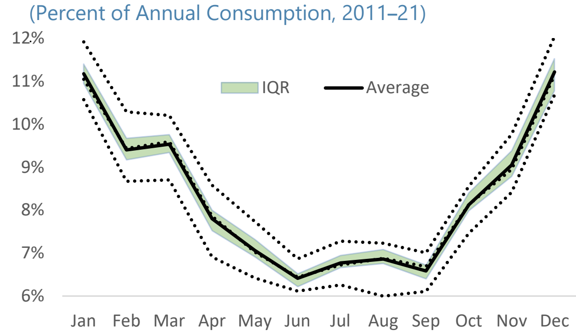
**7. Kosovo's energy strategy aims at achieving a greener electricity sector, integrated into the European market, ensuring energy security and affordability.** The strategy considers the current situation and challenges to achieve these long-term objectives, and to that end, it establishes five pillars:

[5] Household heating using firewood and coal also is a significant source of PM2.5 pollution.

[6] Dust from Kosova B1 is 243.31–389.34 mg/m3; from Kosova B2 is 560.3–896.0 mg/m3; this is far larger than the EU standard of 20 mg/m3; with respect to average NOx, Kosova B1: 809.67–674.27 mg/m3; Kosova B2: 843.2–846.9 mg/m3, compared with a EU standard of 200 mg/m3 (Instrument for Pre-Accession Assistance (IPA II, 2014–20).

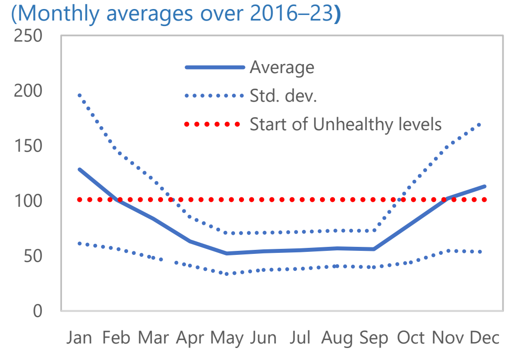
- **Pillar 1: Improving the System's Resilience and Tackling Pollution.** In addition to investment in new generation, achieving this objective will require generation that is more reliable, flexible, and efficient. The main targets for Pillar 1 are to reduce the duration and frequency of service interruptions; create reserve services (of at least 170 MW) using batteries; decrease transmission and distribution losses; and rehabilitate Kosova B1–B2 and Kosova A3–A5 to ensure more efficient and less-polluting 540 MW for baseload and 360 MW of reserve, while decommissioning Kosova A4. The rehabilitation of coal-based plants together with the increase of the share of renewable energy (Pillar 2) would result in a gradual decline in pollution to levels more in line with EU standards.

**Kosovo: Electricity Demand Seasonality**
(Percent of Annual Consumption, 2011–21)




Sources: Kosovar authorities and IMF Staff calculations.

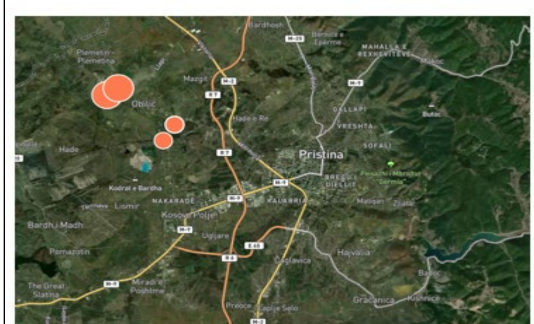
**Pristina: Air Quality Index**
(Monthly averages over 2016–23)




Sources: US EPA and IMF staff calculations.

- **Pillar 2: Expanding Greener Generation and Reducing Emissions.** Reducing lignite-based electricity generation will require to strongly expand renewable generation. While in the long-term the objective is to fully replace coal, the 10-year objective is to increase the share of renewable energy to 35 percent by 2031.[7] The increase in the share of renewables together with improved efficiency of demand, including through the gradual implementation of carbon pricing (Pillar 3) and rehabilitated coal-based generation (Pillar 1), would result in a reduction of emissions of 32 percent by 2031.[8]

**Kosovo: Location of Coal-Fired Power Plants**




Source: Kosovar authorities, MAPBOX, Comply or Close (https://www.complyorclose.org/countries/kosovo)

- **Pillar 3: Increasing Energy Efficiency.** Increased demand efficiency together with greener generation (Pillar 2) and rehabilitated coal-fired plants (Pillar 1) would lead to a less energy-intensive economy. Increased demand efficiency would be achieved by improving the energy

[7] The strategy aims at increasing renewable (mainly wind and solar) generation to 1600 MW by 2031 (280 MW in 2022).

[8] The implementation of carbon pricing would lead to the eventual integration of Kosovo in the EU's Emissions Trading System (ETS).

efficiency of buildings; and by promoting efficient cogeneration and efficient district heating systems.

- **Pillar 4: Strengthening Regional Cooperation and Market Functioning.** The implementation of the Energy Community Treaty would lead to a more integrated and competitive electricity market. Market integration with Albania, including through the full functioning of ALPEX both on the day-ahead and intraday electricity markets will increase energy security and facilitate the expansion and integration of renewable generation into Kosovo's grid. Increasing competition at the retail level would allow consumers to reward more efficient suppliers. Stronger competition would support affordability and competitiveness by optimizing the wholesale and reserve markets and making them more efficient.

- **Pillar 5: Protecting and Empowering Consumers.** Supporting affordability of energy bills is also part of the strategy. This would be achieved by protecting vulnerable consumers and preserving health and environment, for which reducing pollution will be key (Pillar 1). Advancing to a means-tested scheme for social tariffs and introducing new energy-related schemes for vulnerable consumers (e.g., energy efficiency, heating solutions, solar panels, among other) will contribute to achieve these objectives. Implementing energy-related awareness and information campaigns would also help.

**Kosovo: Cost of Pollution**
(Percent of GDP)

| | Variant | | |
|---|---|---|---|
| | Low | Base | High |
| Mortality | 0.72 | 2.02 | 3.40 |
| Respiratory Illneses | 0.09 | 0.14 | 0.19 |
| Hospital Visits | 0.02 | 0.03 | 0.04 |
| Restricted Activity Days | 0.06 | 0.09 | 0.13 |
| **Total** | **0.89** | **2.28** | **3.76** |

Source: Feasibility Study for the environmental and other measures in Kosovo B Thermal Power Plant (2017).

## C. The RSF: Supporting a Greener, Less Polluting, Energy Sector

8. **Kosovo faces various challenges related to climate change.** The country's heavy reliance on coal has led to high GHGs, with thermal power plants being the main contributors. Water scarcity, air pollution, and environmental degradation are also challenges. Climate change has also led to a decline in the country's agricultural productivity, as changing weather patterns affect crops and livestock. Additionally, Kosovo is vulnerable to natural disasters such as floods, landslides, and droughts, which are expected to become more frequent and intense due to climate change.

9. **Kosovo's reliance on coal is especially costly.** While costs from changed weather patterns on agriculture and infrastructure are likely significant, the direct and indirect costs of coal dependence (current and future) have been documented and will increase with time as the EU moves to carbon taxation of imports. Some of these costs include:

- **Health Costs.** The EU and the World Bank have estimated that high PM2.5 concentrations and other toxic emissions are among the leading causes of illness and death associated with respiratory, pulmonary and heart diseases, and are behind school and work absenteeism leading to annual costs of around 3 percent of GDP, in the form of the direct burden to the health system and forgone output.

- **Transition Costs.** Assuming a tax of €100 per tCO2e, staff estimates that the CBAM would lower Kosovo's exports to the EU by about 1–2 percent of GDP per year starting in 2026 depending on the coverage of the carbon taxes. In the absence of decisive efforts, Kosovo's brown energy system will also impact the country's competitiveness and its attractiveness as an FDI destination.

**Kosovo's Energy Strategy: Financing Needs (2023–2032)**
(Euro million) [1/]

| | Identified | Unidentified | Total |
|---|---|---|---|
| Public Sector [2/] | 100 | 300 | 400 |
| Donors | 710 | 700 | 1410 |
| Financing | 355 | 550 | 905 |
| Grants | 355 | 150 | 505 |
| Private Sector | 115 | 1135 | 1250 |
| Total | 925 | 2135 | 3060 |

Source: Kosovar authorities and IMF staff calculations and estimates.
1/ Figures are preliminary
2/ It includes POEs and the Budget

**10. The implementation of the energy strategy will require significant financing.** The energy strategy's cost estimate is about €3 billion over 10 years, out of which about 1/3 has already being identified. Additional private sector investment of about €1 billion would be required, especially in the areas of green electricity generation and distribution. Grants would cover around 15 percent of the cost, and a similar amount would be covered by budgetary and POE resources. Additional €0.5 billion would be required in the form of public debt, which would not represent a threat to sustainability given low public debt ratios.

**11. The RSF will support Kosovo's medium term energy strategy.** The program will insert itself as part of a set of ongoing efforts by other developments partners around Kosovo's medium term energy strategy, as well as Kosovo's "National Emissions Reduction Plan" (NERP). The RSF will support actions in every pillar of the energy strategy, helping Kosovo achieve its objectives, while strengthening and complementing the efforts of other partners.

**12. RSF financing will add to ongoing and planned financing by other development partners.** RSF disbursements would add to more than €500–600 million of already committed financing from donors (mainly in the form of grants) to be disbursed through 2027. Adding RSF resources and other public and private sector resources, this would represent about 30 percent of financing needs over the next 10 years as described in the government's energy strategy. The sustained implementation of reform measures as set by the proposed RSF program would provide clarity on the government objectives as well as on the energy sector's framework more generally, helping catalyze further financing from the private sector, while exploiting synergies with the work of other donors.

**Kosovo's Energy Strategy: Identified Financing**

| Objective | Identified Financing (Euro Million) | Financing Needs (Euro Million) | Main Development Partners Involved |
|---|---|---|---|
| **Improving the System's Resilience and Tackling Pollution** (Pillar 1) | Euro 250 million (Grants) | Euro 590 million | European Union, US MCC |
| **Expanding Greener Generation and Reducing Emissions** (Pillar 2) | Euro 355 million (Blend financing) | Euro 1500 million | KFW, EIB, IMF |
| **Increasing Energy Efficiency** (Pillar 3) | Euro 40 million (Grants) | Euro 500 million | European Union |
| **Strengthening Regional Cooperation and Market Functioning** (Pillar 4) | Euro 30 million (Grants) | Euro 320 million | US MCC |
| **Protecting and Empowering Consumers** (Pillar 5) | Euro 35 million (Grants) | Euro 150 million | European Union |

Sources: Kosovar authorities and IMF staff calculations. Figures are preliminary.

## Kosovo: RSF Reform Measures

| Objective | RST Reform Measures | Main Development Partners Involved |
|---|---|---|
| **Improving the System's Resilience and Tackling Pollution** (Energy Pillar 1) | KEK Budget Plan for 2024 to include allocation to secure the installation of filters in Kosova B2 (RM 1) | European Union; United States' Millenium Challenge Corporation |
| **Expanding Greener Generation and Reducing Emissions** (Energy Pillar 2) | Government to finish technical proposal delineating options and timeline to add 100 – 150 MW of wind or solar capacity to Kosovo's energy matrix (RM 2) and budget for 2024 to include allocation to start its implementation (RM 1); Submit to Parliament the Law on Renewable Energy (RM 3); Complete analysis on the impact of carbon pricing policies (RM 4); Ministry of Economy to adopt Administrative Instruction to launch first auction during 2023 for 100 MW of solar electricity generation (RM 5) | KFW, EIB, EBRD, IMF |
| **Increasing Energy Efficiency** (Energy Pillar 3) | Kosovo Energy Efficiency Fund Board to approve plan to increase energy efficiency of residential buildings (RM 6); | European Union, World Bank, US AID, GIZ |
| **Strengthening Regional Cooperation and Market Functioning** (Energy Pillar 4) | Government to implement actions conducive to the start of the day-ahead electricity market for Kosovo in ALPEX (RM 7) | United States' Millenium Challenge Corporation |
| **Protecting and Empowering Consumers** (Energy Pillar 5) | Securing Budget allocation for the Plan for Supporting Vulnerable and Socially Disadvantaged Consumers (RM 1) | European Union, World Bank |
| **Crisis Preparedness and Monitoring Transition Risks** | Monitoring and reporting data on firms exposed to CBAM (RM 8) | IMF, World Bank, EBRD |

Sources: Kosovar authorities and IMF staff.

# Annex II. Sovereign Risk and Debt Sustainability Analysis[1]

## A. Public Debt Background Coverage and Structure

1. **Kosovo's general government debt is well below the country's debt limit of 40 percent of GDP.**[2] The public debt ratio, which averaged around 16 percent of GDP in the pre-pandemic period between 2015–19, increased to 22.5 percent of GDP in 2020 because of the accommodative fiscal policies addressing the negative impacts of the COVID-19 pandemic. Fiscal consolidation over 2021–22 led to a decline of public debt to 20 percent of GDP at end-2022. In 2023, public debt is projected at 21 percent of GDP given the expected acceleration of PIP implementation, and new external budget support disbursements, including from the World Bank and the IMF.

2. **Kosovo's public debt consists of consolidated general government debt and guarantees.** PAK-related contingent liabilities (of about 2 percent of GDP) and POEs gross debt (estimated at around 5 percent of GDP) are not included.[3] However, as the central government on-lends to POEs, general government debt already includes about 50 percent of POE debt. Domestic debt (12.4 percent of GDP at end-2022) constitutes the largest portion of public debt. External public debt is largely owed to multilaterals (IDA, EIB, EBRD, and the IMF), and denominated in SDRs and euro. Around 99 percent of public debt has a maturity of 2 years or more (Figures 1 and 2).

## B. Assumptions and Realism Assessment

3. **Macroeconomic Assumptions.** GDP growth declined to 3.5 percent in 2022, from about 11 percent in 2021, and it is forecast at about 4 percent in 2023. Inflation is forecast to decline to around 5.5 percent in 2023 (from more than 11 percent in 2022), given the baseline assumption of lower commodity prices. The primary fiscal deficit is expected to increase to 1.8 percent of GDP in 2023 (from about balance in 2022), and to average around 1.3 percent through the medium-term.

4. **Financing Assumptions.** Gross financing needs in 2022 were covered by external project financing and by rollover of maturing domestic debt. Government deposits at CBK at end-2022 (6.5 percent of GDP) include those of the Privatization Agency of Kosovo (PAK, 1.9 percent of GDP), earmarked deposits, including of municipalities (1 percent of GDP), and freely-available cash (3.2 percent of GDP). Financing in the medium-term will come from external budget support, further net domestic placements (of around 1.7–1.8 percent of GDP per year), and external project financing.

5. **Realism Assessment.** The forecast track report of debt drivers, examining the risks to projections that might arise from past forecast errors, suggests persistent forecast pessimism in the

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[1] Prepared by Ezgi Ozturk.

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

[3] PAK-related contingent liabilities reflect potential claims related to the privatization POEs.

past and would not signal a risk to projections. The realism tools indicate that projected 3-year debt reduction and fiscal consolidation fall under the bottom quartile of the distribution among peer emerging market economies with the same program status. The projected change in public debt increase over the next 5 years due to upward contributions from primary deficit and stock-flow adjustment, partially offset by downward contributions from GDP growth. Projected growth is in line with potential but slightly lower than the 10-year average.

## C. Baseline Projections

**6. Under the current baseline projections, public debt is projected to be around 29 percent of GDP by end 2032, up from 19.9 percent of GDP in 2022** (Table 2). The public debt ratio is projected to be around 21 percent in 2023, and moderately increase and average around 23.5 percent of GDP over the medium-term (6-year horizon), and around 26.5 percent of GDP over the long-term (15-year horizon). This increase mainly reflects the implementation of the fiscal rule deficit ceiling, which allows for the accommodation of externally-financed investment provided public debt is below 30 percent of GDP. Public debt held by domestic creditors is projected to reach 17 percent of GDP by 2028 and 22 percent of GDP by 2038, while external public debt is projected to be 9 percent and 7 percent of GDP by 2028 and 2038, respectively. Total government deposits at CBK (including deposits from municipalities and PAK) are projected to decline from 6.3 percent of GDP in 2023 to around 6 percent of GDP in 2028, and further to close to 5 percent of GDP by 2038.

**7. Gross financing needs remain below the sustainability threshold, though vulnerabilities linked with the lack of market access remain.** Gross financing needs (GFNs) in 2023–28 is projected to be around 5–6 percent of GDP. Vulnerabilities remain concentrated in the narrow base of the domestic debt stock. As of end-2022, commercial banks held 24 percent of domestic debt (down from 36 percent at end-2019), whereas KPST's holdings increased to around 50 percent (up from 38 percent at end-2019); individuals, private businesses and insurance companies jointly held around 8 percent, with the rest held by the CBK (18 percent). Sticking to the fiscal rule and continue to increase the average maturity of domestic debt should contribute to manage vulnerabilities arising from the absence of external market access. While there is still room for KPST to increase government debt holdings, the government should aim to diversify the investor base. Obtaining a rating for government securities from a reputable international rating agency would contribute to this end. Keeping CBK holdings of government securities unchanged and limiting KPST's exposure to government securities to no more than 30 percent of its assets is also important going forward.

## D. Medium-Term Risk Analyses

**8. The medium-term risk assessment of the staff is low consistent with the average mechanical signal, despite moderate risk is signaled by the fan chart tool** (Figure 4).

- **GFN Financeability:** The mechanical signal provided by the GFN financeability, which measures medium-term liquidity risks, indicates a low risk with the score of 4.5 (below the 7.6 low-risk threshold). Medium-term GFN to GDP is expected to stabilize at 5–6 percent of GDP, reflecting increased capital spending financed with external sources. But the change in bank claims in stress will remain limited.

- **Fan Chart:** The Fan chart tool provides a moderate mechanical signal, with the score at 1.6 (above the 1.1 low-risk threshold, and below 2.08 high-risk threshold), reflecting mainly a higher probability calculated for debt non-stabilization, which is due to the current low level of debt-to-GDP ratio (around half of the 40-percent-of-GDP ceiling). The debt-to-GDP ratio will increase but will remain well below the 40 percent of GDP threshold over the forecast horizon. Therefore, the increase of debt-to-GDP is not expected to lead to a higher risk in the medium-term.

- **Stress Tests:** Triggered stress tests help capture specific risks facing Kosovo that are not fully covered by the fan chart and GFN tools. In a standard stress scenario, which assumes the real GDP growth to decline by 1 pp for 2 years in 2024–25, interest rates rise by up to 200 bps, and a depreciation equal to the largest of the last 10 years (19.8 percent), financing needs would rise around 3 pp of GDP by 2028 but remain below the 2020 ratios. A commodity price shock is assumed to increase the expenditures-to-GDP ratio by 0.9 pp for each 10-pp increase in fuel prices starting the second year of the projections. Commodity price test generates an initial decline in debt, followed by an upward debt trajectory above 50$^{th}$ percentile but below 75$^{th}$ percentile of the fan chart. Exchange rate stress test is applied to have an internal devaluation shock equal to the depreciation shock by lowering the GDP deflator in equal steps for the six years of the projection horizon. Exchange rate stress test leads to a decline in debt for the entire horizon, while the financing needs remain similar to the baseline.

## E. Long-Term Risk Analyses

9. **Long-term risk is assessed to be moderate** (Figure 5). The large amortizations module suggests that both GFN-to-GDP ratio and amortization-to-GDP ratio do not exceed the 10-year historical average by more than one standard deviation in any of the year of the long-term projection. Under the baseline, which assumes constant t+5 values to extrapolate primary deficits, GFN-to-GDP and public debt-to-GDP increase gradually, and by 2052 reach to 6 percent of GDP and 29 percent of GDP, respectively.

10. **While building resistance to the effects of climate change would not significantly impact debt sustainability, reducing emissions would impair it in the long run.** For adaptation and mitigation, an additional expenditure of 0.5 and 1 pp of GDP, respectively, is added to the baseline expenditures under the customized scenario. With the adaptation costs, the debt ceiling of 40 percent of GDP is reached at the very end of the 30-year forecast horizon, whereas with the mitigation costs, the debt ceiling is reached within the 20-year forecast horizon, reflecting the additional cost assumed for mitigation. These two costs are significantly lower than the standardized scenario. Under the standardized scenario, additional cost for adaptation is 1.3 percent of GDP for relatively low climate risk countries, and additional cost for mitigation is 5.7 percent of GDP per year for countries with carbon emissions from fuel combustion between 200–750 Mt.

11. **To understand the impact of aging population on long-term fiscal costs, pension liabilities and healthcare costs on budget are analyzed.**

- **Potential pension liabilities would not significantly impact debt sustainability in the next 30 years but might have significant impacts in 100 years' time.** In this analysis, only potential pension liabilities associated with basic pension payments (pillar zero) are included as Kosovo's pension system is a defined contribution system managed by a private pension fund (KPST). In 2022, total pension benefits paid accounted for approximately 2 percent of GDP, while pension contributions were around 2.7 percent of GDP. Additionally, the pension system's asset reserves were roughly 27 percent of GDP. Based on these figures, there is currently no need for a permanent adjustment to the pension system to maintain positive pension assets for the next 30 years. However, to ensure positive pension assets for the next 50 years and 100 years, an adjustment of 1.72 percentage points and 4.56 percentage points of GDP per year, respectively, would be necessary. Staff intends to undertake a deeper analysis of pension liabilities during the life of the program.

