INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/379

REPUBLIC OF KOSOVO

FIFTH REVIEW UNDER THE STAND-BY ARRANGEMENT

December 2013

In the context of the Fifth Review Under the Stand-By Arrangement, the following documents have been released and are included in this package:

- The **Staff Report** for the Fifth Review Under the Stand-By Arrangement, prepared by a staff team of the IMF for the Executive Board's consideration on December 20, 2013, following discussions that ended on November 18, 2013, with the officials of the 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 December 5, 2013.
- A **Press Release** including a statement by the Chair of the Executive Board.

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

Letter of Intent sent to the IMF by the authorities of the Republic of Kosovo*
Technical Memorandum of Understanding*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF KOSOVO

FIFTH REVIEW UNDER THE STAND-BY ARRANGEMENT

December 5, 2013

EXECUTIVE SUMMARY

Stand-By Arrangement. A 20-month SBA in an amount of SDR 90.968 million (154 percent of quota) was approved by the Executive Board on April 27, 2012, and the first purchase of SDR 4.251 million was made available following the Board meeting (Country Report 12/100). The second purchase of SDR 39.108 million was made available upon Board approval of the first review on July 16, 2012 (Country Report 12/180), and the third purchase of SDR 34.857 million was made available upon Board completion of the second review on December 20, 2012 (Country Report 12/345). The fourth and the fifth purchases, both of SDR 4.251 million, were made available upon Board completion of the third review on April 24, 2013 (Country Report 13/113) and the fourth review on July 15, 2013 (Country Report 13/224), respectively, but have not been drawn.

Program status. All end-August 2013 and continuous performance criteria were met, as a renewed shortfall in customs collection was over-compensated by under-execution of spending. A prior action on issuing a government decision that specifies the non-allocation of €88 million across expenditure categories was also met. The applicable structural benchmarks were met on substance (although in once case not on form). Missed by small margins were the indicative targets on the non-accumulation of domestic payments arrears by the central and general governments. Under the program, the treasury has implemented several measures to improve the recording and monitoring of payment obligations, covered by structural conditionality.

The authorities have expressed interest in a follow-up arrangement once this SBA expires.

Purchase. The authorities have indicated they will not purchase the amount that would be made available upon completion of this review, in line with their intention to treat the SBA as precautionary in 2013.

Publication. The authorities have agreed to publication of the staff report.

Approved By
Poul M. Thomsen and Dhaneshwar Ghura

Discussions were held in Pristina, Nov 6—18, 2013. The mission met with Prime Minister Hashim Thaçi, Minister of Finance Besim Beqaj, Central Bank Governor Bedri Hamza, other ministers, senior officials, parliamentarians, private sector representatives, and envoys representing the international community.

The staff team comprised Mdms. Budina, Madrid (both EUR) and Fayad (SPR), and Messrs. Wiegand (EUR, head) and Crivelli (FAD). Messrs. Sulemane (Resident Representative) and Thaçi (Economist in the Resident Representative's Office) assisted the mission.

CONTENTS

TABLES

APPENDIX

ATTACHMENT

ANNEX

INTRODUCTION AND SUMMARY

1. **Macroeconomic and financial policies have remained broadly on track** (Letter of Intent, Table 1).

- All end-August and continuous ***performance criteria*** under the Stand-By Arrangement (SBA) were met, as a renewed shortfall in customs revenue collection was overcompensated by over-performance on collection of domestic taxes and under-execution of spending, notably the capital budget (¶8).

Selected Performance Criteria, end-Aug 2013
(In millions of Euros; cum. from beginning of the year)

	Target	Outturn
Floor on the government bank balance	171	261
Floor on the primary fiscal balance	-94	-31
Ceiling on primary expenditures	1003	890
Ceiling on the net contracting of nonconcessional debt	150	60

Sources: Kosovo authorities; and IMF staff estimates

- Also met was a ***prior action*** on issuance of a government decision to lock in €88 million in under-spending and specifying these cuts across expenditure categories. As a result of this measure, achievement of a government bank balance of 4½ percent of GDP at end-2014—the threshold implied by Kosovo's rules-based fiscal framework—is feasible, thus safeguarding that Kosovo is fully financed in 2014 (¶8).
- The end-August ***structural benchmark*** on issuing an administrative instruction to provide for a rules-based setting of minimum wage levels was met. Met on substance (while not on form) was the end-October structural benchmark on submitting a draft budget to the assembly in line with the parameters specified in the Letter of Intent (LOI) for the 4th review. While budgeted current spending exceeds the ceiling specified at the time of the 4th review by a small amount (€12 million, or 0.3 percent of GDP), this is due to issues beyond the central government's control, notably the cost of implementing the Kosovo-Serbia normalization agreement, and higher-than-expected current spending allocations by municipalities (¶9).
- Missed by small margins were the ***indicative targets*** on the non-accumulation of domestic payment arrears. The treasury is implementing several measures to improve the recording and monitoring of payment obligations (¶10).

2. **More broadly, under the SBA—that will expire by December 26—and the preceding Staff-Monitored Program, Kosovo has made significant progress in safeguarding macro-financial stability** (Box 1). Achievements include:

- A ***sustainable fiscal stance*** has been restored, and has been locked in with the rules-based fiscal framework that was passed by the assembly in July 2013. The framework is binding for the 2014 budget.
- While restoration of a fully adequate ***government bank balance*** during the program period seems unlikely due to a renewed delay in PTK privatization (¶7), the draft 2014 budget safeguards maintenance of a government bank balance in line with the minimum implied by

the rules-based fiscal framework, and thus provides an adequate cushion to insure the economy against fiscal and financial shocks. Further, a government T-bill market was established in 2012 and has been off to a good start.

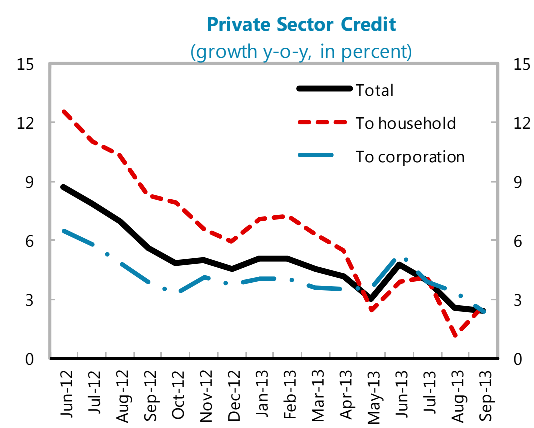
- The ***preparation and costing of spending initiatives*** has improved, with no initiative going forward without conducting a fiscal impact assessment.
- Progress has also been made with respect to the ***recording and monitoring of payment obligations.*** Further, a rules-based framework for setting minimum wage levels has been established.
- In the area of ***financial sector reform,*** a revised banking law, passed in 2012, enhances the supervisory and resolution powers of the central bank. Further, the Special Reserve Fund (SRF) for emergency liquidity assistance (ELA) was funded with a government deposit, and is under the central bank's exclusive control.

3. **This said, important challenges remain.** Kosovo's track record of disciplined macroeconomic management is still short, and the political and institutional framework remains fragile. 2014 is an election year, during which policymakers' commitment to stability-oriented policies will be tested. In some areas, the reform agenda is unfinished, especially with respect to financial sector policies (see ¶¶12, 13 below). In this context, the authorities have expressed interest in a follow-up arrangement once this SBA expires.

RECENT DEVELOPMENTS

4. **Kosovo's economy has continued to evolve in a subdued and uneven manner, while displaying resilience compared to peers**.

- ***Uneven growth*** (Tables 1, 2, Figure 1). Weak customs revenues, subdued imports and a continued slowdown in credit growth on the one hand contrast with over-performance of domestic tax collection and robust exports on the other. Overall, the incoming data are consistent with modest growth of 2–3 percent—compared to a long-term average of 4½ percent—amid substitution of imports with domestic production (Box 2).

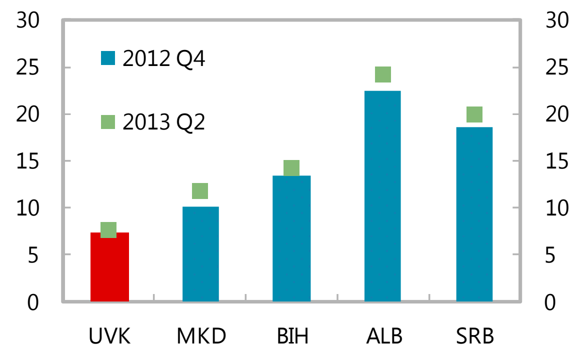


Sources: Central Bank of Kosovo; and IMF staff estimates.

- ***Low inflation.*** Headline inflation decelerated to 0.2 percent (y-o-y) in September, driven by disinflation for imported foodstuffs and energy. Core inflation remained stable at 1.7 percent, consistent with Kosovo's unilateral adoption of the euro.

- ***Stable banking system*** (Figure 3). At end-September, the banking system's aggregate capital adequacy ratio (CAR) stood at 16.4 percent, up from 14.2 percent at end-2012, reflecting both higher equity and slower growth in risk-weighted assets. Non-performing loans (NPLs) have continued to edge up and stand now at 8.5 percent of total loans, reflecting mostly weak credit growth (i.e., a denominator effect, Box 3). This said, NPLs are almost fully provisioned and are low compared to peers.

Non-Performing Loans to Total Gross Loans

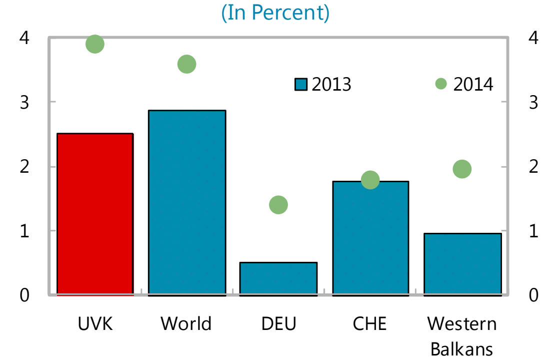


Source: IMF Financial Soundness Indicators (FSI)

ECONOMIC OUTLOOK AND RISKS

5. **The economic outlook remains for a gradual strengthening in activity** (LOI ¶7). Staff forecasts real GDP growth to recover from the estimated 2½ percent for 2013 to around 4 percent for 2014, consistent with expected developments in Germany and Switzerland, the main host countries of Kosovo's Diaspora.[1] Remittances and other Diaspora inflows would remain the main driver of domestic demand and growth, although staff's projections also incorporate a very gradual expansion in production capacity and exports, as efforts to enhance competitiveness bear some fruit. CPI inflation is expected to remain below 2 percent in 2014, in line with lower projected food and fuel prices.

Real GDP Growth 2013 and 2014
(In Percent)



Sources: World Economic Outlook and IMF staff projections.

6. **Risks to the outlook relate mostly to domestic political dynamics and to the external environment.** The key short-term risk is a possible deterioration in employment conditions in the host countries of Kosovo's Diaspora that would curtail remittances and FDI, with negative repercussions for domestic demand, the public finances, and potentially to banks' financial soundness. By contrast, a possible intensification of turbulence in crisis countries is unlikely to have a large impact, given the near-absence of financial or export linkages. The biggest threat to medium-term development prospects is a return to expansionary, short-sighted policies that would undermine macroeconomic stability and competitiveness. This risk is acute especially in view of upcoming national elections that are scheduled for the second half of 2014.

[1] See the 2013 Article IV report for an analysis of the link between Kosovo's growth and economic developments in Diaspora host countries.

POLICY DISCUSSIONS

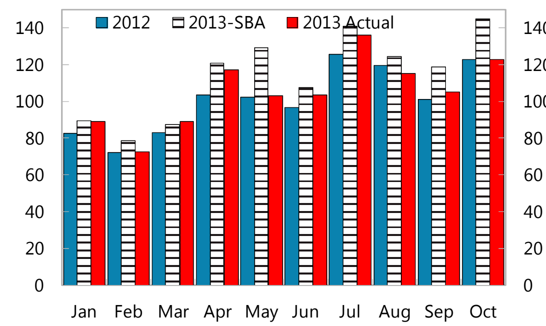
A. Fiscal Policy

The 2013 Budget

7. **Budget implementation has remained broadly in line with the program** (Figure 3, Tables 3, 4, LOI ¶8).

- ***Revenue collection*** has remained significantly below projections, reflecting lower customs receipts due to a drop in the value of imports which, in turn, relates mostly to adverse price developments (Box 2). At the same time, collection of domestic taxes has continued to over-perform. On current trends, staff projects an aggregate revenue shortfall of about €50 million by end-year (one percent of GDP).

Monthly Revenues 1/
(millions of euros)



Source: Country authorities; and IMF staff calculations.
1/ Revenues excluding grants and dividends. Prelim. data for Oct.

- The revenue shortfall has been over-compensated by ***under-execution of spending*** of more than €100 million through end-October, notably on capital expenditures, resulting in considerable over-performance on the general government primary balance. Under-spending reflects in part delays with some projects—such as highway R6 to FYR Macedonia (budget with €28 million) and civil service reform (€10 million)—and in part difficulties with procurement, as the procurement review board was not operational for several months.

- As regards financing, ***privatization of the state telecommunications company PTK***—originally foreseen to be completed in September or October—has been delayed, as both the investor has not yet signed the sales contract and the assembly has not yet approved the sale. While settlement of the sale is still possible before end-year, this outcome is not assured. Without PTK privatization, the government would forego €277 million (5 percent of GDP) in privatization receipts. This renders restoration of the ***government bank balance*** in 2013 to the minimum implied by the rules-based fiscal framework (4½ percent of GDP) unlikely.

- Conditions in the ***government paper market*** have remained favorable, reflecting a mix of excess liquidity in the banking system and sound fiscal management. In October, three-month and one-year T-bills were issued at annual nominal yields of around 0.6 percent and 2 percent, respectively.

8. **The government has taken corrective measures to compensate for the revenue shortfall and limit the draw-down of the government bank balance in 2013** (LOI ¶9).

- On the ***revenue side***, on October 1 the government increased tobacco excises by 11 percent, with another increase of 6 percent foreseen for January 1, 2014. The full-year impact of this increase—that is in line with long-standing IMF staff advice—is estimated at €15 million (0.3 percent of GDP).

- As regards ***expenditures***, on November 29, the government issued a decision to lock in €88 million in under-spending, distributed across spending categories as follows: €71 million on capital spending, €15 million on wages and salaries, and €2 million on goods and services. This decision comes on top of expenditures savings of €11 million already made in June. As a result, the 2013 primary deficit is now projected at 1.7 percent of GDP—as opposed to a deficit of 3.0 percent of GDP contained in the original 2013 budget[2]—while the expected end-2013 government bank balance is 4.0 percent of GDP.

The 2014 Budget

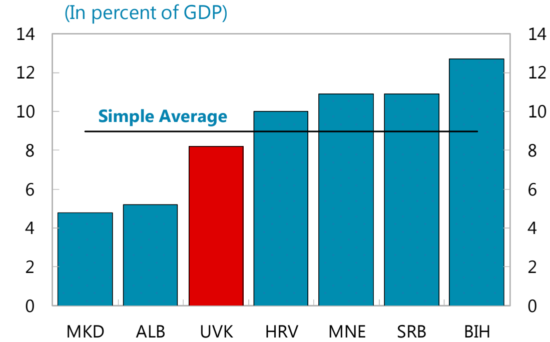
9. **On October 31, the government submitted a draft 2014 budget law to the assembly.** It was passed in first reading by the Assembly on November 21. The budget is guided by the rules-based fiscal framework, and broadly in line with authorities' commitments specified in the Letter of Intent for the 4th review (Box 4, LOI ¶10):

- The budget does not rely on PTK sales proceeds, and is therefore anchored by a ***general government deficit ceiling of 2 percent***—as the rules-based fiscal framework prescribes in case of no privatization receipts. Together with the savings measures enacted in 2013 (see ¶8 above), the budget safeguards an end-2014 government bank balance of at least 4½ percent of GDP.

- ***Revenue projections*** are deliberately cautious and would be achievable even if growth falls short of the 2014 projection by a percentage point.

- The draft budget contains ***current spending*** of €1062 million (19.3 percent of GDP). Within this envelope, ***public sector wages*** increase from 8.2 to 8.9 percent. The increase reflects (i) additional hiring, related in part to the Serbia-Kosovo agreement—notably the need to build up municipalities in Northern Kosovo—(ii) the cost of a long planned, World Bank sponsored civil service reform that comes with some adjustments to the wage structure, and (iii) a general public sector wage increase. While the exact

Government Wage bill, 2013 1/
(In percent of GDP)



Source: Country authorities; and IMF staff calculations.
1/ Projected, General Government.

