INTERNATIONAL MONETARY FUND

Staff Country Reports

December 2011
IMF Country Report No. 11/374

Republic of Kosovo: Staff Report for the First Assessment Under the Staff-Monitoring Program

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on November 12, 2011, with the officials of the Republic of Kosovo on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 15, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

The document(s) listed below will be separately released

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

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF KOSOVO

First Assessment Under the Staff-Monitored Program

Prepared by the European Department
(in Consultation with other Departments)

Approved by Juha Kähkönen and Jan Kees Martijn

December 15, 2011

Staff-Monitored Program (SMP). The SMP was initiated on June 20, 2011, and runs until end-year. It includes important steps towards restoring fiscal sustainability and strengthening budget planning and execution. Successful implementation would create a track record of sound fiscal management that could pave the way to a program supported by a Fund arrangement in 2012.

Program implementation. All end-September 2011 quantitative benchmarks but one have been met. The exception is the ceiling on central government domestic payment arrears, where a minuscule amount has been accumulated, reflecting insufficient capacity to monitor overdue bills. Corrective actions are in preparation, notably the installation of an upgraded software to trace accounts payable. The end-September structural benchmark on the formulation of a tax compliance strategy has also been met. On current trends the end-December quantitative benchmarks appear well within reach.

2012 budget. Staff and the authorities reached understandings on a 2012 budget that includes ¾ of a percent of GDP in structural adjustment. Fiscal prospects are clouded by a failure to privatize the telecommunications company PTK in 2011 that was expected to raise €300 million (6½ percent of GDP). In case there is no decisive progress on PTK privatization in early 2012, the authorities committed to taking additional fiscal and financial measures to safeguard an adequate minimum level of bank balances.

Discussions. Discussions were held in Pristina, November 2–13. The mission met with Prime Minister Hashim Thaçi, Minister of Finance Bedri Hamza, Central Bank Governor Gani Gerguri, other senior officials, and envoys representing the international community. The staff team comprised Messrs. Wiegand (head), Castro, Druck (all EUR), Alper (FAD) and Qu (SPR). Messrs. Sulemane (Resident Representative) and Thaçi (Economist in the Resident Representative's Office) assisted the mission. The team collaborated closely with an overlapping World Bank mission.

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

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I. Introduction and Summary

1. **Kosovo's Staff-Monitored Program (SMP) was initiated on June 20, 2011**. It was agreed after Kosovo's 2010 Stand-By-Arrangement went off track, in large part reflecting outsized public sector wage increases in the 2011 budget. The SMP runs until end-2011 and entails test dates of end-September and end-December. An SMP is an informal arrangement with staff to monitor the implementation of the authorities' economic program; it does not entail endorsement by the IMF Executive Board and does not involve financial assistance by the IMF. The policies under Kosovo's SMP target decisive steps towards fiscal sustainability and stronger budget management and execution. A track record of strong performance under the SMP could pave the way for a return to an IMF-supported program in 2012.

2. **Performance under the SMP has been largely satisfactory to date, with all end-September benchmarks but one having been met.** The exception is the ceiling on the central government's domestic payment arrears, where a minuscule amount was accumulated, primarily in the Ministry of Justice, reflecting insufficient capacity to monitor overdue bills.[1] The end-September structural benchmark on the formulation of a tax compliance strategy was also met. On current trends, the end-December quantitative benchmarks as defined in the attached Letter of Intent (LOI) appear well within reach.

3. **Looking ahead, the cancellation of the auction of the telecommunications company PTK restricts the government's fiscal room for maneuver.** The auction had to be called off after one of the two pre-qualified bidders pulled out on concerns about corporate governance, and the process needs to be restarted. The government expected to raise at least €300 million from the sale of PTK (6½ percent of GDP) before end-year (structural benchmark). In the absence of PTK privatization and on unchanged policies, the government's bank balances would be nearly depleted by end-2011. To prevent this from happening, contingent spending cuts of €60 million have been enacted as agreed under the SMP.

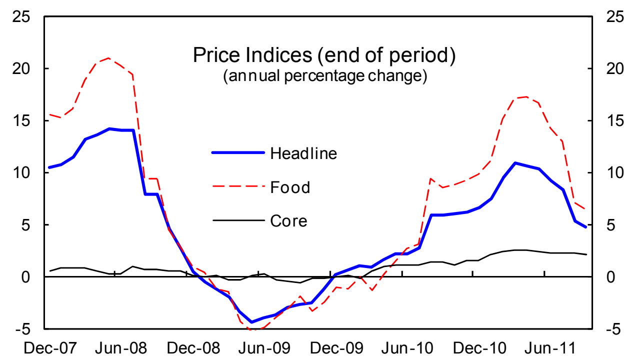
4. **A budget for 2012 was submitted to the Assembly at end-October that is in line with the authorities' commitments under the SMP.** The budget contains ¾ of a percent of GDP in structural fiscal adjustment through a mix of wage restraint, structural reforms in the energy sector that reduce the need for budgetary support, and revenue measures. Passage is a structural benchmark for end-December. The budget would form the basis for any IMF-supported program in 2012. In case no clear progress towards PTK privatization can be made in the early months of 2012, additional measures may be needed to ensure adequate cash buffers throughout the year.

[1] Performance evaluation revealed that end-September wage costs had originally been overestimated, highlighting the need to strengthen near-term expenditure forecasting. Nevertheless, spending still remained within the SMP limits, owing to the—unexpected but legitimate—payments of wages a few days into the subsequent month. December wage payments will be made in December, as required by the budget law.

5. **Fund staff continued to cooperate closely with staff of the World Bank.** The World Bank helps design policies and provides technical expertise in many areas with fiscal implications, such as energy sector reforms, the costing and design of highway projects, social legislation on issues like pensions and war veteran benefits, and health sector reforms. The World Bank is currently preparing the disbursement of a budget grant of €20 million for late December 2011/early January 2012.

II. Recent Developments

6. **Kosovo's economy has remained largely unaffected by financial turbulence in the euro area, owing to Kosovo's low degree of integration into global goods and financial markets.** While there are no direct, high-frequency indicators of economic activity, substantial growth in imports, tax revenues, and credit to the private sector (15.4 percent y-o-y in October) all point to continued robust domestic demand (Figure 1). Inflation is declining rapidly, following a spike to double-digit figures earlier this year caused by price increases for imported food stuffs.



7. **Financial conditions have remained favorable, with no signs of distress in the financial system** (Figure 2). Banks have remained well capitalized—with an overall capital adequacy ratio of 17.2 percent at end-October—liquid, and profitable. Non-performing loans stood at 5.7 percent, up from 5.2 percent at end-2010, but the increase reflects mostly more prudent loan classifications by banks rather than deteriorating credit quality. Moreover, in all systemically important banks non-performing loans are fully provisioned.

III. Economic Outlook and Risks

8. **Kosovo's short-term growth prospects remain for robust expansion, with activity supported by domestic demand, although real growth in 2012 has been marked down in response to the weaker outlook for the euro area** (LOI ¶6, 7; Tables 1–5).

- ***Growth.*** The forecast for real GDP growth in 2011 has been reduced by 0.3 percentage point to 5 percent (compared to the 2011 Article IV report), reflecting primarily the government's spending cuts in reaction to the failure to privatize PTK. Real GDP growth in 2012 has been marked down to 4 percent—from 5 percent—as weaker expected growth in Germany and Switzerland is likely to reduce remittances and FDI from Kosovars living abroad.

- ***Inflation.*** Disinflation is expected to continue, in line with developments in global commodities markets, even though possible tariff increases in the context of a revamped electricity price regulation and lower subsidies for the electricity sector may create some offsetting price pressures. Overall CPI inflation is expected to drop to 1.6 percent in 2012 (annual average; from 7.8 percent in 2011). Core inflation is expected to remain contained around 2 percent, consistent with safeguarding Kosovo's competitive position vis-à-vis the euro area (Kosovo has unilaterally adopted the euro as currency).

- ***Balance of payments.*** The current account deficit is expected to narrow to 21 percent of GDP in 2012 from 24 percent in 2011, reflecting primarily weaker import growth. FDI and other non-debt generating flows are projected to continue finance the deficit.

9. **Risks to the outlook are mainly on the downside, and relate primarily to transfers from the Kosovar diaspora and the financial system.** A deeper downturn and higher unemployment in Germany and Switzerland could depress remittances and FDI and provoke a sharper than anticipated deceleration in domestic demand, with negative knock-on effects on imports and receipts from border taxes—the latter account for almost 80 percent of tax revenue. It could also have a negative impact on the banking system, by draining deposits and impeding credit quality, as remittances are also used to service loans. While Kosovo's financial institutions do not depend on external funding and have little exposure to the euro area economies most affected by financial turmoil, strains on the German, Austrian and Slovenian financial institutions that operate the largest banks in Kosovo cannot be excluded. A low probability risk—against which the CBK has taken precautionary measures (see paragraph 24 below)—is that headquarter institutions would attempt to withdraw excessive amounts of liquidity from their Kosovar subsidiaries, thus restraining their lending ability.

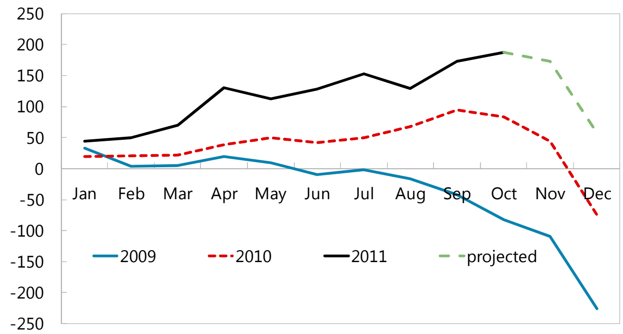
IV. Policy Discussions

A. Fiscal Policy in 2011 and 2012

10. **Strengthening fiscal sustainability and improving budget execution are at the core of the Staff-Monitored Program** (Tables 6, 7). Specifically, the SMP is part of a plan stretching over four years (2011-14) to restore a sustainable fiscal stance through cumulative fiscal adjustment of 3 percentage points of GDP, with ¾ of a percent of GDP in adjustment being executed each year. This would result in a very gradual increase of public debt from current low levels, stabilizing at about 30 percent of GDP in the long term. The second fiscal anchor is the maintenance of adequate government cash buffers which, in a fully euroized economy with limited access to capital markets, are needed not only to satisfy the government's liquidity needs, but also to make resources available to the central bank to provide emergency liquidity assistance if needed.

11. **Budget execution through Q3 2011 has been in line with the program** (LOI ¶8, Figure 3). The cumulative primary balance through end-September exceeded the corresponding quantitative benchmark by €42 million (close to 1 percent of GDP). End-September total revenue and grants exceeded the program projections by €33 million, reflecting strong VAT collection and non-tax revenues, including an unexpected dividend

Primary balance 1/
(Millions of euros, cum. total for year)



Source: Country authorities; and IMF staff calculations
1/ Primary balance excludes highway (R7) expenditures and dividends.

payment of €15 million by PTK. Primary expenditures remained €9 million below the end-September benchmark, reflecting lower energy related transfers in particular.

12. **While the end-December targets on primary spending and the primary deficit are well within reach, contingent spending cuts have been enacted to prevent depletion of the government's bank balances as a result of the delay in PTK privatization.** The cuts comprise reductions in non-highway capital spending (€30 million), lending to the electricity company KEK (€15 million), subsidies and transfers (€8 million), and goods and services (€7 million). Bank balances could receive another boost before end-year if a World Bank budgetary support grant of €20 million originally expected for 2012 is disbursed in December.

13. **The 2012 budget law that was submitted to the Assembly at end-October is consistent with the authorities' commitments under the SMP** (LOI ¶¶9-11). The draft budget is built on (i) cautious revenue projections in view of the uncertain growth outlook; (ii) restraint on current and non-highway capital spending; and (iii) allocating sufficient resources, including for expropriations, to safeguard completion of highway R7 to Albania in 2013 and to prevent the enactment of escalation clauses that would apply in case of delayed completion. It contains structural adjustment measures of €38 million (¾ of a percent of GDP, Box 1) and targets a primary deficit of €159 million (3¼ percent of GDP). Passage of the budget by the Assembly in a form consistent with the LOI is a structural benchmark for end-December.

14. **Financing of the 2012 budget includes, for the first time in Kosovo's history, the issuance of government paper** (LOI ¶12). To prepare this step, the CBK has set up a platform for electronic bond trading, and the U.S. Treasury is providing technical assistance to prepare a debt strategy, to be published by end-December. Overall, about €75 million (1½ percent of GDP) in government paper are expected to be sold to domestic financial institutions in 2012, among them the Pillar II pension fund (KPST). Enabling KPST to purchase government paper requires changes to strict exposure limits of KPST to individual borrowers, including the government, that are currently enshrined in the pension fund law. The authorities and staff agreed that the ceiling on KPST's exposure to the government could be raised to 30 percent of KPST's assets, provided the law would limit KPST's annual purchases of government paper to at most 50 percent of new inflows into KPST in the preceding year, to safeguard prudent investment policies. Submission of the revised law to the Assembly is a structural benchmark for end-December. The draft budget also contains a financing gap of €92 million that could be financed with the domestic counterpart of purchases under an IMF arrangement.