- **Demographic changes are causing healthcare expenditures to rise, which could have a significant impact on debt sustainability in the long run.** As of 2022, healthcare expenditures accounted for approximately 3.6 percent of GDP. Furthermore, healthcare expenditures per capita for citizens aged over 65 years old were roughly four times higher than those for the population aged between 20–64 years old, reflecting the cost of old-age healthcare. Population projections indicate that the population aged over 65 will make up approximately 17 percent of the total population by 2038, compared to 10 percent in 2022. As a result, healthcare costs are expected to increase, which would cause the GFN-to-GDP ratio to rise from 5 in 2029 to 9.5 in 2052. In a scenario where spending per capita increases by 0.6 percent due to excess cost growth (ECG) in addition to the demographic changes, the GFN-to-GDP ratio could reach as high as 12 by 2052. Based on these factors, the total public debt-to-GDP ratio is projected to exceed the 40 percent threshold at the end of a 25-year forecast horizon when only healthcare expenses due to demographic changes are considered. However, if excess cost growth is also considered, the threshold is expected to be exceeded five years earlier, at the end of a 20-year forecast horizon.

## F. Public Debt Sustainability

**12. Public debt is assessed as sustainable.** General government debt to GDP ratio has remained well below the debt ceiling, and it did not get close to the threshold despite significant shocks, such as the COVID-19 crisis in 2020, and the cost-of-living shock in 2022. Under the current baseline projections, debt-to-GDP will remain well below the debt ceiling over the medium-and-long-term horizons. Moreover, stress tests indicate that the public debt-to-GDP ratio will remain at manageable levels over the forecast horizon.

## G. Overall Risk of Sovereign Debt Stress

**13. Overall risk of sovereign debt stress is assessed to be low** (Table 1). As both medium-and-long-term risks are assessed to be low, it is appropriate for the overall risk to be assessed as low. Although public-debt-to GDP ratio is expected to increase, it will be below the threshold, and the regional averages. The increase in debt-to-GDP ratio reflects the increasing financing options in the future, as well as continuous prospective IFI financial support.

## H. External Debt Sustainability Analysis

**14. The external debt-to-GDP ratio rose by 1 percent of GDP to 38.2 percent of GDP in 2022 but it is expected to decline gradually in the projection period.** While before the pandemic, the external debt-to-GDP ratio showcased a declining trend (a decline of 2.8 pp over 2015–19), it increased by 7 pp of GDP over 2019–22, in part due to the increase of public external debt to support pandemic-related measures in 2020, long-term debt (partly financed by EBRD) to the energy sector, FDI intercompany lending, and trade credits. The external debt-to-GDP ratio is projected to gradually decline to around 32 percent of GDP by 2028 (from 38 percent of GDP in 2022) as the current account deficit narrows and the need for private external debt financing declines (Figure 6 and Table 4).

### Annex II. Table 1. Kosovo: Risk of Sovereign Stress

| Horizon | Mechanical Signal | Final Assessment | Comments |
|---|---|---|---|
| **Overall** | … | Low | The overall risk of sovereign stres is low, reflecting low levels of vulnerability in the medium-term horizon. |
| **Medium term** | Low | Low | Medium-term risks are assessed as low consistent with a mechanical low risk signal due to low financeability mechanical signal, and against a moderate signal for fanchart indicating higher probability of debt non-stabilization, whcih is due to very low level of debt-to-GDP (around half of 40 percent of GDP ceiling). The debt-to-GDP ratio will increase but will still remain well below the 40 percent threshold over the forecast horizon. Therefore, the increase of debt-to-GDP will not lead to non-stabilization. |
| Fanchart | Moderate | … | |
| GFN | Low | … | |
| Stress test | … | … | |
| **Long term** | … | Moderate | Long-term risks are moderate despite emigration trends. Debt would increase monotonically rather than stabilize. The population in Kosovo is still young and dynamic. Age-related expenditures on health and social security feed into debt dynamics, but the risk that they create is low. |
| **Sustainability assessment** | | Sustainable | Public debt-to-GDP ratio is projected to stabilize at about 30 percent of GDP by 2038, well below the debt ceiling of 40 percent of GDP. |
| **Debt stabilization in the baseline** | | | No |

**DSA summary assessment**

Commentary: Kosovo is at a low overall risk of sovereign stress and debt is sustainable. Debt is expected to rise over the projection period but it will remain well below the debt ceiling. Medium-term liquidity risks as analyzed by the GFN Financeability Module are low. Over the longer run, Kosovo should address the impacts of emigration and population aging on the social security fund.

Source: IMF staff calculations.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fical adjustment and new financing.

## Annex II. Figure 1. Debt Coverage and Disclosure

### Kosovo: Debt Coverage and Disclosures

**1. Debt coverage in the DSA: 1/**

| CG | GG | NFPS | CPS | Other |
|---|---|---|---|---|
| | ✓ (chosen) | | | |

**1a. If central government, are non-central government entities insignificant?** n.a.

**2. Subsectors included in the chosen coverage in (1) above:**

| | | Subsectors captured in the baseline | Inclusion | Comments |
|---|---|---|---|---|
| CPS / NFPS / GG: expected / CG | 1 | Budgetary central government | Yes | |
| CPS / NFPS / GG: expected / CG | 2 | Extra budgetary funds (EBFs) | No | No EBFs in Kosovo. |
| CPS / NFPS / GG: expected / CG | 3 | Social security funds (SSFs) | No | No public SSFs in Kosovo. |
| CPS / NFPS / GG: expected | 4 | State governments | No | Kosovo is a unitary country. |
| CPS / NFPS / GG: expected | 5 | Local governments | Yes | |
| CPS / NFPS | 6 | Public nonfinancial corporations | Yes | |
| CPS | 7 | Central bank | Yes | |
| CPS | 8 | Other public financial corporations | No | No public financial corporations. |

**3. Instrument coverage:**

| Currency & deposits | Loans | Debt securities | Oth acct. payable 2/ | IPSGSs 3/ |
|---|---|---|---|---|
| ✓ | ✓ | ✓ | ✓ | ✓ |

**4. Accounting principles:**

| Basis of recording | | Valuation of debt stock | | |
|---|---|---|---|---|
| Non-cash basis 4/ | Cash basis (chosen) | Nominal value 5/ (chosen) | Face value 6/ | Market value 7/ |

**5. Debt consolidation across sectors:**

| Consolidated | Non-consolidated |
|---|---|
| | ✓ (chosen) |

**Color code:** Chosen coverage | Missing from recommended coverage | Not applicable

**Reporting on intra-government debt holdings**

| Issuer \ Holder | Budget. central govt | Extra-budget. funds | Social security funds | State govt. | Local govt. | Nonfin. pub. corp. | Central bank | Oth. pub. fin corp | Total |
|---|---|---|---|---|---|---|---|---|---|
| 1 Budget. central govt | | | | | | 0 | 197.24 | | 197.24 |
| 2 Extra-budget. funds | | | | | | | | | 0 |
| 3 Social security funds | | | | | | | | | 0 |
| 4 State govt. | | | | | | | | | 0 |
| 5 Local govt. | | | | | | | | | 0 |
| 6 Nonfin pub. corp. | | | | | | | | | 0 |
| 7 Central bank | | | | | | | | | 0 |
| 8 Oth. pub. fin. corp | | | | | | | | | 0 |
| Total | 0 | 0 | 0 | 0 | 0 | 0 | 197.24 | 0 | 197.24 |

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.

2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.

3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.

4/ Includes accrual recording, commitment basis, due for payment, etc.

5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).

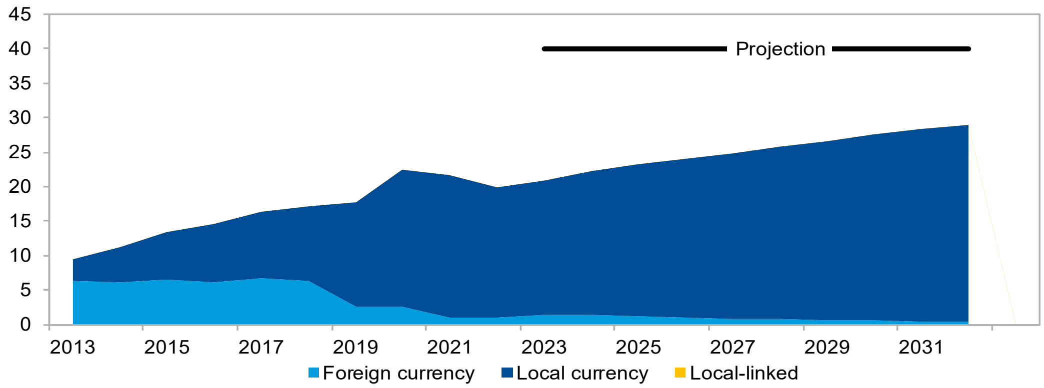
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.

7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

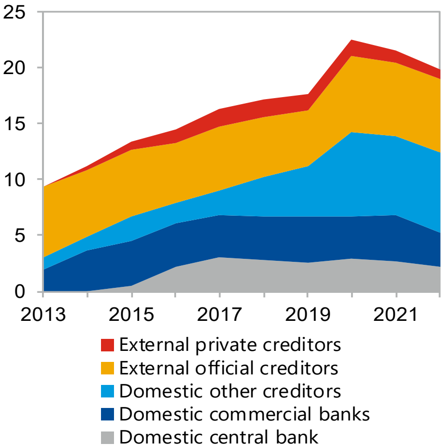
## Annex II. Figure 2. Kosovo: Public Debt Structure Indicators

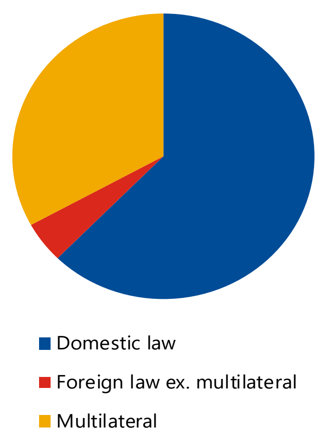
### Kosovo: Public Debt Structure I+AH4:AQ47ndicators

Debt by Currency (Percent of GDP)




Note: The perimeter shown is general government.

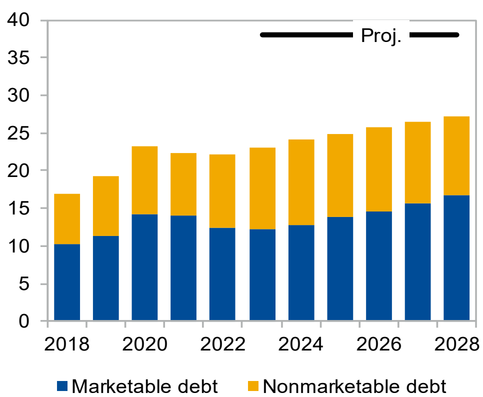



Note: The perimeter shown is general government.

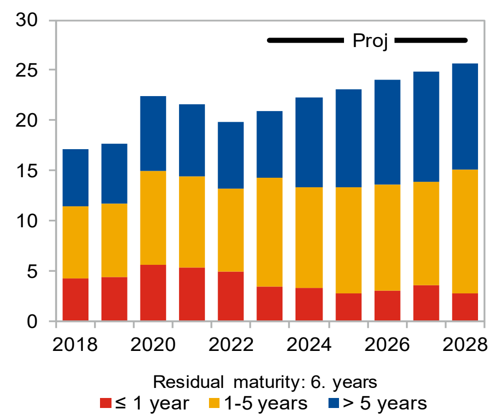
Note: The perimeter shown is general government.

**Debt by Instruments (Percent of GDP)**



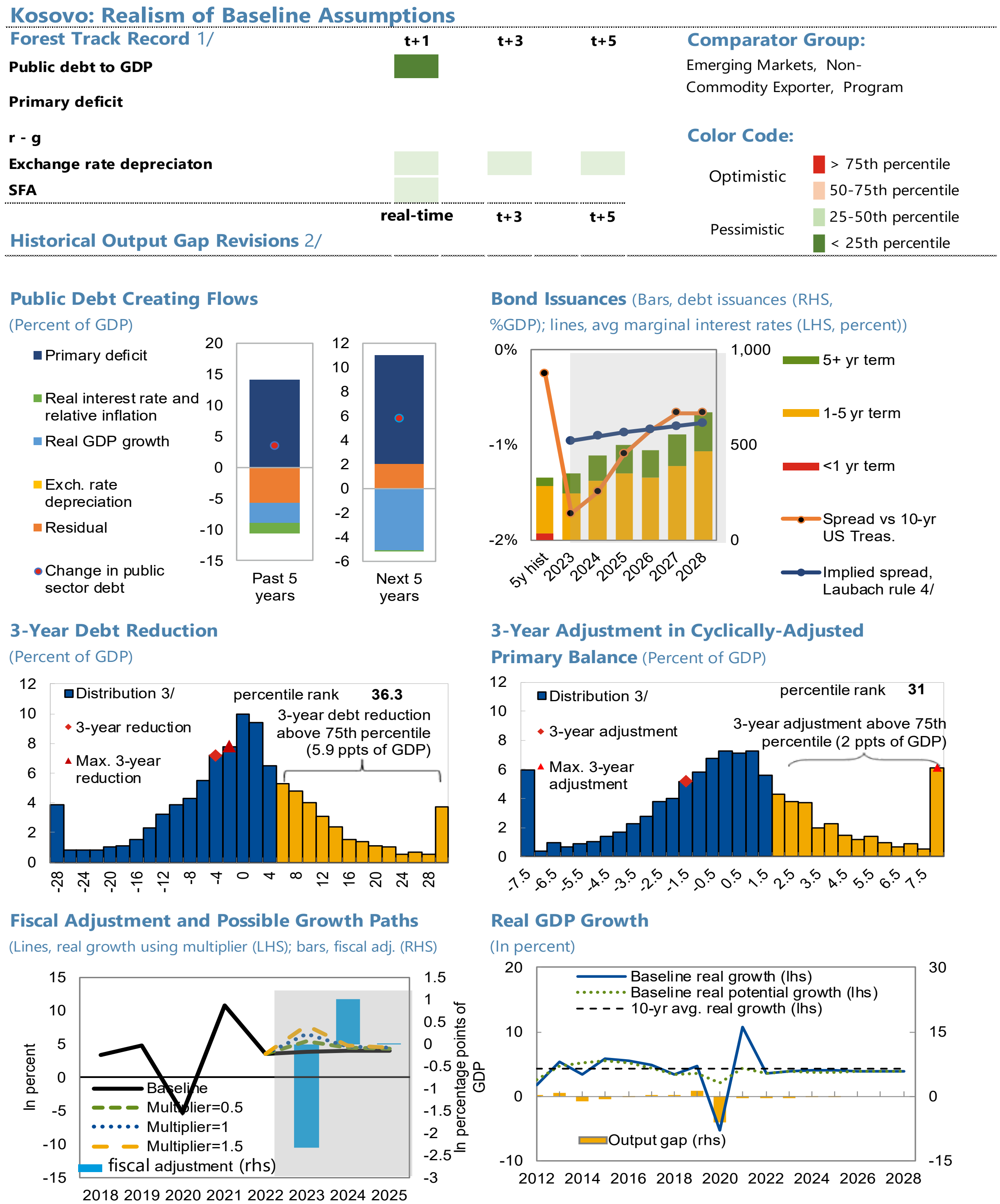

Note: The perimeter shown is general government.

**Public Debt by Matrurity (Percent of GDP)**




Note: The perimeter shown is general government.

## Annex II. Figure 3. Kosovo: Realism of Baseline Assumptions




Source: IMF staff calculations.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

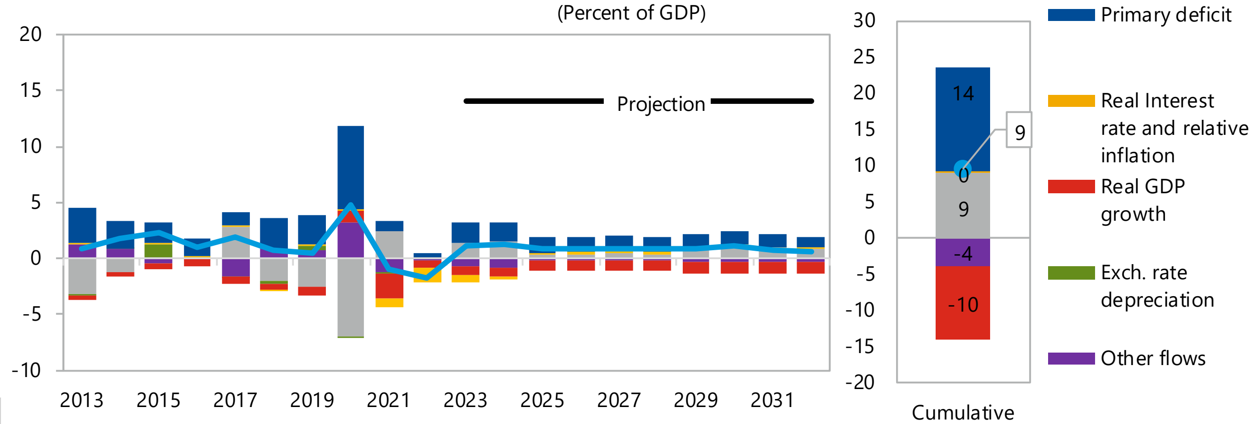
## Annex II. Table 2. Kosovo: Baseline Scenario

(Percent of GDP unless indicated otherwise)

| | Actual | Medium-Term Projection | | | | | | Extended Projection | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 |
| Public debt | 19.9 | 21.0 | 22.3 | 23.2 | 24.0 | 24.9 | 25.7 | 26.6 | 27.7 | 28.4 | 29.0 |
| Change in public debt | -1.7 | 1.1 | 1.3 | 0.9 | 0.9 | 0.9 | 0.8 | 0.9 | 1.1 | 0.8 | 0.6 |
| Contribution of identified flows | -1.6 | -0.3 | -0.2 | 0.5 | 0.5 | 0.5 | 0.4 | 0.0 | -0.1 | -0.2 | -0.3 |
| Primary deficit | 0.3 | 1.8 | 1.7 | 1.5 | 1.3 | 1.3 | 1.3 | 1.2 | 1.1 | 1.1 | 1.0 |
| Noninterest revenues | 27.9 | 28.7 | 27.6 | 27.4 | 27.4 | 27.4 | 27.3 | 27.3 | 27.3 | 27.3 | 27.3 |
| Noninterest expenditures | 28.3 | 30.6 | 29.2 | 29.0 | 28.8 | 28.7 | 28.6 | 28.6 | 28.5 | 28.4 | 28.3 |
| Automatic debt dynamics | -1.9 | -1.4 | -1.1 | -0.8 | -0.6 | -0.6 | -0.7 | -0.8 | -0.9 | -0.9 | -1.0 |
| Real interest rate and relative inflation | -1.3 | -0.7 | -0.3 | 0.0 | 0.3 | 0.3 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 |
| Real interest rate | -1.3 | -0.7 | -0.3 | 0.0 | 0.3 | 0.3 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 |
| Relative inflation | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Real growth rate | -0.7 | -0.7 | -0.8 | -0.9 | -0.9 | -0.9 | -0.9 | -0.9 | -1.0 | -1.0 | -1.0 |
| Real exchange rate | 0.1 | ... | ... | ... | ... | ... | ... | ... | ... | ... | ... |
| Other identified flows | 0.0 | -0.7 | -0.8 | -0.2 | -0.2 | -0.2 | -0.2 | -0.4 | -0.4 | -0.3 | -0.3 |
| Contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other transactions | 0.0 | -0.7 | -0.8 | -0.2 | -0.2 | -0.2 | -0.2 | -0.4 | -0.4 | -0.3 | -0.3 |
| Contribution of residual | -0.1 | 1.3 | 1.5 | 0.4 | 0.3 | 0.4 | 0.4 | 0.8 | 1.2 | 1.0 | 0.9 |
| Gross financing needs | 3.7 | 5.4 | 5.4 | 5.2 | 4.8 | 5.2 | 5.8 | 5.0 | 5.5 | 5.4 | 5.5 |
| of which: debt service | 3.4 | 3.6 | 3.8 | 3.7 | 3.4 | 3.9 | 4.5 | 3.8 | 4.3 | 4.4 | 4.5 |
| Local currency | 3.2 | 3.5 | 3.6 | 3.4 | 3.2 | 3.8 | 4.4 | 3.7 | 4.3 | 4.3 | 4.4 |
| Foreign currency | 0.3 | 0.1 | 0.2 | 0.3 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Memo: | | | | | | | | | | | |
| Real GDP growth (percent) | 3.5 | 3.8 | 4.0 | 4.0 | 3.9 | 3.8 | 3.8 | 3.8 | 3.8 | 3.8 | 3.8 |
| Inflation (GDP deflator; percent) | 8.7 | 6.4 | 4.1 | 2.6 | 2.0 | 1.9 | 1.9 | 2.5 | 2.5 | 2.5 | 2.5 |
| Nominal GDP growth (percent) | 12.5 | 10.4 | 8.2 | 6.7 | 5.9 | 5.8 | 5.8 | 6.0 | 6.0 | 6.0 | 6.0 |
| Effective interest rate (percent) | 2.0 | 2.6 | 2.6 | 2.7 | 3.1 | 3.1 | 3.0 | 2.9 | 2.9 | 2.8 | 2.8 |

### Contribution to Change in Public Debt

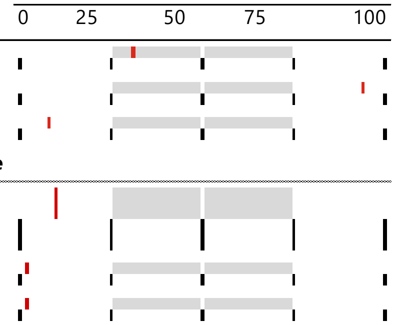
(Percent of GDP)



## Annex II. Figure 4. Kosovo: Medium-Term Risk Analysis
## Debt Fanchart and GFN Financeability Indexes
(Percent of GDP unless otherwise indicated)

