GRAY/21/411

February 10, 2021

Statement by Ms. Mahasandana and Mr. Bautista on Republic of Kosovo
(Preliminary)
Executive Board Meeting
February 12, 2021

We thank staff for the comprehensive report on Kosovo and Mr. Palotai for the insightful Buff statement.

We broadly support staff's policy recommendations for Kosovo to mitigate the economic damage of the health crisis, strengthen economic governance and foster more inclusive growth. Like many countries, Kosovo faces strong near-term headwinds, led by the economic stress from the pandemic, as well as heavy dependence on contact-intensive services and diaspora-related inflows. We support that the authorities are carrying out economic stimulus and recovery programs to boost the economy. It is noteworthy, that the banking system remains strong and the public debt level is still sustainable.

While economic recovery is expected with sizable output gap to gradually close over the medium-term, uncertainties remain. The gradual closing of the output gap is subject to many assumptions, including additional uncommitted debt and political stabilization after February. We support the recommended debt ceiling of 40% of GDP, as prematurely increasing the debt ceiling could encourage risky activities and may also lead to accumulation of contingent liabilities. *Staff may explain how political stabilization has been factored into the baseline. Can staff also comment on possibility of upside risk from unlocking infrastructure financing due to Kosovo's agreement with Serbia as well as the prospects of the visa-free access to the Schengen area?*

We note the warranted suspension of fiscal rule in 2020-21 and support the Mitigation and Recovery Package (MRP) measures to boost the health system. Tackling near-term recession to raise productivity will set the stage for better entrenching economic

recovery and help in pacing-in structural reforms. We lend our view to the urgency for authorities to focus on cushioning income losses in a well-designed, targeted and transparent manner for households and firms while keeping banking stability. This said, we welcome the authorities' close monitoring of use of transfers to private firms and commend the authorities' commitment to good governance and transparency, with its concurrence to the conduct and publication of a special *ex-post* audit of all MRP-related spending.

We also note the concurrence of authorities to staff recommendation to employ a fiscal policy response that considers whether shocks are temporary or persistent. In both scenarios and in consideration of urgency to act with the crisis still unfolding, making determination of depth of shocks difficult and time dependent, we strongly urge the authorities to prioritize its limited fiscal space, secure the uncommitted debt financing, enhance its revenue mobilization, and work towards a gradual fiscal consolidation over the medium-term. We also underscore the importance to address the large gaps in investments in infrastructure and education as capital investments in these areas were slow even before the pandemic, and wider use of e-procurement to support better governance and transparency. Furthermore, we support an undertaking by authorities towards a strategic well-targeted and more inclusive social security system that ensures its long-term viability and strengthen its fairness and thus, help in attaining fiscal.

On financial policies, we encourage staff to closely work with authorities in the formulation of the operational procedures needed for the use of the Emergency Liquidity Assistance (ELA), which is expected to strengthen authorities' response to systemic shock. *Could staff comment on the features of the parallel regulation on the Liquidity Adjustment Facility that delineates it from ELA?* We support transparency in regulatory forbearance to reflect developments in the loan portfolio and agree to implementing financial policies to mitigate the shocks without endangering bank stability. We also note that the 3-month loan payment moratorium and up to 1-year loan restructurings in June-September helped firms remain solvent in the face of liquidity shortages and caused bank credit to grow. *Given the large proportion of loans that have benefited from these measures, what is staff's assessment of the risk posed, especially in relation to the recommendation for flexibility to allow more time for banks to reconstitute their capital buffers.*