---

[2] All deficit and spending ceilings are net of the expenditures of the privatization agency PAK, in line with the definition of program targets under the SBA. PAK is autonomous and self-financed.

annualized percentage wage increase is not yet determined—it depends, among other things, on the increase's exact timing—the parameters set in the budget and the LOI (¶10d) ensure the average general increase would not exceed 14 percent. While on annual basis the increase is generous, it follows constant nominal wages in both 2012 and 2013, and covers also 2015.[3]

Further, the budget contains a contingency allocation of €15 million for possible ***benefits to war veterans and erstwhile political prisoners***. The budget law specifies that these allocations would be executed only once a full fiscal assessment has been conducted, consistent with the corresponding structural benchmark under the SBA.

- As for ***capital spending***, the budget contains an allocation of €135 million (2.5 percent of GDP) to start construction of ***highway R6 to Macedonia*** (LOI ¶11). The selection process for R6 is expected to be finished by end-year, in line with the conditions specified in the LOIs for the 3rd and 4th review to safeguard that R6 is economically viable and can be integrated into a sustainable fiscal framework. The contract is scheduled to be signed in early 2014.

  Further, the budget contains ***non-highway capital spending*** of about 7 percent of GDP, which includes several local road construction and maintenance projects. Staff noted that this level is elevated relative to historical standards, but the authorities expressed confidence that the capital budget would be implemented fully in 2014.

Other Fiscal Issues

10. **Reforms have advanced further to improve the recording and monitoring of payment obligations, with a view to avoiding the accumulation of domestic payment arrears** (LOI ¶13). Following (i) the amendment of internal treasury rules to enforce the timely recording of payments related documents, (ii) a publicity campaign to inform stakeholders about these changes and their implications, and (iii) upgrades to the IT system, the final step is to ensure the proper application of sanction mechanisms in case of non-compliance.

B. Financial Sector Policies

11. **In early November, most banks were in compliance with new prudential rules** that were tightened with the application of the new banking law in late 2012 and early 2013 (Tables 5-7, LOI ¶14). For the computation of capital ratios, banks are now required to deduct related lending from capital. Limits on related party lending and large exposures have also been tightened. Further, as of July, banks must meet a new operational risk capital requirement and a minimum liquid asset ratio. Some banks have raised new capital to meet these requirements, and the central bank (CBK) has

[3] 14 percent is roughly the midpoint between CPI inflation (9 percent) and the increase in nominal GDP (19 percent) in the years 2011-2013. Kosovo's wage bill as a share of GDP would remain in line with peers.

conducted on-site inspections to verify compliance. As of November, one bank (out of 9) was slightly below the new leverage (equity to assets) ratio of 7 percent, and another bank exceeded the large exposure limit. The CBK committed to ensuring full compliance by year-end.

12. **The authorities have made progress with implementing several recommendations from the 2012 report under the IMF/World Bank Financial Sector Assessment Program** (FSAP, LOI ¶¶15, 17). In November, the government approved a guarantee for a back-up facility provided by the EBRD to the deposit insurance fund, and intends to submit the agreement to the assembly for approval in the coming months. Further, the CBK has created a macro-prudential advisory committee, and is developing an action plan to implement recommendations of a recent Monetary and Capital Markets Department (MCM) technical assistance (TA) mission on strengthening the crisis preparedness and management framework. In line with these recommendations, the CBK intends to revise the regulation on emergency liquidity assistance (ELA), as well as create a working group to develop a contingency plan to deal with systemic banking crises.

13. **A key policy priority ahead is the establishment of a bank contribution for ELA** (Box 5, LOI ¶16). Given Kosovo's unilateral euroization and, consequently, the CBK's inability to generate liquidity, resources for ELA need to be set aside ex-ante. Thus far, the only dedicated source is the special reserves fund (SRF) that was funded last year with a government deposit at the CBK.[4] The FSAP recommended complementing the SRF with a bank contribution, to ensure that the resources for ELA remain adequate as the banking system grows. A recent MCM TA mission recommended to establish a bank liquidity fund (BLF) based on an asset contribution (rather than a fee) from commercial banks (Box 4). This would enhance the central bank's ability to provide ELA—independent of the government's willingness to increase central bank deposits—and without unduly affecting banks' profitability. As a first step, the CBK plans to assess the overall level and sources of systemic liquidity funds to determine a possible target for a BLF. It intends to also analyze the legal aspects and macroeconomic implications of a BLF, and will request further Fund TA to this end.

C. Competitiveness and Private Sector Development

14. **The authorities are pursuing several initiatives to strengthen competitiveness and attract foreign direct investment** (LOI ¶¶19, 20). These include (i) various projects aimed at supporting the financial and technical needs of small and medium sized enterprises (SMEs), (ii) revisions to the law on foreign investment, to encourage FDI from the Diaspora, and (iii) initiatives to promote innovation and entrepreneurship, aiming at fostering start-ups and building human capital capacity. The authorities' efforts to enhance the business climate have yielded another improvement in Kosovo's ranking in the World Bank's *Doing Business* survey to #86 (out of 189), from #126 two years ago.

[4] The CBK can also use its capital and reserves to provide ELA.

PROGRAM MODALITIES

15. **The attached Letter of Intent describes the authorities' progress in implementing their economic program** (Tables 8-10, LOI Tables). A ***prior action*** for completion of the review has been set on the issuance of a government decision to specify the non-allocation of €88 million across expenditure categories.

16. **The authorities do not plan to draw the amount available upon the completion of this fifth and final review**, in line with their intention to treat the Stand-By Arrangement as precautionary in 2013.

STAFF APPRAISAL

17. **This final review under Kosovo's Stand-By Arrangement marks 2½ years of institution-building and disciplined macroeconomic management.** In this period, the public finances have been strengthened to a degree that ambitious infrastructure projects, such as highway R6, can now be financed out of domestic resources without putting sustainability at risk, and without recourse to external financing (such as PTK privatization). Kosovo's legal framework has been amended in ways that should strengthen the conduct of macroeconomic policies in a durable manner, such as the enactment of the rules-based fiscal framework in July 2013—passed with the votes of all major political parties—and the establishment of a special reserves fund for liquidity assistance under the central bank's exclusive control. In a parallel process, Kosovo has made progress in strengthening competitiveness, as reflected by its improvement in the World Bank's *Doing Business* survey by 40 ranks in the past 2 years.

18. **This said, establishing a culture of stability-oriented policies, gaining investor confidence, and building a competitive economy is a long-term process**. The achievements under the SBA—and the preceding Staff-Monitored Program—could easily be put at risk by a return to short-sighted, expansionary policies. In this regard, the run-up to the general election in the second half of 2014 will provide an important test.

19. **In the fiscal area, the key challenge is to preserve and build on the progress made, and to complement the strong legal framework with sound and transparent budgetary practices.** The rules-based fiscal framework—that prescribes an overall general government budget deficit of no more than 2 percent of GDP (except when there are privatization receipts, in which case these have to be spent on capital projects)—should assure that Kosovo's fiscal stance remains sustainable. However, the careful preparation and costing of spending initiatives pursued under the SBA needs to continue, as otherwise unfunded spending obligations could rapidly overburden the budget's capacity. Further, large and sudden shifts in the composition of spending—notably from capital to current spending—should be avoided, both to ensure that the composition of the budget remains conducive to growth, and to maintain its flexible structure.

20. In this context, **the planned 2014 public sector wage increase is not ideal.** While its size has been calibrated such that it is commensurable with sustainable budgetary management, the stop-and-go pattern of public sector wage policies—with large hikes typically occurring in election years, and wage freezes thereafter—complicates fiscal planning and triggers significant year-to-year shifts in the composition of spending. A rules-oriented framework for the setting of public sector wages would be superior, similar to the one established for minimum wages this August.

21. **Caution is also required as regards the planned benefits for erstwhile political prisoners and war veterans.** The size of these benefits needs to be calibrated carefully, keeping in mind both their immediate impact on the public finances and expectations that excessively generous benefits would raise with other groups. Experiences from neighboring countries provide warning examples of how outsized war-related benefits can both put fiscal sustainability at risk and result in a poor targeting of social assistance.

22. **In the area of financial sector policies, a key priority is to preserve the high quality of banking supervision, and develop supervision further.** Maintaining the high professional standards at the Central Bank of Kosovo is critical. Moreover, banking supervision should shift gradually from a relatively narrow focus on credit risk to comprehensive risk-based supervision, as recommended by the 2012 FSAP.

23. **Another priority is to establish a bank-financed contribution for emergency liquidity assistance.** This would ensure that the central bank's resources for ELA remain adequate even as the banking system grows. Further, it would render the central bank's ability to provide ELA less dependent on the government's willingness to hold deposits, thus strengthening the CBK's operational independence. For the government, a bank-financed ELA-contribution would reduce the need to hold high cash buffers to insure the economy against financial risks—a task that has proven to be politically testy. Various options exist to ensure that a bank-funded ELA contribution would impact neither unduly banks' profitability nor their ability to lend, such as accounting for the ELA-contribution as an asset rather than a fee, and converting a part of banks' mandatory reserves into an ELA contribution (as proposed by MCM TA).

24. **Kosovo's efforts to enhance competitiveness are encouraging, but much more remains to be done to foster the development of a robust tradable sector and lay the foundations for self-sustained growth.** Priorities include strengthening contract enforcement by the judiciary system, advancing viable public infrastructure projects embedded in a sustainable budgetary framework, and preserving the labor market's ability to adjust.

25. **Staff supports the authorities' request for completion of the fifth review under the Stand-By Arrangement.**

Box 1. Stand-By Arrangement

Key objectives: (i) restoration of a sustainable fiscal stance and an adequate level of government cash buffers; (ii) introduction of a legally binding fiscal rule; (iii) better design and costing of spending initiatives; (iv) enhancing the efficacy of fiscal decentralization; (v) strengthening the legal framework for financial regulation and supervision; and (vi) equipping the central bank with the funds needed for emergency liquidity assistance.

Program Modalities:

- ***Access:*** SDR 90.968 million (154.2 percent of quota)
- ***Length:*** 20 months (through December 26, 2013)
- ***Phasing:*** SDR 4.251 million was made available after Board approval on April27, 2012, SDR 39.108 million after completion of the first review on July 16, 2012, and SDR 34.857 million after the completion of the second review on December 20, 2012. SDR 4.251 million were made available after completion of the third review on April 24, 2013, and again after completion of the fourth review on July 15, but the authorities did not purchase these amounts, in line with their intent to treat the SBA as precautionary in 2013. Another SDR 4.250 million would be made available after completion of this fifth and final review.

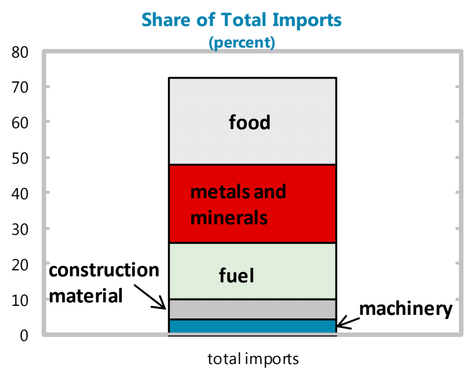
Conditionality:

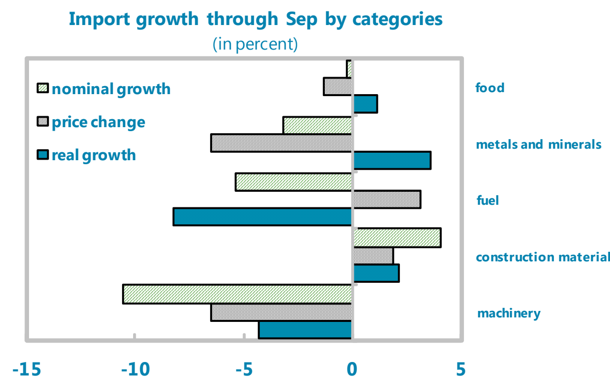
- ***Prior action:*** issuance of a government decision to not allocate spending of €88 million, and specification of non-allocation across spending categories.
- ***Quantitative performance criteria***
    - Floor on the bank balance of the general government
    - Floor on the primary fiscal balance of the general government
    - Ceiling on primary expenditures of the general government
    - Ceiling on the net contracting of nonconcessional debt by the general government
    - Ceiling on guaranteeing nonconcessional debt by the general government
    - Ceiling on the accumulation of external payment arrears of the general government
- ***Quantitative indicative targets***
    - Ceiling on the stock of domestic payment arrears of the central government
    - Ceiling on the stock of domestic payments arrears of the general government
- ***Structural benchmarks***
    - Monthly meetings of the Program Monitoring Committee and transmission of the meetings' minutes to the IMF Resident Representative. *Continuous*.
    - Fiscal impact assessments evaluating the budgetary impact of all new benefit creating laws, amendments to laws or regulations over a period of at least five years. *Continuous.*

Box 2. Imports and Growth

Imports tend to be a good indicator of economic activity in Kosovo, reflecting the strength of Diaspora inflows that, in turn, fund domestic absorption. However, in 2013 nominal imports have contracted by 2.5 percent through September, even though there is much anecdotal evidence that economic activity is still robust, including over-performance of domestic tax collection.

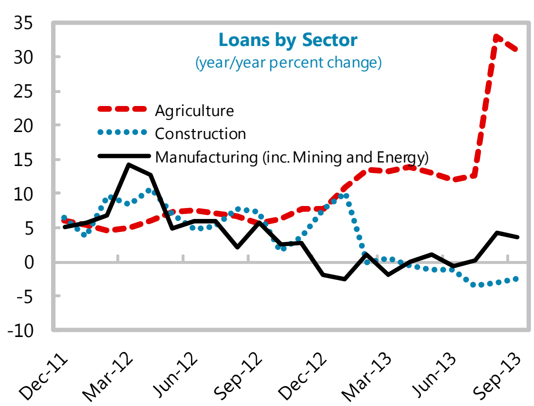
An analysis of disaggregated imports through September indicates that *price*—rather than quantity—reductions for imported food, metals and minerals were the key driver behind the value decline in imports. These results are confirmed by the evolution of WEO indices for international non-fuel commodity prices, including of food and metals.

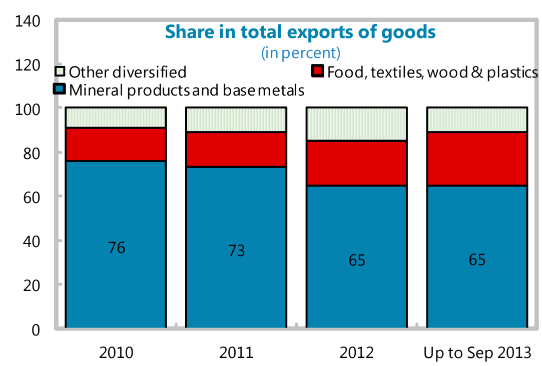




Source: The data used are customs data, based on 6-digit classification as per the Integrated tariff of Kosovo http://dogana.rks-gov.net/Uploads/Documents/tarik/index.htm

Further, there is some evidence of substitution of imports with domestic production, in particularly in agriculture and energy. While starting from low base, credit to agriculture has expanded at a double-digit rate in 2013, owing in part to credit guarantees from donors. As one result, the usable agricultural land increased significantly. Exports of food and textiles have also expanded strongly.





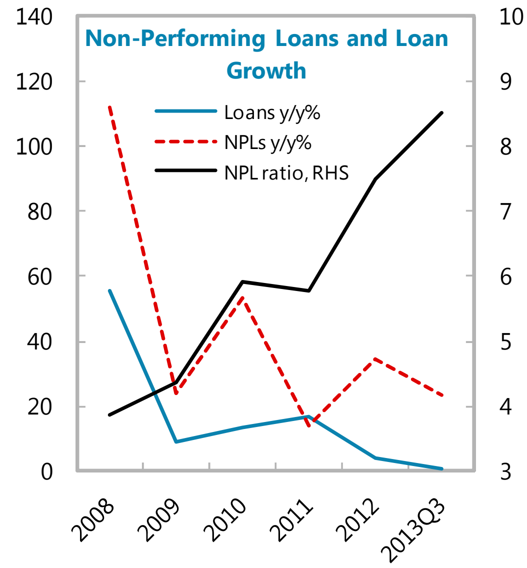
Source: Country authorities and IMF staff calculations.

Box 3. Non-Performing Loans and Credit Growth

The non-performing loan (NPL) ratio of Kosovo's aggregate banking system has been steadily increasing since mid-2009, as NPLs have been growing faster than credit.

In 2013, however, the increase in the NPL ratio reflects primarily a *deceleration in credit growth* rather than acceleration in NPL growth. This is consistent with banks' claims that NPLs from new loans are fairly low, and that the bulk of problem loans originated prior to 2008.

These patterns are confirmed by regression results carried out in the context of the 2012 FSAP:



Source: Central Bank of Kosovo; and IMF staff calculation.