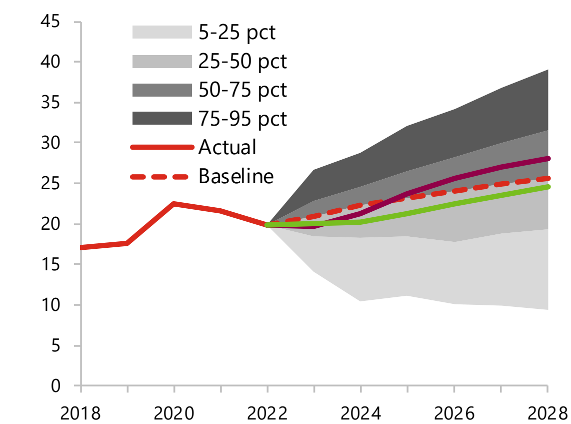
| Module | Indicator | Value | Risk index | Risk signal |
|---|---|---|---|---|
| Debt fanchart module | Fanchart width | 29.6 | 0.4 | ... |
| | Probability of debt not stabilizing (pct) | 97.7 | 0.8 | ... |
| | Terminal debt level x institutions index | 17.4 | 0.4 | ... |
| | **Debt fanchart index** | **...** | **1.6** | **Moderate** |
| GFN finance-ability module | Average GFN in baseline | 5.3 | 1.8 | ... |
| | Bank claims on government (pct bank assets) | 4.1 | 1.3 | ... |
| | Chg. in claims on govt. in stress (pct bank assets) | 2.5 | 0.8 | ... |
| | **GFN financeability index** | **...** | **4.0** | **Low** |

Adv. Econ., Non-Com. Exp, Program

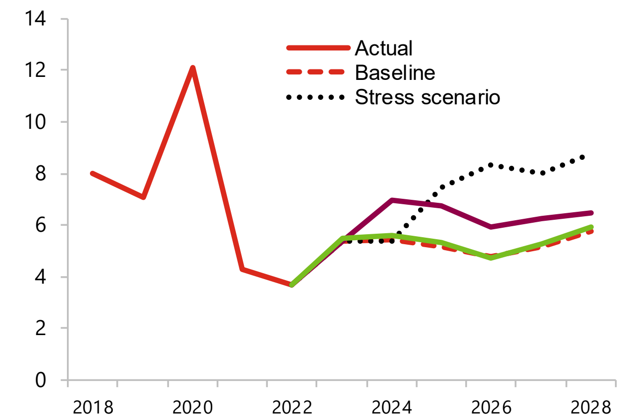



Legend: Interquartile range Kosovo

### Final Fanchart (Pct of GDP)



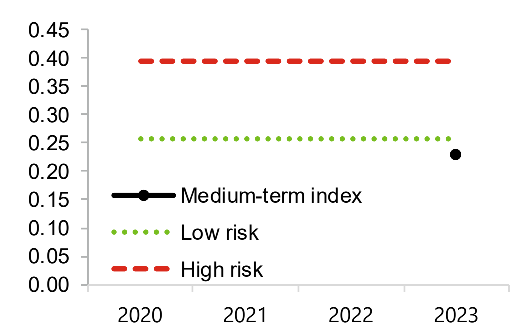

### Gross Financing Needs (Pct of GDP)




Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

### Medium-Term Index
(Index number)




### Medium-Term Risk Analysis

| | Low risk threshold | High risk thresholod | Weight in MTI | Normalized level |
|---|---|---|---|---|
| Debt fanchart index | 1.1 | 2.1 | 0.5 | 0.4 |
| GFN finaceability index | 7.6 | 17.9 | 0.5 | 0.1 |
| Medium-term index (MTI) | 0.3 | 0.4 | ... | 0.2, Low |

Prob. of missed crisis, 2023-2028 (if stress not predicted): 9.1 pct.

Prob. of false alarm, 2023-2028 (if stress predicted): 48.9 pct.

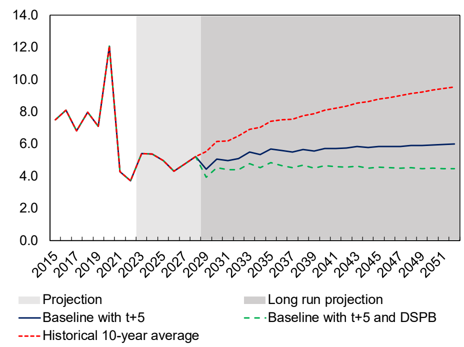
## Annex II. Figure 5. Long-Term Risk Analysis

### Large Amortization

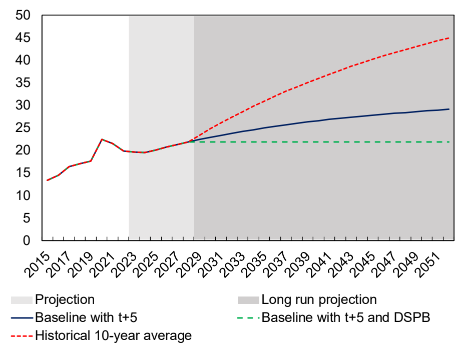
| Projection | Variable | Risk Indication |
|---|---|---|
| Medium-term extrapolation | GFN-to-GDP ratio | |
| | Amortization-to-GDP ratio | |
| | Amortization | |
| Medium-term extrapolation with debt stabilizing | GFN-to-GDP ratio | |
| | Amortization-to-GDP ratio | |
| | Amortization | |
| Historical average assumptions | GFN-to-GDP ratio | |
| | Amortization-to-GDP ratio | |
| | Amortization | |

| Overall Risk Indication | |
|---|---|

GFN-to-GDP ratio

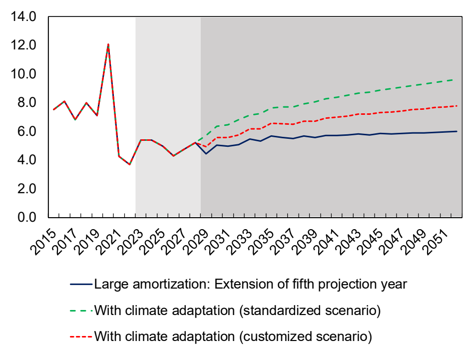



Total public debt-to-GDP ratio

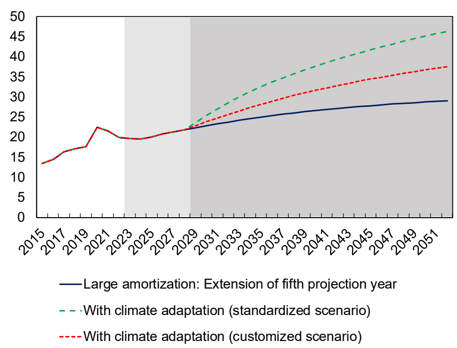



### Climate Change: Adaptation

GFN-to-GDP ratio

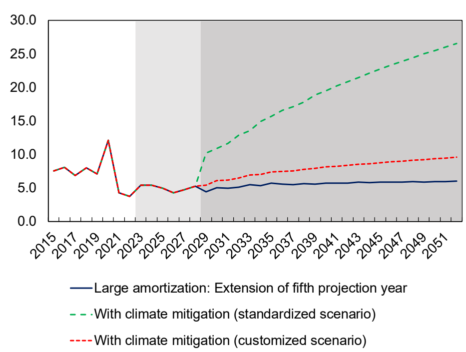



Total public debt-to-GDP ratio

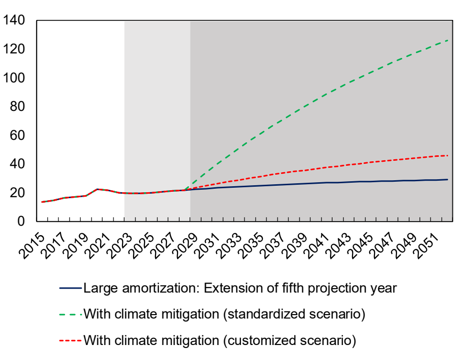



### Climate Change: Mitigation

GFN-to-GDP ratio




Total public debt-to-GDP ratio

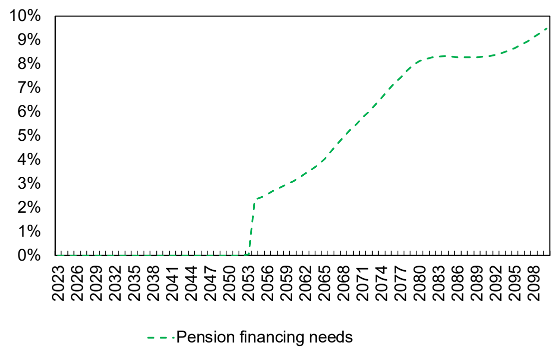


## Annex II. Figure 5. Long-Term Risk Analysis (Concluded)

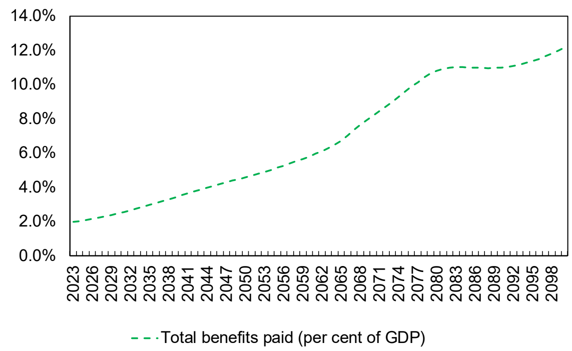
### Demographics: Pension

| Permanent adjustment needed in the pension system (pp of GDP per year) | To keep pension assets positive for: | | |
|---|---|---|---|
| | 30 years | 50 years | Until 2100 |
| | 0.00% | 1.72% | 4.56% |

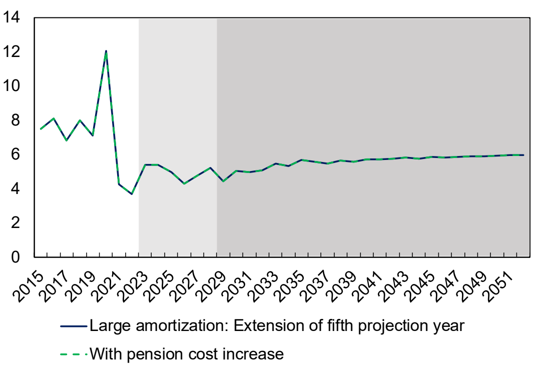
**Pension Financing Needs**



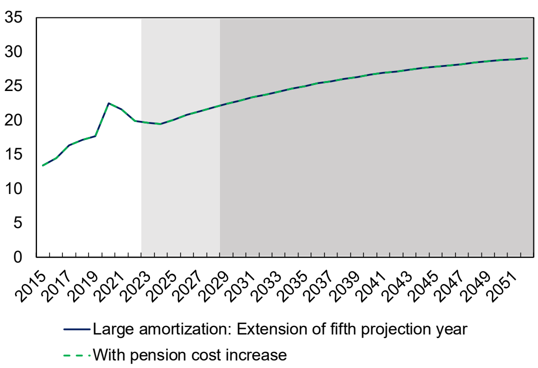

**Total benefits paid**




**GFN-to-GDP ratio**

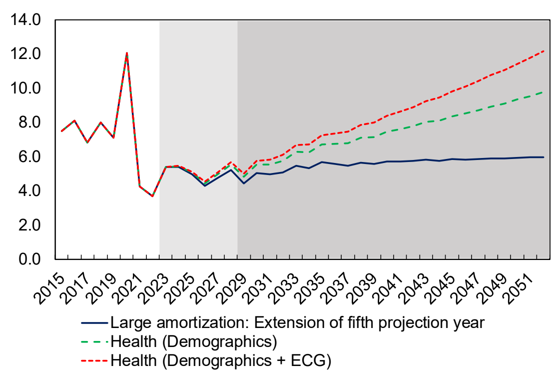



**Total public debt-to-GDP ratio**

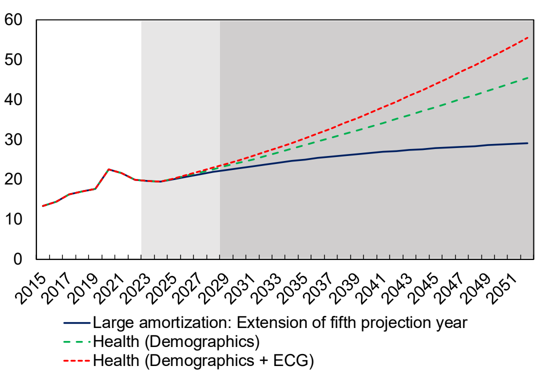



### Demographics: Healthcare

**GFN-to-GDP ratio**




**Total public debt-to-GDP ratio**



## Annex II. Table 3. Decomposition of Public Debt and Debt Service by Creditor 2022–24[1]

| | Debt Stock (End of period) | | | Debt Service | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2022 | | | 2022 | 2023 | 2024 | 2022 | 2023 | 2024 |
| | *(In mil, EUR)* | *(Percent total debt)* | *(Percent GDP)* | *(In mil. EUR)* | | | *(Percent GDP)* | | |
| **Total** | 1,752 | 100% | 19.6% | 281 | 309 | 333 | 3.1% | 3.1% | 3.1% |
| **External** | 641 | 36.6% | 7.2% | 57.9 | 54.2 | 50.5 | 0.6% | 0.5% | 0.5% |
| Multilateral creditors[2,3] | 779 | 44.4% | 8.7% | 42.7 | 38.0 | 37.2 | 0.5% | 0.4% | 0.3% |
| IMF | 51 | 2.9% | 0.6% | 12.5 | 0.0 | 0.0 | 0.1% | 0.0% | 0.0% |
| World Bank | 320 | 18.3% | 3.6% | 17.0 | 18.0 | 19.6 | 0.2% | 0.2% | 0.2% |
| EBRD | 25 | 1.4% | 0.3% | 9.1 | 15.4 | 10.8 | 0.1% | 0.2% | 0.1% |
| Other Multilaterals | 191 | 10.9% | 2.1% | 2.1 | 2.3 | 3.4 | 0.0% | 0.0% | 0.0% |
| *o/w: EU* | 100 | 5.7% | 1.1% | 0.0 | 0.0 | 0.0 | 0.0% | 0.0% | 0.0% |
| Council of Europe Dev. Bank (CEB) | 45.82 | 2.6% | 0.5% | 0.0 | 0.0 | 0.0 | 0.0% | 0.0% | 0.0% |
| European Inv. Bank (EIB) | 30.8 | 1.8% | 0.3% | 0.0 | 0.0 | 1.1 | 0.0% | 0.0% | 0.0% |
| Islamic Dev. Bank (ISDB) | 14.48 | 0.8% | 0.2% | 0.8 | 1.0 | 1.0 | 0.0% | 0.0% | 0.0% |
| OPEC Fund for Int. Dev (OFID) | 0.2 | 0.0% | 0.0% | 1.2 | 1.3 | 1.3 | 0.0% | 0.0% | 0.0% |
| Bilateral Creditors[2] | 49.52 | 2.8% | 0.6% | 13.0 | 13.7 | 9.7 | 0.1% | 0.1% | 0.1% |
| Paris Club | 23.45 | 1.3% | 0.3% | 6.5 | 6.9 | 4.8 | 0.1% | 0.1% | 0.0% |
| o/w: KfW Dev. Bank | 23.45 | 1.3% | 0.3% | 6.5 | 6.9 | 4.8 | 0.1% | 0.1% | 0.0% |
| Non-Paris Club | 1.31 | 0.1% | 0.0% | 1.0 | 1.0 | 1.0 | 0.0% | 0.0% | 0.0% |
| *o/w:* Saudi Fund for Dev. (SFD) | 1.31 | 0.1% | 0.0% | 1.0 | 1.0 | 1.0 | 0.0% | 0.0% | 0.0% |
| Bonds | 0 | 0.0% | 0.0% | | | | 0.0% | 0.0% | 0.0% |
| Commercial creditors | 28.73 | 1.6% | 0.3% | 0.2 | 0.2 | 0.3 | 0.0% | 0.0% | 0.0% |
| *o/w:* Uni Credit Bank | 23.6 | 1.3% | 0.3% | 0.2 | 0.2 | 0.3 | 0.0% | 0.0% | 0.0% |
| Raiffeisen Bank International (RBI) | 5.13 | 0.3% | 0.1% | 0.0 | 0.0 | 0.0 | 0.0% | 0.0% | 0.0% |
| **Domestic** | 1,111 | 63.4% | 12.4% | 222.8 | 255.3 | 282.9 | 2.5% | 2.6% | 2.6% |
| T-Bills | n.a. | | | | | | | | |
| Bonds | 1111.05 | 63.4% | 12.4% | 222.8 | 255.3 | 282.9 | 2.5% | 2.6% | 2.6% |
| Loans | n.a. | | | | | | | | |
| **Memo items:** | | | | | | | | | |
| Collateralized debt[4] | | | | | | | | | |
| *o/w:* Related | | | | | | | | | |
| *o/w:* Unrelated | | | | | | | | | |
| Contingent liabilities | 76.62 | 4.4% | 0.9% | | | | | | |
| *o/w:* Public guarantees | 76.62 | 4.4% | 0.9% | | | | | | |
| *o/w:* Other explicit contingent liabilities[5] | 0 | | | | | | | | |
| Nominal GDP | 8,955 | | | 8,955 | 9,886 | 10,700 | | | |

1/As reported by Country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as the DSA.

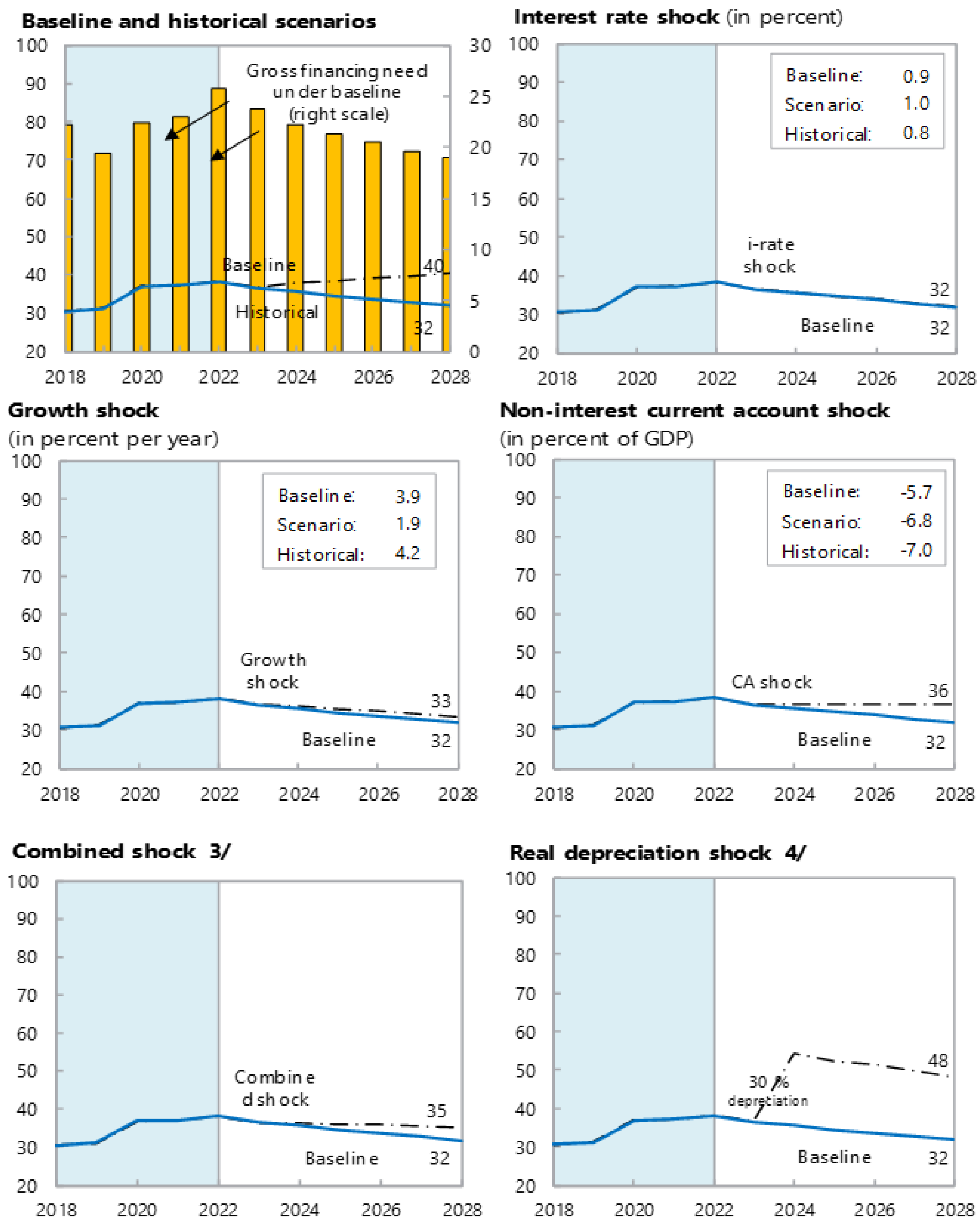
2/All creditors are included.

3/Multilateral creditors" are simply institutions with more than one official shareholder and may not necessarily align with creditor classification under other IMF policies (e.g. Lending Into Arrears)

4/Debt is collateralized when the creditor has rights over an asset or revenue stream that would allow it, if the borrower defaults on its payment obligations, to rely on the asset or revenue stream to secure repayment of the debt. Collateralization entails a borrower granting liens over specific existing assets or future receivables to a lender as security against repayment of the loan. Collateral is "unrelated" when it has no relationship to a project financed by the loan. An example would be borrowing to finance the budget deficit, collateralized by oil revenue receipts. See the joint IMF-World Bank note for the G20 "Collateralized Transactions: Key Considerations for Public Lenders and Borrowers" for a discussion of issues raised by collateral.

5/Includes other-one off guarantees not included in publicly guaranteed debt (e.g. credit lines) and other explicit contingent liabilities not elsewhere classified (e.g. potential legal claims, payments resulting from PPP arrangements). For Kosovo, public guarantees onlending are already included in debt stock.

