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January 13, 2016

Statement by Mr. Yambaye and Mr. Lopes Varela on Republic of Kosovo
(Preliminary)
Executive Board Meeting
January 15, 2016

We thank staff for the comprehensive report and Mr. Canakci and Mr. Mehmedi for their insightful Buff statement. Despite some slowdown in 2014, the Kosovo economy has continued to perform well with GDP growth estimated at 3.5 percent for 2015, driven by strong remittances, high credit growth, increased FDI inflows, and solid exports. Further strengthening of economic activity is expected in 2016 and over the medium term. However, further efforts are needed to preserve fiscal sustainability and increase Kosovo's competitiveness and the business environment. We commend the Kosovo authorities for their strong commitment to the program's objectives and for achieving and in some cases over-performing on the quantitative performance criteria. In light of that, we support the completion of the First Review under Stand-By Arrangement and the authorities' request for modification of the performance criterion.

In the fiscal sector, we take a good note that the program is on track and all end-August 2015 performance criteria and indicative targets were met by comfortable margins, and commend the authorities for their efforts to maintain fiscal adjustment and limit fiscal deficit to 2 percent of GDP. However, it will be important for the authorities to address delays in transferring revenues and privatization funds from PAK and the sale of new telecommunication licenses to meet end-December targets.

We appreciate the authorities' assurance to take any further measures that may become necessary to keep fiscal performance in line with program's objectives; therefore, we support the authorities request for modification of the performance criterion on the headline fiscal balance ex-PAK of the general government, to include capital spending by publicly-owned enterprises via on-lending from the general government.

We note the expenditure containment in the program, including the wage bill freeze, while preserving high priority capital spending. We agree that additional efforts will have to be made to ensure the achievement of the deficit target of 1.6 percent next year, including, the increase of excise tax in tobacco, and cuts in current spending.

We welcome authorities' efforts to modify the fiscal rule's "investment clause", by submitting its amendments to the parliament which will allow additional space for new donor

financed much needed capital projects. We also welcome the approval of the budget 2016 in line with program targets, as noted by Mr. Canakci and Mr. Mehmedi on their Buff statement.

In the **financial sector**, we note that banks remain well capitalized, liquid and profitable, and that credit to the private sector is on the rise, while NPLs are fully provisioned and declining. Although there has been significant increase in credit growth, further efforts are needed to reverse Kosovo's low credit penetration ratio to help address its development and lending needs. In this regard, further enhancements of the contract enforcement system are needed, in order to increase the bank's willingness to lend. We commend the authorities for the adoption of a new emergency liquidity assistance regulation in line with international best practices and to fully roll out risk-based supervision to all banks. In addition, we encourage the authorities to develop a macro-prudential framework and policy toolkit to help preserve stability. Further strengthening of Kosovo's AML/CTF framework is also needed.

S**tructural reforms** remain vital to the authorities' efforts in enhancing growth potential, competitiveness and business environment. We welcome the authorities' adoption of a public sector wage bill that allows the public wage bill to grow up to nominal GDP, an important measure to tackle Kosovo's permanent increase in public wage bill, and boost competitiveness with the private sector.
We encourage the authorities to step up efforts to improve the business environment and reduce corruption. In this regard, full implementation of reforms to the public procurement process system, e-procurement, and filling of vacant seats at the Procurement Review Board are keys for more transparency. In addition, we take good note of the efforts being made by the authorities to address long-standing issues in the energy sector with the support of World Bank.