- On average, a one percentage point decline in GDP growth is associated with a 0.33 percentage point increase in the NPL ratio.
- Growth in banks' assets is related to both domestic and parent bank supply factors, i.e., the level of NPLs and pressure on the parent. NPLs affect asset growth with a lag of about one year, while pressure on the parent has an immediate impact.

With GDP growth expected roughly the same in 2013 as in 2012, and assuming no renewed pressure on parent banks, a further leveling off of the NPL ratio should be expected.

Box 4. Key Elements of the 2014 Budget

The 2014 budget targets an overall deficit of 2 percent of GDP (excluding PAK-related spending), in compliance with the rules-based fiscal framework. Together with the planned under-execution of the 2013 budget, the government bank balance would reach or exceed 4.5 percent of GDP at end-2014 (the floor implied by the rules-based fiscal framework), even though the budget does not plan with the receipts from PTK privatization.

- ***Recurrent revenues***. Revenue projections (excluding policy changes and one-off revenue) are consistent with real growth of about 3 percent of GDP—hence one percentage point less than the forecast—to leave a safety buffer in case the economy does not perform envisaged. The budget includes an additional €15 million from the increase in the tobacco excise.
- ***One-off revenues.*** The revenue administration (TAK) and the privatization agency (PAK) have signed a MoU on tax arrears related to firms in liquidation. As a result, PAK is expected to transfer €30 million to TAK in tax debt and associated interest payments (recorded as "direct taxes" in Tables 3 and 4). Further, the authorities plan to collect another dividend of €30 million from PTK.
- ***Current expenditures.*** The 2014 budget allocates €45 million for salary increases, split between (i) implementation of the civil service reform (full-year impact about €18 million) that establishes a grading structure for public employees, developed in cooperation with the World Bank; a (ii) general wage increase.
- ***Capital expenditures.*** The 2014 budget includes an allocation of €135 million or 2.5 percent of GDP for highway R6 to Macedonia—significantly less than the allocation for highway R7 in the 2013 budget of 4.7 percent of GDP. This frees up space for an increase in non-highway capital spending to 7.1 percent of GDP (from 5.7 percent of GDP in 2013).
- ***Financing*** includes €16 million in net external borrowing—mostly project loans from multilateral donors—€120 million in net T-bill issuance (2.1 percent of GDP), and €20 million in transfers of privatization receipts from PAK.

Box 5. Bank Contributions for ELA and the Design of a Bank Liquidity Fund

In countries that do not issue their own currency, ex-ante resources for ELA typically come from two main sources: the government (treasury) or banks. Country practices vary, depending in part on the legal framework. For example, in Ecuador ELA funds come solely from banks as the central bank is prohibited from lending, whereas in Kosovo the Central Bank Law allows for ELA using central bank capital and reserves, and a government deposit into a special reserve fund (SRF). In Kosovo, these funds currently amount to €96 million, or about 4.5 percent of total deposits.

The 2012 FSAP recommended complementing the CBK and Kosovo government's funds for ELA with a contribution from banks, given that banks benefits from access to ELA, and to ensure that resources for ELA remain adequate as the banking system grows. This raises the issues of the form the contribution and the amounts of the contribution:

- *Banks contributions may take two forms:* an expense charge (e.g., a fee, premium, or tax) or an asset quota, similar to required reserves. An expense is appropriate when the funds are destined to cover operating costs or losses (e.g., for deposit insurance) or to set economic incentives (e.g., a macro-prudential charge on short-term external borrowing). Alternatively, an asset quota is appropriate when it serves as a buffer and is not expected to be lost or cover costs.
- *Defining a target is a necessary element of designing a pre-funded ELA scheme*. However, there is no single best approach or firm rule to calculate the target for an ELA fund. Some metrics or approaches include: a yardstick for reserve buffers to ensure against bank runs, potential liquidity needs based on stress test results, and/or resources needed to assist banks in relation to their Tier 1 capital. For Kosovo, these metrics provide a range for ELA-related funds of 4-10 percent of bank deposits. This, in turn, suggests that existing coverage is on the low side.

The recent MCM TA mission proposed that the CBK design a bank liquidity fund (BLF) that would pool banks' asset contributions for ELA. Key design elements that need to be specified include the target size of the fund, the legal instrument and legal entity form to establish the fund, as well as institutional and operational arrangements.

Table 1. Kosovo: Main Indicators, 2010–18

(Percent, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
			Est.	Projections					
Real growth rates									
GDP	3.2	4.4	2.5	2.5	3.9	4.5	5.0	4.5	4.5
GDP per capita	1.7	3.0	0.9	1.0	2.4	3.0	3.4	3.0	3.0
Consumption	1.9	2.1	1.9	2.2	3.8	3.0	3.3	2.9	3.0
Investment	12.3	11.3	-11.8	-1.1	1.4	7.3	8.1	7.8	7.8
Exports	13.0	8.3	0.7	5.3	10.0	11.9	12.2	10.5	9.2
Imports	8.5	5.3	-7.2	0.8	4.6	5.7	6.2	5.7	5.6
Official unemployment (percent of workforce)	…	…	30.9	…	…	…	…	…	…
Price changes									
CPI, period average	3.5	7.3	2.5	1.9	1.8	1.5	1.5	1.5	1.5
CPI, end of period	6.6	3.6	3.7	1.5	1.5	1.5	1.5	1.5	1.5
Import prices	6.5	6.3	4.3	-2.2	0.0	-0.4	0.2	1.1	-0.2
GDP deflator	3.7	6.5	0.5	2.1	2.0	2.0	2.0	2.0	2.0
Real effective exch. rate (average; -=depreciation)	-0.7	3.5	-0.1	…	…	…	…	…	…
Real effective exch. rate (end of period; -=depreciation)	0.8	0.9	1.4	…	…	…	…	…	…
General government budget (percent of GDP)									
Revenues, incl. interest income	27.1	27.4	26.9	26.9	27.3	27.0	27.1	27.2	27.6
Primary expenditures	29.5	29.0	29.3	28.7	29.1	28.7	28.8	28.8	28.7
Of which									
Wages and salaries	7.3	8.1	8.3	8.2	8.9	8.9	8.8	8.8	8.8
Subsidies and transfers	6.3	5.7	5.9	6.1	6.0	5.9	5.9	5.9	5.9
Capital and net lending, incl. highways	11.7	11.5	11.3	10.3	9.5	9.4	9.4	9.4	9.4
Capital expenditures on highways	2.9	5.4	5.7	4.7	2.5	3.2	3.6	2.7	0.0
Overall balance	-2.3	-1.8	-2.6	-2.1	-2.2	-2.2	-2.2	-2.2	-2.0
Debt financing, net	0.3	-0.1	3.2	1.3	2.5	2.2	1.9	1.9	2.5
Privatization	0.0	0.0	0.9	0.5	0.4	0.9	0.8	0.2	0.1
Stock of government bank balances	5.7	3.4	4.4	4.0	4.5	5.1	5.3	4.8	5.1
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Savings-investment balances (percent of GDP)									
Domestic savings	-3.8	-4.6	-6.7	-6.4	-6.0	-4.1	-1.9	0.0	1.9
Transfers excluding general government (net)	15.4	14.7	16.1	15.9	15.4	14.9	14.3	13.7	13.1
Net factor income	1.6	2.4	3.1	3.2	3.2	3.1	3.1	3.1	2.8
National savings	13.2	12.4	12.5	12.7	12.5	13.9	15.4	16.8	17.8
Investment	32.7	33.0	28.4	25.6	24.6	24.7	25.2	26.2	26.6
Current account, excl. official transfers	-19.5	-20.6	-15.9	-12.9	-12.1	-10.8	-9.8	-9.4	-8.9
Current account balance, incl. official transfers	-12.0	-13.8	-7.7	-6.8	-7.7	-6.9	-7.1	-7.4	-7.1
Of which: official transfers 1/	7.4	6.8	8.2	6.0	4.4	3.9	2.7	2.0	1.7
Net foreign direct investment	7.7	7.9	4.3	5.6	6.0	6.3	6.7	6.8	7.1
Portfolio investment, net	-1.1	-1.2	-3.8	-3.2	-1.9	-2.2	-1.6	-1.8	-1.5
Bank credit to the private sector	12.6	14.7	4.5	4.6	7.9	…	…	…	…
Deposits of the private sector	23.1	11.4	10.9	10.1	9.2	…	…	…	…
Non-performing loans (percent of total loans)	5.2	5.7	7.4	8.5 2/	…	…	…	…	…
Regulatory capital/risk weighted assets	18.8	17.6	14.4	16.4 2/	…	…	…	…	…
GDP (millions of euros)	4,291	4,770	4,916	5,149	5,460	5,820	6,231	6,639	7,074
GDP per capita (euros)	2,418	2,652	2,708	2,794	2,919	3,065	3,234	3,394	3,563
GNDI per capita (euros)	2,830	3,103	3,229	3,329	3,460	3,617	3,795	3,964	4,130
Population (thousands) 3/	1,775	1,799	1,816	1,843	1,870	1,899	1,927	1,956	1,985

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

1/ Total foreign assistance excluding capital transfers.
2/September 2013.
3/ Series updated according to Kosovo Agency of Statistics (2013), *Estimation of Kosovo population, 2012*, Pristina, Kosovo.

Table 2. Kosovo: Real Growth, 2010–18

(Percent, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
			Est.	Projections					
				(Real growth, percent)					
Consumption	1.9	2.1	1.9	2.2	3.8	3.0	3.3	2.9	3.0
Private	3.0	3.1	2.5	2.4	2.9	3.2	3.3	2.9	3.0
Public	-4.5	-2.8	-0.9	0.8	9.1	1.8	3.2	2.9	3.1
General government	2.9	-2.0	0.3	3.6	11.7	1.3	5.5	4.9	4.9
Donor sector 1/	-16.1	-4.6	-3.9	-6.5	-7.4	-6.0	-5.9	-6.1	-6.0
Investment	12.3	11.3	-11.8	-1.1	1.4	7.3	8.1	7.8	7.8
Private	11.6	10.5	-19.3	0.5	5.2	9.5	9.6	9.5	9.7
Public	13.7	12.9	2.2	-3.4	-4.4	3.7	5.5	4.6	4.1
General government	14.8	13.7	2.4	-3.3	-4.3	4.2	5.9	4.9	4.4
Donor sector 1/	-6.5	-4.0	-2.7	-6.3	-6.2	-10.2	-10.1	-10.0	-9.9
Exports	13.0	8.3	0.7	5.3	10.0	11.9	12.2	10.5	9.2
Imports	8.5	5.3	-7.2	0.8	4.6	5.7	6.2	5.7	5.6
GDP	3.2	4.4	2.5	2.5	3.9	4.5	5.0	4.5	4.5
Memorandum item:									
GDP (millions of euros)	4291	4770	4916	5149	5460	5820	6231	6639	7074

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

1/ Donor sector includes UNMIK, EULEX, KFOR, and other donor spending.

Table 3. Kosovo: Consolidated Government Budget, 2011–14 1/

(Excluding donor designated grants; millions of euros; cumulative from the beginning of the year)

	2011	2012	2013					2014
			Apr.		Aug.		Dec.	
			Prog.	Actual	Prog.	Actual	Proj.	Proj.
Total primary revenue and grants	1,303	1,322	412	398	911	859	1,381	1,488
Total primary revenue	1,277	1,284	412	398	909	859	1,381	1,487
Taxes	1,072	1,112	321	322	744	728	1,162	1,287
Direct taxes	151	170	61	69	107	123	189	229
Indirect taxes	949	975	271	265	656	629	1,008	1,095
Tax refunds	-28	-33	-11	-12	-19	-24	-35	-37
Nontax revenues	205	172	91	76	166	131	219	201
Of which:								
Dividends	60	45	15	30	30	33	43	30
Grants	26	37	1	0	2	0	0	1
Budget support	19	37	0	0	0	0	0	0
Project grants	3	0	1	0	2	0	0	1
Primary expenditure	1,382	1,441	450	390	1,010	894	1,476	1,590
Of which:								
PAK-related expenditures		6	2	1	5	4	7	7
Primary expenditure excluding PAK	...	1,435	448	388	1,005	890	1,469	1,583
Current expenditure	832	888	265	276	598	596	948	1,069
Wages and salaries	385	408	110	104	256	272	424	487
Goods and services	177	191	58	62	132	117	209	252
Subsidies and transfers	270	289	98	110	208	207	312	326
Pension and social assistance	178	198	74	75	153	151	228	248
Other transfers and subsidies 2/	92	91	23	35	55	57	84	78
Reserve	0	0	0	0	2	0	3	4
Capital expenditure and net lending	550	553	185	114	412	298	528	521
Capital expenditure	520	541	187	116	416	302	534	521
Highways	259	281	94	63	189	151	243	135
R7	...	239	...	44	...	124	215	0
R6	...	0	...	0	...	0	0	102
Expropriation	...	42	...	19	...	27	28	33
Other capital spending	261	260	93	53	228	150	291	386
Net lending	30	12	-2	-2	-4	-4	-6	0
Primary balance	-79	-119	-38	8	-99	-35	-95	-101
Primary balance net of PAK		-113	-36	9	-94	-31	-88	-94
Interest income, net	-6	-10	-7	-5	-10	-6	-13	-18
Overall balance	-84	-129	-45	2	-109	-41	-108	-119
Financing	86	129	45	-2	109	42	108	119
Foreign financing	2	83	-4	-4	-1	-3	-11	16
Drawings, incl. official financing	8	94	2	2	4	3	3	38
Amortization	-12	-11	-6	-6	-6	-6	-14	-22
Domestic financing	85	46	49	2	110	45	120	103
Domestic borrowing (net)	0	73	20	20	60	60	80	120
Privatization revenues	0	45	0	0	26	26	26	20
Other financial assets, net	0	0	-1	0	-2	0	-1	0
Own-source revenue (– = increase)	0	-15	-38	-2	-30	4	2	4
Bank balance (prog.; – = increase)	84	-56	67	-16	56	-45	12	-42
Financing gap	0	0	0	0	0	0	0	0
Memorandum items:								
Bank balance of the general government	160	216	160	232	171	261	204	246
Of which: ELA	0	0	0	0	0	0	46	46
Minimum bank balance (fiscal rule)	...	...	...	...	...	...	...	246
Recommended bank balance (SBA)	271	297	...	...	...	...	342	381

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

1/ Does not yet reflect the GFSM 2001 methodology to ensure consistency within a program context.

2/ Including capital transfers to public enterprises.