Box 1. Structural Adjustment Measures in the 2012 Budget

Structural adjustment in the 2012 draft budget consists of the following measures:

- ***Restraint on public sector wages, €10 million (0.2 percent of GDP)***. The budget contains zero wage increases for public sector employees, following increases of 30–50 percent in the context of the 2011 budget that caused the 2010 SBA to derail. The wage bill is nonetheless expected to increase somewhat because of (i) the full-year effect of the 2011 wage hikes (that took effect in March 2011), and (ii) the hiring of new public sector employees, reflecting *inter alia* the creation of new municipalities in Kosovo's North and the transfer of responsibilities (special police, privatization fund) from the international community to the Kosovar government. Wage restraint is vital both to keep current spending under control and to safeguard competitiveness in the context of an euroized economy.
- ***Electricity sector, €15 million (0.3 percent of GDP).*** Subsidies to the electricity company KEK will be reduced by €10 million (relative to a passive, no-measures scenario) and lending to KEK by another €5 million, reflecting better revenue collection (that materialized already in 2011) and regulatory measures. The lower amount of KEK-subsidies should induce an increase in electricity prices, in line with the regulatory formula. These are important steps in the right direction, as the electricity sector has been a significant drag on the budget in recent years. Means-tested electricity subsidies to the most vulnerable groups of the population will be maintained.
- ***Tax measures, €13 million (0.25 percent of GDP).*** These include increases in the excise on tobacco by €2 per 1000 units (yielding about €7 million), the minimum property tax rate to 0.15 percent (€3 million), and the presumptive tax to 9 percent (€3 million); broadly in line with recommendations of a recent IMF TA mission on tax policy (see also Box 2).

15. **The authorities and staff agreed that additional fiscal measures may be needed if the delay in PTK privatization were to stretch beyond 2012,** to safeguard a minimum of government bank balances of at least €150 million by end-2012 (LOI ¶13). To this end, the 2012 draft budget contains a clause keeping €60 million spending unallocated. Such spending cuts could eventually be complemented or replaced by revenue measures. The authorities and staff agreed to revisit the situation early in 2012.

16. **There was also agreement that tight financing constraints and insufficient preparation prevent the inclusion of ambitious medium-term projects into the 2012 budget**. These include in particular the construction of a second highway (R6) to Macedonia, and an overhaul of the health care system (LOI ¶¶11, 23). The authorities noted they would use 2012 to advance technical and financial preparations, in cooperation with the World Bank.

17. **Careful preparation is also needed for some social policy initiatives, in particular war related benefits** (LOI ¶14). The government submitted a draft law on war related benefits to the Assembly in July that was subsequently rendered inconsistent with the authorities' commitments under the SMP through amendments inserted by a parliamentary committee. In particular, the modifications created new benefits and expanded eligibility for existing benefits without fiscal impact assessments, and removed safeguards that allow cutting benefits in case of fiscal strains. Following additional parliamentary consultations, the

amendments inconsistent with the LOI were removed prior to the law's second reading in the Assembly. The law was passed on December 8, ensuring compliance with a prior action for the completion of this assessment. Preparations are ongoing for costing exercises on war veterans' pensions and possible benefits for former political prisoners, with a view to designing such benefits in a manner consistent with a sustainable medium-term fiscal framework, but these endeavors will take more time than originally envisaged (LOI ¶4). Setting up working groups to prepare a methodology for these assessments in consultation with the World Bank and defining these groups' terms of reference is a structural benchmark for end-December.

B. Structural Fiscal Reforms

18. **The authorities welcomed the recommendations of a recent IMF technical assistance mission on tax policy** (LOI ¶15). Revenue measures are likely to be an important part of the fiscal adjustment effort in future years; they could also help create space for the authorities' ambitious medium-term spending initiatives. The TA mission's recommendations focus on broadening the tax base and increasing tax progressivity, raising excises on harmful activities, and increasing the revenue share from direct taxes, including property taxes (Box 2). The revenue measures taken in the context of the 2012 budget are broadly consistent with these recommendations.

19. **The authorities and staff agreed that the system of fiscal decentralization requires reforms to enhance its effectiveness** (LOI ¶17). The current grant system from the central government to the municipalities provides the latter with adequate funds, but gives few incentives for municipalities to raise own-source revenues. Moreover, municipalities are unduly restricted to allocate funds according to their spending needs. An IMF technical assistance mission is in the process of analyzing these issues carefully, in close cooperation with the authorities and donors.

20. **There was agreement that improvements are needed regarding the authorities' ability to monitor overdue payment obligations and prevent the accumulation of arrears** (LOI ¶16). The domestic payment arrears accumulated in the context of the SMP are minuscule in size, not indicative of funding constraints, and of no macroeconomic relevance, but their emergence is difficult to avoid, given shortcomings in the recording of invoices by budgetary organizations. Steps to improve invoice recording are in preparation, notably an upgrade of the software that monitors accounts payable. However, while such measures are vital for properly monitoring the government's payment obligations and, more broadly, fiscal governance, it will likely take time until they bear fruit.

Box 2. Key Recommendations of the October 2011 Tax Policy Mission

An FAD Tax Policy mission visited Kosovo September 30—October 13, 2011, to advise the Kosovar authorities on a strategic reorientation of tax policies and to identify possible high-quality structural revenue increasing measures in view of the need for structural fiscal adjustment in 2012 and beyond. Kosovo relies heavily on indirect taxes collected at the border, with only about 14 percent of tax revenues stemming from direct taxes. However, indirect taxes will continue to provide the revenue for required fiscal consolidation during the transition towards greater reliance on direct taxes. Key recommendations are as follows:

1. ***Preserve the integrity of the tax system.*** Given the low rate of Corporate Income Tax of 10 percent, tax holidays—that have been discussed by the government—would have negligible incentive effects and cannot be afforded. Similarly, the authorities should refrain from introducing reduced VAT rates and/or exemptions for intermediary inputs from VAT. More generally, the VAT system is well-designed and efficient owing to the relatively low single rate, a high threshold and few exemptions, advantages that should be preserved.

2. ***Increase fiscal disincentives for harmful activities.*** Options include:
   a) Excises: phase in increases in tobacco excises over 3 years
   b) Introduce environmental taxes.

3. ***Increase the revenue collected from direct taxes*** annually by 0.5 percent of GDP, without reducing the overall tax-to-GDP ratio, with an emphasis on personal and corporate income tax, property taxes, and circulation taxes for motor vehicles.

4. ***Broaden the tax base and increase progressivity.*** Options are:
   a) *Corporate income tax*: include a thin capitalization rule in the tax law (i.e., limit deductibility of interest expenditures).
   b) *Capital incomes*: introduce a 10 percent withholding tax on all capital incomes for both individuals and corporations.
   c) *Personal income tax*: adjust the tax threshold upwards and introduce a more progressive PIT rate structure.
   d) *Property taxes*: introduce a minimum rate band to which all local governments must adhere. This should ideally begin with a rate band ranging from 0.25 to 1 percent, with the commitment that the minimum rate is increased annually by 0.05 percentage points until a minimum rate of about 0.8 percent has been reached.
   e) *Presumptive tax*: unify tax rate and increase minimum payment to provide incentives for formalization. Require professional service providers to file tax returns under the standard income tax regime.

C. Monetary and Financial Policies

21. **The Central Bank of Kosovo (CBK) has completed the resolution of Kosovo's largest microfinance institution.** The institution had been under the central bank's administration since early 2011, when the CBK intervened in reaction to a governance problem. A new management was appointed in November and the CBK's administrator removed after completing the transition. The process was delayed by the absence of a proper

regulatory framework for the resolution of financial institutions and required several rounds of negotiations by the CBK with the institution's owners.

22. **In this context, important progress is being made as regards strengthening the legislative framework for the supervision and resolution of banks and microfinance institutions** (LOI ¶21).

- *Banking and Microfinance Law* (BML). The draft law that is scheduled to be considered by the Assembly in December improves the previous legal framework in several areas, including by strengthening governance rules, limiting banks' exposure to related parties and large borrowers, and by expanding the CBK's toolkit for rehabilitating, restructuring, or liquidating problem institutions. The law also establishes a legal framework for the oversight of microfinance institutions. An upcoming IMF technical assistance mission will help the CBK with revising norms and regulations to ensure consistency with the new legal framework.
- *Deposit Insurance Law* (DIL). The authorities confirmed their commitment to revise the DIL once the BML has been adopted, to ensure consistency between the two laws. The revised DIL will also include provisions to allow purchase and assumption transactions. The deposit insurance fund has made good progress in collecting contributions from banks, the government, and donors.

23. **Emergency Liquidity Assistance (ELA) for banks is close to being fully operational** (LOI ¶21). The CBK had been given the legal responsibility for ELA with the introduction of a new Central Bank law in 2010. In early November 2011, the Ministry of Finance, the CBK, and the Assembly Committee for Budget and Finance signed a memorandum of understanding defining roles and responsibilities in the provision of ELA, and the CBK approved the corresponding regulations in late November. Moreover, the 2012 budget law will be amended to contain a provision to deposit €46 million in an account earmarked for ELA, contingent on the existence of a sufficient level of freely available government bank balances that could be ensured through financing received in the context of a possible IMF supported program.

24. **The CBK and staff discussed crisis preparedness measures in case of a more severe drag on growth than currently anticipated in the baseline** (LOI ¶20). The CBK has already taken a number of measures to contain risks, including safeguarding prudent loan-to-deposit ratios, prescribing conservative asset qualification rules for reserve requirements that ensure ample liquidity buffers, and limiting exposure of banks to their controlling institutions to a small fraction of the banks' capital. Nonetheless, staff urged the central bank to vigilantly monitor risks emanating from regional developments on the domestic financial system. Staff welcomed the CBK's willingness to take additional measures as needed, such as suspending banks' dividend payments to shareholders to increase capital buffers.

D. Enhancing Competitiveness

25. **The authorities have prepared a package of laws with a view to improving the ranking in the Doing Business survey of the World Bank, including on enhancing business management, property rights, and auditing** (LOI ¶24). Improving the business climate is a key pillar of the government's economic development strategy published in the summer of this year, together with support for the agricultural sector and the expansion of Kosovo's highway network. Preparation for the envisaged privatization of energy distribution and generation are advancing, with completion of privatization in 2012 within reach. Progress is critical to improve the reliability of electricity supply and to further limit costs to the budget (LOI ¶22).

V. Program Modalities

26. **The attached Letter of Intent describes the authorities' progress in implementing their economic program and sets out quantitative and structural benchmarks through December 2011** (LOI ¶4, LOI Tables 2–3, and TMU ¶¶4, 6, 9):

- ***An adjustor is introduced to the quantitative benchmark on the bank balance of the general government*** to account for the shortfall in privatization receipts due to the delay in PTK privatization (TMU ¶4).
- ***Adjustors are introduced to the quantitative benchmarks on the bank balance of the general government, the primary fiscal balance of the general government, and primary expenditures of the general government*** to adjust for the spending cuts in reaction to the delay in PTK privatization (TMU ¶¶4, 6, 9).
- ***The structural benchmark on fiscal impact assessments for the planned war veterans' pensions and possible benefits for former political prisoners is being modified.*** To account for a methodology suggested by the World Bank whose application is more time consuming than originally anticipated, the benchmark is being modified from completing the fiscal impact assessments to setting up working groups that prepare the impact assessments' methodology, and defining the groups' term of reference (LOI ¶4).
- ***A structural benchmark is introduced on the submission to the Assembly of a revised law on the Kosovo pension fund.*** The revised law will limit both KPST's overall exposure to the general government—to 30 percent of KPST's assets—and KPST's annual purchases of government paper—to 50 percent of new inflows into the KPST in the preceding year (LOI ¶12).
- ***A prior action is introduced on ensuring that the law regulating the benefits for war-related categories is either approved by the Assembly in a form consistent with the LOI from June 20, 2011, or withdrawn from the Assembly*** (LOI ¶14).

VI. Staff Appraisal

27. **Implementation of Kosovo's Staff Monitored Program (SMP) has been largely satisfactory to date.** All quantitative benchmarks for end-September but one have been met. The exception is the ceiling on central government's domestic payment arrears, where a minuscule amount has been accumulated, reflecting insufficient capacity to monitor overdue bills. Corrective measures, notably an upgrade of the software that monitors accounts payable, are in preparation, but will take time to yield results. On current trends the end-December quantitative benchmarks as defined n the attached LOI appear well within reach. The end-September structural benchmark on the formulation of a tax compliance strategy has also been met. Contingent spending cuts of €60 million have been enacted to limit the impact of the delay in PTK privatization on the government's bank balances, as agreed under the SMP. Any additional outperformance on revenues or expenditures should be saved.

28. **While Kosovo has remained largely unaffected by financial turbulence, owing to limited integration into global financial markets, a sustained downturn in the euro area could harm growth by lowering remittances and FDI.** Inflation is expected to continue to decelerate rapidly, in line with developments in global food markets, while the current account deficit is expected to narrow somewhat in 2012, reflecting in particular slower growth in imports. The banking system has remained liquid, well capitalized, and profitable.

29. **The draft 2012 budget submitted to the Assembly at end-October is a key step on the path to a sustainable fiscal stance.** The budget includes ¾ percent of GDP in structural fiscal adjustment through a mix of wage restraint, energy sector reforms that limit the need for budget support to the sector, and tax reforms. It also contains cautious revenue forecasts in view of the downside risks to growth. Financing of the budget foresees the issuance of government paper, a first in Kosovo's history; reforms are needed to the pension fund law to allow the pillar II pension fund KPST to purchase government bonds while safeguarding prudent investment policies. Additional fiscal measures would be required if the delay in PTK privatization were to stretch beyond 2012; the need for such measures should be reassessed in the early months of 2012. Going forward, structural fiscal adjustment in the years ahead is likely to rely to a substantial part on revenue measures. The recommendations of the recent IMF technical assistance mission on tax policy provide a useful yardstick for this endeavor.

