INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/210

REPUBLIC OF KOSOVO

July 2015

REQUEST FOR STAND-BY ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF KOSOVO

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

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 29, 2015, following discussions that ended on June 9, 2015, with the officials of Republic of Kosovo on economic developments and policies underpinning the IMF arrangement under the Stand-By Arrangement. Based on information available at the time of these discussions, the staff report was completed on July 8, 2015.
- A **Statement by the Executive Director** for Republic of Kosovo.

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

Letter of Intent sent to the IMF by the authorities of Republic of Kosovo*
Memorandum of Economic and Financial Policies by the authorities of Republic of Kosovo*
Technical Memorandum of Understanding*
*Also included in Staff Report

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

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Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

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Press Release No. 15/362
FOR IMMEDIATE RELEASE
July 29, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves €147.5 million Stand-By Arrangement for Republic of Kosovo

The Executive Board of the International Monetary Fund (IMF) today approved a 22-month Stand-By Arrangement for the Republic of Kosovo, in an amount equivalent to SDR 147.5 million (about €184 million, 250 percent of Kosovo's quota in the IMF).The program's approval enables the immediate disbursement of SDR 28.1 million (about €35 million).

The program mainly aims at (i) preserving low public deficits and debt by containing current spending, while creating fiscal space for growth-enhancing capital spending; (ii) lifting Kosovo's economic potential by removing key structural impediments to growth, including by creating a more conducive environment for private activity and investment, upgrading Kosovo's infrastructure, and strengthening bank intermediation; and (iii) catalyzing support from other multilateral and bilateral creditors.

Following the Executive Board's decision, Mr. Min Zhu, Deputy Managing Director and Acting Chair, issued the following statement:

"Despite relatively resilient growth and a stable financial sector, Kosovo faces the dual challenges of maintaining fiscal credibility and debt sustainability and increasing its growth prospects. The Fund-supported program will help the authorities meet these challenges by preserving financial stability and low debt, rebuilding the government's bank balances, and creating conditions for a more dynamic economy and better-balanced growth. Achieving these objectives will require the authorities' strong and continued commitment to the program and the timely implementation of all measures.

"Strengthening public finances is a key plank of the program, which includes measures to keep the deficit within the authorities' fiscal rule while improving the composition of the budget by deflating unproductive current spending. At the same time, it creates space for much-needed infrastructure upgrade through donor-financed capital investments in key development areas, under appropriate safeguards to preserve fiscal credibility and ensure continued debt sustainability. As the fiscal consolidation takes hold, restoring government bank balances to adequate levels will be important for this euroized economy.

"Under the program, financial sector reforms, including the adoption of an emergency liquidity assistance framework in line with international best practice and the full rollout of risk-based supervision to all banks, will make Kosovo's already-healthy banking sector sounder and safer. The program will also seek to further identify and, as appropriate, address potential structural impediments to bank lending, thus allowing the financial sector to more fully support economic growth.

"Structural reforms under the program will be critical to moving Kosovo away from its current remittance-driven growth model and toward one that is led by production and trade. To this end, the program includes measures to improve Kosovo's competitiveness and business environment. In particular, the introduction of a public wage rule linked to a macroeconomic indicator will help contain high labor costs, while implementation of public procurement reform should increase transparency and oversight."

Annex

Recent Economic Developments

In 2014, growth in Kosovo slowed to an estimated 2.7 percent of GDP, from 3.4 percent the previous year. Key reasons include the protracted political stalemate following the 2014 general elections, as well as the accident in the main energy plant that led to electricity cut-offs and higher imports. Low energy prices and the historically low inflation environment in the euro area have brought inflation into negative territory since end-2014. Given the narrow productive base and high dependence on imports, the external trade accounts have remained in large deficits (around 30 percent of GDP), but they have been mostly financed by stable, non-debt creating financial flows, such as remittances and official transfers. International reserves fell in 2014, but still remain at safe levels.

Sharp increases in public wages and social pensions ahead of last year's elections, together with ill-targeted benefits to interest groups, have led to a significant increase in current spending. The budget deficit stayed within the fiscal rule last year, but only thanks to a 2 percentage point of GDP capital underspending. Public debt remains low, well below 20 percent of GDP.

Banks are in good shape, with liquid assets covering about 40 percent of short-term liabilities and capital adequacy ratios well above regulatory requirements. Asset quality is also improving, as witnessed by NPLs now below 8 percent of total loans. Credit growth is accelerating on the back of declining interest rate spreads. Despite this, credit penetration remains low at some 35 percent of GDP.

Despite steady growth since independence, GDP per capita of about €3000 remains well below standards in other Western Balkan countries. In addition, very low employment ratios (particularly among women and youth) remain a significant social concern.

Program Summary

The Stand-By Arrangement will support the authorities' program to maintain macro-fiscal stability and foster growth and competitiveness. Consistent with this, the objectives of the authorities' program are:

- **Promoting fiscal consolidation and rebuilding government bank balances over the program period**. Following a large pre-electoral relaxation, fiscal adjustment is required to arrest the rapid growth in unproductive current spending, create space for priority areas such as infrastructure projects, and safeguard low public debt. Because of this, the program envisages a continued freeze on wages and benefits (already initiated in the 2015 budget), as well as some tax measures.

- **Further enhancing financial stability**. The Central Bank of Kosovo is in the process of adopting a new framework for emergency liquidity assistance (key in a euroized economy) in line with best international practice. In addition, recently adopted risk-based supervision will be rolled out to all banks in the course of the program, allowing for a better identification of any risks building in the sector. Finally, development of a macroprudential toolkit and operationalization of the financial stability committee will be important elements of enhanced financial stability.

- **Boosting competitiveness and productive capacity**. The program includes a number of structural reforms aimed at boosting Kosovo's growth potential and moving away from the remittance-based growth model. This will be achieved by (i) modifying the investment clause of the fiscal rule to create additional space for donor-financed infrastructure projects; (ii) putting in place a rules-based mechanism for the public sector wage bill, to help contain high labor costs; (iii) removing legal and judiciary obstacles that prevent banks from better supporting economic growth; and (iv) reforming the public procurement—in particular, moving towards centralized procurement of common goods and adopting e-procurement—so as to lead to a more even and transparent business environment.

Republic of Kosovo has been a member of the IMF since June 29, 2009 and has a quota of SDR 59.0 million.

INTERNATIONAL MONETARY FUND

REPUBLIC OF KOSOVO

REQUEST FOR STAND-BY ARRANGEMENT

July 8, 2015

EXECUTIVE SUMMARY

Key issues: Kosovo faces the dual challenge of maintaining fiscal credibility and debt sustainability while shifting its growth model from one driven by remittances and consumption to one driven by investment and the tradable sector. This requires fiscal consolidation over the next two years that deflates unproductive current spending while increasing space for critical public investment and donor-financed capital projects. It also requires steps to further preserve financial stability, improve competitiveness, remove structural impediments to bank lending, and reduce corruption.

Stand-By Arrangement (SBA): The authorities have requested a 22-month, SDR 147.5 million (250 percent of quota) SBA. An initial purchase of SDR 28.1 million would become available upon approval of this request. The program will seek to preserve low debt and financial stability and rebuild government bank balances while creating conditions for more dynamic and better-balanced growth. Specifically, policies would aim at:

- Strengthening public finances through fiscal consolidation, with the deficit path within the fiscal rule's limits. This will be supported by steps to improve budget composition and deflate unproductive current spending. Capital expenditure will be protected and even enhanced through the modification of the investment clause under the fiscal rule. A new debt limit will ensure that debt remains sustainable.

- Advancing financial sector reforms related to emergency liquidity assistance and risk-based supervision to bolster financial sector stability.

- Raising Kosovo's long-term growth prospects. Reforms will include the introduction of a public wage bill to boost competitiveness, a new public procurement process to improve the business environment, and steps to catalyze donor-project financing related to Kosovo's large development needs.

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

Approved By
Thanos Arvanitis and Dan Ghura

A staff team comprising Messrs. Miniane (head), Cipollone, Weiss (all EUR), Misch (FAD), and Ms. Zdzienicka (SPR) visited Pristina during May 28–June 9, joined by Messrs. Lakwijk and Thaci (Resident Representative Office). Mr. Mehmedi (OED) joined policy meetings. The team met with Prime Minister Isa Mustafa, Finance Minister Avdullah Hoti, Central Bank Governor Bedri Hamza, other government officials, parliamentarians, private sector representatives, trade unions, multilateral agencies, and envoys of the international community.

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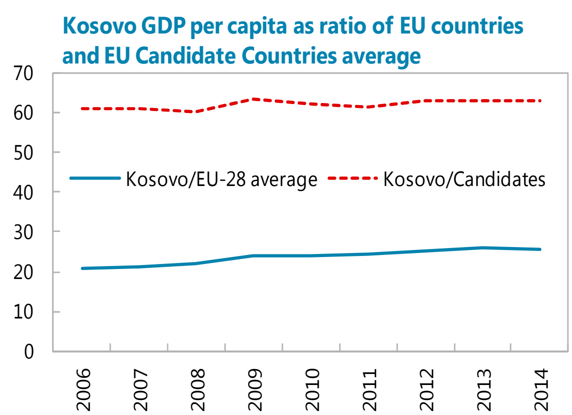
APPENDIX

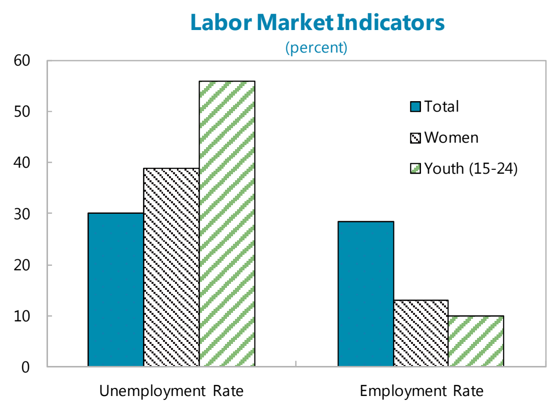
CONTEXT

1. Kosovo has enjoyed financial stability as well as more resilient economic growth than other Western Balkan countries. Steady remittance inflows from the Diaspora in Germany, Switzerland, and other advanced European economies have helped support average growth of 3.3 percent over the past five years. But these remittances have driven consumption and investment mostly in the non-tradable sector and, without a well-established productive and export base, imports. Kosovo's resulting trade deficit is very large, at about 30 percent of GDP.

2. Absent reforms, medium-term growth would be insufficient to meaningfully lift incomes and improve subpar labor outcomes. Given a young and growing population, growth of about 3½ percent would not be enough to lift per capita income of about €3,000 (among the lowest in Europe) toward the Western Balkans average, much less toward the rest of Europe. This level of growth would likewise not generate enough jobs to dent very high unemployment (30 percent, and even higher among women and youth). Competitiveness is hampered by high labor costs and an overvalued (by about 15–20 percent) real exchange rate; infrastructure gaps remain large; bank credit does not sufficiently support investment and growth; and persisting perceptions of corruption undermine recent *de jure* improvements in the business environment.



Sources: World Economic Outlook; national authorities.



Source: National authorities.

3. There is now political support for reforms to lift Kosovo's growth potential. Following June 2014 elections and protracted negotiations, a grand coalition that includes Kosovo's two largest political parties was formed in December 2014. The government enjoys a comfortable majority in parliament. The next parliamentary elections are provisionally planned for 2018.

RECENT DEVELOPMENTS

4. Economic growth waned in 2014. Despite steady remittance inflows and a large pre-election increase in wages, staff estimates that growth slowed to 2.7 percent last year from 3.4 percent in 2013. Culprits include a six-month political stalemate that dented confidence and spending, together with the prolonged shutdown of the main energy plant, which was bridged by power cuts and higher electricity imports. Low international and euro area prices kept inflation low (0.4 percent on average). The current account deficit (including official transfers) widened from 6.4 to 8.0 percent of GDP despite strong export growth (from a low base), as import volumes rose in line with low import prices, large pre-electoral wage increases, and the closure of the power plant. Financing sources—which come mainly from the Diaspora in Western Europe—remained stable.

5. **Fiscal policy deteriorated in 2014, threatening the credibility of the fiscal rule and eroding space for productive spending**. The government increased public sector wages and pensions by 25 percent ahead of elections, promised new benefits for war veterans and political prisoners, signed a generous collective agreement on labor relations, and introduced a health insurance law. This sharp increase in current spending was balanced by 2 percent of GDP in capital underspending to limit the deficit (excluding PAK spending) to 2.5 percent of GDP, within the fiscal rule's margin.[1]

6. **The authorities face a challenging fiscal environment this year**. The 2015 budget—drafted by a caretaker government during the prolonged political transition last year—relies on overly optimistic revenue assumptions. With more realistic revenue assumptions, combined with the full-year effect of 2014 pre-electoral promises and a ramp-up in highway spending, staff estimates that the deficit would reach 3.9 percent of GDP in 2015, even after several measures already taken by the authorities earlier this year to rein in the deficit.

7. **In addition, the budget's worsening composition constrains infrastructure and development plans**. Absent corrective measures, staff expects current spending to increase by 4.4 percentage points of GDP over 2011–15, largely due to the wage bill (2.7 percentage points of GDP) and subsidies and transfers (1.6 percentage points of GDP). Public sector wages have more than doubled since independence in 2008, significantly outpacing productivity, private sector wages, and public wages in other Western Balkan countries. Capital spending has been substantially cut between 2011 and 2015 (by 2.9 percentage points of GDP) to accommodate this sharp increase, drawing resources away from Kosovo's urgent development needs.

8. **At the same time, the government's bank balances (bank balances) have fallen below prudent levels**. These bank balances—a critical buffer for a unilaterally euroized economy without its own currency—currently stand at 1.8 percent of GDP, well below the 4.5 percent level considered prudent by staff and enshrined in the fiscal rule.

9. **While banks are generally sound, bank intermediation remains limited**. Kosovo's banks are well capitalized (with an aggregate capital adequacy ratio of 19 percent), liquid (liquid assets cover 41 percent of short-term liabilities), and profitable (the system's return on average assets was 2.4 percent in April). The NPL ratio is falling (now below 8 percent) and NPLs are well provisioned.

[1] Because of the 0.5 percent of GDP margin of error, an "excessive" deficit is considered a deficit above 2.5 percent of GDP.

Credit growth has picked up in recent months, although at 6.3 percent y/y in April, it remains modest for a country with relatively low credit penetration (35 percent of GDP). Roughly two-thirds of the banking sector's total loan portfolio is comprised of corporate loans, with a heavy focus on trade, while one-third is comprised of household loans, although the household segment is currently growing at a notably faster rate (about 11 percent y/y) than total loans.

THE FUND-SUPPORTED PROGRAM

A. Program Objectives

10. The program's dual objectives are to (i) maintain macrofinancial stability by shoring up fiscal policy, rebuilding government bank balances, and enhancing the financial sector's regulatory and supervisory frameworks; and (ii) boost competitiveness and productive capacity to achieve stronger and better-balanced growth through structural reforms. The program will seek to keep the budget deficit path—excluding new donor-financed projects (see below for details)—within the fiscal rule while improving the composition of the budget. This will ensure debt sustainability, contain unproductive current spending, and allow space for much-needed priority spending. Purchases under the SBA will cover Kosovo's financing needs over 2015–17 and rebuild government bank balances back to adequate levels (of 4.5 percent of GDP). The program will support the central bank's efforts to improve its emergency liquidity assistance (ELA) and supervisory frameworks, further enhancing macrofinancial stability. The program will also target several areas to improve competitiveness and bolster growth, including via deflating excessive labor costs, catalyzing donor-financed infrastructure investment, addressing structural impediments to credit provision, and improving the business environment.

B. Macroeconomic Framework

11. The program is based on the following macroeconomic framework:

- ***Real GDP growth*** in 2015 is projected at 3.2 percent. The improvement over 2014 is driven by stronger momentum on remittances, the full-year impact of last year's large wage increases, and a ramp up in highway construction, but it is tempered by nominal wage freezes in the public sector this year. Over the medium term, staff expects growth to gradually increase to 4.1 percent, helped by stronger investment and export growth as donor-financed capital projects and measures to improve competitiveness begin to bear fruit. In addition, the newly-agreed Brezovica tourism project is expected to boost real investment growth in 2016–18 (averaging 7.3 percent per year) and, once it is operational, exports of services as well.

- ***Consumer price inflation*** is projected at 0.1 percent for 2015, influenced by the low-inflation environment in the euro area, as imports from these countries comprise a very large portion of Kosovo's CPI basket. Staff expects inflation to gradually rise to around 2 percent in subsequent years, in line with a policy-supported price recovery in the euro area and global commodity price developments.

- ***The current account deficit***, including official transfers, is expected to narrow marginally to 7.9 percent of GDP in 2015, as stronger momentum in remittances is partially compensated by higher imports. Beyond 2015, the current account deficit (including official transfers) is projected to temporarily widen to 10.3 percent of GDP in 2016, as the Brezovica resort and new donor-financed projects trigger a spike in imports. Subsequently, the current account should steadily narrow in the medium term (to 8.6 percent by 2020) as projects are completed and exports rise as operations begin. Non-debt creating flows should remain the primary financing items, with FDI projected to average around 5.3 percent through the forecast period. Including Fund disbursements, reserves are expected to remain sufficient at 3.5 months of imports, on average.