Table 4. Kosovo: Consolidated Government Budget, 2011–18 1/

(Excluding donor designated grants; percent of GDP)

	2011	2012	2013 Proj. 4th Review 2/	2013 Proj.	2014	2015	2016	2017	2018
					Projections				
Total primary revenue and grants	27.3	26.9	26.9	26.8	27.3	26.9	27.1	27.1	27.3
Total primary revenue	26.8	26.1	26.8	26.8	27.2	26.9	27.1	27.1	27.3
Taxes	22.5	22.6	22.5	22.6	23.6	23.1	23.3	23.4	23.4
Direct taxes	3.2	3.5	3.5	3.7	4.2	3.8	3.9	4.0	4.0
Indirect taxes	19.9	19.8	19.6	19.6	20.1	20.0	20.1	20.1	20.1
Tax refunds	-0.6	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
Nontax revenues	4.3	3.5	4.4	4.3	3.7	3.8	3.8	3.8	3.9
Of which:									
Dividends	1.3	0.9	0.8	0.8	0.5	0.5	0.5	0.5	0.5
Grants	0.5	0.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Budget support	0.4	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project grants	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Primary expenditure	29.0	29.3	30.0	28.7	29.1	28.7	28.8	28.8	28.7
Of which:									
PAK-related expenditures	...	0.1	0.2	0.1	0.2	0.2	0.2	0.2	...
Primary expenditure excluding PAK	...	29.2	29.8	28.5	29.0	28.6	28.7	28.7	28.7
Current expenditure	17.4	18.1	18.6	18.4	19.6	19.4	19.4	19.4	19.4
Current expenditure excluding PAK	...	17.9	18.4	18.3	19.4	19.2	19.2	19.2	19.4
Wages and salaries	8.1	8.3	8.3	8.2	8.9	8.9	8.8	8.8	8.8
Goods and services	3.7	3.9	4.3	4.1	4.6	4.6	4.6	4.6	4.6
Subsidies and transfers	5.7	5.9	5.9	6.1	6.0	5.9	5.9	5.9	5.9
Pension and social assistance	3.7	4.0	4.5	4.4	4.5	4.3	4.3	4.3	4.3
Other transfers and subsidies 3/	1.9	1.9	1.4	1.6	1.4	1.6	1.6	1.6	1.6
Reserve	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital expenditure and net lending	11.5	11.3	11.3	10.3	9.5	9.4	9.4	9.4	9.4
Capital expenditure	10.9	11.0	11.4	10.4	9.5	9.5	9.5	9.5	9.5
Highways	5.4	5.7	5.2	4.7	2.5	3.2	3.6	2.7	0.0
R7	...	4.9	4.1	4.2	0.0	0.0	0.0	0.0	0.0
R6	...		0.5	0.0	1.9	2.7	3.1	1.5	0.0
Expropriations	...	0.9	0.5	0.5	0.6	0.5	0.5	0.5	0.0
Other capital spending	5.5	5.3	6.3	5.7	7.1	6.3	5.9	6.8	9.5
Net lending	0.6	0.2	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.1
Primary balance	-1.7	-2.4	-3.1	-1.8	-1.9	-1.8	-1.7	-1.7	-1.4
Primary balance net of PAK	0.0	-2.3	-3.0	-1.7	-1.7	-1.8	-1.7	-1.7	-1.4
Interest income, net	-0.1	-0.2	-0.3	-0.3	-0.3	-0.4	-0.5	-0.5	-0.6
Overall balance	-1.8	-2.6	-3.4	-2.1	-2.2	-2.2	-2.2	-2.2	-2.0
Overall balance (excluding PAK)	...	-2.5	-3.2	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0
Financing	1.8	2.6	3.4	2.1	2.2	2.2	2.2	2.2	2.0
Foreign financing	0.0	1.7	-0.1	-0.2	0.3	-0.4	-0.9	-0.8	-0.2
Drawings, incl. official financing	0.2	1.9	0.2	0.1	0.7	0.0	0.0	0.0	0.0
Amortization	-0.3	-0.2	-0.3	-0.3	-0.4	-0.4	-0.9	-0.8	-0.2
Domestic financing	1.8	0.9	3.5	2.3	1.9	2.6	3.0	3.0	2.2
Domestic borrowing (net)	0.0	1.5	1.5	1.6	2.2	2.6	2.8	2.7	2.6
Privatization revenues	0.0	0.9	5.8	0.5	0.4	0.9	0.8	0.2	0.1
Other financial assets (net)	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Own-source revenue (– = increase)	0.0	-0.3	0.1	0.0	0.1	0.0	0.0	0.0	0.0
Bank balance (prog.; – = increase)	1.8	-1.1	-3.7	0.2	-0.8	-0.9	-0.5	0.2	-0.6
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Bank balance of the general government	3.4	4.4	7.9	4.0	4.5	5.1	5.3	4.9	5.1
Of which: ELA	0.0	0.9	0.9	0.9	0.8	0.8	0.7	0.7	0.7
Minimum bank balance (fiscal rule)	...	...	...	...	4.5	4.5	4.5	4.5	4.5
Recommended bank balance (SBA)	5.7	6.0	6.7	6.6	7.0	7.2	7.3	7.2	7.1
Nominal GDP (millions of euros)	4,770	4,916	5,256	5,149	5,460	5,820	6,231	6,639	7,074

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

1/ Does not yet reflect the GFSM 2001 methodology to ensure consistency within a program context.

2/ Since the 4th Review, the 2013 nominal GDP has been revised downwards by about €100 million reflecting mostly lower GDP deflator for 2012.

3/ Including capital transfers to public enterprises.

Table 5. Kosovo: Balance of Payments, 2010-18

(Millions of euros, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
				Projections					
Goods and services balance	-1,565	-1,793	-1,728	-1,649	-1,672	-1,677	-1,694	-1,738	-1,751
Goods	-1,752	-2,059	-2,073	-2,015	-2,102	-2,192	-2,306	-2,444	-2,543
Exports	305	325	287	309	346	393	448	504	571
Imports	-2,057	-2,384	-2,360	-2,324	-2,447	-2,585	-2,754	-2,948	-3,114
Services	187	266	345	366	430	515	612	706	792
Receipts	573	619	637	653	714	808	920	1,028	1,125
Payments	-386	-353	-292	-287	-284	-293	-307	-323	-334
Income	68	113	154	166	173	182	193	205	198
Compensation of employees (net)	172	208	214	223	232	241	251	261	271
Investment income	-104	-95	-60	-57	-59	-59	-57	-56	-74
Interest payments on public debt	-9	-9	-8	-10	-13	-13	-12	-11	-29
Transfers	982	1,021	1,194	1,131	1,080	1,095	1,060	1,044	1,049
Official transfers	320	322	402	311	240	228	170	134	122
Other transfers (net)	663	699	793	820	840	866	889	910	928
Of which: inflows of remittances	584	585	605	633	662	693	727	762	798
Current account	-515	-659	-380	-352	-419	-400	-441	-489	-505
Capital and financial account	298	419	140	152	219	200	241	289	305
Capital account	21	42	13	2	0	0	0	0	0
Of which: WB Trust Fund	0	10	0	0	0	0	0	0	0
Financial account, incl. CBK	277	377	127	150	220	200	240	289	305
Foreign direct investment, net	331	379	213	286	326	367	417	453	502
Commercial banks, excl. FDI	-44	7	102	-84	2	-18	0	-22	-5
General government	21	-6	83	-11	16	-26	-55	-55	-12
Drawings	22	5	94	3	38	0	0	0	0
Repayments	-11	-11	-11	-14	-22	-26	-55	-55	-12
Other	10	0	0	0	0	0	0	0	0
Other sectors, excl. FDI 1/	9	-18	-33	-14	-110	-86	-80	-87	-93
Central Bank of Kosovo	-41	15	-237	-27	-15	-37	-42	0	-87
Reserve assets	-53	61	-267	-32	-62	-37	-39	6	-79
Government balances (program definit	-55	73	-56	12	-42	-51	-32	12	-40
Other reserve assets, incl. SDRs	2	-12	-211	-44	-20	14	-7	-6	-39
Non-reserves assets	13	-46	30	5	47	0	-3	-6	-8
Liabilities 2/	0	0	0	0	0	0	0	0	0
Net errors and omissions 3/	217	241	239	200	200	200	200	200	200
Overall balance	0	0	0	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0	0
Memorandum items:									
Current account, excl. official transfers	-835	-982	-781	-663	-659	-628	-611	-623	-626
(in percent of GDP)	-19.5	-20.6	-15.9	-12.9	-12.1	-10.8	-9.8	-9.4	-8.9
Current account, incl. official transfers	-515	-659	-380	-352	-419	-400	-441	-489	-505
(in percent of GDP)	-12.0	-13.8	-7.7	-6.8	-7.7	-6.9	-7.1	-7.4	-7.1
Official transfers (percent of GDP)	7.4	6.8	8.2	6.0	4.4	3.9	2.7	2.0	1.7
Debt service to export ratio (percent)	2.3	2.1	2.1	2.5	3.2	3.2	4.9	4.3	2.4
Net foreign assets of commercial banks	508	509	491	575	574	592	591	613	618
Net foreign assets of CBK	1,108	1,095	1,239	1,266	1,281	1,318	1,359	1,359	1,446
Gross international reserves of the CBK	686	626	899	925	987	1,024	972	966	1,045

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

1/ Including trading companies, insurance companies, and pension funds.

2/ Includes SDR allocations and IMF account at historical value.

3/ Projections of errors include unidentified private remittances and other capital based on average historical levels.

Table 6. Kosovo: Central Bank and Commercial Bank Survey, 2008–14

(Millions of euros, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013 (Projections)	2014 (Projections)
			Central Bank				
Net foreign assets	1,111	1,088	1,108	1,095	1,239	1,266	1,281
Foreign assets	1,111	1,198	1,247	1,235	1,469	1,496	1,511
Of which: Securities	541	530	199	25	286	326	346
Deposits	529	522	854	1,059	1,034	1,021	1,016
Foreign liabilities	0	110	139	140	230	230	230
Net domestic assets	-1,111	-1,088	-1,108	-1,095	-1,239	-1,266	-1,281
Net claims on the central government	-870	-681	-813	-797	-838	-827	-822
Liabilities	-870	-681	-813	-797	-838	-827	-822
Of which: KTA (privatization) fund	-406	-451	-522	-586	-549	-551	-504
Of which: Government balances (program definition)	-414	-178	-233	-160	-216	-204	-246
Commercial banks	-137	-233	-204	-210	-302	-340	-360
Other institutions	-64	-131	-45	-39	-51	-51	-51
Other items, net	-39	-43	-46	-49	-48	-48	-48
			Commercial banks				
Net foreign assets	325	444	508	509	491	575	574
Assets	401	584	710	666	634	728	742
Liabilites	76	140	202	156	143	153	168
Net domestic assets	815	949	1,206	1,399	1,625	1,754	1,970
Credit to private sector	1,183	1,289	1,451	1,664	1,740	1,819	1,963
Claims on the CBK	137	233	203	220	301	340	360
Net claims on the central government	-1	-165	-12	-1	59	125	220
Net claims on other public entities	-264	-123	-120	-129	-74	-78	-82
Other items, net	-240	-286	-316	-355	-401	-452	-492
Liabilities to the private sector	1,140	1,393	1,714	1,908	2,116	2,329	2,544
Demand deposits	384	441	545	598	694	762	830
Time deposits	756	951	1,169	1,311	1,422	1,567	1,713
Memorandum item:							
Gross international reserves	670	625	686	626	892	925	987
			(12-month percent change)				
Liabilities to private sector	25.8	22.2	23.1	11.4	10.9	10.1	9.2
Loans to the private sector	32.7	8.9	12.6	14.7	4.5	4.6	7.9
			(Percent of GDP)				
Total private sector deposits	28.9	34.7	39.9	40.0	43.0	45.2	46.6
Credit to the private sector	30.0	32.2	33.8	34.9	35.4	35.3	36.0

Sources: Central Bank of the Republic of Kosovo; and IMF staff estimates and projections.

Table 7. Kosovo: Selected Financial Soundness Indicators, 2009–13

	2009	2010	2011	2012	2013		
					Q1	Q2	Q3
Capital adequacy							
Regulatory capital/risk weighted assets 1/	18.1	18.8	17.6	14.2	15.1	15.1	16.4
Tier 1 capital/risk weighted assets 1/	15.2	15.8	14.8	11.6	12.5	12.2	12.5
Capital to assets	9.8	10.1	10.2	10.0	10.5	10.5	10.0
Asset quality							
NPL ratio 2/	4.3	5.2	5.7	7.5	7.6	7.6	8.5
NPL net of provisions to capital	2.9	3.7	4.6	7.4	6.7	6.9	8.7
Large Exposures to capital	64.6	72.4	77.8	80.4	69.2	78.5	106.1
Sectoral breakdown of loans							
Agriculture	3.0	2.6	2.4	2.5	2.6	2.7	3.1
Manufacturing	11.5	11.0	10.1	9.5	9.5	9.3	9.6
Trade	37.4	37.1	37.8	37.8	37.9	37.8	36.4
Other services	14.6	12.0	11.7	11.6	11.6	11.8	12.3
Construction	6.9	7.5	7.0	7.2	7.2	7.0	7.0
Households	26.7	29.8	31.0	31.4	31.3	31.4	31.6
Liquidity							
Liquid assets/total assets 3/	37.4	37.5	32.6	34.3	33.8	31.0	35.5
Deposits to loans	129.7	126.1	117.6	122.6	121.9	116.3	125.8
Liquid assets to short-term liabilities 4/	47.0	46.2	39.6	40.8	39.2	37.3	41.2
Profitability							
Return on average assets 5/	1.6	1.6	1.6	0.8	0.7	1.0	0.9
Return on average equity 5/	15.5	16.9	16.9	8.3	7.7	10.3	9.8
Interest margin to total income	55.3	55.5	56.9	55.6	54.1	54.8	54.5
Non-interest expense to total income 6/	16.4	16.6	18.0	23.9	21.9	19.9	22.0
Interest margin to gross income 7/	74.4	74.4	75.2	74.7	73.8	74.0	73.2
Non-interest expense to gross income 7/ 8/	79.2	76.6	77.3	87.8	84.6	80.8	82.7
Market risk							
Net open currency position to tier 1 capital	12.4	-0.1	2.5	0.7	0.3	0.3	4.4

Source: Central Bank of the Republic of Kosovo.

1/ As of Dec. 2012, new capital adequacy rules include an additional capital requirement for operational risk, higher risk-weights for assets rated B- or less, and a deduction for related party loans.

2/ Loans classified as doubtful or loss.

3/ Liquid Assets are cash and balances with the CBK, balances with commercial banks, and securities.

4/ Short-term liabilities are deposits, short-term borrowing, and other liabilities (up to 1 year maturity).

5/ Profits are before taxes and extraordinary items.

6/ Non-interest expenditure from fees, commissions, provisions, and depreciation (i.e., excluding general and administrative expenses).

7/ Gross income is net interest income plus non-interest income.

8/ Non-interest expense including general and administrative costs.

Table 8a. Kosovo: Gross Financing Requirements, 2011–13

(Millions of euros)

	2011	2012	2013
Gross Financing Requirements	671	391	366
Current account deficit	659	380	352
Amortization of medium and long term public debt	11	11	14
Sources of Financing	671	391	366
Capital account (net)	42	13	2
Foreign direct investment (net)	379	213	286
Net bank financing	7	102	-84
Government loans	5	94	3
Net Foreign assets of the Central Bank of Kosovo	15	-237	-27
Other financing inc. net erros and omissions	223	206	186
Financing need	0	0	0
IMF 1/	0	0	0
in percent of quota	0	0	0
Memorandum items:			
Kosovo IMF quota (SDR millions)	59	59	59
Kosovo IMF quota (Euro millions)	69	69	69

Sources: IMF staff estimates and projections.

Table 8b. Kosovo: Gross Financing Requirements, 2011–13

(Percent of GDP)

	2011	2012	2013
Gross Financing Requirements	14.1	8.0	7.1
Current account deficit	13.8	7.7	6.8
Amortization of medium and long term public debt	0.2	0.2	0.3
Sources of Financing	14.1	8.0	7.1
Capital account (net)	0.9	0.3	0.0
Foreign direct investment (net)	7.9	4.3	5.6
Net bank financing	0.1	2.1	-1.6
Government loans	0.1	1.9	0.1
Net Foreign assets of the Central Bank of Kosovo	0.3	-4.8	-0.5
Other financing inc. net erros and omissions	4.7	4.2	3.6
Financing need	...	0.0	0.0
IMF	...	0.0	0.0

Sources: IMF staff estimates and projections.

1/ Program is assumed to be precautionary in 2013. The remaining purchases amount to 12.753 million SDR, 22 percent of quota.

Table 9. Kosovo: Indicators of Capacity to Repay the Fund, 2013–18

	2013	2014	2015	2016	2017	2018
Fund obligations based on existing and prospective purchases (millions of SDR) 1/						
Principal	2.4	9.4	13.0	39.1	39.5	6.4
Charges and interest	0.8	1.1	1.0	0.8	0.3	0.0
Total obligations based on existing and prospective purchases						
SDR millions	3.1	10.5	14.0	39.9	39.8	6.4
Euro millions	3.6	11.9	15.7	44.7	44.4	7.1
Percent of exports of goods and services	0.4	1.1	1.3	3.3	2.9	0.4
Percent of debt service	15.2	34.6	40.7	67.2	67.8	17.4
Percent of GDP	0.1	0.2	0.3	0.7	0.7	0.1
Percent of government revenue	0.3	0.8	1.0	2.6	2.5	0.4
Percent of quota	5.3	17.8	23.7	67.6	67.5	10.9
Outstanding Fund credit						
SDR millions	107.4	98.0	85.0	45.9	6.4	0.0
Euro millions	122.6	110.9	95.6	51.4	7.1	0.0
Percent of exports of goods and services	12.7	10.5	8.0	3.8	0.5	0.0
Percent of debt service	518.9	323.0	247.2	77.4	10.9	0.0
Percent of GDP	2.4	2.0	1.6	0.8	0.1	0.0
Percent of government revenue	8.9	7.4	6.1	3.0	0.4	0.0
Percent of quota	182.0	166.1	144.1	77.8	10.8	0.0
Net use of Fund credit (millions of SDR)	10.4	-9.4	-13.0	-39.1	-39.5	-6.4
Purchases	12.8	0.0	0.0	0.0	0.0	0.0
Repurchases	2.4	9.4	13.0	39.1	39.5	6.4

Sources: IMF staff estimates and projections.
1/ Assumes full drawings under the SBA.