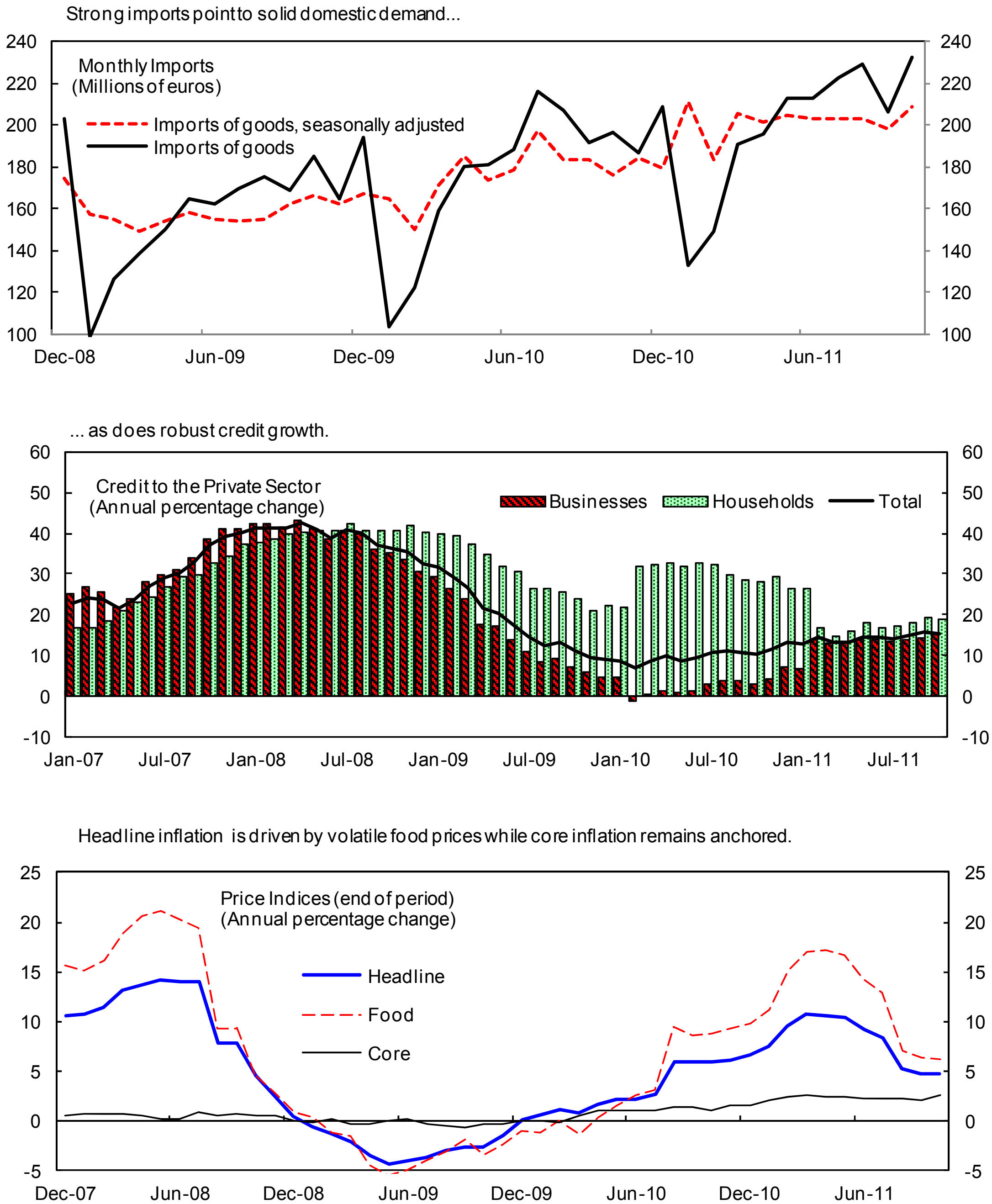
30. **More preparatory work is needed for some ambitious medium-term policy priorities, notably a new highway R6 to Macedonia, an overhaul of the health care system, and social initiatives.** 2012 should be used to advance technical and financial preparations, in close cooperation with World Bank. Budgetary risks arising from highway R7 to Albania need to be managed carefully as the projects nears completion in 2012/13. The design of social benefits for war veterans and former political prisoners also requires careful preparation, especially the preparation of thorough fiscal impact assessments that need to

include an evaluation of eligible beneficiaries. More generally, careful design and costing of capital and social spending initiatives is pivotal to safeguard sound public finances.

31. **Good progress has been made in the area of financial sector reforms.** Emergency Liquidity Assistance (ELA) is close to being fully operational. A revised banking law grants the Central Bank better instruments to safeguard governance in banks and limit banks' exposure to related parties and large borrowers. It also strengthens the bank resolution framework. The central bank has taken important measures to contain liquidity risk in case of external strains on the financial system, but should stand ready to take additional measures as needed.

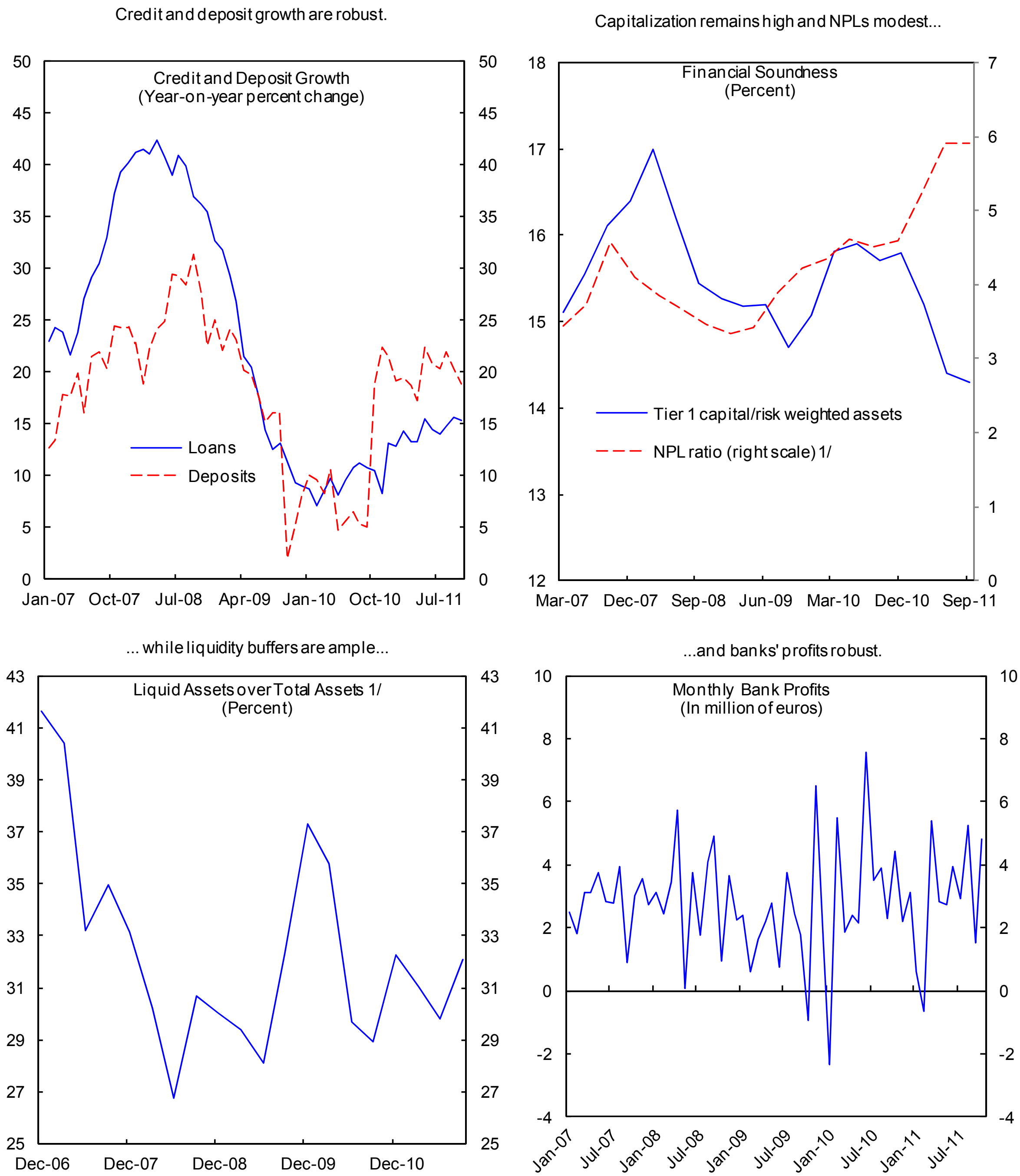
32. **Steadfast implementation of the policies under the Staff-Monitored Program remains essential to restoring fiscal sustainability and fostering macro-financial stability,** and is vital for paving the way for an IMF supported program in 2012.

Figure 1. Kosovo: Recent Economic Developments



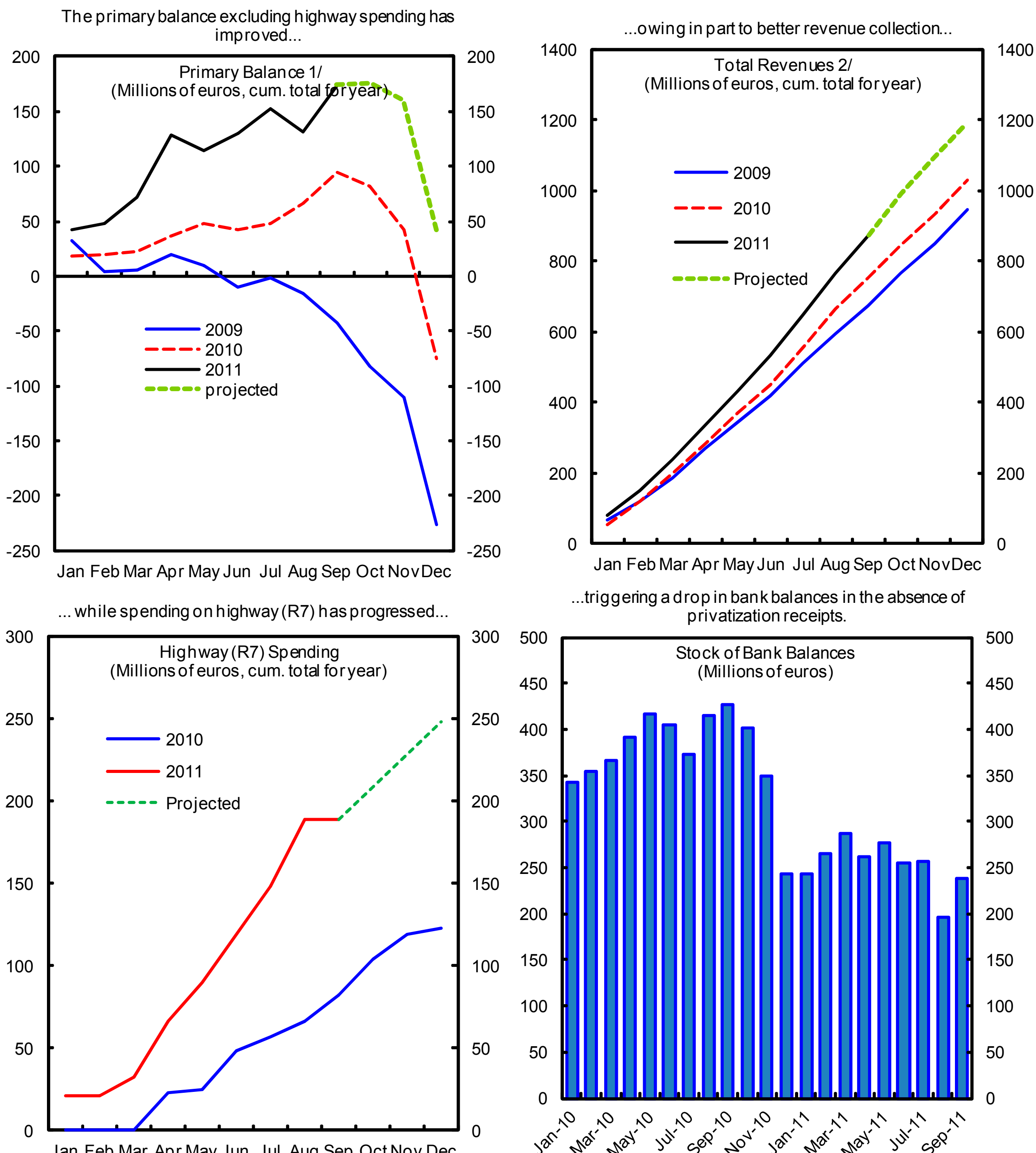
Source: National authorities; and IMF staff estimates and projections.

Figure 2. Kosovo: Selected Banking Sector Indicators



Sources: Cental Bank of Kosovo; IMF staff estimates.
1/ Liquid assets are cash, balances with CBK and commercial banks, and securities.

Figure 3. Kosovo: Recent Fiscal Developments



Source: Country authorities; and IMF staff calculations.

1/ Primary balance excludes highway (R7) expenditures and dividends.
2/ Total revenues exclude grants and dividends.