C. Fiscal Policy

12. The program will ensure that the budget deficit remains within the bounds of the fiscal rule, maintaining debt sustainability, while improving budget composition and providing space for critical capital projects. The general government deficit will be targeted to comply with the fiscal rule, and adjustment will focus on improving budget composition. Staff expects the deficit to average 1.8 percent of GDP over 2015–17, excluding new, yet to be determined donor-financed capital projects (see below for more detail).

13. This includes significant measures this year to bring the 2015 deficit down from 3.9 percent (without further corrective measures) to 2.4 percent. In addition to the March increases in excises on alcohol and tobacco, the authorities will carry out additional adjustment this year through new tax measures as well as a series of actions focused on deflating current expenditures (see text table). Capital expenditures would be preserved. A revised mid-year budget will be approved by parliament as a prior action for the program, and include (MEFP ¶6):

- *An increase in the standard VAT rate from 16 to 18 percent.* The rate increase will come with a reduction to 8 percent for a limited category of goods but is still expected to yield about 0.2 percent of GDP in additional revenues.[2]
- *Additional excise increases* that will yield another 0.15 percent of GDP.
- *A reduction in the wage bill* by 0.4 percent of GDP relative to the 2015 budget, partly by not filling vacancies.
- *Savings on transfers* to yield 0.2 percent of GDP.
- *A reduction in the goods and services allocation* relative to the 2015 budget to yield another 0.2 percent of GDP.

[2] Revenue yields are on a non-annualized basis.

Fiscal Measures to Reach Program Targets

(Percent of GDP)

	2015: Changes relative to pre-program policies	2016 change relative to 2015 1/
Revenue measures		
VAT reform	0.2	0.2
July excise increase	0.1	0.1
Tax amnesty	0.1	-0.1
Sale of telecom licenses	0.3	-0.3
Total revenue measures	**0.7**	**0.0**
Revenue losses from free trade agreements 2/	0.0	-0.5
Change in revenues	**0.7**	**-0.5**
Expenditure measures 3/		
Reduction in the wage bill	-0.4	-0.4
of which not filling vacancies	-0.3	0.1
of which wage freeze 4/	0.0	-0.4
of which postponement of health insurance law 5/	-0.2	-0.1
Savings on transfers 5/	-0.2	0.1
Savings on goods and services	-0.2	-0.2
Total current expenditure measures	**-0.8**	**-0.4**
Non-donor financed capital spending	0.0	-0.4
Total expenditure measures	**-0.8**	**-0.8**
Yet to be identified measures needed to reach program targets	0.0	0.4

1/ These estimates are provisional until discussion of the 2016 budget.

2/ Revenue losses may be lower as the Stabilization and Association Agreement with the EU has not been ratified yet.

3/ Minus denotes savings.

4/ The 2015 budget already froze nominal wages, hence no savings in 2015 relative to pre-program commitments.

5/ These postponements do not incur retroactive obligations.

14. **Measures will also be taken to ensure revenues due by the privatization agency**. The government has committed, as a structural benchmark under the program, to submit to parliament candidates to fill the Board of the Privatization Agency of Kosovo (PAK) (structural benchmark, MEFP ¶8) to enable the transfer of 0.3 percent of GDP in funds owed by PAK to the Tax Administration of Kosovo.[3]

15. **The authorities will continue to improve the direction and composition of fiscal policy post-2015**. For 2016, the program envisages further adjustment by 0.8 percent of GDP, to arrive at a deficit excluding new donor-financed projects of 1.6 percent. The authorities plan to achieve this via additional improvements to budget composition, particularly by reducing the weight of current spending relative to 2015 levels. In 2016, current expenditure will fall by 0.4 percent of GDP, helped

[3] These are above-the-line revenues related to tax liens of state or socially-owed firms managed/liquidated by the privatization agency, not below-the-line privatization funds.

by a continued freeze in wage levels. The annualized impact of the 2015 revenue measures noted above will also support adjustment. At this stage, staff estimates that an additional ½ percent of GDP in measures will need to be identified and incorporated in the 2016 budget to be prepared in October, so as to reach the 1.6 percent target. As for 2017, marginal adjustment would then deliver an average underlying deficit of 1.8 percent over the program period.

16. The program will also restore government bank balances to an adequate level. The combination of fiscal adjustment and Fund disbursements will bring bank balances back to 4.5 percent of GDP by 2016, thereby filling the corresponding balance of payments gap. Balances are expected to remain at this level for the following years.

17. The above policies will ensure that Kosovo remains on a sustainable debt path. Public debt is expected to increase moderately over the course of the program, peaking at 28.3 percent of GDP in 2020[4,5] as major donor-financed projects are taken up (see below). The program includes safeguards, including the fiscal rule and a new debt limit, to ensure that debt remains sustainable (see paragraph 24 for more detail).

D. Financial Sector

18. Financial sector measures under the program will focus on strengthening the financial safety net and bank supervisory framework. The authorities have made good strides in recent years—with the support of Fund technical assistance—to improve the financial sector's regulatory and supervisory framework. The Fund-supported program will help close some of the remaining gaps.

19. Finalizing a strong ELA framework is critical for a euorized economy. Without its own currency, the central bank (CBK) has limited capacity to act as a lender of last resort for Kosovo's banks. As discussed in the recent Article IV staff report, the CBK has sufficient ELA reserves to cover both of Kosovo's domestic banks in the event of a severe liquidity shock. In addition, letters from parents of foreign subsidiaries provide additional comfort in the context of a banking sector that is 90 percent foreign-owned by assets. However, Kosovo still needs to move toward an ELA legal framework in line with international best practice. The CBK has committed to adopting a new ELA regulation (structural benchmark, MEFP ¶12), and is currently incorporating refinements to the draft regulation in consultation with Fund staff so as to ensure the final draft meets best standards.

20. Fully adopting risk-based supervision will strengthen financial stability. With the help of Fund technical assistance, the authorities have made good progress in recent years in gradually moving toward risk-based supervision, which will help the CBK conduct better surveillance of banks and better identify risks. Under the program, the CBK will conduct on-site examinations under these

[4] Excluding ex-Yugoslavia debt that Kosovo does not recognize or service, debt will peak at 22.5 percent in 2020.

[5] The fiscal rule was initially designed with a 30 percent debt ratio being judged prudent for a euroized economy exposed to external shocks and with no independent monetary policy.

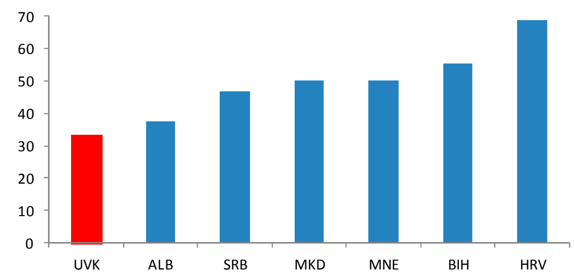
new procedures (including post-examination reports) at all banks supervised by the CBK, so as to have fully adopted risk-based supervision by early 2016 (structural benchmark, MEFP ¶12).

21. Development of a macroprudential policy toolkit and crisis management body are also important elements of macrofinancial stability. The program will closely monitor the authorities' efforts to further develop the recently created Macroprudential Advisory Committee—the CBK plans to formally adopt a policy framework, develop indicators, and begin reporting to the CBK Board later this year—and to fully institutionalize the National Committee for Financial Stability and Crisis Management.

22. The program will also seek to address structural obstacles to bank lending to help the banking sector better support economic growth. Credit penetration in Kosovo (35 percent of GDP) remains the lowest in the Western Balkans despite banks' ample liquidity. This is partly related to Kosovo's weak business environment, underdeveloped private sector, and limited business opportunities. However, structural impediments—such as inefficient court processes and difficult debt collection procedures—contribute to high interest rate spreads (currently at 750 bps, although on a downward trend) and collateral requirements. The authorities are already engaged in several initiatives to alleviate these supply-side bottlenecks, including increased training for judges and court staff that deal with commercial cases; work undertaken in conjunction with USAID to reduce the large backlog of outstanding court cases; refinements to the recently-introduced system of private collection agents, which has already helped with enforcement and debt collection; and a new draft bankruptcy law to improve the liquidation and administration process, particularly with regard to SMEs. These, and other initiatives, will be monitored under the program. In addition, in the coming months, Fund staff will undertake a comprehensive diagnostic of legal and structural impediments to credit provision in Kosovo, assess the initiatives currently underway, and identify any areas beyond those already being addressed that might help to further alleviate such obstacles.

Western Balkans Credit Depth

(credit/GDP; MNE 2013, HRV 2012)



E. Competitiveness and Structural Reforms

23. The program will support a prudent increase in fiscal space for needed development projects. The authorities have requested the modification of the investment clause of the fiscal rule to accommodate additional targeted and much-needed infrastructure spending on high-priority areas. The investment clause currently stipulates that the government can use privatization proceeds to finance capital projects above the 2 percent deficit ceiling (i.e., the excess over 2 percent is not counted as an excessive deficit), if (i) budget commitments are consistent with a deficit of 2 percent of GDP or less; and (ii) bank balances are at least 4.5 percent of GDP. This clause is currently of limited practical value as privatization receipts are low and there are no assets that can be immediately privatized. With technical support from the Fund, the authorities plan to modify this clause to allow for new donor-financed capital projects, in addition to privatization-financed projects, to not count as an excessive deficit against the fiscal rule.

24. Safeguards will ensure good use of fiscal space and preserve debt sustainability:

- *Good use of fiscal space.* By design, additional spending allowed by this modification will be aimed towards needed capital spending. Moreover, as these will be donor-financed projects, their robust vetting processes will ensure that the projects are of high quality and are targeted at priority development areas. In addition, Kosovo's constitution requires that all external borrowing, including donor-funded projects, be approved by parliament with a two-thirds majority. To enhance parliamentary oversight, the Ministry of Finance will submit to parliament semiannual reports on all new projects for information, detailing the projects' rationale, expected cost, and financing terms (<u>structural benchmark,</u> MEFP ¶22). Finally, limits on current spending under the program (see above), together with the planned wage rule (see below), will prevent the substitution of government-financed capital spending for current spending.

- *Safeguards.* By design, no spending under the investment clause can take place unless the underlying deficit is below 2 percent of GDP and government bank balances are above 4.5 percent of GDP, thereby ensuring that any additional spending takes place from a strong starting position.

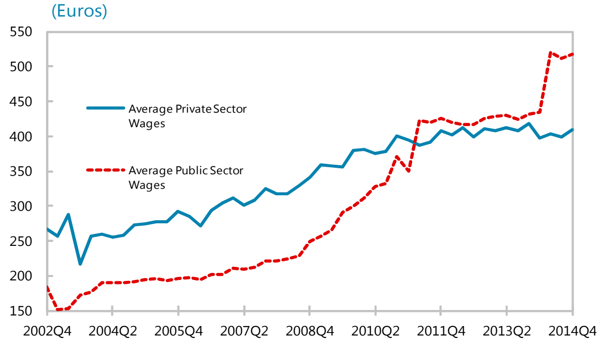
- *Debt sustainability.* The amendment to the clause will specify that no new donor-financed project will be allowed under the clause if it would cause public debt to exceed 30 percent of GDP. In this case, only privatization-financed (i.e., non-debt creating) projects would be allowed above the fiscal rule's deficit ceiling.

- *Sunset clause.* To reinforce credibility, a sunset clause will be put in place on the changes. Given the long lead time required for large-scale investment projects, the sunset clause will specify that the changes will expire in 10 years.

25. Planned projects are only at the concept stage. Given significant potential in agriculture, the authorities are considering two large irrigation projects which, together, could significantly scale up arable land under irrigation. Other projects under consideration include IT modernization in schools and universities, and upgrades to both the road and rail networks that would facilitate intra-regional commerce.

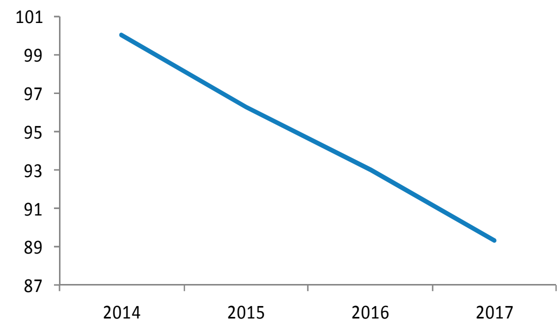
26. A public sector wage bill will be introduced to ensure that wage developments are aligned with economic developments. Strong remittance inflows, while helpful in smoothing consumption and stabilizing growth, have pushed reservation wages beyond levels that domestic productivity can sustain. Moreover, unrestrained public sector wage increases have compounded the problem of high labor costs: today, the positive gap between public and private sector wages makes it difficult for the private sector to attract and retain the talent it needs to compete. Staff estimates the price competitiveness gap (real exchange rate overvaluation) at 15–20 percent. And, as a euroized economy, any increase in cost competitiveness must come via a deflation in real labor costs. As such, the program will introduce a public wage rule that will link growth in the public wage bill to an easily-monitorable macroeconomic indicator, to prevent large discretionary increases in public sector wages as seen in the past (typically before elections).[6] A rule will be approved this year but not adopted in the 2016 budget (structural benchmark, MEFP ¶17). Given the large share of public employees in the workforce, the combination of ongoing nominal wage freezes and, later, the introduction of this rule should help deflate unit labor costs.

Trends in Average Public and Private Sector quarterly wages 1/
(Euros)



1/ 2014 data on private sector wages is preliminary. Series calculated based on projected GDP per capita growth.

Projected Public Sector Wage Deflation
(public wages per GDP per capita; 2014 = 100)



27. Reforms to the public procurement process will reduce corruption and improve the business environment. While Kosovo has improved its rankings in the World Bank's Doing Business and governance indices in recent years, widespread perceptions of corruption remain, further holding back the development of a more robust private sector. The program will target reforms to the public procurement process as part of the authorities' efforts to reduce corruption, since the government is a key economic actor in Kosovo. The authorities recently passed a general procurement law in line with international best practice that provides a good starting point for improving the procurement process. However, the actual procurement of common goods by centralized means within the government has not yet been implemented. As such, the program will support the finalization of the first centralized tendering bid for fuel and other major common goods for 43 central government procurement units,[7] in line with the processes set forth in the new law, this year (structural benchmark, MEFP ¶20). This will cover the needs of these units for the next three years, with the list of goods and services to fall under the new system to be expanded over 2016 (structural benchmark, MEFP ¶20). Municipalities and publicly-owned enterprises will also gradually be brought into this new system. The program will also facilitate the adoption of a draft law to make e-procurement mandatory for all central government agencies—which will also help to ensure better oversight of the process—by the second review (structural benchmark, MEFP ¶20).[8]

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[6] The specific indicator(s) and formula to be incorporated in the rule are being discussed between Fund staff and the authorities, to arrive at a rule that best captures productivity trends and sustainability concerns within the constraints of available data.

[7] The list of 43 agencies was mutually agreed with the authorities.

[8] On the critical but non-core issue of procurement, staff will rely on World Bank expertise where needed. The World Bank has been involved in procurement reform in Kosovo.

28. To further strengthen the AML/CFT regime, the staff will encourage Kosovo to undergo a comprehensive AML/CFT assessment against the revised 2012 FATF standard.

PROGRAM MODALITIES

29. The SBA will fully cover Kosovo's balance of payments need over 2015–17. Staff estimate the external financing gap at SDR 147.5 million (equivalent to €184 million, 250 percent of quota, and 3.1 percent of GDP) for 2015–17. Fund financing would fully close this gap. As part of this, government bank balances would increase to prudent levels by the end of 2016 and remain at that level over the medium term. From the second review onwards, staff envisions semi-annual reviews with end-December and end-June targets (see Table 9). The first review (end-August 2015 test date) would not follow this semi-annual pattern as its timing would be determined by the 2016 budget cycle.

30. Kosovo's capacity to repay the Fund and meet its debt service obligations more generally is good. Public debt is currently low. Kosovo's outstanding debt to the Fund will peak at 286 percent of quota in 2016, declining to 66 percent of quota by 2020—relatively modest as a share of GDP, exports plus remittances, and government revenue. Strong bank balances will ensure the authorities' repayment position. The current account deficits are fully funded, and the funding sources have proven stable in recent years and are expected to remain so. External public debt will increase under the program, but at a slower pace than in the recent Article IV baseline scenario.[9]

31. Risks to the program include political considerations and revenue outturns.

- ***Implementation risk***. The authorities have expressed a desire to deflate unproductive current spending and a willingness to remain within the fiscal rule and enjoy a comfortable parliamentary majority. However, a shift in the political climate, together with social opposition toward wage and benefit freezes, could present stronger challenges to implementation than currently exist. Reform to the public procurement process could also face opposition from vested interests.

- ***Revenue outturns***. Weaker-than-expected revenue performance would complicate plans to bring the underlying deficit within the fiscal rule. The authorities' planned strong measures to freeze much unproductive current spending (discussed above) means that there would not be much room for cuts to current expenditures were revenues to fall meaningfully short of program targets. This being said, there is room to cut the capital budget should there be a strong justification to do so.

- ***Upside risks***. There are also a number of upside risks to the program. Revenue performance could also come in stronger than expected, thus easing the authorities' efforts to remain within

[9] IMF Country Report 15/131.

the fiscal rule. The authorities could also implement their ambitious structural reform agenda more quickly than anticipated, thus bringing greater competitiveness gains than are currently expected under the program.

32. **In addition, post-program risks cannot be underestimated**. In particular, populist measures in the run-up to the 2018 elections, should they happen, could undo some of the program gains. This time around though, the combination of the fiscal rule and the new wage rule would help limit the scope for pre-electoral excesses.