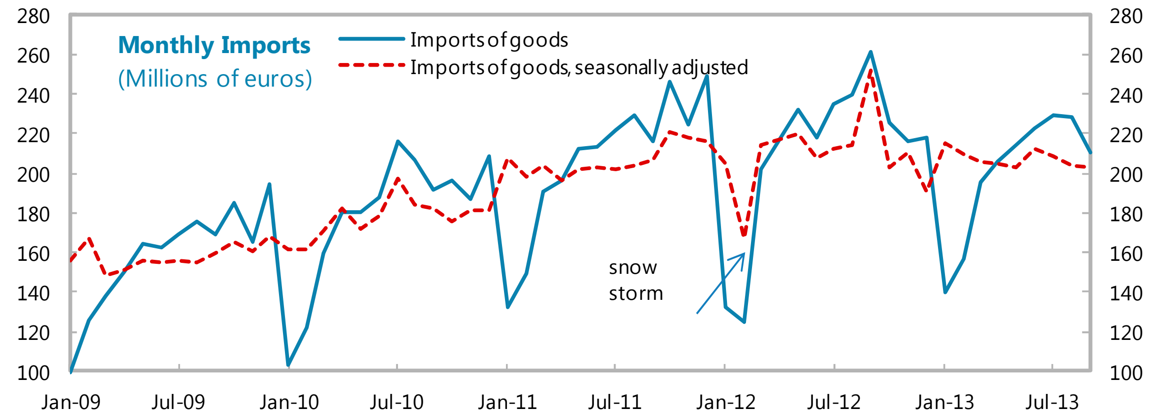
Table 10. Kosovo: Schedule of Purchases Under the Stand-By Arrangement, 2012–13

Amount	Percent of	Date Available	Conditions Necessary for Purchase
SDR 4.251 million	7	April 27, 2012	Purchase made
SDR 39.108 million	66	July 16, 2012	Purchase made
SDR 34.857 million	59	December 20, 2012	Purchase made
SDR 4.251 million	7	April 24, 2013	Purchase not made (authorities treating arrangement as precautionary)
SDR 4.251 million	7	July 15, 2013	Purchase not made (authorities treating arrangement as precautionary)
SDR 4.250 million	7	October 28, 2013	Observance of the continuous performance criterion and of the performance criteria for August 31st, 2013; and completion of the fifth SBA review.

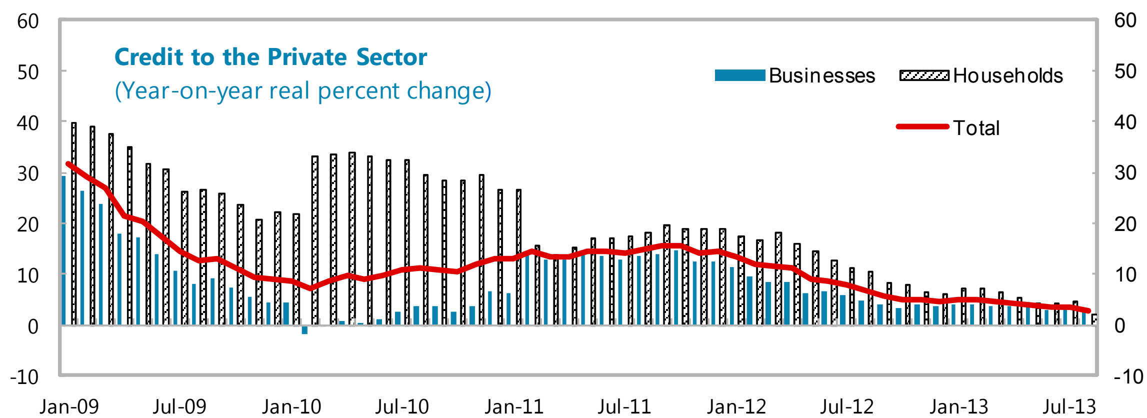
Total: SDR 90.968 million (154 percent of quota)

Figure 1. Kosovo: Recent Economic Developments

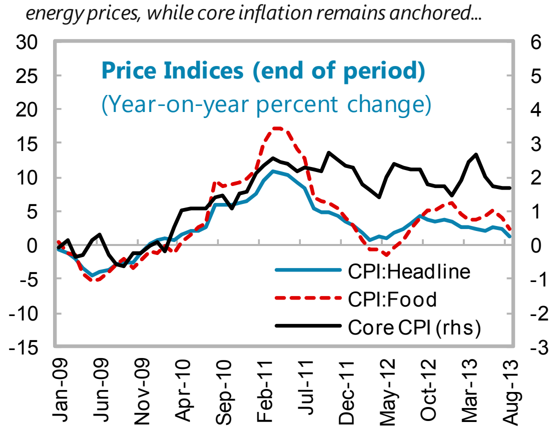
Following last year's stagnation, import growth has weakened further, after picking in the early part of the year...



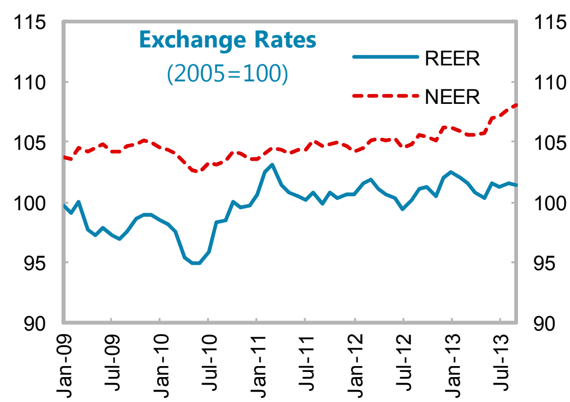
... bank credit growth has moderated after picking in the early part of the year.



Headline inflation has moved in line with food and energy prices, while core inflation remains anchored...

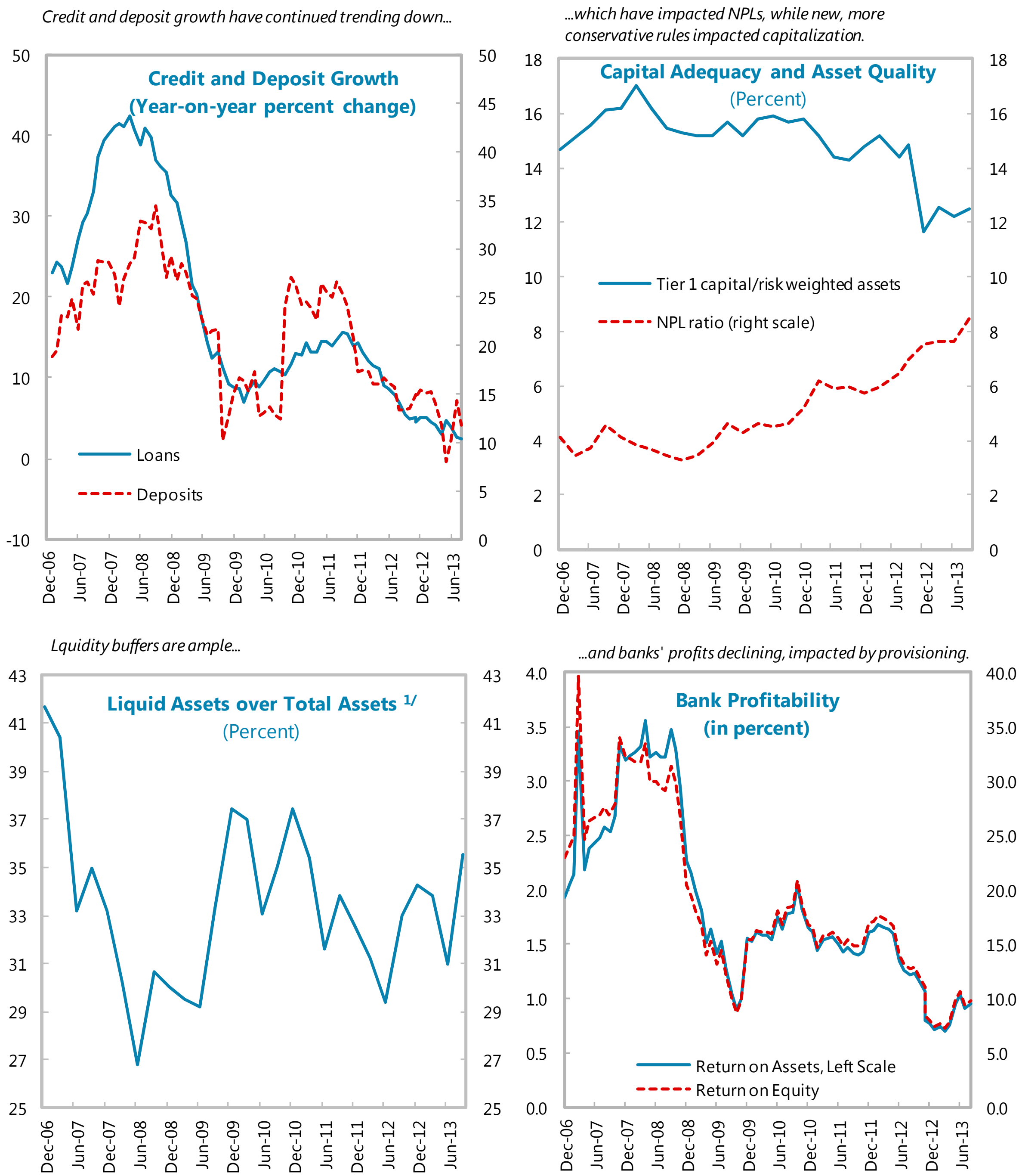


... and effective exchange rates have remained broadly stable.



Sources: Central Bank of the Republic of Kosovo; and IMF staff estimates and projections.

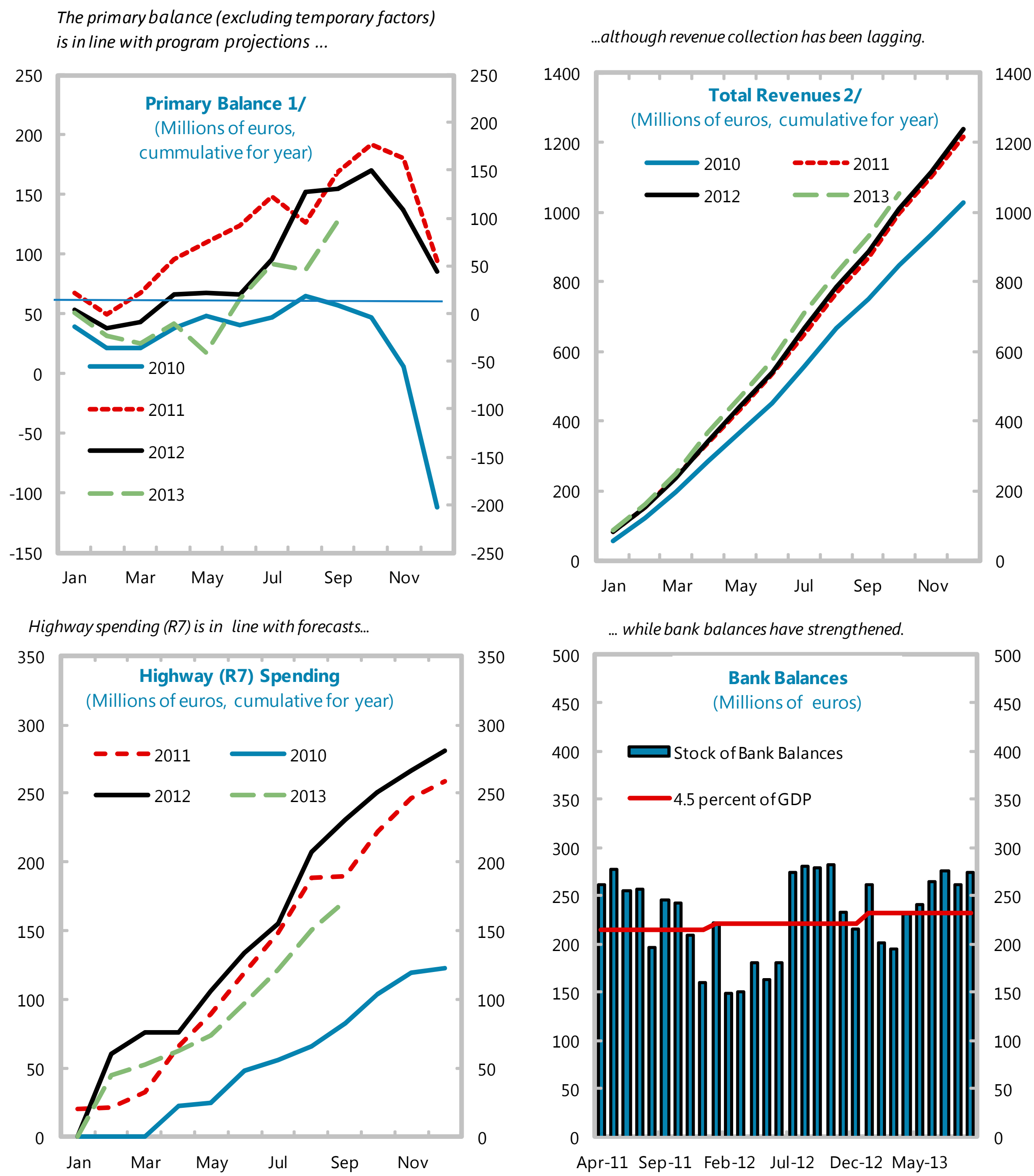
Figure 2. Kosovo: Selected Banking Sector Indicators, 2006–13



Sources: Cental Bank of Kosovo; and IMF staff estimates.

1/ Liquid assets are cash, balances with CBK and commercial banks, and securities.

Figure 3. Kosovo: Recent Fiscal Developments



Sources: Country authorities; and IMF staff calculations.
1/ Primary balance excluding highway (R7) expenditures, grants, and dividends. The 2011 outcome exceeded the program target under the SMP by a large margin.
2/ Total revenues excluding grants and dividends.

Appendix: Letter of Intent

Pristina, December 5, 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431
U.S.A.

Dear Ms. Lagarde:

1. As this is the final review under our Stand-By Arrangement (SBA), we would like to take stock of the progress made in advancing macro-financial stability in the past two years. Kosovo has restored a sustainable fiscal stance through a mix of structural expenditure savings—notably a significant reduction of subsidies to publicly owned enterprises, including the energy sector—and growth-friendly revenue increases—in particular tobacco excises and lignite royalties. We are on-track to bringing the government bank balance to an adequate level. A legally binding rules-based fiscal framework, enacted in July 2013, safeguards responsible fiscal policies going forward. We have improved the preparation and costing of spending initiatives, as well as the recording and monitoring of payment obligations. A new banking law, passed in 2012, enhances the supervisory and resolution powers of the central bank. The Special Reserve Fund (SRF) for Emergency Liquidity Assistance (ELA) was funded with a government deposit over which the central bank has exclusive control. As regards labor market policies, we have established a rules-based framework for setting minimum wage levels. Further, Kosovo's rank in the World Bank's *Doing Business* survey has improved by 40 positions in the past two years.

2. While we are pleased to bring this program to a successful conclusion, we plan to continue close cooperation with the IMF, and intend to discuss the possibility of a successor program in the first half of next year.

3. Kosovo's economy has continued to display considerable resilience in the face of external headwinds. While growth was modest in both 2012 and 2013, it still exceeded that of other economies in the region. The banking system continues to be well-capitalized and liquid. We remain vigilant to risks, including those that could emerge from a possible deterioration in economic conditions in Diaspora host countries and, consequently, a reduction in current and capital inflows. As such, we remain committed to disciplined fiscal management, an adequate level of the government bank balance, the further strengthening of the legal and regulatory framework for Kosovo's financial system, prudent financial supervision, and structural reforms to boost competitiveness.

4. Since the 4th review, implementation of our economic program has remained broadly consistent with commitments under the Stand-By Arrangement (SBA; Tables 1 and 2):

- All quantitative performance criteria for end-August were met. The primary fiscal balance was higher than programmed by €63 million, as a shortfall in customs revenue collection was overcompensated by over-performance of domestic tax collection and under-execution of spending, notably of the capital budget. The floor on government bank balance was exceeded by €90 million. Both the general government's primary expenditures and the net contracting of non-concessional debt remained below program ceilings.

- The indicative (zero) targets for domestic payment arrears of the central and general government were missed by small amounts, but corrective action is being taken.

- We have also made good progress on structural benchmarks:

  (i) On August 30, the Minister of Labor issued an administrative instruction to establish a rules-based treatment for setting minimum wage levels consistent with ¶21 of the Letter of Intent (LOI) of June 28, 2013.

  (ii) On October 31, we submitted the draft 2014 budget to the Assembly. The budget is consistent with the rules-based fiscal framework and most elements specified in ¶12 of the LOI of June 28, 2013. The exception is current spending, where the budget exceeds the ceiling specified in the June LOI by €12 million. The additional allocations reflect higher-than-expected current expenditures by municipalities (€3 million)—which is beyond the control of the central government--and of implementing Law No. 04/L199—with relates to strengthening to the public administration in northern municipalities.

  (iii) The continuous structural benchmarks on monthly meetings of our Program Monitoring Committee, and on fiscal impact assessments evaluating the budgetary impact of all new benefit creating laws and amendments to such laws over a period of at least 5 years, were also met.

- On November 29, 2013, we issued a decision not to allocate €88 million relative to the 2013 mid-year budget review, with specification of non-allocation across expenditure categories as follows: €71 million on capital spending, €15 million on wages and salaries, and €2 million on goods and services—thus satisfying the corresponding prior action.