Table 1. Kosovo: Main Indicators, 2008–13

(Percent, unless otherwise indicated)

	2008	2009	2010	2011		2012	2013
				SMP	Proj.	Projections	
Real growth rates							
GDP	6.9	2.9	3.9	5.3	5.0	4.0	4.1
GDP per capita	5.6	1.4	2.4	3.7	3.4	2.5	2.6
Consumption	4.3	1.0	2.9	2.7	2.6	2.0	2.6
Investment	18.1	11.7	8.8	13.3	9.6	6.1	8.0
Exports	4.7	7.8	24.2	7.2	13.0	7.3	7.7
Imports	5.9	5.3	11.9	5.5	6.0	2.7	5.2
Official unemployment (percent of workforce)	47.5	45.4	45.1	…	…	…	…
Price changes							
CPI, period average	9.4	-2.4	3.5	8.3	7.8	1.6	1.0
CPI, end of period	0.5	0.1	6.6	6.2	5.0	1.4	0.7
Import prices	11.8	-4.9	3.2	14.4	13.5	-1.5	-1.9
GDP deflator	6.2	-1.3	3.7	5.8	5.1	2.7	2.0
Real effective exch. rate (average; -=depreciation)	3.2	-1.0	-0.7	…	…	…	…
Real effective exch. rate (end of period; -=depreciation)	0.2	-1.0	0.9	…	…	…	…
General government budget (percent of GDP)							
Revenues, incl. interest income 1/	24.5	29.3	27.6	27.1	27.9	27.6	27.9
Primary expenditures	24.7	29.9	30.0	31.8	30.7	30.6	30.7
Of which							
Wages and salaries	5.9	6.8	7.4	8.3	8.3	8.2	8.2
Subsidies and transfers	7.1	7.3	6.4	6.3	6.2	6.0	6.1
Capital and net lending, incl. the highway	7.6	11.6	11.9	13.0	12.1	12.3	12.2
Capital expenditures on the highway 2/	…	…	2.9	5.3	5.3	6.0	5.6
Overall balance	-0.2	-0.7	-2.6	-5.0	-2.9	-3.3	-3.1
Debt financing, net	0.0	-0.2	0.3	0.2	0.3	1.5	0.4
Privatization	0.0	0.0	0.0	6.4	0.0	6.0	0.2
Stock of government bank balances	10.8	8.7	5.8	6.5	2.3	8.1	5.9
Recommended minimum bank balances	…	…	5.7	7.6	5.8	8.1	5.9
Financing gap	0.0	0.0	0.0	0.0	0.0	1.8	0.8
Savings-investment balances (percent of GDP) 3/							
Domestic savings	-12.6	-7.4	-6.7	-7.3	-7.8	-5.0	-2.4
Transfers excluding general government (net)	14.0	11.9	12.5	12.1	12.2	11.7	11.8
Net factor income	4.3	2.1	2.1	2.6	2.6	2.6	2.8
National savings	5.8	6.6	8.0	7.4	7.1	9.3	12.2
Investment	28.6	32.3	33.9	37.8	36.8	35.5	35.6
Current account, excl. official transfers	-22.8	-25.7	-25.9	-30.4	-29.7	-26.2	-23.3
Current account balance, incl. official transfers	-15.3	-15.4	-17.4	-25.0	-23.8	-20.9	-18.4
Of which: official transfers 4/	7.5	10.3	8.6	5.5	5.8	5.3	4.9
Net foreign direct investment	8.9	7.1	8.5	15.2	8.8	13.4	7.4
Portfolio investment, net	1.7	-1.4	-5.5	-3.0	-3.4	-3.2	-2.0
Bank credit to the private sector	32.7	8.9	12.6	12.9	15.0	9.4	…
Deposits of the private sector	25.8	22.2	23.1	12.0	16.1	9.6	…
Non-performing loans (percent of total loans)	3.3	4.3	5.2	5.9 5/	5.7 6/	…	…
GDP (millions of euros)	3,851	3,912	4,216	4,672	4,649	4,966	5,275
GDP per capita (euros)	2,323	2,325	2,468	2,070	2,682	2,822	2,953
GNDI per capita (euros)	2,749	2,650	2,829	2,376	3,079	3,224	3,386
Population (thousands) 7/	1,658	1,683	1,708	2,256	1,734	1,760	1,786

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

1/ Projections assume that grants from the EC and IDA will be received in 2011–14.
2/ Based on World Bank estimates.
3/ Savings-investment balance of entire economy, including donor sector.
4/ Total foreign assistance excluding capital transfers.
5/ March 2011.
6/ October 2011.
7/ Series updated with the 2011 census.

Table 2. Kosovo: Real Growth, 2007–13

(Percent, unless otherwise indicated)

	2007	2008	2009	2010	2011	2012	2013
						Proj.	
			(Real growth, percent)				
Consumption	5.3	4.3	1.0	2.9	2.6	2.0	2.6
Private	8.0	6.4	0.4	3.8	2.5	2.5	3.0
Public	-5.4	-5.9	3.9	-1.5	3.2	-0.7	0.2
General government	-2.3	-0.2	15.9	7.1	10.0	4.1	5.6
Donor sector 1/	-8.7	-12.2	-11.4	-16.0	-11.3	-13.1	-17.0
Investment	15.2	18.1	11.7	8.8	9.6	6.1	8.0
Private	21.6	0.6	4.8	7.0	9.2	3.9	9.9
Public	-9.7	109.2	29.0	12.6	10.2	10.3	4.6
General government	-8.7	153.6	35.1	13.8	11.3	10.9	4.9
Donor sector 1/	-12.3	-18.6	-26.0	-7.3	-11.5	-6.0	-5.5
Exports 2/	13.4	4.7	7.8	24.2	13.0	7.3	7.7
Imports	11.0	5.9	5.3	11.9	6.0	2.7	5.2
GDP	6.3	6.9	2.9	3.9	5.0	4.0	4.1
Memorandum item:							
GDP (millions of euros)	3,394	3,851	3,912	4,216	4,649	4,966	5,275

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

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

2/ Including service receipts comprising donor sector consumption.

Table 3. Kosovo: Balance of Payments, 2009-13
(Millions of euros, unless otherwise indicated)

	2009	2010	2011	2012	2013
			Projections		
Goods and services balance	-1,553	-1,710	-2,069	-2,009	-2,005
Trade balance	-1,673	-1,776	-2,136	-2,147	-2,212
Exports	177	305	344	392	439
Imports	-1,851	-2,081	-2,479	-2,539	-2,651
Services	121	66	66	138	207
Receipts	429	476	583	630	684
Payments	-308	-410	-517	-492	-477
Income	83	89	122	129	149
Compensation of employees (net)	169	172	178	186	193
Investment income	-86	-82	-57	-56	-44
Interest payments on public debt	-1	-9	-8	-13	-11
Transfers	866	889	839	844	882
Official transfers	401	361	272	265	258
Other transfers (net)	465	528	567	579	625
Of which: inflows of remittances	506	512	549	549	577
Current account	-604	-732	-1,109	-1,036	-973
Capital and financial account	543	553	909	744	733
Capital account	108	25	8	2	2
Of which: WB Trust Fund	89	0	6	0	0
Financial account, incl. CBK	435	527	901	742	731
Foreign direct investment, net	277	358	408	663	390
Commercial banks, excl. FDI	-98	-101	-86	-86	-40
General government	-132	21	14	-2	-4
Disbursements, incl. IMF	0	22	27	10	10
Repayments	-132	-11	-13	-11	-14
Prepayment of debt	-132	-11	-13	-11	-14
Other repayments	0	0	0	0	0
Other sectors, excl. FDI 1/	366	284	459	489	316
Central Bank of Kosovo	22	-35	106	-322	70
Reserve assets	94	-47	123	-322	70
Government balances (program definition)	-17	236	126	-298	91
Other reserve assets, incl. SDRs	111	-283	-4	-24	-21
Non-reserves assets	-132	12	-16	0	0
Liabilities 2/	60	0	-1	0	0
Net errors and omissions 3/	61	180	200	200	200
Financing gap	0	0	0	92	40
Memorandum items:					
Current account, excl. official transfers	-1,005	-1,093	-1,381	-1,301	-1,231
(in percent of GDP)	-25.7	-25.9	-29.7	-26.2	-23.3
Current account, incl. official transfers	-604	-732	-1,109	-1,036	-973
(in percent of GDP)	-15.4	-17.4	-23.8	-20.9	-18.4
Official transfers (percent of GDP)	10.3	8.6	5.8	5.3	4.9
Debt service to export ratio (percent)	21.9	2.6	2.2	2.4	2.2
Net foreign assets of commercial banks	444	545	632	718	758
Net foreign assets of CBK	1,088	1,108	1,002	1,324	1,254
Gross international reserves of the CBK	625	686	563	885	815

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

1/ Including trading companies, insurance companies, and pension funds.
2/ Includes SDR allocations and IMF account at historical value.
3/ Projections of errors include unidentified private remittances and other capital based on average historical levels.

Table 4. Kosovo: Central Bank and Commercial Bank Survey, 2008-12
(Millions of euros, unless otherwise indicated)

	2008	2009	2010	Proj. 2011	Proj. 2012
			Central Bank		
Net foreign assets	1,111	1,088	1,108	1,002	1,324
Foreign assets	1,111	1,198	1,247	1,140	1,462
Of which: Securities	541	529	199	279	299
Deposits	529	522	854	667	969
Foreign liabilities	0	110	139	138	138
Net domestic assets	-1,111	-1,088	-1,108	-1,002	-1,324
Net claims on the central government	-870	-681	-813	-687	-984
Liabilities	-870	-681	-813	-687	-984
Of which: Government balances (program definition)	-414	-178	-233	-107	-404
Commercial banks	-137	-233	-204	-217	-238
Other institutions	-64	-131	-46	-46	-46
Other items, net	-39	-43	-46	-52	-55
			Commercial banks		
Net foreign assets	325	444	545	632	718
Assets	401	584	710	797	899
Liabilites	76	140	165	165	180
Net domestic assets	815	949	1,169	1,358	1,462
Credit to private sector	1,183	1,289	1,451	1,669	1,825
Claims on the CBK	137	233	203	217	238
Net claims on the central government	-1	-165	-12	0	25
Net claims on other public entities	-264	-123	-120	-132	-142
Other items, net	-240	-285	-354	-395	-484
Liabilities to the private sector	1,140	1,393	1,714	1,990	2,181
Demand deposits	384	441	545	630	701
Time deposits	756	951	1,169	1,360	1,480
Memorandum item:					
Gross international reserves	670	625	686	563	885
			(12-month percent change)		
Liabilities to private sector	25.8	22.2	23.1	16.1	9.6
Loans to the private sector	32.7	8.9	12.6	15.0	9.4
			(Percent of GDP)		
Total private sector deposits	29.6	35.6	40.7	42.8	43.9
Credit to the private sector	30.7	32.9	34.4	35.9	36.7

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

Table 5. Kosovo: Selected Financial Soundness Indicators, 2006–11 1/

(Percent)

	2006	2007	2008	2009	2010		2011
					Oct.	Dec.	Oct.
Capital adequacy							
Regulatory capital/risk weighted assets	16.8	17.4	16.5	17.9	19.2	18.8	17.2
Tier 1 capital/risk weighted assets	14.7	16.4	15.3	15.1	16.1	15.8	14.4
Asset quality							
NPL ratio 2/	4.1	4.1	3.3	4.3	4.0	5.2	5.7
NPL net of provisions/capital	NA	2.6	2.8	2.3	5.1	3.7	5.2
Sectoral breakdown of loans							
Agriculture	2.0	3.2	3.2	3.0	2.7	2.6	2.4
Manufacturing	7.5	9.9	7.8	9.4	11.3	10.9	9.7
Trade	47.3	46.6	42.6	41.4	36.8	37.1	36.8
Other services	7.7	11.4	16.9	9.8	11.9	12.3	13.7
Construction	4.0	5.6	5.5	6.9	7.4	7.5	7.4
Households	22.9	22.5	23.7	26.6	29.9	29.5	30.0
Liquidity							
Liquid assets/total assets 3/	41.7	33.2	30.0	37.3	33.2	36.8	31.1
Deposits/loans	145.2	128.1	122.0	138.6	116.3	126.1	117.2
Liquid assets to short-term liabilities 3/	59.8	47.8	42.1	47.0	43.0	46.2	39.4
Profitability							
Return on assets 4/	2.3	2.9	2.6	1.4	1.9	1.8	1.6
Return on equity 4/	25.7	27.1	24.7	21.4	19.3	18.8	16.7
Interest margin to gross income 5/	60.4	58.4	60.3	55.3	74.6	74.5	75.6
Non-interest expense to gross income 6/	12.0	12.6	11.2	16.3	73.2	74.3	77.7
Market risk							
Net open currency position/tier 1 capital	…	17.8	8.9	18.8	…	-0.1	…

Source: Central Bank of the Republic of Kosovo.

1/ End-year unless indicated otherwise.
2/ NPL ratio includes the loans which are classified as doubtful loans and bad loans.
3/ Liquid assets are cash, balances with CBK and commercial banks, and securities.
4/ Not annualized.
5/ Interest income minus interest expenditures. Gross income taken from income statement. Quarterly value.
6/ Includes fees, commissons, provisions for loan and other asset losses, and depreciation of fixed assets.

