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July 27, 2015

**Statement by Mr. Hiroshima and Mr. Shoji on Republic of Kosovo
(Preliminary)
Executive Board Meeting
July 29, 2015**

We welcome the recent Kosovo's resilient economic growth and financial stability. Meanwhile, the country has limited capacity deriving from insufficient industrial base and weak competitiveness that constrain the medium-term growth potential. **This said, given the authorities' strong commitment to reform-agenda as mentioned in Mr. Canakci and Mr. Mehmedi's statement, which will pave the way for a higher economic growth, we support the request for a Stand-By Arrangement (SBA).**

As we broadly agree with the thrust of the staff appraisal, we will limit our comments to the following points:

Fiscal Policy and Structural Reforms

We share the staff's view in the sense that fiscal discipline is a key to build up the credibility of the program. In this context, we commend that a 2015 revised mid-year budget includes significant measures to decrease the deficit. The approval of the revised budget prior to the program will be strongly encouraged. We further urge the authorities to make adjustments in improving the budget composition and improve the government's bank balances that are under prudent levels. Especially, the higher wage of public sector will make it difficult for private sector to retain talented workers and will remain as weakened industries' competitiveness, and therefore, the introduction of a public wage bill will be a key step. On the other hand, the authorities need to allocate sufficient budget resources to the infrastructure investment which will stimulate the short-term economic growth and help improve the business environment in the long term while preserving debt sustainability. In this regard, we appraise the authorities' intention to accommodate flexibility in the fiscal rule setting that allow donor –financed capital projects to exceed over 2 percent deficit ceiling. We also note the importance that a set of reforms to address corruption will matter in order to facilitate infrastructure projects.

Financial Sector

We welcome that the financial sector in Kosovo is generally sound and banks are well capitalized and bank's NPL ratio is manageable. However, Kosovo's credit penetration is lowest in the Western Balkans while credit demand seems low reflecting the economy which highly depends on remittances without fostering domestic industries. When a set of reforms are materialized, we expect that money demand from the private sector will increase for starting businesses. *From this viewpoint, how do staff assess the banking sector's capability such as credit evaluation to accommodate money demand from emerging domestic industry? Are there any potential risks of instability in the financial systems as a result of accelerating financial depth? Comments are welcome.*