5. Based on this performance, we request completion of the fifth and final review under the Stand-By Arrangement. We will continue treating the Stand-By Arrangement as precautionary, and therefore intend not to draw the amount that we would be entitled to purchase with the completion of this review.

6. We believe that the policies set out in the letters of April 12, 2012, June 27, 2012, December 5, 2012, April 8, 2013, June 28, 2013 and in this letter are adequate for successful implementation of the program. However, the government stands ready to take additional measures as appropriate to

ensure achievement of the program's objectives. As is standard under all IMF arrangements, we will consult with the IMF before modifying measures contained in this letter or before the adoption of new measures that would deviate from the goals of the program, in accordance with the Fund's policies on such consultations, and provide IMF staff with the necessary information for program monitoring. The understandings between us and the IMF regarding program criteria and structural measures described in this letter are further specified in the Technical Memorandum of Understanding. In line with our commitment to transparency, we authorize the IMF to publish this letter and the associated staff report.

I. Macroeconomic Outlook

7. The macroeconomic framework underpinning our program is based on prudent assumptions, with a view to minimizing the risk of downward revisions during the period ahead.

- *Real GDP growth* is expected to recover to around 4 percent in 2014, consistent with projected developments in Diaspora host countries and other advanced economies. Both domestic demand and exports are expected to contribute to the recovery.
- Annual average *consumer price inflation* is expected to moderate to below 2 percent, in line with projected developments for global food and fuel prices.
- *The trade deficit* is estimated to gradually narrow from 35 percent in 2012 to about 30 percent of GDP in 2014, reflecting the recovery in exports, the substitution of imports with domestic production, and lower projected import prices. We expect the deficit to be financed by current transfers, FDI and other inflows, mostly from the Diaspora.

II. Fiscal Policy

a. The 2013 Budget

8. Budget implementation through October 2013 was broadly in line with our program, as lower-than-expected revenues were compensated by under-execution of spending.

a. *Revenue collection* through end-August was short of the original program projections by €52 million, owing to continued weakness in the collection of border taxes and the delayed receipt in mobile telecommunication licenses. The pattern continued in September and October, due in part to a disruption of trade with Macedonia. We are now projecting a revenue shortfall for the entire year of €45-50 million, which assumes that the 3G-licenses would be sold before end-year.

b. Execution of *expenditures* through end-August was lower than budgeted by about €115 million. The bulk was due to under-spending on the capital budget. Another €15 million in under-execution accumulated in September and October, partly due to delays in enacting the mid-year budget review.

9. At the time of the 4th review, we expected the sale of PTK (with a gross sales price of €277 million) to be settled in September. However, the process is not yet complete, as the assembly has still to approve the report on the PTK privatization process and the winning bidder has not yet signed the sales contract. While we expect that privatization will proceed before end-year, we do, as a precaution, not base fiscal policy in 2013 and 2014 any longer on the sale of PTK, and are taking compensating measures to achieve our fiscal objectives regardless.

a. Compensating revenue and expenditure measures with expected savings of €24 million have already been taken in the context of the 4th review earlier this year (¶8 LOI June 28, 2013).

b. On November 29, 2013, we issued a decision to not allocate spending of €88 million, in addition to the €11 million already covered in June, and in line with the corresponding prior action.

c. We have increased tobacco excises effective October 1, 2013, and we have approved a second round of tobacco excise increases effective January 1, 2014.

b. The 2014 Budget

10. On October 31, we submitted the 2014 budget to the Assembly, in line with the corresponding end-October structural benchmark. Preparation of the 2014 budget was guided by the rules-based fiscal framework and the elements specified in ¶12 of the LOI for the 4th Review:

a. The budget is anchored by a ceiling for the general government deficit of 2 percent of GDP (excluding PAK-related spending). Together with the targeted budgetary outcome for 2013 and the planned 2014 financing envelop, the 2014 budget is consistent with achieving an adequate end-2014 government bank balance.

b. In this context, in the event that the revenue from the sale of mobile telecommunication licenses is received in 2014—instead of 2013 as currently projected—the 2014 mid-year budget review would use these receipts for additional spending only if this does not put achievement of an adequate end-2014 bank balance at risk.

c. A deviation relative to the 4th review is an increase in the ceiling on current spending by €12 million, of which €3 million relate to higher-than-expected current expenditures by municipalities—which is beyond the control of the central government. Another €9 million are due to the cost of implementing Law No. 04/L199, which relates to strengthening to the public administration in northern municipalities (costs that were not known by the time of the 4th review).

d. Within the current spending envelope, the budget accommodates a public sector wage bill of €483 million (excluding PAK). The wage bill accommodates (i) additional hiring, accounting for €13 million, which relates in part to strengthening the public administration in northern municipalities and the creation of new educational institutions, and (ii) higher salaries of €45 million. For the latter purpose, a contingency allocation at the Ministry of Finance includes both the cost for civil service reform (estimated at around €18 million) that is expected to be implemented early in the year, and a public sector wage increase. In case the civil service reform is delayed beyond the first quarter, the corresponding amount foreseen for this purpose will be saved. The wage increase follows zero wage rounds in 2012 and 2013, and will cover both 2014 and 2015. We intend to make the wage increase effective no later than mid-year, in order to safeguard sustainability of the public sector wage bill also in 2015.

e. The budget includes a contingency allocation of €15 million for benefits to former political prisoners and a pension for war veterans. These allocations will be executed only after full fiscal impact assessments have been finalized.

f. The budget incorporates an allocation of €531 million for capital expenditures (including 10.6 million is capital subsidies), of which €135 million (for both construction and expropriation) are for the new highway R6 to Macedonia. While the allocation for non-highway capital spending of €386 million is high compared to previous budgets, we are confident that implementation capacity is sufficient to ensure successful execution.

g. We plan net issuance of government paper for €120 million in 2014. At the same time, we will seek to increase the average maturity of government debt, including by issuing paper with a 2-year maturity.

c. Highway R6

11. We have received three proposals for construction of Highway R6. Some proposals are substantially below the cost we had planned for R6 originally. We will select the winning bid by end-year, guided by the need to ensure cost effectiveness and maximize the project's economic benefits for the country. In this process, we will consult closely with the World Bank representative who acts as observer in the R6 steering committee.

d. Other Fiscal Issues

12. Looking ahead, we are planning a review of the government's revenue structure, in view of changes in the structure of Kosovo's economy, notably the ongoing shift from imports to domestic production and upcoming free trade agreements. To this end, we seek to (i) investigate options to further enhance the effectiveness of tax and customs collection, (ii) explore ways to reduce the amount of informality in the economy, and (iii) explore the adequacy of the tax structure in view of recent and anticipated developments. To this end, we are considering requesting technical assistance (TA) from the IMF, as a follow-up to the tax policy TA mission from 2011.

13. We have continued to make progress with our action plan to improve the recording and monitoring of payment obligations. We have amended treasury rules to enforce the timely recording of payments, carried out a publicity campaign to inform stakeholders about these changes and their implications, and upgraded our IT system (LOI June 28, 2013, ¶14 and LOI April 8, 2013, ¶14). As a result, we have noticed that suppliers are now increasingly approaching the Treasury directly for the clearance of outstanding arrears. Next, the Auditor General (AG) will audit budget

organizations whose arrears have been cleared by the Treasury, and recommend sanctions as foreseen in the Law on Public Financial Management and Accountability.

III. Financial Sector Policies

14. We remain vigilant of banks' risks and committed to ensuring compliance with prudential rules. In July and August, the CBK conducted on-site inspections to check the adequacy of provisioning, compliance with limits on related lending, recently tightened capital adequacy rules, and the sources of capital. As of end-September, the banking system's aggregate capital adequacy ratio (CAR) was 16.4 percent (from 14.8 at end-April) and all banks were in compliance with minimum required CARs and the new regulation on related lending. Also the banking sector's liquidity is satisfactory. However, the leverage ratio (equity to assets) of one bank was slightly below the minimum of 7 percent, while another bank had a large exposure above prudential limits. We will ensure that these banks are in compliance before end-year. While non-performing loans have been increasing, they are adequately provisioned. Nonetheless, we will monitor developments closely, in particular in banks with limited capital buffers or large exposures, and in the context of developing risk-based supervision.

15. We have made progress in implementing key recommendations from the 2012 Financial System Stability Assessment. In particular, since the 4th review:

a. a CBK macro-prudential advisory committee was established and is meeting on a regular basis;

b. the CBK is developing an action plan to implement the recommendations of a recent IMF TA mission to further strengthen crisis preparedness and management arrangements, including by establishing a bank contribution for ELA (see below); and

c. the government is reviewing the guarantee for a back-up facility (i.e., a stand-by credit line of €10 million from the EBRD) for the deposit insurance fund (DIFK), aiming at submitting the guarantee for approval by the Assembly by end-year. Establishing a pre-arranged borrowing facility is a condition under the agreement with the donors that provided part of DIFK's seed capital.

16. As regards the planned bank contribution to ELA, the CBK will, as a first step, review the systemic liquidity framework. This will include an assessment of the overall level and sources of systemic liquidity funds that are adequate and feasible given Kosovo's specific circumstances, and compare these to existing back-up facilities (notably the government deposit funded SRF for ELA). Further, the review will analyze the modalities for establishing a bank-financed contribution, including financial and macroeconomic implications and relevant legal aspects. We aim to complete the assessment by end-March 2014. We will request IMF technical assistance to support this endeavor.

17. We remain committed to further progress with other FSAP recommendations, and plan the following next actions:

a. The CBK will draft amendments to the ELA regulation and establish a working group to develop operational procedures for providing ELA to solvent banks during the first quarter of 2014. It will also draft a regulation and procedures for bank resolution (supported by forthcoming TA).

b. The Financial Stability Committee, led by the CBK, will establish a working group charged with drafting a contingency plan to deal with systemic banking crises by end-April 2014.

c. The CBK will receive IMF TA on risk-based supervision, macro modeling, and stress testing to further strengthen micro- and macro-prudential surveillance capacity and processes.

IV. Competitiveness and Structural Reforms

18. We have issued an administrative instruction for a rules-based framework for setting minimum wages, in line with the corresponding end-August structural benchmark (¶21, LOI, June 28 2013). We expect to generate the final figures for potential minimum wage changes in 2014 by end-December.

19. We are making progress with implementing our SME development strategy; specifically on two projects aimed at improving SMEs' access to finance and enhancing their international competitiveness. The first project—supported by the Swiss Corporation—supports SMEs' business needs through a voucher counseling scheme, which is now operational, and, in addition, will provide for their financing needs through a credit guarantee scheme, which is being supported by a number of donor institutions. The latter is being negotiated also with commercial banks and expected to be operational in the first part of 2014. The second project, funded by the Ministry of Trade and Industry and the EC, will provide grants for export-oriented SMEs and SMEs producing import substitution goods, with a view to improving technology, increasing production lines and export capacity. The call for proposals will be launched in December, and the first grants are expected to be disbursed in February 2014. We will also launch in January 2014 a project with EU's IPA (Instrument for Pre-Accession Assistance) which will provide technical assistance for export-oriented companies.

20. Several initiatives are in preparation to foster innovation, entrepreneurship and human capital development. First, a law on foreign investment that grants Kosovar investors with double nationality the same protection as foreign investors was passed in first reading, and is expected to be enacted by end-year. We also collaborate with the IFC on streamlining business registration. Second, we are funding innovation centers in Kosovo to promote start-ups and are collaborating with (i) the South East European Centre for Entrepreneurial Learning (SEECEL) on integrating entrepreneurship training courses in schools and universities and (ii) the European Training Foundation (ETF) on developing a national strategy for human capacity building. Our efforts have yielded another improvement of Kosovo's ranking in the World Bank's Doing Business survey to #86 (out of 189), from #126 two years ago. Kosovo ranks this year among the top 5 reformers due to the reforms in opening a business, construction permits, and registration of property. The ranking is now superior to that of several peers in the region.

Sincerely yours,

Hashim Thaçi /s

Prime Minister

Besim Beqaj /s

Minister of Finance

Bedri Hamza /s

Governor, Central Bank of the Republic of Kosovo

Table 1. Kosovo: Quantitative Performance Criteria and Indicative Targets, 2012–13

(Millions of euros; flows cumulative from beginning of the year)

	2012						2013				
	End-Apr.		End-Aug.		End-Dec.		End-Apr.		End-Aug.		
	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Adj. Prog.	Actual
Performance Criteria 1/											
Floor on the bank balance of the general government 2/	166	180	237	281	205	216	160	232	171	171	261
Floor on the primary fiscal balance of the general government 2/, 3/	-21	4	-19	6	-112	-113	-37	9	-94	-94	-31
Ceiling on primary expenditures of the general government 3/	399	353	911	842	1,490	1435	448	388	1005	1003	890
Ceiling on the net contracting of nonconcessional debt by the general government 3/	150	30	150	49	150	73	150	20	150	150	60
Ceiling on guaranteeing nonconcessional debt by the general government 3/	0	0	0	0	0	0	0	0	0	0	0
Ceiling on the accumulation of external payments arrears of the general government 4/	0	0	0	0	0	0	0	0	0	0	0
Indicative Targets											
Ceiling on the stock of domestic payment arrears of the central government	0	2	0	0	0	3	0	1	0	0	1
Ceiling on the stock of domestic payment arrears of the general government	0	2	0	3	0	5	0	5	0	0	6
Memorandum items:											
Program assumptions											
Repayment of policy loans extended to public corporations	...	4	4	4	4	4	2	2	4	4	4
Non-project grants	4	1	37	37	37	37	0	0	0	0	0
Budget support loans	0	0	0	0	0	0	0	0	0	0	0
Project grants	1	0	3	0	0	0	0	0	2	0	0
Project loans	0	0	6	0	7	7	2	2	3	3	3
PAK-related spending	...	...	5	4	8	6	2	1	5	5	4

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

1/ Adjusted according to the Technical Memorandum of Understanding.

2/ The end-August and end-December, 2012, and end-April, 2013 PCs have been adjusted to reflect higher than expected budget grants relative to program assumptions, as specified in the TMU.

3/ Excluding PAK related spending from August 2012.

4/ Continuous ceiling on the gross flow of new accumulation.

Table 2. Kosovo: Program Monitoring

Review # Test date	**Program Approval**	**First Review** End-April 2012	**Second Review** End-August 2012	**Third Review** End-December 2012	**Fourth Review** End-April 2013	**Fifth Review** End-August 2013
Performance criteria						
Floor on the bank balance of the general government	…	Met	Met	Met	Met	Met
Floor on the primary fiscal balance of the general government	…	Met	Met	Missed	Met	Met
Ceiling on primary expenditures of the general government	…	Met	Met	Met	Met	Met
Ceiling on the net contracting of nonconcessional debt by the general government	…	Met	Met	Met	Met	Met
Indicative targets						
Ceiling on the stock of domestic payment arrears of the central government	…	Missed	Missed	Missed	Missed	Missed
Ceiling on the stock of domestic payment arrears of the general government	…	Missed	Missed	Missed	Missed	Missed
Prior actions						
Passage of the Pension Fund Law in a version that limits (i) exposure of the pillar II pension fund to the government to 30 percent of the fund's assets and (ii) annual investments of the fund in government paper to 50 percent of inflows into the fund in the previous calendar year	Met	…	…	…	…	…
Passage of the revised Banking and Microfinance Law in a version consistent with the recommendations of IMF technical assistance	Met	…	…	…	…	…
Issuance of a government decision that specifies spending cuts of €20 million across expenditure categories relative to the approved 2012 budget	Met	…	…	…	…	…
Passage of the 2013 Budget Law by the Assembly, consistent with the objectives of the program.	…	…	Met	…	…	…
Issuance of a government decision that specify spending cuts of €11 million across spending categories relative the the approved 2013 budget	…	…	…	…	Met	…
Submission of the 2013 Mid-Year Budget Review to the Assembly consistent with ¶9 of the Letter of Intent	…	…	…	…	Missed 2/	…
Issuance of a government decision that specifies non-allocation of €88 million across expenditure categories	…	…	…	…	…	Met
Structural benchmarks						
Publication of budget circulars for municipalities that contain no limits on spending allocations across non-wage categories (by end-May, 2012)	…	Met	…	…	…	…
Submission of a revised Deposit Insurance Fund Law to the Assembly that is consistent with the new Banking and Microfinance Law (by end-May, 2012)	…	Met with delay	…	…	…	…
Amendment of the Law on Public Financial Management and Accountability by a provision that specifies that only the central bank can dispose over the funds in the Special Reserves Fund designated for Emergency Liquidity Assistance (by June 15, 2012)	…	Met	…	…	…	…
Launch of the tender offer for PTK (by end-August, 2012)	…	…	Met with delay	…	…	…
Submission of the 2013 Budget, consistent with the objectives of the program, to the Assembly (by end-October).	…	…	Met	…	…	…
Submission of an economic viability study for highway R6 to the World Bank and IMF staff (by end-January, 2013)	…	…	…	Missed 3/	…	…
Submission of legislation to the assembly on the Rules-Based Fiscal Framework that is consistent with ¶11 of the Letter of Intent as of Dec 5th, 2012 (by end-March 2013).	…	…	…	Met	…	…
Approval of the amended financial rules 02 and 04 of the Treasury to ensure the recording of all payment-related documents within 3 days in the IT system (by End-May 2013). 3/	…	…	…	…	Met 4/	…
Approval by CBK's Executive Board of an instruction to pay for legal representation of staff when they are sued for carrying out official duties in good faith (by End-May 2013).	…	…	…	…	Met	…
Drafting of secondary legislation to provide for a more rules-based treatment of setting minimum wage levels (by end-May 2013)	…	…	…	…	Met	…
Issuance of an administrative instruction to provide for a rules-based setting of minimum wage levels consitent with ¶21 of the Letter of Intent as of Jun 28th, 2013 (by end-August 2013).	…	…	…	…	…	Met
Submission of a 2014 budget to the Assembly consistent with ¶12 of the Letter of Intent as of Jun 28th, 2013 (by end-October 2013).	…	…	…	…	…	Missed 5/
Continuous structural benchmarks						
Monthly meetings of the Program Monitoring Committee and transmission of meetings' minutes to the IMF	…	Met	Met	Met	Met	Met
Inclusion of a paragraph into all new benefit creating laws, amendment to laws or regulations that allows cutting benefits if budgetary funds are unavailable 1/	…	Missed	…	…	…	…
Fiscal impact assessments evaluating the budgetary impact of all new benefit creating laws, amendments to such laws or regulations over a period of at least 5 years	…	Met	Met	Met	Missed 2/	Met

1/ Eliminated after the first review following a corresponding amendment of the Law on Public Financial Management and Accountability.
2/ The 2013 Mid-Year Budget Review contained a spending allocation for an unspecified benefit to erstwhile political prisoners without prior compilation of a fiscal impact assessment.
3 /The study was submitted on time, but did not contain all the elements defined in the LOI of December 2012.
4 /The amended financial rules have been renumbered rules 01 and 02.
5 /The ceiling on current spending was exceeded by €12 million, although for reasons outside the central government's control (the cost of implementing Law No. 04/L199 - that relates to the strengthening of municpalities in Northern Kosovo - and a higher share of current spending by municipalities).

