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January 23, 2023

**Statement by Mr. Subramanian and Mr. Hansda on Republic of Kosovo  
(Preliminary)  
Executive Board Meeting  
January 25, 2023**

1. We thank staff for the comprehensive analysis/ update on Kosovo's recent economic and policy developments. We also thank Mr. Palotai for his helpful buff statement.
2. Like many other economies, the economy of Kosovo is struck by the adverse impact of COVID-19 followed by the conflict in Europe. As wage growth has lagged inflation, social protests/ strikes, coupled with intermittent tensions in Serb-dominated northern towns have affected economic activities in Kosovo. While the GDP growth had turned around to 10.7% in 2021 from a negative territory, it's expected to have slowed down to 2.7% in 2022 before clocking 3.5% in 2023 and further beyond.
3. Headline inflation has since come off the peak of 14.2% in July 2022 to 11.6% in November, reflecting the passthrough of global energy and food price shocks. While Kosovo's inflation is in line with the western Balkans' average, core inflation has increased to 5% even though second round effects remain moderate. This is also reflected in lower wage growth as also in negative output gap. Overall, inflation is projected to rise to 11.6% in 2022 from 3.3% in 2021, before declining to 4.9% in 2023 and finally converging to below 2% in 2026.
4. The staff has welcomed the projected rise in fiscal deficit to 2.2% in 2023 from 0.3% in 2021 as helpful for soft-landing the economy. In staff assessment, the impact of the fiscal impulse on inflation is stated to be moderate as most of the increase in deficit is to result from higher capital spending, which will ease supply bottlenecks. **While the text-book**

literature recognizes government borrowing for investment as part of the golden rule of fiscal policy, reality could be much more complex as the demand for wage goods may, in the interim, rise, pushing up inflation. Increased supply of capital goods may not necessarily translate into larger supply of wage goods immediately. This could be more likely for an economy like Kosovo where the share of food in CPI basket is stated to be as high as 46%. Staff is welcome to throw light on these aspects.

5. The staff is of the opinion that large blanket allocation for contingencies in the budget, amounting to more than 2% of GDP for each of the three years (including 2023), needs to be accompanied by a description of their possible use. The authorities, however, hold that they are an indispensable tool in the current context of heightened uncertainty. **In this context, the staff may please elaborate on the actual uses of such allocations out of past budgets. They may also share data on the contingent liability of the government of Kosovo or of the public sector as a whole.**

6. The staff has mentioned that the new law on public wages, expected to be implemented in H2: 2023, may not provide enough incentives to retain talent in public service regulation and justice administration. Further, too high public sector wages may crowd out private sector jobs. **In this context, staff is welcome to clarify whether they recommend incentive for public service regulation and justice administration similar to health and information technology. Further, staff may please share evidence, if any, on crowding-in or -out impact of public investment in the economy of Kosovo.**

7. The staff has recommended that CBK profits should be reserved, including to cover CBK costs during periods of low international interest rates, and increase the CBK's capacity to provide liquidity assistance. The authorities have also agreed on this. **In this context, staff is welcome to offer their views on whether it would be worthwhile for CBK to diversify its foreign exchange assets in favour of dynamically emerging market and developing economies for higher returns. Staff may also elaborate on how the CBK's capacity to lend is constrained when a central bank, unlike a commercial bank, is expected to issue its liabilities/currencies against purchase of government securities/ foreign assets.**

8. With these remarks, we wish the authorities and the people of Kosovo every success in their endeavors.

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