33. **The phasing of Fund purchases and program reviews are designed to mitigate risks to the Fund**. The SBA will last for 22 months beginning in July 2015. The purchase and review schedule through 2017 is aligned with Kosovo's financing needs. In particular, the program's disbursement schedule is frontloaded to ensure that the government's bank balances return to adequate levels (4.5 percent of GDP) by the end of 2016 and not later. Strong fiscal adjustment at the beginning of the program (close to 3 percentage points of GDP in annualized terms in the 2015 mid-year budget and an additional 0.8 percentage points of GDP in 2016) will help in this regard.

34. **Program conditionality is centered on securing that program's objectives are met**. Quantitative performance criteria and indicative targets are summarized in the Letter of Intent. They include, *inter alia*, floors on the fiscal balance of the general government, both including and excluding new donor-financed projects; and a floor on the bank balance of the central government. Conditionality also includes an indicative target for a ceiling on the current expenditures of the central government. Structural benchmarks through 2016 are summarized in the Letter of Intent.

35. **An updated central bank safeguards assessment will be completed before the first review**. The CBK underwent a safeguards assessment in the context of the SBA approved on April 27, 2012. At the time, the assessment found that a majority of previous safeguards recommendations had been implemented, in particular a strengthening of Audit Committee oversight and an improvement in the standards of the internal audit department.

STAFF APPRAISAL

36. **The authorities' program aims at entrenching macrofinancial stability and lifting Kosovo's growth potential**. The program's immediate goal is to support a prudent fiscal adjustment and help rebuild government bank balances to adequate levels. At the same time, measures will be taken to pave the way for higher and more inclusive growth through attracting high quality infrastructure and development projects; strengthening the financial sector and freeing up resources for bank lending; and improving the business environment, including through a more level and transparent playing field for all businesses.

37. **The program will preserve fiscal and debt sustainability**. Kosovo's underlying fiscal deficit is expected to average 1.8 percent of GDP over the life of the program, within the bounds of the fiscal rule. With this, debt should remain below 30 percent of GDP over the forecast horizon even

including new, large infrastructure projects. The debt limit built into the fiscal rule's modified investment clause will act as an additional safeguard.

38. While staying within the fiscal rule, the authorities will improve the budget's composition. Current spending will be contained to preserve space for the growth-enhancing capital expenditure that Kosovo needs. This will be accomplished by restraining the public wage bill, along with savings on goods and services and transfers. Revenue mobilization will complement these efforts.

39. The investment clause of the fiscal rule will be modified so that the authorities have even more space for high-quality development projects. Delivering adjustment and staying within the fiscal rule will still not provide as much space as Kosovo needs for investments in priority areas. Given its low debt and large development needs, modification of the investment clause will allow the authorities to unlock additional, well-vetted projects financed by multilateral and bilateral donors—with safeguards in place to ensure debt sustainability.

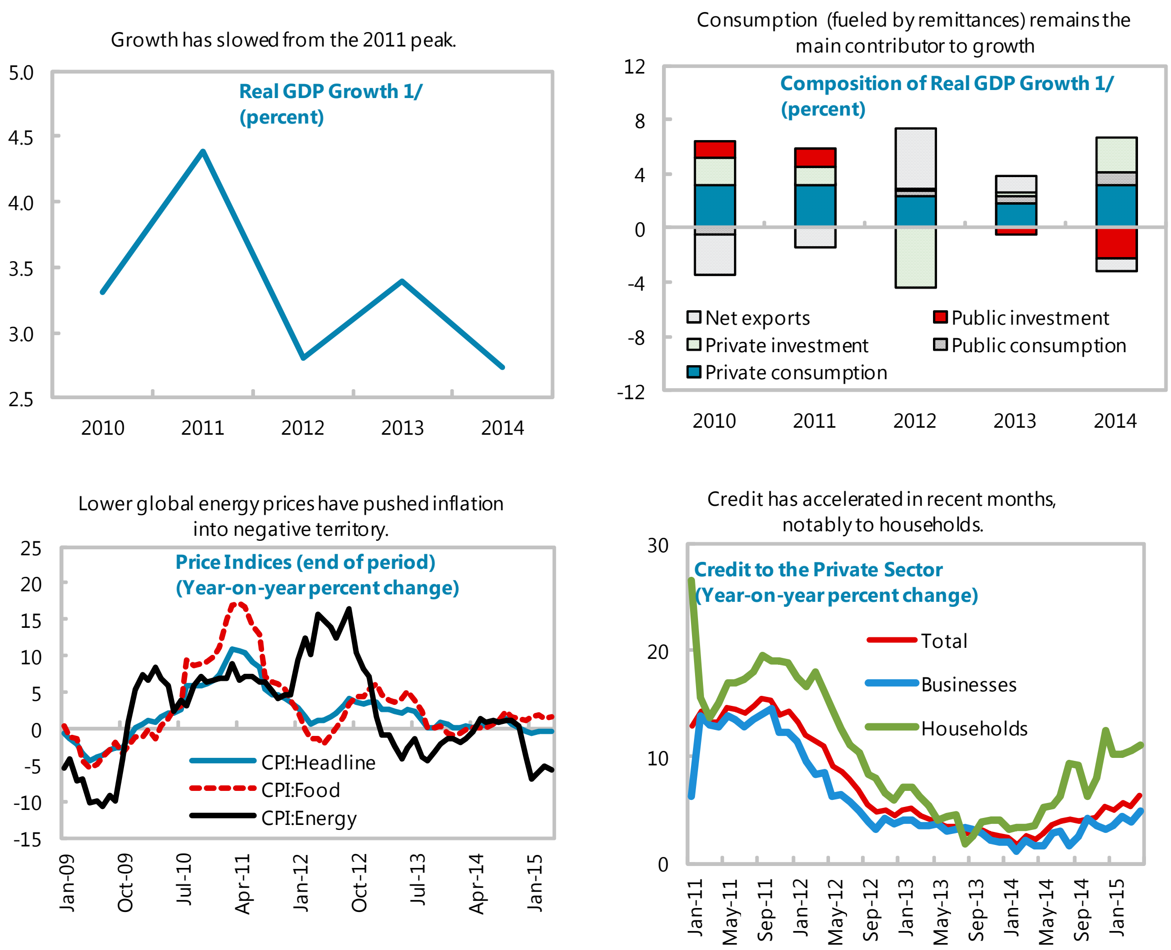
40. The financial sector will become safer and more supportive of economic growth. Under the program, the authorities will adopt an ELA framework in line with international best practice and fully adopt risk-based supervision of all banks, thereby strengthening the financial safety net and giving the CBK more tools to identify and deal with risks. Further progress will also be made in identifying potential structural impediments to bank lending.

41. Strong steps will be taken to improve competitiveness and the business environment, aiming for a more productive and dynamic private sector. The authorities will introduce a public wage rule linked to a macroeconomic indicator to deflate labor costs, reduce real exchange rate overvaluation, and address hiring challenges that high public wages cause for the private sector. They will also implement public procurement reform which will increase transparency, improve oversight, and, ultimately, reduce corruption.

42. The program's success will critically depend on the government's willingness to see through some potentially politically difficult measures. The authorities are strongly committed to the program's goals and enjoy a coalition government with a healthy majority in parliament. At the same time, some of the measures discussed above will be politically difficult to implement. It will be critical for the authorities to maintain the positive momentum they have shown since taking office in December 2014 and to continue making the difficult policy decisions necessary for Kosovo to break its remittance-and-consumption growth cycle and deliver better jobs and prospects to its people. Looking beyond the program, and to entrench its gains, it will be important to avoid populist measures in the run-up to elections planned in 2018, as happened in the past.

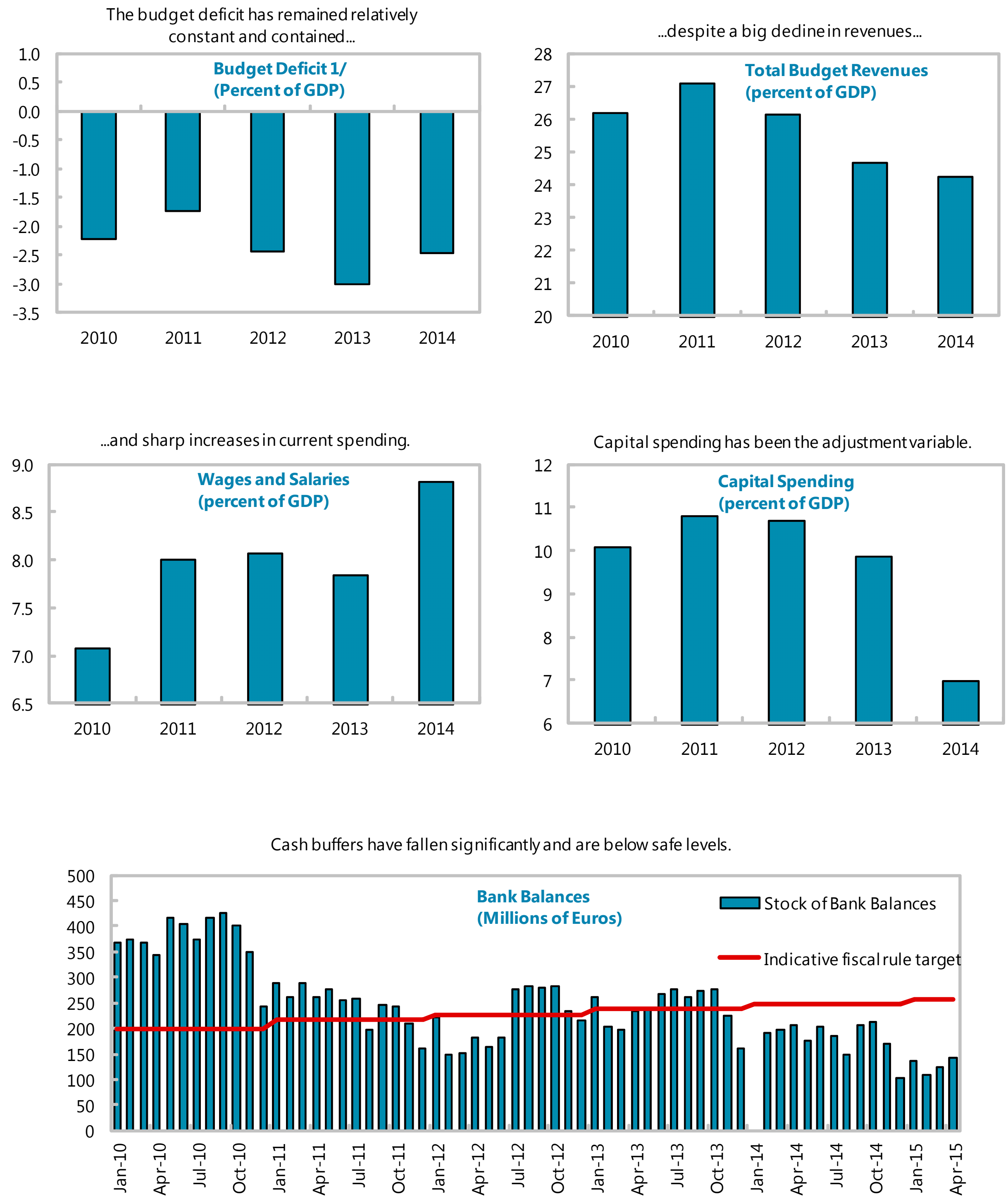
43. Staff supports the authorities' request for a 22-month SBA with access of 250 percent of quota (SDR 147.5 million).

Figure 1. Kosovo: Recent Economic Developments, 2009–14



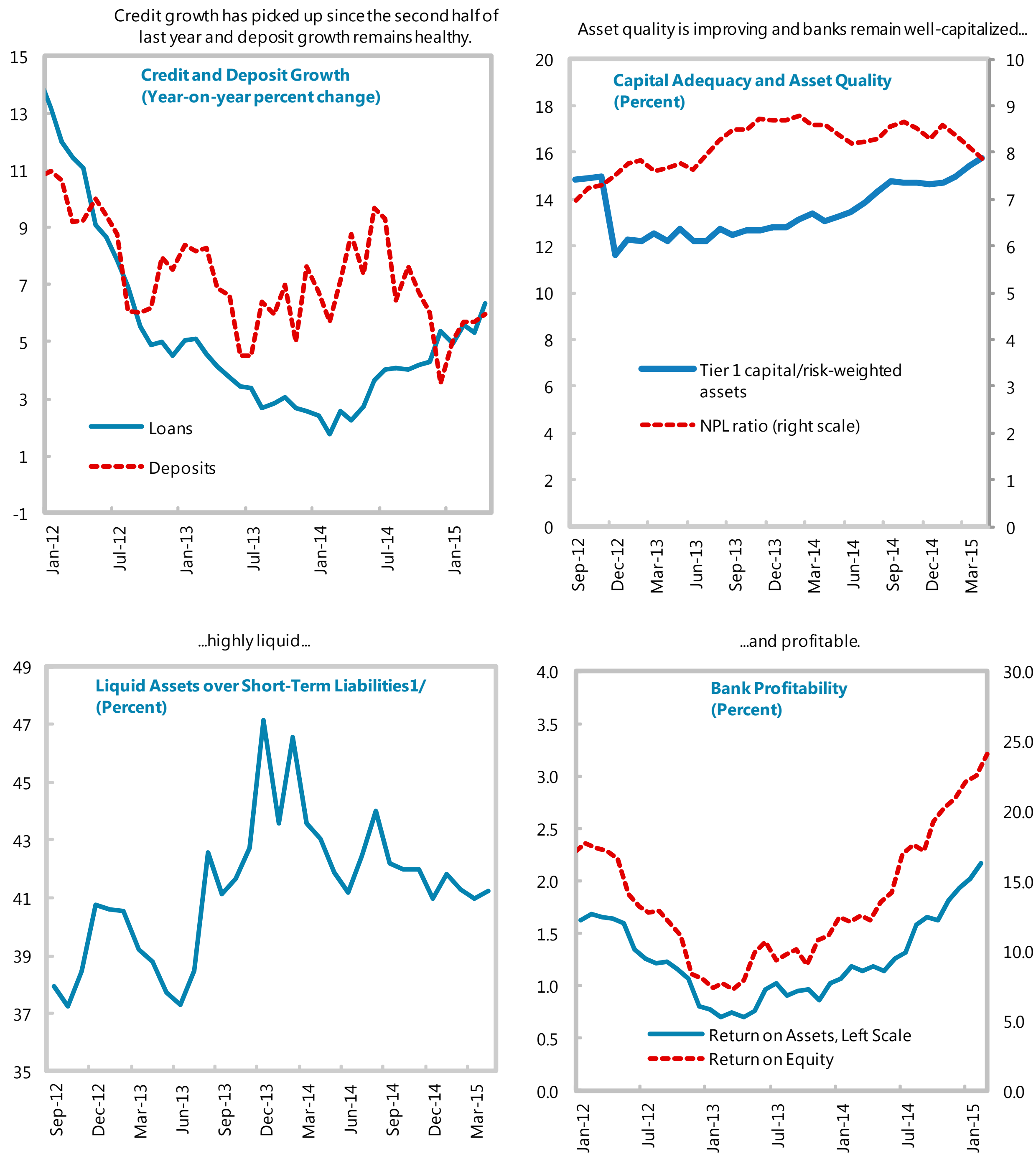
Source: Central Bank of the Republic of Kosovo; and IMF staff estimates and projections.
1/ 2014 annual data is an estimate.

Figure 2. Kosovo: Recent Fiscal Developments, 2010–14



Source: Country authorities; and IMF staff calculations.
1/ Overall balance excluding PAK spending.