## Annex II. Figure 6. External Debt Sustainability: Bound Tests[1, 2]




Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2024.

## Annex II. Table 4. Kosovo: External Debt Sustainability Framework, 2018–28

(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2018 | 2019 | 2020 | 2021 | 2022 | | | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | Debt-stabilizing non-interest current account 6/ |
| 1 **Baseline: External debt** | 30.5 | 31.2 | 37.0 | 37.1 | 38.2 | | | **36.5** | **35.7** | **34.5** | **33.7** | **32.7** | **31.8** | **-4.3** |
| 2 Change in external debt | -2.3 | 0.7 | 5.8 | 0.2 | 1.1 | | | -1.7 | -0.8 | -1.2 | -0.8 | -1.0 | -0.9 | |
| 3 Identified external debt-creating flows (4+8+9) | -0.3 | 2.2 | 2.8 | 2.8 | 1.2 | | | 2.0 | 1.5 | 1.1 | 1.3 | 1.2 | 1.2 | |
| 4 Current account deficit, excluding interest payments | 7.4 | 5.4 | 6.8 | 8.6 | 10.4 | | | 7.1 | 6.7 | 6.2 | 5.7 | 5.2 | 4.9 | |
| 5 Deficit in balance of goods and services | 28.2 | 27.1 | 32.2 | 31.8 | 32.5 | | | 29.5 | 28.6 | 27.6 | 26.8 | 26.2 | 25.9 | |
| 6 Exports | 29.1 | 29.3 | 21.7 | 33.4 | 38.3 | | | 37.6 | 37.2 | 37.2 | 37.2 | 37.3 | 37.3 | |
| 7 Imports | 57.3 | 56.4 | 53.9 | 65.2 | 70.9 | | | 67.1 | 65.8 | 64.8 | 64.0 | 63.5 | 63.2 | |
| 8 Net non-debt creating capital inflows (negative) | -6.4 | -1.8 | -5.4 | -0.5 | -5.2 | | | -4.1 | -4.1 | -4.1 | -3.4 | -3.1 | -2.9 | |
| 9 Automatic debt dynamics 1/ | -1.3 | -1.4 | 1.4 | -5.3 | -4.0 | | | -1.1 | -1.1 | -1.1 | -1.0 | -0.9 | -0.8 | |
| 10 Contribution from nominal interest rate | 0.3 | 0.2 | 0.1 | 0.2 | 0.1 | | | 0.2 | 0.3 | 0.2 | 0.3 | 0.3 | 0.3 | |
| 11 Contribution from real GDP growth | -1.1 | -1.4 | 1.7 | -3.4 | -1.2 | | | -1.3 | -1.3 | -1.3 | -1.3 | -1.2 | -1.2 | |
| 12 Contribution from price and exchange rate changes 2/ | -0.5 | -0.3 | -0.4 | -2.1 | -3.0 | | | ... | ... | ... | ... | ... | ... | |
| 13 Residual, incl. change in gross foreign assets (2-3) 3/ | -2.0 | -1.5 | 2.9 | -2.6 | -0.1 | | | -3.7 | -2.3 | -2.2 | -2.1 | -2.2 | -2.1 | |
| External debt-to-exports ratio (in percent) | 105.0 | 106.4 | 170.2 | 111.2 | 99.7 | | | 97.1 | 96.0 | 92.9 | 90.7 | 87.8 | 85.2 | |
| **Gross external financing need (in millions of euros) 4/** | 1484.1 | 1366.1 | 1514.9 | 1822.2 | 2310.6 | | | 2352.9 | 2376.2 | 2433.8 | 2469.2 | 2494.5 | 2554.5 | |
| in percent of GDP | 22.2 | 19.4 | 22.4 | 22.9 | 25.8 | 10-Year | 10-Year | 23.8 | 22.2 | 21.3 | 20.4 | 19.5 | 18.9 | |
| **Scenario with key variables at their historical averages 5/** | | | | | | | | **36.5** | **37.8** | **38.6** | **39.2** | **39.7** | **40.2** | **-5.0** |
| **Key Macroeconomic Assumptions Underlying Baseline** | | | | | | Historical Average | Standard Deviation | | | | | | | |
| Real GDP growth (in percent) | 3.4 | 4.8 | -5.3 | 10.7 | 3.5 | 4.2 | 4.0 | 3.8 | 4.0 | 4.0 | 3.9 | 3.8 | 3.8 | |
| GDP deflator in Euro (change in percent) | 1.5 | 1.0 | 1.4 | 6.1 | 8.7 | 2.2 | 2.8 | 6.4 | 4.1 | 2.6 | 2.0 | 1.9 | 1.9 | |
| Nominal external interest rate (in percent) | 0.9 | 0.8 | 0.4 | 0.5 | 0.4 | 0.8 | 0.3 | 0.6 | 0.8 | 0.7 | 0.8 | 0.9 | 1.1 | |
| Growth of exports (Euro terms, in percent) | 11.6 | 6.7 | -28.9 | 80.9 | 29.2 | 14.1 | 28.0 | 8.2 | 7.2 | 6.6 | 5.9 | 6.0 | 6.0 | |
| Growth of imports (Euro terms, in percent) | 13.2 | 4.2 | -8.3 | 42.2 | 22.3 | 9.6 | 14.2 | 4.5 | 6.1 | 5.0 | 4.7 | 4.9 | 5.3 | |
| Current account balance, excluding interest payments | -7.4 | -5.4 | -6.8 | -8.6 | -10.4 | -7.0 | 2.0 | -7.1 | -6.7 | -6.2 | -5.7 | -5.2 | -4.9 | |
| Net non-debt creating capital inflows | 6.4 | 1.8 | 5.4 | 0.5 | 5.2 | 2.8 | 2.7 | 4.1 | 4.1 | 4.1 | 3.4 | 3.1 | 2.9 | |

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

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

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

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

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

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

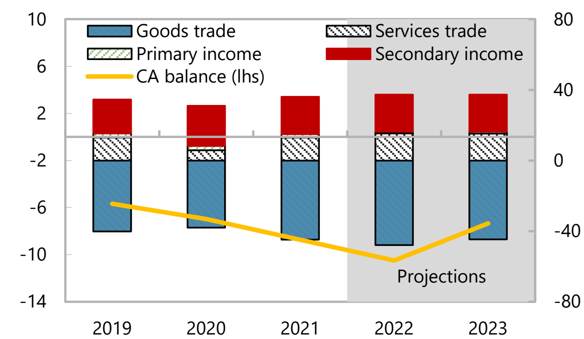
# Annex III. External Sector Assessment[1]

*The current account deficit widened in 2022, driven by higher food and energy prices. The deficit was mainly financed by continued FDI in real estate, private external loans, and unrecorded travel credit and remittances (reflected in errors and omissions). Excluding temporary factors, the external position of Kosovo is assessed to be weaker than the level implied by fundamentals and desirable policies in 2022. At 97 percent of the IMF's reserve adequacy (RA) metric, the level of gross international reserves in 2022 is considered broadly adequate.*

***External Balance***

**1. Kosovo's current account deficit widened to 10.5 percent of GDP in 2022 from 8.7 percent in 2021.** Concretely:

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




Sources: Haver Analytics and IMF staff calculations.

- **The goods trade deficit widened by 3.1 pp of GDP in 2022 due to higher energy and food prices.** The value of goods imports rose by 4.0 pp of GDP, driven by the increase in the value of imports of food, electricity, and mineral products; other imports as a share of GDP declined by 1.4 pp of GDP in 2022. Despite a decline in nickel exports, total exports of goods increased by 0.9 pp of GDP on the back of larger exports of furniture, plastic, and rubber products.[2]

- **The positive net balance of services increased by 2.4 pp of GDP.** This was driven by higher travel credits (which account for three-fourths of total exports of services) and exports of telecommunication and computer services.

- **The primary income balance declined by 0.9 pp of GDP.** The decline was mainly driven by higher dividend debits arising from higher profits earned by FDI companies (including banks) in 2022.

- **The secondary income balance declined by 0.2 pp of GDP.** The decline was mainly driven by private transfers, which decreased by 0.5 pp of GDP in 2022.

**2. The current account deficit in 2022 was mainly financed by FDI and external loans.** More specifically:

[1] Prepared by Si Guo.

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

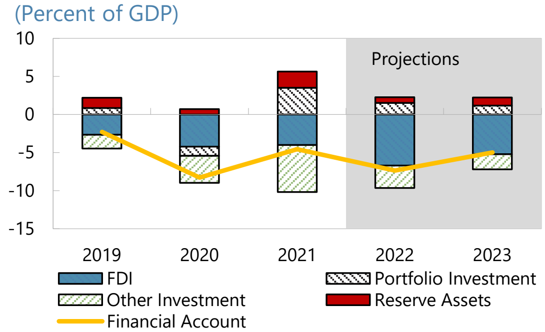
- **Net FDI inflows** increased by 2.7 pp of GDP compared to 2021 due to diaspora real estate investments.

- **Net portfolio investment** showed net outflows estimated at 1.5 percent of GDP in 2022, compared to 3.5 percent of GDP in 2021. Kosovo has a negligible level of recorded portfolio investment liabilities, and its portfolio investment assets mainly include overseas investments by KPST and commercial banks. The decline in the size of net portfolio investment outflows in 2022 was mainly attributed to slower growth in KPST's external investments.

- **Net other investment** showed net inflows of 2.9 percent of GDP in 2022. This mainly reflected net inflows from private external loans and trade credits.

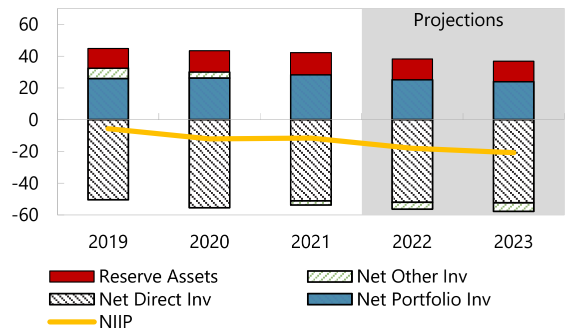
- **Errors and omissions** were 2.7 percent of GDP in 2022. These reflected informal inflows of remittances, FDI and travel credits.

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




Sources: Haver Analytics, IMF staff calculations.

**Kosovo: Net International Investment Position**
(Percent of GDP)




Sources: Haver Analytics and IMF staff calculations.

3. **The Net International Investment Position (NIIP) declined from -11.5 percent of GDP in 2021 to -18.0 percent of GDP in 2022.** This was in line with the sizable current account deficit in 2022 and the corresponding increase in public and external liabilities described above.

4. **In the medium term, current account deficits are projected to narrow as commodity prices normalize.** The structural pattern of goods trade deficits broadly offset by services trade surpluses is likely to persist. The NIIP is expected to continue declining in the medium term, but at a lower speed than observed in 2022.

***Assessment of the External Position***

5. **Kosovo's external position in 2022 is assessed to be weaker than the level implied by medium-term fundamentals under desirable policy settings.** The current balance (CAB) in 2022 was -10.5 percent of GDP. The cyclically-adjusted CAB after multilateral consistency adjustment is estimated to be -9.1 percent of GDP. The CAB norm estimated by the IMF's EBA-Lite CA model is -5.9 percent of GDP. The comparison of adjusted CAB and the norm yields a CA

gap of -3.3 percent of GDP, equivalent to a REER overvaluation of about 11.1 percent.[3] A large portion of the CA gap is attributed to model residuals, possibly reflecting factors that are not accounted by the model such as the large errors and omissions in the balance of payments (2.7 percent of GDP in 2022). As error and omissions reflect mostly unrecorded exports of services and remittances, the size of the CA gap is likely overestimated.

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

| | **CA model** 1/ | **REER model** 1/ |
|---|---|---|
| | (in percent of GDP) | |
| **CA-Actual** | **-10.5** | |
| Cyclical contributions (from model) (-) | -0.8 | |
| Natural disasters and conflicts (-) | -0.5 | |
| **Adjusted CA** | **-9.1** | |
| **CA Norm** (from model) 2/ | **-5.9** | |
| Adjustments to the norm (-) | 0.0 | |
| **Adjusted CA Norm** | **-5.9** | |
| **CA Gap** | **-3.3** | **-0.7** |
| o/w Relative policy gap | 5.4 | |
| Elasticity | -0.3 | |
| **REER Gap** (in percent) | **11.1** | **2.2** |

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

### *Reserve Adequacy Assessment*

6. **The CBK's gross international reserves are mainly funded by commercial bank reserves and government deposits.** GIRs increased to €1.37 billion in 2022 (from €1.29 billion at end-2021). Commercial banks' reserves and government deposits (excluding PAK) were €0.59 billion and €0.42 billion at end-2022, respectively. The rise in GIRs in 2022 mainly reflects the increased deposits from KPST and POEs.

7. **Reserve adequacy using standard rules of thumb is estimated to have strengthened slightly in 2022.** Kosovo's GIR adequacy assessment using standard and alternative GIR definitions is shown in Table 2. Standard GIRs are estimated to have increased from 2.4 months of (next year's) imports in 2021 to 2.5 months of imports in 2022, which partly reflects the expected decrease in commodity prices in 2023.

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

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

- **CBK's definition:** Standard GIR net of PAK and KPST deposits.

- **Staff's alternative definition:** Standard GIR net of banks' excess reserves.

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

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Projections | | | | | | |
| Standard Definition of GIR | | | | | | | | | | | | |
| Import cover (months of next year's imports) | 3.7 | 3.5 | 3.8 | 2.7 | 2.4 | 2.5 | 2.5 | 2.6 | 2.6 | 2.7 | 2.7 | 2.7 |
| Reserves to short-term external debt (%) | 168 | 167 | 152 | 147 | 133 | 116 | 130 | 138 | 143 | 147 | 152 | 155 |
| Reserves to Broad Money (%) | 42 | 38 | 34 | 29 | 29 | 28 | 28 | 28 | 27 | 27 | 27 | 26 |
| Conservative (CBK) Definition of GIR | | | | | | | | | | | | |
| Import cover (months of next year's imports) | 2.1 | 2.3 | 2.8 | 2.1 | 2.1 | 2.1 | 2.2 | 2.3 | 2.3 | 2.4 | 2.4 | 2.4 |
| Reserves to short-term external debt (%) | 98 | 110 | 115 | 115 | 113 | 100 | 113 | 120 | 125 | 130 | 136 | 139 |
| Reserves to Broad Money (%) | 24 | 25 | 25 | 23 | 25 | 24 | 24 | 24 | 24 | 24 | 24 | 24 |
| GIR, net of banks' excess reserves | | | | | | | | | | | | |
| Import cover (months of next year's imports) | 3.2 | 3.1 | 3.1 | 2.0 | 1.9 | 2.0 | 2.1 | 2.1 | 2.2 | 2.2 | 2.1 | 2.1 |
| Reserves to short-term external debt (%) | 147 | 146 | 127 | 108 | 103 | 95 | 107 | 114 | 117 | 120 | 117 | 120 |
| Reserves to Broad Money (%) | 37 | 34 | 28 | 22 | 23 | 23 | 23 | 23 | 23 | 22 | 21 | 20 |

Source: IMF staff calculations.

8. **GIRs are estimated to have been 97 percent of the IMF standard RA metric by end-2022 and are projected to broadly remain at similar levels the medium term.**[4] IMF (2011) suggests the following reserve adequacy (RA) metric for an economy with fixed exchange rate:

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

Where X is export revenues, STD is short-term external debt, BM is broad money and OPL is other external liabilities. Text Table 3 shows that GIRs will stabilize at 98 percent of the standard RA metric during 2004–28, after a temporary decline in 2023. To complement the analysis above, a more conservative measure of GIRs (defined as standard GIRs excluding deposits from KPST and PAK) is also considered. In addition, a modified RA metric is used to reflect Kosovo's reliance on remittance inflows (R) and to account for the risk of domestic deposit (D) outflows in a euroized economy (Table 3).[5]

9. **The projected nominal GIRs for 2023–28 reflected in Text Table 3 are higher than the GIR levels projected in the 2022 Article IV Staff Report.** This reflects (i) Actual GIRs at end-2022 higher than projected in the 2022 Article IV (€60 million); (ii) higher external and net domestic debt placements and lower utilization of government deposits for deficit financing over 2023–27; (iii) domestic financial institutions' deposits at the CBK in line with their pre-pandemic trend over the projection period.

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

[5] Modified RA = 10% (X+R) + 30% STD + 15% D + 20% OPL. The weight on total deposits was increased from 10 to 15 percent to reflect the absence of a lender of last resort.

***Other Reserve Adequacy Indicators***

**10. While the reserve adequacy metric is projected to deteriorate in the medium term, Kosovo has shown capacity to absorb a moderate fiscal financing or bank liquidity shock.** As a euroized economy lacking a lender of last resort, reserve adequacy should also be assessed by capacity to mitigate shocks to fiscal financing and for bank emergency liquidity assistance (ELA).

- **Fiscal Buffers.** The government's deposits placed at the CBK (excluding PAK deposits) were €420 million at end-2022, sufficient for 1.5 months of projected expenditure plus debt amortization in 2023. This is higher than the yardstick of one-month government spending proposed in IMF (2013).[6] In addition, PAK deposits placed at the CBK (€166 million as of end-2022) are also government assets.

- **Bank Liquidity Buffers.** Kosovo's banks generally have high liquidity ratios, and it is expected that the largest banks would receive liquidity support from their parent groups in emergency times. However, banks' ability to respond to a system-wide liquidity shock is limited by (i) some liquid assets are in the form of Kosovo government bonds, which may not be immediately tradable; and (ii) the coverage of the deposit insurance is not high enough to substantially reduce the risks of bank runs. The CBK's GIRs excluding commercial banks' deposits are about 15 percent of banks' short-term liabilities as of end-2022, which should be sufficient to absorb a moderate to severe liquidity shock.[7]

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

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Projections | | | | | | |
| Standard GIR (millions of euros) | 1168 | 1164 | 1142 | 1149 | 1293 | 1371 | 1480 | 1610 | 1706 | 1797 | 1908 | 1994 |
| Percent of RA metric | 151 | 140 | 126 | 120 | 107 | 97 | 97 | 98 | 98 | 98 | 99 | 98 |
| Percent of RA modified metric | 119 | 110 | 99 | 92 | 84 | 77 | 77 | 78 | 78 | 78 | 79 | 78 |
| Conservative GIR (millions of euros) | 683 | 769 | 864 | 900 | 1100 | 1176 | 1279 | 1405 | 1500 | 1591 | 1702 | 1789 |
| Percent of RA metric | 88 | 92 | 95 | 94 | 91 | 83 | 84 | 86 | 86 | 87 | 88 | 88 |
| Percent of RA modified metric | 70 | 73 | 75 | 72 | 72 | 66 | 67 | 68 | 69 | 69 | 70 | 70 |
| GIR, net of excess reserves (millions of euros) | 1026 | 1021 | 955 | 847 | 1008 | 1124 | 1218 | 1324 | 1403 | 1475 | 1475 | 1544 |
| Percent of RA metric | 132 | 123 | 105 | 88 | 83 | 79 | 80 | 81 | 81 | 80 | 77 | 76 |
| Percent of RA modified metric | 104 | 97 | 83 | 68 | 66 | 63 | 64 | 64 | 64 | 64 | 61 | 60 |

Source: IMF staff calculations.

***Reserve Adequacy Under an Adverse Scenario***

**11. Under the adverse scenario and without IMF financing, standard GIRs as a share of RA metric will be below 95 percent during 2023–28.** The lower projected GIRs in the adverse scenario reflect the larger fiscal and current account deficits in 2023–24 that are financed by reserve assets.

[6] See IMF (2013) Republic of Kosovo: Selected Issues Paper.

[7] In addition, to address the potential liquidity risks during the pandemic, the CBK negotiated a repo line to borrow euro liquidity from the ECB (via Deutsche Bundesbank), against collateral consisting of euro-denominated marketable debt securities issued by euro area governments and supranational institutions of €100 million. The repo line will expire in early 2024.