Table 6. Kosovo: Consolidated Government Budget, 2011-13

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

	2011					2012		2013
	Sept.		Year			Year		Year
	SMP (May 2011)	Prelim.	SMP (May 2011)	Program	Proj.	Unadjusted Policies	Proj.	Proj.
Total primary revenue and grants	903	936	1,261	1,281	1,295	1,348	1,361	1,459
Total primary revenue	896	932	1,253	1,253	1,270	1,314	1,327	1,406
Taxes 1/	741	765	1,057	1,057	1,048	1,108	1,121	1,225
Direct taxes	101	102	151	151	140	144	150	165
Indirect taxes	661	682	939	939	941	998	1,005	1,096
Tax refunds	-20	-19	-33	-33	-34	-35	-35	-38
Nontax revenues	155	166	196	196	222	206	206	181
Of which : dividends	45	60	45	45	60	35	35	0
Grants	7	4	8	28	26	34	34	53
Budget support	0	0	0	20	20	30	30	50
Trust fund at the World Bank	5	3	5	5	3	0	0	0
Project grants	2	1	3	3	3	4	4	3
Primary expenditure	902	893	1,487	1,426	1,426	1,544	1,519	1,618
Current expenditure	560	550	879	864	865	929	909	973
Wages and salaries 1/	270	250	386	386	386	417	407	433
Goods and services	107	107	195	187	187	198	198	213
Subsidies and transfers	182	193	296	289	289	310	300	323
Pension and social assistance	144	133	188	188	179	197	197	213
Other transfers and subsidies 2/	38	61	109	102	111	113	103	110
Of which : subsidies for imports of electricity 1/	…	…	…	…	…	30	20	…
Reserve	0	0	3	3	3	4	4	4
Capital expenditure and net lending	342	343	608	562	562	615	610	645
Capital expenditure	315	319	563	532	532	599	599	635
Highway project 3/	180	190	248	248	248	296	296	293
Other capital spending	135	129	315	284	284	303	303	342
Net lending 1/	27	24	45	30	30	16	11	10
Disbursement	27	24	45	30	30	20	15	10
Repayment	0	0	0	0	0	-4	-4	0
Primary balance	1	43	-226	-146	-131	-197	-159	-159
Interest income, net	-8	-6	-7	-5	-5	-5	-5	-2
Overall balance	-7	37	-233	-151	-136	-201	-163	-161
Overall balance (excluding highway expenditures)	173	226	15	97	112	95	133	132
Financing	7	-37	233	151	136	110	72	121
Foreign financing	8	-6	16	21	21	-2	-2	-4
Drawings, incl. official financing	14	0	22	27	27	10	10	10
Amortization	-11	-13	-11	-11	-13	-11	-11	-14
Trust fund at the World Bank	6	6	6	6	6	0	0	0
Domestic financing	-1	-30	217	130	115	111	73	126
Domestic borrowing (net)	0	0	0	0	0	74	74	27
Privatization revenues	0	0	300	0	0	300	300	10
Other financial assets, net	-13	0	-17	-17	-17	-3	-3	-3
Change in the stock of own source revenues (– = increase)	-11	-28	-5	-5	-5	0	0	0
Change in bank balance (program definition; – = increase)	23	-2	-61	151	137	-260	-298	91
Financing gap	0	0	0	0	0	92	92	40
Memorandum items:								
Bank balance of the general government	221	246	305	93	107	366	404	313
Of which: ELA	0	0	0	0	0	46	46	46

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

1/ Structural adjustment in 2012 of ¾ of a percent of GDP (€ 38 million) is composed of € 13 million in revenue measures, €10 million in wage restraint, and € 15 million in reduction of support to the electricity sector (of which € 10 in subsidies and € 5 million in net lending).
2/ Including capital transfers to public enterprises.
3/ Based on the WB estimates.

Table 7. Kosovo: Consolidated Government Budget, 2011–13

(Excluding donor designated grants; percent of GDP)

	2011					2012		2013
	Sep.		Year			Year		Year
	SMP (May 2011)	Prelim.	SMP (May 2011)	Program	Proj.	Unadjusted Policies	Proj.	Proj.
Total primary revenue and grants	19.3	20.1	27.0	27.5	27.9	27.1	27.4	27.7
Total primary revenue	19.2	20.0	26.8	26.9	27.3	26.5	26.7	26.7
Taxes 1/	15.9	16.5	22.6	22.7	22.5	22.3	22.6	23.2
Direct taxes	2.2	2.2	3.2	3.2	3.0	2.9	3.0	3.1
Indirect taxes	14.1	14.7	20.1	20.2	20.2	20.1	20.2	20.8
Tax refunds	-0.4	-0.4	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
Nontax revenues	3.3	3.6	4.2	4.2	4.8	4.2	4.2	3.4
Of which: dividends	1.0	1.3	1.0	1.0	1.3	0.7	0.7	0.0
Grants	0.1	0.1	0.2	0.6	0.5	0.7	0.7	1.0
Budget support	0.0	0.0	0.0	0.4	0.4	0.6	0.6	0.9
Trust fund at the World Bank	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Project grants	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Primary expenditure	19.3	19.2	31.8	30.7	30.7	31.1	30.6	30.7
Current expenditure	12.0	11.8	18.8	18.6	18.6	18.7	18.3	18.4
Wages and salaries 1/	5.8	5.4	8.3	8.3	8.3	8.4	8.2	8.2
Goods and services	2.3	2.3	4.2	4.0	4.0	4.0	4.0	4.0
Subsidies and transfers	3.9	4.2	6.3	6.2	6.2	6.2	6.0	6.1
Pension and social assistance	3.1	2.9	4.0	4.0	3.8	4.0	4.0	4.0
Other transfers and subsidies 2/	0.8	1.3	2.3	2.2	2.4	2.3	2.1	2.1
Of which: subsidies for imports of electricity 1/	…	…	…	…	…	0.6	0.4	…
Reserve	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Capital expenditure and net lending	7.3	7.4	13.0	12.1	12.1	12.4	12.3	12.2
Capital expenditure	6.7	6.9	12.0	11.4	11.4	12.1	12.1	12.0
Highway project 3/	3.8	4.1	5.3	5.3	5.3	6.0	6.0	5.6
Other capital spending	2.9	2.8	6.7	6.1	6.1	6.1	6.1	6.5
Net lending	0.6	0.5	1.0	0.6	0.6	0.3	0.2	0.2
Disbursement 1/	0.6	0.5	1.0	0.6	0.6	0.4	0.3	0.2
Repayment	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1	0.0
Primary balance	0.0	0.9	-4.8	-3.1	-2.8	-4.0	-3.2	-3.0
Interest income, net	-0.2	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	0.0
Overall balance	-0.1	0.8	-5.0	-3.2	-2.9	-4.1	-3.3	-3.1
Overall balance (excluding highway expenditures)	3.7	4.9	0.3	2.1	2.4	1.9	2.7	2.5
Financing	0.1	-0.8	5.0	3.2	2.9	2.2	1.4	2.3
Foreign financing	0.2	-0.1	0.3	0.5	0.4	0.0	0.0	-0.1
Drawings, incl. official financing	0.3	0.0	0.5	0.6	0.6	0.2	0.2	0.2
Amortization	-0.2	-0.3	-0.2	-0.2	-0.3	-0.2	-0.2	-0.3
Trust fund at the World Bank	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Domestic financing	0.0	-0.7	4.6	2.8	2.5	2.2	1.5	2.4
Domestic borrowing (net)	0.0	0.0	0.0	0.0	0.0	1.5	1.5	0.5
Privatization revenues	0.0	0.0	6.4	0.0	0.0	6.0	6.0	0.2
Other financial assets (net)	-0.3	0.0	-0.4	-0.4	-0.4	-0.1	-0.1	-0.1
Change in the stock of own source rev. (– = increase)	-0.2	-0.6	-0.1	-0.1	-0.1	0.0	0.0	0.0
Change in bank balance (– = increase)	0.5	0.0	-1.3	3.3	3.0	-5.2	-6.0	1.7
Financing gap	0.0	0.0	0.0	0.0	0.0	1.8	1.8	0.8
Memorandum items:								
Bank balance of the general government	4.7	5.3	6.5	2.0	2.3	7.4	8.1	5.9
Of which: ELA	0.0	0.0	0.0	0.0	0.0	0.9	0.9	0.9
Nominal GDP (millions of euros)	4,672	4,649	4,672	4,649	4,649	4,966	4,966	5,275

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

1/ Structural adjustment in 2012 of ¾ of a percent of GDP is composed of 0.25 percent of GDP in revenue measures, 0.2 percent of GDP in wage restraint, and 0.3 percent of GDP in reduction of support to the electricity sector (of which 0.2 percent of GDP in subsidies and 0.1 percent of GDP in lending).

2/ Including capital transfers to public enterprises.

3/ Based on World Bank estimates.

Appendix. Debt Sustainability Analysis

Table A1. Kosovo: External Debt Sustainability Framework, Baseline Scenario, 2008-2031 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2008	2009	2010			2011	2012	2013	2014	2015	2016	2011-2016 Average	2021	2031	2017-2031 Average
External debt (nominal) 1/	**21.4**	**17.6**	**16.6**			**15.4**	**16.4**	**16.8**	**15.9**	**14.8**	**14.2**	**15.6**	**18.5**	**23.2**	**19.9**
o/w public and publicly guaranteed (PPG)	21.4	17.6	16.6			15.4	16.4	16.8	15.9	14.8	14.2		18.5	23.2	
Change in external debt	-3.9	-3.7	-1.0			-1.2	1.0	0.4	-0.9	-1.1	-0.6		0.7	0.4	
Identified net debt-creating flows	**5.8**	**8.5**	**8.4**			**15.4**	**7.9**	**11.4**	**7.2**	**7.3**	**6.4**		**5.0**	**8.1**	
Non-interest current account deficit	**15.1**	**15.0**	**16.9**	**9.7**	**4.2**	**23.5**	**20.4**	**18.0**	**14.2**	**14.6**	**13.8**	**17.4**	**12.0**	**14.5**	**12.9**
Deficit in balance of goods and services	41.2	39.7	40.6			44.5	40.5	38.0	34.5	33.4	32.0		27.8	27.0	
Exports	14.8	15.5	18.5			19.9	20.6	21.3	22.1	22.9	23.9		20.6	20.0	
Imports	56.0	55.2	59.1			64.5	61.0	59.3	56.5	56.4	55.8		48.4	47.0	
Net current transfers (negative = inflow)	-21.5	-22.1	-21.1	-22.5	1.5	-18.0	-17.0	-16.7	-16.9	-15.6	-15.0	-16.5	-13.6	-11.2	-12.9
o/w official	-7.5	-10.3	-8.6			-5.8	-5.3	-4.9	-4.7	-3.6	-3.3		-1.9	-0.7	
Other current account flows (negative = net inflow)	-4.5	-2.6	-2.6			-3.0	-3.0	-3.3	-3.3	-3.3	-3.2		-2.3	-1.4	
Net FDI (negative = inflow)	**-6.6**	**-6.6**	**-7.7**	**-4.3**	**3.4**	**-7.7**	**-12.4**	**-6.4**	**-6.9**	**-7.0**	**-7.1**	**-7.9**	**-7.0**	**-7.0**	**-7.0**
Endogenous debt dynamics 2/	**-2.8**	**0.1**	**-0.8**			**-0.4**	**-0.1**	**-0.2**	**0.0**	**-0.3**	**-0.3**	**-0.2**	**0.0**	**0.6**	**0.2**
Contribution from nominal interest rate	0.2	0.4	0.5			0.4	0.4	0.5	0.5	0.4	0.4		0.8	1.6	
Contribution from real GDP growth	-1.5	-0.6	-0.6			-0.7	-0.6	-0.6	-0.5	-0.7	-0.7		-0.7	-1.0	
Contribution from price and exchange rate changes	-1.5	0.3	-0.6			…	…	…	…	…	…		…	…	
Residual, including assets, errors, and ommissions (3-4) 3/	**-9.7**	**-12.2**	**-9.4**			**-16.6**	**-6.9**	**-11.0**	**-8.2**	**-8.4**	**-7.0**		**-4.3**	**-7.7**	
o/w exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	14.7			13.8	15.0	15.5	14.9	14.0	13.6		15.7	18.9	
In percent of exports	...	...	79.4			69.3	72.9	73.0	67.6	61.3	56.9		76.1	94.4	
PV of PPG external debt	**...**	**...**	**14.7**			**13.8**	**15.0**	**15.5**	**14.9**	**14.0**	**13.6**		**15.7**	**18.9**	
In percent of exports	**...**	**...**	**79.4**			**69.3**	**72.9**	**73.0**	**67.6**	**61.3**	**56.9**		**76.1**	**94.4**	
In percent of government revenues	**...**	**...**	**55.6**			**50.6**	**56.1**	**58.3**	**55.0**	**51.0**	**48.6**		**55.8**	**67.3**	
Debt service-to-exports ratio (in percent)	**28.6**	**38.7**	**31.6**			**25.3**	**20.9**	**17.7**	**16.3**	**15.5**	**15.9**		**29.0**	**114.5**	
PPG debt service-to-exports ratio (in percent)	**0.0**	**2.5**	**2.5**			**2.2**	**2.4**	**2.8**	**3.3**	**4.2**	**5.4**		**11.3**	**13.4**	
PPG debt service-to-revenue ratio (in percent)	**0.0**	**1.3**	**1.8**			**1.6**	**1.9**	**2.2**	**2.7**	**3.5**	**4.6**		**8.3**	**9.5**	
Total gross financing need (Billions of euros)	0.5	0.6	0.6			1.0	0.6	0.8	0.6	0.7	0.7		0.9	5.0	
Non-interest current account deficit that stabilizes debt ratio	19.1	18.7	17.9			24.6	19.4	17.6	15.1	15.7	14.4		11.3	14.1	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.9	2.9	3.9	3.8	2.3	5.0	4.0	4.1	3.2	5.0	5.0	4.4	4.4	4.6	4.4
GDP deflator in euro terms (change in percent)	6.2	-1.3	3.7	0.7	3.2	5.1	2.7	2.0	1.8	1.9	1.8	2.5	2.0	2.0	2.0
Effective interest rate (percent) 5/	1.0	2.1	2.8	1.4	1.2	2.6	3.0	3.1	2.9	2.9	3.0	2.9	4.7	7.6	5.5
Growth of exports of G&S (euro terms, in percent)	11.1	6.4	28.8	15.7	36.7	18.8	10.2	9.9	8.9	11.2	11.3	11.7	5.2	6.7	5.3
Growth of imports of G&S (euro terms, in percent)	18.4	0.1	15.4	8.0	9.4	20.3	1.2	3.2	0.2	6.7	5.9	6.2	5.2	6.7	5.3
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	37.7	7.7	12.4	11.5	11.5	11.5	15.4	11.5	11.5	12.2
Government revenues (excluding grants, in percent of GDP)	23.8	29.3	26.4			27.3	26.7	26.7	27.1	27.5	28.0		28.1	28.1	28.1
Aid flows (in Billions of euros) 7/	0.0	0.0	0.0			0.0	0.0	0.1	0.1	0.0	0.0		0.0	0.0	
o/w Grants	0.0	0.0	0.0			0.0	0.0	0.1	0.1	0.0	0.0		0.0	0.0	
o/w Concessional loans	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			0.8	0.9	1.2	0.9	0.1	0.2		0.4	0.4	0.4
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			66.5	29.5	45.6	78.4	11.5	11.5		11.5	11.5	12.2
Memorandum items:															
Nominal GDP (Billions of euros)	3.9	3.9	4.2			4.6	5.0	5.3	5.5	5.9	6.3		8.6	16.3	
Nominal dollar GDP growth	13.5	1.6	7.8			10.3	6.8	6.2	5.1	7.0	6.8	7.0	6.5	6.7	6.5
PV of PPG external debt (in Billions of euros)			0.6			0.6	0.7	0.8	0.8	0.8	0.9		1.3	3.1	
(PVt-PVt-1)/GDPt-1 (in percent)						0.5	2.2	1.5	0.1	0.1	0.5	0.8	1.4	1.5	1.4
PV of PPG external debt (in percent of GDP)	...	...	14.7			13.8	15.0	15.5	14.9	14.0	13.6		15.7	18.9	
PV of PPG external debt (in percent of exports)	...	...	79.4			69.3	72.9	73.0	67.6	61.3	56.9		76.1	94.4	
Debt service of PPG external debt (in percent of exports)	...	...	2.5			2.2	2.4	2.8	3.3	4.2	5.4		11.3	13.4	

Sources: Country authorities; and staff estimates and projections.