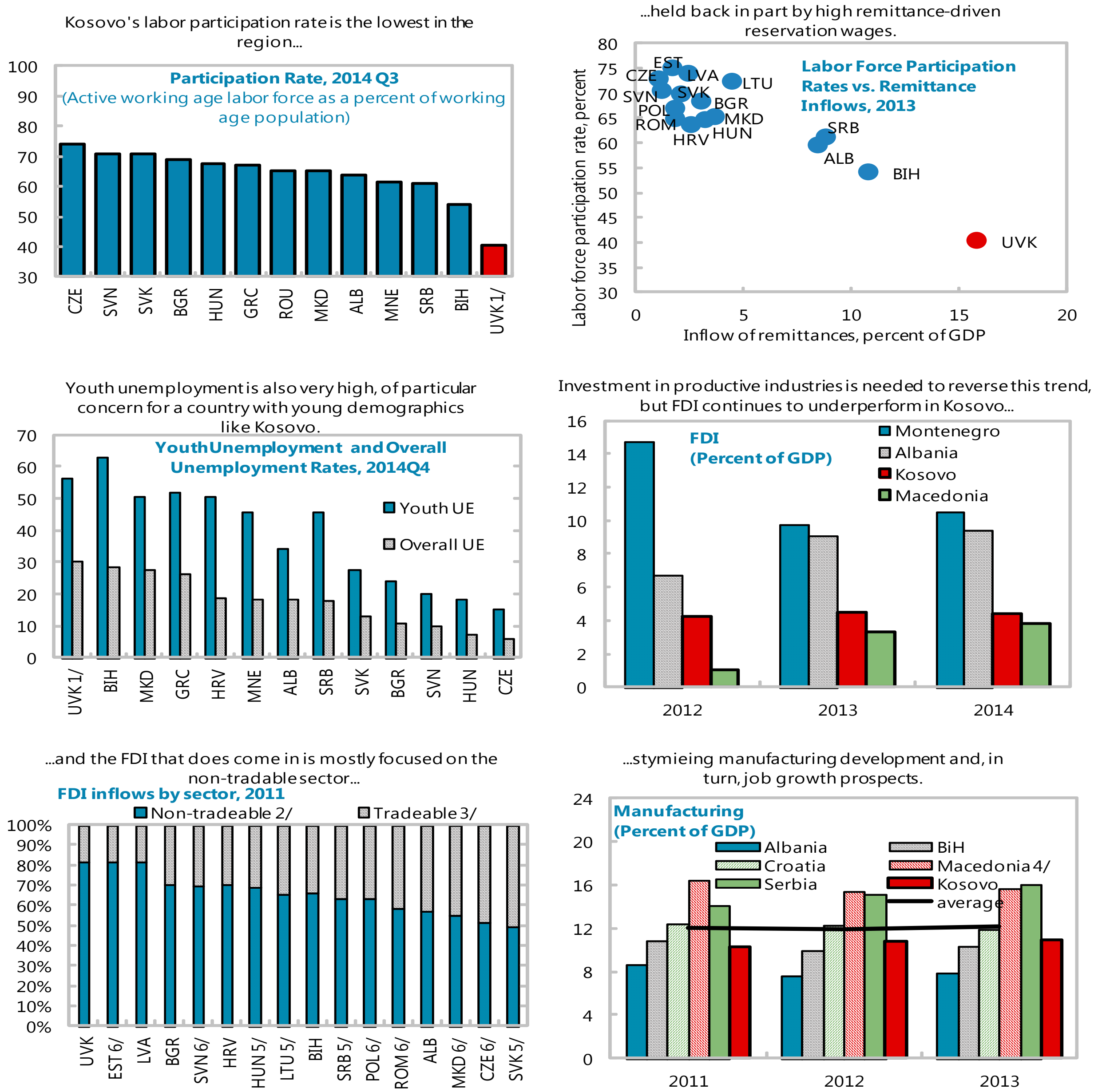
Figure 3. Kosovo: Selected Banking Sector Indicators, 2012–15



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

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

Figure 4. Selected Labor Market Outcomes in Kosovo



Source: Country authorities; Haver; World Economic Outlook; World Development Indicators World Bank; WIIW; and IMF staff calculations.

1/ 2013 data is used.

2/ Construction, Wholesale, retail trade, repair of motor vehicles etc., Hotels and restaurants, Transport, storage and communication, Financial intermediation, Real estate, renting and business activities, Public administration, defence, compuls.soc.security, Education, Health and social work, Other.

3/ Agriculture, hunting and forestry, Fishing, Mining and quarrying, Manufacturing, Electricity and water supply.

4/ Industry excluding construction.

5/ Data as of 2010.

6/ Data as of 2007.

Table 1. Kosovo: Main Indicators, 2012–20

(Percent, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
			Est.			Projections			
Real growth rates									
GDP	2.8	3.4	2.7	3.2	3.8	4.1	4.1	4.1	4.1
Consumption	2.6	2.2	3.9	3.3	3.3	3.6	3.8	3.8	3.8
Investment	-12.9	-0.3	0.9	4.3	12.8	4.3	4.9	4.7	6.4
Exports	0.5	2.5	15.3	4.2	4.6	9.2	8.0	7.0	7.2
Imports	-7.7	-1.5	7.4	4.4	8.0	6.6	5.2	5.7	5.5
Official unemployment (percent of workforce)	30.9	30.0	...	...	...	...	...	...	...
Price changes									
CPI, period average	2.5	1.8	0.4	0.1	1.3	1.6	1.8	1.9	2.1
CPI, end of period	3.7	0.5	-0.4	1.3	1.5	1.8	1.9	2.0	2.2
Import prices	4.9	0.0	-0.4	-0.3	1.1	0.8	1.0	1.3	1.1
GDP deflator	2.2	1.8	0.6	0.2	1.3	1.8	1.9	2.0	2.0
Real effective exch. rate (average; -=depreciation)	-0.7	0.0	1.8	...	...	...	...	...	...
Real effective exch. rate (end of period; -=depreciation)	0.6	-1.1	9.3	...	...	...	...	...	...
General government budget (percent of GDP)									
Revenues, incl. interest income	26.1	24.6	24.2	26.4	26.4	26.5	26.6	26.5	26.5
Primary expenditures	28.5	27.6	26.6	28.7	29.3	29.1	28.5	28.7	28.7
Of which: Wages and salaries	8.1	7.8	8.8	9.4	9.0	8.8	8.8	8.8	8.8
Subsidies and transfers	5.7	6.0	6.7	7.7	7.8	7.7	7.7	7.7	7.7
Capital and net lending	10.9	9.7	7.3	7.8	8.9	8.8	8.3	8.5	8.5
Overall balance excluding PAK 1/	-2.4	-3.0	-2.5	-2.4	-3.1	-2.9	-2.3	-2.5	-2.6
Overall balance ex-PAK and new donor projects 2/	-2.4	-3.0	-2.5	-2.4	-1.6	-1.4	-1.4	-1.6	-1.7
Privatization	0.9	0.5	0.0	0.5	0.0	0.0	3.0	0.0	0.0
Stock of government bank balances	4.3	3.0	1.8	3.0	4.5	4.5	4.5	4.5	4.5
Balance of Payments (percent of GDP)									
Current account balance, incl. official transfers	-7.5	-6.4	-8.0	-7.9	-10.3	-9.4	-9.0	-8.8	-8.6
Of which: official transfers 3/	7.9	6.4	5.2	4.9	3.9	3.8	3.5	3.2	3.2
Capital and financial account	2.8	3.1	3.0	2.0	5.0	6.6	6.8	7.0	6.9
Of which: Net foreign direct investment	4.2	4.5	2.3	4.2	5.7	5.6	5.5	5.5	5.5
Portfolio investment, net	-3.7	-2.5	-4.2	-1.6	-0.8	0.8	-0.2	-2.9	-2.9
Errors and Omissions	4.7	3.2	5.0	4.8	3.7	2.6	2.3	1.9	1.6
Savings-investment balances (percent of GDP)									
National savings	13.7	14.7	13.9	14.6	15.6	16.5	17.4	18.1	18.9
Investment	29.2	27.5	27.1	27.4	29.7	29.7	29.9	30.0	30.7
Current account, excl. official transfers	-15.4	-12.8	-13.2	-12.8	-14.1	-13.2	-12.5	-12.0	-11.8
Non-performing loans (percent of total loans)	7.5	8.7	8.3	...	...	...	...	...	...
Bank credit to the private sector (percent change)	4.5	2.7	5.4	5.5	6.7	7.6	8.5	8.7	9.2
Deposits of the private sector (percent change)	10.9	8.0	4.0	5.9	7.3	8.1	8.3	8.4	8.4
Regulatory capital/risk weighted assets	14.4	16.8	17.8	...	...	...	...	...	...
Memorandum items									
Total public debt (percent of GDP)	17.1	17.5	18.7	21.8	26.0	27.8	25.8	27.0	28.3
Of which: Debt of the former Yugoslavia 4/	8.7	8.3	8.0	7.8	7.4	7.0	6.6	6.2	5.8
GDP (millions of euros)	5059	5327	5506	5693	5988	6343	6732	7152	7594
GDP per capita (euros)	2799	2935	2989	3098	3210	3350	3503	3666	3835
GNDI per capita (euros)	3323	3488	3521	3679	3823	4010	4215	4442	4667
Population (thousands) 5/	1807	1815	1842	1838	1866	1894	1922	1951	1980

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

Note: Forecasts are based on staff's understanding of current policies, not on a reform scenario.

1/ Projected balance in the Article IV does not conform with the fiscal rule, but the projected balance in the SBA does.

2/ Donor projects have not been fully identified yet, nor donor financing agreed upon.

3/ Total foreign assistance excluding capital transfers.

4/ This debt is neither recognized nor serviced by Kosovo.

5/ Series updated according to Kosovo Agency of Statistics (2013), Pristina, Kosovo.

Table 2. Kosovo: Consolidated Government Budget, 2012–20 1/

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

	2012	2013	2014	2015	2016	2017	2018	2019	2020
			Est.			Projections			
Total primary revenue and grants	1,322	1,313	1,334	1,503	1,581	1,680	1,788	1,897	2,013
Total primary revenue	1,284	1,313	1,333	1,503	1,581	1,680	1,788	1,897	2,013
Taxes	1,112	1,121	1,162	1,280	1,367	1,458	1,548	1,644	1,746
Direct taxes	170	174	188	222	234	239	254	270	286
Indirect taxes	975	985	1,007	1,098	1,175	1,263	1,340	1,424	1,512
Of which: VAT	549	560	560	606	667	725	770	817	868
Tax refunds	-33	-37	-33	-39	-41	-44	-46	-49	-52
Nontax revenues	172	192	171	223	214	222	240	253	267
Of which: Dividends	45	43	15	30	30	30	30	30	30
Grants	37	0	1	0	0	0	0	0	0
Budget support	37	0	0	0	0	0	0	0	0
Project grants	0	0	1	0	0	0	0	0	0
Primary expenditure	1,441	1,469	1,464	1,634	1,757	1,843	1,920	2,053	2,180
Of which:									
PAK-related expenditures	6	7	5	10	11	11	12	13	14
Current expenditure	888	950	1,059	1,187	1,226	1,284	1,365	1,447	1,537
Wages and salaries	408	417	485	535	541	560	594	631	670
Goods and services	191	216	206	211	212	231	247	260	276
Subsidies and transfers	289	318	368	436	468	488	518	550	584
Pension and social assistance	198	225	347	305	328	341	362	385	409
Other transfers and subsidies 2/	91	93	21	131	140	146	155	165	175
Reserve	0	0	0	5	5	6	6	6	7
Capital expenditure and net lending	553	518	404	447	530	560	556	606	643
Capital expenditure	541	524	404	448	538	570	570	606	643
Highways	281	215	94	110	110	165	219	0	0
R7	281	215	38	0	0	0	0	0	0
R6	0	0	56	110	110	165	219	0	0
Expropriation	0	0	21	30	30	30	27	0	0
Other capital spending	260	309	289	308	398	375	324	606	643
Donor-financed new projects 3/				0	90	90	61	64	68
Net lending	12	-6	0	-2	-8	-10	-14	0	0
KSF-KAF				0	0	0	0	0	0
Primary balance	-119	-156	-129	-130	-175	-163	-132	-156	-167
Primary balance net of PAK	-113	-149	-124	-120	-164	-152	-120	-143	-153
Interest income, net	-10	-11	-13	-17	-24	-30	-38	-35	-42
Overall balance	-129	-167	-142	-147	-199	-193	-170	-190	-209
Overall balance excluding PAK	-123	-160	-137	-137	-188	-182	-158	-178	-195
Overall balance ex-PAK and new donor-financed projects	-123	-160	-137	-137	-98	-92	-97	-113	-127
Financing	186	168	136	137	188	182	158	178	195
Foreign financing	83	-8	-18	-13	74	52	108	54	22
Drawings, incl. official financing	94	6	4	12	44	15	65	59	54
Amortization	-11	-14	-22	-25	-60	-53	-18	-69	-100
Donor financing for new projects				0	90	90	61	64	68
Domestic financing	103	176	154	80	15	113	50	123	173
Domestic borrowing (net)	73	78	104	120	114	129	-133	142	193
Privatization revenues	45	26	0	30	0	0	200	0	0
Own-source revenue (– = increase)	-15	14	-7	0	0	0	0	0	0
Accumulation of Assets (- = increase)	-56	57	58	-69	-99	-16	-17	-19	-20
IMF financing				69	99	16	0	0	0
Memorandum items:									
Bank balance of the general government	216	159	101	171	269	285	303	322	342
Of which: ELA	0	46	46	46	46	46	46	46	46
Total public debt	864	935	1,028	1,240	1,555	1,763	1,739	1,933	2,146
Of which: Debt of the former Yugoslavia 4/	442	442	442	442	442	442	442	442	442

Note: Forecasts are based on staff's understanding of current policies, not on a reform scenario.
1/ Does not yet reflect the GFSM 2001 methodology.
2/ Including capital transfers to public enterprises.
3/ New donor projects have not been fully identified yet, nor donor financing
4/ This debt is neither recognized nor serviced by Kosovo.

Table 3. Kosovo: Consolidated Government Budget, 2012–20

(Excluding donor designated grants; percent of GDP)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
			Est.	Projections					
Total primary revenue and grants	26.1	24.6	24.2	26.4	26.4	26.5	26.6	26.5	26.5
Total primary revenue	25.4	24.6	24.2	26.4	26.4	26.5	26.6	26.5	26.5
Taxes	22.0	21.0	21.1	22.5	22.8	23.0	23.0	23.0	23.0
Direct taxes	3.4	3.3	3.4	3.9	3.9	3.8	3.8	3.8	3.8
Indirect taxes	19.3	18.5	18.3	19.3	19.6	19.9	19.9	19.9	19.9
Tax refunds	-0.7	-0.7	-0.6	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
Nontax revenues	3.4	3.6	3.1	3.9	3.6	3.5	3.6	3.5	3.5
Of which:									
Dividends	0.9	0.8	0.3	0.5	0.5	0.5	0.4	0.4	0.4
Grants	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Budget support	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary expenditure	28.5	27.6	26.6	28.7	29.3	29.1	28.5	28.7	28.7
Of which:									
PAK-related expenditures	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Primary expenditure excluding PAK	...	...	...	...	...	...	...	...	...
Current expenditure	17.5	17.8	19.2	20.8	20.5	20.2	20.3	20.2	20.2
Current expenditure excluding PAK	17.4	17.7	19.1	20.7	20.3	20.1	...	...	...
Wages and salaries	8.1	7.8	8.8	9.4	9.0	8.8	8.8	8.8	8.8
Goods and services	3.8	4.0	3.7	3.7	3.5	3.6	3.7	3.6	3.6
Subsidies and transfers	5.7	6.0	6.7	7.7	7.8	7.7	7.7	7.7	7.7
Pension and social assistance	3.9	4.2	6.3	5.4	5.5	5.4	5.4	5.4	5.4
Reserve	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Capital expenditure and net lending	10.9	9.7	7.3	7.8	8.9	8.8	8.3	8.5	8.5
Capital expenditure	10.7	9.8	7.3	7.9	9.0	9.0	8.5	8.5	8.5
Highways	5.6	4.0	1.7	1.9	1.8	2.6	3.3	0.0	0.0
R7	5.6	4.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0
R6	0.0	0.0	1.0	1.9	1.8	2.6	3.3	0.0	0.0
Expropriations	0.0	0.0	0.4	0.5	0.5	0.5	0.4	0.0	0.0
Other capital spending	5.1	5.8	5.3	5.4	6.6	5.9	4.8	8.5	8.5
Donor-financed new projects 1/				0.0	1.5	1.4	0.9	0.9	0.9
Net lending	0.2	-0.1	0.0	0.0	-0.1	-0.2	-0.2	0.0	0.0
KSF-KAF				0.0	0.0	0.0	0.0	0.0	0.0
Primary balance	-2.4	-2.9	-2.4	-2.3	-2.9	-2.6	-2.0	-2.2	-2.2
Primary balance net of PAK	-2.2	-2.8	-2.3	-2.1	-2.7	-2.4	-1.8	-2.0	-2.0
Interest income, net	-0.2	-0.2	-0.2	-0.3	-0.4	-0.5	-0.6	-0.5	-0.5
Overall balance	-2.6	-3.1	-2.6	-2.6	-3.3	-3.0	-2.5	-2.7	-2.7
Overall balance excluding PAK	-2.4	-3.0	-2.5	-2.4	-3.1	-2.9	-2.3	-2.5	-2.6
Overall balance ex-PAK and ex-new donor-financed projects	-2.4	-3.0	-2.5	-2.4	-1.6	-1.4	-1.4	-1.6	-1.7
Financing	3.7	3.2	2.5	2.4	3.1	2.9	2.3	2.5	2.6
Foreign financing	1.6	-0.1	-0.3	-0.2	1.2	0.8	1.6	0.8	0.3
Drawings, incl. official financing	1.9	0.1	0.1	0.2	0.7	0.2	1.0	0.8	0.7
Amortization	-0.2	-0.3	-0.4	-0.4	-1.0	-0.8	-0.3	-1.0	-1.3
Donor financing for new projects				0.0	1.5	1.4	0.9	0.9	0.9
Domestic financing	2.0	3.3	2.8	1.4	0.3	1.8	0.7	1.7	2.3
Domestic borrowing (net)	1.4	1.5	1.9	2.1	1.9	2.0	-2.0	2.0	2.5
Privatization revenues	0.9	0.5	0.0	0.5	0.0	0.0	3.0	0.0	0.0
Own-source revenue (– = increase)	-0.3	0.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Accumulation of Assets (- = increase)	-1.1	1.1	1.0	-1.2	-1.6	-0.3	-0.3	-0.3	-0.3
IMF financing				1.2	1.6	0.3	0.0	0.0	0.0
Memorandum items:									
Bank balance of the general government	4.3	3.0	1.8	3.0	4.5	4.5	4.5	4.5	4.5
Of which: ELA	0.0	0.9	0.8	0.8	0.8	0.7	0.7	0.6	0.6
Total public debt	17.1	17.5	18.7	21.8	26.0	27.8	25.8	27.0	28.3
Of which: Debt of the former Yugoslavia 2/	8.7	8.3	8.0	7.8	7.4	7.0	6.6	6.2	5.8
Nominal GDP (millions of euros)	5,059	5,327	5,506	5,693	5,988	6,343	6,732	7,152	7,594

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

Note: Forecasts are based on staff's understanding of current policies, not on a reform scenario.