# Annex IV. Capacity Development Activities to Support Program Priorities

| Program Priorities | Recent CD Activities | Planned/Proposed CD Activities |
|---|---|---|
| **Fiscal Reforms** | | |
| • Strengthen tax administration and fight against informality.<br>• Tax policy reforms to offset the expected decline in customs revenues.<br>• Increase the transparency of tax expenditure.<br>• Improve the implementation of public investment program.<br>• Improve POE performance and contain fiscal risks. | • Tax administration: tax audit, tax compliance risk management, tax debt management, IT modernization.<br>• PFM: medium term expenditure framework (MTEF), budget costing and fiscal risk management, monitoring of expenditure arrears and multi-annual commitments, fiscal risks related to POEs.<br>• Pension policy diagnostic assessment.<br>• Tax policy diagnostic assessment<br>• Statistics<br>• Strengthening the budget framework. | • PIMA update with C-PIMA module.<br>• Fiscal risks related to POEs, guarantees and lending.<br>• Multi-year budgeting of public investment.<br>• Budget preparation and the reconciliation between budget and MTEF.<br>• Budget execution and controls<br>• Cash management |
| **Financial Sector Reforms** | | |
| • Strengthen central bank governance.<br>• Increase the CBK's financial sector surveillance capacity. | • 2019 FSSR and 2020 SA<br>• FSSR follow up TAs on stress testing, banking and insurance supervision, reserve management, and central bank governance, IFRS9 Implementation.<br>• Monetary and financial statistics | • Central bank governance<br>• Stress testing<br>• Risk-based supervision<br>• Reserve management<br>• Housing price index and external sector statistics |
| **Macro-Structural Reforms** | | |
| • Strengthen economic governance and close infrastructure gaps. | • 2015 PIMA and 2018 PIMA update | • PIMA update<br>• National account and price statistics |
| **Climate Change Reforms** | | |
| • Ensure energy security; achieve climate neutrality and environment sustainability. | | • Climate-PIMA<br>• Workshop on climate-related PFM areas<br>• Carbon pricing and CPAT training |

# Annex V. Global Risk Assessment Matrix

**(February 13, 2023)[1]**

| Source of Risks and Relative Likelihood | Expected Impact | Policy Responses |
|---|---|---|
| | **Conjunctural risks** | |
| **High**<br>**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, refugee flows, FDI and financial flows, and payment systems. | **High**<br>No direct impact is expected 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. | • Design targeted and temporary policies to cope with additional commodity price shocks.<br>• Accelerate broad-based structural reforms to boost competitiveness and gradually reduce the dependency on diaspora-related flows by strengthening governance and the policy framework.<br>• 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. |
| **Medium**<br>**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**<br>Social discontent can result in social and economic losses as well as costly policy proposals. | • Minimum wage increases should be implemented as planned. Veteran benefits should be delinked from minimum wage to reduce the impact of higher minimum wage on fiscal spending.<br>• Fiscal transfers should be more targeted and more transparent to better protect the vulnerable. |
| **Medium**<br>• **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.<br>• **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". | **High**<br>An economic slowdown in Europe will weigh on Kosovo's growth through reduced consumption, investment, and lower diaspora flows that may lead to a higher current account deficit. | • Design targeted and temporary policies to cope with shocks.<br>• Accelerate broad-based structural reforms, including greening the energy matrix and reducing diaspora dependency through policies to strengthen governance, the general policy framework, increase exports and domestic production.<br>Further strengthen the monitoring of financial risks and establish contingency plans to address fiscal risks. |

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.

| | | |
|---|---|---|
| • **Europe:** Intensifying fallout from the war in Ukraine, worsening energy crisis and supply disruptions, and monetary tightening exacerbate economic downturns and housing market corrections.<br>• **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.<br>**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. | | |
| **Medium**<br>**Commodity price volatility.** A succession of supply disruptions (e.g., due to conflicts and export restrictions) and demand fluctuations (e.g., reflecting China reopening) causes recurrent commodity price volatility, external and fiscal pressures, and social and economic instability. | **High**<br>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.<br>• Accelerate broad-based structural reforms to boost competitiveness, green the coal-based energy matrix, and increase public investment absorption.<br>• 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. |
| **Medium**<br>**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**<br>Increased inflation rates can lead to increased social discontent. | • Design targeted and temporary policies to cope with additional commodity price shocks.<br>• Fiscal transfers should be more targeted and transparent to better mitigate the impact of inflation on the most vulnerable. |
| **Medium**<br>**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**<br>Sharp financial market fluctuations in the euro will be transmitted to Kosovo through interest rates and risk premia. | • Strengthen the capacity of the CBK to monitor bank credit and liquidity risks; Stand ready to take supervisory actions.<br>• Strengthen CBK Governance and finalize the appointment of CBK Executive Board members, including a new Governor at the shortest delays.<br>• Improve the monitoring of key sectors such as the residential real estate sector. |

| Structural risks | | |
|---|---|---|
| **High**<br>**Deepening geo-economic fragmentation.** Broader and deeper conflict(s) and weakened international cooperation leads to a more rapid reconfiguration of trade and FDI, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth. | **Medium**<br>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. | • Targeted and temporary policies to cope with additional shocks.<br>• Accelerate broad-based structural reforms, including greening the energy matrix and reducing diaspora dependency through policies to increase exports and domestic production. |
| **Medium**<br>**Cyberthreats.** Cyberattacks on critical domestic and/or international physical or digital infrastructure (including digital currency and crypto ecosystems) trigger financial and economic instability. | **Medium**<br>Sharp financial market fluctuations will weigh on credit growth and the balance sheets of corporates and financial institutions. | • Improve the physical and regulatory infrastructure of monitoring and mitigating cyberthreats. Have a contingent plan for the worst scenarios. |
| **Medium**<br>**Extreme climate events.** Extreme climate events cause more severe than expected damage to infrastructure (especially in smaller vulnerable economies) and loss of human lives and livelihoods, amplifying supply chain disruptions and inflationary pressures, causing water and food shortages, and reducing growth. | **Medium**<br>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. | • Finalize work on Law on Climate Change and associated National Environment and Climate Plan.<br>• Strengthen preparedness to deal with shocks through contingent fiscal and financial plans to mitigate the impact of extreme climate events. Maintain appropriate fiscal buffers to ensure capacity to respond swiftly.<br>• Improve the targeting of transfer programs to ensure that support only reach the most vulnerable households. |

# Stand-by Arrangement

Attached hereto is a letter from Kosovo's Minister of Finance, Labor, and Transfers and the Acting Governor of the Central Bank of Kosovo, dated May 9, 2023 ("**Letter**"), with its annexed Memorandum of Economic and Financial Policies ("**MEFP**") and Technical Memorandum of Understanding ("**TMU**"), requesting a Stand-By Arrangement ("**Arrangement**") from the International Monetary Fund ("**Fund**") and setting forth:

a) the objectives and policies that the authorities intend to pursue for the period of this Arrangement;

b) the policies and measures that the authorities intend to pursue during the first twelve months of this Arrangement; and

c) understandings of Kosovo with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities will pursue for the remaining period of this Arrangement.

To support these objectives and policies, the Fund grants this Arrangement in accordance with the following provisions:

1. For a period of 24 months from the date of the approval of this Arrangement, Kosovo will have the right to make purchases from the Fund in an amount equivalent to SDR 80.122 million, subject to paragraphs 2, 3, 4, and 5 of this Arrangement, without further review by the Fund.

2. (a) Purchases under this Arrangement shall not, without the consent of the Fund, exceed the equivalent of:

   - SDR 20.031 million until October 15, 2023,
   - SDR 40.062 million until February 20, 2024,
   - SDR 53.416 million until September 15, 2024, and
   - SDR 66.77 million until February 20, 2025.

   (b) None of the limits in (a) above shall apply to a purchase under this Arrangement that would not increase the Fund's holdings of Kosovo's currency subject to repurchase beyond 25 percent of quota.

2. Kosovo will not make purchases under this Arrangement that would increase the Fund's holdings of Kosovo's currency subject to repurchase beyond 25 percent of quota:

   (a) Subject to paragraph 2 of Decision No. 14407-(09/105), during any period in which the data at the end of the preceding period indicate that:

      i. the floor on the overall balance of the general government; or

ii. the floor on the stock of general government deposits at the Central Bank of Kosovo (CBK), as specified in Table 1 of the MEFP and as further specified in the TMU, is not observed; or

(b) if at any time during the period of this Arrangement:

i. the ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government, as specified in Table 1 of the MEFP and as further specified in the TMU, is not observed; or

ii. Kosovo imposes or intensifies restrictions on the making of payments and transfers for current international transactions; or

iii. Kosovo introduces or modifies multiple currency practices; or

iv. Kosovo concludes bilateral payments agreements that are inconsistent with Article VIII; or

v. Kosovo imposes or intensifies import restrictions for balance of payments reasons; or

(c) after October 14, 2023, February 19, 2024, September 14, 2024, and February 19, 2025, until the respective reviews contemplated in the MEFP are completed.

When Kosovo is prevented from purchasing under this Arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Kosovo and understandings have been reached regarding the circumstances in which such purchases can be resumed.

3. Kosovo will not make purchases under this Arrangement during any period in which Kosovo: (i) has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation in respect of a noncomplying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action; (ii) is failing to meet a repayment obligation to the PRG Trust established by Decision No. 8759-(87/176), as amended, or a repayment expectation to that Trust pursuant to the provisions of Appendix I to the PRG Trust Instrument; or (iii) is failing to meet a repayment obligation to the Resilience and Sustainability Trust (RST) established by Decision No. 17231-(22/37), or a repayment expectation to that Trust pursuant to the provisions of Appendix II to the RST Instrument.

4. Kosovo's right to engage in the transactions covered by this Arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Kosovo. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this Arrangement will be resumed only after

consultation has taken place between the Fund and Kosovo and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Purchases under this Arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, unless, at the request of Kosovo, the Fund agrees to provide SDRs at the time of the purchase.

6. Kosovo shall pay a charge for this Arrangement in accordance with the decisions of the Fund.

7. (a) Kosovo shall repurchase the amount of its currency that results from a purchase under this Arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Kosovo's balance of payments and reserve position improves.

   (b) Any reductions in Kosovo's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

8. During the period of this Arrangement, Kosovo shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Kosovo or of representatives of Kosovo to the Fund. Kosovo shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Kosovo in achieving the objectives and policies set forth in the Letter and the attached MEFP and TMU.

9. In accordance with the Letter, Kosovo will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government of Kosovo or whenever the Managing Director of the Fund requests consultation because any of the criteria in paragraph 3 of this Arrangement have not been observed or because the Managing Director considers that consultation on the program is desirable. In addition, after the period of this Arrangement and while Kosovo has outstanding purchases in the upper credit tranches, the Government of Kosovo will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director of the Fund, concerning Kosovo's balance of payment policies.

# Arrangement Under the Resilience and Sustainability Facility

Attached hereto is a letter dated May 9, 2023 (the "**Letter**"), with its attached Memorandum of Economic and Financial Policies (the "**MEFP**") and Technical Memorandum of Understanding (the "**TMU**"), from Kosovo's Minister of Finance, Labor, and Transfers and the Acting Governor of the Central Bank of Kosovo, requesting from the International Monetary Fund, as Trustee of the Resilience and Sustainability Trust (the "**Trustee**"), an arrangement under the Resilience and Sustainability Facility ("**RSF Arrangement**") of the Resilience and Sustainability Trust (the "**RST**"), and setting forth the reform measures ("**Reform Measures**") that the authorities of Kosovo intend to pursue during the period of the arrangement.

1. To support the Reform Measures, the Trustee approves the RSF Arrangement for Kosovo for a period of two years from the date of the approval of this RSF Arrangement in accordance with the following provisions, and subject to the provisions of the Instrument to Establish the Resilience and Sustainability Trust (the "**RST Instrument**"):

(a) during the period of the RSF Arrangement, Kosovo will have the right to obtain disbursements from the Trustee in a total amount equivalent to SDR 61.95 million, subject to the availability of resources in the RST; and

(b) notwithstanding the period set forth above, the period of this RSF Arrangement will terminate on date of the expiration, termination or cancellation of the Stand-By Arrangement for Kosovo approved by the Executive Board of the International Monetary Fund on May 25, 2023 (the "**SBA**"), or when all amounts committed under this RSF Arrangement have been drawn.

2. At the request of Kosovo, during the period of the RSF Arrangement and subject to the conditions set out in paragraph 3 below:

(a) the first through fourth disbursements, each in an amount equivalent to SDR 7.744 million, will be available on or after October 15, 2023;

(b) the fifth disbursement, in an amount equivalent to SDR 7.744 million, will be available on or after February 20, 2024;

(c) the sixth and seventh disbursements, each in an amount equivalent to SDR 7.744 million, will be available on or after September 15, 2024; and

(d) the eight disbursement, in an amount equivalent to SDR 7.742 million, will be available on or after September 15, 2024.

3. Kosovo will not request a disbursement under this RSF Arrangement specified in paragraph 2 above:

(A) Until the Trustee has completed a review under this RSF Arrangement, which shall take place concurrently with the completion of a review under the SBA, and determined that:

a. with respect to the first disbursement, Reform Measure 5,

b. with respect to the second disbursement, Reform Measure 6,

c. with respect to the third disbursement, Reform Measure 7,

d. with respect to the fourth disbursement, Reform Measure 3,

e. with respect to the fifth disbursement, Reform Measure 1,

f. with respect to the sixth disbursement, Reform Measure 2,

g. with respect to the seventh disbursement, Reform Measure 4,

h. with respect to the eighth disbursement, Reform Measure 8,

as set out in Table 3 of the MEFP has been implemented, or that any deviation in implementation of the respective Reform Measure relative to its design and underlying objective was minor; or

(B) After 30 calendar days have passed from the date of the completion of a review under this RSF Arrangement in accordance with Section II, paragraph 3 (c) of the RST Instrument.

4. In accordance with the Letter, Kosovo will provide the Trustee with such information as the Trustee requests in connection with the progress of Kosovo in implementing the Reform Measures supported by this RSF Arrangement.

5. During the period of this RSF Arrangement, Kosovo shall remain in close consultation with the Trustee. In accordance with the Letter, Kosovo shall consult with the Trustee on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director of the Trustee requests such a consultation. Moreover, after the period of this RSF Arrangement and while Kosovo has outstanding financial obligations to the Trustee arising from loan disbursements under this RSF Arrangement, Kosovo will consult with the Trustee from time to time, at the initiative of the government or whenever the Managing Director of the Trustee requests consultation on Kosovo's economic and financial policies. These consultations may include correspondence and visits of officials of the Trustee to Kosovo or of representatives of Kosovo to the Trustee.

# Appendix I. Letter of Intent

Prishtinë, May 9, 2023

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

Dear Ms. Georgieva:

The Government of Kosovo remains committed to maintaining macroeconomic stability and advancing structural reforms to increase potential growth, reduce inequality and mitigate and adapt to the consequences of climate change.

During 2022, our government swiftly implemented policies to mitigate the impact of the higher commodity prices on households and businesses. But we did so while maintaining a prudent fiscal policy and replenishing our fiscal buffers. While inflation inevitably increased given Kosovo's reliance on imports of food and energy, economic activity remained resilient, with GDP expanding by 3.5 percent.

More generally, our structural reform efforts in the last two years have been aimed at increasing Kosovo's growth potential, increasing the effectiveness and efficiency of budgetary spending, protecting vulnerable households, reducing infrastructure gaps, strengthening financial governance, and continue advancing in the path to EU accession. Importantly, we have also made strides in establishing the policy framework for climate change mitigation and adaptation. In this regard, Parliament's approval in early 2023 of Kosovo's energy strategy for the next 10 years will organize the government's actions to increase renewable electricity production, improve demand efficiency, reduce pollution, strengthen energy market competition, attract private resources to green electricity sources, and protect the most vulnerable energy consumers.

The Russian unprovoked invasion against Ukraine, however, will continue to present challenges to Kosovo, as commodity prices will likely remain volatile and could spike again, with possible negative impact on economic activity and the budget. Indeed, if risks materialize, inflation could be more persistent and economic growth slower. If unaddressed, the materialization of these risks could also hinder our efforts to accelerate economic convergence and may slow the momentum of structural reform implementation.

In this context and to support our reform program, the Government of Kosovo is requesting access to IMF resources under a 24-month Stand-By Arrangement (SBA) in an amount equivalent to €100 million (SDR 80.122 million, 97 percent of quota) over 2023–24. As our intention is to mitigate the impact of a possible materialization of downside risks (for instance, higher than projected commodity prices or lower than programmed external financing), we intend to treat the SBA as precautionary in the baseline. The proposed reform measures under the SBA, provide a roadmap for our fiscal and financial reform agenda. This reform agenda is outlined in the attached Memorandum of Economic and Financial Policies (MEFP), which entails policies that are crucial to achieve sustainable growth and sustain fiscal and financial stability. In addition, we are requesting an arrangement under the Resilience and Sustainability Facility (RSF) in the amount of €78 million (SDR 61.95 million, 75 percent of quota), to support our efforts for climate change mitigation and adaptation, especially in energy. We expect RSF resources to complement financing by other development partners and to catalyze additional climate finance from private sources. To this end, we have prepared a comprehensive reform program described in the attached MEFP, that aim to boost our efforts towards energy transition. Given our strong commitment to program implementation and the significant financing needs to advance the energy transition and implement policies for climate change mitigation and adaptation, we intend to request an RSF augmentation once we identify additional actions in these areas, including from the upcoming Climate-Public Investment Management Assessment mission.

The Government of Kosovo will maintain its 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/

Bashkim Nurboja
Acting Central Bank Governor

# Attachment I. Memorandum of Economic and Financial Policies

## I. OVERVIEW

**1. This memorandum provides an overview of macroeconomic developments and outlines the policy framework and reform program of the government of the Republic of Kosovo under a 24-Month Precautionary Stand-By Agreement (SBA) and a concurrent Resilience and Sustainability Facility (RSF) arrangement.** The primary objective of these arrangements is to promote macroeconomic stability, mitigate downside risks, and support the implementation of our reform agenda, with a particular focus on climate change mitigation and adaptation. More specifically, the precautionary SBA will help mitigate downside risks related to higher than projected commodity prices or lower than programmed budgetary financing, while the RSF will be crucial in accelerating towards a more environmentally sustainable energy mix, reducing carbon emissions and pollution, improving energy efficiency, strengthening energy market competition, and protecting vulnerable energy consumers.

## II. MACROECONOMIC CONDITIONS

**2. Russia's unprovoked invasion against Ukraine has weighed on Kosovo's economy in 2022 and increased uncertainty and risks.** Higher and more volatile commodity prices have fueled inflation, which reached 11.7 percent in 2022. Along with the negative terms-of-trade shock, that has adversely impacted real disposable income, economic growth remained resilient, at around 3.5 percent.

**3. Lower commodity prices and a stronger implementation of the public investment program (PIP) should support an increase in GDP growth to about 4–5 percent in 2023.** Lower food and oil prices in 2023 will provide needed relief to households and businesses and will also result in a decrease in inflation, which is projected at 5–6 percent. Uncertainty, however, remains high, with risks tilted to the downside. Higher commodity prices could result in more persistent inflation, lower private demand, and slower growth, and in increased fiscal financing needs. Tighter financial conditions, including due to the recent bout of bank failures in the U.S. and Europe, may also weigh on banks' asset quality and liquidity.

## III. POLICY FRAMEWORK AND REFORMS PROPOSED UNDER THE STAND-BY ARRANGEMENT

**4. We have a comprehensive policy framework and an ambitious reform agenda under the SBA-supported program.** Our macroeconomic and financial policies and reform agenda under the SBA, aim to further strengthen fiscal, financial, and economic governance, maintain financial stability, gradually close infrastructure gap, tackle informality and promote new growth engines.

***Fiscal Policies and Reforms***

5. **Our fiscal policy for 2023–24 will be anchored by the fiscal rule deficit ceiling.** Following a decisive fiscal consolidation effort over 2021–22 that allowed to replenish our reserve buffers, the fiscal deficit in 2023–24 is expected, on average, to moderately increase mainly due to improved public investment program (PIP) absorption and the implementation of the public wage law, but to stay nonetheless within the fiscal rule deficit ceiling **(quantitative performance criteria).** We project domestic fiscal revenues to remain about constant as a share of GDP, as the expected decrease in customs revenues due to the implementation of free trade agreements with, among other, the EU and Türkiye will be broadly offset by collection improvements underpinned by gradual decreases in informality. While we project PIP absorption to improve significantly in 2023–24 we will continue to exercise prudency in the management of current primary spending.

6. **Continued tax administration improvements will allow for sustained progress in reducing informality.** In line with IMF staff analysis, we assess that a substantial amount of the increase in fiscal revenues over 2021–22 was due to a reduction in informality. This remarkable outcome was in part the result of continued efforts to strengthen tax administration. Going forward, we will customize enforcement and preventive actions for different taxpayers, use risk analysis more effectively, and evaluate options to finalize the implementation of the new IT system in the Tax Administration of Kosovo (TAK) at the shortest possible delays. Additionally, we will adopt the 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, TAK will adopt a new action plan to reduce informality. This plan will describe the proposed actions, include implementation and monitoring procedures, expected outcomes, and the activities as well as the results from this plan will published on TAK's website **(SB for end-July 2023).**

7. **We are committed to continue strengthening the effectiveness, targeting and transparency of budgetary spending.** Given the uncertainty characterizing the outlook, contingency budgetary allocations were necessary during the COVID-19 pandemic and subsequent energy crisis. In this regard, the budget for 2023 includes allocations of 3.4 percent of GDP for current expenditure contingencies, and of 0.2 percent of GDP of capital expenditure contingencies, for a total of 3.6 percent of GDP. To foster transparency on the use of these allocations, the treasury quarterly report will include a section describing their use, intended impact and rationale, as well as beneficiaries **(SB for end-July 2023).** As exceptional uncertainty eases, we intend to decrease these allocations, so they jointly represent less than 2 percent of GDP in the budget for 2024 **(indicative target).**

8. **The government has started implementing the public wage law in 2023.** The approval and implementation of the public wage law has introduced a more transparent salary structure, and will contribute to improved governance, accountability, and transparency in the public sector's pay structure. It will also help manage wage expectations going forward. Importantly, the coefficients that were set following the implementation of the new public wage will result in a wage bill consistent with its legal ceiling, with positive spillovers for private sector competitiveness.

**9. We remain committed to monitoring and containing fiscal risks.** To this end, we will produce an annual fiscal risk analysis report starting with the 2024 budget **(SB for end-November 2023).** This annual fiscal risk analysis will succinctly describe the main macroeconomic risks facing the budget and the economy more generally. It will also discuss other macroeconomic risks, such as those arising from the operation of Publicly Owned Enterprises including from guaranteed loans, in line with the provisions of the new Public Debt Law, adopted in December 2022.

**10. We will continue working to improve the targeting of government subsidies and transfers.** In line with this objective, the Energy Regulator Office (ERO) increased, in late March 2023, electricity tariffs to ensure that the electricity sector's financial flows remain balanced in 2023, without the need of blanket government subsidies **(prior action).** In parallel, the government, in collaboration with the World Bank, is revisiting the definition of vulnerable energy clients so to ensure that subsidy recipients pass poverty tests. The government intends to start implementing the new definition in the budget for 2024 (See Section IV). While import electricity prices have eased during the first few months of 2023, we intend to minimize the use of blanket subsidies should electricity prices rebound to 2022 levels, including by ensuring that price signals are at least partially passed through to non-vulnerable consumers. Moreover, any newly proposed social scheme will be targeted and sustainable. In this regard, the results of the 2023 Census will provide valuable data for designing targeted and effective social schemes and benefits.