1/ Data on private external debt estimated by Fund staff.

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

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

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

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

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

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

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

Table A2. Kosovo: Public Sector Debt Sustainability Framework, Baseline Scenario, 2008-2031
(In percent of GDP, unless otherwise indicated)

	Actual				Average 6/	Standard Deviation 6/	Estimate	Projections								
	2007	2008	2009	2010			2011	2012	2013	2014	2015	2016	2011-16 Average	2021	2031	2017-31 Average
Public sector debt 1/	25.3	21.4	17.6	16.6			15.4	17.9	18.8	18.6	18.9	19.4		24.5	30.1	
o/w foreign-currency denominated	25.3	21.4	17.6	16.6			14.8	13.6	12.6	11.6	10.5	9.6		4.2	0.0	
Change in public sector debt	-3.4	-3.9	-3.7	-1.0			-1.2	2.5	0.8	-0.1	0.3	0.5		0.8	0.4	
Identified debt-creating flows	-21.2	-13.6	0.5	1.6			1.4	-3.6	2.2	-0.1	0.0	0.1		0.4	0.0	
Primary deficit	-7.2	0.2	0.7	2.7	-0.6	3.6	2.8	3.2	3.0	0.5	0.9	0.9	1.9	0.9	1.0	0.9
Revenue and grants	26.5	24.5	29.3	27.3			27.9	27.4	27.7	28.0	27.5	28.0	27.7	28.1	28.1	28.1
of which: grants	0.0	0.6	0.0	0.9			0.5	0.7	1.0	0.9	0.0	0.0		0.0	0.0	
Primary (noninterest) expenditure	19.3	24.7	29.9	30.0			30.7	30.6	30.7	28.5	28.5	28.9	29.6	29.0	29.1	29.0
Automatic debt dynamics	-2.3	-3.0	-0.2	-1.1			-1.4	-0.7	-0.6	-0.5	-0.8	-0.7	-0.8	-0.6	-0.9	-0.6
Contribution from interest rate/growth differential	-2.4	-2.1	-0.7	-0.6			-0.8	-0.6	-0.6	-0.5	-0.8	-0.7		-0.6	-0.9	
of which: contribution from average real interest rate	-0.8	-0.5	-0.1	0.0			-0.1	0.0	0.1	0.1	0.1	0.2		0.4	0.4	
of which: contribution from real GDP growth	-1.7	-1.6	-0.6	-0.7			-0.8	-0.6	-0.7	-0.6	-0.9	-0.9		-1.0	-1.3	
Contribution from real exchange rate depreciation	0.1	-0.9	0.5	-0.4			-0.5	-0.1	0.0	0.0	0.0	0.0		...	...	
Other identified debt-creating flows	-11.7	-10.8	0.0	0.0			0.0	-6.0	-0.2	-0.2	-0.2	-0.2		0.0	0.0	
Privatization receipts (negative)	-11.7	-10.8	0.0	0.0			0.0	-6.0	-0.2	-0.2	-0.2	-0.2		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes 2/	17.8	9.6	-4.2	-2.6			-2.6	6.1	-1.3	0.0	0.3	0.5	0.5	0.4	0.4	0.4
Other Sustainability Indicators																
PV of public sector debt	...	...	...	14.7			13.8	16.5	17.5	17.6	18.1	18.8		21.7	25.8	
o/w foreign-currency denominated	...	...	...	14.7			13.8	15.0	15.5	14.9	14.0	13.6		15.7	18.9	
PV of contingent liabilities (not included in public sector debt)	...	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 3/	-7.2	0.2	1.0	3.1			3.3	3.7	4.2	2.1	3.3	4.0		6.2	7.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	…	54			50	60	63	63	66	67		77	92	
PV of public sector debt-to-revenue ratio (in percent)	…	…	…	56			51	62	65	65	66	67		77	92	
o/w external 4/	…	…	…	56			51	56	58	55	51	49		56	67	
Debt service-to-revenue and grants ratio (in percent) 5/	0.0	0.0	1.3	1.7			1.6	1.8	4.1	5.7	8.5	11.1		19.0	21.9	
Debt service-to-revenue ratio (in percent) 5/	0.0	0.0	1.3	1.8			1.6	1.9	4.3	5.9	8.5	11.1		19.0	21.9	
Primary deficit that stabilizes the debt-to-GDP ratio		4.1	4.4	3.7			4.0	0.7	2.2	0.6	0.7	0.4		0.2	0.5	
Key macroeconomic and fiscal assumptions																
Nominal GDP (local currency)	3.4	3.9	3.9	4.2			4.6	5.0	5.3	5.5	5.9	6.3		8.6	16.3	
Real GDP growth (in percent)	6.3	6.9	2.9	3.9	3.8	2.3	5.0	4.0	4.1	3.2	5.0	5.0	4.4	4.4	4.6	4.4
Average nominal interest rate on forex debt (in percent)	0.0	0.0	0.8	1.2	0.3	0.5	1.2	1.9	2.1	2.1	2.1	2.1	1.9	3.6	2.9	3.4
Average nominal interest rate on domestic debt (in percent)	...	...	...	...	…	…	...	...	5.8	5.5	5.3	5.5	5.6	5.3	5.3	5.3
Average real interest rate (in percent)	-2.8	-2.1	-0.4	0.3	-2.0	1.3	-0.4	-0.1	0.4	0.5	0.6	0.9	0.3	2.0	1.4	1.9
Average real interest rate on foreign-currency debt (in percent)	-2.7	-2.1	-1.1	-0.9	-2.2	0.8	2.4	2.0	2.0	2.0	2.0	2.0	2.1	2.0	2.0	2.0
Real exchange rate depreciation (in percent, + indicates depreciation)	0.5	-3.8	2.5	-2.6	1.6	3.5	-3.3	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.3	6.2	-1.3	3.7	0.7	3.2	5.1	2.7	2.0	1.8	1.9	1.8	2.5	2.0	2.0	2.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	36.8	24.8	4.1	7.5	13.6	7.3	3.7	4.4	-4.1	4.8	6.6	3.8	4.5	4.7	4.5
Grant element of new external borrowing (in percent)	...	...	...	...	…	…	37.7	7.7	12.4	11.5	11.5	11.5	15.4	11.5	11.5	12.2

Sources: Country authorities; and staff estimates and projections.

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

2/ The residual includes changes in assets, notably bank balances of the central government at the central bank. The large residual in 2011-12 results from the fluctuations of these balances related to the privatization of the telecommunications company.

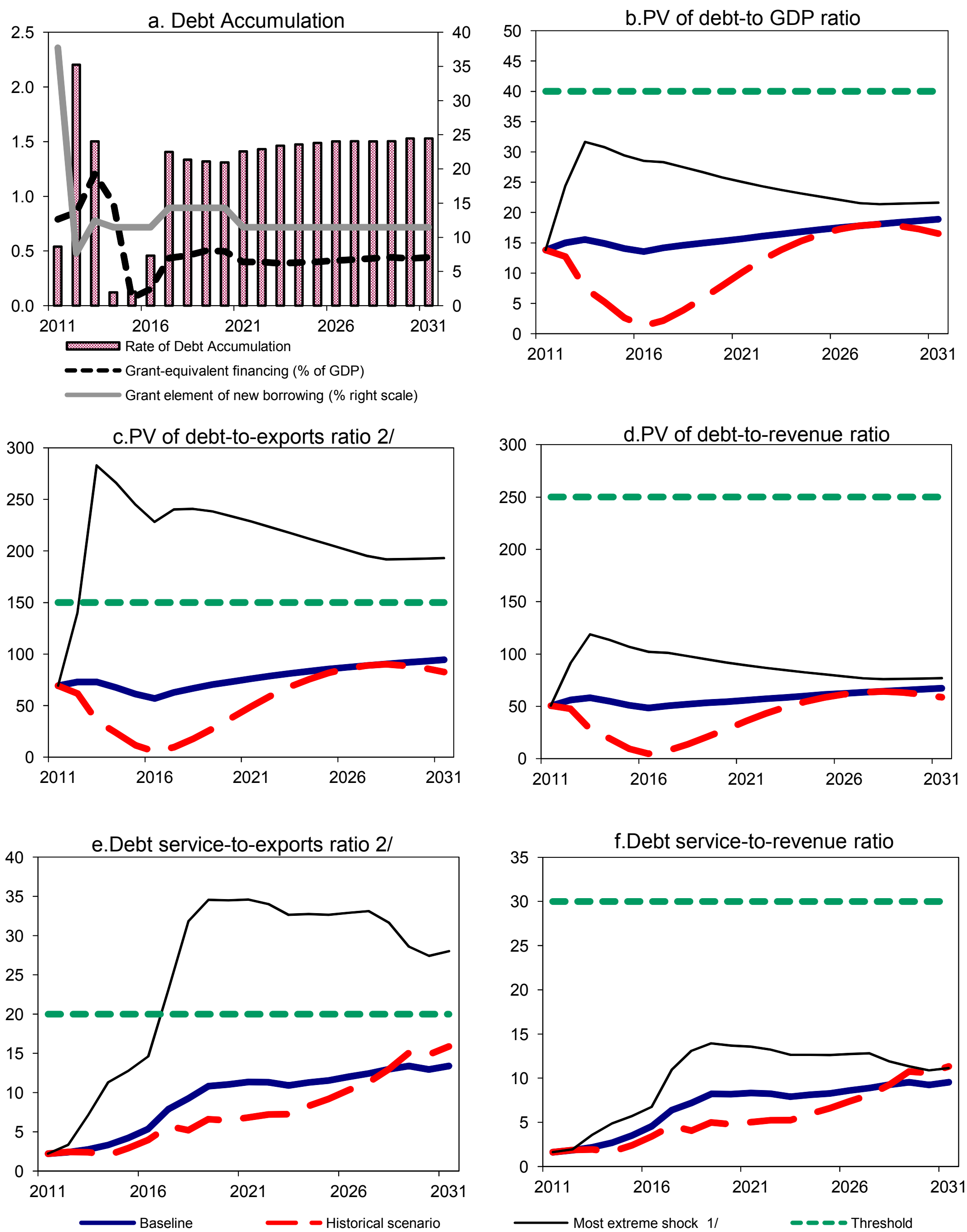
3/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

4/ Revenues excluding grants.

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

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

Figure A1. Kosovo: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2011-2031 1/

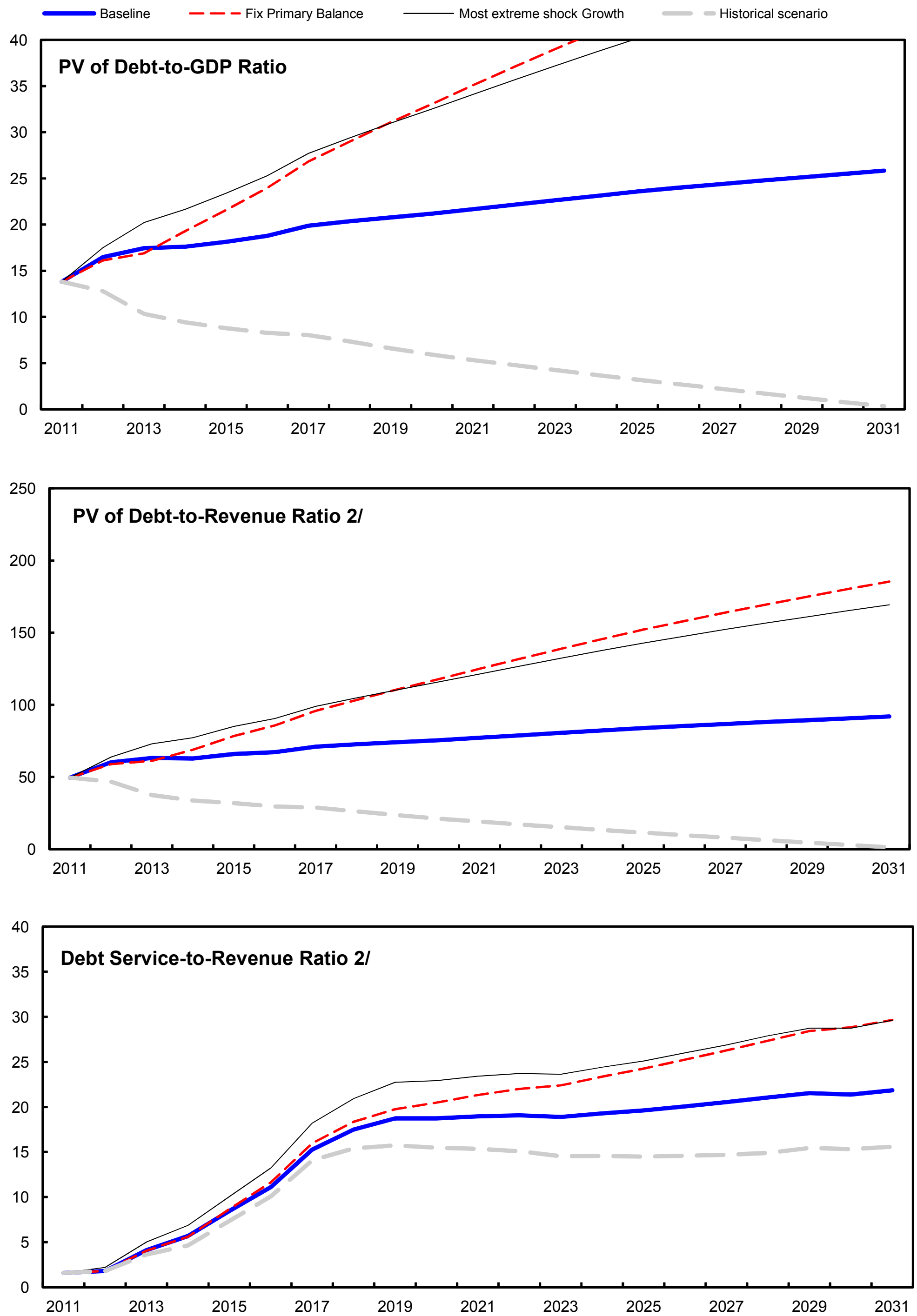


Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2021. In figure b. it corresponds to a Combination shock; in c. to a Exports shock; in d. to a Combination shock; in e. to a Exports shock and in figure f. to a Combination shock

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

Figure A2. Kosovo: Indicators of Public Debt Under Alternative Scenarios, 2011-2031 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2021.
2/ Revenues are defined inclusive of grants.