1/ New Donor projects have not been fully identified yet, nor donor financing agreed upon.

2/This debt is neither recognized nor serviced by Kosovo.

Table 4. Kosovo: Balance of Payments, 2012–20

(Millions of euros, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
			Est.	Projections					
Goods and services balance	-1,728	-1,684	-1,714	-1,787	-1,970	-2,060	-2,147	-2,275	-2,404
Goods	-2,073	-1,992	-2,052	-2,167	-2,380	-2,550	-2,707	-2,901	-3,088
Exports	287	305	321	327	361	410	452	495	555
Imports	-2,360	-2,297	-2,372	-2,494	-2,741	-2,959	-3,159	-3,396	-3,643
Services	345	308	337	380	410	489	560	626	684
Receipts	637	622	756	792	843	939	1,025	1,109	1,178
Payments	-292	-314	-419	-412	-432	-450	-465	-483	-494
Income	154	122	106	120	127	136	143	155	137
Compensation of employees (net)	214	219	200	208	217	225	234	244	244
Investment income	-60	-97	-95	-88	-89	-90	-91	-89	-107
Interest payments on public debt	-8	-9	-12	-16	-17	-17	-18	-18	-41
Transfers	1,194	1,222	1,168	1,215	1,227	1,326	1,396	1,488	1,616
Official transfers	402	342	288	277	231	239	233	225	243
Other transfers (net)	793	880	880	938	995	1,087	1,163	1,263	1,373
Workers' remittances (net)	519	552	625	655	692	762	815	880	956
Inflows of remittances	605	621	694	717	753	796	856	919	988
Other (net)	274	328	255	282	303	325	348	383	418
Current account	-380	-339	-441	-452	-616	-599	-608	-632	-651
Capital and financial account	140	167	167	111	298	419	456	499	526
Capital account	13	35	21	2	2	2	2	2	3
Financial account, incl. CBK	127	133	145	109	296	417	454	497	523
Foreign direct investment, net	213	241	124	240	340	355	374	393	417
Commercial banks, excl. FDI	102	-47	75	-3	26	124	58	82	60
General government	83	-9	-18	-13	-16	-38	47	-13	-49
Drawings	94	3	4	12	44	15	65	59	54
Repayments	-11	-11	-22	-25	-60	-53	-18	-72	-104
Other	0	0	0	0	0	0	0	0	0
Other sectors, excl. FDI 1/	-33	90	-278	-69	8	40	58	136	176
Central Bank of Kosovo	-237	-142	242	-45	-62	-66	-84	-101	-80
Reserve assets	-267	21	57	-20	-68	-70	-87	-106	-85
Government balances (program definition)	-56	57	58	-69	-99	-16	-17	-19	-20
Other reserve assets, incl. SDRs	-211	-36	-1	49	31	-54	-70	-88	-65
Non-reserves assets	30	-163	185	-25	5	5	4	5	5
Liabilities 2/	0	0	0	0	0	0	0	0	0
Net errors and omissions 3/	239	171	274	272	219	164	152	133	124
Overall balance	0	0	0	-69	-99	-16	0	0	0
IMF financing				69	99	16	0	0	0
Financing gap	0	0	0	0	0	0	0	0	0
				(In percent of GDP)					
Goods and services balance	-34.2	-31.6	-31.1	-31.4	-32.9	-32.5	-31.9	-31.8	-31.7
Exports	18.3	17.4	19.6	19.7	20.1	21.3	21.9	22.4	22.8
Imports	-52.4	-49.0	-50.7	-51.0	-53.0	-53.7	-53.8	-54.2	-54.5
Current account, excl. official transfers	-15.4	-12.8	-13.2	-12.8	-14.1	-13.2	-12.5	-12.0	-11.8
Current account, incl. official transfers	-7.5	-6.4	-8.0	-7.9	-10.3	-9.4	-9.0	-8.8	-8.6
Capital and financial account	2.8	3.1	3.0	2.0	5.0	6.6	6.8	7.0	6.9
Foreign direct investment, net	4.2	4.5	2.3	4.2	5.7	5.6	5.5	5.5	5.5
Other sectors, excl. FDI 1/	-0.7	1.7	-5.1	-1.2	0.1	0.6	0.9	1.9	2.3
Net errors and omissions 3/	4.7	3.2	5.0	4.8	3.7	2.6	2.3	1.9	1.6
Overall balance	0.0	0.0	0.0	-1.2	-1.6	-0.3	0.0	0.0	0.0
Memorandum items:									
Debt service to export ratio (percent)	2.1	2.2	3.2	3.6	6.4	5.2	2.4	5.6	8.3
Debt service to exports and remittances (percen	1.3	1.3	1.9	2.2	3.9	3.3	1.5	3.6	5.3
Net foreign assets of CBK	1,239	1,392	1,146	1,192	1,254	1,320	1,403	1,504	1,584
Gross international reserves of the CBK	892	850	800	820	888	958	1,045	1,152	1,237
Gross international reserves in months of import	4.0	3.9	3.4	3.4	3.4	3.4	3.5	3.6	3.6

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

Note: Forecasts are based on staff's understanding of current policies, not on a reform scenario.

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 5. Kosovo: Central Bank and Commercial Bank Survey, 2012–15

(Millions of euros, unless otherwise indicated)

	2012	2013	2014	2015
			Est.	Proj.
Central Bank				
Net foreign assets	1,239	1,392	1,146	1,192
Foreign assets	1,469	1,610	1,368	1,413
Of which: Securities	286	561	121	141
Deposits	1,034	896	1,085	1,111
Foreign liabilities	230	218	222	222
Net domestic assets	-1,239	-1,392	-1,146	-1,158
Net claims on commercial banks	-302	-333	-316	-260
Claims on commercial banks	0	0	0	0
Liabilities to commercial banks	-302	-333	-316	-260
Net claims on the central government	-838	-773	-730	-808
Claims on central government	0	0	0	0
Liabilities to central government	-838	-773	-730	-808
Of which: KTA (privatization) fund	-549	-550	-558	-572
Of which: Government balances (program definition)	-216	-159	-101	-171
Net Claims on other sectors	-51	-238	-52	-41
Claims on other sectors	1	1	0	11
Liabilities to other sectors	-51	-239	-52	-52
Other items, net 1/	-48	-48	-48	-48
Commercial banks				
Net foreign assets	491	573	534	538
Assets	634	748	716	716
Liabilites	-143	-175	-182	-178
Net domestic assets	2,025	2,145	2,320	2,464
Claims on the CBK	301	333	316	260
Net claims on the central government	59	99	187	286
Claims on central government	60	100	193	286
Liabilities to central government	-1	-1	-5	0
Net claims on other public entities	-74	-73	-65	-67
Claims on other public entities	1	0	1	1
Liabilities to other public entities	-76	-73	-65	-68
Credit to private sector	1,740	1,786	1,881	1,984
Deposits of the private sector	2,116	2,286	2,378	2,518
Demand deposits	694	841	1,131	1,197
Time deposits	1,422	1,445	1,247	1,321
Other items, net 1/	401	432	476	483
Memorandum item:				
Gross international reserves	892	850	800	820
Deposits of the private sector (12-month percent change)	10.9	8.0	4.0	5.9
Credit to the private sector (12-month percent change)	4.5	2.7	5.4	5.5
Deposits of the private sector (Percent of GDP)	41.8	42.9	43.2	44.2
Credit to the private sector (Percent of GDP)	34.4	33.5	34.2	34.9

Note: Forecasts are based on staff's understanding of current policies, not on a reform scenario.
1/ Includes shares and other equity.

Table 6. Kosovo: Selected Financial Soundness Indicators, 2010–15

	2010	2011	2012	2013	2014	April 2015
Capital adequacy						
Regulatory capital to risk weighted assets 1/	18.8	17.6	14.2	16.7	17.8	19.0
Tier 1 capital to risk weighted assets 1/	15.8	14.8	11.6	12.8	14.6	15.8
Capital to assets	10.1	10.2	10.0	9.7	10.8	11.6
Asset quality						
NPL to total loans 2/	5.2	5.7	7.5	8.7	8.3	7.9
NPL net of provisions to capital	3.7	4.6	7.4	7.8	4.7	4.0
Large exposures to capital	72.4	77.8	80.4	107.4	97.1	108.1
Sectoral breakdown of loans						
Agriculture	2.6	2.4	2.5	2.6	2.4	2.6
Manufacturing	11.0	10.1	9.5	9.7	10.0	9.9
Trade	37.1	37.8	37.8	36.9	35.8	36.2
Other services	12.0	11.7	11.6	12.4	12.8	11.8
Construction	7.5	7.0	7.2	6.6	6.0	5.5
Households	29.8	31.0	31.4	31.8	33.0	34.0
Liquidity						
Liquid assets to total assets 3/	37.5	32.6	34.3	37.8	38.3	38.0
Deposits to loans	126.1	117.6	122.6	130.8	129.4	128.4
Liquid assets to short-term liabilities 4/	46.2	39.6	40.8	47.1	41.0	41.3
Profitability						
Return on average assets 5/	1.6	1.6	0.8	1.0	1.9	2.4
Return on average equity 5/	16.9	16.9	8.3	10.8	20.2	24.0
Interest margin to total income	55.5	56.9	55.6	54.3	62.2	68.2
Non-interest expense to total income 6/	16.6	18.0	23.9	22.2	12.9	8.2
Interest margin to gross income 7/	74.4	75.2	74.7	73.1	76.1	76.4
Non-interest expense to gross income 7/ 8/	76.6	77.3	87.8	84.5	66.8	55.7
Market risk						
Net open currency position to tier 1 capital	-0.1	2.5	0.7	2.3	1.8	1.5

Source: Central Bank of the Republic of Kosovo.

1/ As of Dec. 2012, new capital adequacy rules include an additional 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.

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

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

Table 7. Kosovo: Indicators of Capacity to Repay the Fund, 2015–20

	2015	2016	2017	2018	2019	2020
Fund obligations based on prospective purchases (millions of SDR) 1/						
Principal	0.0	0.0	0.0	3.5	38.0	67.2
Charges and interest	0.4	1.2	1.6	1.6	1.4	0.8
Fund obligations based on existing and prospective purchases (millions of SDR) 1/						
Principal	8.3	39.1	33.2	3.5	38.0	67.2
Charges and interest	0.8	1.8	1.8	1.6	1.4	0.8
Total obligations based on existing and prospective purchases 1/						
SDR millions	9.1	40.9	34.9	5.1	39.4	68.0
Euro millions	11.3	51.1	43.4	6.3	48.6	83.2
Percent of exports of goods and services	1.0	4.2	3.2	0.4	3.0	4.8
Percent of exports of goods and services and remittances	0.6	2.6	2.0	0.3	1.9	3.1
Percent of debt service	28.3	66.2	62.0	17.5	53.6	57.7
Percent of GDP	0.2	0.9	0.7	0.1	0.7	1.1
Percent of government revenue	0.8	3.2	2.6	0.4	2.6	4.1
Percent of quota	15.4	69.3	59.2	8.6	66.8	115.3
Outstanding Fund credit (based on existing and prospective drawings) 1/						
SDR millions	128.5	168.6	147.5	144.0	106.0	38.8
Euro millions	160.2	210.5	183.5	178.3	130.6	47.4
Percent of exports of goods and services	14.3	17.5	13.6	12.1	8.1	2.7
Percent of exports of goods and services and remittances	8.7	10.8	8.6	7.6	5.2	1.7
Percent of GDP	2.8	3.5	2.9	2.6	1.8	0.6
Percent of government revenue	10.7	13.3	10.9	10.0	6.9	2.4
Percent of quota	217.8	285.7	250.0	244.0	179.6	65.7
Net use of Fund credit (millions of SDR) 1/	47.9	40.1	-21.1	-3.5	-38.0	-67.2
Purchases	56.2	79.2	12.1	0.0	0.0	0.0
Repurchases	8.3	39.1	33.2	3.5	38.0	67.2
Memorandum items:						
Exports of goods and services (millions of euros)	1,119	1,203	1,349	1,477	1,604	1,733
Exports of goods and services and remittances (millions of euros)	1,836	1,956	2,145	2,333	2,523	2,721
External debt service (millions of euros) [1]	40.1	77.1	70.0	35.9	90.6	144.4
Nominal GDP (millions of euros)	5,693	5,988	6,343	6,732	7,152	7,594
Government revenue (millions of euros)	1,503	1,581	1,680	1,788	1,897	2,013
Quota (millions of SDR)	59.0	59.0	59.0	59.0	59.0	59.0

Sources: IMF staff estimates and projections.

1/ Assumes prospective SBA disbursements in 2015–2017 (baseline scenario).

Table 8. Kosovo: Gross Financing Requirements, 2015–17

(Millions of euros)

	2015	2016	2017
Gross Financing Requirements	465	654	624
Current account deficit	441	594	572
Amortization of medium and long term public debt	25	60	53
Sources of Financing	396	555	608
Capital account (net)	2	2	2
Foreign direct investment (net)	230	324	340
Net bank financing	-3	26	124
Government loans	12	44	15
Net Foreign assets of the Central Bank of Kosovo	-45	-62	-66
Other financing inc. net erros and omissions	201	221	192
Financing need	69	99	16
IMF	69	99	16
in percent of quota	94	135	21

Sources: IMF staff estimates and projections.

Table 8. Kosovo: Gross Financing Requirements, 2015–17

(Percent of GDP)

	2015	2016	2017
Gross Financing Requirements	8.2	10.9	9.8
Current account deficit	7.7	9.9	9.0
Amortization of medium and long term public debt	0.4	1.0	0.8
Sources of Financing	6.9	9.3	9.6
Capital account (net)	0.0	0.0	0.0
Foreign direct investment (net)	4.0	5.4	5.4
Net bank financing	-0.1	0.4	2.0
Government loans	0.2	0.7	0.2
Net Foreign assets of the Central Bank of Kosovo	-0.8	-1.0	-1.0
Other financing inc. net erros and omissions	3.5	3.7	3.0
Financing need	1.2	1.6	0.3
IMF	1.2	1.6	0.3

Sources: IMF staff estimates and projections.

Table 9. Kosovo: Schedule of Purchases Under the Stand-By Arrangement, 2015–17

Amount	Percent of Quota	Date Available	Conditions Necessary for Purchase
SDR 28.1 million	48	July 24, 2015	Executive Board approval of the SBA arrangement.
SDR 28.1 million	48	November 1, 2015	Observance of continuous and end-August 2015 performance criteria and completion of the first review.
SDR 39.6 million	67	May 1, 2016	Observance of continuous and end-December 2015 performance criteria and completion of the second review.
SDR 39.6 million	67	November 1, 2016	Observance of continuous and end-June 2016 performance criteria and completion of the third review.
SDR 12.1 million	20	May 1, 2017	Observance of continuous and end-December 2016 performance criteria and completion of the fourth review.