**11. More broadly, 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 to 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 criteria).**

**12. The budget for 2023 is fully financed in the baseline.** Prudent fiscal policy over 2021–22 has led to replenished fiscal buffers. In 2023, domestic fiscal revenues will be complemented by budget support grants from the EU of €86 million. The financing program for 2023 includes external budget support from the World Bank, the OPEC Fund for International Development (OFID), and bilateral assistance of €111.8 million. In turn, domestic debt placements will be consistent with a net increase of domestic debt of €101.5 million in 2023. In that regard, the government of Kosovo will fill vacancies in Kosovo's Pension Savings Trust (KPST) Board by June 2023, which will continue ensuring the normal functioning of the domestic public debt market.

**13. If downside risks materialize, our government may decide to make purchases of SBA resources.** While available financing and strong fiscal buffers ensure program financing 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 €100 million over 2023–24; a financing gap may also arise if planned external budget support operations fail to materialize. The precautionary SBA will help mitigate these risks. The government is working with other development partners (including the World Bank, and the bilateral development agencies of France and Germany) to identify additional budget support of about €150 million for 2024. These policies should allow to keep government deposits at the Central Bank of Kosovo (CBK) at adequate levels **(quantitative performance criteria).**

***Financial Sector Policies and Reforms***

**14. The process to select a new Central Bank Governor is ongoing and is expected to be concluded soon.** This requires a decision by the Assembly which is expected to be taken by mid-2023. To preserve the international liquidity of foreign exchange reserves, the Central Bank of Kosovo (CBK) will keep its holdings of domestic government securities constant in nominal terms over 2023–24 **(indicative target);** and the 2021 SDR allocation will remain as part of the CBK's international reserves.

**15. Reviewing and updating the organizational structure of the CBK will ensure its effective and efficient operation.** In line with the 2019 Financial Sector Stability Review (FSSR) recommendations, the non-executive and executive boards of the CBK will review the effectiveness of decision-making bodies and issue a circular clarifying the roles and responsibilities of the CBK Board (including its interactions with risk management and internal audit committees) and specify ways to structure information requests, confidentiality, and secrecy arrangements **(SB for end-November 2023).** This circular will be approved by both the executive and non-executive boards of the CBK and be fully in line with the CBK charter.

**16. The government will continue strengthening the governance of the financial sector.** To that end, we plan to finalize a new Bank Law establishing improved licensing criteria for banks, and standards for their operations, organization, and management, while strengthening the bank resolution framework and make it available for public consultation. We plan to finalize a draft in line with international best practice in 2023 **(SB for end-November 2023),** and to submit it to the Assembly in early 2024 **(SB for end-January 2024).**

**17. We will continue to improve our capacity to effectively monitor and analyze financial sector risks.** In this regard, 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 relevant CBK departments and the dissemination of stress testing results. Moreover, the Kosovo Agency of Statistics (KAS) in collaboration with the CBK is working to strengthen the surveillance of the residential housing sector. To that end, KAS will produce a roadmap to create a housing price index and related surveillance data **(SB for end-September 2023).**

**18. The CBK will conclude a safeguards assessment ahead of the SBA's first review.** The last safeguards assessment was completed in 2021. Most of its recommendations have been implemented, and work towards the implementation of remaining recommendations is ongoing. The Ministry of Finance, Labor, and Transfers and the CBK will sign an updated Memorandum of Understanding clarifying their respective responsibilities for servicing financial obligations to the IMF under the new arrangements.

***Structural Reforms to Foster Convergence with Benefits for All***

**19. The Government of Kosovo will continue to implement policies to close infrastructure and governance gaps with the aim of creating new growth engines.** In this regard, we have taken measures to improve the absorption of the public investment program (PIP) and plan to continue working in this area. Measures to increase PIP absorption in 2022, included compensating contractors for higher inflation and increasing the allocation for expropriations. In 2023, the Ministry of Finance, Labor, and Transfers plans to issue circulars to require budget organizations to include needed expropriations as part of project costs (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 submitted unless expropriations costs are budgeted for. As part of our effort to enhance implementation of the PIP, we are committed to finalize the Public Procurement Law that will be aligned with the EU *acquis* and plan to send it for approval by the Government after public consultation.

**20. In parallel, the government continues to work on enhancing the PIP's effectiveness.** In this regard, the government has requested an update of the Public Investment Management Assessment (PIMA) to identify emerging challenges since the last update in 2018 (See also Section IV). We are persuaded that the implementation of PIMA recommendations should allow to continue strengthening the planning, and execution of public investment. In this regard, the Ministry of Finance, Labor, and Transfers will continue implementing quality control checks of data entered by budget organizations in the PIP system to ensure investment quality.

**21. The government of Kosovo remains committed to strengthen the operations of publicly owned enterprises (POEs).** This should ensure a gradual improvement in the quality of public services and contribute to mitigate fiscal risks. We understand that the collection, analysis, and dissemination of POE financial data can help identify challenges, monitor, and contain fiscal risks, and increase accountability. To that end, we will start publishing, on a quarterly basis, POE's financial and economic data; and ensure that 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).** To strengthen POE management and attract private capital, the largest 5 POEs (out of total 18 POEs) will be transferred to a new Sovereign Fund (SF) that will operate as an autonomous public institution under the Assembly. The draft law creating the SF is currently undergoing public consultation. The SF will not create contingent liabilities for the state.

**22. We will continue with our efforts to close AML/CFT gaps.** Since 2020 we have published a money laundering typology and strengthened the cooperation between the Financial Investigation Unit (FIU) and tax and customs authorities. Moreover, work is ongoing on a concept-document analyzing the changes needed in Kosovo's legislation to abide with EU directives regarding anti-money laundering and countering the financing terrorism.

## IV. POLICY FRAMEWORK AND REFORMS PROPOSED UNDER THE RESILIENCE AND SUSTAINABILITY TRUST ARRANGEMENT

**23. The RST-supported program will support the implementation of our energy and climate reform agenda.** In general terms, RST policies will support efforts to increase the share of renewables in energy generation, decrease emissions, tackle pollution, foster energy security, strengthen competition in electricity markets, and protect vulnerable energy consumers.

**24. As part of our efforts towards climate mitigation and adaptation, the Assembly recently approved Kosovo's energy strategy for 2023–32.** In addition, a law on environmental impact assessment was approved by Parliament in January 2023 and published in the Official Gazette; and the government is preparing laws on climate change and a national strategy to reduce emissions. These efforts are in line with our commitment to accelerate the green transition and reduce emissions and pollution, which are a part of our European roadmap in the context of the Sofia Declaration and the Green Agenda for the Western Balkans.

**25. Reducing high pollution levels is a one of our government's priorities.** To that end, Kosovo's Electricity Corporation (KEK) will install filters in each of the units of "Kosova B" power plant over 2024–25 to bring pollution levels from these units to EU standards. This action will result in a decrease of pollution in and around Prishtina of around 40 percent. To secure the installation of the filters, the preparatory technical work by KEK will be finalized by the third quarter of 2023; moreover, KEK will include in its Budget Plan for 2024 an allocation to complement the secured EU financing for the installation of the first of the filters in the Kosova B2 Unit. As installing the filter will require to stop operating 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 supply of electricity. A similar process will be followed over 2024–25 to secure the installation of the filter in the B1 Unit.

**26. We remain committed to support the affordability of energy bills for vulnerable energy consumers.** In collaboration with the World Bank, the government of Kosovo is working to redefine the universe of vulnerable energy consumers, to ensure that lower-income households can access to adequate levels of electricity without jeopardizing other basic household needs. As this work will be finished in the third quarter of 2023, the budget for 2024 will include an allocation to secure the implementation of transfers to these vulnerable energy consumers.

**27. Increasing the share of renewable energy generation is a key objective of the Government.** As outlined in our energy strategy, we aim to increase the share of renewable electricity to 35 percent by 2031, from around 5 percent in 2022. To that end, the government has been working to attract private financing to renewable electricity production and plans to conduct a first pilot competitive auction for 100 MW of solar electricity generation to be installed in public lands before end-2023. This will require defining the auction's terms of reference through an administrative instruction of the Minister of Economy which will be in line with best international practice **(Reform Measure (RM) for end-May 2023).** Moreover, KEK has been working with the

German International Cooperation Agency (KfW) to secure the installation of 100 MW of state-owned solar electricity generation capacity in KEK premises by 2026; in parallel, the government has been analyzing the possibility of adding state-owned renewable electricity capacity for another 100–150 MW. As Kosovo has proved potential for both solar and wind-based electricity generation, the government will analyze the advantages and disadvantages of each option and decide on a course of action by the fourth quarter of 2023; on this basis, the government will prepare a technical proposal describing the possible locations, technical specifications, the project's timeline, and estimated project costs by the first quarter of 2024 **(RM for end-March 2024).** To secure the project's financing, the government will create, before July 2023, a sub-account under the Treasury Single Account that will be used to earmark resources to this end, with the procedures for the spending of these resources to be defined in the budget law. The submission to the Assembly of a budget for 2024 that includes allocations to subsidize electricity consumption of vulnerable energy consumers according to redefined criteria as described above; and to begin implementation of the project to add 100–150 MW of new state-owned renewable electricity capacity, will be a main action in the context of our program **(RM for end-October 2023).**

**28. More generally, the government has been preparing a law on renewable energy that transposes Kosovo's energy commitments with the EU.** This law defines, among other elements, the general framework to attract private capital into renewable energy using competitive auctions. The government will submit this law to Parliament in the third quarter of 2023 **(RM for end-September 2023)** and intends to start implementing it in 2024. To that end, the Ministry of Economy has begun working on the regulations and administrative instructions that will accompany the law.

**29. Strengthening regional integration and promoting competition in electricity markets is an essential part of our plan to attract private investment.** In line with this, Kosovo's electricity market operator (KOSTT) has transferred the rights for the organization of day-ahead and intra-day electricity market, as well as the right for clearing and settlement, to the recently created regional electricity market between Albania and Kosovo (ALPEX). In addition, the Ministry of Finance, Labor, and Transfers will issue an administrative instruction on the reverse charge procedure for VAT declaration for electricity supply, so the tax treatment of ALPEX transactions on both sides of the border is similar (RM for end-June 2023). These actions will allow ALPEX to start operating the day-ahead electricity market in Kosovo in the third quarter of 2023. Market determined reference prices will gradually replace those established by ERO in the competitive auctions to attract private capital to renewable energy generation.

**30. Increasing energy-efficiency is an essential part of our development pathway.** As outlined in our energy strategy, we plan to improve the energy efficiency of buildings and promote efficient cogeneration and efficient district heating systems. To that end, Kosovo's Energy Efficiency Fund (EEF) will adopt a plan describing the objectives, scope, expected impact, costs, monitoring and reporting to increase energy efficiency of residential buildings, which will begin implementation in the second half of 2023 **(RM for end-July 2023).**

**31. Increasing efficiency also requires to gradually start accounting for the negative externalities associated with the use of brown energy.** To analyze the impact of a gradual recognition of these externalities in Kosovo's economy, the Government of Kosovo will create, before end-May 2023, a working group with representatives from the Ministries of Finance, Labor, and Transfers; of Economy; and of Environment, Spatial Planning, and Infrastructure. This working group will use state of the art techniques, including the IMF's Climate Policy Assessment Tool (CPAT) to develop alternative scenarios to assess the possible impact on emissions, pollution, activity, and inequality, over the next 10–15 years of a gradual recognition of the negative externalities of brown energy use. The working group will prepare a report describing alternative scenarios and policy options that will be presented 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.

**32. To better identify climate change-related transition costs, we will start collecting data on the possible impact of the Carbon Border Adjustment Mechanism (CBAM) on Kosovo's exports.** To that end, the Central Bank will also issue a regulation to standardize bank practices to monitor and report data related to climate risks, including transition risks related to CBAM implementation **(RM for end-June 2024).** In addition, we will work to enhance the CBK's stress testing framework to consider the impact of energy price increases; and we will take the necessary steps to develop green financing in collaboration with our international partners.

## V. PROGRAM MONITORING

**33. Program implementation will be monitored through quantitative performance criteria, indicative targets, a continuous performance criterion, prior actions, structural benchmarks, and RST reform measures.** The program will feature reviews every six months. The prior actions and structural benchmarks are set out in Table 1. The quantitative targets for end-June and end-December 2023 and indicative targets for 2024, along with continuous quantitative performance criteria, and other indicative targets, are set out in Table 2. RST reform measures are set out in Table 3. The attached 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<br>Prog. Target | September<br>Ind. Target | December<br>Prog. Target | March<br>Ind. Target | June<br>Ind. Target | September<br>Ind. Target | December<br>Ind. Target |
| **1. Quantitative performance criteria** | | | | | | | |
| Floor on the Overall Balance of the General Government 1/ | (113) | (169) | (225) | (58) | (116) | (174) | (232) |
| Floor on the Stock of General Government Deposits at CBK | 576 | 571 | 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 |
| **3. Indicative targets** | | | | | | | |
| Ceiling on Contingent Budget Allocations 3/ | 358 | 358 | 358 | 210 | 210 | 210 | 210 |
| Ceiling on Holdings of Government Debt by the CBK 2/ | 200 | 200 | 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: Proposed Prior Actions and Structural Benchmarks Under the SBA

| | Measure | Timeframe |
|---|---|---|
| **Proposed Prior Actions** | | |
| 1 | The ERO to adjust electricity tariffs so the electricity sector's financial flows remain balanced in 2023 with no blanket subsidies | Before end-April 2023 |
| **Proposed Structural Benchmarks** | | |
| ***Fiscal Governance*** | | |
| 1 | Government starts publishing publicly-owned enterprises' (POEs) annual financial reports; and quarterly data on POE performance. | June 2024 |
| 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 |
| 3 | Government starts publishing annual fiscal risk analysis together with budget submission to Parliament | November 2023 |
| 4 | Government approves new Customs Code | June 2023 |
| 5 | Tax administration agency (TAK) adopts new action plan to reduce informality | July 2023 |
| 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 |
| ***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 |
| 2 | Finalization of draft Banking Sector Law in line with FSSR recommendations | November 2023 |
| 3 | Finalization of circular clarifying roles and responsibilities of Central Bank Board based on Kosovo's legal framework | November 2023 |
| 4 | Submission to Parliament of Banking Sector Law in line with FSSR recommendations | January 2024 |

## Table 3. Kosovo: Reform Measures Under the RSF

| | Measure | Timeframe |
|---|---|---|
| **Proposed 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 |
| ***Expanding Greener Generation and Reducing Emissions (Energy Pillar 2)*** | | |
| RM2 | Government to finish technical proposal to add 100 – 150 MW of wind or solar PVPs capacity to Kosovo's energy matrix to start implementation in 2024 | March 2024 |
| 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 |
| RM4 | Working group presents to Cabinet draft report discussing implications of EU carbon price initiatives for Kosovo, using CPAT tool. | March 2024 |
| 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 |
| ***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 |
| ***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 |
| ***Crisis Preparedness and Monitoring Transition Risks*** | | |
| RM8 | Central Bank to issue regulation defining practices for banks to monitor and report data on exporting firms that may be exposed to transition costs related with CBAM implementation | June 2024 |

# Attachment II. Technical Memorandum of Understanding

1. **This Technical Memorandum of Understanding (TMU) sets out understandings between the Kosovo authorities and the IMF.** These understandings refer to the definitions of quantitative performance criteria (QPCs), indicative targets (ITs), adjusters, and data reporting requirements for the Stand-By Arrangement (SBA) and Resilience and Sustainability Facility Arrangement (RSF) as per the Letter of Intent and Memorandum of Economic and Financial Policies (LOI–MEFP) dated May 9, 2023. The TMU also sets out the necessary conditions without which SBA Structural Benchmarks (SBs) and RSF Reform Measures (RMs) cannot be considered implemented.

2. **Any variable mentioned but not explicitly defined in this TMU will be defined in accordance with the IMF's standard statistical methodology.** For any variable or definition that is relevant for program targets but is omitted from the TMU, the authorities shall consult with the Fund staff on the appropriate treatment to reach an understanding based on the Fund's standard statistical methodology. All references to "days" indicate "calendar days" unless stated otherwise. All variables expressed as percent of GDP will use those in Table 1 of this TMU for their computation.

3. **Program Exchange Rates.** For the purposes of the program, the exchange rates of the Euro for the duration of the program are those projected by the World Economic Outlook corresponding to April 2023 as shown in Table 1 of this TMU.

4. **In addition to the quantitative performance criteria listed in Table 1 of the MEFP, the SBA will include the following performance criteria standard to all IMF arrangements, namely:**

I. no imposition or intensification of restrictions on the making of payments and transfers for current international transactions.

II. no imposition or intensification of import restrictions for balance of payments reasons.

III. no introduction or modification of multiple currency practices.

IV. no conclusion of bilateral payments agreements that are inconsistent with Article VIII of the IMF Articles of Agreement.

These four performance criteria will be monitored continuously.

## I. SBA QUANTITATIVE PERFORMANCE CRITERIA

## A. Floor on the Overall Budgetary Balance of the General Government

***Definitions***

5. **General Government.** For the purpose of this TMU, general government (GG) is defined as per Government Financial Statistics Manual (GFSM) 2014 and it includes the Executive, Legislative, and Judiciary branches of the Government, its Municipalities, and any other public entities that

receive direct budgetary appropriations. It excludes publicly owned enterprises (POEs) and socially owned enterprises (SOEs).

**6. Overall Balance of the GG.** It is defined as the total revenues of the GG minus the total spending of the GG. The program includes a floor on the overall balance of the GG as shown in Table 1 of the MEFP, which in no circumstance will result in a "fiscal rule" deficit exceeding 2 percent of GDP.[1]

**7. Total Revenues of the GG.** They are recorded on a cash basis cumulatively since the beginning of the year. They include direct and indirect tax revenues, non-tax revenues, interest revenues, other receipts associated with dedicated revenues of the Air Navigation Service Agency and inflows held in trust (Deposit Funds), as well as [budget support grants] and donor-designated grants (DDGs). Transfers from the Privatization Agency of Kosovo (PAK) to finance PAK's current expenditures as included in the GG budget are not revenue; instead, they are part of domestic financing (a "below the line" transaction).

**8. Total Spending of the GG.** It is recorded on a cash basis cumulatively since the beginning of the year and comprises spending on wages and salaries, purchases of goods and services, subsidies and transfers, interest expenditure, capital expenditures (including under the "Investment Clause" (¶10), capital transfers and other investment outlays and recapitalizations of the Kosovo Credit Guarantee Fund, KCGF), PAK current expenditures as included in the GG budget and expenditures financed by DDGs. The change in the balance of accounts payable (if any) between the test date and the end of the previous fiscal year will also be included. Government on-lending to POEs is excluded from GG spending as it is a "below the line" transaction. If an entity cannot pay debt service on a loan guaranteed by the GG, the liabilities assumed by the GG because of the failure of debt repayment will be included in GG spending.

**9. Balance of Accounts Payable.** They are defined as all claims that have remained unpaid for more than 30 days including wages, social contributions (including pensions), family allowances, amortization, domestic interest payments, and payments to suppliers for goods provided and services rendered. For reference, the balance of accounts payable at end-2022 was € 23.7 million.

***Adjusters***

**10. External Disbursements Under the Investment Clause.** The floor defined in ¶6 is subject to an adjuster based on the deviations between actual and programmed disbursements of external project loans under the Investment Clause (IC). Disbursements of IC-linked external financing are defined as disbursements for projects contracted with multilateral and bilateral development agencies (donors) by the General Government and approved after 2015, in line with the provisions of Article 7 of the Law No. 05/L -063 on Amending and Supplementing the Law on Public Financial Management and Accountability. Programmed IC-linked external project disbursements are

[1] The computation of the "fiscal rule" deficit excludes externally financed (IFI and bilateral) investment contracted after 2015. Kosovo's legal framework mandates the "fiscal rule" deficit ceiling to be at most 2 percent of GDP.

specified in Table 1 of this TMU. Specifically, if the cumulative proceeds from IC-linked external project financing

**I.** exceed program projections, the floor defined in ¶6 will be adjusted downwards by 100 percent of the excess in IC-linked external project financing. This excess will be capped at €54 million in 2023, which represents the difference between programmed and budgeted amounts, as shown in Table 1 of this TMU.

**II.** fall short of program projections, the floor defined in ¶6 will be adjusted upwards by 100 percent of the shortfall in IC-linked external project financing.

**Table 1. Stand-By Arrangement: Relevant Economic Assumptions**

(Cumulative flows in Euro million unless otherwise noted)

| | 2023 | | | 2024 |
|---|---|---|---|---|
| | Q2 | Q3 | Q4 | |
| **External Budget Support Grants** | **67** | **67** | **86** | **0** |
| **Budget Support Loans (exc. RST and SBA)** | **15** | **53** | **113** | **60** |
| World Bank | 15 | 15 | 75 | 60 |
| OFID | 0 | 38 | 38 | 0 |
| **Net PAK Balance** | 0 | 0 | 0 | 0 |
| **Domestic Fiscal Revenues** | **1,373** | **2,060** | **2,746** | **2,952** |
| **Primary Current Expenditure** | **1,171** | **1,756** | **2,341** | **2,434** |
| **Investment Clause Capital Spending** | | | | |
| Programmed | 38 | 56 | 75 | 103 |
| Budgeted | 65 | 97 | 129 | 117 |
| **Memorandum** | | | | |
| Nominal GDP (full year; Euro million) | | | 9,886 | 10,700 |
| Euro - SDR Exchange Rate (year average) | | | 1.255 | 1.264 |
| Euro - USD Exchange Rate (year average) | | | 0.941 | 0.948 |
| Euro - SDR Exchange Rate (end of period) | | | 1.260 | 1.268 |
| Euro - USD Exchange Rate (end of period) | | | 0.946 | 0.950 |

Sources: World Economic Outlook database and IMF staff.