REPUBLIC OF KOSOVO

ATTACHMENT I. LETTER OF INTENT

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

Pristina, December 15, 2011

Dear Ms. Lagarde:

1. Economic activity in Kosovo has remained robust, supported by buoyant domestic demand and solid credit growth, while our financial system remains well capitalized and liquid. However, downside risks have increased owing in part to the deteriorating outlook for the euro area. A protracted weakness in activity in Europe could negatively affect remittances and foreign direct investment from Kosovars living abroad, and therefore constrain an important source of funding for the Kosovar economy. Our policy strategy is based on steadfast commitment to disciplined fiscal management—including through safeguarding sufficient government cash buffers—the further strengthening of surveillance and the regulatory framework of Kosovo's financial system, and progress with structural reforms to boost competitiveness. These policies provide the best safeguard to steer the Kosovar economy successfully through the period ahead and enhance its medium-term growth prospects.

2. Implementation of our Staff-Monitored Program (SMP) that was initiated in June has been largely successful to date.

- *Quantitative benchmarks* for end-September were all met with the exception of the benchmark on accumulation of domestic arrears, where a minor amount has been accumulated. Reforms are underway to improve our ability to monitor overdue bills and reduce the likelihood of arrears built-up (¶16).
- The *structural benchmark* on publication of our tax compliance strategy was also met, as were the continuous structural benchmarks on monthly meetings of our program monitoring committee and on inclusion of a clause into all laws that create new or modify existing benefits to permit adjustment of the benefits to the amounts available in the budget.

3. Moreover, we have submitted a budget for 2012 to the Assembly that is consistent with our commitment to achieve ¾ of a percent of GDP in structural fiscal adjustment, as

part of our strategy stretching over a period of 4 years to restore a sustainable fiscal stance (¶10). Passage of this budget is a structural benchmark under the SMP for end-December.

4. Looking ahead, meeting some other end-December program targets has become infeasible, and we request corresponding modifications of benchmarks.

- The privatization of the post and telecommunications company PTK will not go forward this year, as one of the two pre-qualified bidders has dropped out of the process, forcing us to cancel the auction and restart the process. We had expected to raise at least €300 million with the privatization. This delay will cause us to miss the end-December structural benchmark on PTK privatization. To limit the impact of the delayed privatization on our bank balances with the central bank (CBK), we have enacted spending cuts of €60 million, as agreed under the SMP. We request to introduce adjusters to the quantitative benchmark on bank balances for both the shortfall in privatization receipts and the impact of the corresponding spending cuts, and to the quantitative benchmarks on primary expenditures and the primary fiscal balance for the spending cuts in reaction to the delay in PTK privatization.
- We also request to modify the end-December structural benchmark on fiscal impact assessments for the planned war veteran pension and possible benefits for former political prisoners. Delays in getting the work started and a methodology suggested by the World Bank that is more time consuming than originally anticipated render the end-December deadline for completion of these assessments infeasible. We request to modify the benchmark to setting up working groups to prepare the methodology for the impact assessments and defining the groups' terms of reference in cooperation with the World Bank.

5. We believe that the policies set forth in our letter of June 20, 2011 and this letter is adequate to achieve the objectives of our economic program. However, the Government stands ready to take additional measures as appropriate to ensure achievement of its objectives. We will consult with IMF staff before modifying measures contained in this letter or adopting new measures that would deviate from the goals of the program, and provide IMF staff with the necessary information for program monitoring. We authorize IMF staff to publish this letter.

I. Macroeconomic Outlook

6. We have marked down our projection for real GDP growth in 2011 by 0.3 percentage points to 5 percent, reflecting the spending cuts in reaction to the delay in PTK privatization. For 2012, we are basing our policy framework on a cautious real growth forecast, reflecting among other things the worse growth outlook for the euro area and the possible knock-on effects on domestic demand through lower remittances and capital inflows. The current account deficit is expected to improve to about 21 percent of GDP in 2012, from 24 percent in 2011, reflecting mostly weaker imports.

7. Consumer price inflation is projected to continue to fall rapidly throughout end-year, reflecting rapidly declining food prices. In 2012 we expect this process to continue, with inflation falling to around 2 percent, even though possible increases in electricity prices as a result of new regulations on electricity tariffs and coal royalties may yield some counteracting price pressures.

II. Fiscal Policy for 2011 and 2012

8. We intend to continue to strictly adhere to the budgetary ceilings for 2011, while taking measures as needed to safeguard an adequate minimum level of cash buffers through end-year.

- *Revenues.* Tax revenue collection through September was €24 million higher than targeted under the SMP, owing to a stronger than expected performance of indirect taxes (VAT and excises). On current trends, we expect to exceed our end-year revenue targets somewhat, reflecting inter alia factors such as one-off payments by PTK for licensing fees and a budgetary grant from the World Bank that was originally expected for 2012.
- *Expenditures.* The end-year targets for primary expenditures are well within reach, based on continued disciplined budget execution. In response to the delay in PTK privatization, we have enacted contingent spending cuts on goods and services, subsidies and transfers, and net lending for the electricity sector, and non-highway spending, to prevent that our bank balances with the central bank fall too far below recommended levels.

9. Our draft 2012 budget submitted to the Assembly at end-October targets a primary deficit of €159 million (3.2 percent of GDP). The budget is built on (i) cautious revenue projections, seeking to preserve the gains in tax collection made in 2011 while building in some buffer in view of the uncertain growth outlook; (ii) restraint on current and non-highway capital spending; and (iii) the acceleration of spending on highway R7, to set the ground for a successful completion of R7 in 2013 (¶11).

10. The 2012 will budget contain €38 million (¾ of a percent of GDP) in structural adjustment that is composed of the following measures:

- *Restraint on public sector wages, €10 million* (0.2 percent of GDP). The budget contains zero wage increases for public sector employees. The wage bill is nonetheless expected to increase somewhat because of (i) the full-year effect of the 2011 wage hikes (that took effect in March 2011), and (ii) the hiring of new public sector employees, reflecting inter alia the creation of new municipalities in Kosovo's North and the transfer of responsibilities (special police, privatization fund) from the international community to the Kosovar government.

- *Electricity sector, €15 million (0.3 percent of GDP).* Reforms in the electricity sector—notably better revenue collection by the electricity company KEK (that materialized already in 2011) and regulatory measures—allow cutting subsidies by €10 million and gross lending to the sector by €5 million.[1] Of the remaining subsidies of €20 million, a maximum of €13 million will be budgeted for KEK, while the remainder will be placed in a budgetary reserve. The lower amount of KEK-subsidies should affect electricity prices, in line with the regulatory formula.

- *Revenue measures, €13 million (0.25 percent of GDP).* These include increases in the excise on tobacco by €2 per 1000 units (yielding about €7 million), the minimum property tax rate to 0.15 percent (€3 million), and the presumptive tax to 9 percent (€3 million); broadly in line with recommendations of a recent IMF TA mission on tax policy (¶15).

11. The expansion and modernization of our highway network remains a strategic priority. Our highway projects need to be managed carefully, however, to assure sustainability of the public finances.

- *Highway R7 to Albania.* The 2012 budget increases the amount for R7-related expropriations to €56 million, with the objective of finalizing expropriations in 2012 to the extent possible, to set the stage for the timely completion of R7 in 2013 that is needed to avoid cost escalation clauses that would materialize from 2014. Budgetary risks emanating from R7 need to be managed especially carefully as the project nears completion. We will make every effort to keep costs as small as possible, including variation costs reflecting changes from and additions to the original contract.

- *Highway R6 to Macedonia.* The 2012 budget contains no allocation for the planned R6 highway in view of tight financing constraints, the need to revisit technical specifications, and insufficient information about the final costs from highway R7 that complicate medium term budgetary planning. We will use 2012 to advance technical and financial preparations for R6. With the currently planned design, only the northern section of R6 close to Pristina is economically viable. We will therefore revise, in collaboration with the World Bank, technical specifications and analyze different design and financing options for the southern portion of R6.

12. To finance the 2012 deficit, the government will issue sovereign paper for the first time in Kosovo's history. To this end, the central bank has successfully tested a new platform for electronic bond trading. A debt strategy paper, developed with the technical support from the U.S. Treasury, is expected to be published by year-end. We anticipate that at least

[1] Structural measures are assessed relative to the passive (=no measures) scenario inscribed, inter alia, into the IMF's 2011 Article IV Report.

€75 million can be purchased by domestic banks and the Pillar II pension fund KPST. However, for this to be possible we need loosen the strict investment constraints for KPST currently inscribed into the pension fund law that prohibit KPST from being exposed to a single borrower with more than 5 percent of its portfolio. We will replace this constraint with provisions that limit (i) KPST's overall exposure to the government to 30 percent of KPST's assets, and (ii) KPST's annual purchases of government paper to at most 50 percent of new inflows into KPST in the preceding year. We will consult closely with World Bank and IMF staff on the wording of the corresponding articles in the pension fund law. Submission of the revised law to the Assembly is envisaged for end-December (structural benchmark).

13. While we remain committed to finalizing the privatization of PTK in 2012, we are developing a back-up plan in case that further delays may occur. The back-up plan aims at ensuring that bank balances are at least €150 million by end-December 2012, even in the absence of PTK privatization. To this end, we will leave €60 million in the 2012 budget unallocated. By February 2012, we will specify the expenditure categories that will be affected by the back-up plan, unless there is clear evidence by then that privatization of PTK in 2012 is ensured. Additional measures may be needed to achieve the envisaged minimum level of bank balances that would likely consist of a mix of revenue and financing measures. Also these measures would be identified no later than February 2012.

14. We have ensured passage of the law regulating the benefits for war-related categories by the Assembly in a form consistent with the government's commitments specified in the paragraphs 13-15 of the LOI from June 20, 2011 (prior action). More generally, to facilitate budgetary planning and execution, we remain committed to the principles that (i) all new laws or amendments to laws that create benefits will grant only cash benefits, with no link to the minimum wage; (ii) all such laws will be preceded by a thorough fiscal impact assessment over a period of at least 5 years; (iii) and such laws include a paragraph that explicitly allows cutting benefits in case of insufficient budgetary funds.

III. Structural Fiscal Reforms

15. We remain committed to achieving a sustainable fiscal stance through structural adjustment of 3 percent of GDP over a period of 4 years, half of which remains to be implemented in 2013/14. Going forward, it is likely that a significant part of the structural adjustment effort will come from revenue policies. Further, over the longer term a strategic re-orientation of the tax system is called for to reduce our dependence on border taxes. The recent recommendations by an IMF technical assistance mission on tax policy provide a useful yardstick for these endeavors, oriented on best international practices. Meanwhile, we will protect the integrity of our current tax system and will, in this context, refrain from introducing tax holidays and/or exemptions for intermediary inputs from VAT. To enhance our capacity to devise and analyze tax policies, we will merge the macroeconomics and fiscal policy divisions within the Ministry of Finance by end-December.

16. We are upgrading our public financial management software, with a view to enhancing our capacity to monitor overdue bills and prevent the accumulation of domestic arrears. The software will be tested at end-2011. The new monitoring system will be fully operational once the budget officers in all budget organizations have been trained in the use of the software. We expect this to be the case in the second half of 2012.

17. We are conducting an analysis of the inter-governmental grants system, in cooperation with a technical assistance mission from the IMF, with a view to enhancing the effectiveness of the system. Should this analysis result in a reduction of budgetary grants, we would compensate for this by increasing own source revenues of municipalities, for example by further raising minimum property tax rates or municipal fees on motor vehicles. We also intend to grant municipalities more flexibility in allocating resources in line with spending needs.

18. A preliminary version of the 2012 tax compliance strategy was completed in September and is published on the Tax Administration website. This version has been reviewed by stakeholders and is currently being upgraded, in cooperation with technical assistance from the IMF.

IV. Monetary and Financial Sector Policies

19. The financial system has remained well-capitalized, liquid, and profitable. Capital adequacy stood at 17.2 percent at end-October, while non-performing loans have continued to hover around 6 percent. Credit to private sector grew by about 15½ percent in the 12 months to October. A new management of Kosovo's largest microfinance institution has been appointed in November. The central bank plans to keep the current administrator until end-December 2011 to allow a smooth transition. Since the Central Bank's intervention in the institution in 2011 due to governance concerns, it has strengthened its liquidity position and recovered profitability.