Total: SDR 147.5 million (250 percent of quota)

Kosovo Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP unless otherwise indicated)

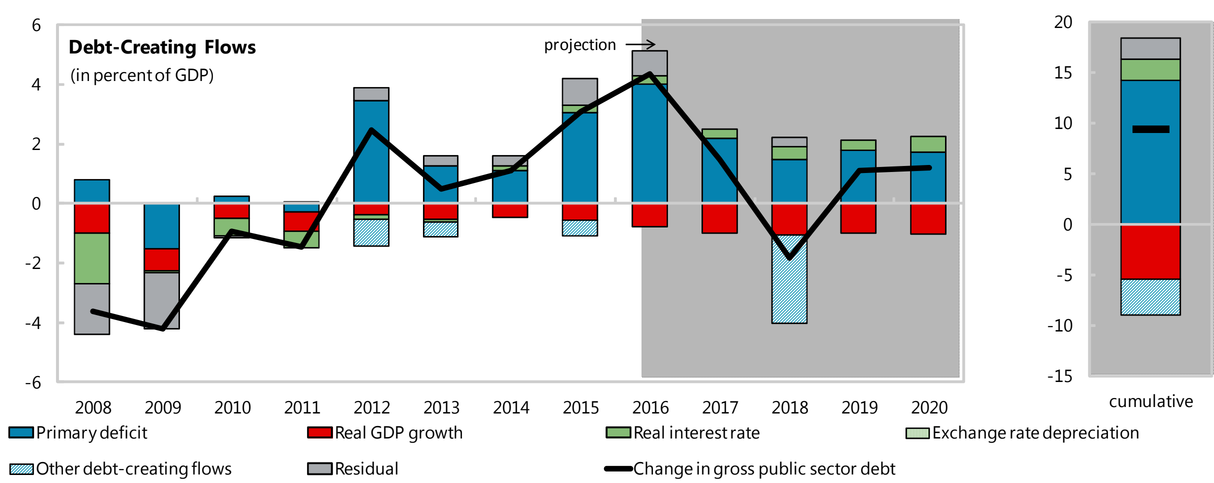
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	17.2	17.5	18.7	21.7	26.1	27.6	25.7	26.9	28.1
Public gross financing needs	1.2	6.1	6.8	8.2	10.6	9.9	8.6	8.2	10.1
Real GDP growth (in percent)	3.7	3.4	2.7	3.2	3.8	4.1	4.1	4.1	4.1
Inflation (GDP deflator, in percent)	4.0	1.8	0.6	0.2	1.3	1.8	1.9	2.0	2.0
Nominal GDP growth (in percent)	7.9	5.3	3.4	3.4	5.2	5.9	6.1	6.2	6.2
Effective interest rate (in percent) [4/]	0.9	1.4	1.5	1.7	2.8	3.2	3.7	3.5	4.1

As of June 07, 2015		
Sovereign Spreads		
EMBIG (bp) 3/		na
5Y CDS (bp)		na
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	n.a.	n.a.
Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-1.5	0.5	1.1	3.1	4.3	1.5	-1.8	1.1	1.2	9.4	
Identified debt-creating flows	0.3	0.1	0.8	2.2	3.5	1.5	-2.1	1.1	1.2	7.4	
Primary deficit	1.6	1.2	1.1	3.0	4.0	2.2	1.5	1.8	1.7	14.2	-0.5
Primary (noninterest) revenue and grants	26.6	24.6	24.2	26.4	26.4	26.5	26.6	26.5	26.5	158.9	
Primary (noninterest) expenditure	27.0	25.9	25.3	29.4	30.4	28.7	28.0	28.3	28.2	173.1	
Automatic debt dynamics [5/]	-1.3	-0.6	-0.3	-0.3	-0.5	-0.7	-0.6	-0.7	-0.5	-3.3	
Interest rate/growth differential [6/]	-1.3	-0.6	-0.3	-0.3	-0.5	-0.7	-0.6	-0.7	-0.5	-3.3	
Of which: real interest rate	-0.6	-0.1	0.1	0.3	0.3	0.3	0.4	0.3	0.5	2.2	
Of which: real GDP growth	-0.7	-0.5	-0.5	-0.6	-0.8	-1.0	-1.1	-1.0	-1.0	-5.5	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.2	-0.5	0.0	-0.5	0.0	0.0	-3.0	0.0	0.0	-3.5	
Privatization revenues (negative)	-0.2	-0.5	0.0	-0.5	0.0	0.0	-3.0	0.0	0.0	-3.5	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.6	0.4	0.3	0.9	0.8	0.0	0.3	0.0	0.0	2.0	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

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

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

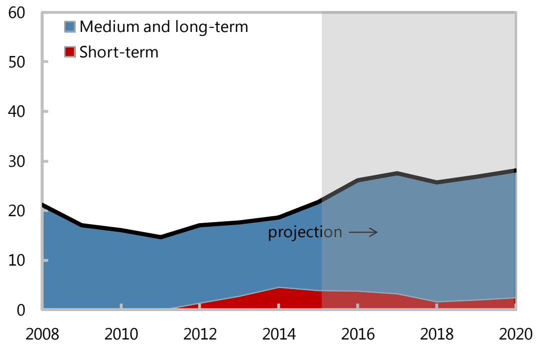
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Kosovo Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

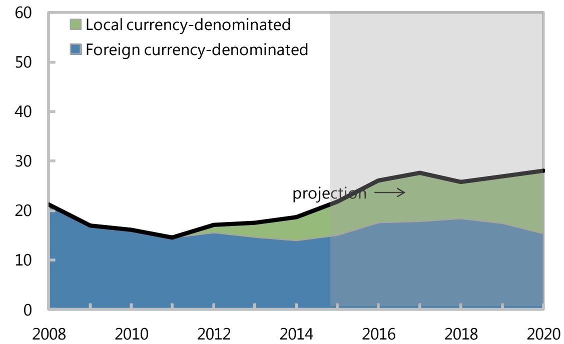
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

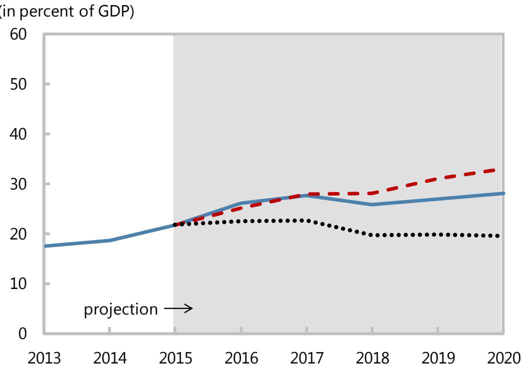


Alternative Scenarios

Baseline Historical Constant Primary Balance

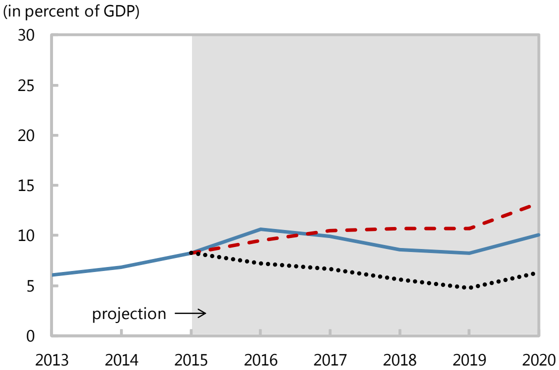
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.2	3.8	4.1	4.1	4.1	4.1
Inflation	0.2	1.3	1.8	1.9	2.0	2.0
Primary Balance	-3.0	-4.0	-2.2	-1.5	-1.8	-1.7
Effective interest rate	1.7	2.8	3.2	3.7	3.5	4.1
Constant Primary Balance Scenario						
Real GDP growth	3.2	3.8	4.1	4.1	4.1	4.1
Inflation	0.2	1.3	1.8	1.9	2.0	2.0
Primary Balance	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
Effective interest rate	1.7	2.8	3.2	3.6	3.4	3.7

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.2	4.0	4.0	4.0	4.0	4.0
Inflation	0.2	1.3	1.8	1.9	2.0	2.0
Primary Balance	-3.0	-0.6	-0.6	-0.6	-0.6	-0.6
Effective interest rate	1.7	2.8	2.0	2.1	2.2	2.4

Source: IMF staff.

Kosovo: External Debt Sustainability Framework, 2010–20

(in percent of GDP, unless otherwise indicated)

	Actual							Projections							
	2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020		Debt-stabilizing non-interest current account 6/
Baseline: External debt	16.1	15.4	15.3	14.3	15.1			**15.2**	**17.7**	**18.0**	**18.5**	**18.1**	**17.3**		-5.0
Change in external debt	-0.1	-0.7	-0.1	-1.1	0.9			0.1	2.5	0.2	0.6	-0.4	-0.8	0.0	
Identified external debt-creating flows (4+8+9)	2.3	5.1	1.4	1.6	5.3			3.3	4.0	3.0	2.1	2.3	1.5	0.0	
Current account deficit, excluding interest payments	11.5	13.5	7.3	6.2	7.8			7.5	9.7	8.7	7.9	7.2	6.5	5.0	
Deficit in balance of goods and services	35.6	37.2	34.2	31.6	31.1			31.4	32.9	32.5	31.9	31.8	31.7		
Exports	19.9	19.6	18.3	17.4	19.6			19.7	20.1	21.3	21.9	22.4	22.8		
Imports	55.5	56.8	52.4	49.0	50.7			51.0	53.0	53.7	53.8	54.2	54.5		
Net non-debt creating capital inflows (negative)	-7.5	-7.9	-4.2	-4.5	-2.3			-4.0	-5.4	-5.4	-5.3	-4.5	-4.5	-4.5	
Automatic debt dynamics 1/	-1.7	-0.5	-1.7	-0.1	-0.2			-0.2	-0.3	-0.4	-0.4	-0.5	-0.4	-0.5	
Contribution from nominal interest rate	0.2	0.2	0.2	0.2	0.2			0.2	0.3	0.3	0.3	0.3	0.3	0.2	
Contribution from real GDP growth	-0.5	-0.7	-0.4	-0.5	-0.4			-0.4	-0.6	-0.7	-0.7	-0.7	-0.7	-0.7	
Contribution from price and exchange rate changes 2/	-1.5	0.0	-1.5	0.2	-0.1			...	...	...	...	...	...	0.0	
Residual, incl. change in gross foreign assets (2-3) 3/	-2.4	-5.8	-1.5	-2.6	-4.4			-3.2	-1.4	-2.7	-1.5	-2.7	-2.3	0.0	
External debt-to-exports ratio (in percent)	80.9	78.7	83.9	82.0	77.4			77.4	88.3	84.5	84.5	80.8	75.9		
Gross external financing need (in billions of US dollars) 4/	471.0	560.8	384.7	342.1	428.9			495.6	631.3	607.3	580.5	566.5	539.7		
in percent of GDP	14.2	16.2	9.8	8.5	10.4	10-Year	10-Year	9.9	11.9	11.0	10.0	9.3	8.5		
Scenario with key variables at their historical averages 5/								**15.2**	**16.7**	**16.9**	**18.3**	**18.6**	**19.1**		-6.7
						Historical	Standard							For debt	
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							stabilization	
Real GDP growth (in percent)	3.3	4.4	2.8	3.4	2.7	3.4	0.6	3.2	3.8	4.1	4.1	4.1	4.1	4.1	
GDP deflator in US dollars (change in percent)	9.9	-0.1	10.6	-1.4	0.5	4.4	5.4	17.6	1.2	0.8	0.8	0.8	0.2	0.2	
Nominal external interest rate (in percent)	1.4	1.2	1.3	1.3	1.5	1.3	0.3	1.8	1.8	1.6	1.5	1.4	1.4	1.4	
Growth of exports (US dollar terms, in percent)	32.6	2.5	6.0	-2.9	16.1	13.9	14.5	22.0	7.4	11.0	8.3	7.3	6.1		
Growth of imports (US dollar terms, in percent)	21.3	6.8	4.9	-4.7	6.8	6.5	8.4	22.2	9.1	6.4	5.1	5.7	4.8		
Current account balance, excluding interest payments	-11.5	-13.5	-7.3	-6.2	-7.8	-9.2	2.8	-7.5	-9.7	-8.7	-7.9	-7.2	-6.5		
Net non-debt creating capital inflows	7.5	7.9	4.2	4.5	2.3	5.6	2.2	4.0	5.4	5.4	5.3	4.5	4.5		

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

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

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

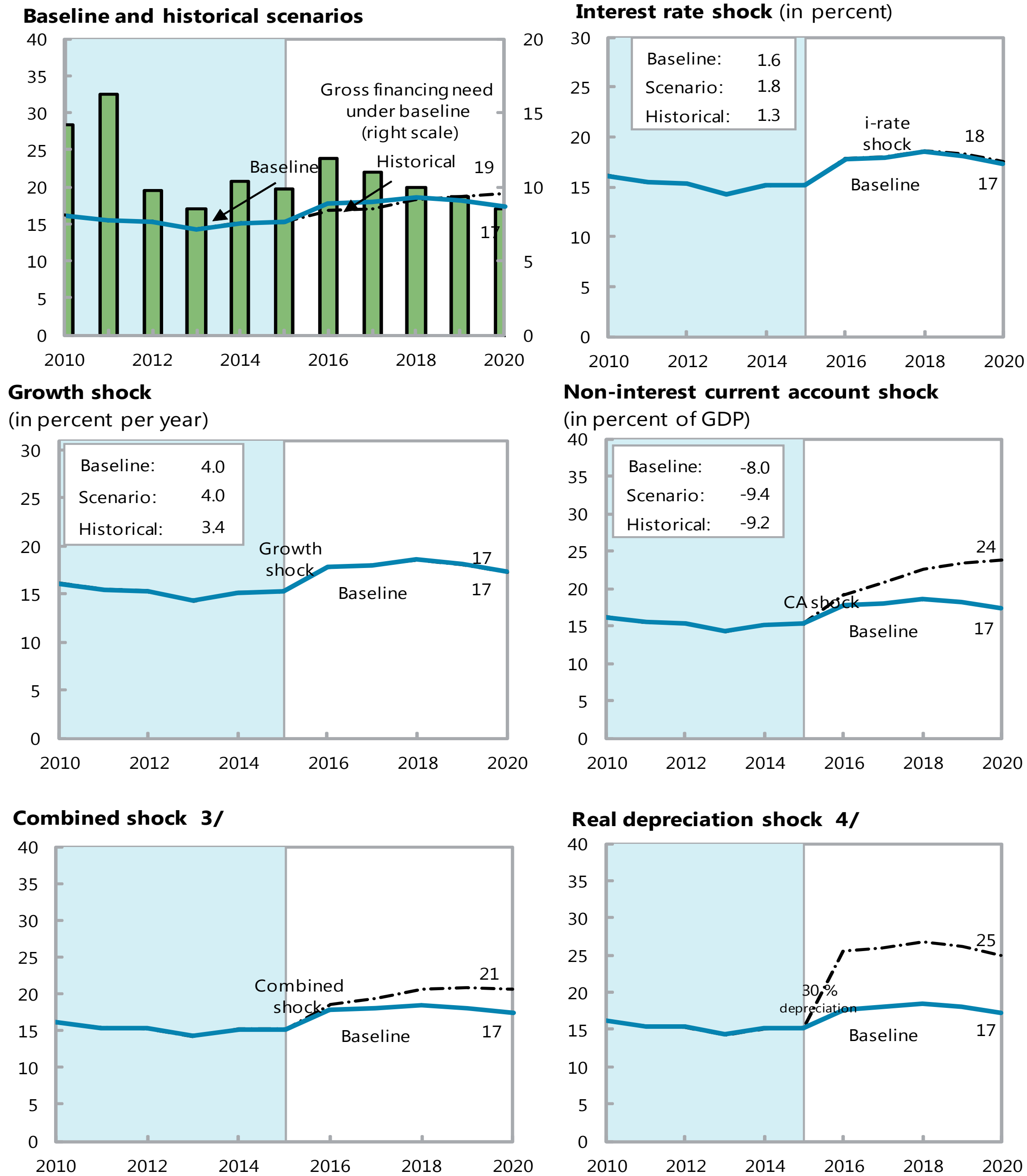
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Kosovo: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2010.

Appendix I. Letter of Intent

July 6, 2015

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

Dear Ms. Lagarde:

1. In collaboration with the Fund, Kosovo has preserved macroeconomic stability, characterized by low public deficits and debt and a sound financial system. Over the last five years, the economy has performed well with an average GDP growth of around 3.5 percent, the highest in the Western Balkans. Nevertheless, this growth performance has been insufficient to substantially lift incomes and accelerate convergence towards the EU average. Unemployment has remained at a high level particularly among the younger generations while female labor participation is very low. Relatively high labor costs, a significant infrastructure gap and a weak business environment—notwithstanding recent improvements—are the main factors holding back our medium-term prospects.

2. The Government of Kosovo has recently formulated a comprehensive reform agenda in the National Economic Reform Program 2015–2018 (NERP) and the Medium-Term Expenditure Framework (2016–18), aimed at increasing Kosovo's economic growth potential and creating new jobs. Sustainable growth will be achieved by ensuring a sound and credible fiscal policy, preserving financial stability, and accelerating the implementation of our ambitious structural reform agenda.

3. On the fiscal front, we remain committed to bringing the deficit down so as to preserve the credibility of the fiscal rule and ensure debt sustainability. However, adjustment will be focused on mobilizing revenue and reducing the relative weight of current spending to create space for development and education projects, together with well-targeted social assistance.

4. Part of our strategy is to accelerate the implementation of key infrastructure projects, including those that could be financed by multilateral and bilateral development agencies (donors). To this end, we are actively seeking resources from donors to expand and accelerate the implementation of key growth-enhancing investment projects. We believe that a Fund-supported program would further reassure our creditors about the credibility of our policies and thus facilitate the mobilization of donors' funding and FDI more generally.

5. The financial sector has remained well capitalized, liquid and profitable. In the coming months, we will adopt a new legal framework for Emergency Liquidity Assistance (ELA) in line with best practices. We are making substantial progress on rolling out risk-based supervision to all banks operating in Kosovo, while developing our nascent macroprudential and crisis prevention frameworks. An important challenge remains to unlock bank liquidity to support increased lending

and, hence, support higher levels of economic growth. To this end, we will continue to work with Fund staff to identify any outstanding institutional bottlenecks to credit provision in the regulatory, legal, or judicial areas and to outline policy measures to address them in a timely and effective manner.

6. We are committed to fully implement our structural reform agenda, which we are confident will deliver higher growth and job creation. Our top priorities are to align wages closer to productivity, raise workforce skills through targeted training and better education, and enhance the business environment.

7. The enclosed Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU) provide comprehensive details of our reform agenda and program. In support of it, the Government of Kosovo hereby requests a 22-month Stand-by Arrangement (SBA) of SDR 147.5 million (250 percent of quota).

8. The Kosovo authorities will consult with the IMF, at our own initiative or whenever the Managing Director of the IMF requests such a consultation, on the adoption of these measures and in advance of any revisions to the policies contained in our MEFP, in accordance with the IMF's policies on such consultations. We will provide IMF staff with data and information necessary for the purpose of monitoring the program.

9. The Government of Kosovo authorizes the IMF to publish this letter, the attached MEFP and TMU, and the related staff report, including placement of these documents on the IMF website.

Sincerely yours,

/s/
Mr. Isa Mustafa
Prime Minister

/s/
Mr. Avdullah Hoti
Minister of Finance
Ministry of Finance

/s/
Mr. Bedri Hamza
Governor
Central Bank of the Republic of Kosovo

Attachment I. Memorandum of Economic and Financial Policies of the Government for 2015–2017

Economic and Financial Policies

I. Recent Developments

1. **This memorandum reports on recent economic developments and outlines the economic and financial policy agenda of the Government of Kosovo, which could be supported by the IMF with a 22-month Stand-by Arrangement (SBA)**. The policy agenda is based upon the Government's recent Program 2015–2018 and the Medium-Term Expenditure Framework (2016–18).