**11. External Budget Support Grants.** The floor defined in ¶6 is subject to an adjuster based on temporary negative deviations between actual and programmed disbursements of external budgetary support grants. Programmed external budget support grants are specified in Table 1 of this TMU. Specifically, if disbursed grants are lower than programmed, the floor defined in ¶6 will be adjusted downwards by 100 percent of the shortfall, provided deviations are temporary. The temporary nature of the deviation will be determined through discussions with corresponding donors. If the deviation is permanent, (i.e., grant disbursements were permanently cancelled), this adjuster will not apply. The adjuster will not apply if grant disbursements are higher than programed.

**12. 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 will be adjusted downwards by 100 percent of the shortfall, with the shortfall capped at €50 million in 2023.

**13. Monitoring.** The overall balance of the GG and applicable adjusters will be measured at the end of each test date. The data that should be provided to IMF staff for monitoring the Quantitative Performance Criteria (QPC) on the overall balance of the GG are specified in Section F of this TMU.

## B. Floor on the Stock of General Government Deposits

***Definitions***

**14. GG Deposits.** GG deposits include the totality of funds in the Kosovo Treasury Single Account (TSA), including the account created for the expansion of renewable electricity generation capacity (¶40), and in which RSF resources will be deposited pending their use for climate change mitigation purposes. It also includes the deposits of the Privatization Agency of Kosovo (PAK) and (or) its successor agencies or institutions. For reference, GG deposits at the end-2022 were €586 million, comprised by €420 million in the TSA and €166 million in PAK deposits. The program includes a floor on GG deposits as shown in Table 1 of the MEFP. This floor will be net of the resources deposited in the TSA sub-account created for the expansion of renewable electricity capacity (¶40).

***Adjusters***

**15. External Budget Support Grants.** The floor defined in ¶14 is subject to an adjuster based on temporary negative deviations between actual and programmed disbursements of external budgetary support grants (Table 1 of this TMU). Specifically, if disbursed grants are less than that programmed, the floor defined in ¶14 will be adjusted downwards by 100 percent of the shortfall, provided deviations are temporary. If the deviation is permanent, this adjuster will not apply. The permanent or temporary nature of deviations is defined as in ¶11. The adjuster will not apply if disbursed grants are more than programmed.

**16. Budget Support Loans.** The floor defined in ¶14 is subject to an adjuster based on temporary negative deviations between actual and programmed disbursements of external budgetary support loans (Table 1 of this TMU). In the baseline, budget support loans do not include SBA resources, as the SBA is intended to be precautionary. Specifically, if disbursed budget support loans are less than programmed, the floor defined in ¶14 will be adjusted downwards by 100 percent of the amount of the shortfall, net of any purchases made under the SBA, provided deviations are temporary. If the deviation is permanent, this adjuster will not apply. The permanent or temporary nature of deviations will be defined as in ¶11. The adjuster will not apply if disbursed loans exceed the programmed amounts.

**17. Downside Risk Scenario.** If budget support loans are disbursed as programmed but a downside risk scenario materializes (¶12), 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 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 2023.

**18. Net PAK Balance.** The floor defined in ¶14 incorporates net PAK balance as reported in Table 1 of this TMU. The floor defined in ¶14 will be adjusted 100 percent upwards by the excess of actual net PAK balance and programmed amounts. If actual net PAK balance is lower than programmed, the floor defined in ¶14 will be adjusted downwards by the shortfall, with this shortfall capped at €20 million for 2023.[2] Shortfalls will not include pure transfers to successor agencies or institutions.

**19. Monitoring.** The stock of GG deposits will be measured at the end of each test date.

## C. Ceiling on External Payment Arrears by the General Government

***Definitions***

**20. Non-Financial Public Sector (NFPS).** The NFPS includes the GG (¶5) plus all non-financial publicly owned enterprises (POEs). POEs include all entities defined in Article 2 of Law No. 03/L-087. Non-financial POEs include all POEs whose principal activity is the production of goods and non-financial services.

**21. External arrears** are defined as total external debt service obligations of the government that have not been paid when due (including the relevant grace period), including of debt of NFPS entities guaranteed by the general government. External arrears exclude external debt service obligations subject to ongoing good faith negotiations of debt rescheduling agreements. A debt service obligation is defined to be external if the creditor is not resident in Kosovo.

**22. External payment arrears for program monitoring purposes.** These are defined as external debt obligations (principal and interest) falling due after May 15, 2023, that have not been paid within 90 days of the due date, considering the grace periods specified in contractual agreements.

**23. Monitoring.** This QPC will be monitored on a continuous basis. The Ministry of Finance, Labor, and Transfers will inform IMF staff immediately of any accumulation of external payment arrears. Data on (i) debt-service payments, and (ii) external arrears accumulation and payments will be transmitted monthly by the Ministry of Finance, Labor, and Transfers upon the signature of the Letter of Intent and within 5 days of the end of each month.

[2] Extra spending from PAK includes payments of court orders and expropriations, among other. Revenues include mainly privatizations but can also include interest and other revenues from assets.

## II. SBA INDICATIVE TARGETS (IT)

**24. Central Bank of Kosovo (CBK) holdings of Kosovo government securities.** The program will include a ceiling on the amount of Kosovo government securities held by the CBK. This ceiling will be €200 million and apply on a continuous basis. If the amount of Kosovo government securities held by the CBK is more than €200 million, the floor defined in ¶14 will be adjusted upwards by 100 percent of the deviation. The adjuster will not apply if the amount of Kosovo government securities held by the CBK is less than €200 million. For reference, the stock of government securities held by the CBK at end-2022 was €197 million.

**25. Contingent Budget Allocations.** Contingent allocations in the budget for 2023 as approved by the National Assembly in the fourth quarter of 2022 include those in the following budgetary lines: "Contingencies in the Ministry of Finance, Labor and Transfers" (€121.9 million), "Contingency for Energy" (€75 million), "Contingent Expenditures" (€10 million), "Economic Revival Program" (€144.3 million), and "Unforeseen Expenditures" (€6.7 million), for a total of €358 million. The program will include a ceiling for all contingent allocations (i.e., considered jointly) of €358 million in 2023; moreover, the budget for 2024 will include contingent allocations that, jointly, will not surpass €210 million. This ceiling will apply on a continuous basis.

## III. SBA CONSULTATION CLAUSE

**26. Definition.** Beginning in May 2023, in case cumulative domestic fiscal revenues (that is, excluding budget support grants and DDGs) are lower than programmed by 5 percent or more, and (or) if expenditures to address unexpected shocks result in an expected increase of total current primary spending of more than 5 percent (both as specified in Table 1 of this TMU), IMF staff and Kosovar authorities will reengage to assess whether a revision to quantitative targets is warranted by a persistent shock. The upcoming 2023 July and October World Economic Outlook updates will be used as a key input 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.

## IV. SBA PRIOR ACTIONS STRUCTURAL BENCHMARKS

**27. The program includes prior action (PA) and structural benchmarks (SBs) as referred to in Table 2 of the MEFP.** This section defines necessary conditions for the PA and SBs to be considered implemented.

**28. The Energy Regulatory Office (ERO) will adjust electricity tariffs so the electricity sector's financial flows remain balanced in 2023 with no blanket subsidies.** The tariff adjustment will occur before end-April 2023. Total subsidies factored in the calculation of the new tariffs will include at most €18 million of unused subsidies in 2022, and additional €20 million of subsidies targeting households consuming less than 800 kWh/month. International electricity prices factored in tariffs will be in line with market prices and domestic electricity production costs will be in line with those agreed in contracts with state-owned and private domestic electricity generators.

Tariffs will include investment plans agreed with the sector's stakeholders. Tariffs will gradually compensate for the deviations between actual and notional tariffs in 2022.

**29. Government to start publishing POEs' annual financial reports and quarterly data on POE performance.** Annual reports should include summary information of at least the 7 largest POEs to allow monitoring of their annual financial performance. The report should include the standard income statement and balance sheet information, covering variables such as income, salary, and non-salary expenses, profits, debt ratios, assets, liabilities, and financial flows to and from the government budget, based on audited data. The report should have a descriptive summary of the financial transactions between the government and POEs, including direct budget transfers, subsidies, direct lending, on-lending, government guarantees, and dividends received. The annual report will be produced by the Ministry of Economy and be published in the Ministry of Economy's website. The quarterly reports (summarized versions of the annual report with readily available data at a quarterly frequency) will be produced by the Ministry of Finance, Labor, and Transfers and be published in the Ministry of Finance, Labor, and Transfers' website.

**30. Government to start publishing within the quarterly report of the Treasury, the rationale and intended impact, use and beneficiaries of contingency allocations to boost transparency.** Contingent allocations include those ¶25 and any other created subsequently to address a contingent need. To foster transparency on the use of these allocations, the treasury quarterly report will include a section describing their use, intended impact and rationale, as well as beneficiaries. The section will include references to decisions by the government on the use of these allocations. The Treasury quarterly report will be published in the Ministry of Finance, Labor, and Transfers' website as is customary.

**31. Government to start publishing stand-alone annual fiscal risk analysis at the time of the budget submission to Parliament.** The stand-alone annual fiscal risk analysis should discuss the main risks envisaged at the time of the budget preparation and their assessed impact on economic activity, inflation, external accounts, budget revenues and expenditures for the upcoming fiscal year. These risks may include but are not limited to exogenous external risks (changes in international commodity prices and external financial conditions, among other), other macroeconomic risks, public debt interest rate and refinancing risks, and risks related to POE performance. The stand-alone fiscal risk analysis will be published in the MOFLT's website at the time of the submission of the budget documents to Parliament.

**32. Government approves a new Customs Code.** The provisions of updated Customs and Excise Code will transpose those of the European Union customs code and excise *acquis*. Accordingly, the new Customs and Excise Code will provide a comprehensive framework for customs rules and procedures in Kosovo, considering recent developments in the field of trade and modern means of communication, and will result in a fully automated system that will reduce administrative burden and improve the effectiveness of customs checks. The decision of the Government will be published in the Official Gazette as is customary.

**33. The Tax administration agency (TAK) to adopt a new action plan to reduce informality.** The plan's objective will be to further mobilize revenues, and will describe proposed actions, include implementation and monitoring procedures, expected outcomes; the plan will be shared with IMF staff and its activities and results will be published on TAK's website.

**34. 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.** The Ministry of Finance, Labor, and Transfers will issue circulars requiring budget organizations to include needed expropriations as part of project costs to gradually replace the current system of centralized expropriations, with one that will ensure that no new projects can be submitted unless expropriations costs are budgeted for. The circulars will be published in the Ministry of Finance, Labor, and Transfers' website upon approval.

**35. KAS to finalize roadmap to produce a residential housing price index and compile related surveillance data in collaboration with CBK.** The roadmap should include the major steps to be taken to compile a residential housing index, such as identifying data sources, assessing source data quality, and compilation methods. The roadmap should specify the implementation plans of each step, including the leading ministry or agency, the ministries and agencies involved, the timeline, and the measurable milestones. This roadmap will be published at KAS' website.

**36. Finalization of circular clarifying roles and responsibilities of Central Bank of Kosovo Board based on Kosovo's legal framework.** The executive and non-executive boards of the CBK will review the effectiveness of decision-making bodies and issue a circular clarifying the roles and responsibilities of the CBK Board (including its interactions with risk management and internal audit committees) and specify ways to structure information requests, confidentiality, and secrecy arrangements. The circular will incorporate recommendations of the Financial Sector Stability Review (FSSR) assessment of 2019 and subsequent capacity building missions. This circular will be approved by both the CBK Executive and Non-Executive Boards, be in line with CBK's charter, and will be published at the CBK's website.

**37. Finalization of draft Banking Sector Law in line with the 2019 FSSR recommendations, and subsequent submission to Parliament.** The new law will establish, *inter alia*, improved licensing criteria for banks; strengthened standards for their operations, organization, and management; and, strengthened bank resolution framework. Finalization of a draft law; and submission to Parliament will be considered as two separate actions. The decision of the Government approving the new Banking Law will be published in the Official Gazette as is customary.

## V. RSF REFORM MEASURES

**38. The program includes Reform Measures (RMs) as referred to in Table 3 of the MEFP.** This section defines necessary conditions for RMs to be considered implemented. RSF purchases will also be conditional on the SBA being on track.

**39. Submission to Parliament of Budget for 2024 in line with RSF objectives.** The budget for 2024 will include allocations to: (i) secure implementation of transfers to vulnerable energy consumers, in line with redefined criteria to select such consumers agreed in the context of collaboration with the World Bank; (ii) an allocation to add renewable electricity capacity for 100–150 MW; earmarked resources to this end will be kept in a sub-account within the Treasury Single Account (TSA) (¶40). Kosovo's Electricity Corporation (KEK) Budget Plan for 2024 will include an allocation to complement the secured EU financing for the installation of the first of the filters in the B2 unit of "Kosova B" in 2024; such a commitment will be informed through a letter from KEK's management to the Minister of Economy no later than end-July 2023. This letter and/or KEK Budget Plan will be published in KEK's website.

**40. Government to finish technical proposal to add 100–150 MW of wind or solar PVPs capacity to Kosovo's energy matrix to start implementation in 2024.** As Kosovo has proved potential for both solar and wind-based electricity generation, the government will analyze the advantages and disadvantages of each option and decide on a course of action by the fourth quarter of 2023; on this basis, the government will prepare a technical proposal describing the possible locations, technical specifications, the project's timeline, estimated project costs, and future operator of the additional capacity by the first quarter of 2024; the project will start implementation in 2024 as defined by the project's timeline. The proposal will be published on the website of the Ministry of Economy. To secure the project's financing, the government will create, before July 2023, a sub-account within the TSA that will be used to earmark resources to this end, including from the RSF; and a corresponding allocation will be included in the budget for 2024 (¶39).

**41. Submission to Parliament of Law on Renewable Energy delineating the use of competitive auctions to attract private sector investment in renewable electricity generation.** The law on renewable energy will transpose Kosovo's energy commitments with the EU and define, among other elements, the general framework to attract private capital into renewable energy using competitive auctions. The decision of the Government approving the law will be published in the Official Gazette as is customary.

**42. Working group presents to Cabinet draft report discussing implications of EU carbon price initiatives for Kosovo, using the Climate Policy Assessment Tool (CPAT).** To this end, the Government of Kosovo will create, before end-May 2023, a working group with representatives from the Ministries of Finance, Labor, and Transfers; of Economy; and of Environment and Infrastructure. This working group will use state of the art techniques, including the IMF's CPAT to develop alternative scenarios to assess the possible impact on emissions, pollution, activity, and inequality over the next 10–15 years of a gradual recognition of the negative externalities of brown energy use. This work will be reflected in a report describing alternative scenarios and policy options that will be presented to the Cabinet by end-March 2024. Upon presentation to the Cabinet, a summary of the report will be posted in the Ministry of Environment, Spatial Planning, and Infrastructure's website.

**43. Ministry of Economy to adopt Administrative Instruction allowing the launch of first auction for solar electricity generation in 2023.** The auction's primary objective will be to attract private financing to renewable solar electricity generation (of 100 MW) to be installed in public lands. The administrative instruction will define the auction's terms of reference and will be in line with best international practice, to ensure transparency and the attraction of reputable bidders. The administrative instruction will be published in the Official Gazette upon approval.

**44. Kosovo Energy Efficiency Fund (EEF) Board to approve plan to increase energy efficiency of residential buildings to start implementation in 2023:H2.** In line with Kosovo's energy strategy, Kosovo's EEF will adopt a plan describing the objectives, scope, expected impact, costs, monitoring and reporting to increase energy efficiency of social and residential buildings, which will begin implementation in the second half of 2023, as described by the plan. The plan will be posted in the EEF's website.

**45. 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).** Kosovo's electricity market operator (KOSTT) will transfer the rights for the organization of day-ahead and intra-day electricity market, as well as the right for clearing and settlement to the recently created regional electricity market between Albania and Kosovo (ALPEX). In addition, the Ministry of Finance, Labor, and Transfers will issue an administrative instruction on the reverse charge procedure for VAT declaration for electricity supply, so the tax treatment of ALPEX transactions on both sides of the border is similar. This administrative instruction will be published in the Official Gazette upon approval. These actions will allow ALPEX to start operating the day-ahead electricity market in Kosovo in the third quarter of 2023.

**46. CBK to issue regulation 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 a regulation 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.

## VI. REPORTING REQUIREMENTS AND FREQUENCY

***Daily***

**47. Government Revenues, Grants, Expenditure, Financing, and TSA Deposits.** Data include cumulative grants, revenues by type of tax and nontax income, and cumulative expenditure by main expenditure categories (wages, subsidies, goods and services, interest payments, capital expenditure). Financing should include all forms of financing (budget support loans, domestic debt amortization and placements, external debt amortization and placements, on-lending, deposits, and transfers from PAK deposits). Data for each working day should be available with a 5-day lag.

***Monthly***

**48. Central Bank Financial Statistics.** Includes central bank balance sheet and central bank survey. The information should be available with a 30-day lag from the end of the previous month.

**49. Electricity exports, imports, domestic production, and consumption, including volume and values,** as produced by KAS, with a 30-day lag after the end of each month.

**50. Balance of Accounts Payable.** They include claims that have remained unpaid for more than 30 days as defined in ¶9, reported by the Ministry of Finance, Labor, and Transfers. These data should be available monthly with a 5-day lag of the previous end of the month.

**51. General Government Financial Assets.** Includes information on the TSA account and disaggregation of level of the usable bank balance and special purpose accounts within the TSA account, as compiled by the Ministry of Finance, Labor, and Transfers with a 2-week lag from the end of each month.

**52. Net PAK Operations.** Includes the detail of PAK income, expenditures, and financing accounts with a lag of 2 weeks from the end of each month, complied by PAK. If PAK is succeeded or superseded (totally or partially) by other public agency and (or) institution, this requirement will apply as well to the new agency.

**53. Expenditure arrears of the central and local government.** They are defined as all claims that have remained unpaid for more than 60 days, compiled by the Ministry of Finance, Labor, and Transfers. These data should be available monthly with a 30-day lag from the end of each month.

**54. Financial Soundness Indicators of individual banks** compiled by the CBK within four weeks after the end of each month.

**55. Business turnover by economic sector,** as produced by TAK, with a 60-day lag from the end of each month.

**56. Movement of people at the border,** with a 60-day lag from the end of each month, will be transmitted by the Ministry of Finance, Labor, and Transfers.

***Quarterly***

**57. Balance of payments** in BPM6 format compiled by the CBK, available monthly with a 65-day lag.

**58. Revenues and expenditures reported in GFSM format.** They include a detailed breakdown of revenues between tax categories and nontax categories. Data compiled by the Ministry of Finance, Labor, and Transfers should be reported with a 30-day lag from the end of each month.

**59. Tax refund arrears,** with a 30-day lag from the end of each month, reported by the Ministry of Finance, Labor, and Transfers.

**60. Exports and imports,** including volume and prices compiled by the KAS, will be transmitted on a quarterly basis within 45 days after the end of each quarter.

**61. Debt Report.** The report should include information about debt service (external and domestic), debt placements, on-lending, guarantees, contingent liabilities arising from PPPs, project financing (differentiating by project and among those that are IC and non-IC), and financing terms by type of debt. The monthly report should be provided by the Ministry of Finance, Labor, and Transfers with a 30-day lag from the end of each month.

**62. Balance Sheet and Income Statement of Individual Banks.** Information should include bank-by-bank information with loans by economic sector and quality, provisions, NPLs, deposits by sector (household, corporate, public), etc. The information should be provided by the CBK with a 45-day lag from the end of each quarter.

**63. The number of government employees** will be provided by the Ministry of Finance, Labor, and Transfers with a 30-day lag from the end of each quarter.

# REPUBLIC OF KOSOVO

May 10, 2023

## REQUEST FOR STAND-BY ARRANGEMENT AND AN ARRANGEMENT UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY—WORLD BANK ASSESSMENT LETTER FOR THE RESILIENCE AND SUSTAINABILITY FACILITY

## WORLD BANK ASSESSMENT LETTER FOR THE RESILIENCE AND SUSTAINABILITY FACILITY

### A. Country Vulnerability to Climate Change Including Human, Social and Economic Costs

1. **Climate change poses a substantial risk to Kosovo's development progress.** The country is prone to a wide variety of natural hazards—including droughts, wildfires, landslides, earthquakes, and floods—that could inflict considerable damage to economic activity, fiscal balances, and the well-being of vulnerable populations. Projections for the Western Balkans region show higher regional warming than the world average, especially for mountainous areas, resulting in a decrease in overall annual precipitation, but with contrasting increases in winter precipitation. In Kosovo, this could lead to a decline of 50 days per year of snow cover by 2050[1], and more frequent spring flooding. Based on projections of higher temperatures, population growth, and decreases in annual precipitation, four out of five water basins in Kosovo may become water-stressed or water-scarce by 2050. Climate impacts on water resources are expected to impact the agricultural sector, which is the source of seven percent of value added in the economy, providing income security particularly for rural households where poverty is concentrated. Recent floods associated to heavy rain caused damages for an amount equivalent to 0.9 percent of GDP[2]. Climate change is also expected to impact the forestry sector with rising temperatures associated with increased risks of wildfires, change in species composition and soil erosion.

2. **Additional environmental degradation compounds the effects of climate change, with a disproportionate impact on the poor and most vulnerable.** High levels of atmospheric pollutants, including dust and particulate matter from coal-fired

[1] USAID (2017). Climate Change Risk Profile for Kosovo.