Attachment: Technical Memorandum of Understanding

Definitions and Data Reporting Requirements under the 2012–13 Stand-By Arrangement

1. This Technical Memorandum of Understanding (TMU) sets out the understandings between the Kosovo authorities and the IMF staff regarding the definition of quantitative performance criteria and indicative targets, and reporting requirements for the Stand-By Arrangement ("SBA") requested in April 2012.

I. Performance Criteria and Indicative Targets

A. Coverage

2. For the purpose of this memorandum, the central government is composed of the Executive, the Legislative, and Judiciary branches of the Government, and any other public authorities except municipalities that receive direct budgetary appropriations. The general government includes the central government and municipalities. Both the central and the general government exclude publicly-owned enterprises and socially-owned enterprises.

3. Performance Criteria and Indicative Targets. The performance criteria, indicative targets, and their respective test dates are set in Table 1 of the Letter of Intent (LOI).

B. Bank Balances of the General Government

4. Bank balances are funds usable and readily available (i.e., liquid or marketable, and free of any pledges or encumbrances), held and controlled by the general government for the purposes of making payments and transfers. Bank balances include Undistributed Funds of the Government of Kosovo plus funds specifically reserved for policy purposes including emergency liquidity assistance but do not include the balance of unspent Own Source Revenues (OSR) carried forward, or funds encumbered or pledged as Donor Designated Funds and funds relative to onlending operations. Bank balances do not include investments made and managed by an outside Investment Manager assigned by the Minister pursuant to Kosovo's Law on Public Financial Management Article 7.1.(iii). Bank balances may be held in the form of gold, holdings of foreign exchange and traveler's checks, demand and short-term deposits at the Central Bank of the Republic of Kosovo (CBK), long-term deposits abroad that can be liquidated without penalty, and any holdings of investment-grade

securities held directly by the general government. Bank balances were € 159.986 million at December 31, 2011, and € 215.587 million at December 31, 2012.

- The floor on the bank balance set in Table 2 will be raised by
    - the excess of budget grants and loans relative to program assumptions
    - the excess of privatization proceeds, including from the telecommunication company (PTK) and the receipt of transfers from the Privatization Agency of Kosovo (PAK) relative to program assumptions

5. **Reporting requirements.** A table on bank balances will be transmitted by the Treasury with a maximum delay of five weeks after the end of each month. In addition, the CBK will submit twice a month, with a delay of 1 day, the Report of Positions of Treasury Accounts. Within 45 days after each test date, the CBK will submit to the IMF the independent audit of the reconciliation of government accounts.

C. Primary Expenditures of the General Government

6. **Primary expenditures** are measured on a cash basis cumulatively from the beginning of the calendar year. Expenditures of the Privatization Agency of Kosovo (PAK) are excluded. Primary expenditures include current expenditures (wages and salaries, goods and services, subsidies and transfers, reserves), capital expenditures, and net lending. They do not include interest payments or receipts or expenditures designated by donors financed with grants ("donor designated grants"). Net lending comprises loans granted by the general government except that it does not include onlending such as funds borrowed from KfW, which is instead included as a domestic financing item ("below the line"). All expenditures and net lending financed with loans to be serviced by the general government are in the program's concept of expenditures and net lending, even if the cash did not transit through the Treasury.

- The ceiling on primary expenditures set in Table 2 will be raised by the excess of project grants and loans relative to program assumptions.

- The ceiling on primary expenditures set in Table 2 will be lowered by
    - the shortfall of project grants and loans relative to program assumptions.

- the repayment of loans extended to public corporations in excess of program assumptions.

7. For the purposes of this memorandum, **proceeds of privatizations** will be understood to mean all monies received by the government from the sale of a publicly-owned company, organization, or facility to a private company or companies, organization(s), or individual(s), as well as any proceeds generated from the sale of government nonfinancial assets and from the liquidation of the assets of the Privatization Agency of Kosovo (PAK). Proceeds of privatizations are not part of revenues. Instead, these are recorded as a domestic financing (Net acquisition of financial assets).

8. **Reporting requirements.** Data on the monthly execution, budget appropriations, and budget allocations of revenues and expenditures will be provided monthly no later than five weeks after the end of each month, including (i) government domestic revenue detailing by components direct taxes, indirect taxes, and nontax revenues; (ii) external budget support grants; (iii) primary recurrent expenditure, (iv) domestic and external interest payments and receipts, (v) capital expenditure detailing all those related to the construction of Route 7 and Root 6, and including domestically and budget support financed capital expenditure and externally project financed capital expenditure; (vi) the gross payment and gross accumulation of domestic payments arrears; (vii) external loan receipts and principal payments; (viii) external arrears payments and accumulation; (ix) bank and nonbank financing; (x) privatization and receipts of the sales of nonfinancial assets; and (xi) any other revenue, expenditure, or financing not included above.

D. Primary Fiscal Balance of the General Government

9. **Primary fiscal balance** of the general government is defined as revenues and grants minus primary expenditures cumulatively since the beginning of the calendar year. Expenditures of the Privatization Agency of Kosovo (PAK) are excluded. Revenues do not include privatization receipts.

- The floor on the primary fiscal balance set in Table 2 will be lowered by the excess in project loans relative to program assumptions.

- The floor on the primary fiscal balance set in Table 2 will be raised by
  - the shortfall in project loans relative to program assumptions
  - the excess in budget grants relative to program assumptions.

E. Contracting and Guaranteeing Nonconcessional Debt by the General Government

10. **Nonconcessional debt** is defined as debt contracted or guaranteed by the general government with a grant element of less than 35 percent. The grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency-specific commercial interest reference rates (CIRRs) published by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD). For debt with a maturity of at least 15 years, the ten-year-average CIRR will be used to calculate the PV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. To both the ten-year and six-month averages, the same margins for differing repayment periods as those used by the OECD need to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

11. The ceilings on contracting and on guaranteeing nonconcessional debt cover both domestic and external debt, but exclude purchases from the IMF and the sale of the SDR holdings allocated to Kosovo. Debt rescheduling and debt reorganization of debts contracted before the approval of the SBA are excluded from the limits on nonconcessional debt. The quantitative performance criteria apply not only to debt as defined below but also to commitments contracted or guaranteed for which value has not been received. The contracting or guaranteeing nonconcessional debt by the general government will be assessed at each test date.

12. The government of Kosovo will consult with Fund staff before contracting or guaranteeing any new debts in circumstances where they are uncertain whether the instrument in question is covered under the quantitative performance criterion.

13. **Definition of debt.** The definition of debt is set out in Executive Board Decision No. 12274-(00/85), Paragraph 9, as amended on August 31, 2009 (Decision No. 14416-(09/91)):

> "(a) For the purpose of this guideline, the term **"debt"** will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor

to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

"(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

"(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

"(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

"(b) Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt."

14. **Reporting requirements.** Details of all new debt taken or guaranteed, indicating terms of debt and creditors, will be provided on a quarterly basis within five weeks of the end of each quarter.

F. Domestic Payments Arrears

15. A domestic payment obligation to suppliers or creditors is deemed to be in **arrears** if: (a) goods and services have been received; (b) they have been certified to conform to the order of the contract; and (c) the obligation has remained unpaid for more than 60 days after the invoice was received. A payment obligation is defined to be domestic if the creditor is resident in Kosovo.

16. **Reporting requirements.** The Ministry of Finance will submit a monthly table with the stock of domestic payments arrears. The data are to be provided within five weeks after the end of the month.

G. External Payments Arrears

17. **External arrears** are defined as total external debt service obligations of the government that have not been paid by the time they are due (after the expiration of the relevant grace period). 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.

18. **Reporting requirements.** The Ministry of Finance will inform the Fund staff immediately of any accumulation of external arrears. Data on (i) debt-service payments; and (ii) external arrears accumulation and payments will be transmitted on a quarterly basis by the Ministry of Finance within five weeks of the end of each quarter.

II. Other Data Requirements

19. The monthly monetary statistics (including balance sheets and monetary surveys) of the CBK, the consolidated commercial banks and revisions to historical data (if any) will be transmitted on a monthly basis with a maximum delay of five weeks

20. Data on exports and imports, including volume and prices and compiled by the Statistical Office of Kosovo (SOK), will be transmitted on a quarterly basis within forty-five days after the end of each quarter.

21. A preliminary quarterly balance of payments, compiled by the CBK, will be forwarded within three months after the end of each quarter.

22. The table of Financial Soundness Indicators and the regulatory capital and liquidity ratios of individual banks will be transmitted by the CBK to the IMF on a monthly basis within six weeks after the end of each month.

23. A monthly report on the number of employees will be transmitted to the IMF by the Treasury Department of the Ministry of Finance within two weeks after the end of each month.

Annex: Debt Sustainability Analysis

Table A1. Kosovo: External Debt Sustainability Framework, Baseline Scenario, 2009-2032 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/	Standard 6/	Est.	Projections								
				Average	Deviation							2012-2017			2018-2032
	2009	2010	2011			2012	2013	2014	2015	2016	2017	Average	2022	2032	Average
External debt (nominal) 1/	**17.2**	**16.3**	**14.6**			**15.9**	**15.0**	**14.4**	**13.1**	**11.4**	**9.8**	**13.3**	**10.3**	**12.7**	**11.1**
o/w public and publicly guaranteed (PPG)	17.2	16.3	14.6			15.9	15.0	14.4	13.1	11.4	9.8		10.3	12.7	
Change in external debt	-3.7	-0.9	-1.7			1.3	-0.9	-0.5	-1.3	-1.7	-1.5		0.3	0.1	
Identified net debt-creating flows	**2.6**	**4.0**	**5.3**			**3.6**	**1.4**	**1.6**	**0.4**	**0.2**	**0.5**		**5.0**	**9.4**	
Non-interest current account deficit	**9.2**	**11.8**	**13.6**	**9.8**	**3.1**	**7.4**	**6.6**	**7.5**	**6.7**	**6.9**	**7.2**	**7.0**	**11.5**	**16.1**	**12.7**
Deficit in balance of goods and services	35.4	36.5	37.6			35.2	32.0	30.6	28.8	27.2	26.2	30.0	26.9	27.0	26.8
Exports	17.3	20.5	19.8			18.8	18.7	19.4	20.6	21.9	23.1		20.5	20.0	
Imports	52.8	56.9	57.4			53.9	50.7	50.0	49.4	49.1	49.3		47.4	47.0	
Net current transfers (negative = inflow)	-24.5	-22.9	-21.4	-22.5	1.5	-24.3	-22.0	-19.8	-18.8	-17.0	-15.7	-19.6	-13.3	-11.0	-12.6
o/w official	-8.1	-7.4	-6.8			-8.2	-6.0	-4.4	-3.9	-2.7	-2.0		-1.7	-0.6	
Other current account flows (negative = net inflow)	-1.7	-1.8	-2.6			-3.4	-3.4	-3.4	-3.4	-3.3	-3.2		-2.2	0.1	
Net FDI (negative = inflow)	**-6.4**	**-6.9**	**-6.9**	**-4.8**	**3.2**	**-3.8**	**-5.0**	**-5.5**	**-5.8**	**-6.3**	**-6.4**	**-5.5**	**-6.4**	**-6.4**	**-6.4**
Endogenous debt dynamics 2/	**-0.2**	**-0.9**	**-1.5**			**0.0**	**-0.2**	**-0.3**	**-0.4**	**-0.4**	**-0.3**	**-0.3**	**-0.1**	**-0.2**	**-0.1**
Contribution from nominal interest rate	0.2	0.2	0.2			0.3	0.2	0.2	0.2	0.2	0.2		0.4	0.3	
Contribution from real GDP growth	-0.7	-0.5	-0.6			-0.4	-0.4	-0.6	-0.6	-0.6	-0.5		-0.4	-0.5	
Contribution from price and exchange rate changes	0.4	-0.6	-1.0			...	...	...	...	...	...		...	...	
Residual, including assets, errors, and omissions (3-4) 3/	**-6.3**	**-4.9**	**-7.0**			**-2.3**	**-2.3**	**-2.2**	**-1.7**	**-1.9**	**-2.0**	**-2.1**	**-4.6**	**-9.3**	**-5.9**
o/w exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	14.7			14.3	13.8	13.5	12.5	11.1	9.8		9.2	10.5	
In percent of exports	...	...	74.1			76.3	73.8	69.7	60.8	50.5	42.6		44.8	52.3	
PV of PPG external debt	**...**	**...**	**14.7**			**14.3**	**13.8**	**13.5**	**12.5**	**11.1**	**9.8**		**9.2**	**10.5**	
In percent of exports	**...**	**...**	**74.1**			**76.3**	**73.8**	**69.7**	**60.8**	**50.5**	**42.6**		**44.8**	**52.3**	
In percent of government revenues	**...**	**...**	**54.6**			**54.9**	**51.4**	**49.6**	**46.4**	**40.9**	**36.2**		**33.2**	**37.9**	
Debt service-to-exports ratio (in percent)	**2.2**	**2.3**	**2.2**			**10.0**	**17.9**	**16.1**	**12.4**	**14.0**	**11.8**		**37.6**	**160.2**	
PPG debt service-to-exports ratio (in percent)	**2.2**	**2.3**	**2.2**			**2.4**	**2.7**	**3.2**	**3.2**	**5.8**	**4.3**		**7.9**	**7.4**	
PPG debt service-to-revenue ratio (in percent)	**1.3**	**1.8**	**1.6**			**1.7**	**1.9**	**2.3**	**2.5**	**4.7**	**3.6**		**5.9**	**5.4**	
Total gross financing need (billions of euros)	0.1	0.2	0.3			0.3	0.3	0.3	0.2	0.2	0.2		1.2	7.3	
Non-interest current account deficit that stabilizes debt ratio	12.9	12.7	15.4			6.2	7.5	8.0	8.0	8.6	8.7		11.1	15.9	
Key macroeconomic assumptions															
Real GDP growth (in percent)	3.5	3.2	4.4	4.7	1.9	2.5	2.5	3.9	4.5	5.0	4.5	3.8	4.6	4.5	4.6
GDP deflator in euro terms (change in percent)	-1.7	3.7	6.5	1.2	3.7	0.5	2.1	2.0	2.0	2.0	2.0	1.8	2.0	2.0	2.0
Effective interest rate (percent) 5/	0.8	1.2	1.2	0.4	0.6	2.2	1.5	1.6	1.6	1.6	1.5	1.7	4.0	2.9	3.6
Growth of exports of G&S (euro terms, in percent)	22.1	26.4	7.5	21.9	31.2	-2.1	4.2	10.1	13.3	13.8	12.1	8.6	5.5	6.6	5.7
Growth of imports of G&S (euro terms, in percent)	-1.9	15.6	12.0	10.0	7.7	-3.1	-1.5	4.6	5.3	6.4	6.9	3.1	6.3	6.6	6.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	44.7	11.5	11.5	11.5	11.5	18.1	11.5	11.5	12.0
Government revenues (excluding grants, in percent of GDP)	28.6	26.0	26.8			26.1	26.9	27.3	27.0	27.1	27.2		27.6	27.6	27.6
Aid flows (in billions of euros) 7/	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
o/w Grants	0.0	0.0	0.0			0.037	0.000	0.0	0.0	0.0	0.0		0.0	0.0	
o/w Concessional loans	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			...	0.0	0.1	0.0	0.0	0.0		0.3	0.2	0.2
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			...	44.7	11.5	11.5	11.5	11.5		11.5	11.5	12.0
Memorandum items:															
Nominal GDP (billions of euros)	4.0	4.3	4.8			4.9	5.1	5.5	5.8	6.2	6.6		9.3	17.6	
Nominal dollar GDP growth	1.7	7.1	11.2			3.1	4.7	6.0	6.6	7.1	6.5	5.7	6.7	6.6	6.7
PV of PPG external debt (in billions of euros)			0.7			0.7	0.7	0.7	0.7	0.7	0.7		0.8	1.8	
(PVt-PVt-1)/GDPt-1 (in percent)						0.1	0.1	0.6	-0.2	-0.7	-0.6	-0.1	0.7	0.8	0.7
PV of PPG external debt (in percent of GDP)	...	...	14.7			14.3	13.8	13.5	12.5	11.1	9.8		9.2	10.5	
PV of PPG external debt (in percent of exports)	...	...	74.1			76.3	73.8	69.7	60.8	50.5	42.6		44.8	52.3	
Debt service of PPG external debt (in percent of exports)	...	...	2.2			2.4	2.7	3.2	3.2	5.8	4.3		7.9	7.4	

Sources: Country authorities; and staff estimates and projections.