2. **Kosovo's economy has continued to perform well despite the slow recovery of the European economy**. In the last few years, the economy has expanded at a steady rate of around 3.5 percent, which is higher than our neighbors. Going forward, the economy is projected to grow at a 3.8 percent rate this year, and slightly above in the following years. Continued growth in Germany and Switzerland will keep remittances steady, and thus stimulate consumption. Moreover, the recent signing of a significant investment project in the tourism sector will boost investment, employment and, in a few years, boost our export receipts. On the inflation front, low import prices (a key component of our CPI basket) will be reflected in very low domestic inflation.

3. **The risks to our baseline remain balanced**. While we are confident that the outlined medium-term macroeconomic outlook underpinning our program is based on reasonable assumptions, there are risks that we see as balanced. Stronger impact on private consumption from last year's public wage increase is an upside risk. At the same time, a lower-than-expected growth in Diaspora countries, notably Germany and Switzerland, could affect, via remittances, the Kosovo economy. Nevertheless, past remittances have proven resilient to economic and financial turmoil in Europe.

4. **We recognize that the current growth model, which largely hinges on remittance-fueled consumption, is insufficient to lift income per capita and to make a dent in the large unemployment rate**. In recent years, remittances have been a key source of growth by supporting private consumption and housing investment, in turn fueling high imports in the face of limited domestic production. Remittances might have contributed to raising the reservation wage above levels that productivity can sustain, thus creating labor supply disincentives. Despite recent economic growth performance, unemployment has remained high, labor participation has not improved and the income gap with Europe and neighboring countries has shown limited improvement. Higher growth can be generated by improving competitiveness which requires deflating domestic costs, scaling up infrastructure spending, improving the skills of our labor force, and enhance the business environment to boost private sector development.

II. Fiscal Policy

5. **A key principal objective of the program is to maintain a sustainable fiscal position and bring government bank balances back to a prudent level**. To preserve the credibility of the fiscal rule, we are committed to parliamentary approval of a supplementary budget targeting a deficit, excluding PAK spending, of no more than €137 million for this year (prior action).

6. **In 2015, a number of measures have already been adopted to contain deficits and improve the quality of the budget**. The 2014 decision to increase public wages and other pension benefits led to a significant erosion of fiscal space for productive spending within the fiscal rule's ceiling. Having fully acknowledged the impact of these measures on the quality of the budget, we decided in the 2015 budget to keep public sector wages at 2014 levels, and more recently introduced an increase in tobacco and alcohol excises. We are also working to increase tax compliance. However, because these measures are not enough to contain the deficit, we are committed to adopting the following additional measures, as part of the 2015 supplementary budget:

a. A further increase in excises yielding 0.3 percent of GDP in annualized gains.

b. A new VAT law to enter into force in July 2015 that will increase the standard rate from 16 to 18 percent while introducing a reduced 8 percent rate for a limited category of goods together with a number of exemptions. This new law will yield 0.4 percent of GDP in annualized gains.

c. A half percentage point of GDP reduction in the wage bill relative to the original 2015 budget, in part by not filling a number of vacancies. Lengthy technical and legal preparations are delaying the implementation of the health insurance law agreed in 2014 and will therefore yield additional savings.

d. Savings in transfers will yield 0.2 percent of GDP.

e. A 0.2 percentage point of GDP reduction in the goods and services allocation relative to the original budget.

f. The 2015 supplementary budget also commits us to sell mobile telecom licenses by end-2015.

g. Further gains in tax compliance will also help us to mobilize revenues.

7. **We are also committed to using any revenue over-performance or under-execution in capital spending because of normal implementation delays towards a lower deficit or higher allocation for Route 6 payments to minimize any backloading of its payment schedule**. Any revenue windfall or capital spending saving will not be used to finance higher wages and salaries, or subsidies and transfers. Revenue over-performance could be used to finance an additional goods and services allocation up to a maximum of €4 million.

8. **Because the supplementary budget foresees €15 million owed to the government under the Memorandum of Understanding between the Privatization Agency of Kosovo (PAK) and Tax Administration of Kosovo (TAK), and because these funds are available but cannot be transferred without an acting Board in PAK, the Government will act as expeditiously as possible and no later than end-September 2015 to submit to parliament the list of recommended candidates to fill the PAK Board** (structural benchmark for the first review).

9. **We have also started discussions on the prospective 2016 budget, which will continue to reflect our ongoing commitment to responsible public financial management and sound fiscal policies**. The 2016 budget will aim for a further reduction in the deficit by reducing the weight of current spending relative to 2015 levels, while preserving capital spending at the nominal level in the 2015 supplementary budget. As part of this effort, public sector wages will remain at 2015 levels in nominal terms. Any necessary revenue measures will be taken to meet an overall deficit target of €98 million, excluding new donor-financed capital projects under the revised investment clause. We are confident that, with this plan, our bank balances will end the year at the prudent level of 4.5 percent of GDP.

10. **Looking ahead, we need to substantially scale up public investment to address our structural bottlenecks**. The government is strongly committed to prudent budgetary policy and macroeconomic stability. At the same time, we are convinced that this objective would become meaningless in the absence of substantial gains in economic development and job creation. Therefore, a key objective is to increase spending for large growth-enhancing projects, including those financed by donors. However, the fiscal rule framework does not give us the space we need for this investment. In fact, even under the previously discussed fiscal adjustment, the rule would not allow any room for new capital projects in the next few years. This would severely constrain our development strategy and economic objectives, in a country that is currently servicing little more than 10 percent of GDP in public debt.

11. **With the support of Fund staff, the investment clause in the fiscal rule will be modified to support capital spending with high economic returns**. The current investment clause allows the government to use privatization proceeds to finance capital projects above the 2 percent deficit ceiling, with the excess not counting as excessive deficit, provided that the underlying deficit is at most 2 percent of GDP and cash balances are at least at 4.5 percent of GDP. This clause, while good in principle, is currently of limited use given the low amount of available privatization receipts and limited assets for future privatization. Therefore, we will expand the investment clause to enable capital spending financed through donors' funding, in addition to resources from privatization (PAK) receipts, still provided the abovementioned safeguards are met. In addition, we will add a public debt limit of 30 percent of GDP and a sunset clause (10 years) for the use of this flexibility to ensure that donor-financed projects do not compromise in any way our strong and sustainable debt position. To enhance oversight of the process, we will submit to parliament for information semi-annual reports on these projects (economic rationale, projected cost, financing terms), starting in early 2016 (structural benchmark for the second review).

III. Financial Sector

12. **Progress has been made in strengthening the banking system**. The system is, overall, well capitalized, highly liquid, and profitable. All banks comfortably meet minimum capital requirement ratios. Liquidity positions are such that banks would have enough resources to withstand significant deposit shocks, a key consideration in a euroized economy; in addition, parent banks have provided letters of comfort regarding their subsidiaries and branches in Kosovo in a liquidity event. In addition, the central bank (CBK) has made substantial progress in strengthening the bank supervisory and regulatory framework. We have implemented most of the 2012 FSAP recommendations. The draft regulation for the use of Emergency Liquidity Assistance (ELA) is in line with international best practices and reflects in full all recommendations provided by Fund staff; its approval by the CBK Board is expected by end-September 2015 at the latest (structural benchmark for the first review). Following the adoption of the risk-based supervision framework (guided by Fund technical assistance), including the new manual and reporting system, the CBK will complete the full rollout of risk-based supervision to all banks operating in Kosovo. More precisely, following the risk-based manual prepared in junction with IMF technical assistance, we are committed to completing on-site examination of one bank by end-September 2015 (structural benchmark for the first review) and of the three remaining banks by end-February 2016, at the latest (structural benchmark for the second review), including completion of a report of examination for each bank.

13. **We are also taking steps to address systemic risk**. The CBK Executive Board has established a Macroprudential Advisory Committee (MAPC) and approved the Terms of Reference of its tasks and responsibilities. We have recently completed our Macroprudential Policy, strategy which will develop the CBK's macroprudential toolkit and advise the CBK Board on systemic risk in the financial sector. As part of this effort, the CBK's Board is expected to establish the MPAC by August 2015, with indicators to be selected and reporting to begin by the end of 2015. The MPAC will, as necessary, also inform the National Committee for Financial Stability and Crisis Management (NCFSCM), comprising the CBK, Ministry of Finance and Parliamentary Budget Committee, of systemic risk in the financial sector. We intend to take steps to more fully institutionalize the NCFSCM in order to further build up Kosovo's financial safety net, in particular its contingency planning and crisis management capacity.

14. **A key challenge is to make the financial system more supportive of inclusive and broad-based growth**. Despite ample liquidity in the banking system, credit penetration remains low, with credit to GDP at 35 percent. Limited credit growth is partly due to supply-side factors. Impediments to stronger credit provision include high levels of informality, uncertain and slow court processes, and difficult debt collection procedures. These have influenced high collateral requirements and interest rate spreads at many banks. Addressing these structural impediments, which requires substantial changes across the legal system, is a central pillar of our overall growth strategy aimed at mobilizing bank liquidity for productive investment. Several initiatives are already underway, including draft legislation currently in parliament to establish a commercial section of the court system that would focus on commercial cases with appropriate staffing and expertise; work undertaken with USAID to reduce the current court backlog; a legislative amendment to improve the

recently introduced system of private bailiffs, which will help to improve debt collection processes; and the drafting of legislation for a bankruptcy law that will improve liquidation and administration processes. To support our goals in this area, we remain committed to working with Fund staff towards a comprehensive diagnostic of impediments—legal or structural—that is holding back credit growth. We would welcome an assessment of efforts currently underway as well as proposals for potential additional measures that could supplement those discussed above.

15. **We will continue our efforts to enhance collaboration with foreign supervisors**. Following the signing of Memoranda of Understanding (MoU) with all foreign banking supervisors of subsidiaries operating in Kosovo except Austria's Financial Market Authority, our intension is to intensify negotiations with the latter. A delegation from the FMA is expected in Kosovo over the summer.

IV. Structural Reforms

16. **Faster implementation of structural reforms is essential to raise potential growth, reduce the trade deficit, and boost job creation**. The National Economic Reform Program (NERP), the 2015–2018 Government Program and the Medium-Term Expenditure Framework provide the blueprint for our reform agenda and the top priorities are ensure close alignment of wages to productivity, accelerate infrastructure implementation, reform education and the labor market, and foster a business-friendly environment. Remittances have helped support household income and smooth consumption, but as mentioned above they may have also pushed reservation wages well above productivity levels. Recent large increases in public sector wages have further deteriorated cost competitiveness given significant pass-through to private sector wages. Currently, the average public sector wage is above that of the private sector, making it very difficult for the latter to attract and retain talent.

17. **In a context of euroized economy, close monitoring of wage developments is a key tool to regain competitiveness**. To prevent large and discretionary jumps in public sector wages as have happened in recent years, we are committed to developing a rules-based mechanism in cooperation with Fund staff that will cap the growth of the public sector wage bill in accordance to a well-identified proxy for productivity. Our plan is to adopt this new mechanism by the end of 2015 (structural benchmark for the second review).

18. **A skilled labor force is essential to support job creation and foster foreign investments**. Despite significant flexibility, the labor market suffers from a lack of skilled supply of workers. Therefore, our objective is to better align labor force skills to market needs. With the support of the European Union and the World Bank, we are upgrading all curricula for pre-university education. We are also determined to modernizing the vocational school system in cooperation with our European partners, in particular for the IT and agricultural sectors. We are also adopting active labor market measures aimed at increasing labor participation particularly among women and the poor, including targeted wage subsidies and training.

19. **We will persevere in our efforts to make the business environment more attractive and tackle the informal sector**. While the World Bank's Doing Business Indicators have recently improved and reached the Western Balkans' average, we are fully aware that the *de-facto* implementation of legal reforms is still lagging. In particular, perceptions of weak governance continue to be a deterrent to domestic and foreign direct investment.

20. **In this context, we are committed to mainstreaming the use of centralized procurement and e-procurement so as to create a more level and transparent playing field for businesses dealing with the government**. A few months ago, the government approved for the first time a list of six categories of common goods and services that will be subject to centralized procurement for all central administrations. To operationalize this, we are committed to issuing, by end-September 2015, the tenders for contracts of centralized procurement for fuel, office supplies and plane tickets, covering the three-year needs of 43 central government administrations and agencies (<u>structural benchmark for the first review</u>). Implementation of the process will be led by the Central Procurement Agency. We also commit to awarding these bids in 2016 (<u>structural benchmark for the third review</u>). In addition, we will expand the list of goods and services eligible for centralized procurement in the next round of tenders, guided by the importance of the various goods and services in our procurement spending (<u>structural benchmark for the third review</u>). We will also gradually bring in publicly-owned enterprises and municipalities under centralized procurement. The government is also committed to adopt, by end-2015, draft legislation that would make the use of e-procurement mandatory for all central administrations (<u>structural benchmark for the second review</u>). We strongly believe the combined use of centralized and e-procurement will increase efficiency and transparency, ensure a level playing field for all agents dealing with the public sector, and substantially reduce costs.

21. **Ensuring energy security is a key goal of our government**. The two available power plants are old, inefficient, and one of them will soon need to be decommissioned. This creates doubts about our country's energy supply, in turn deterring private sector development. The completion of the regional transmission line with Albania will definitely help increase energy trade in the region and mitigate any temporary shortage in energy supply. In addition, with the collaboration of the World Bank, we have been actively seeking international partners to build a more efficient and cleaner power plant with larger capacity, and are now moving closer to naming a preferred bidder.

22. **Upgrades to our physical infrastructure are moving forward, creating conditions for economic development**. Construction of Route 6, linking Pristina to Skopje, will continue as planned, and once completed the road will substantially reduce travel time and costs in a key trade route for our country. With the support of the EBRD and EIB, we will move ahead with the rehabilitation of the railway Line 10, which will facilitate interconnectivity with neighboring countries. Following recently signed loans with various development agencies, we plan to accelerate the expansion and upgrade of the road connecting Pristina to Mitrovica. As part of the expanded investment clause, we plan to move forward with infrastructure investments in key identified growth sectors, not least agriculture. We commit to adopting a detailed concept note of all these donor-

financed projects (structural benchmark for the second review) and to submitting a semi-annual report to parliament for information starting in January 2016 assessing these projects (structural benchmark for the second review).

23. **The development of the Brezovica resort is expected to have a significant impact on investment, job creation and revenues**. The total investment, led by a very reputable foreign consortium, is about 8 percent of GDP over three phases, with an estimated investment of around 3 percent of GDP for the first phase (2016–18). The plan calls for a world class, year-round tourism resort in the mountains of Brezovica. Given short travel time from Pristina International Airport, we expect the project to attract a significant volume of international tourists. Similarly, the rapid and smooth implementation of this large investment will send positive signals to other potential investors that Kosovo is a good place to do business.

24. **Regional trade agreement negotiations are advancing**. The Stabilization and Association Agreement (SAA) with the European Union (EU) has been endorsed by the EU Commission and is now awaiting the final adoption by the EU Council and parliament. Over the medium term, both the SAA and the trade agreement with Turkey will enhance economic efficiency by facilitating free trade.

25. **Program implementation will be monitored through prior actions, reviews, quantitative and continuous performance criteria, indicative targets, and structural benchmarks**. These are detailed in Tables 1 and 2, with definitions provided in the attached Technical Memorandum of Understanding (TMU). Quantitative performance criteria have been set for end-August and end-December 2015 and indicatives targets have been set through end-December 2016.The first review is scheduled to take place in November 2015 with the following reviews scheduled to be completed on a semi-annual basis.

Table 1. Kosovo: Quantitative Performance Criteria and Indicative Targets, 2015–16

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

	2015		2016	
	End-Aug.	End-Dec.	End-June	End-Dec.
	Prog.	Prog.	Ind. Targets	Ind. Targets
Performance Criteria 1/				
Floor on the headline fiscal balance (ex PAK) of the general government 1/	-105	-137	-122	-188
Floor on the underlying fiscal balance (ex PAK and ex new donor-financed projects) of the general government 1/	-105	-137	-64	-98
Floor on the bank balance of the general government 1/	125	171	220	269
Ceiling on the accumulation of external payments arrears of the general government 2/	0	0	0	0
Indicative Targets				
Ceiling on current expenditures of the general government 1/	873	1,187 4/	796	1,226
Memorandum items:				
Program assumptions 3/				
Sectoral budget support	0	0	0	0
Disbursements for new donor-financed projects contracted after the SBA approval.	0	0	45	90
Change in OSR Balances	0	0	0	0

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

1/ Adjusted according to the Technical Memorandum of Understanding (TMU).

2/ Continuous ceiling throughout the SBA period.

3/ For adjusters as indicated in the TMU.

4/ Only for end-December 2015 target, current spending could be raised by up to €4 million provided that revenues overperform the forecast (€1503 million) by an equal amount.

Table 2. Kosovo: Structural Benchmarks for SBA 2015–17

Measure	Review	Justification
Prior actions		
Adoption by parliament of a supplementary budget for 2015 in line with program objectives as defined in paragraphs 5 and 6 of the MEFP.		
Entrenching wage restraint		
Government approval of a rules-based mechanism governing increases in the public sector wage bill.	March 15, 2016	Prevent large, discretionary jumps in wages that undermine budget composition and compromise fiscal credibility.
Improving governance		
Government submission to parliament of a list of recommended candidates to fill the Privatization Agency of Kosovo Board.	October 31, 2015	Improve governance and unlock available resources to be transferred to the Ministry of Finance.
Issuing the bids for contracts for centralized procurement covering 43 central government administrations and agencies for fuel, office supplies and plane tickets.	October 31, 2015	Improve oversight and control of public procurement, with potential budgetary savings and a more transparent and level playing field for bidding firms.
Awarding the contracts for centralized procurement, covering 43 central government administrations and agencies for fuel, office supplies and plane tickets.	October 31, 2016	Improve oversight and control of public procurement, with potential budgetary savings and a more transparent and level playing field for bidding firms.
Government adoption of the draft Law making e-procurement mandatory for all central government agencies.	March 15, 2016	Improve oversight and control of public procurement, with potential budgetary savings and a more transparent and level playing field for bidding firms.
Government adoption of an expanded list of goods and services eligible for centralized procurement in the next round of tenders.	October 31, 2016	Improve oversight and control of public procurement, with potential budgetary savings and a more transparent and level playing field for bidding firms.