[2] Based on estimation from WB's Global Rapid Post Disaster Damage Estimation (GRADE).

power plants, add to the negative impact of climate change on the population. Pristina and other cities already have among the worst air quality in Europe [3], with concentrations of $PM_{2.5}$ exceeding WHO guidelines throughout the year[4]. Close to two thirds of the population currently uses solid fuels for winter heating, especially wood. The annual estimated economic cost associated with mortality from exposure to air pollution is in the range of US$160–US$310 million, equivalent to 2.5–4.7 percent of GDP in 2016.[5] Given Kosovo's high reliance on coal for power generation (it accounted for close to 95 percent of electricity generation in 2020)[6] and widespread practice of burning solid fuels in homes, particulate matter (PM) emissions are not expected to decline markedly under existing policies. Furthermore, climatic hazards have a greater impact on Kosovo's population, particularly poor and vulnerable groups, in comparison to peer countries because of a) use of obsolete industrial technologies, especially in coal power plants and mining; b) unsustainable water management and agronomic practices, deforestation, and destruction of slopes by mining activities; c) socio-economic vulnerability due to a high incidence of poverty and limited protection provided by the social protection system; and d) inadequate land use, municipal planning and construction regulation, which increases exposure of the population to hazards. Based on the latest Census (2011), around 6 in 10 people lived in rural areas. Nearly two thirds of the poor and extremely poor residing in rural areas face falling agricultural productivity. Alternative economic opportunities are limited because of the unproductive agricultural sector and because natural resources (for example water and land) are increasingly threatened by unmanaged pollution and deteriorating infrastructure. Key climate impacts such as crop failure, loss of pasture lands and water resources for livestock would negatively affect the most at-risk and poor households.

**3. Annual GHG emissions are estimated at 9,613 Gg of $CO_2$ eq in 2019.** $CO_2$ makes up most of all emissions in Kosovo (88 percent), followed by methane (10 percent). As such, fossil fuel combustion represents the key driver of GHG emissions. The 2019 GHG inventory identified the energy sector as the source of most emissions with 86 percent of the total, followed by the agriculture sector and land use (8 percent of the total) and the waste sector (5 percent of the total GHG emissions). In comparison with other countries in Europe, Kosovo has relatively low emissions per capita (5 tons of $CO_2$ equivalent per capita per annum), while GHG emissions per unit of GDP (0,5 kg $CO_2$ equivalent per EUR) are higher. Transport is the fastest growing contributing sector contributing to GHG emissions, with an estimated annual traffic growth of 4.4 percent and an increase in motorization of 80 percent between 2010 and 2020.[7] Kosovo's heavy reliance on fossil fuels for energy production, as well as for transport, underscores the need to support the energy transition.

[3] The World Bank (2019). Air Quality Management in Kosovo.

[4] IQAir 2022. World Air Quality Report 2021. https://www.iqair.com/world-most-polluted-cities

[5] The World Bank (2019). Air Quality Management in Kosovo.

[6] Source: IEA

[7] Envisaging a healthier, greener, and more inclusive urban future in Kosovo, UNDP, December 13, 2021

## B. Government Policies and Commitments in Terms of Climate Change Adaptation and Priority Areas to Strengthen Resilience

4. **Kosovo has prepared and approved several climate-related strategic documents with a specific focus on climate change adaptation.** Efforts have also been made to align legislation to the EU climate acquis. The Climate Change (CC) Strategy for the period 2019–28[8] is the basic framework for adaptation to climate change. The CC Strategy aims to a) develop a framework for climate change policies; b) establish disaster risk reduction mechanisms for sectors exposed to climate change risks; c) enhance adaptive capacities of vulnerable communities, particularly of the poor farmers, marginal groups and women to address the climatic impacts and related risks on their lives and livelihoods and d) strengthen the institutional framework. A three-year action plan for the CC Strategy was approved covering the period 2019–21. The Ministry of Environment and Spatial Planning (MESP) is responsible for the monitoring of the implementation of the CC Strategy. In the water sector, Kosovo has a good policy, legal and strategy framework in place, which is mostly in line with EU requirements. An Intersectoral coordination mechanism through the Inter-Ministerial Water Council is in place which aims at integrating water issues in Government's development policies.

5. **Despite the progress on the adoption of the CC Strategy and action plan, the advancements in the regulatory framework for climate adaptation and resilience strengthening remain limited.** The adoption of the Law on Climate Change is pending although the target date for adoption was end-2022. In the absence of the Law on Climate Change, there is no legal basis for a National Energy and Climate Plan (NECP) as required by the Energy Community. Moreover, the country has not yet adopted a National Adaptation Strategy (NAS), and currently is working on a voluntary Nationally Determined Contributions[9] (NDCs) system, which will also include adaptation measures in the sectors of water, health, biodiversity and agriculture, forestry, and land use. With donor support, Kosovo has reestablished the Climate Change Council, initiating the process of developing the voluntary NDCs. In the water sector, key challenges lie in the implementation and enforcement of the existing policy framework and the practical development of integrated development plans based on national level coordination.

6. **Adaptation measures to climate change are central to the reduction of risks and damages from the current and future impacts of climate change in a cost-effective manner.** The aim of the NAS under development is to establish new and enhance present-day instruments and tools of disaster risk reduction that are important for sectors of economic significance which are particularly vulnerable to climate change impacts. The NAS also aims to improve the adaptive capacity of natural systems, in particular vulnerable ecosystems, and society (for example

[8]https://konsultimet.rks-gov.net/Storage/Consultations/14-13-59-04102018/Climate%20Change%20Strategy%20and%20Action%20Plan_sep_2018.pdf

[9] Given its status, Kosovo is not a party to the United Nations Framework Convention on Climate Change and the Paris Agreement, hence is not required to submit NDCs. Nevertheless, in 2021, Kosovo launched a discussion with international stakeholders to prepare a voluntary NDC.

marginalized groups and women, poor farmers), to address the climatic impacts and related risks on their lives and livelihoods.[10]

## C. Government Policies and Commitments in Terms of Climate Change Mitigation and Priority Areas to Reduce Greenhouse Gas Emissions

7. **Several strategic documents guide the climate mitigation agenda.** Kosovo has prepared a GHG inventory for the period 2008–19[11], the CC Strategy 2019–28 and Action Plan on Climate 2019–21[12]. The CC Strategy is the basic framework for the reduction of GHGs. The 2019–28 National Strategy and Action Plan on Climate Change has been approved by the Government and a climate change concept paper was approved in December 2020. An Administrative Instruction for Monitoring GHG Emissions of 2016 defines the governance, inter-institutional arrangements, and sets out deadlines for providing data on GHG emissions.

8. **The Government has recently approved a new Energy Strategy for 2022–31, targeting a 32 percent reduction of GHG emissions in the power sector.** Moreover, Kosovo has an overall target to reduce GHG emissions by 8.95 Mt $CO_2$ eq by 2030 (i.e. a reduction of approximately 16.3 percent compared to 2016 levels)[13]. The strategy foresees that by 2031, 35 percent of total electricity consumption will be covered by Renewable Energy Sources (RES), with total installed RES capacity reaching 1600 MW, coupled with major energy efficiency investments. Implementation of this strategy will require significant mobilization of both private sector investment and public sector resources, which the strategy estimates at around Euro 3.1 billion. Kosovo has a Law on Energy Efficiency (2018) and a Law on the Energy Performance of Buildings (2016), which are currently being reviewed by the Government.

9. **With the signing of the Sofia Declaration on the Green Agenda in November 2020, Kosovo committed to decarbonization by 2050**. One of the milestones to attain this target is the adoption of targets on renewable energy, energy efficiency, and reducing greenhouse gas emissions by 2030. Kosovo has a working group preparing for the National Energy and Climate Plan (NECP) development and drafting has started, however, there has been limited progress on the NECP with only initial steps being taken to revise the modelling assumptions based on the incoming 2030 targets. The NECP is expected to be updated in line with the Energy Strategy 2022–31 in order to ensure consistency across the documents and also with the Energy Community 2030 targets for Kosovo[14]. A comprehensive framework for carbon taxation has not been developed yet. As part of

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[10] Kosovo Environmental Program, Ministry of Environment and Spatial Planning (MESP) - Environmental Protection and Water Department, http://kepweb.org/state-of-environment/

[11] Authorities are in the process of updating the GHG inventory.

[12] http://kepweb.org/state-of-environment/

[13] Energy community: https://www.energy-community.org/dam/jcr:421f0dca-1b16-4bb5-af86-067bc35fe073/Decision_02-2022-MC_CEP_2030targets_15122022.pdf

[14] Kosovo Annual Implementation Report, Energy Community Secretariat, November, 2022

the new energy strategy, the government has committed to finalizing preparations for introducing carbon taxation by end 2025. Under the existing legal framework, royalties on coal extraction and excise taxes on fossil fuels are levied as part of the general budget. Yet, current royalty and tax rates are still not at a level that reflects the negative externalities produced and discourage demand away from energy intensive activities. Moving forward, pricing of carbon can contribute to reduce use of fossil fuels and promote a more efficient use of energy.

## D. Other Challenges

**10. After the war of independence ended in 1999, a focus on rapid reconstruction helped propel an economic recovery but has left the country exposed to climate and environmental shocks.** Rapid construction since 1999 associated with poorly regulated land use planning and lack of adherence to building codes has increased the risk of exposure to natural and climatic hazards for the growing population. Mining of mineral deposits, lignite and inadequate wastewater treatment have contributed to key environmental degradation challenges that Kosovo needs to address.

**11. Kosovo's economic integration with Europe, and the country's ambition to join the European Union (EU), provides both opportunities as well as challenges.** The EU is Kosovo's largest trade and investment partners, and the share is expected to grow as neighbors in the Western Balkans join the EU. Close integration with the EU offers significant economic opportunities for Kosovo, to align with the EU on key economic and institutional criteria, and to integrate with value chains as part of Europe's green transition. However, there are a number of short-term policy challenges, including the risk that the EU's Carbon Border Adjustment Mechanism (CBAM) may undermine the competitiveness of Kosovo's exports in the EU market due to the emissions intensity of production and the concentration of exports in emissions-intensive goods (metals, plastics and minerals). Though the overall impact may not be immediately large, some of the manufactured goods exported to the EU could be significantly affected. Moving forward, Kosovo will need to prepare for the EU's CBAM. Diversifying into renewable energy sources will become particularly important both due to the CBAM and to ensure adequate energy supply.

## E. WB Engagement in the Area of Climate Change

**12. World Bank engagement in the area of climate change has focused on strengthening climate change resilience and preparedness.** The new **Country Partnership Framework for 2023–27** identifies environmental resilience as a key objective of the World Bank's program in Kosovo. The last Country Partnership Framework for Kosovo (2017–21) recognized that water availability and the treatment of wastewater are major bottlenecks to shared prosperity and poverty reduction in the country.

**13. The World Bank has supported Kosovo's climate agenda through the Public Finances and Sustainable Growth Development Policy Financing (DPF) in the areas of environmental sustainability, renewable energy and waste management.** A new programmatic DPF under preparation will support Kosovo's reform efforts in laying stronger foundations for greener growth.

The DPF will support policy measures in the areas of renewable energy, energy efficiency and climate change policy. Moreover, the DPF will support policy measures aimed at supporting vulnerable energy consumers during the energy transition. The DPF is expected to be used as a platform for coordinated policy dialogue and financing between development partners on Kosovo's climate action agenda.

**14. In the water sector, the World Bank is supporting Kosovo's climate change agenda through the Water Security and Canal Protection Project, which aims at restoring the Iber Canal and the Fostering and Leveraging Opportunities for Water Security Program (FLOWS1) which has the objective of strengthening the national capacity for managing water resources.** Also, the Bank has been advancing the energy efficiency and energy transition agendas through **Kosovo Energy Efficiency and Renewable Energy Project.**

**15. The proposed WBG program for 2023–27 will continue supporting investments in water infrastructure to increase service network capacity and coverage, as well as to address the climate change-exacerbated risk.** Thus, investments planned under the EU TF-funded **Improvement and Rehabilitation of Irrigation Systems project** will provide for increased efficiency of water utilization and the pipeline **FLOWS2** will finance construction of a dam in South-Eastern Kosovo - the country's most water scarce area. The CPF also envisages support to an innovative approach to contaminated land remediation and repurposing under the planned **Cleaning and Greening Kosova** Project. The project is expected to contribute to climate change adaptation efforts by undertaking "resilient remediation" approaches, whereby climate risks and impacts are integrated into the land remediation and redevelopment options, such as protecting water resources and agricultural land/food safety, mitigation of flash flooding and heat stress, carbon sequestration, and renewable energy development. The proposed **Livable Cities project** will help address the global and local emission challenges by improving the environmental footprint of urban areas with a focus on urban redevelopment, urban mobility and domestic heating.

**16. The World Bank is planning to support Kosovo's authorities with analytical and advisory services, including through the Western Balkans Climate Change and Development Report (CCDR) under preparation which will emphasize the links between decarbonization and development, highlighting priority interventions, for both policies and investments, to build climate resilience and meet development goals.** The **Pristina Infrastructure Assessment** informed policy and investment decisions that can lead to improving sustainability of domestic heating and urban mobility for improved air quality and greater livability. Through the Global Partnership for Social Accountability on **Climate Action and Civic Technology** the Bank will contribute by improving accountability of relevant Kosovo public institutions in the implementation of the Green Agenda. The **Western Balkans Green Transformation** analytical work will support the authorities in developing a framework for greening the financial sector, considering both how can it better manage climate risks, as well as help facilitate the green transition. The World Bank is also exploring possibilities to work with the authorities at addressing the impact of the floods, while boosting the country's preparedness and overall resilience.

Through advisory services and direct investment IFC, is planning to support the Government to attract the private sector for the development, financing, and operation of new renewable energy sources. MIGA will continue to support Kosovo's financial sector through providing guarantees to support climate finance-related activities.

**Statement by Mr. Daniel Palotai, Executive Director for Republic of Kosovo**
**May 25, 2023**

On behalf of the Kosovo authorities, we would like to thank management and staff for the constructive and productive discussions and express our appreciation for an excellent report.

Over the past two years, Kosovo has managed to rebuild and consolidate its fiscal position, build strong capital buffers and maintain a healthy and sustainable financial system. But given geo-political tensions caused by the Russian invasion of Ukraine and its subsequent impact across the region and beyond, the risks and uncertainties have increased significantly. Bracing for possible further shocks, including the risk of a fall out of aging energy generation capacities, and an euroized economy without market access, the authorities need a strategy to avoid demand compression while being able to continue with their structural reform agenda. Therefore, to preserve the progress made to date, support further the reform agenda and mitigate the impact of any materializing risks, the Kosovo authorities are requesting access to the Fund's resources under a 24-month Stand-By Arrangement (SBA) in the amount of SDR80.122 million (97 percent of quota), which they intend to treat as precautionary in the baseline. The SBA will support the implementation of a mix of fiscal, financial, and structural reforms with the aim to further enhance to-date achievements by improving fiscal transparency, increasing revenue mobilization, including by formalizing economic activity, making budget planning and execution more efficient and further improving the regulatory framework of the banking sector.

In addition, to support the government's efforts on climate change mitigation and adaptation, especially in energy, the authorities are requesting an arrangement under the Resilience and Sustainability Facility (RSF) in the amount of SDR61.95 million (75 percent of quota). Such financing is expected to support the implementation of a recently approved energy sector strategy, which aims at diversifying energy sources by increasing the share of renewables, tackle pollution, foster energy security, strengthen competition, and protect vulnerable energy consumers. Measures which will be supported by the RSF are expected to result in increased efficiency of the energy system, as well as enable to expand greener generation capacities, and reduce emissions, among others. In addition to the RSF financing, the Kosovo authorities have secured commitments from other development partners, amounting to around EUR500 million. The RSF will leverage and support WB and EU green initiatives. But the needs are significant, and the authorities have expressed a strong interest in designing additional reform measures following the envisaged C-PIMA that may unlock further RSF access.

We note the authorities' strong commitment to implement significant reforms that would transform the economy into a more competitive growth model and generate more sustainable jobs. It also is reassuring that the governing party will be in power another two years and that all political parties have been supportive of the Fund's supported programs in the past and this time is no different.

**While risks to the outlook are elevated, Kosovo's economic fundamentals remain strong.** After robust economic performance in 2021, economic growth moderated in 2022, due to the effects of Russia's war against Ukraine and elevated commodity prices. High inflation caused diaspora remittances to decline in real terms, disrupted implementation of investment projects and imposed reallocation of finances and resources to support various groups of society affected by those developments. Financial sector performance remains solid; the fiscal position, including cash buffers, annual deficit as well as debt level, have all improved, and implementation of structural reforms – often based on Fund advice – has started to yield results, such as an increasing formalization of economic activity which led to a considerable increase in tax revenues. The authorities and staff estimate real GDP growth in 2022 at 3.5 percent, supported by an increase in exports of both goods and services by around 30 percent. Foreign direct investments also increased significantly, by 85 percent. However, imports continue to be high, in particular of goods, which in 2022 increased by around 22 percent.

For the next three years, the authorities project an average growth rate of around 5.5 percent (compared to staff's projections of around 4 percent, based on projected lower increases in investments and exports). This is largely due to an increase in private investments reflecting further efforts by the authorities to improve Kosovo's business environment as well as to enhance execution of public investments. This, together with favorable export growth should markedly contribute to future growth. The outlook, however, is exposed to internal and external downside risks. As laid out in the staff report, in particular higher commodity prices could risk Kosovo's reserve position due to higher external and fiscal financing needs, while weaker growth in the rest of Europe could lower remittance inflows. Furthermore, a possible collapse of aging energy generation capacities, would further worsen the reserve position, given that current energy tariffs are much lower than import costs.

**With higher tax revenues, a low deficit and low debt, the fiscal position is expected to continue to be strong.** The progress made in 2021 continued in 2022, contributing further to the country's fiscal consolidation. The primary budget balance declined from -7.7 percent of GDP in 2020 to -0.9 percent in 2021, and -0.3 percent in 2022. Fiscal reserves stood at or above adequate levels, which is crucial given the absence of monetary policy (due to euroization). And finally, the stock of public debt declined for the second year in a row, standing at around 19 percent of GDP.

Fiscal revenues continued to show solid growth. While tax revenues increased by around 13 percent, it is encouraging that direct taxes continue to perform better, with an annual growth rate of 22 percent. Within direct taxes, corporate tax revenues increased the most (around 40 percent). Indirect taxes increased by around 12.7 percent, with excise revenues displaying a more modest increase due to higher prices and the impact on the quantity of imports.

On budget spending, a relatively low execution rate in public investments was offset by higher recurring expenditures, which reflects the increase in subsidies and transfers towards the most vulnerable population to cope with inflation. Nominally, capital expenditures were at the 2021 level, whereas recurrent spending increased by 13 percent. It should be noted that in 2022 expenditures on wages were almost the same as in 2021, however, starting this year, the overall wage-bill is expected to be higher, given the entry into force of a new law on salaries for employees in the public sector. This law, among other, aims to create a uniform system of salaries in the public sector as well as a transparent and manageable system of salaries and bonuses where the main element is the basic salary. Overall, supported by the forthcoming SBA and technical assistance by the Fund, the authorities seek to improve the composition of public spending.

Going forward, the authorities remain committed to further improve on tax policy and administration as well as on budget planning and execution. The approved budget for 2023 is fully in line with the legally binding fiscal rule which was designed with the IMF's support and since its entry into force back in 2013, has served Kosovo well. In addition to complying with the deficit rule that imposes a 2 percent cap on the budget deficit, the overall budget structure favors investment projects. Also, important measures that will improve fiscal transparency, encourage formalization and improve budget execution are being designed and implemented.

**The financial sector continues to exhibit significant resiliency and is financing the economy.** The banking sector continues to be liquid and profitable with credit activity continuing to be an important source of investments and overall private sector aggregate demand, with an annual increase in 2022 of 16 percent. Deposits also increased by 13 percent. Interest rates on loans (the average for the year) remained broadly unchanged around 6 percent, whereas deposit rates increased from 1.3 in 2021 close to 1.7 percent in 2022. This increase in deposit rates may reflect a slight increase in competition for attracting more funds, given the actual increase in credit activity, and expected future demand. The quality of assets continues to be impressive, with non-performing loans standing at 1.9 percent, compared with 2.1 percent in 2021. Capitalization of the sector is well above legal requirements, with regulatory capital over risk-weighted assets being at around 15 percent (vs. 12 percent requirement).

Looking forward, the authorities are committed to implement the outstanding FSSR recommendations on stress testing, banking and insurance supervision, reserve management, and central bank governance. This will ensure that policy frameworks as well as the prudential supervisory toolkit evolves in line with best practices and that the Central Bank can discharge its functions effectively.

**The authorities remain committed to advance with designing and implementing structural reforms to increase potential growth**, reduce inequality and mitigate and adapt to the consequences of climate change. They put a premium on the implementation of the energy sector strategy, formalization of economic activity, fiscal transparency, consolidation and targeting of social schemes, as well as more effective budget planning and execution.

Increasing energy efficiency and diversifying sources of production, with the aim to increase the share of renewable capacities, and strengthening regional cooperation are only some of the measures planned to be implemented in the area of energy. Support by the IMF, WB and EU will also help the authorities increasingly replace cheap domestic lignite with alternative energy sources while ensuring a just transition. The authorities are also concerned by the public health consequences and long-term health costs of pollution. The RSF is therefore a crucial component of the authorities' green transition agenda. Noting the recent progress, reducing informality in economic activity continues to be high on the authorities' agenda, including through measures that encourage voluntary compliance, such as introduction of additional e-services for taxpayers, enhancing transparency on tax collection and budget execution and ensuring a structured dialogue with businesses on both tax policy design and tax administration issues. On capital projects, the authorities have already identified some specific actions and additional measures are expected to be identified following the PIMA review later this month as well as the CPIMA which the authorities see as a valuable instrument to increase the overall resilience of institutions and policy frameworks to shocks and should result in increasing regulatory certainty and thereby the attractiveness of climate change mitigation and adaptation projects for private sector investment.

The above reforms, combined with planned reforms in education and other critical areas as detailed by the Kosovo National Development Strategy 2030, would unlock a significant potential for Kosovo's youngest population in Europe. Also, removing barriers to trading, combined with investments in infrastructure, could increase trade and investment opportunities for Kosovo.