1/ Data on private external debt is unavailable.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in euro terms.

3/ Includes exceptional financing; changes in gross foreign assets; errors and omissions, and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

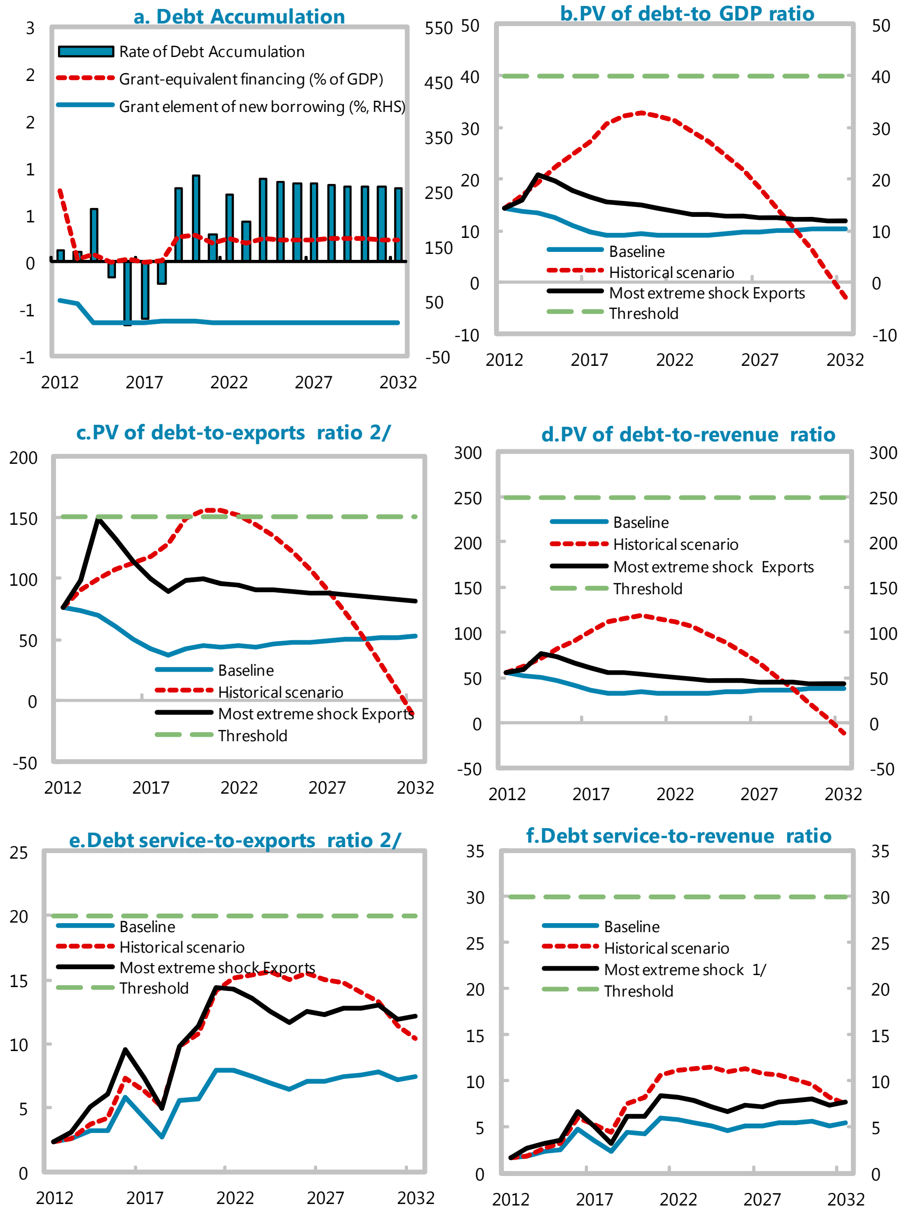
5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Figure A1. Kosovo: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2012-2032 1/



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

1/ The most extreme stress test is the test that yields the highest ratio in 2022. In figure b. it corresponds to a Exports shock; in c. to a Exports shock; in d. to a Exports shock; in e. to a Exports shock and in figure f. to a Exports shock.

2/ The magnitude of the export shock reflects the variability of prices of metals, which represented 76 percent of Kosovo's exports in 2010.

Table A2. Kosovo: Public Sector Debt Sustainability Framework, Baseline Scenario, 2009-2032

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2009	2010	2011	Average 4/	Standard Deviation 4/	2012	2013	2014	2015	2016	2017	2012-17 Average	2022	2032	2018-32 Average
Public sector debt 1/	17.2	16.3	14.6			17.3	17.9	19.4	20.4	21.0	21.6		25.9	31.3	
Change in public sector debt	-3.7	-0.9	-1.7			2.7	0.6	1.5	1.0	0.5	0.6		0.7	0.4	
Identified debt-creating flows	0.5	1.7	0.2			1.3	0.8	0.8	0.1	0.0	0.8		0.4	0.1	
Primary deficit	0.6	2.6	1.6	-0.2	3.5	2.4	1.8	1.8	1.7	1.6	1.6	1.8	0.9	0.8	0.9
Revenue, grants, and interest income	28.6	26.9	27.4			26.9	26.9	27.3	27.0	27.1	27.2	27.1	27.6	27.6	27.6
of which: grants	0.0	0.9	0.5			0.8	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Primary (noninterest) expenditure	29.2	29.5	29.0			29.3	28.7	29.1	28.7	28.8	28.8	28.9	28.6	28.4	28.5
Automatic debt dynamics	-0.2	-0.9	-1.5			-0.2	-0.5	-0.7	-0.7	-0.8	-0.7	-0.6	-0.5	-0.7	-0.6
Contribution from interest rate/growth differential	-0.8	-0.5	-0.7			-0.4	-0.4	-0.6	-0.7	-0.8	-0.7		-0.5	-0.7	
of which: contribution from average real interest rate	-0.1	0.0	0.0			-0.1	0.0	0.0	0.1	0.2	0.2		0.6	0.6	
of which: contribution from real GDP growth	-0.7	-0.5	-0.7			-0.4	-0.4	-0.7	-0.8	-1.0	-0.9		-1.1	-1.3	
Contribution from real exchange rate depreciation	0.6	-0.4	-0.7			0.2	0.0	0.0	0.0	0.0	0.0		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			-0.9	-0.5	-0.4	-0.9	-0.8	-0.2		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			-0.9	-0.5	-0.4	-0.9	-0.8	-0.2		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-4.1	-2.6	-1.9			1.4	-0.3	0.7	0.9	0.5	-0.2	0.5	0.3	0.3	0.3
Other Sustainability Indicators															
PV of public sector debt	...	...	14.7			15.8	16.8	18.5	19.9	20.7	21.6		24.8	29.0	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	1.0	3.1	2.1			2.9	3.8	5.4	5.5	6.7	6.1		8.3	9.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	54			59	62	68	74	76	79		90	105	
PV of public sector debt-to-revenue ratio (in percent)	...	...	55			61	62	68	74	76	79		90	105	
Debt service-to-revenue and grants ratio (in percent) 3/	1.3	1.7	1.6			1.6	7.5	13.1	14.1	18.5	16.6		26.7	30.2	
Debt service-to-revenue ratio (in percent) 3/	1.3	1.8	1.6			1.7	7.5	13.1	14.1	18.5	16.6		26.7	30.2	
Primary deficit that stabilizes the debt-to-GDP ratio	4.3	3.5	3.3			-0.3	1.2	0.3	0.7	1.1	1.0	0.7	0.2	0.4	0.2
Overall balance	-0.8	-2.8	-1.8			-2.7	-2.1	-2.2	-2.2	-2.2	-2.2	-2.3	-2.0	-2.0	-2.0
Key macroeconomic and fiscal assumptions															
Nominal GDP (local currency)	4.0	4.3	4.8			4.9	5.1	5.5	5.8	6.2	6.6		9.3	17.6	
Real GDP growth (in percent)	3.5	3.2	4.4	4.7	1.9	2.5	2.5	3.9	4.5	5.0	4.5	3.8	4.6	4.5	4.6
Average nominal interest rate on public debt (in percent)	0.8	1.2	1.2	0.4	0.6	1.5	2.0	2.2	2.5	2.8	3.1	2.3	4.6	4.2	4.5
Average nominal interest rate on forex debt (in percent)	0.8	1.2	1.2	0.4	0.6	1.5	1.5	1.6	1.6	1.6	1.5	1.6	4.0	2.9	3.6
Interest on domestic debt (percentage of previous year stock, in percent)	...	...	...	...	...	...	7.4	5.0	5.0	5.0	5.0	5.5	5.0	5.0	5.0
Average real interest rate (in percent)	-0.4	0.3	-0.3	-1.8	1.3	-0.5	0.0	0.2	0.5	0.8	1.1	0.4	2.6	2.1	2.4
Real exchange rate depreciation (in percent, + indicates depreciation)	2.9	-2.7	-4.6	1.2	4.1	1.4	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	-1.7	3.7	6.5	1.2	3.7	0.5	2.1	2.0	2.0	2.0	2.0	1.8	2.0	2.0	2.0
Growth of real primary spending (deflated by GDP deflator, in percent)	25.4	4.0	2.7	3.7	8.3	3.7	0.3	5.6	3.2	5.2	4.5	3.7	4.5	4.5	4.5
Grant element of new external borrowing (in percent)	...	...	...	...	...	...	44.7	11.5	11.5	11.5	11.5	18.1	11.5	11.5	12.0

Sources: Country authorities; and staff estimates and projections.

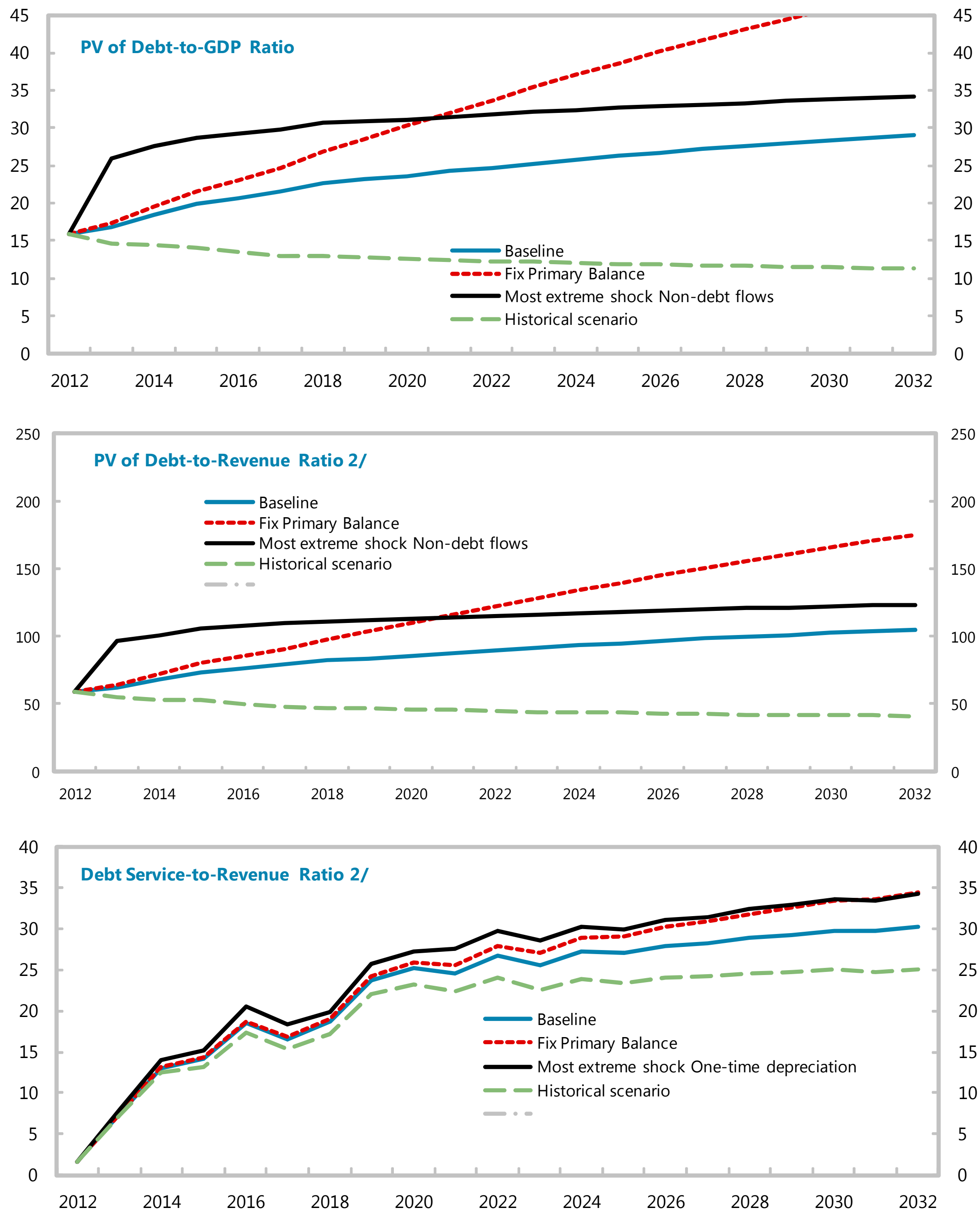
1/ Covers general government. Gross debt concept is used.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

4/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Figure A2. Kosovo: Indicators of Public Debt Under Alternative Scenarios, 2012-2032 1/



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

1/ The most extreme stress test is the test that yields the highest ratio in 2022.

2/ Revenues are defined inclusive of grants.

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 13/537
FOR IMMEDIATE RELEASE
December 20, 2013

International Monetary Fund
700 19th Street, NW
Washington, D.C. 20431 USA

IMF Executive Board Completes Fifth Review Under the SBA with Kosovo; Approves €4.8 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the fifth and final review of the Republic of Kosovo's economic performance under a program supported by a Stand-By Arrangement (SBA). The decision, which was taken on a lapse of time basis,[1] enables the authorities to draw an additional amount equivalent to SDR 4.25 million (about €4.8 million), bringing the total resources available to the Republic of Kosovo under the arrangement to SDR 90.968 million (about €102.2 million). The authorities have indicated they will not purchase the amount made available by the completion of this review, in line with their intention to treat the SBA as precautionary in 2013.

All end-August 2013 and the continuous performance criteria were met. Good progress has also been made with respect to the applicable structural benchmarks.

The Executive Board approved a 20-month SBA for the Republic of Kosovo on April 27, 2012 (see Press Release No. 12/154) in an amount equivalent to SDR 90.968 million (about €102.2 million). Total disbursements so far amount to SDR 78.216 million (about €87.9 million). The arrangement expires on December 26, 2013.

[1]The Executive Board takes decisions under its lapse-of-time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.