Building needed infrastructure		
Government adoption of a detailed concept note of new capital projects to be financed by donors.	March 15, 2016	Facilitate implementation and monitor progress in capital spending associated with the government's development strategy.
Semi-annual submission to parliament of reports for information assessing donor-financed projects under the investment clause.	March 15, 2016	Enhancing transparency and oversight of capital projects.
Developing the financial sector		
Approval of the ELA regulation by the CBK Board.	October 31, 2015	Strengthening the crisis-prevention framework.
Completion of an on-site examination of one bank following the risk-based manual prepared in junction with IMF technical assistance, including completion of a report of examination.	October 31, 2015	Enhancing banking sector supervision.
Completion of an on-site examination of the remaining three banks following the risk-based manual prepared in junction with IMF technical assistance, including completion of a report of examination.	March 15, 2016	Enhancing banking sector supervision.

Attachment II. Technical Memorandum of Understanding

I. Introduction

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 July 2015.

II. Definitions and Performance Criteria and Indicative Targets

A. Coverage

2. For the purpose of this memorandum, **general government** is composed of the Executive, Legislative, and Judiciary branches of the Government, its Municipalities, and any other public authorities that receive direct budgetary appropriations. It excludes 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 Memorandum of Economic and Financial Policies (MEFP).

4. **The Bank balances of the General Government** 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 Grants and funds relative to on lending 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 at end-December 2014 were €101 million.

B. Expenditures of the General Government

5. **Current expenditures are measured on a cash basis cumulatively from the beginning of the calendar year**. Current expenditures include wages and salaries, goods and services, subsidies and transfers including capital transfers to publicly-owned enterprises, and reserves. Current expenditures of the Privatization Agency of Kosovo (PAK) are included. They do not include

expenditures financed by donor-designated grants. Current expenditures 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.

6. **Total expenditures**, calculated on a cash basis, include current expenditures, capital expenditures, and net lending. Net lending comprises loans granted by the general government except that it excludes on-lending, such as funds borrowed from official creditors, passed on to publicly-owned enterprises, which is included as a 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.

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. **Expenditures financed from OSR** carried forward are defined as budget appropriations of municipalities and central budget organizations financed by own-source revenues of previous years, which had not been used in the prevailing year, but spent in the following years.

9. **The balances of OSR** are defined as the accumulated stock of unused and unexpired budget appropriations financed by OSR from previous years.

C. Fiscal Balance of the General Government

10. **Headline fiscal balance (ex PAK) of the general government is defined as revenues and** grants minus total 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 (PAK). The headline fiscal balance includes capital spending related to the implementation of new donor-financed projects contracted after the approval of this SBA.

11. **Underlying fiscal balance (ex PAK and ex new donor-financed projects)** of the general government is defined as the headline fiscal balance (ex PAK) excluding capital spending related to the implementation of donor-financed projects contracted after the approval of this SBA.

12. **New donor-financed projects are all projects** contracted with multilateral and bilateral development agencies (donors) by the General Government after the approval of this SBA.

D. External Payments Arrears

13. **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.

III. Adjusters

14. **The quantitative target on the current spending of the general government specified under the program is subject to the following adjusters**:

- The ceiling on current expenditures set in Table 1 will be raised by the excess of disbursed amounts in sectoral budget support grants to be used for current spending relative to program assumptions.

15. **The quantitative target on the headline and underlying fiscal balance of the general government specified under the program is subject to the following adjusters**:

- The floor on the **headline fiscal balance** set in Table 1 will be adjusted downward (lowered) by the excess in disbursed amounts of new donor-financed projects relative to program assumptions up to an additional €15 million.
- The floor on the **headline fiscal balance** set in Table 1 will be adjusted upward (increased) by the full shortfall in disbursed amounts of new donor-financed projects relative to program assumptions.
- The floor on the **headline and underlying fiscal balance** set in Table 1 will be adjusted upward (increased) by the excess in the change of OSR balances relative to program assumptions. These assumptions are always set to zero.
- The floor on the **headline and underlying fiscal balance** set in Table 1 will be adjusted downward (lowered) by the shortfall in the change of OSR balances relative to program assumptions. These assumptions are always set to zero.
- Only for **the end-December 2015 target**, current spending could be raised by up to €4 million provided that revenues over-perform the forecast (€1503 million) by an equal amount.

IV. Data Requirements

16. The Bank balances data (table) 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 every month, with a delay of

one 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.

17. Data on the monthly budget 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 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, including new signed external guarantees and loans; (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.

18. 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.

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, compiled by the Statistical Agency of Kosovo (SAK), will be transmitted on a quarterly basis within 45 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 and asset quality of individual banks will be transmitted by the CBK to the IMF on a monthly basis within four 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.

Statement by Ibrahim Halil Canakci, Executive Director for Kosovo and Mentor Mehmedi, Advisor to the Executive Director July 29, 2015

On behalf of our Kosovar authorities, we would like to thank management and staff for the constructive discussions and their support for a new 22-month Stand-by Arrangement (SBA) in the amount of SDR 147.5 million (250 percent of quota). While Kosovo is in a solid fiscal and financial position, the new arrangement with the Fund will build upon the progress accomplished over the recent years while further strengthening the macro-economic framework and accelerating the implementation of structural reforms.

In this vein, the SBA will support the authorities' continued commitment and efforts to maintain fiscal stability through a front-loaded fiscal adjustment, in order to preserve the credibility of the fiscal rule and maintain low levels of public debt, improve the quality of the budget by increasing the share of more productive spending, rebuild government bank balances to prudential levels, and further enhance the financial safety net and banking system supervision. The program also envisages a realistic set of structural policy reforms that are aimed at expanding Kosovo's productive and export capacity through tackling the country's wage and nonwage competitiveness gap and improving the business environment and governance.

In order to address Kosovo's significant development needs, the program design also allows for a prudent increase in fiscal space for much needed development projects, through the modification of the existing investment clause within the broad-based fiscal rule, while preserving debt sustainability.

With a grand coalition in place which enjoys a comfortable majority in the parliament, and with no general elections scheduled until 2018, there is political commitment to move ahead with a comprehensive reform agenda which will lift Kosovo's growth potential and ensure inclusive and sustainable development. Indeed, at the beginning of 2015, the government approved its four-year program which includes a comprehensive set of reforms, including the fiscal, financial and structural reforms that are part of the proposed SBA, illustrating the authorities' commitment to elevate their reform agenda and program ownership, which is key to its successful implementation. The authorities remain committed to address any potential risks to the program.

A revised mid-year budget, a prior action for the program, has been approved by the parliament on July 16, including all the fiscal measures outlined in the Memorandum of Economic and Financial Policies.

Macroeconomic Developments and Outlook

Kosovo has enjoyed a much more resilient economic growth than other Western Balkan countries, being the highest growth performer in the region with a five-year average growth rate of 3.5 percent. Nonetheless, income per capita remains low while the unemployment rate, especially among the youth, remains relatively high.

In 2014, economic activity slowed down due to political uncertainty and is estimated to have grown by 2.7 percent, mainly driven by remittances, particularly from Germany and Switzerland where most of the Diaspora resides, and consumption. The authorities are more upbeat than staff regarding the outlook. They expect growth to accelerate to 3.8 percent this year, supported by continued remittances, an increase in consumption due to the strong impact of last year's public wage increase, and an increase in public investment as a result of the construction of the highway which links Pristina to Skopje. Implementation of the ambitious reforms is expected to yield results in 2016 with a projected growth rate reaching 4.1 percent. The authorities' macroeconomic baseline scenario shows some upside risks, including the start of the Brezovica Resort project, a year-round ski resort (approximately 8 percent of GDP), which is expected to generate considerable numbers of jobs and create new opportunities for SMEs.

Low energy and import prices (a key component of the CPI basket) have kept inflation low. A modest inflation of 0.2 percent is expected for this year, which will gradually climb to 1.3 percent in 2016. The current account deficit (CAD), including official transfers, is expected to narrow marginally to around 7.5 percent of GDP in 2015 but will then widen in 2016, as the Brezovica resort project and new donor-financed investments will trigger an increase in imports. However, the financing sources for the CAD are stable and non-debt creating, with the main contributions coming from remittances, official transfers, and FDI. With a considerable trade deficit, approximately 32 percent of GDP, the authorities' efforts are aimed at increasing domestic production and expanding the export base, which would ultimately reduce the trade imbalance and substitute some of the imports.

The Stabilization and Association Agreement (SAA) with the European Union (EU) has been approved by the EU Commission and is expected to come into effect in 2016. The SAA will serve as a blueprint for economic and administrative reforms while opening up EU markets to Kosovo's companies and products, and facilitating free trade.

Fiscal Policy

The authorities attach utmost priority to maintaining macro-fiscal stability and preserving the credibility of the fiscal rule which sets an overall ceiling on the general government deficit at 2 percent of GDP. In this context, fiscal adjustment will be at the core of the program in order to strengthen public finances, rein in current spending, and improve the composition of the budget.

The proposed SBA envisages a front-loaded fiscal adjustment in the order of 1.5 percent of GDP for this year, to bring down the fiscal deficit close to 2 percent of GDP, as envisaged with the fiscal rule. In the absence of corrective measures, the deficit this year would reach 3.9 percent of GDP due to last year's increases in public sector wages and too optimistic revenue projections. A further fiscal adjustment of 0.8 percent will be targeted in 2016 in order to attain an overall fiscal deficit of 1.6 percent of GDP.

Aside from the corrective measures taken in March, such as the increase in the excise taxes on tobacco, alcohol, vehicles, and heavy oil, further fiscal revenue measures have been legislated in the context of the mid-year budget review. The standard VAT rate has been increased from 16 to 18 percent while a differentiated rate (at 8 percent) for a limited category of goods and services has also been introduced and the net effect will yield 0.4 percent of GDP in annualized gains. Excise taxes on tobacco and gambling have been further increased and all these measures will yield more than 0.3 percent of GDP annually. On the expenditure side, current spending has been reined in by savings in transfers (0.2 percent of GDP) and goods and services (0.2 percent of GDP). The authorities have frozen the wage bill and have taken the decision not to fill vacancies this year, measures which will yield another 0.5 percent of GDP in fiscal savings. Public sector wages will be maintained constant in nominal terms also in 2016, thereof decrease public sector wages as a ratio to GDP from 9.6 percent to 8.8 percent.

A large part of the purchases under the SBA will be used to rebuild the low government bank balances at the central bank. In line with the methodology for assessing the adequacy of the cash balances, the program aims at restoring the bank balance to 4.5 percent of GDP by the end of 2016 (from the current level of 1.8 percent of GDP).

In order to tackle unproductive current spending, improve the budget structure, and create more space for growth-enhancing capital expenditures, the authorities will approve by the end of this year a public wage rule that will link growth in the public wage bill to a macroeconomic indicator. The wage rule will keep public sector wages in line with productivity dynamics and enhance the competitiveness of Kosovo's economy. Importantly, the rule is intended to prevent large discretionary increases in the public wage bill, as seen prior to the elections in 2014 and 2011. Due to the wage freeze in 2016, the rule is intended to be implemented with the 2017 budget.

With the aim of addressing Kosovo's large infrastructure needs and providing financing for growth-enhancing capital projects, the investment clause of the fiscal rule will also be modified to allow new donor-financed capital projects, in addition to privatization-financed investments, not to count as an excessive deficit against the fiscal rule. The amendment to the rule includes safeguards regarding the approval of the projects, vetting procedures, and debt sustainability. Given Kosovo's large infrastructure gap and social needs, and a very low level of public debt (10.4 percent of GDP), the IFI-financed projects, aimed at sectors such as agriculture, road and railway infrastructure, health ,and IT will provide the desirable impetus for growth and job creation.

Several measures are being enacted with the objective of strengthening the tax administration and customs, including the medium-term goal of unifying these two revenue administrations, broadening the tax base, increasing compliance and preventing and reducing the informal economy. The operational departments of both Tax and Customs have been merged and the IT systems have been revamped, as to produce efficiency gains and narrow the tax gap. The authorities have requested Fund technical assistance on the full merger of the revenue-collecting agencies.

Financial Sector

Banks in Kosovo are well capitalized, liquid, and profitable and they follow a traditional banking model (loan-to-deposit ratio of 76.1 percent). The system's capital adequacy ratio stands at 19.2 percent (end of May), among the highest in the region, with all banks, both domestic and foreign, above the regulatory minimum. The aggregate liquid assets cover 43 percent of short-term liabilities, a key consideration in a euroized economy, and profitability remains high (return on equity at 27.2 percent). Non-performing loans (NPLs) have been declining and are now at 7.4 percent and are fully provisioned. While the interest rate on loans has dropped by around 50 percent in the last three years to 7.9 percent, interest rate spreads are still elevated.

While good progress has been made in improving the financial sector's regulatory and supervisory framework, in large part due to the Fund's technical assistance, further efforts are needed in strengthening the financial safety net, crisis preparedness and crisis management. As part of the program, the Central Bank of Kosovo (CBK) will approve a new legal framework for Emergency Liquidity Assistance (ELA), in line with best practices, which will govern the conditions, processes, and modalities of any emergency assistance provided to banks. Additionally, letters of comfort from parent banks of local subsidiaries have been received which stipulate that parent banks would work with their subsidiaries in the event of a liquidity crisis. Collaboration with foreign bank supervisors, including the Turkish, German, and Austrian supervisory authorities (the origin of most foreign banks) is also being enhanced as to identify risks and vulnerabilities.

Banking supervision and oversight will also be enhanced. The CBK will fully adopt risk-based supervision by mid-March next year, a key recommendation of the 2012 FSAP, which will strengthen financial stability and help the CBK to conduct better surveillance of banks and cover risks on a more consolidated basis.

Despite banks' ample liquidity, credit penetration in Kosovo remains low at 35 percent of GDP, mainly due to structural problems, including lengthy and costly court proceedings, difficult debt collection procedures, and high interest rate spreads and collateral requirements. In order to better utilize the high levels of liquidity in the banking sector, several policy actions are being envisioned in order to tackle the binding constraints to credit access and growth. A private bailiff system, recently introduced, will be further enhanced as to speed-up the enforcement of collateral recovery while the NPL recovery and write-off procedures will be revised. In order to address the current backlog of bank cases which stretch up to five years, measures are being considered to improve the courts' proceedings of commercial cases. In addition, the authorities, with the support of donors, are in the process of establishing a credit guarantee scheme for increasing access to credit for SMEs.

The Kosovar authorities remain committed and are working with staff to further develop the macroprudential toolkit and strengthening the crisis management framework. The recently created Macroprudential Advisory Committee will adopt its policy framework, with specific indicators, by the end of this year while plans to functionalize the National Committee for Financial Stability and Crisis Management are underway.

Structural Reforms

The authorities acknowledge that for Kosovo to move to a growth model which is driven by investment and the tradable sector, decisive reforms are needed to increase the productive and export capacity of the economy, strengthening the private sector, and improving competitiveness. The government approved its four-year program at the beginning of the year while the Economic Reform Program 2015 (ERP), along with its action plan, was submitted to the European Commission in January and provides a platform for the implementation of structural reforms aimed at boosting growth and jobs. The authorities intend to focus their interventions on improving governance and the business environment, reducing skills mismatch, and ensuring an adequate supply of energy.

Measures are being implemented to improve the oversight and control of the public procurement process which will reduce the perception of corruption and provide a level and transparent playing field. In this regard, the procurement law will be amended to ensure its full compliance with international standards and make e-procurement mandatory for all central government agencies, beginning next year. The procurement process at the central level is also being centralized, with the tendering process for three main goods (fuel, office supply, and plane tickets) already initiated.

Despite major improvements in enhancing the business and investment environment in recent years, further reforms are being envisaged to tackle some of the remaining binding constraints to private sector growth such as resolving insolvency, enforcing contracts, and electricity supply. The National Council on Economic Development, a public-private dialogue mechanism which consists of representatives from the government institutions and the business community, has been reactivated and is meeting on a regular basis and coordinating these reform efforts.

In view of Kosovo's high unemployment rate and low labor participation rates, improving the labor market and enhancing the quality of education are essential. Aside from the introduction of the new public sector wage rule which will reduce labor costs and boost competitiveness, the education system curricula (for primary and secondary level) is being upgraded in order to make it responsive to the market needs and reduce skills mismatch.

The vocational educational system is also being revamped, based on the German model, and a new Agency on Vocational Training has been established, coordinating the efforts of the Ministry of Education, the Ministry of Labor and Chambers of Commerce. Additionally, active labor market policies aimed at increasing female participation in the labor market are being designed.

Lastly, in collaboration with the World Bank, the authorities are moving forward with the energy reforms in order to ensure a sustainable and reliable energy supply. The tendering process for building a new thermo-power plant (600 MW) is in progress while the new regional transmission line with Albania will be completed next year.