20. Against the backdrop of the international financial crisis, we have upgraded prudential policies with a view to safeguard sufficient liquidity and capital buffers in case of external strains. Measures include:

- the central bank is acquiring the ability to provide emergency liquidity assistance (¶21);
- a deposit insurance scheme has been introduced;
- the legal framework for bank resolution and prudential regulation has been strengthened with the new central bank law and will be strengthened further with the upcoming banking and microfinance law (¶21);
- the central bank is committed to maintaining prudent loan-to-deposit ratios of around 80 percent;

- the central bank issued regulations limiting banks' exposure to their foreign controlling institutions to 20 percent of Tier 1 capital, containing the risk that liquidity strains on the controlling institutions could spread to their Kosovar affiliates;
- we will reduce banks' exposure limits to single borrowers from 20 percent of Tier 1 capital to 15 percent with the new banking and microfinance law;
- to contain liquidity risk, we will maintain prudent rules on the assets that are eligible to fulfill banks' minimum reserve requirements. In particular, Kosovar government paper will remain non-eligible, as long as the market for such securities remains thin and the investor base insufficiently diversified. However, banks will be allowed to apply a zero risk weight to government paper for capital adequacy purposes.

We are confident that these measures provide strong support for our financial system to withstand strains, but are prepared to take additional measures as needed, such as requesting banks to temporarily suspend dividends payments to increase capital buffers.

21. Good progress is being made with financial sector structural reforms.

- *Emergency Liquidity Assistance (ELA).* The Ministry of Finance (MoF), the CBK, and the Committee for Budget and Finance have signed a Memorandum of Understanding that establishes duties and responsibilities with respect to ELA. The Board of the CBK approved regulations governing ELA in November. Further, we will modify the government's budget law for 2012 to contain a provision to deposit €46 million in a CBK account earmarked for ELA. The CBK will provide another €46 million for ELA with its own resources.
- *Banking and Microfinance Law (BML).* The draft law on banking and microfinance institutions has been finalized, in close cooperation with the IMF and the World Bank, and been submitted to the Assembly. The law will enhance governance in financial institutions and tighten prudential regulations regarding portfolio concentration and lending to related parties.
- *Deposit Insurance Law (DIL).* We plan to revise the DIL, including authorizing the CBK to use the Deposit Insurance Fund for purchase and assumption transaction, to ensure consistency with the BML. We expect to submit the revised DIL to the Assembly in the first half of 2012, after the BML is adopted. The CBK has collected about €5 million from banks and the government for the deposit insurance fund, and expects to receive €4.5 million from KFW and another US$4 million from the government, facilitated by a World Bank loan.

V. Other Issues

22. Ongoing reforms in the energy sector aim at enhancing the quality of electricity supply and reducing the dependence of the sector on the government budget. The regulator will issue key financial variables of the revised energy pricing formula before end-year, to

enable pre-qualified companies to make bids for the privatization of electricity distribution. The privatization schedule is somewhat behind earlier plans, reflecting the change of the transaction advisor. On current plans, the winning bid for the privatization of distribution will be announced in early 2012, with the subsequent transfer in ownership shares. Preparations for the privatization of mining and electricity generation are ongoing, with the Request for Proposals to be issued in the first quarter of 2012. A report on staffing and a functional audit of the coal division of KEK will be completed by end-2011.

23. We are in the process of preparing an overhaul of our healthcare system. A key element of the draft reform is a health insurance fund financed by premium payments from the insured. No budgetary allocation for the reform is made in the context of the 2012 budget. Moreover, total transfers from the treasury to the insurance fund, including premia paid on behalf of the poorest Kosovar citizens, will be designed to not exceed existing budget allocations for healthcare, thus the reform will have no direct budgetary impact also in the medium term.

24. We have prepared a package of twelve laws that aim at strengthening the business environment and improving our ranking in the Doing Business survey of the World Bank. Some laws—on enhancing business management, property rights, internal trade, information reporting and auditing—have already been passed. To safeguard labor market competitiveness and the employability of women, an annual report on the implementation of the labor law will be conducted in early 2012, with the emphasis on the maternity leave provisions and in close cooperation with the World Bank.

/s/

Hashim Thaçi

Prime Minister

/s/

Bedri Hamza

Minister of Finance

/s/

Gani Gërguri

Governor, Central Bank of the Republic of Kosovo

Table 1. Kosovo: Program Monitoring, September 2011

Quantitative benchmarks	
Floor on the bank balance of the general government	Met
Floor on the primary fiscal balance of the general government	Met
Ceiling on primary expenditures of the general government	Met
Ceiling on contracting or guaranteeing nonconcessional debt by the general government	Met
Ceiling on the accumulation of domestic payment arrears of the central government	Missed
Ceiling on the accumulation of external payments arrears of the general government	Met
Prior actions for the initiation of the SMP (June 2011)	
Dissolve the committee reviewing eligibility for all current categories of war related benefits and freeze the number of beneficiaries at a maximum corresponding to the level at end-May 2011, with the exception of applications that have already been received by that date	Met
Issue a sub-legal act on the “Law on the Rights of Formerly Politically Convicted and Persecuted Persons” that determines that the benefits payable under this law shall only be paid from funds that have been specifically and explicitly appropriated for this purpose under the then applicable budget law	Met
Structural benchmarks	
Development of a taxpayer compliance strategy aligned with the TA recommendation	Met
Continuous structural benchmarks	
Monthly meetings of the Program Monitoring Committee and transmission of meetings' minutes to the IMF	Met
Inclusion of a paragraph into all new benefit-creating laws and amendments to laws allowing to cut benefits if budgetary funds are unavailable	Met

Table 2. Kosovo: Quantitative Benchmarks (QB) and Indicative Targets (IT), 2011

(Millions of euros, cumulative from beginning of the year)

	2011						
Test date	Jun.		Sep.		Dec.		
Type of objective	IT	Act.	QB adjusted 1/	Prelim.	QB	QB adjusted 1/ 2/	Proj.
Objective to be observed							
Floor on the bank balance of the general government	249	255	200	246	305	90	107
Floor on the primary fiscal balance of the general government	27	54	-20	43	-226	-144	-127
Ceiling on primary expenditures of the general government	537	528	913	893	1,487	1,433	1,426
Ceiling on contracting or guaranteeing nonconcessional debt by the general government	0	0	0	0	0	0	0
Ceiling on the accumulation of domestic payment arrears of the central government 3/	…	1	0	0.3	0	0	0
Ceiling on the accumulation of external payments arrears of the general government 4/	0	0	0	0	0	0	0
Memorandum items:							
Ceiling on the accumulation of domestic payment arrears of the general government	…	4	0	2	0	0	0
Program assumptions							
New privatization receipts from PTK	0	0	0	0	300	0	0
Spending cuts contingent on non-privatization of PTK	0	0	0	0	0	60	60
Non-project grants	5	3	5	3	5	23	23
Budget support loans	0	0	0	0	0	6	6
Project grants	0	1	0	1	2	6	6
Project loans	0	0	0	0	2	4	4

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

1/ The floors and ceilings are adjusted according to the applicable Technical Memorandum of Understanding.

2/ Adjusted in line with expected application of adjustors by end-December.

3/ A zero ceiling on the stock of domestic arrears of the central government is to be observed at end-June 2011; a zero ceiling on the accumulation of new domestic payment arrears by the central government is to be observed continuously beginning in July 1, 2011.

4/ To be observed continuously.

Table 3. Kosovo: Prior Action and Structural Benchmarks

Actions	Type	Timing
Passage of the law regulating benefits for war-related categories by the Assembly in a form that is consistent with the Letter of Intent of June 20, 2011, or withdrawal of the law from the Assembly	Prior Action	December 10, 2011
Passage of a budget for 2012 by the Assembly agreed with IMF staff that contains fiscal tightening of at least ¾ of a percent of GDP, based on realistic macro-forecast and prudent budgeting	Structural benchmark	End-December 2011
Completion of the privatization of PTK	Structural benchmark	End-December 2011
Submission to the Assembly of a revised law on the Kosovo pension fund that limits both (i) exposure of the Pillar II pension fund (KPST) to the general government to 30 percent of its total portfolio and (ii) annual purchases of government paper by KPST to 50 percent of the new inflows into KPST in the previous calendar year	Structural benchmark	End-December 2011
Setting up working groups to prepare the methodology for fiscal impact assessments for (i) the planned war veteran pension and (ii) possible benefits for former political prisoners, and defining the groups' terms of reference.	Structural benchmark	End-December 2011
Inclusion of a paragraph into all new benefit-creating laws and amendments to benefit-creating laws that explicitly allows cutting the level of benefits in case sufficient budgetary funds are unavailable	Structural benchmark	Continuous
Monthly meetings of the Program Monitoring Committee as defined in paragraph 38 of the Letter of Intent to assess progress with implementation of the SMP and consistency of all relevant policy initiatives with the SMP's objectives, and transmission of the meetings' minutes to the IMF Resident Representative within 5 business days	Structural benchmark	Continuous

REPUBLIC OF KOSOVO

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING

Definitions and Data Reporting Requirements under the 2011 Staff-Monitored Program

1. This Technical Memorandum of Understanding (TMU) sets out the understandings between the Kosovo authorities and the IMF staff regarding the definition of quantitative benchmarks and indicative targets, and reporting requirements for the Staff-Monitored Program ("SMP") requested in June 2011.

I. QUANTITATIVE BENCHMARKS AND INDICATIVE TARGETS

A. Coverage

2. For the purpose of this memorandum, **general government** is composed of the Executive, the 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. **Quantitative Benchmarks and Indicative Targets.** The quantitative benchmarks, indicative targets, and their respective test dates are set in Table 2 of the Letter of Intent (LOI).

B. Bank Balances of the General Government

4. **Bank balances** are funds usable and readily available (i.e., liquid or marketable, and free of any pledges or encumbrances), held and controlled by the general government for the purposes of making payments and transfers. Bank balances include Undistributed Funds of the Government of Kosovo plus funds specifically reserved for policy purposes but do not include the balance of unspent Own Source Revenues (OSR) carried forward, or funds encumbered or pledged as Donor Designated Funds and funds relative to 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 foreign banks, domestic banks, and 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 December 31, 2010, were € 244.112 million.

- The floor on the bank balance set in Table 2 will be raised by

- the excess of budget grants and loans relative to program assumptions
- the repayment of loans extended to public enterprises.
- spending cuts of €60 million in the event that the proceeds from the privatization of the post and telecom company PTK are not received before end-2011.

➢ The floor on bank balance set in Table 2 will be lowered by €300 million in the event that the proceeds from the privatization of the post and telecom company PTK are not received before end 2011.

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

C. Primary Expenditures of the General Government

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

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

➢ The ceiling on primary expenditures set in Table 2 will be lowered by

- the shortfall of project grants and loans relative to program assumptions.
- spending cuts of €60 million in the event that the proceeds from the privatization of the post and telecom company PTK are not received before end-2011

7. For the purposes of this memorandum, **proceeds of privatizations** will be understood to mean all monies received by the government from the sale of a publicly owned company, organization, or facility to a private company or companies, organization(s), or individual(s), as well as any proceeds generated from the sale of government nonfinancial assets and from the liquidation of the assets of the Privatization Agency of Kosovo (PAK). Proceeds of

privatizations are not part of revenues. Instead, these are recorded as a domestic financing (Net acquisition of financial assets).

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

D. Primary Fiscal Balance of the General Government

9. **Primary fiscal balance** of the general government is defined as revenues and grants minus primary expenditures cumulatively since the beginning of the calendar year. Revenues do not include privatization receipts.

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

- The floor on the primary fiscal balance set in Table 2 will be raised by

- the shortfall in project loans relative to program assumptions
- the excess in budget grants relative to program assumptions.
- spending cuts of €60 million in the event that the proceeds from the privatization of the post and telecom company PTK are not received before end-2011

E. Contracting or Guaranteeing Nonconcessional Debt by the General Government

10. **Nonconcessional debt** is defined as debt contracted or guaranteed by the general government with a grant element of less than 35 percent. The grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the using currency-specific commercial interest reference rates (CIRRs) published by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD). For debt with a maturity of at least 15 years, the ten-year-average CIRR will be used to calculate the PV of debt and,

hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. To both the ten-year and six-month averages, the same margins for differing repayment periods as those used by the OECD need to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more). The ceilings exclude purchases from the IMF, the sale of the SDR holdings allocated to Kosovo, and the contracting of Partial Risk Guarantees with the World Bank for the privatization of the energy sector. Debt rescheduling and debt reorganization of debts contracted before the approval of the SMP are excluded from the limits on nonconcessional debt. The definition of short-term nonconcessional debt excludes normal short-term (less than one year) import-related financing. The quantitative benchmark applies not only to debt as defined below but also to commitments contracted or guaranteed for which value has not been received. The contracting or guaranteeing nonconcessional debt by the general government will be assessed at each test date.

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

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

> "(a) For the purpose of this guideline, the term **"debt"** will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:
>
> > "(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);
> >
> > "(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and
> >
> > "(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the

lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

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

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

F. Domestic Payments Arrears

14. A domestic payment obligation to suppliers or creditors is deemed to be in **arrears** if: (a) goods and services have been received; (b) they have been certified to conform to the order of the contract; and (c) the obligation has remained unpaid for more than 60 days after the invoice was received. The stock of arrears will be assessed at end-June 2011 and the accumulation of new domestic arrears will be assessed continuously. A payment obligation is defined to be domestic if the creditor is resident in Kosovo.

15. **Reporting requirements.** The Ministry of Finance will submit detailed tables of the stocks of domestic arrears and of domestic payment obligation to suppliers or creditors not in arrears as of end-September and end-December 2011. Moreover, it will submit a monthly table with the stock of domestic payments arrears, including the accumulation (if any), payment, rescheduling and write-off of domestic payments arrears during the month. The data are to be provided within five weeks after the end of the month.

G. External Payments Arrears

16. **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.

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

II. Other Data Requirements

18. 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

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

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

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

22. 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.